January 18, 2011

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

Re: RIN 3038–AD99; 17 CFR Part 190
Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies

Dear Mr. Stawick:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on Commodity Futures Trading Commission (the "CFTC") RIN 3038–AD99, *Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies* (the "ANPR"), which outlines four models for the segregation of collateral posted by customers to futures commission merchants ("FCMs") in support of swaps cleared through a derivatives clearing organization (a "DCO"). The CFTC is considering these models as ways to implement Commodity Exchange Act ("CEA") Section 4d(f)(2), which was added by Section 724 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").

The CFTC proposed two goals for the implementation of Section 4d(f)(2): protection of customers and their collateral and minimization of costs imposed on customers and on the industry as a whole. SIFMA supports both goals. SIFMA is submitting this comment letter to remind the CFTC that the expansion of portfolio margining is also a goal of Dodd-Frank[2] and to urge the CFTC not to implement Section 4d(f)(2) in a way that would frustrate that goal.

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[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to develop policies and practices which strengthen financial markets and which encourage capital availability, job creation and economic growth while building trust and confidence in the financial industry. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

[2] See, e.g., Sections 713 and 983 of Dodd-Frank.

I. Portfolio Margining Background.

In very general terms, each customer is required to deliver margin to protect against the customer's default in circumstances where the customer's positions are closed at a loss. Margin requirements are therefore calibrated to the risk posed by the customer's positions. The methods for the calibration of margin generally take one (or a combination of) the following approaches:

> (a) trade-by-trade or "gross" margining, where a margin requirement is set independently for each position and the margin requirements for all of the customer's positions are simply the sum of the margin requirements for each of the positions; and
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> (b) portfolio margining, where a margin requirement is set based on the risk posed by the customer's portfolio of positions, rather than for each position considered in isolation.

While gross margining is commonplace in, for instance, the listed futures markets, there are also a number of instances where portfolio margining arrangements are currently and have historically been used. For example, since 1991, the Options Clearing Corporation (the "OCC") and the Chicago Mercantile Exchange (the "CME") have employed cross-margining arrangements for equity index option and offsetting futures positions held by market professionals.[3] In 2006, the SEC approved portfolio margining for positions held in a securities account for equities, securities options, equity-based over-the-counter ("OTC") derivatives, single stock futures, and broad-based index futures (although, for the reasons discussed in Part II below, portfolio margining of securities and offsetting futures positions is currently limited).[4] Finally, under current practice, market participants typically margin OTC derivatives transactions on a portfolio basis (on terms negotiated between the parties to the transactions).

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[3] See Memorandum Recommending Approval of the Chicago Mercantile Exchange's and The Intermarket Clearing Corporation's Proposals to Expand Their Respective Cross-Margining Programs with the Options Clearing Corporation to Include the Cross-Exchange Net Margining of the Positions of Certain Market Professionals, Comm. Fut. L. Rep. ¶ 25, 190 (Dec. 30, 1991) and Securities and Exchange Commission ("SEC") Release No. 34-29991 (Nov. 26, 1991). Many clearing organizations have also employed cross-margining arrangements for proprietary accounts. See, *e.g.*, SEC Release No. 34-27296 (Sept. 26, 1989) (original order approving of cross-margining between the OCC and the CME); SEC Release No. 34-29888 (Oct. 31, 1991) (order approving cross-margining between the OCC and the Board of Trade Clearing Corporation); SEC Release No. 34-32534 (June 28, 1993) (order approving cross-margining between the OCC, the CME, and the OCC's wholly-owned futures clearing subsidiary, the Intermarket Clearing Corporation); and SEC Release No. 34-41766 (order approving cross-margining between the Government Securities Clearing Corporation and the New York Clearing Corp.).

[4] See NYSE Rule 431(g) and NASD Rule 2520(g). These pilot programs were made permanent in 2008. See SEC Release No. 34-58251 (July 30, 2008).

Portfolio margining has many salutary benefits. Where customers enter into transactions that reduce the risk of ("hedge") other transactions in their portfolio (*e.g.*, an interest rate swap hedged by treasury futures), moving away from gross margining towards portfolio margining can reduce the customer's margin requirements.[5] This reduction in margin encourages customers to consider the overall risk that their positions pose and allows customers and FCMs to make more efficient use of their margin. By encouraging effective risk management, portfolio margining reduces systemic risk. Portfolio margining also enables effective cash management by corporate end-users, institutional investors, and financial institutions. In contrast, a failure to facilitate continued portfolio margining in the OTC derivatives markets would result in large negative cash flows that would significantly reduce the funds available for investment in the real economy.

II. Portfolio Margining and the Fragmentation of Segregation Requirements.

Portfolio margining is currently limited by the existence of separate customer protection regimes for customer securities positions and customer futures positions. Although there are a number of examples of successful portfolio margining arrangements in existence today (as described above), each of those arrangements involves circumstances where either or both of the customer protection regimes for customer securities positions or customer futures positions does or do not apply. Attempts to provide portfolio margining to customers across securities and futures positions have been frustrated by the separate segregation regimes applicable to securities accounts and futures accounts. Because of the separate segregation requirements under current law and regulation, the amount of margin that an FCM must deliver to a DCO in respect of a customer futures position (and segregate for customers) must be determined without regard to that customer's offsetting securities positions.[6] The FCM is therefore effectively unable to offer the customer portfolio margining based on the risk of the customer's securities and futures portfolio,

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5 Where the customer is long a futures position on the 10-year U.S. treasury note and a fixed rate payer under a 10-year interest rate swap, the values of the two positions will move in opposite directions in response to interest rate changes. For this reason, the risk of a portfolio consisting of these two positions is less than the risk of either position on its own. Accordingly, appropriate portfolio margin, calibrated to the portfolio risk, would be less than the gross margin – the sum of the margin requirements reflecting the risks of the futures and swap positions considered in isolation.

6 Where portfolio margining is limited to entities that are not "customers" under the SEC's customer protection rule and only the CFTC segregation requirements apply, the SEC and CFTC have jointly approved a number of cross-margining programs , beginning with the 1988 approval of cross-margining that covered options cleared by the OCC and index futures cleared by the CME. See note 3, above. We urge the CFTC to work with the SEC to build on the success of these programs by facilitating portfolio margining of customer positions.

because the FCM would need to post to the DCO (and segregate for customers) more margin than it receives from the customer.[7]

SIFMA is concerned about the possibility that fragmented segregation requirements will be adopted that place client collateral for OTC transactions, which are currently in one pool, into four separate pools – one for cleared swaps, one for uncleared swaps, one for cleared security-based swaps, one for uncleared security-based swaps – and thereby create barriers to portfolio margining across positions in these separate pools which can easily be portfolio margined today, replicating the current problem that creates for portfolio margining securities and futures positions.[8] SIFMA urges the CFTC to comply with Dodd-Frank's portfolio margining mandate and to work with the SEC towards consistent segregation regimes which would enable portfolio margining, not only across OTC derivatives positions, but also across swaps, futures, security-based swaps and securities positions.

Because of the complex interrelationship between margining and segregation, new segregation rules should be developed with great care and attention to all effects that they may have. Because the segregation models were outlined in the ANPR in isolation from the margining regime and we do not believe segregation can be considered apart from margining, we are not advocating at this time the adoption of any of the models outlined in the ANPR. As a near-term measure, however, SIFMA requests that the CFTC not fragment further segregation requirements and adopt a cleared swap customer protection regime that facilitates portfolio margining through consistency with the futures customer protection regime.[9] This would, at least, set the stage for portfolio margining of futures and cleared swaps positions (allowing offsets where, *e.g.*, a cleared interest rate swap is hedged by a treasury future or a metals future is hedged by a cleared commodity swap).

We understand that other interested parties have raised a number of concerns and issues regarding the ANPR, the resolution of which could impact the potential to establish portfolio margining regulations. Therefore, we encourage the CFTC to review carefully the potential implications of regulatory initiatives regarding the segregation of clients'

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7 Although an FCM might, in some instances, be able to use its own capital to make up the difference between the customer's portfolio margin requirement and the DCO's requirement, it would not be sustainable for FCMs to take this approach on any significant scale.

8 SIFMA also shares the concerns raised by the Futures Industry Association in their comment letter about the sheer complexity that would be created by the fragmentation of segregation requirements and by the International Swaps and Derivatives Association in its comment letter estimating the costs of the segregation proposals.

9 SIFMA will make a corresponding request to the SEC to adopt consistent customer protection regimes on the securities side by incorporating the segregation requirements applicable to margin for security-based swaps into the existing SEC Rule 15c3-3 and PAIB ("proprietary account of introducing broker") reserve requirements.

collateral. Given the complexity of these concerns and issues, an industry study group may be an appropriate approach. We are prepared to support such an effort.

As a final note, the process of preparing this letter once again made apparent the importance of the CFTC and the SEC working together in the development of the rule sets required under Dodd-Frank. Consistency in these rule sets promotes the efficient functioning of swap dealers, FCMs and broker-dealers, and, in the context of the purpose of the CFTC's ANPR, facilitates the protection of client assets and the minimization of costs imposed on customers and the market as a whole. SIFMA would be pleased to meet with the CFTC to discuss the contents within this letter and Dodd-Frank more generally. If you have any questions, please call Kyle Brandon at 212-313-1280.

Respectfully submitted,

Kenneth E. Bentsen, Jr.
Executive Vice President
Public Policy and Advocacy
SIFMA

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner

Division of Clearing and Intermediary Oversight
Ananda Radhakrishnan, Director
Robert Wasserman, Associate Director
Nancy Liao Schnabel, Associate Deputy Director

Office of the General Counsel
Martin White, Assistant General Counsel