CalPERS
Investment Office
P.O. Box 2749
Sacramento, CA 95812-2749
TTY: For Speech & Hearing Impaired - (916) 795-3240
Phone: (916) 795-3400

January 18, 2011 **Via Agency Process: http://comments.cftc.gov**

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

Dear Mr. Stawick:

RE: 17 CFR Part 190 Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies - RIN Number 3038-AD99 - Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act

The California Public Employees' Retirement System (CalPERS) is respectfully submitting this letter in response to the ANPR on the topic of the protection of customer collateral posted for cleared swap transactions. CalPERS represents more than 1.6 million beneficiaries and holds more than $225 billion in assets to support current and future benefit payments.

The array of issues attached to extending clearing to the OTC derivatives market, have been identified and discussed by a number of commentators. These issues are substantial, complex, and appear to have little concrete data available to truly understand the potential costs associated with models varying from the "Baseline" or current futures practice. There appears to be two themes emanating from the perspectives offered:

1. Buy side participants wish to have no diminished collateral security in a cleared market, than they currently have available in existing un-cleared OTC market practice.
2. The current collateral treatment in the cleared futures markets provides a degree of "mutualization" of default risk that serves to reduce the collateral levels necessary from any individual when compared to a "Full Physical Segregation" model.

Of the four models outlined in the ANPR, either the "Legal Segregation with Commingling" or "Moving Customers to the Back of the Waterfall" appear to offer improved default protection relative to the "Baseline Model" while possibly avoiding excessive collateral levels that could be required from "Full Physical Segregation". Either of these models would be preferred to the "Baseline Model".

CalPERS believes that another model also needs consideration in an effort to mitigate potential cost while providing a level of collateral security that could possibly exceed the protection available in current OTC market practice.

Clearing Membership by Custodial Entities.

The four models proposed in the ANPR all share the common attribute that centers clearing membership on the Futures Commission Merchants (FCM's) that transact in the market. Posting collateral via the FCM relationship separates the maintenance of collateral from the provision of general custody for investor assets. There are several byproducts of this separation:

1. Significant movement of cash and collateral assets back and forth between custodial and FCM entities.
2. Diffusion of custodial responsibility and uneven exposure to loss.
3. Difficulty in assessing custodial security at multiple entities.
4. Accounting and informational inefficiency caused by the separation of investor assets into multiple, discrete entities.
5. Limitations on collateral types potentially impacting investment asset allocation.

The issues attached to these byproducts are significant and appear unnecessary. Our view is that more preferable model would be delivered by having clearing membership centered on the entities providing the actual custody of investors' financial assets. It is conceivable that clearing membership could be defined by having only "clearing custodians" as members, or having custodians as members alongside traditional FCM's. A distinction could be that FCM's have the ability to provide leverage in contrast to custodians facilitating collateral management. Such a structure may provide the benefit of "Full Physical Segregation" in a cost effective manner.

Benefits

1. Greater security of investor assets by complete custodial segregation.
2. Operational efficiency achieved by collateral posting via custodial segregation in contrast to physical movement of cash and securities.
3. Efficient assessment of custodial security and capability by investors.
4. Increased flexibility regarding the type of assets that could collateralize a liability.
5. Reduced investor need to hold assets which are not contributing to the achievement of investment objectives.

6. Possible increased competition within derivative trade execution, by moving to an "agency" model with custodial provision no longer a required attribute.
7. Improved risk management by investors through simplification of the acquisition, reconciliation, and analysis of needed information.
8. Improved regulatory transparency by consolidation of liability and collateral information at custodial entities irrespective of the number of trading entities employed.

Detriment

1. The fiduciary responsibility of custodial entities implies a very high standard of care necessary to avoid any form of "fellow customer risk". To protect against this risk, the likely action of the custodians would be to segregate significantly higher amounts of collateral than is currently being posted in futures clearing. This is viewed as potentially a dramatic increase in the cost associated with collateral and one of the primary issues with "Full Physical Segregation". A possible mitigation of this collateral increase would be to allow a much wider array of asset types to be segregated with appropriate "haircuts", thus minimizing the need to convert asset exposure into cash for collateral segregation. Except in cases of investors using very high overall leverage, it is likely that sufficient assets exist to satisfy a higher collateral level assuming more flexibility in the types of assets being segregated.

The attractiveness of "Full Physical Segregation" from a security standpoint, combined with the potential cost associated with collateral form inflexibility (cash only), is very likely to create a new cottage industry as firms step in to "repo" a variety of different collateral types. Driving this activity to new providers will potentially add a whole new layer of risk by creating a large amount of positional movement and making transparency harder to achieve. Custodial clearing membership may be much more efficient in facilitating this desired collateral flexibility without creating new risks.

Moving to a model of custodial clearing membership appears to simplify the process by which investor liabilities, attached to cleared OTC derivatives activity, are collateralized. The benefits outlined above, may outweigh the impact on existing clearing members and the potential cost of migrating to a new structure. It may also be possible to allow investors to "select" the form of clearing arrangement, choosing between the potentially lower cost of a "Baseline" type model and the greater security of a "Full Physical Segregation" alternative.

CalPERS appreciates the opportunity to opine on this important topic, and encourages the contemplation of a model with custodians being the members of clearing entities.

We would be glad to provide any further details required or to provide any assistance that you might require. Thank you for considering our comments. If you would like to discuss any of these points, please do not hesitate to contact either me directly at (916) 795-0549 or my colleague Anne Simpson, Senior Portfolio Manager at (916) 795-9672.

Sincerely

Eric Baggesen

ERIC BAGGESEN
Senior Investment Officer
Global Equity

cc: Joseph A. Dear, Chief Investment Officer – CalPERS
Anne Simpson, Senior Portfolio Manager – CalPERS