The Pulse of Finance

Newedge

BY OVERNIGHT MAIL AND E-MAIL

January 18, 2011

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 18th Street, N.W.
Washington, D.C. 2058
secretary@cftc.gov

Re: Newedge USA, LLC Comment Letter Relating to Conflicts of Interest/RIN Number 3038-AC96

Dear Mr. Stawick:

Newedge USA, LLC ("Newedge USA") is pleased to submit this comment letter on behalf of itself and its parent organization, Newedge Group SA ("Newedge Group")[1] in response to the Commodity Futures Trading Commission's ("CFTC") request for comment regarding proposed Regulation § 1.71 – the CFTC's proposed conflict of interest rule to be adopted under the Dodd-Frank Wall Street Transparency and Accountability Act of 2010 ("Dodd-Frank"). In general, we wholeheartedly support the CFTC's efforts to minimize conflicts of interest at futures commission merchants ("FCM"). However, as we set forth below, we believe that (1) swaps dealers that are parent shareholders of FCMs are required by regulation and as a matter of sound business practice to coordinate credit, risk and other policies for such FCM affiliates, and the plain language of proposed Regulation 1.71, as currently written, would preclude that, and; (2) FCMs that engage in minimal proprietary trading should not be subject to the burdensome and somewhat bureaucratic conflicts rules regarding research analysts.

[1] "Newedge" refers to Newedge Group, a 50%-50% joint venture between Société Générale and Credit Agricole CIB, headquartered in Paris, France, and all of its worldwide branches, subsidiaries and other units. Newedge maintains offices in over 15 countries, and is a member of over 85 exchanges worldwide.

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Introduction

Newedge Group was founded in January 2008 by its two 50% shareholders – Société Générale and Credit Agricole Corporate and Investment Bank – as a separate, quasi-independent global brokerage operation with minimal conflicts or potential conflicts of interest. Indeed our Fourth Fundamental Principle of Conduct unequivocally states:

> We will seek to minimize conflicts and potential conflicts of interest. If conflicts do arise, we will manage them fairly and in the best legitimate interest of our clients.[2]

From its beginning, the nature of governance of Newedge Group by its parent shareholders has supported this principle of minimizing conflicts, and we believe that our customers have found that Newedge USA's conduct has lived up to this high standard.[3] Indeed, although both our shareholders are recognized swaps dealers, Newedge has been a pioneer in offering central counterparty clearing services for its institutional clients through the Chicago Mercantile Exchange (Clearport and Eris initiatives); ICE Europe; IDCG and SGX Asia Clear. Newedge also has been an outspoken advocate publicly in global forums and through comment letters, as well as privately in meetings with regulators worldwide, regarding the benefits of central clearing and execution of OTC swaps and opening up such forums to non-dealers.[4]

All that being said, while Newedge has operated quasi-independently since its inception, it has also lived respectfully within two global organizations (SG and CA CIB) that need to coordinate credit, risk and other policies across all their respective subsidiaries as part of their own regulatory mandates and prudent conduct. This has been accomplished, however, in a non-discriminatory manner that has not been prejudicial to Newedge's clients or potential clients. In fact, we believe it has been highly beneficial to Newedge and its clients.

Regrettably, we believe that adoption of proposed Regulation § 1.71, as written, would discourage swap dealers from establishing and maintaining stand alone FCMs like Newedge – despite the success of Newedge in achieving many of the minimum conflict of interest objectives sought by the CFTC in an affiliated entity of a swaps dealer. Why? Because international and domestic regulators (including, for example, the Federal Reserve Board) expect an international financial services group to coordinate certain activities (e.g., risk, credit, and increasingly compensation) and prudence demands this too. Proposed CFTC Regulation § 1.71 would prohibit this coordination – no matter how light the touch -- despite the fact that such coordination clearly can be accomplished in a non-discriminatory manner beneficial to the marketplace at large, as demonstrated by the success of Newedge to date.

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[2] All of Newedge's fundamental Principles of Conduct can be found at http://www.newedge.com/web/guest/92.

[3] As of June 30, 2010, Newedge Group had an estimated global market share in listed derivatives of 11.6% (clearing) and 12.4% (execution), and over $56.4 billion of client assets on deposit. Newedge USA is a leading US futures commission merchant ("FCM") and broker-dealer ("BD"). According to CFTC statistics, Newedge USA, as of the end of November 2010, held the larges pool of segregated and secured customer funds among all US-registered FCMs.

[4] See generally, http://www.newedge.com/web/guest/about_us/regulation/comment_letters. Newedge USA is also pleased to have been one of the first (and few) FCMs to become a member of the Swaps and Derivatives Market Association, a new, leading advocate of "open access" in centralized swaps clearing and execution. See http://www.thesdma.org/.

We are also concerned with the proposed provisions of CFTC Regulation § 1.71 to the extent they attempt to regulate research within all FCMs. Although such provisions are well-meaning, they make little sense for FCMs like Newedge that engage in incidental proprietary trading only. Indeed, for such FCMs, they require the creation of a bureaucracy that cures a problem that does not exist. At a minimum, such provisions should only apply to FCMs that take more than a de minimis amount of market risk for their own account. And, even where such provisions should apply, they need to be adapted for stand alone FCMs that engage predominantly in execution and brokerage for customers. Otherwise, so-called research analysts risk being virtually unsupervised. This cannot be the result of the adoption of a well-meaning CFTC regulation!

Specific Analysis

First and foremost, Newedge endorses the positions articulated by FIA, ISDA and SIFMA in their comment letter dated 18 January 2010 ("Industry Letter"). The views expressed in the letter are exceptionally well-considered and we hereby adopt them as our own. To ensure brevity, we will not restate extensively in this comment letter the points raised and discussed in detail in the Industry Letter. We only make the following supplemental points.

1. Supervisory Provisions Involving Financial Services Organizations

To the extent that an FCM that principally engages in clearing activities is part of a group of companies that is affiliated with a swaps dealer, proposed CFTC Regulation §1.71 effectively prohibits such swaps dealer from effectively managing such FCM – even if the FCM is a subsidiary -- in a way that it may be required by regulation or prudent standards of oversight. This would add systemic risk to the financial system and, respectfully, should be avoided. Such prohibition is based on the precise language of proposed CFTC Regulation 1.71 (d) which appears to require an FCM to prohibit

> ...any affiliated swap dealer or major swap participant to directly or indirectly interfere with, or attempt to influence, the decision of the clearing unit personnel of the futures commission merchant with regard to the provision of clearing services and activities [with regard to certain enumerated activities including whether to accept a particular customer, setting risk tolerance levels for particular customers or determining acceptable forms of collateral from particular customers].[5]

However, such restrictions are inconsistent with a global organization maintaining a holistic view of all customers to ensure prudent credit and risk standards. If a parent or otherwise affiliated company is responsible for the overall credit and risk of a global organization it must be permitted – even if a swaps dealer – to have influence over the credit and risk policies, and even application of such policies to individual clients, of an FCM in such organization. Such practice is required by international regulation and prudence.

That being said, it would be fair for the CFTC to require that the persons at such swap dealer exercising such oversight over the FCM are not the same persons in the business unit engaging in the swap dealing activity or directly overseeing such activity. Proposed CFTC Regulation § 1.71 (d) could achieve this by being amended to read:

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[5] Applying the plain language of this proposal, an affiliated swaps dealer, even if a parent company, could not tell a subsidiary FCM to refuse a customer because it is on an OFAC list of internationally prohibited customers.

No futures commission merchant shall permit any employee of a business trading unit of an affiliated swap dealer or major swap participant to directly or indirectly interfere with, or attempt to influence, the decision of the clearing unit personnel of the futures commission merchant with regard to the provision of clearing services and activities...

2. Research Provisions

Although the provisions of Regulation 1.71 which endeavor to segregate research analysts and research reports at FCMs may be justified where a firm engages in proprietary trading and there is a risk that its employees may take advantage of such research to the detriment of the firm's customers, we believe such risk is eliminated, or virtually eliminated, where a firm engages in no or de minimis proprietary trading. Because many FCMs today conduct what tomorrow may be deemed research as part of the firm's business trading unit without any detriment to their clients,[6] the CFTC should consider granting an FCM an option to escape application of the bureaucracy of this provision by agreeing not to engage in any proprietary trading or proprietary trading that results in only a minimum amount of market risk.[7]

- The definition of Research Report in § 1.71(a)(9) is too broad. Traditionally, derivatives are contracts which typically reference some underlying physical commodity (agricultural or otherwise), or financial instrument. As a result, broadly speaking, any discussion of a derivative that references the underlying physical commodity or financial instrument could be deemed to provide "...information reasonably sufficient upon which to base a decision to enter into a derivatives transaction." For example, a macro-economic discussion of gold futures generally that references past performance, current fundamental and statistical rationales for the current spot price (that references Comex spot gold prices), and a projection of future price trends – even though not referencing at all any specific derivatives contracts or including a recommendation to buy or sell could be "...information reasonably sufficient upon which to base a decision to enter into a derivatives transaction."[8] This is too broad. At most, the term "research report" should be limited to:

  > ...any written communication....that includes an analysis of the price or market for any specific derivative contract, and that provides information reasonably sufficient upon which to base a decision to enter into a transaction involving such specific derivative contract.

- If adopted "as is," it is not clear for a firm engaged exclusively or substantially in the brokerage and clearing of derivatives who would be available within such organization to supervise, as well as administer the compensation and evaluation of, research analysts. This is because of the specific language of proposed §1.71 (c)(1)(ii) which reads:

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[6] It is not uncommon for sales teams at FCMs to be organized by product expertise and to produce research as part of the service of such team. Thus for example, a "Metals Team" may not only be the experts who handle their customers purchases and sales of metals derivatives, but as part of their service offering, may produce research to help their customers assess market conditions. Where a firm does not engage in proprietary trading or only a de minimis amount of proprietary trading that results in market risk, any potential conflict with customers is neutralized.

[7] Firms that broker OTC or certain other "cash" instruments must engage in proprietary trading because of the principal nature of such trading. However, if such trading is conducted on a back to back basis with the firm taking no or minimal market risk, it is akin to traditional agency brokerage activity.

[8] We note that such macro-economic analyses are generally exempted from the definition of "research" under the securities laws.

> ...and no personnel engaged in trading or clearing activities may have any influence or control over the evaluation or compensation of a research analyst.

At a minimum, to accommodate firms (or divisions of broader firms) that are engaged exclusively or substantially in the brokerage and clearing of derivatives, it must be permitted for senior officers (e.g., the CEO) and employees of departments other than those specifically in the business trading or clearing unit (e.g., Human Resources, Legal and Compliance) to have input regarding the evaluation or compensation of research analysts. This could be accomplished through the following de minimis change to §1.71 (c)(1)(ii):

> ...and no personnel employed in the business trading unit or clearing unit may have any influence or control over the evaluation or compensation of a research analyst.

Moreover, in general, the CFTC should make clear that all compensation decisions are permitted to be performed in accordance with general compensation guidelines approved by a firm for all employees that do not single out research analysts specifically. Otherwise, research analysts could inadvertently be exempted for compensation guidelines adopted globally in response to performance generally of the firm (or group of which the firm is a member) or regulatory requirements.

- If adopted "as is," it is not clear that proposed research analysis can be pre-reviewed for compliance with applicable regulatory standards (e.g., NFA Rule 2-29) except by Legal and Compliance staff. This is because of the specific language of proposed §1.71 (c)(1)(iii) which reads:

> Except as provided in paragraph (c)(1)(iv)....non-research personnel, other than the board of directors and any committee thereof, shall not review or approve a research report...before its publication.

§1.71 (c)(1)(iv) does not, as proposed, contain an exemption for review to ensure compliance with applicable regulatory requirements by any non-research personnel other than legal or compliance personnel. This may be inconsistent with organizations that establish such review within other control functions (eg, Operational Risk Management). We respectfully request that such flexibility be accomodated.

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Newedge is proud to have been created in an effort to create a conflict free brokerage company, including an FCM, within two organizations that engage in swap dealing activities. We believe our success to date reflects the foresight of our shareholders and our own success in carrying out our mandate.

We applaud the efforts of the CFTC to implement provisions of Dodd Frank requiring elimination or at least the minimization of conflicts of interest, but encourage the CFTC not to do so in ways that are impractical or ignore the way that groups of companies manage themselves, especially their global credit risk exposure.

Thank you for allowing us to provide you with our comments proposed CFTC Regulation §1.71. We would be happy to discuss them further with you to the extent you wished to do so. If you have any questions or would like further information regarding this matter, please do not hesitate to contact the undersigned at (646) 557-8548 or John Nicholas, US Securities Compliance Director and Global Securities Coordinator, Newedge Group, at (646) 557-8516.

Sincerely,

Newedge USA, LLC

Gary DeWaal
Senior Managing Director and
Group General Counsel