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 Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies/RIN 3038-AD99

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") in response to the Commodity Futures Trading Commission's ("CFTC") advanced notice of proposed rulemaking regarding the above-referenced matter.[1] Newedge USA applauds the CFTC for seeking input from the industry on this very important issue. As you may know, Newedge USA staff members routinely work with regulators to develop new rules and market practices, and welcome the opportunity to do so here.

Newedge USA previously submitted a comment letter to the CFTC addressing individual customer collateral protection in response to the Staff's Public Roundtable on this topic. In that letter (a copy of which is attached hereto as Exhibit A), we urged the Staff to apply the current customer off-set practices involving insolvent FCMs – i.e., that a

[1] "Newedge" refers to Newedge Group, a 50%-50% joint venture between Societe Generale and Credit Agricole CIB, headquartered in Paris, France, and all of its worldwide branches, subsidiaries and other units. Newedge Group maintains offices in over 15 countries, and is a member of over 85 exchanges worldwide. 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 largest pool of segregated and secured customer funds among all US-registered FCMs.

customer's losses will be netted at a clearinghouse against collateral provided by other customers of the same insolvent FCM – to cleared swaps customers. Given the continued debate on the topic and, in our view, the critical nature of this issue, we believe it is important to reiterate our views here.

First, as a member of the Futures Industry Association ("FIA"), we have participated in the drafting of its thoughtful letter submitted as of January 18, 2011 on this matter. We adopt as our own all the essential arguments of the FIA. We also applaud the Chicago Mercantile Exchange ("CME") for the exceptionally well-considered letter it has submitted on this matter. Among other things, we believe the CME has very eloquently discussed the "moral-hazard risk" of amending the current customer off-set rule (also known as the "baseline model" of customer funds protection).

As noted in our previous letter, we feel strongly that – absent a showing of compelling evidence to the contrary which, we believe, has not been made by the Staff -- the current customer off-set rule (set forth in Commission Interpretive Letter No. 85-3 (March 1985)) should be applied to cleared swaps activity because, among other things:

1. eliminating customer off-sets in insolvent FCMs is "anti-customer" in that it would increase systemic risk generally by discouraging clearing members from maintaining substantial excess capital; and

2. swap counterparties – all of whom must qualify as eligible contract participants – are already, as a practical matter, in the best position to mitigate their off-set risk by selecting FCMs that are well-capitalized and have robust risk management procedures (and the CFTC can aid them in such decisions by requiring FCMs to disclose additional material financial and risk related information to the public.[2]

Bottom line: why would the CFTC want to add uncertainty to a system that is true and tested, when the customers who potentially would benefit from such modification already have adequate means to protect themselves against the default of any particular FCM?

1. <u>Eliminating Customer Off-Sets Is "Anti-Customer</u>."

Failing to extend the current customer off-set rule to cleared swaps customers would, in our view, hurt customers (except for non-defaulting customers of a defaulting FCM) because it would weaken the entire futures capital and clearing structure. Specifically, at this time, FCMs routinely maintain substantial excess capital in order to attract significant institutional as well as other customers. This strengthens the entire clearing process. However, to the extent clearinghouses will be required to look through the

[2] Newedge USA also asserted in its previous comment letter on the subject that the current customer off-set rule should be applied to cleared swaps customers because: (a) Congress has not clearly indicated that the Staff should create an exception to the current rule and, in the absence of such a clear mandate, the CFTC is bound as a matter of statutory construction to the existing rule, and; (b)the CFTC should not add "Madoff Risk" to a system that is "tried and tested."

default of a clearing member and satisfy all non-defaulting customers of that member through other clearing member funds, clearing members, in our view, will be motivated to maintain only the minimum capital required because they: (1) will be able to attract large customers without having to maintain substantial excess capital by pointing out that such customers will always be made whole by the clearinghouse regardless of what happens at a defaulting FCM, and (2) will want to protect themselves against supplemental calls for guaranty fund deposits by the clearinghouse to satisfy amounts that must be paid to the aggregate "winners" of a defaulting member for which they are not responsible and have no practical way to protect themselves against (e.g., non-defaulting FCMs effectively must guarantee possibly poor risk policies and insufficient capital of other clearing members).

Unfortunately, an increase in undercapitalized FCMs would, in our view, increase systemic risk which will hurt most customers and is inconsistent with one of the primary objectives of the Dodd-Frank Wall Street Transparency and Accountability Act of 2010 ("Dodd-Frank"); i.e., to decrease systemic risk in the cleared swaps market. Indeed, Dodd-Frank is about the "mutualization" of risks. Any proposal that moves away from that concept directly or indirectly – even if limited to cleared swaps at first – to us is anti-customer and weakens the clearing system systemically and profoundly. Some customers may benefit – certainly those at defaulting firms – but not customers at the non-defaulting firms who potentially will be put at risk because of the possible strain on their broker's capital – a risk non-defaulting brokers cannot fairly protect themselves against.

2. Swap Customers Can Limit Their Off-Set Exposure By Choosing Their FCM Wisely.

Rather than creating a swaps exception to the customer off-set rule, we believe it would make more sense for the CFTC to require all FCMs to disclose certain additional material financial and risk-related information publicly (similar to BD FOCUS Reports) and then allow prospective swaps customers to minimize their off-set risk by selecting well capitalized FCMs and FCMs with robust risk policies. This is a position Newedge has consistently proposed and that has repeatedly been overlooked, and we applaud the CME for taking a similar position in its comment letter! For example, FCMs could be required to disclose the following to their prospective customers in "plain English" on at least an annual basis:

- the FCM's total equity, regulatory capital and net worth;
- the dollar value of the FCM's proprietary margin requirements as a percentage of its segregated and secured customer margin requirements;
- what number of the FCM's customers comprise an agreed significant percentage of its customer segregated funds;
- the aggregate notional value of non-hedged, principal OTC transactions into which the FCM has entered;

- the amount, generic source and purpose of any unsecured and uncommitted short-term funding the FCM is using;

- the aggregate amount of financing the FCM provides for customer transactions involving illiquid financial products for which it is difficult to obtain timely and accurate prices;

- the percentage of customer "bad debts" the FCM had during the prior year compared to its year-end segregated and secured customer funds,[3] and

- a summary of the FCM's current risk practices, controls and procedures.[4]

In short, sophisticated customers can protect themselves by choosing well-capitalized FCMs with good risk procedures. That's how our system has always worked, and that's how it should work going forward. If individual customers want better protection, they can work this out with their brokers; there are creative solutions we can all come up with – and we should! But let's not propose to weaken the system for most everyone.

* * *

Thank you again for entertaining our views on this matter. If you have any questions, do not hesitate to contact the undersigned at (646) 557-8458 or John Nicholas, US Securities Compliance Director and Global Securities Coordinator, at (646) 557-8516.

Sincerely,

Newedge USA, LLC

Gary DeWaal
Senior Managing Director and
Group General Counsel

Attachments: Exhibits A and B

[3] The CFTC could consider reviewing the adequacy of such disclosures in connection with an FCM's routine examinations.

[4] Newedge USA previously expressed its view that systemic risk can be mitigated by requiring each FCM to disclose the material risks associated with its business activities – and the controls and procedures it has in place to mitigate those risks – in a comment letter (copy attached as Exhibit B) submitted in response to the CFTC's 2009 proposal to raise FCM capital requirements.

# Exhibit A

BY OVERNIGHT MAIL AND E-MAIL

October 21, 2010

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

Re: Newedge Submission In Connection With The CFTC's Public Roundtable on Individual Customer Collateral Protection

Dear Mr. Stawick:

Newedge USA, LLC ("Newedge USA") is pleased to provide its views on individual customer collateral protection on behalf of itself and its parent company, Newedge Group SA ("Newedge"), in connection with the Commodity Futures Trading Commission's ("CFTC") October 22, 2010 Public Roundtable.[1] As you may know, Newedge USA staff members routinely work with regulators to develop new rules and market practices, and welcome the opportunity to do so here.

One of the topics to be discussed at the Roundtable is to what extent, if any, should one swap customer's losses be netted at a clearinghouse against collateral provided by other swap customers of the same insolvent FCM. This issue has, it appears, been raised to the CFTC Staff by a number of market participants who are concerned with extending the

[1] "Newedge" refers to Newedge Group, a 50%-50% joint venture between Societe Generale 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 80 exchanges worldwide. As of December 31, 2009, Newedge had an estimated global market share in listed derivatives of 12.1% (clearing) and 11.1% (execution), and over $54.8 billion of client assets on deposit. Newedge USA is a leading US futures commission merchant ("FCM") and broker-dealer ("BD"), and currently holds the largest pool of customer segregated and secured funds among US FCMs according to CFTC statistics.

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existing interpretation of Section 4d of the Commodity Exchange Act ("CEA") – which provides for such off-sets – to swaps centralized clearing activity.[2]

In our view, the Staff should not create an exception to the existing customer off-set rule for swaps activity because: (1) Congress has not clearly indicated that it should do so and, in the absence of such a clear mandate, the CFTC is bound as a matter of statutory construction to the existing rule; (2) eliminating customer off-sets in insolvent FCMs would increase systemic risk by discouraging clearing members from maintaining substantial excess capital; (3) swap counterparties – all of whom must qualify as eligible contract participants – can already mitigate their off-set risk by selecting FCMs that are well-capitalized and have robust risk management procedures (and the CFTC can aid them in such decisions by requiring FCMs to disclose additional material financial and risk related information to the public), and; (4) the CFTC should not add "Madoff Risk" to a system that is "tried and tested." Bottom line: why would the CFTC wish to add uncertainty to a system of certainty that is true and tested, when the customers who potentially would benefit from such modification already have adequate means to protect themselves against the default of any particular FCM?

1. Congress Did Not Clearly Contravene Current Law, And Thus, There is no Legislative or Administrative Basis To Create an Exception For Swaps Activity.

Under current law, a customer's losses will be netted at a clearinghouse against collateral provided by other customers of the same insolvent FCM. See Section 4d(a)(2) of the CEA. In our view, the Staff should not (and arguably cannot) create an exception to this rule for swaps activity because Congress did not clearly indicate in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") that it should do so and, in the absence of such clear legislative mandate, the CFTC is essentially bound, as a matter of statutory construction, to abide by the existing rule. Indeed, not only did Congress not indicate that the CFTC should create an exception for swaps activity to the current customer off-set rule, it essentially reiterated in Dodd-Frank the same exceptions (allowing for the commingling of customer assets) that formed the basis for the current practice.[3] Our side-by-side comparison of Section 4d(a)(2) of the CEA and the comparable section established under Dodd-Frank showed, at least in our view, no material differences (including with respect to the exceptions portions of the general rule). It is well-settled that an administrative agency should not withdraw or amend a

[2] It is our understanding that this debate is confined to swaps activities; that is, the current rule relating to futures customer off-sets in insolvent FCMs will not be amended.

[3] See Section 724(f)(3) of Dodd-Frank ("money, securities, and property of swap customers of [an FCM] ..... may, for convenience, be commingled and deposited in the same bank account or accounts with any bank or trust company or with a [DCO];" "such share of the money, securities, and property ..... as in the normal course of business shall be necessary to margin, guarantee, secure, transfer, adjust, or settle a cleared swap with a [DCO] or with any member of the [DCO] may be withdrawn and applied to such purposes, including the payment of commissions, brokerage, interest, taxes, storage, and other charges, lawfully accruing in connection with the cleared swap," and; "according to such terms and conditions as the Commission may prescribe by rule, regulation, or order, any money, securities, or property of the swaps customers of a [FCM] ... may be commingled and deposited in customer accounts with any other money, securities, or property received by the [FCM] and required by the Commission to be separately accounted for and treated and dealt with as belonging to the swaps customer of the [FCM]").

rule issued prior to a legislative enactment when the subsequent legislation not only fails to clearly contravene the rule but in fact supports it.

2. Eliminating Customer Off-Sets Could Result in More Undercapitalized FCMs and Increase Systemic Risk.

Currently, clearing member FCMs routinely maintain substantial excess capital in order to attract significant institutional as well as other customers.[4] To the extent that clearing houses will be required to look through the default of a clearing member and satisfy in the aggregate all customers with positive total equity, irrespective that one customer may have negative equity greater than such aggregate positive equity, clearing members will be motivated to maintain only the minimum capital required because they (1) will still be able to attract large customers without substantial excess capital by pointing out to customers that they will always be made whole by the clearinghouse regardless of what happens at the FCM, and (2) will want to protect themselves against calls by the clearinghouse to satisfy amounts that must be paid to the aggregate "winners" of a defaulting clearing member for which they are not responsible and have no practical way to protect themselves against.

Although we expect that the CFTC and the clearing-houses will certainly impose minimum capital, operational and other standards on FCMs involved in centrally clearing swaps, we believe that many such FCMs will be inclined to implement only the minimum such safeguards for the reasons described above. Unfortunately, an increase in undercapitalized FCMs would, in our view, increase systemic risk (not to mention the fact that FCMs may be more inclined to attract and take on customers outside of their capital "comfort zone" knowing that the clearinghouse will guarantee all their customers' assets in the event they become insolvent).

3. Swap Customers Can Limit Their Off-Set Exposure By Choosing Their FCM Wisely.

Rather than creating a swaps exception to the customer off-set rule, we believe it would make more sense for the CFTC to require FCMs to disclose certain additional material financial and risk-related information publicly (similar to BD FOCUS Reports) and then allow prospective swaps customers to minimize their off-set risk by selecting the most well-capitalized FCMs and FCMs with the most robust risk policies. For example, FCMs could be required to disclose the following to their prospective customers in "plain English" on at least an annual basis:

- the FCM's total equity, regulatory capital and net worth;
- the dollar value of the FCM's proprietary margin requirements as a percentage of its segregated and secured customer margin requirements;

[4] Indeed, a review of Selected FCM Financial Data as of August 31, 2010 (from reports filed by September 30, 2010) on the CFTC's website indicates that at least 46 FCMs have over $100 million in excess net capital.

- what number of the FCM's customers comprise an agreed significant percentage of its customer segregated funds;
- the aggregate notional value of non-hedged, principal OTC transactions into which the FCM has entered;
- the amount, generic source and purpose of any unsecured and uncommitted short-term funding the FCM is using;
- the aggregate amount of financing the FCM provides for customer transactions involving illiquid financial products for which it is difficult to obtain timely and accurate prices;
- the percentage of defaulting assets (debits and deficits) the FCM had during the prior year compared to its year-end segregated and secured customer funds,[5] and
- a summary of the FCM's current risk practices, controls and procedures.[6]

Indeed, because all swap counterparties must qualify as eligible contract participants, we believe that most such customers will have the sophistication and knowledge to make an educated choice as to the correct FCM.

4. <u>It would be Ill-Advised for the CFTC to Introduce Madoff Risk to the Clearing Process</u>

The Ponzi scheme of Bernard Madoff is well-known, and the critical role fictional books and records played in permitting the scheme are undisputed. The futures industry was very fortunate to avoid being tarnished by Madoff's nefarious actions. However, the CFTC proposes to add "Madoff Risk" to the clearing process by, in the case of an FCM default, requiring non-defaulting clearing members potentially to "pay-up" to cover money owed (at the clearing house level) to ultimate customers disclosed by such defaulting clearing member. These customers may not only be fully disclosed customers of such clearing member, but disclosed customers only of omnibus accounts of such clearing member, or omnibus accounts within omnibus accounts.

This reliance on such books and records of a defaulting clearing member at the time of industry stress could prove to be a mistake and require substantial efforts subsequently to

[5] The CFTC could consider reviewing the adequacy of such disclosures in connection with an FCM's routine examinations.

[6] Providing effective disclosures to customers and enabling them to choose the level of security they want is consistent with the industry's treatment of customer asset protections with respect to single stock futures; i.e., provide customers with a basic understanding of the protections that apply and then give them a choice as to whether to elect securities or futures-related protections.

correct – all to the detriment of "innocent" non-defaulting clearing members. The CFTC clearly should avoid adding Madoff risk to the clearing system.

* * *

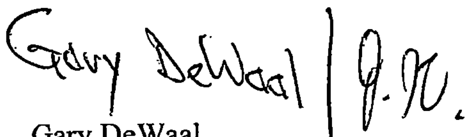
This all being said we are aware that some buy-side participants seek greater protection for customer funds held at an FCM. However, the CFTC's current mix of FCM margin, customer protection and capital requirements – including the existing rule on customer off-sets – has worked well throughout the years to protect customers against insolvency and reduce systemic risk. In fact, there have been only very isolated instances, to our knowledge, of a failure of an FCM that caused a run on segregated funds that left customers with a deficiency. More specifically, since the creation of the FCM structure and the capital rules governing FCMs, only a tiny proportion of FCMs have become fiscally insolvent resulting in a loss of customer segregated funds. Thus, to a certain extent, those seeking to carve out an exception to the customer off-set rule for swaps activity seek to "fix what is not broken."

In short, the CFTC's capital and customer protection rules have worked, and continue to work now during times of significant market volatility and instability.[7] Considering that FCMs involved in the centralized clearing of swaps will continue to be subject to the same if not greater margin, capital and customer protection requirements, we see no reason why the present regulatory structure should not be used (and we do not believe that those arguing it should not have put forward a compelling case or empirical evidence as to why it should be changed). Uncertainty and systemic risk should not be added to a system that ironically was designed by Congress to reduce uncertainty and systemic risk.

Thank you again for entertaining our views on this matter. If you have any questions, do not hesitate to contact the undersigned at (646) 557-8548 or, in my absence, John Nicholas, Acting Head of Compliance, Newedge Americas, at (646) 557-8516.

Sincerely,

NEWEDGE USA, LLC



Gary DeWaal
Senior Managing Director and
General Counsel

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[7] See, e.g., NFA Comment Letter to SEC (December 5, 2001) ("[t]he customer protections in the futures and securities industries work very well ..... [a]s the following discussion shows, both industries have excellent track records for protecting customer funds from insolvency losses"); CFTC Release RIN 3038 (July 3, 2003) ("[t]he current capital rule generally has worked well as a measure of the minimum amount of capital an FCM needs in order to augment the Segregated Account to provide protection for customer funds and to meet the FCM's responsibility of maintaining orderly markets").

# Exhibit B

The Pulse of Finance

**BY E-MAIL AND OVERNIGHT MAIL**

June 8, 2009

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

Re: Commodity Futures Trading Commission's Proposed Adjusted Net Capital Requirements for Futures Commission Merchants and Introducing Brokers, 17 CFR Part 1, RIN 3038-AC66

Dear Mr. Stawick:

Newedge USA, LLC ("Newedge USA") is pleased to submit this comment letter on behalf of itself and its parent company, Newedge Group ("Newedge") relating to the proposal by the Commodity Futures Trading Commission ("CFTC") to amend its net capital requirements for futures commission merchants ("FCM") and introducing brokers ("IB").

As an initial matter, we applaud the CFTC for examining ways to strengthen the financial condition of FCMs and IBs, and thereby enable them better to protect their customers' assets and meet their financial obligations. Clearly, in light of current market conditions and the high profile failures of a number of leading financial institutions over the past year or so, this is a topic worthy of strong consideration.[1] However, as we set forth below, we do not believe the CFTC's proposal to increase FCMs' risk-based capital requirements to ten percent of the total risk margin requirement for positions carried in their customer and noncustomer accounts is the most effective means of accomplishing this objective. In fact, we believe increasing capital as proposed would provide only mild relief, at best, while decreasing competition among FCMs and likely driving up customer costs.[2] Rather, we believe customers would be better served by requiring FCMs to disclose certain key information regarding their assets and risk-profiles, and then let the customers decide which FCM would provide the most security for their deposits. Before discussing these matters in more detail, however, we would like to provide a brief background of Newedge and Newedge USA.

## BACKGROUND

Newedge, which is one of the world's largest brokerage organizations, offers 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

[1] We do note, however, that the most significant such failures appear to have involved banks and broker-dealers that had acquired large amounts of "toxic" debt, as opposed to FCMs conducting normal futures brokerage activities.

[2] We are not providing comments at this time on the other proposed amendments set forth in the CFTC's rule proposal.

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between Calyon (part of Credit Agricole) and Société Générale, 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 80 exchanges worldwide. Newedge estimates that its customers – who are principally institutional – execute 6.4 million lots and clear 7.0 million lots, globally, on a daily basis.[3]

Newedge USA is one of the leading broker-dealer ("BD")/FCMs in the US.[4] Indeed, according to CFTC statistics, Newedge USA holds the second largest pool of customer "segregated" and "secured" assets of all US-based FCMs.[5] Newedge USA's primary function is that of a broker – i.e., to execute and clear customer transactions across multiple asset classes on either 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. As a result, Newedge USA does not generally hold large positions in inventory.

## DISCUSSION

1. The CFTC's Capital Increase Proposal is Not, in Our View, the Most Effective Means of Protecting Customers' Assets

The CFTC's proposal to increase FCMs' risk-based capital requirements to ten percent of the total risk margin requirement for positions carried in their customer and noncustomer accounts is not, in our opinion, the most effective means of increasing customer asset protection. Indeed, the past twelve months have taught us that increasing capital requirements does not necessarily ensure fiscal solvency. For example, at least one of the two high-profile BD/FCMs that failed in 2008 maintained, to our knowledge, substantial excess net capital. Thus, rather than simply raising capital requirements, we believe the key is to identify the primary factors that put an FCM's capital at risk, and then ensure that such factors are disclosed to customers and potential customers so that they can better assess the financial strength of their firm – i.e., "to be able to look behind the capital."

Before discussing such factors, however, we would like to point out two facts which we believe the Staff should consider carefully prior to increasing FCM capital requirements. First, it is well-recognized that the linchpin of FCM financial stability – and thus the key to the protection of customer assets – is the collection and segregation of customer margin on a daily basis. Indeed, it is the maintenance of such funds on a segregated and secured basis, rather than a firm's capital, that most principally ensures that FCMs will be able to meet their basic obligation – the daily clearance and settlement of customer trades. Second, there has never been, to our knowledge, a failure of an FCM that caused a run on segregated funds that left customers with a deficiency. More specifically, since the creation of the FCM structure and the capital rules governing FCMs, no FCM has become fiscally insolvent resulting in a loss of customer segregated funds. Thus, to a certain extent, the FCM's current proposal tries to "fix what is not broken." In short, as a result of the CFTC's customer margin rules, the current capital requirements – i.e., 8% of customer risk margin requirements and 4% of noncustomer risk margin requirements – have worked for many years, including during times of significant market volatility and instability.

Importantly, the capital held by an FCM is generally only implicated when there is a deficiency in customer segregated funds.[6] Indeed, only if some relatively unusual event causes a large deficit in segregated funds – such as a fraud or a default by a customer with a very large percentage of an FCM's segregated funds (greater than the FCM's capital) – does an FCM's capital come into question. Thus, in general, assuming an FCM, as it is required to do, marks its customers' transactions to market and collects the required margin on a daily basis – not to mention conducts daily risk-based analyses of the impact potential market movements could have on such positions – history has shown that it will not be at risk of insolvency based

[3] As of December 31, 2008.

[4] Effective January 2, 2008, Fimat USA, LLC changed its name to Newedge USA, and effective September 2, 2008, Newedge Financial, Inc. – the former Calyon Financial, Inc. – merged into Newedge USA.

[5] As of March 31, 2009.

[6] It should be noted FCM fraud could also cause an inadequacy in segregated funds. Only routine auditing (not capital) can probably help against this.

on current capital requirements.[7] In assessing ways to better protect customer assets, we hope the CFTC does not lose sight of the key role played by customer segregated and secured funds and the long-term success of the current capital requirements.

That being said, even a financially strong FCM's capital can be put at risk based on it conducting a number of permitted activities, such as: (a) conducting a large amount of proprietary trading; (b) having a small number of customers make up a significant percentage of its total customer margin requirement; (c) executing OTC derivative transactions on a principal, non-hedged basis; (d) maintaining a small percentage of liquid assets in relation to its overall equity; (e) relying heavily on unsecured and uncommitted short-term funding to meet its regulatory obligations; and (f) financing a large number of customer transactions involving illiquid financial products for which it is difficult to obtain timely and accurate prices. Accordingly, we believe that the CFTC's objective – namely, increasing the protection of customer assets – would be better served by identifying key risk factors such as these and requiring FCMs to disclose them to customers and potential customers so that they may better assess the true security of their deposits.

For example, FCMs could be required to disclose the following – as well as other possible measures of an FCM's true risk – to their customers in "plain English" on at least an annual basis:

- the FCM's total equity, regulatory capital and net worth;
- the dollar value of the FCM's proprietary margin requirements as a percentage of its segregated and secured customer margin requirements;
- what number of the FCM's customers comprise an agreed significant percentage of its customer segregated funds;
- the aggregate notional value of non-hedged, principal OTC transactions into which the FCM has entered;
- the amount, source and purpose of any unsecured and uncommitted short-term funding the FCM is using;
- the aggregate amount of financing the FCM provides on customer transactions involving illiquid financial products for which it is difficult to obtain timely and accurate prices;
- the percentage of defaulting assets (debits and deficits) the FCM had during the prior year compared to its year-end segregated and secured customer funds, and
- a summary of the FCM's current risk practices, controls and procedures.[8]

Given the importance of "looking behind the capital" to the risk factors more closely indicative of an FCM's true financial stability, we also believe it would be unfair to apply an across-the-board capital increase without taking such risk factors into account. For example, in our view, it would be unfair to subject a firm such as Newedge USA – which conducts only a minimal amount of proprietary trading – to the same capital requirements as a firm that conducts a substantial amount of proprietary trading (and particularly one that conducts a large amount of highly leveraged proprietary trading), since a firm that focuses on brokerage incurs less risk to its capital than a firm that concentrates on proprietary trading.

## 2. The Rule Proposal Could Have Anticompetitive Results

We also believe the CFTC's proposal would have an anticompetitive impact on the industry by reducing the number of FCMs operating in the US. As the CFTC is aware, there has been a significant trend toward consolidation among FCMs in the US over the past ten years. Indeed, the CFTC notes in its proposal that there were 255 FCMs in the US as of August 31, 1995, but only 134 FCMs as of December 31, 2008. Further, as the Staff is aware, a number of the largest FCMs have merged in recent years, including Fimat USA, LLC and Calyon Financial, Inc., which has resulted in approximately 80% of all global segregated customer funds being held by only six FCMs.

[7] Consequently, we believe it is somewhat ironic that an FCM's capital requirements generally increase in the first instance as it increases the amount of margin it collects from its segregated and secured customers.
[8] The CFTC should also consider reviewing the adequacy of such disclosures in connection with an FCM's routine examinations.

Raising FCM capital requirements would, in our opinion, exacerbate this trend toward consolidation. We believe that FCMs that do not carry nor have access to large amounts of capital in excess of current requirements – but are otherwise financially stable as a result of customer margin deposits and low-risk business models – would be forced to go out of business, merge into more well-capitalized firms or reduce the number and variety of business activities they perform. Indeed, under the CFTC's proposal, minimum capital requirements for even large international firms such as Newedge USA could increase by as much as 45% without any change in their risk profile, solely because they hold large amounts of required customer margin deposits. Such a percentage increase can translate into FCMs being required to increase their capital by hundreds of millions of dollars. Unfortunately, we believe that such a significant increase will, as noted, reduce the number of FCMs from which customers could choose, decrease competition within the industry and increase transaction costs to customers.[9]

As the Staff is aware, the CFTC must consider the potential anticompetitive impact when promulgating rules, and "take the least anticompetitive means of achieving [its] objectives."[10] We believe the alternative cited above in Section 1 would constitute a much less anticompetitive (and more effective) means of achieving the CFTC's objective. Indeed, in the proposal we articulate above, it would be the customers themselves – based on the FCM disclosures we have recommended – that would decide which FCM with which to conduct business.

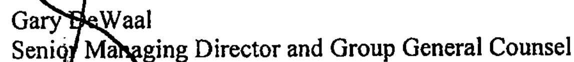
* * *

We appreciate the opportunity to comment on these proposed rules. Feel free to contact the undersigned at (646) 557-8458 or at gary.dewaal@newedgegroup.com if you have any questions.

Sincerely,

Newedge USA, LLC

Gary DeWaal
Senior Managing Director and Group General Counsel



[9] We are also concerned that increasing capital requirements based on higher risk-based margin percentages could cause FCMs to push out certain unregulated businesses to unregulated entities such as special purpose vehicles, thereby decreasing customer protection relating to such transactions.

[10] 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").