

# Coalition for Derivatives End-Users

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January 18, 2011

Mr. David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

*Via agency website*

**Re: Request for Comments on Advanced Notice of Proposed Rulemaking  
Pertaining to Protection of Cleared Swaps Customers Before and After  
Commodity Broker Bankruptcies / RIN 3038-AD99**

The Coalition for Derivatives End-Users (the “Coalition”) is pleased to offer comments regarding the Commodity Futures Trading Commission’s (“CFTC” or the “Commission”) Advanced Notice of Proposed Rulemaking titled “Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies” (“ANPR”).

The Coalition represents companies that employ derivatives predominantly to manage risks. Hundreds of companies have been active in the Coalition and our message is straightforward: Throughout the legislative and regulatory process, the Coalition has sought to ensure that financial regulatory reform measures promote economic stability and transparency without imposing undue burdens on derivatives end-users. Imposing unnecessary regulation on derivatives end-users, who did not contribute to the financial crisis, would create more economic instability, restrict job growth, decrease productive investment, and hamper U.S. competitiveness in the global economy.

The ANPR seeks comment on four potential models that offer varying levels of protection for cleared swaps customers. The models are as follows: (1) Full Physical Segregation (“Full Segregation”); (2) Legal Segregation with Commingling (“LSC”); (3) Moving Customers to the Back of the Waterfall (“Waterfall”); and (4) Baseline model (current law). From the ANPR, we understand that, under the Full Segregation and LSC models, the collateral of a defaulted Futures Commission Merchant’s (“FCM”) customers will not be available to the Derivatives Clearing Organization (“DCO”) as a default resource. Under the Waterfall model, the collateral of a defaulted FCM’s non-defaulting customers will only be available to the DCO after the DCO has first applied its own capital and the guarantee fund contributions of its clearing members. And under the Baseline model, the collateral of a defaulted FCM’s non-defaulting customers would be immediately available to the DCO as a DCO default resource.

The ANPR seeks from cleared swaps customers information on the costs and benefits associated with moving from the Baseline to each of the other models. The Coalition is not in a position to undertake such cost and benefit calculations at this time, given the number of variables associated with the four potential models.

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Coalition members have concerns about each of the four models and urge the Commission strongly not to impose a model on a particular company or a particular transaction. Coalition members are concerned about potential “fellow-customer” risk attendant to the Baseline model. And we are concerned about the additional collateral burdens and other costs that could be imposed under any of the three new models and being forced to accept those costs due to limited choices.

Due to the lack of adequate information regarding potential cost increases, at this early stage of the regulatory process, the Coalition urges the following course of action:

- Postpone settling on a regime for the protection of cleared swaps customers until the CFTC has more concrete information about the implications of forcing each particular model onto cleared swaps customers. In this regard, we strongly advocate that the CFTC not tie this rulemaking to an effective date that may force the promulgation of regulations before end-users and other market participants have been able to perform a proper cost-benefit analysis; and
- At least until the Commission has sufficient data, and has given the rulemaking sufficient consideration to select one or multiple models, the Commission should allow cleared swaps customers to choose among the four models noted above. Such a course of action would be the most likely to meet the ANPR’s stated goal of “maximizing customer protection and minimizing cost,” as any one model is highly unlikely to meet the stated goal for all cleared swaps customers.

With respect to this last point, we do not believe that the Commission should adopt a “one-size-fits-all” approach. Instead, market participants should be able to determine for themselves which clearing model is most appropriate for their needs and circumstances. Moreover, a single market participant may choose one clearing model in certain markets and a different clearing model in others. If the Commission ultimately uses the four model approach, we urge the Commission to permit each market participant to choose the clearing model that best fits its circumstances.

Each of the proposed clearing models presents different risk, protection, and cost considerations, and a market participant would need to weigh these various factors in determining which of the models best suits its needs and capabilities in a given instance. For example, for certain clearing houses, or when clearing through certain clearing brokers, a market participant might conclude that it needs greater protection against a clearing member default. Thus, the safeguards provided by the full physical segregation might warrant the additional costs associated with that model. Conversely, a market participant might conclude that a particular product generally gives rise to lower risks, regardless of the clearing house or clearing broker, and that it is willing to accept increased exposure to the clearing broker in return for reduced costs. Further, a market participant with a stronger credit position than its clearing broker might take a different view than a market participant with a weaker credit position than its clearing member.

The important point, therefore, is not only that market participants could well reach different conclusions with respect to the optimal clearing model, but also that a given market

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participant could best meet the ANPR's stated goals through different models, depending on the market and circumstances. The decision of the clearing model to be utilized, therefore, should be left to the market participant, subject to negotiation with its clearing broker and the willingness and ability of the relevant clearinghouse to provide the various models.

For these reasons, we respectfully request that the Commission adopt rules that permit market participants to choose the clearing model they prefer in a given instance and that appropriate amendments be made to the Commission's Part 190 bankruptcy rules, and other provisions of Commission rules, as necessary, in order to accommodate such clearing models. To the extent necessary, we also encourage the Commission to work with Congress to make any required statutory changes to the Bankruptcy Code to ensure that market participants will receive the full protection of these various clearing models. We believe that this approach will best facilitate the realization of Congress's and the Commission's objectives with respect to the reduction of credit risk through centralized clearing.

We understand that the Commission may not want to give market participants the unfettered ability to select among the four clearing models based upon their goals, and not necessarily the goals stated in the ANPR. The Coalition thus recommends that the CFTC issue guidance on the costs and benefits (including risk reduction) of each clearing model in order to assist market participants in selecting among them. At this stage, given the aforementioned lack of data concerning the implications of choosing a given model based upon the particular circumstances of a market participant and a given trade, we believe strongly that the guidance should be permissive, not prescriptive. Only through a partnership with market participants, in which such participants can rely largely on their own judgment and experience, can the ANPR's goals be achieved.

Sincerely,

Business Roundtable  
National Association of Corporate Treasurers  
National Association of Manufacturers  
National Association of Real Estate Investment Trusts  
The Real Estate Roundtable  
U.S. Chamber of Commerce