February 25, 2011

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

Re: VMAC, LLC Comment Letter Relating to Risk Management Requirements for Derivatives Clearing Organizations/RIN Number 3038-AC98

Dear Mr. Stawick,

We appreciate the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC's") proposed rulemaking. VMAC, LLC ("VMAC") operates a clearing service for traders of electricity and natural gas swaps and options. VMAC would like to comment on two issues with respect to proposed Regulation § 39.13 (Risk Management) contained in the CFTC's notice of proposed rulemaking on Risk Management Requirements for Derivatives Clearing Organizations:

1) Trade Origin Dependent Liquidation Times; and
2) Initial Margin Confidence Levels

VMAC feels that derivatives clearing organizations ("DCOs") should be broadly responsible for setting their own initial margin levels. The CFTC's rules governing risk management requirements should not be so prescriptive as to dictate the confidence level and liquidation time that DCOs use in calculating initial margin. VMAC is also concerned that specifying longer liquidation times for trades not originated on designated contract markets ("DCMs") would unfairly disadvantage trades executed away from DCMs, and impose needless administrative burdens on DCOs.

**1) Trade Origin Dependent Liquidation Times**: VMAC is concerned that proposed Regulation § 39.13(g)(2)(ii), which requires DCOs to use "a liquidation time that is a minimum of five business days for cleared swaps that are not executed on a designated contract market" and "a liquidation time that is a minimum of one business day for all other products that it clears" in setting its initial margin levels, discriminates against trades not executed on DCMs and imposes onerous and unnecessary administrative costs on DCOs. The adoption of this rule would force DCOs to impose higher initial margin for swaps executed on swap execution

facilities ("SEFs") than those executed on DCMs. The CFTC proposed rule does not present any rationale for imposing such a distinction and we cannot perceive one. In addition, the divergent treatment of otherwise economically indistinguishable swaps conflicts with the CFTC proposed Regulation § 39.12(b)(2) which requires DCOs to provide "non-discriminatory clearing of a swap executed bilaterally or on or subject to the rules of an unaffiliated designated contract market or swap execution facility." It also conflicts with § 2(h)(1)(B)(ii) of the Commodity Exchange Act ("CEA"), as amended by Dodd-Frank, which states that DCOs "shall provide for non-discriminatory clearing of a swap (but not a contract of sale of a commodity for future delivery or option on such contract) executed bilaterally or on or through the rules of an unaffiliated designated contract market or swap execution facility."

Apart from the unfairness to non-DCM executed trades, this rule would have a number of unfortunate effects on both DCOs and their clearing members. DCOs would be forced to call for initial margin and manage netting rules based on the origin of trades rather than on the economic terms of such trades. This responsibility would be costly to fulfill from an administrative standpoint. Its related cost would likely be passed on to clearing members. The rule would complicate the task of calculating clearing member margin on a portfolio basis. A clearing member which had a net flat position, in economically equivalent swaps, would be forced to post margin unless the long and short constituent swaps of that position were exactly equally distributed between SEF and DCM originated trades. The rules' adverse effects would not be offset by any reduction in systemic risk or increased access to clearing.

**Therefore VMAC urges the CFTC to make the following change to proposed Regulation § 39.13(g)(2)(ii): whereas it currently reads "a derivatives clearing organization shall use a liquidation time that is a minimum of five business days for cleared swaps that are not executed on a designated contract market.... and a liquidation time that is a minimum of one business day for all other products that it clears", the proposed Regulation should read simply "a derivatives clearing organization shall use a liquidation time that is a minimum of one business day for all products it clears."**

**2) Initial Margin Confidence Levels**: VMAC believes that a DCO should determine the level of initial margin for products for which it offers clearing services based on the specific CFTC approved risk mitigation policies of the DCO. The CFTC has requested comments on whether DCOs should be required to use a 99% confidence level for calculating initial margin, as specified in proposed Regulation § 39.13(g)(2)(iii). VMAC feels that the adoption of this proposed rule would be inappropriate from a risk perspective, and have a decisively negative impact on the clearing marketplace. Prospective DCOs have differing methods of disposing of risk in the event of a clearing member default. Consequently, a range of initial margin levels for the same product is actually appropriate. The Wall Street Transparency and Accountability Act of 2010 ("Dodd-Frank") mandates the CFTC to regulate derivatives clearing markets; it does not instruct the CFTC to homogenize all clearinghouses. The adoption of this proposed rule would stifle innovation and competition, and would effectively raise the cost of clearing.

Dodd-Frank specifically mandates the CFTC to encourage swaps market participants to move their trading into a cleared environment. Setting the confidence level at 99% for all swaps, regardless of product or DCO clearing methodology could have an unintended negative effect on

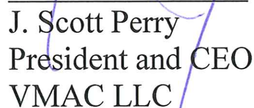
swap volumes. A rise in the cost of clearing would discourage swaps end users from clearing (and potentially from hedging at all), thereby increasing systemic risk in direct contravention of the principles laid out in Dodd-Frank.

The current proposed rule implies that, given an identical set of clients and product portfolios, all DCOs will have substantially the same obligations to their clients in the event of a member default. Were that the case, it could be argued that a single confidence level applied universally to all DCOs would in fact be appropriate. It is not the case: there are structural differences between DCOs and their obligations in the case of a clearing member default can differ substantially. It would be counterproductive and anti-competitive for the CFTC not to recognize this fact.

Rather than establishing a one size fits all rule, the CFTC should retain the ability to encourage innovation and competition within prescribed guidelines. The CFTC should not require a DCO to collect margin which would be substantially in excess of the DCO's obligations to clearing members in a default scenario, given the DCO risk model. The CFTC should retain the ability set confidence levels that would be appropriate to each product and DCO given the risk disposition models of different DCOs. A DCO should be required to demonstrate that the given confidence level results in an initial margin amount which is sufficient to allow the DCO to discharge its obligations fully upon a clearing member default event.

**VMAC strongly urges the CFTC to add language allowing it to review and set minimum confidence levels for each DCO on an ongoing basis, based on the product being cleared and the method of risk allocation implemented by such DCO. Whereas proposed regulation §39.13(g)(2)(iii) currently states that DCOs must set an initial margin level based upon "an established confidence level of at least 99%", VMAC would suggest that the CFTC add "or, subject to specific authorization from the CFTC, a lower confidence level" This change would give the CFTC the flexibility to prescribe confidence levels that are appropriate to the risks undertaken by the DCO. It would also be in harmony with accepted international best practices. For instance, the CPSS-IOSCO Recommendations For Central Counterparties (also cited in reference to the comments request for proposed Regulation § 39.13(g)(2)(iii)) state on page 23 that "Margin requirements for new and low-volume products might be set at a lower coverage level if the potential losses resulting from such products are minimal".**

Yours Sincerely,



J. Scott Perry
President and CEO
VMAC LLC