

## By Commission Website

March 25, 2011

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

**Re: RIN 3038-AC98: Risk Management Requirements for Derivatives Clearing Organizations, 76 Fed.Reg. 3698 (January 20, 2011)**

Dear Mr. Stawick:

Jefferies & Company, Inc. (“Jefferies”) welcomes the opportunity to comment on the Commodity Futures Trading Commission’s proposed Risk Management Requirements for Derivative Clearing Organizations, 76 Fed.Reg. 3698 (January 20, 2011). In particular, Jefferies wishes to express its strong support for the provisions of proposed Rule 39.12(a), which would require derivatives clearing organizations (“DCOs”) to “establish appropriate admission and continuing participation requirements for clearing members” that “permit fair and open access.”

Jefferies is a wholly-owned subsidiary of Jefferies Group, Inc. (“Jefferies Group”), a global securities and investment banking firm, which has served companies and their investors for nearly 50 years. Jefferies Group is a publicly-traded company with a market capitalization in excess of \$4 billion; our most recent full-year net revenues exceeded \$2.2 billion. We currently employ 3,100 people in offices in 30 cities worldwide and our approximately 1,100 sales and trading professionals transact business as a principal to, and on behalf of, thousands of institutional investors in most major markets in the world today.

Jefferies has been registered with the Securities and Exchange Commission as a broker-dealer since 1969. Given the current size and scope of Jefferies’ institutional trading and sales operations, we carefully examine all new business opportunities that enable us to better serve our clients and better compete in the marketplace. To this end, we recently became registered with the Commission as a futures commission merchant and expect to apply to become clearing members of the major derivatives clearing organizations.<sup>1</sup>

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<sup>1</sup> Jefferies’ Futures Division is headed by Patrice Blanc, formerly Chief Executive Officer of Newedge Group.

Jefferies currently is not a major participant in the over-the-counter derivatives markets. However, the traditional barriers to entry that the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) removes by, among other things, requiring the central clearing of many swaps, will enable Jefferies to participate more actively in the swaps market.

As the Commission has noted, a primary goal of the Dodd-Frank Act is to establish a comprehensive regulatory framework to reduce risk, increase transparency and promote market integrity within the financial system. In support of this goal, Section 725 of the Dodd-Frank Act revised Section 5b(c) of the Commodity Exchange Act (“CEA”) to enhance the core principles for DCOs. In particular, Section 5b(c)(2) of the CEA was amended to provide, in relevant part, that the participation and membership requirements of each DCO must: (i) be objective; (ii) be publicly disclosed; and (iii) permit fair and open access. Jefferies believes that proposed Rule 39.12(a) properly implements this core principle and urges to Commission to adopt it without change.

We recognize that the proposed \$50 million minimum capital requirement for clearing members that intend to clear swaps is significantly smaller than the minimum capital requirements established by those DCOs that currently offer swaps clearing services.<sup>2</sup> However, since the capital requirements may be “scalable so that they are proportional to the risks posed by the clearing members,”<sup>3</sup> a lower capital requirement, by itself, should not expose a DCO, or other clearing members, to unnecessary financial risk.

Moreover, as the proposed rule recognizes, adequate capital is only one element of the participant eligibility requirements that a DCO is required to take into account in considering an application for membership. More important from Jefferies’ perspective, is the proposed requirement that a clearing member be able to demonstrate that it has “sufficient operational capacity to meet obligations arising from participation in” the DCO. Specifically, proposed Rule 39.12(a)(3) provides:

The participation requirements shall require clearing members to have adequate operational capacity to meet obligations arising from participation in the derivatives clearing organization. The requirements shall include, but are not limited to: the ability to process expected volumes and values of transactions cleared by a clearing member within required time frames, including at peak times and on peak days; the ability to fulfill collateral, payment, and delivery obligations imposed by the derivatives clearing organization; and the ability to

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<sup>2</sup> Also in contrast to certain existing DCO participant eligibility requirements, the proposed rule would prohibit a DCO from requiring a swaps clearing member to: (i) be a swap dealer; (ii) maintain a swap portfolio of any particular size; or (iii) meet a swap transaction volume threshold. Proposed Rule 39.12(a)(1)(iv) and (v).

<sup>3</sup> Proposed Rule 39.12(a)(2)(ii).

participate in default management activities under the rules of the derivatives clearing organization and in accordance with § 39.16 of this part.<sup>4</sup>

The proposed rules further authorize a DCO to exclude certain market participants from clearing membership, or restrict the activities of clearing members, if the DCO is able to demonstrate that the exclusion or restriction “is necessary to address credit risk or deficiencies in the participants’ operational capabilities that would prevent them from fulfilling their obligations as clearing members.”<sup>5</sup>

We further note that the proposed rules require each DCO “to ensure that it possesses the ability to manage the risks associated with discharging the responsibilities of the [DCO] through the use of appropriate tools and procedures.”<sup>6</sup> Among other measures, each DCO is authorized to: (i) impose risk limits on each clearing member, by customer origin and house origin, in order to prevent a clearing member from carrying positions for which the risk exposure exceeds a specified threshold relative to the clearing member’s and/or the derivatives clearing organization’s financial resources;<sup>7</sup> and (ii) require its clearing members to maintain current written risk management policies and procedures.<sup>8</sup>

In addition, the proposed rules require a DCO to take additional actions with respect to a particular clearing member, when appropriate, based on the application of objective and prudent risk management standards. Such actions may include: (i) enhanced capital requirements; (ii) enhanced margin requirements; (iii) position limits; (iv) liquidation or transfer of positions; and (v) suspension or revocation of clearing membership.

We respectfully submit that, taken together, the above-referenced rules provide DCOs with more than sufficient authority to assure the financial integrity and efficient operation of its swaps clearing activities. Provided a DCO’s capital requirements are “scalable so that they are proportional to the risks posed by the clearing members,” and a clearing member is able to demonstrate that it has “adequate operational capacity to meet obligations arising from participation in the [DCO]”, Jefferies supports the proposed minimum capital requirement of \$50 million.

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<sup>4</sup> Proposed Rule 39.16 requires each DCO to adopt rules and procedures “to allow for the efficient, fair and safe management” of a clearing member default. Among other requirements, each DCO must specify in its default procedures any obligations that the DCO “imposes on its clearing members to participate in auctions, or to accept allocations of, a defaulting clearing member’s positions, provided that any allocation shall be proportional to the size of the participating or accepting clearing member’s positions” at the DCO. Proposed Rule 39.16(c)(2)(iii).

<sup>5</sup> Proposed Rule 39.12(a)(1)(iii).

<sup>6</sup> Proposed Rule 39.13(a).

<sup>7</sup> Proposed Rule 39.13(h)(1)(iii).

<sup>8</sup> Proposed Rule 39.13(h)(5).


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**Jefferies**

**Conclusion**

Jefferies thanks the Commission for the opportunity to comment on the proposed Risk Management Requirements for Derivatives Clearing Organizations. If the Commission has any questions regarding the matters discussed herein, please contact the undersigned at (212) 707-6409.

Very truly yours,

A handwritten signature in black ink, appearing to read "Michael Sharp". The signature is stylized and cursive, with a large, sweeping flourish at the end.

Michael Sharp  
General Counsel