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Filed Electronically

David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: "Requirements for Processing, Clearing and Transfer of Customer Positions," 76 *Fed. Reg.* 13101 (March 10, 2011); RIN 3038-AC98.

Dear Mr. Stawick:

The Commodity Futures Trading Commission ("CFTC" or "Commission") recently re-opened the comment period[1] on a number of proposed rules in order to provide the public with an opportunity to comment on the mosaic of proposed rules implementing Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") in its entirety.[2] Natural Gas Exchange Inc. ("NGX") appreciates the Commission inviting comment on the rules as a complete package.

NGX is taking this opportunity to supplement its previously filed comment letters on the proposed rules relating to Derivatives Clearing Organizations with this comment on the proposed rules entitled, "Requirements for Processing, Clearing and Transfer of Customer Positions," 76 *Fed. Reg.* 13101 (March 10, 2011) ("Notice"). The Notice proposes rules regarding the time frames and product standards for clearing transactions on DCOs, including rules the effect of which would:

(a) prohibit a DCO from declining to clear a product in which neither party is a clearing member;[3]

(b) prohibit a non-U.S. DCO from investing customer funds in the sovereign debt of its home jurisdiction;[4] and

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[1] Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 25274 (May 4, 2011).
[2] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No. 111-203, 124 Stat. 1376 (2010).
[3] Proposed Rule 39.12(b)(4).
[4] Proposed Rule 39.15(e).

(c) require that a DCO accept for clearing transactions without an opportunity to conduct pre-acceptance risk management procedures.[5]

As discussed in greater detail below, these proposed implementing rules, while intended to standardize and streamline the clearing process, may have serious, albeit unintended, consequences. Accordingly, NGX respectfully requests that the Commission provide greater flexibility in the manner in which the proposed rules would be applied.

NGX

NGX operates a trading and clearing system for energy products that provides electronic trading, central counterparty clearing and data services to the North American natural gas, electricity and oil markets. On December 12, 2008, NGX, which is located in Calgary, Alberta, was registered by the Commission as a DCO.[6]

As explained in our prior comment letters, NGX offers a unique, non-intermediated clearing model. All participants on the NGX trading platform self-clear on NGX DCO. Both the NGX market and the DCO are non-intermediated. None of the participants in NGX DCO clear for customers. In addition, NGX is non-mutualized. Accordingly, clearing participants are not required to contribute to the guaranty fund which NGX DCO finances through its proprietary funds.

A significant number of the participants in the NGX market are commercial end-users. These participants typically make or take delivery on a routine basis in the cash markets. Moreover, among the contracts traded on NGX and cleared by NGX DCO are forward contracts in the physical commodity. Reflecting its focus on commercial end-user participants, unlike other clearinghouses which may step out of the settlement process, NGX DCO sees its role as central counterparty ("CCP") as including guaranteeing completion of the settlement process. Accordingly, NGX as CCP arranges for deliveries and settlement payments to be made. NGX DCO ultimately stands behind the settlement process, and in case of default, will complete the delivery process to the non-defaulting party.

Mandate to Clear Contracts for Non-Clearing Members

Proposed Rule 39.12(b)(4) prohibits a DCO from declining to clear a product because neither party to the original contract, agreement, or transaction is a clearing member. The Commission proposed this rule based upon its reasoning that this proposed prohibition would remove a potential barrier, and increase access, to clearing services.[7]

NGX agrees that clearing access should be broadly available. For this reason, NGX requires that all participants also become clearing participants in NGX DCO. Because all

[5] Proposed Rules Rules 39.12(b)(7)(ii), (iii), and (iv).
[6] NGX also operates as an exempt commercial market ("ECM"). NGX notified the Commission on November 5, 2002, of its operation as an ECM and has requested an extension to operate as an ECM for a period of one year following the effective date of the Dodd-Frank Act.
[7] 76 *Fed. Reg.* 13101, 13105.

clearing participants clear for their own account, NGX accepts for clearing *only* contracts that are between clearing participants and would decline to clear contracts involving non-clearing participants under the terms of its contracting party's agreement. This is not a barrier to clearing access. In a non-intermediated clearinghouse, there is no guarantee to clearing participants which can be extended to the positions of non-clearing participants. Rather, every clearing participant enjoys a direct relationship with the clearinghouse.

Although NGX expresses no view on the merits of the proposed prohibition, it is without doubt that the proposed rule clearly has application to intermediated clearinghouses where a limited number of members routinely clear for a wide-array of non-member customers. However, the proposed rule, if applied to a non-intermediated clearinghouse, such as NGX, would require a fundamental restructuring of the manner in which the clearinghouse admits members, guarantees trades, and provides risk management. There is no indication that the Commission by proposing this rule intended to require such a fundamental and profound realignment of the manner in which non-intermediated clearinghouses operate. NGX respectfully requests that the proposed rule be clarified accordingly.

Prohibition on sovereign debt of home jurisdictions

Proposed Rule 39.15(e) mandates that a DCO may only invest the funds or assets of clearing members in instruments permitted under Proposed Rule 1.25. In a separate notice entitled, "Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions," the Commission proposes that non-U.S. sovereign debt no longer be a "permitted investment" under Rule 1.25.[8] The Commission's rationale for removing foreign debt as a "permitted investment" is that recent international events have undermined confidence in the solvency of foreign debt.[9] The Commission also cites a 2007 review finding negligible investment in foreign debt among future commission merchants ("FCM") and DCOs.[10]

NGX appreciates and shares the Commission's goal that customer funds be prudently invested. NGX believes, however, that the proposed rule fails adequately to take into account that DCOs may be domiciled in jurisdictions other than the U.S. Prohibiting such DCOs from investing in the sovereign debt of their home jurisdictions may impose a significant hardship without providing customers with substantially greater protections. To the extent that the Commission has concerns that the sovereign debt of a foreign DCO's home jurisdiction does not provide sufficient liquidity and safety for customer funds, the Commission could prohibit such investment as part of the DCO's registration, or retain authority to prohibit such investment on a case-by-case basis. However, where the Commission authorizes a DCO that is domiciled in a G-7 country,[11] it should permit the non-U.S. DCO to invest customer funds in the sovereign debt of its domicile.

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[8] 75 *Fed. Reg.* 67642 (November 3, 2010); RIN 3038-AC15.
[9] The Commission expressed its goal as limiting the investment of customer funds to instruments with "minimal credit, market, and liquidity risks." Proposed Rule 39.15(e).
[10] 75 *Fed. Reg.* 67642, 67645.
[11] The G-7 countries include Canada, France, Germany, Italy, Japan, United Kingdom and United States.

Mandate for Immediate Clearing

Proposed Rules 39.12(b)(ii) and (iii) would mandate that a DCO:

(ii) "accept for clearing, *immediately upon execution*, all contracts, agreements, and transactions . . . (A) That are entered into on a [SEF] or [DCM]; and

(iii) "accept for clearing, *upon submission* to the [DCO], swaps (A) That are not executed on a [SEF] or [DCM]; (B) That are subject to mandatory clearing.

In proposing these rules, the Commission noted its concern that in connection with clearing of OTC instruments there can be as much as a one-week delay in the novation process of certain clearinghouses.[12] Although shortening the clearing cycle is a goal that NGX shares with the Commission, the language of the proposed ruled fails to take into account that there may be risk management procedures that are conducted between contract execution and trade acceptance by the clearinghouse. These may include matching trade data submitted by the counterparties, conducting credit checks to ascertain if accepting the transaction would infringe on any credit limits of either counterparty, ensuring that the counterparties meet the initial payment or margin requirements, and checking the membership status of clearing members (i.e., that they are not suspended). These processes are necessary in detecting inappropriate transactions, including, for instance, those that are erroneously submitted for clearing as a result of technical glitches.

Although automated, these risk management procedures occur subsequent to trade execution or submission of a trade to the clearinghouse and prior to acceptance. However, the language of the proposed rule, requiring that acceptance be immediate upon execution or submission to the clearinghouse suggests that such risk management procedures are not permitted between the time of execution/submission and acceptance. Such a reading is contrary to sound risk management and potentially puts the clearinghouse at substantial risk.

NGX respectfully requests that the Commission clarify that clearinghouses may establish and conduct pre-acceptance risk management procedures.

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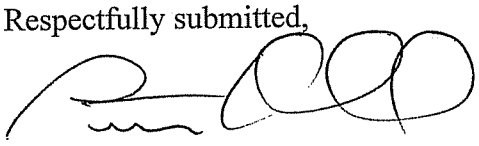
NGX appreciates the Commission's focus on proposing clear and precise standards related to clearing. However, the proposed rules discussed in this comment letter have unintended, serious consequences which might require some DCOs, such as NGX, to fundamentally restructure, cause foreign DCOs to not be able to invest in the debt of their domicile and to weaken certain pre-acceptance risk management processes and protections for the clearinghouse. We believe that these issues can be readily resolved by the Commission in the final rules.

[12] 76 *Fed. Reg.* 13101, 13102.

Please feel free to contact Cheryl Graden, NGX chief legal counsel, at (416) 947-4359, or our outside counsel, Paul M. Architzel of Wilmer Cutler Pickering Hale and Dorr LLP, at (202) 663-6240, with any questions about these comments.

Respectfully submitted,



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