Scott C. Goebel
Senior Vice President
General Counsel
FMR Co.
82 Devonshire Street V10E, Boston, MA 02109-3614
617.563.0371 FAX 617.385.1331 SCOTT.GOEBEL@FMR.COM

August 8, 2011

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

Re: Comments on the Proposed Rules for Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions (RIN 3038-AC99)

Dear Mr. Stawick:

Fidelity Investments[1] ("Fidelity") appreciates the opportunity to comment on the Proposed Rules for Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, published by the Commodity Futures Trading Commission ("CFTC") in the Federal Register on June 9, 2011 (the "Proposed Rules").[2]

Fidelity has a strong interest in the implementation of an effective regulatory structure to protect collateral posted in connection with cleared swaps and to protect the assets of the investing public in connection with the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). We have been active in meetings with CFTC staff and in various public forums on the topic of protecting posted collateral as well as on other provisions of the Dodd-Frank Act more generally. Fidelity also previously submitted a comment letter to the CFTC on January 18, 2011, supporting the full physical segregation model for collateral posted in connection with cleared swaps.[3]

---

[1] Fidelity is one of the world's largest providers of financial services, with assets under administration of more than $3.6 trillion, including managed assets of over $1.6 trillion. Fidelity is a leading provider of investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and many other financial products and services to more than 20 million individuals and institutions, as well as through 5,000 financial intermediary firms.

[2] CFTC Proposed Rule: Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 76 Fed. Reg. 33818 (June 9, 2011) (to be codified at 17 C.F.R. pts. 22 and 190).

[3] Comment Letter from Fidelity Investments to David A. Stawick responding to CFTC's Advance Notice of Public Rulemaking for Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies, 75 Fed. Reg. 75162 (Dec. 2, 2010) (the "CFTC's 2010 Advance Notice") (January 18, 2011).

We continue to believe that the full physical segregation model would provide the most protection for customer assets posted as collateral for cleared swaps, as we disagree with the CFTC's conclusion that the full physical segregation model provides only incremental advantages over the complete legal segregation model. In particular, we remain concerned about the fellow-customer risk and bankruptcy risks presented by the models proposed by the CFTC. Additionally, we do not believe that the assertions of increased costs due to implementing the full physical segregation model have been substantiated. Therefore, we strongly recommend that the CFTC revisit the decision not to consider the full physical segregation model.

Given the options presented, Fidelity necessarily supports adoption of the proposed complete legal segregation model, which we believe provides the best level of protection for collateral posted by customers in connection with cleared swaps and is the best choice for the market generally. We request that the CFTC take into account the following considerations:

- The existing protections for customer collateral should not be weakened as a result of implementing the Dodd-Frank Act.
- The final rules should ensure a customer's ability to transfer collateral together with cleared swap transactions to a new futures commission merchant ("FCM") immediately, particularly following an event of a default by the customer's current FCM.
- More than the other collateral models now being considered, the complete legal segregation model is supported by the statutory language and the purposes of the Dodd-Frank Act.
- There has been little, if any, substantiation of the increased costs that would be incurred as a result of implementing the complete legal segregation model, relative to any other model.

The Appropriate Collateral Model Should Not Degrade Existing Collateral Protections

As noted in the release accompanying the Proposed Rules, the Dodd-Frank Act was enacted to, among other things, reduce risk and promote market integrity within the financial system.[4] In furtherance of that objective, we believe that the collateral protection model that the CFTC implements for cleared swaps should not afford less protection to market participants than either the protections they currently enjoy in the over-the-counter swaps market or the protections CFTC has proposed for uncleared swaps.[5]

---

[4] CFTC Proposed Rule, 76 Fed. Reg. at 33820.

[5] CFTC Proposed Rule: Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy, 75 Fed. Reg. 75432 (Dec. 3, 2010) (to be codified at 17 C.F.R. pts. 23 and 190) (the "Uncleared Swap Proposal"). The Uncleared Swap Proposal would implement the right of counterparties under the Dodd-Frank Act to elect that initial margin posted in connection with uncleared

Some of the models that the CFTC is considering to protect collateral would expose market participants to risks that they do not face today in the over-the-counter swaps market. These risks to customer collateral increase the farther any proposed model moves away from the present use of full physical segregation. These new risks include investment risk and fellow-customer risk, as noted in the Proposed Rules.

Fellow customer risk is particularly problematic for market participants, because it would be necessary for a market participant to evaluate not only the creditworthiness of its FCM, but also the creditworthiness of each FCM customer. Market participants cannot currently view an FCM's customer list, and even were they permitted to do so, regular monitoring and evaluation of other customers of an FCM would be burdensome if not outright impossible and an inappropriate allocation of risks. We expect that the risk of inaccuracies and lack of transparency would be heightened with any entity (whether FCM or customer) that is failing. We believe that these risks should be allocated to the party best able to evaluate them, and that each market participant should bear the burden and consequences of its own investment decisions. Therefore, short of full physical segregation, the complete legal segregation model is the most appropriate choice of the models the CFTC is contemplating.

Apart from investment risk and fellow-customer risk, there are other risks inherent in implementing a model that degrades the protections provided to collateral by current practices in the over-the-counter swaps market. For example, as the nascent market for cleared swaps develops, there are likely to be significant initial operational hurdles arising due to the need to implement new technology platforms, new trading arrangements and new communication processes, any of which could result in disruptions in the trading and clearing process among FCMs, swap execution facilities, derivatives clearing organizations ("DCO") and the ultimate customers. Further, neither the market nor the CFTC has had an opportunity to analyze fully and prepare for the risks that might arise when an FCM's credit deteriorates. Market participants will need time to develop and implement policies and documentation that provide for the assignment of swap positions and the movement of related collateral to more creditworthy FCMs when necessary or desirable.

The over-the-counter market for uncleared swaps has established practices that effectively mitigate the most significant risks of swap transactions. In the current market, a swap counterparty can negotiate the extent to which it is willing to assume risks, including counterparty credit risk. Many buy-side participants currently have tri-party custodial arrangements in place with dealer counterparties that require segregation of collateral posted to such dealers in connection with swaps transactions. Market participants who assess the risk of entering into

---

swap transactions be segregated at a third-party custodian in order to isolate such initial margin from the credit risk of swap dealer or major swap participant counterparties. In contrast, under the Proposed Rule, the ability of market participants to utilize a third-party custodian does not exist.

swaps, in part, based upon the practice of using tri-party custodial arrangements for protection of their collateral should not be required to take on additional risks in their use of swaps as a result of central clearing. We also believe that collateral posted to an FCM to secure cleared swaps should have similar protections to uncleared swaps collateral; anything less than a segregated collateral model would provide less protection for cleared swaps than what has been proposed for uncleared swaps.[6]

Commenters supporting omnibus collateral arrangements have not attempted to address the risks associated with adopting those models, other than to argue that the risks do not exist. Simply observing that the futures model has worked well in the past for the futures market is not a credible argument that the same approach would be equally suitable for swaps. Although we do not dispute that the model for protecting collateral in the futures markets has worked well for that market, the futures and swaps markets and the risks to the relevant participants are very different. Margin practices in the futures market developed to protect participants in a highly liquid market for standardized contracts, in which the historical contract size was small and easily tradable. That market is inherently different from the current over-the-counter swaps market, which developed on the basis of infrequent trading by sophisticated financial institutions of tailored products in relatively large dollar amounts. The notional amount of the current uncleared swaps market dwarfs the current size of the futures market.[7] These inherent differences in the markets, and the difficulties associated with a cleared swaps market still in its infancy, will exacerbate any weakness in the regime for collateral protections (e.g., by making it difficult to transfer cleared swap positions, among other things).

We suggest that the CFTC mandate the complete legal segregation model as the minimum standard for protection of cleared swaps collateral required to be offered by FCMs and DCOs to customers in order to address the risks described above. Any other model (other than the full physical segregation model, of course) should only be considered after market participants have had the time to adjust to, and evaluate, the new collateral system and after the market itself becomes more mature.

---

[6] Section 4s of the Commodity Exchange Act ("CEA"), as added by Section 724(c) of the Dodd-Frank Act, and the related implementing CFTC proposals, would require a dealer to segregate customer collateral posted to secure obligations for such swaps, at the customer's election. *See* the Uncleared Swap Proposal.

[7] In the statistical annexes attached to its most recent quarterly report, the Bank for International Settlements estimated that the outstanding notional amount of over-the-counter derivatives totaled approximately $601 trillion and that the outstanding notional amount of futures contracts traded on organized exchanges totaled approximately $27 trillion. BANK FOR INT'L SETTLEMENTS, BIS QUARTERLY REVIEW: INTERNATIONAL BANKING AND FINANCIAL MARKET DEVELOPMENTS, statistical annex at A131 and A136, tbls. 19 and 23A (June 2011), *available at* http://www.bis.org/publ/qtrpdf/r_qt1106.htm.

The Final Rules Should Ensure Portability

The omnibus models that the CFTC has proposed that do not ensure portability could effectively concentrate the risk and cost of an FCM default among fewer customers. As an FCM's credit deteriorates, customers will inevitably attempt to transfer their cleared swap positions and the associated collateral to a more creditworthy FCM. If DCOs are able to access collateral of non-defaulting customers, customers that have more assets and can post additional collateral to the FCM to whom they are porting their positions are more likely to be able to port their positions. The ability of larger or more solvent customers to transfer first would mean a greater share of the cost of default would be borne by those customers who remain unable to transfer their cleared swap positions, effectively concentrating the cost of a default with those customers and leaving less assets for the DCO than anticipated by the market.

We believe that immediate portability is essential to protect non-defaulting customers and the financial system more generally, as well as to establish a consistent and open system for trading. International regulators have emphasized the importance of portability,[8] and we are hopeful that regulators in other jurisdictions will eventually adopt similar models to the complete legal segregation model. Consistent international regimes are critical to mitigating the risk of regulatory arbitrage. Should arbitrage opportunities arise due to different regulations in the international swaps market, smaller market participants, particularly participants who are not international swap dealers, will be disadvantaged in the market. Of the currently proposed models, the complete legal segregation model is most likely to help ensure that swap transactions are readily transferable and help facilitate the creation of a functioning cleared swaps market.

Complete Legal Segregation Model Supported by Statutory Language and Purposes of Dodd-Frank

We believe that, among the current proposals, the complete legal segregation model is the most supportable model under the statutory language and purposes of the Dodd-Frank Act. Section 4d of the CEA, as amended by Section 724 of the Dodd-Frank Act, prescribes the manner in which cleared swaps collateral must be treated. We believe that a literal reading of the statutory language would require that either the full physical segregation or the complete legal segregation model be implemented in the final rules. Section 4d(f)(6) of the CEA prohibits "any person, including any derivatives clearing organization … from holding, disposing, or using customer collateral … for deposit in a separate account or accounts … as belonging to … any person other than the swaps customer of the futures commission merchant."[9] The CFTC notes in

---

[8] *See, e.g*, EUROPEAN COMMISSION, PROPOSAL FOR A REGULATION ON OTC DERIVATIVES, CENTRAL COUNTERPARTIES AND TRADE REPOSITORIES BY THE EUROPEAN PARLIAMENT AND COUNCIL, 10 (September 15, 2010) (noting that the "important rules on segregation and portability of positions and corresponding collateral ... are critical to effectively reduce counterparty credit risk … to achieve a level playing field … and to protect the legitimate interests of clients of clearing members").

[9] Commodity Exchange Act, 7 U.S.C. § 6d(f)(6).

its release, there are differences in the language between Section 4d(f)(6), which governs cleared swaps collateral, and Section 4d(b) of the CEA, which governs collateral in connection with futures, and those differences appear to support more robust protections in connection with cleared swaps.[10] However, regardless of the differences between those sections, it would be inappropriate to extend the current, lenient interpretation of the statutory language that governs futures collateral into the new market for cleared swaps. The existing model for collateral in the futures context relies on an interpretive statement issued by the CFTC's Office of the General Counsel in August 1985[11] that should be reviewed in light of changes that have occurred to the financial markets. When the Office of the General Counsel issued that interpretive statement, many of the contracts that would bring the futures market into the modern financial era were just being developed, including futures contracts for Eurodollars and stock indexes.[12] The markets have developed significantly since this time, and this potentially outdated interpretive statement should not be the basis for applying a similar collateral regime to cleared swaps.

No Evidence Has Been Provided Regarding Increased Costs

While some have argued that costs will rise from implementation of the complete legal segregation model as opposed to any other model, there has been little, if any, substantiation of such claim of increased costs. The Proposed Rules note that the additional, incremental cost of maintaining separate legal accounts relates primarily to reporting. However, other regulatory rulemakings that require similar reporting[13] will likely result in many of these incremental operational costs being incurred regardless of which model is chosen.

There is also factual support that refutes arguments of increased costs incurred as the result of implementing the complete legal segregation model. For example, in the comment letter submitted by LCH.Clearnet Group ("LCH.Clearnet") in response to the CFTC's 2010 Advance Notice,[14] LCH.Clearnet stated that "there should be no economic difference in terms of margin" for implementing a complete legal segregation model as compared to each of the other models then being considered by the CFTC. LCH.Clearnet explained in its comment letter that the models it currently employs do not assume the availability of customer funds that constitute initial margin upon an FCM's default and, therefore, LCH.Clearnet does not rely on initial margin

---

[10] Proposed Rule, 76 Fed. Reg. at 33822.

[11] Interpretive Statement, No. 85-3, *Regarding the Use of Segregated Funds by Clearing Organizations Upon Default by Member Firms* (OGC Aug. 12, 1985).

[12] *See* EMILY LAMBERT, THE FUTURES, 135-148 and 165-177 (Basic Books 2011).

[13] *See* CFTC Proposed Rule: Real-Time Public Reporting of Swap Transaction Data, 75 Fed. Reg. 76140 (Dec. 7, 2010) (to be codified at 17 C.F.R. pt. 43); CFTC Proposed Rule: Reporting Certain Post-Enactment Swap Transactions, 75 Fed. Reg. 78895 (Dec. 17, 2010) (to be codified at 17 C.F.R. pt. 44).

[14] Comment Letter from LCH.Clearnet to David Stawick responding to the CFTC's 2010 Advance Notice (January 18, 2011).

posted by non-defaulting customers as being available to it to satisfy the obligations of a defaulting customer at the time of an FCM's default.

Finally, we suggest that the proper cost analysis should be measured starting with the costs presently incurred with respect to the existing over-the-counter swaps market as the appropriate baseline, as opposed to starting with current costs for cleared futures, which is a completely different market. Many buy-side participants in the over-the-counter swaps market, including mutual funds, currently utilize tri-party custodial arrangements to protect collateral. Any incremental costs with respect to complete legal segregation beyond the cost baseline of the current over-the-counter swaps market would be a fair measure of the potential additional costs that the market might face in implementing complete legal segregation of collateral for cleared swaps.

* * *

We appreciate the opportunity to comment on the Proposed Rules. Fidelity would be pleased to provide any further information or respond to any questions that the CFTC's staff may have.

Sincerely,

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott D. O'Malia, Commissioner