Peter Krenkel
President & CEO
Natural Gas Exchange Inc.
2330, 140 – 4 Avenue SW
Calgary, Alberta T2P 3N3
T (403) 947-1705
F (403) 974-1719
Peter.krenkel@ngx.com

August 8, 2011

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

Re: "Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions," 76 *Fed. Reg.* 33818 (June 9, 2011) (RIN 3038-AC99)

Dear Mr. Stawick:

The Natural Gas Exchange, Inc. ("NGX") appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("Commission") Notice of Proposed Rulemaking on segregation and other requirements for futures commission merchants and derivatives clearing organizations ("Proposed Rulemaking").[1] NGX supports the Commission's efforts to implement the Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[2] and to protect customer collateral held at a derivatives clearing organization.

Overview of the Natural Gas Exchange

NGX is a trading system for energy products in the North American market. It is located in Calgary, Canada. Since March 1, 2004, NGX has been a wholly owned subsidiary of TMX Group Inc.[3] NGX also provides clearing services through which it

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1 "Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions," 76 *Fed. Reg.* 33818 (June 9, 2011) ("Proposing Release").

2 Public Law 111-203, 124 Stat. 1376 (2010).

3 TMX Group operates cash and derivative markets for multiple asset classes including equities, fixed income and energy products. TMX Group is a corporation incorporated under the Business Corporations Act (Ontario) and has its head office in Toronto, Ontario. Its shares have been listed for trading on the Toronto Stock Exchange since November 2002. TMX Group is a reporting issuer in every province and territory of Canada.

acts as central counterparty ("CCP") for transactions entered into on the NGX electronic marketplace, certain transactions executed in the OTC market and transactions entered into on a third party trading platform. On December 12, 2008, NGX was registered with the Commission as a Derivatives Clearing Organization ("DCO").[4]

NGX employs a unique, non-intermediated trading and clearing model. All participants self-clear and none of the participants clear for customers.

NGX's participants include both Canadian and U.S. entities. Most of the participants in the NGX market are commercial end-users and all are sophisticated entities, qualifying either as Eligible Contract Participants or Exempt Commercial Entities.

The Proposed Rules

The Dodd-Frank Act mandates that each FCM and DCO "segregate" customer collateral supporting cleared swaps and that the FCM and the DCO (i) must hold such customer collateral in an account (or location) that is separate from the property belonging to the FCM or DCO; and (ii) must not use the collateral of one customer to cover the obligations of another customer or the obligations of the FCM or DCO, itself.[5]

In furtherance of this statutory requirement, the Commission has proposed a number of rules. Regulation 22.3(a) proposes to require a DCO to treat and deal with the Cleared Swaps Collateral[6] deposited by an FCM as belonging to the Cleared Swaps Customers of such FCM and not other persons.[7] The Commission also proposes: (1) to require a DCO to segregate in its books and records the cleared swaps of each individual customer and relevant collateral; (2) to permit a DCO to operationally hold (or "commingle") all relevant collateral in one account;[8] and (3) if there is a default by an

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4 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 as an ECM for a period of one year following the effective date of the Dodd-Frank Act.

5 See Proposing Release, supra note 1 at 33819 and Section 724 of the Dodd-Frank Act amending Section 4d of the Commodity Exchange Act (7 U.S.C. 6d).

6 The Commission proposes to define "Cleared Swaps Customer Collateral" to include money, securities or other property that an FCM or a DCO receives from, for, or on behalf of a Cleared Swaps Customer, which (i) is intended to or does margin, guarantee, or secure a Cleared Swap, or (ii) if the Cleared Swap is in the form or nature of an option, constitutes the settlement value of such option. Additionally, the Commission proposes that Cleared Swaps Customer Collateral would include "accruals," which are the money, securities or other property that an FCM or DCO receives, either director or indirectly, as incident to or resulting from a Cleared Swap that the FCM intermediates for a Cleared Swaps Customer.

7 *See* Proposing Release, *supra* note 1 at 33835.

8 The Commission notes that paralleling explicit provisions of Regulations 1.20(b) and 1.26(b), a DCO is permitted to hold Cleared Swaps Customer Collateral from FCMs outside itself and requires that the DCO maintain a Cleared Swaps Customer Account with Each Permitted Depository.

FCM and with one or more cleared swaps customers, the DCO may access the collateral of the FCM's defaulting cleared swaps customers to cure the default, but may not access the collateral of the FCM's non-defaulting cleared swaps customers.[9] The Commission has reasoned that the rules as proposed best balance the benefits of protecting cleared swaps customer collateral in the manner mandated by the Dodd-Frank Act, mitigating fellow-customer risk,[10] investment risk,[11] systemic risk, enhancing portability and potentially facilitating portfolio margining against operational and other costs.[12]

Legal Situs of Accounts

The Commission further proposes in regulation 22.8 to require that the DCO designate the United States as the site (*i.e.*, legal situs) of the physical locations and of the accounts that the DCO maintains for each cleared swaps customer with respect to the customers of an FCM.[13] The Commission's intent in proposing the rule on situs of accounts is, in light of cross-border activity, to "ensure that . . . Cleared Swaps Customer Collateral, whether received by an FCM or DCO, would be treated in accordance with the United States Bankruptcy Code."[14]

The Commission makes clear, however, that the proposed requirement to designate the legal situs of the account in the U.S. is *not* intended to affect the actual locations in which a DCO may hold Cleared Swaps Customer Collateral[15] or the choice of law provisions that a DCO might set forth in its rules.[16] As discussed below, NGX has

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9 *See* Proposing Release, *supra* note 1 at 33819

10 The Commission defines "fellow-customer risk" as the risk that a DCO would access the collateral of non-defaulting cleared swaps customers to cure an FCM default; *see* Proposing Release *supra* note 1 at Footnote 21, 33821.

11 The Commission defines "investment risk" as the risk that each cleared swaps customer would share pro rata in any decline in the value of FCM or DCO investments of cleared swaps customer collateral; *see* Segregation Proposing Release *supra* note 1 at Footnote 22, 33821.

12 *See* Proposing Release, *supra* note 1 at 33819.

13 We note that proposed rule 22.8 would require that the situs be in the U.S. of a DCO's Cleared Swap Customer Account with respect to the Cleared Swaps Customers of a futures commission merchant. All of NGX DCO's participants self-clear. Accordingly, each clearing participant deposits its own, and not customer collateral with NGX. It follows that because no Customer Account of the DCO in respect of the customers of an FCM is maintained by NGX, rule 22.8 as proposed would not require that the situs of NGX clearing participant accounts be in the U.S. *See* proposed Regulation 22.8; *see also* Proposing Release *supra* note 1 at 33838.

14 *Id.*

15 Specifically, the Commission permits a DCO to hold Cleared Swaps Customer Collateral (i) in denominations other than the United States dollar; and (ii) at depositories within or outside of the United States.

16 *See* Proposing Release, *supra* note 1 at 33838.

reservations on the legal situs of accounts proposal; however if the CFTC decides to move forward with this proposal, NGX supports these two significant *provisos* as they recognize that DCOs registered with the Commission may be located outside of the U.S., hold customer collateral outside of the U.S. and choose to apply the law of their home jurisdiction in the event of an insolvency.

Despite the Commission's intent to ensure that U.S. Bankruptcy law apply, the implementation of the proposed rule may very well increase, rather than reduce, uncertainty with respect to the insolvency regime that will apply. It remains unclear how designating the U.S. as the situs of the accounts, especially if a non-U.S. DCO has chosen in its rules to apply the laws of its home jurisdiction (as permitted under Commission rules), will affect the jurisdiction of the bankruptcy courts.[17]

Moreover, the legal uncertainty created by the Commission's proposal to require non-U.S. DCOs to designate the U.S. as the legal situs of customer accounts may, in the event of a clearing participant default and insolvency, lead to results that are contrary to the expectations of both U.S. and non-U.S. clearing participants. In the event of the default by a clearing participant, the DCO expects to be able to remedy the default quickly, applying the DCO's own rules, supported by its home country insolvency law. Any other result could compromise the ability of a DCO to act decisively in the face of a defaulting participant.

As noted above, the Commission acknowledges the reasonableness of a non-U.S. DCO applying its home country insolvency regime through a choice of law provision in its rules. Where the clearing house includes such a choice of law provision all parties would have a reasonable expectation that the law so specified will be applied. It is unclear how the U.S. account situs requirement will interact with the choice of law provision.

In order to eliminate this confusion, the Commission needs to provide greater guidance on the operation of the proposed rule. Specifically, the Commission should make clear that such a DCO choice of law rule should be able to include both choice of forum as well as the substantive law to be applied, at least with respect to the insolvency of the clearing house itself and with respect to the remedies available to the clearing house in the event of the default or insolvency of a clearing participant. To determine otherwise risks disturbing the reasonable expectations of market participants.

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17 NGX notes that generally it is the debtor over which the bankruptcy court exercises jurisdiction. In determining the legal situs of accounts under U.S. Bankruptcy law, bankruptcy courts either look to the actual location of the account, or have found that the "situs of the bank accounts is the location of the bank accounts themselves" (*See e.g., Bank of America v. World of English,* 23 B.R. 1015 (Oct 29, 1982)), or determine the situs of property is where the power of "efficient control" exists *(See In re San Antonio Land & Irrigation Co.,* 228 F. 984 (S.D.N.Y. 1916)). Additionally, bankruptcy courts have determined that the situs of securities is where they are located. *See In re Fidelity Assurance Association,* 42 F. Supp. 973 (S.D.W.Va. 1941).

Given the uncertainty of how the U.S. account situs requirement will interact with the choice of law provision, NGX respectfully recommends that the Commission avail itself of an already proposed alternative. Specifically, the Commission proposed an alternative means of addressing the issue of cross-border insolvency issues. The Commission has proposed that as a condition of a non-U.S. clearing house applying for registration as a DCO, the application include a memorandum of local counsel analyzing insolvency issues in the foreign jurisdiction where the applicant is based and describing how the applicant clearing house has addressed any conflict of law issues, which jurisdiction's law is intended to apply to each aspect of the applicant clearing house's operations, and the enforceability of the choice of law in relevant jurisdictions.[18] NGX proposes that the Commission adopt this alternative means for addressing cross-border insolvency issues because it will provide greater certainty to those market participants that choose to clear through a non-U.S. DCO.

Permissibility of Liens on Customer Collateral by a DCO

NGX notes that proposed Regulation 22.2(d) would prohibit an FCM from imposing, or permitting the imposition of, a lien on Cleared Swaps Customer Collateral[19] including on any FCM residual financial interest therein.[20] The proposed amendment is designed to prevent a creditor of the FCM from obtaining a claim superior to that of a customer.[21] No similar limitation would be applied to a DCO.[22] NGX supports this distinction, noting that a DCO, such as NGX, may in fact secure its primary interest in deposited customer collateral through a lien or other type of security interest. This is particularly true for non-U.S. DCOs that may rely on commercial law rather than on specific provisions of their home jurisdiction's bankruptcy code to establish the DCO's rights in the deposited customer collateral.

Conclusion

NGX recognizes the importance of safeguarding customer collateral and supports the Commission's efforts to ensure that the customer property and funds are protected in the event of default by either a DCO or FCM. However, NGX respectfully requests that the Commission in the final rules provide for greater clarity with respect to the ability of a DCO to have the insolvency law of its home jurisdiction apply through its choice of law provision under its rules. Alternatively, NGX recommends the Commission require a

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18 "Risk Management Requirements for Derivatives Clearing Organizations," 76 *Fed. Reg.* 3698, 3742 (January 20, 2011).

19 *See supra* note 6 for the Commission's proposed definition of Cleared Swaps Customer Collateral.

20 *See* proposed regulation 22.2; *see also* Proposing Release, *supra* note 1 at 33833.

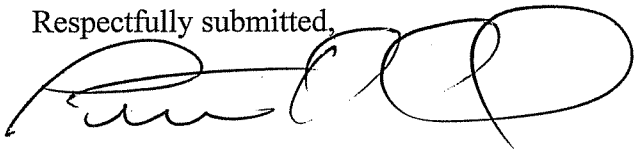
21 *Id.*

22 NGX further notes that regulations 1.20(b) and 1.26(b) do not prevent a DCO from imposing a lien on collateral received.

foreign DCO obtain a memorandum of local counsel analyzing insolvency issues in the foreign jurisdiction.

Please feel free to contact Cheryl Graden 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,



Peter Krenkel
President and CEO, NGX