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December 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: Further 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 Investments¹ (“Fidelity”) would like to take the opportunity in light of recent events to provide additional comments 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 adoption of an effective regulatory structure to protect collateral posted in connection with cleared derivatives trades 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”). Fidelity previously submitted a comment letter to the CFTC regarding the Proposed Rules on August 8, 2011 (the “August Fidelity

¹ Fidelity is one of the world’s largest providers of financial services, with assets under administration of nearly \$3.4 trillion, including managed assets of over \$1.5 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).

Letter”),³ as well as a comment letter on the CFTC’s Advanced Notice of Proposed Rulemaking for Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies (the “CFTC’s Advanced Notice”) on January 18, 2011 (the “Fidelity ANPR Letter” and together with the August Fidelity Letter, the “Prior Fidelity Letters”).⁴

In the Fidelity ANPR Letter, we expressed our support for the adoption of the full physical segregation model for collateral posted in connection with cleared swaps. In the August Fidelity Letter, we encouraged the CFTC to adopt the complete legal segregation model from among the options the CFTC presented in the Proposed Rules; however, we also continued to strongly support the full physical segregation model and recommended that the CFTC revisit its decision not to give further consideration to this model.

In light of recent events relating to the bankruptcy of MF Global, we urge the CFTC to reconsider the Proposed Rules and reissue a proposal to adopt full physical segregation as the standard for protecting collateral in connection with cleared swaps to ensure that swaps customers are provided with the strongest protections possible for their collateral. We believe that by requiring full physical segregation of customer collateral, the CFTC can better safeguard customer collateral held at both futures commission merchants (“FCMs”) and derivatives clearing organizations (“DCOs”).

The prolonged delay in determining both the amount and location of missing customer funds in the wake of MF Global’s collapse highlights the need for stringent measures to ensure that the collateral posted by customers to an FCM will be kept secure and promptly returned upon a failure of the FCM. Customers should be protected fully against loss of the collateral posted to an FCM for their cleared swaps positions and of collateral an FCM posts on their behalf to a DCO, regardless of whether that loss arises from the actions of the FCM’s other customers or the FCM itself. We strongly believe that the only model that will achieve the goal

³ Comment Letter, dated August 8, 2011, from Fidelity Investments to David A. Stawick responding to CFTC’s Proposed Rules for Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 76 Fed. Reg. 33818 (June 9, 2011), available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48014&SearchText=>.

⁴ Comment Letter, dated January 18, 2011, from Fidelity Investments to David A. Stawick responding to CFTC’s Advanced Notice of Proposed Rulemaking for Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies, 75 Fed. Reg. 75162 (Dec. 2, 2010), available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27188&SearchText=>.

of adequately protecting customer collateral is the full physical segregation model originally included in the CFTC's Advanced Notice.⁵

The Current Proposed Models Would Not Have Provided Adequate Protection to Swap Customers in the Event of a Situation Similar to MF Global

In the absence of the full physical segregation model as an option in the Proposed Rules, we supported the complete legal segregation model, also commonly known as legally separated but operationally commingled (or "LSOC"), as the best of the alternatives presented. In the wake of the MF Global failure, however, we question seriously whether the LSOC model is sufficient to adequately protect customer funds and assure the integrity of the cleared swaps system. Although it is unclear what caused the shortfall in MF Global customer funds, all possible safeguards should be implemented to help ensure similar events do not happen again.⁶

We believe that the LSOC model is not sufficient to protect customer funds, whether held at an FCM or at a DCO, from an FCM that commits fraud or that is unwilling or unable to comply with required recordkeeping and reporting. If the LSOC model had been in effect for customer collateral posted with MF Global, it would have prevented neither the loss of customer funds nor the CME Group's difficulties in closing out the positions of MF Global customers.⁷ We believe that such losses would not occur under the full physical segregation model because the collateral posted to secure the open positions would have been segregated, easily and readily identifiable and not dependent on the recordkeeping or actions of the FCM, and we urge the CFTC to consider the comments we submitted in the Fidelity ANPR Letter in support of that model.

⁵ CFTC Commissioners have recognized the importance of segregation for customer protection. E.g., Opening Statement of Chairman Gary Gensler for the CFTC Open Meeting on December 5, 2011 ("The Commission also is looking to soon finish rules on segregation for cleared swaps. Segregation of funds is the core foundation of customer protection."); Statement of Commissioner Scott D. O'Malia Regarding MF Global, Next Steps (Nov. 16, 2011) ("Segregation of customer funds is fundamental to our markets.").

⁶ CFTC Commissioners expressed their general agreement with this statement at a CFTC open meeting on December 5, 2011. E.g., Opening Statement of Commissioner Mark Wetjen for the CFTC Open Meeting on December 5, 2011 ("Futures customers generally and, indeed, the public are rightly demanding that the Commission take immediate steps – even before the MF Global investigation is complete – to reassure them we are doing everything we can to safeguard customer money.").

⁷ See e.g., "CME Group Statement on MF Global", November 2, 2011, available at: <http://cmegroup.mediaroom.com/index.php?s=43&item=3202&pagetemplate=article>

One of the biggest weaknesses of the LSOC model is that it bases the protection of customers' funds on non-verifiable recordkeeping, which may not be sound, and on FCMs doing business appropriately. Unfortunately, when numerous customers post collateral mistakes may occur even without malfeasance and shortfalls routinely arise purely as a result of operational error. The full physical segregation model would require customer collateral be held in separate accounts, reducing the risk of losing customer assets due to poor recordkeeping, operational errors or fraud because third party custodians are in a position to confirm receipts and deliveries of funds and to provide appropriate statements to FCMs, their customers and the DCO.

As proposed, LSOC would not protect customer funds in the event of misappropriation or other fraud, which would result in all customers sharing equally in losses, while the full physical segregation model would mitigate this risk by ensuring customer funds are held in separate accounts that are unaffected by such fraudulent activity.

There are also untested bankruptcy questions presented by the LSOC model that would be avoided if customer collateral was held by third party custodians in fully physically segregated accounts. In particular, a segregated customer account will enable a clearing house to intervene quickly to transfer non-defaulting customers because it precludes a trustee in bankruptcy from potentially claiming some or all of the amounts held in segregated accounts.

As we highlighted in the August Fidelity Letter, immediate portability is an essential element of a functioning cleared swaps market. MF Global has shown that the futures collateral model was not effective in ensuring portability. Instead of customers' positions being transferred to other FCMs, the trades were liquidated and customers are still waiting for their assets to be returned, more than one month after MF Global filed for bankruptcy. Of the customers who were able to port their positions, many were required to post additional collateral to the transferee FCMs to continue their trades, while waiting, and continuing to wait, for the collateral posted with MF Global to be sorted out. Operation of the market under the LSOC model still may have resulted in a large customer shortfall and the inability to promptly port positions due to poor recordkeeping or misappropriation. Only the full physical segregation model would have ensured immediate portability of customer positions, helping to ensure an orderly and efficient market, because customers would have been able to immediately and fully collateralize their open positions with funds already being held in segregated accounts.

Furthermore, as we stated in the Prior Fidelity Letters, the collateral protection model adopted for cleared swaps should not afford less protection to market participants than either the protections they currently have in the over-the-counter swaps market or than the CFTC has

proposed for uncleared swaps.⁸ Mutual funds and other buy-side participants currently have tri-party custodial arrangements in place with dealer counterparties that require segregation of collateral with the customer's custodian in connection with swaps transactions. The only way to ensure that centrally cleared swap trades are less risky than swap transactions in today's over-the-counter environment for these participants is to adopt the full physical segregation model for cleared swaps. Certainly the MF Global collapse has demonstrated that the futures collateral model is vulnerable and does not always mitigate risk. Even the LSOC model would not sufficiently protect against the risks reports indicate were realized in the MF Global situation (e.g., inadequate recordkeeping, misappropriation, etc.).⁹

The full physical segregation model also would provide the CFTC, National Futures Association and market participants with the most transparency into customer positions. It also bears repeating, as we pointed out in the Prior Fidelity Letters, that there has been little, if any, substantiation of the claims of some participants that full physical segregation (or LSOC) would result in increased costs, particularly when compared to the costs presently incurred in the over-the-counter swaps market as opposed to those related to the futures market.

Proposed Implementation of the Full Physical Segregation Model

While there are many ways to implement the full physical segregation model to ensure that all participants are adequately protected, we believe that a structure in which an FCM, both

⁸ 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 (CFTC 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 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.

⁹ E.g., Silla Brush & Matthew Leising, *MF Global Didn't Segregate Client Collateral, CME Group Says*, Bloomberg Businessweek, Nov. 8, 2011, available at <http://www.businessweek.com/news/2011-11-08/mf-global-didn-t-segregate-client-collateral-cme-group-says.html>; Michael J. De La Merced, *CME Raises Suspicions on MF Global Transfers*, N.Y. Times, Nov. 2, 2011, available at <http://dealbook.nytimes.com/2011/11/02/cme-raises-suspicions-on-mf-global-transfers/>. According to testimony of Terrence Duffy, Executive Chairman of CME Group Inc., as late as Wednesday, October 26th, just 5 days prior to Monday, October 30th, the day on which the SIPC trustee took control of MF Global's operations, CME's auditors found no material discrepancies in MF Global's accounting records. However, early the morning of October 30th, MF Global informed both the CFTC and the CME that customer money had been wrongly transferred out of customer segregated accounts to firm accounts without knowledge of either the CFTC or the CME. Terrence Duffy, Prepared Testimony before the House Committee on Agriculture, Washington, DC (Dec. 8, 2011).

for its own account and as agent of the applicable DCO, the customer and the relevant custodian enter into the requisite collateral control agreements (each a “Collateral Control Agreement”) is a simple and efficient way to implement the model. Under this implementation scheme, the DCO will be adequately protected with the FCM acting as its agent under the Collateral Control Agreements until such time as the FCM may be in default, at which time, the DCO will have the right to step into the shoes of the FCM. From a practical standpoint, we believe this concept eliminates the argument that negotiation and implementation of the Collateral Control Agreements will be too time consuming and costly to the DCOs, while at the same time it would protect the DCO’s ability to access collateral upon a default of the relevant FCM. With respect to FCMs, many of these entities already have the infrastructure and systems to accommodate the full physical segregation model as many market participants already have these agreements in place with dealers for over-the-counter swaps trading. There are already many circumstances in the futures market today where the FCM acts as an agent of the clearinghouse and we believe that it would be appropriate and efficient for the FCM to act as agent of the DCO in this capacity as well.

The use of independent custodians will also improve recordkeeping practices and standards and provide an additional deterrent to fraud and malfeasance. Assuming that each such custodian is required by regulatory rules to conduct reconciliations and to take action to remove imbalances, any errors should be quickly identified (not less than daily) and resolved quickly thereafter. Additionally, any malfeasance on the part of an FCM should be easier to detect as the custodian can deliver statements to the customer and DCO as well as the FCM which will allow balances held to be confirmed and reconciled on a real-time basis. Thus, the introduction of an additional party into the process would create a more robust framework for customer protection.

CFTC Commissioners also have recently commented on the paramount importance to the derivatives industry of ensuring full protection of customer assets.¹⁰ In order for the CFTC to achieve this goal most effectively, we believe that the CFTC should implement the full physical

¹⁰ Opening Statement of Commissioner Scott O’Malia for the CFTC Open Meeting on December 5, 2011 (“As recent events have highlighted, the protection and preservation of customer funds is fundamental to our markets.”); Opening Statement of Commissioner Bart Chilton for the CFTC Open Meeting on December 5, 2011 (“Protecting consumer funds is a national economic priority...”); Statement of Commissioner Bart Chilton Regarding the Importance of Protecting Customer Funds, Top Priority (Dec. 1, 2011); Chairman Gary Gensler, Testimony before the US Senate Committee on Agriculture, Nutrition and Forestry, Washington, DC (Dec. 1, 2011) (“Segregation of funds is the core foundation of customer protection ... [and the rule is] critical for the safeguarding of customer funds.”).

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segregation model for collateral relating to cleared swaps, as outlined as one of the options in the CFTC's Advanced Notice.

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We appreciate the opportunity to further 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, Commodity Futures Trading Commission
Honorable Jill E. Sommers, Commissioner, Commodity Futures Trading Commission
Honorable Bart Chilton, Commissioner, Commodity Futures Trading Commission
Honorable Scott D. O'Malia, Commissioner, Commodity Futures Trading Commission
Honorable Mark Wetjen, Commissioner, Commodity Futures Trading Commission

Honorable Mary L. Schapiro, Chairman, Securities and Exchange Commission
Honorable Elisse B. Walter, Commissioner, Securities and Exchange Commission
Honorable Luis A. Aguilar, Commissioner, Securities and Exchange Commission
Honorable Troy A. Paredes, Commissioner, Securities and Exchange Commission
Honorable Daniel M. Gallagher, Commissioner, Securities and Exchange Commission

Director Eileen P. Rominger, Division of Investment Management, Securities and Exchange Commission