



**VIA Electronic Mail**

David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, N.W.  
Washington, DC 20581

**Re: Notice of Proposed Rulemaking on Protection of Cleared Swap Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions: RIN 3038-AC99**

Dear Mr. Stawick:

Och-Ziff Capital Management Group ("**OZCap**") welcomes the opportunity to comment on the Commodity Futures Trading Commission's (the "**CFTC**" or "**Commission**") proposed rules regarding the protection of cleared swap customer accounts and collateral (the "**Proposed Rulemaking**").<sup>1</sup> OZCap strongly urges the Commission to require a full physical segregation of the contracts and collateral of cleared swaps customers so as to offer the greatest protection possible to swaps customers. Alternatively, OZCap believes that at a minimum the Commission should require that cleared swap customers be offered the choice of full physical segregation.

**A. Och-Ziff Capital Management Group**

OZCap is one of the largest alternative asset managers in the world with approximately \$28.8 billion in assets under management as of December 1, 2011. OZCap, through its private investment funds, is responsible for serving the investment needs of pension funds, fund of funds, foundations and endowments, corporations and other institutions, private banks and family offices. OZCap has over 400 employees in its headquarters in New York and across its offices in London, Hong Kong, Mumbai and Beijing.

**B. Full Physical Segregation Offers the Greatest Amount of Customer Protection**

In December 2010, the Commission, in an advanced notice of proposed rulemaking (the "**ANPR**"), sought comment on four potential models for protecting the collateral of cleared

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<sup>1</sup> Notice of Proposed Rulemaking "Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions" 76 Fed. Reg. 33818 (June 9, 2011).

swaps customers.<sup>2</sup> One of the models was full physical segregation in which each customer's account and the contracts and collateral supporting trades in the account would be kept separately for and on behalf of each cleared swaps customer at the futures commission merchant ("**FCM**"), derivatives clearing organization ("**DCO**") and each depository. In its proposed rulemaking, however, the Commission chose to propose adopting complete legal segregation in which the collateral of all cleared swaps customers would be held on an omnibus basis, i.e., commingled with the collateral of all other cleared swaps customers.<sup>3</sup> Under the proposed rules the FCM would have the responsibility of preparing records and filing reports to the DCO on a daily basis that identify the rights and obligations of each cleared swaps customer in the omnibus account. In the event of default by a cleared swaps customer, the DCO would only have recourse to the value of the defaulting customer's positions, which value would be determined based upon the records and reports created by the FCM. There is, however, still a risk that the DCO would access the collateral of non-defaulting customers as well as that of the defaulting customer.

In order for legal segregation to be effective, the FCM must create and maintain complete and accurate records pertaining to each customer. When segregation of customer funds is most important, when an FCM is in financial trouble and on the cusp of default, is when this part of the legal segregation model is most likely to fail. Recent events surrounding the bankruptcy of MF Global Inc. ("**MF Global**") drives this point home. Media reports, including statements made by representatives of the trustee, make clear that poor recordkeeping by MF Global have presented problems for determining where customer assets are being held and the amount available to customers.<sup>4</sup> With full physical segregation there would not be the need to solely rely upon the records of the FCM to determine the amount of assets, and where the assets are held, for each cleared swaps customer, rather the records of each account at the FCM, the DCO and any other permitted depository would include the necessary information.

As the Commission recognizes in the Proposed Rulemaking, full physical segregation provides greater protections to customers than legal segregation.<sup>5</sup> Full physical segregation would eliminate the risk of another customer's default causing the DCO to access non-defaulting customer's collateral ("**Fellow-Customer Risk**"), while legal segregation would only mitigate this risk. When entering into a transaction, market participants knowingly accept the market and counterparty risk presented by a transaction and take these factors, as well as others, into account when analyzing any transactions and when managing risks presented by investment activities.

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<sup>2</sup> Advanced Notice of Proposed Rulemaking; request for comments: "Protection of Cleared Swap Customers Before and After Commodity Broker Bankruptcies" 75 Fed. Reg. 75162 (Dec. 2, 2010).

<sup>3</sup> Proposed Rulemaking, 76 Fed. Reg. at 33825.

<sup>4</sup> See, for example CNN Money web site article "The MF Global Money Chase" [http://money.cnn.com/2011/12/06/news/companies/mf\\_global\\_money/](http://money.cnn.com/2011/12/06/news/companies/mf_global_money/) (retrieved on December 6, 2012)(quoting Kent Jarrell, a spokesman for the trustee overseeing the MF Global brokerage liquidation, as stating "record-keeping was bad . . . [i]n many cases, there were no records of transactions that were done at the end because there was so much activity.

<sup>5</sup> Proposed Rulemaking, 76 Fed. Reg. at 33826 - 33827.

OZCap, however, does not believe that a market participant should have to take on the risk of other customers of the FCM when they would not otherwise accept such risk. Taking on Fellow-Customer Risk is particularly frustrating when the market participant will not be in a position to assess this risk. Protection of customer assets and the confidence in the markets that follows thereon, clearly calls for adopting the model that can completely eliminate this risk, full physical segregation, rather than the model that at best mitigates the risk, legal segregation.

Full physical segregation would also eliminate risk of a decline in value of investments of cleared swap customer assets by the FCM or DCO ("**Investment Risk**"). Although OZCap appreciates that the Commission has recently adopted amendments to CFTC Rule 1.25 that would eliminate some of the more disconcerting aspect of the investment of customer assets by FCMs and DCOs, including eliminating investments in foreign sovereign debt and in-house and affiliate repurchase agreements,<sup>6</sup> Investment Risk is still not eliminated. As the Commission recognizes, legal segregation would do nothing to alleviate or even mitigate Investment Risk.<sup>7</sup>

Full physical segregation would also best facilitate the ability to reliably transfer the contracts and associated collateral of cleared swaps customers out of an insolvent FCM. The transferee FCM could feel comfortable that it is receiving those positions and all the necessary collateral to support those positions that belong solely to the customer when it accepts a customer's account. Moreover, the cleared swap customer would have the ability to continue to trade without having to worry about posting more collateral to avoid liquidation of existing positions and would not have to become involved in a drawn out bankruptcy process to recover its assets.

### **C. Permit Cleared Swaps Customers the Choice of Full Physical Segregation**

Participants in the swap market are currently able to obtain full physical segregation through the use of third-party custodial arrangements. Pursuant to a tri-party agreement, an account is established in the name of the customer for holding collateral at an independent third-party in support of swap transactions entered into between the customer and the swap dealer. Under the agreement the obligations and rights of the parties are clearly delineated. In the event that the swap dealer becomes insolvent the market participant will not lose its collateral, while the swap dealer is permitted to access the collateral in the event the market participant defaults. Additionally, there is no concern that a market participant's funds will be affected by the default of another market participant that trades with the swap dealer. It would seem to be a perverse result that, because of rulemaking promulgated under the Dodd-Frank Wall Street Reform and Consumer Protection Act, which was, among other things, meant to enhance the safety of the over-the-counter markets by reducing systemic and counterparty risks, market participants were to be placed a worse position with regard to risk than they are currently.<sup>8</sup> If the Commission determines that, despite the greater customer protection benefits, it will not mandate full physical

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<sup>6</sup> Final Rule "Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions" (Dec. 5, 2011).

Available at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister120511a.pdf>

<sup>7</sup> Proposed Rulemaking, 76 Fed. Reg. at 33827.

<sup>8</sup> See, S. Rep. No. 111-176 at 33 -34.

segregation it should require that FCMs and DCOs provide cleared swaps customers with the choice of full physical segregation.

**D. Segregation for Futures Customers**

As noted above, the events surrounding the failure of MF Global make clear the benefits that physical segregation offers over an omnibus approach. OZCap believes that, just like cleared swaps customers, futures customers should also have the benefit of full physical segregation. Accordingly, we encourage the Commission to adopt physical segregation for not just cleared swaps but also for futures. OZCap recognizes that the system for segregation of futures customer assets by FCMs and DCOs has been in place for many decades and has resulted in a unique set of processes, systems and technology, unlike the system for cleared swaps customers, which is only now being created. Although this may caution against making immediate changes, it should not prevent the Commission from seeking changes with the ultimate goal of providing all customers of FCMs and DCOs with the protection and confidence offered by physical segregation.

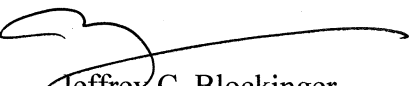
**E. Conclusion**

Full physical segregation offers the greatest protection for customers and should be required for all cleared swaps customer accounts. If the Commission determines not to mandate physical segregation by FCMs and DCOs, then it should require that cleared swap customers be offered the choice of full physical segregation. Finally, the Commission should look at making changes to the segregation requirements for futures customers with an ultimate goal of providing physical segregation for futures customers as well.

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We thank the staff for consideration of our views on this important issue. We would welcome the opportunity to further discuss the issues raised in this letter with Commission members or staff. Please feel free to contact me at (212) 719-7302.

Very truly yours,



Jeffrey C. Blockinger  
Chief Legal Officer

cc: The Hon. Gary Gensler, Chairman  
The Hon. Jill E. Sommers, Commissioner  
The Hon. Bart Chilton, Commissioner  
The Hon. Scott D. O'Malia, Commissioner  
The Ho. Mark P. Wetjen, Commissioner