



December 14, 2012

Via Electronic Submission: <http://comments.cftc.gov>

Ms. Sauntia S. Warfield
Assistant Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: ICE Clear Europe Limited Request for Order Pursuant to Section 4d(f) of the Commodity Exchange Act Permitting Commingling of Customer Funds and Portfolio Margining for Swaps and Security-Based Swaps

Dear Ms. Warfield:

Managed Funds Association (“**MFA**”)¹ appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the “**Commission**”) regarding ICE Clear Europe Limited’s (“**ICE Clear Europe**”) petition² for an exemptive order (the “**Order**”) under Section 4d(f)(3)(B) of the Commodity Exchange Act, as amended (the “**CEA**”), to permit ICE Clear Europe to: (a) hold in a cleared swaps customer account as defined in Commission Rule 22.1, which account is subject to the requirements of Section 4d(f) of the CEA and the rules thereunder, customer funds in single customer omnibus accounts (“**cleared swaps customer**

¹ MFA represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and all other regions where MFA members are market participants.

² ICE Clear Europe Limited Request for Order Pursuant to Section 4d(f) of the Commodity Exchange Act Permitting Commingling of Customer Funds and Portfolio Margining for Swaps and Security-Based Swaps, dated May 31, 2012, submitted to the Commission by Paul Swann, President & Chief Operating Officer, ICE Clear Europe Limited (the “**ICE CFTC Petition**”). The ICE CFTC Petition states that ICE Clear Europe is simultaneously seeking a similar exemption from the Securities and Exchange Commission (“**SEC**”) under Section 36(a)(1) of the Securities Exchange Act of 1934, as amended (the “**Exchange Act**”) granting relief from the application of Exchange Act Section 3E(b), Section 15(c)(3), and Rule 15c3-3 thereunder (the “**ICE SEC Petition**”). *Id.* at 2. Both the ICE CFTC Petition and the ICE SEC Petition are together referred to herein as the “**ICE Petitions**”.

accounts”) to margin, secure or guarantee positions in single-name credit default swaps (“CDS”) and narrow-based index CDS (together, “**Security-Based CDS**”) and broad-based index CDS (“**Index CDS**”); (b) calculate margin for cleared swaps customer accounts on a portfolio basis pursuant to ICE Clear Europe’s portfolio margining methodology³; and (c) provide similar relief to entities that are dually registered as futures commission merchants (“FCMs”) and securities broker-dealers (“BDs”) (such dually registered entities referred to herein as “**BD/FCMs**”) that maintain clearing accounts for customers at ICE Clear Europe.⁴

Executive Summary

MFA believes that the authority to calculate margin for cleared swaps customer accounts on a portfolio margin basis is essential to encourage increased clearing of swaps, enhance customer hedging and reduce systemic risk through clearing, and provide capital efficiencies for market participants. Thus, MFA supports the ICE CFTC Petition because of the significant benefits to customers in the form of capital efficiencies and clearing access that result from portfolio margining and netting. MFA also supports the ICE CFTC Petition’s request to hold customer positions in Index CDS and correlated Security-Based CDS, and related assets supporting such positions, in cleared swaps customer accounts to implement its portfolio margining program. The ICE CFTC Petition requests that the Order be effective no later than

³ In the ICE CFTC Petition, ICE Clear Europe states that it is filing separately with the Commission pursuant to Rules 39.4(b) and 40.6 its portfolio margining program between Index CDS and Security-Based CDS. *Id.* at 5 (“Upon the implementation of portfolio margining under that program, ICE Clear Europe intends to apply portfolio margining to commingled customer accounts pursuant to the relief requested hereunder.”) *Id.*

⁴ The ICE CFTC Petition states that the relief sought therein is substantially the same as that requested by ICE Clear Credit LLC, the U.S. affiliate of ICE Clear Europe (“**ICE Clear Credit**”). *Id.* at p. 2, n. 8. On December 21, 2011, MFA filed a letter in support of ICE Clear Credit’s Request for Order Pursuant to Section 4d of the Commodity Exchange Act re: Commingling of Customer Funds and Portfolio Margining, dated October 4, 2011, submitted to the Commission by Michael M. Philipp, Partner, Winston & Strawn LLP, as counsel to ICE Clear Credit, available at: http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/mfa_122111.pdf. Given the substantive similarity between the petitions of ICE Clear Europe and ICE Clear Credit, this letter also reiterates MFA’s prior supporting positions and related rationales in such previously filed letter. In addition, on June 13, 2012, MFA filed a letter in support of ICE Clear Credit’s companion request for order pursuant to Section 36(a)(1) of the Exchange Act to provide exemptive relief from the application of Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder re: commingling of customer funds and portfolio margining, dated November 7, 2011, submitted to the SEC by Michael M. Philipp, Partner, Winston & Strawn LLP, as counsel to ICE Clear Credit (the “**ICE Clear Credit SEC Petition**”).

Today, in response to the ICE Clear Credit SEC Petition and the ICE SEC Petition, the SEC issued an order and request for comment to grant conditional exemptive relief under the Exchange Act to facilitate portfolio margining treatment for customer-related positions in credit default swaps that are cleared pursuant to the terms of the order. *See* SEC Release No. 34-68433; File No. S7-13-12, “Order Granting Conditional Exemptions under the Securities Exchange Act of 1934 in Connection with Portfolio Margining of Swaps and Security-Based Swaps” (December 14, 2012), available at <http://sec.gov/rules/exorders/2012/34-68433.pdf>.

such time as the Section 4d(f) requirements come into effect.⁵ MFA strongly urges the Commission to grant the Order as soon as possible, particularly in light of the Commission's recent adoption of its final clearing requirement determination for certain Index CDS.⁶

If the Commission does not grant the requested Order, ICE Clear Europe's BD/FCM clearing members would have to hold their customers' cleared Index CDS and Security-Based CDS in separate customer accounts, and accordingly, would have to margin such positions separately. MFA submits that this separate account structure would result in additional margin costs and unnecessary capital inefficiencies for customers of ICE Clear Europe's BD/FCM clearing members.

Accordingly, we encourage the Commission to issue the Order requested in the ICE CFTC Petition to enable ICE Clear Europe to offer portfolio margining relief with respect to customer-related CDS transactions as soon as possible. Otherwise, customers, including many MFA members, will not benefit from the same capital relief and access to clearing that self-clearing dealers will have when ICE Clear Europe implements its portfolio margining program for clearing participant proprietary positions. Customers would thus be unfairly and unjustifiably disadvantaged by the Commission's withholding or delaying approval of the ICE CFTC Petition.

MFA Supports ICE Clear Europe's Petitions Because of the Benefits of Netting and Portfolio Margining to Customers and the CDS Market as a Whole

MFA believes that ICE Clear Europe's portfolio margining program, if approved by the Commission and the SEC, will benefit customers and the CDS market as a whole by: (1) facilitating systemic risk reduction; (2) providing capital efficiencies; (3) encouraging greater clearing and facilitating the transition to clearing; (4) improving buy-side access to clearing and removing economic barriers to customer clearing; (5) promoting competitive equality; and (6) improving the efficiency and effectiveness of risk management. MFA understands that ICE Clear Europe's portfolio margining program will provide these benefits with no compromise of the margin reserves required to protect the clearinghouse in a default event, and accordingly, the safety and soundness of the clearinghouse will be maintained. However, without the requested Order, MFA fears that none of these benefits will be realized.

MFA strongly believes that by granting the requested exemptive relief in the ICE Petitions, the Commission and the SEC will provide customers in the CDS market with the economic incentives and capital efficiencies necessary to promote clearing of a broader scope of CDS contracts. The requested Order would thus facilitate the achievement of the systemic risk reduction goal of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-**

⁵ *Id.* at p. 6, n. 15. We note that the part 22 regulations implementing Section 4d(f) became effective November 14, 2012.

⁶ *See* Commission Final Rule, "Clearing Requirement Determination Under Section 2(h) of the CEA," RIN 3038-AD86, adopted by the Commission via seriatim vote on November 28, 2012.

Frank Act)⁷. Customers will be able to expend less capital on margin by virtue of the ability to net customers' offsetting positions in Security-Based CDS and Index CDS in cleared swaps customer accounts under ICE Clear Europe's margin methodology. Moreover, without portfolio margin treatment, many customers may determine that clearing their Security-Based CDS and Index CDS will be prohibitively expensive. MFA believes that such a result would have a continuously limiting effect on both the volume of voluntary clearing prior to the Commission's clearing mandate becoming effective, and the breadth of CDS clearing after the clearing mandate becomes effective. These results would be inconsistent with a key Dodd-Frank Act goal to promote greater central clearing of swaps to reduce systemic risk.

Without the exemptive relief requested in the ICE Petitions, ICE Clear Europe and its BD/FCMs would be required to maintain separate accounts subject to the different margin rules of the Commission and the SEC to hold customer collateral relating to Index CDS and Security-Based CDS, respectively. Separate accounts would make clearing significantly more expensive for customers because they would be required to fully margin both accounts. For example, a customer that sells single-name CDS to offset the risk of a correlated Index CDS will, without the ability to net margin under a portfolio margining program, have to post full margin for both assets. The resulting inability of BD/FCMs clearing such transactions on behalf of customers to net the margin of correlated Index CDS and Security-Based CDS held in separate accounts would eliminate the economic efficiencies that can be gained from portfolio margining and that are inherent in a wide range of hedging strategies. MFA believes these inefficiencies will act as an economic disincentive, not only to customers' efficient portfolio risk management, but also to moving the CDS marketplace to central clearing. Any such significant disincentive would be inconsistent with, and would severely undermine, a fundamental objective of the Dodd-Frank Act to reduce systemic risk through promotion of greater clearing of swaps and the reduction of systemic risk.⁸

MFA's support for the ICE Petitions is also based on our understanding that the Dodd-Frank Act expressly sought to encourage portfolio netting for the systemic risk management reasons set forth, charging the Commission and the SEC with issuing exemptive orders under Section 713(a) in support of portfolio margining.⁹ There is ample regulatory and academic

⁷ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁸ MFA notes that the proposed European Market Infrastructure Regulation ("EMIR") in the European Union ("EU") does not have any such jurisdictional bifurcation regarding collateral segregation requirements for derivatives positions relating to commodities and securities. Thus, the U.S. CDS market could be competitively disadvantaged relative to the CDS markets in the EU, particularly if the requested exemptive relief in the ICE Petitions is not granted by the Commission and the SEC.

⁹ Section 713(a) of the Dodd-Frank Act amended Section 15(c)(3) of the Exchange Act to authorize the SEC to grant exemptions under section 36 of the Exchange Act or to adopt rules or regulations that permit securities to be held in a portfolio margining account that is regulated as a futures account under Section 4d of the CEA pursuant to a portfolio margining program approved by the CFTC. The ICE CFTC Petition noted that Congress's broad reference to a "futures account subject to section 4d" in Section 713(a) would encompass section 4d(f) thereunder, which provides for the segregation of customer funds used to margin, guarantee or secure cleared swaps, and

support for the benefits of portfolio margining. For example, in the Federal Reserve Bank of New York Staff Report no. 424, “Policy Perspectives on OTC Derivatives Market Infrastructure,” published January 2010 and widely referenced in the deliberations of the Dodd-Frank Act’s language, Darrell Duffie, Ada Li and Theo Lubke stated:

Furthermore, because posting margin is a material cost of participating in a CCP, market participants have an additional incentive to clear more if they can reduce the amount of margin to post against their exposures. Regulators should therefore encourage methods for reducing the use of margin whenever this can be done without increasing systemic risk. In particular, the joint clearing of different derivative products in the same CCP improves the opportunity to net positive against negative counterparty exposures, and increases the incentives for market participants to clear their derivatives trades, without increasing systemic risk.¹⁰

In addition, the SEC and FINRA’s Rule 4240 illustrates that the SEC appreciates the benefits of portfolio margining, and acknowledge that approved portfolio margining (Rule 4240 included approval of the ICE portfolio margining program in discussion here) is both of benefit to indirect clearing participants and consistent with the risk management requirements of the Dodd-Frank Act.¹¹ Further, the Commission has broad authority under Section 4d(f)(3)(B) of the CEA to permit the ICE CFTC Petition’s requested commingling of cleared Index CDS and cleared Security-Based CDS in a Section 4d(f) account to enable ICE Clear Europe to provide portfolio margining across such positions.

Competitive Concerns

ICE Clear Europe currently clears Security-Based CDS and Index CDS proprietary positions for ICE Clear Europe’s direct clearing members, the largest swap dealers, and is prepared to offer portfolio margining for these accounts as soon as ICE Clear Europe obtains

accordingly, should be construed to facilitate portfolio margining of cleared swaps and security-based swaps by permitting commingling of such products in a Section 4d(f) account. *Id.* at p. 7, n. 17.

¹⁰ Policy Perspectives on OTC Derivatives Market Infrastructure; Darrell Duffie, Ada Li, and Theo Lubke; Federal Reserve Bank of New York Staff Reports, no. 424; January 2010; revised March 2010, at page 14; http://www.ny.frb.org/research/staff_reports/sr424.pdf

¹¹ FINRA Rule 4240, as revised, Effective Date: July 16, 2011, and Regulatory Notice 11-31 (July 2011) (addressing FINRA approval of margin methodologies used by clearing agencies or derivatives clearing organizations for purposes of Rule 4240, and extending the interim pilot program for CDS margin requirements to January 17, 2012); <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p124089.pdf>. On March 7, 2012, the SEC granted accelerated approval of a proposed rule change from FINRA to extend to July 17, 2012, retroactively from January 17, 2012, the existing interim pilot program under FINRA Rule 4240 with respect to margin requirements for Security-Based CDS; <http://www.sec.gov/rules/sro/finra/2012/34-66528.pdf>. On July 17, 2012, the SEC approved a further extension of such interim pilot program to July 17, 2013, <http://www.sec.gov/rules/sro/finra/2012/34-67449.pdf>.

regulatory approval, which we understand is forthcoming and does not require the requested Order to go into effect. Once ICE Clear Europe's direct clearing member proprietary account portfolio margining program becomes effective, such proprietary account holders will gain the significant benefits in capital efficiencies that result from portfolio margining. However, these benefits will not be realized by customers until the Commission and the SEC grant the requested exemptive relief in the ICE Petitions. As a result, the capital required for clearing will be significantly greater for customers than for direct clearing members' proprietary positions. This inequality will put customers at a substantial competitive disadvantage, with no justification under the Dodd-Frank Act. This inequality will not only create a significant economic barrier to buy-side clearing in the CDS markets, but will substantially restrain the healthy evolution of increased liquidity that should develop with increased clearing. Burdened by unequal margining, all participants in the market that are not direct clearing members will be unable to offer competitive bids and offers. Liquidity will thus remain concentrated, as it is today in the bilateral markets, in a relatively small number of the largest swap dealer desks, both undermining price competition and concentrating risk in the swaps markets.

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Without portfolio margining, MFA is concerned that customers will have to dedicate increasing funds to initial margins which are not risk-driven, directly reducing customers' ability to support their trading and hedging activities. Thus, the amount of clearing that customers could implement for all of their CDS contracts will be limited, a result that is inconsistent with the systemic risk reduction goal of the Dodd-Frank Act. Further, the inability of customers to net Security-Based CDS with offsetting Index CDS, and *vice versa*, will inhibit open access to clearing for all market participants. This result is inconsistent with Sections 723 and 763 of the Dodd-Frank Act, which require open access and nondiscriminatory clearing of swaps and security-based swaps for all market participants. Voluntary clearing of CDS by the "buy-side" remains relatively low because of continuing material structural and economic barriers to clearing access for customers. Removal of this specific excess margin cost barrier will help to level the playing field on margin – between cleared and uncleared, and between customers and dealers – at a critical time in the progress toward enabling and expanding buy-side clearing, particularly as the clearing mandate becomes effective.

For the reasons set forth above, MFA believes the requested Order, if issued, will promote greater clearing and more efficient and effective risk management in the CDS market as a whole. Therefore, MFA respectfully requests that the Commission approve the requested exemptive relief in the ICE CFTC Petition and issue the requested Order as soon as possible.

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MFA thanks the Commission for the opportunity to provide comments to support ICE CFTC Petition. Please do not hesitate to contact Laura Harper, Assistant General Counsel, or the undersigned at (202) 730-2600 with any questions the Commission or its staff might have regarding this letter.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing
Director, General Counsel

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 Hon. Mark P. Wetjen, Commissioner

The Hon. Elisse B. Walter, Chairman
The Hon. Luis A. Aguilar, Commissioner
The Hon. Troy A. Paredes, Commissioner
The Hon. Daniel M. Gallagher, Commissioner