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Ms. Melissa Jurgens
Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington, DC 20581

RE: **RIN 3038 AD88: Enhancing Protections Afforded Customer and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 77 Fed.Reg.67866 (November 14, 2012)**

Dear Ms. Jurgens:

Jefferies Bache, LLC ("Jefferies Bache") welcomes the opportunity to submit this letter in response to the Commodity Futures Trading Commission's (the "Commission") request for comment on its proposed amendments designed to afford greater protections to customers and customer funds held by Futures Commission Merchants ("FCMs") and Derivatives Clearing Organizations ("DCOs").

Jefferies Bache is a wholly owned subsidiary of Jefferies Group, Inc. ("Jefferies Group"), a global securities and investment banking firm that has served companies and their investors for over 50 years. Jefferies Group is a publicly traded company with a market capitalization of approximately $3.6 billion and annual revenues of $3.0 billion (fiscal year ended November 30, 2012). We currently employ over 3,800 people in offices in more than 30 cities worldwide, and our approximately 1,500 sales and trading professionals transact business with and on behalf of thousands of institutional investors in most major markets in the world today.

The proposed amendments look to strengthen customer protection by requiring a FCM to: 1) maintain more detailed records and submit more detailed reporting on investments of customer funds and locations of safekeeping; 2) provide more detailed information on the FCM and its affiliates that may be material to a customer's decision to doing business with the FCM; and 3) strengthen risk management with effective policies and procedures.

EXECUTIVE SUMMARY:

Jefferies Bache is a committed supporter of: i) effective transparency; ii) the safeguarding of customer funds; and iii) the business realities of operating a global clearing organization.
We would like to comment specifically on four of the Commission's proposed rules ("Proposed Rules"):

(1) Proposed Rule 1.32: Jefferies Bache believes that the Commission's proposed adoption of the current practice of submitting detailed information on how FCMs invest customer funds and how the depositories are holding customer funds, which is made public twice a month on the National Futures Association's ("NFA") website, does not meet the objective of transparency.

(2) Proposed Rules 1.23, 22.17 and 30.7(g): Jefferies Bache believes that the Commission's proposed recommendation of calculating residual interest based upon a FCM's most recent daily segregation calculation is too restrictive and could unintentionally discourage firms from increasing their residual interest when conservative risk practices would encourage it.

(3) Proposed Rule 30.7(c): Jefferies Bache believes that the Commission's proposed amendment is too restrictive in regards to the realities of running a global clearing organization and operating in multiple time zones, products and currencies. The amendment is inconsistent with current rules for client funds in segregation held in similar locations. To further transparency, we would suggest that the Commission adopt the same percentages (150 percent) as segregated funds, which is consistent with how the Commission adopted the Rule 1.25 investment rules for secured funds (Rule 30.7).

(4) Proposed Rules 1.20(i)(4), 22.2(f)(6) and 30.7(a): Jefferies Bache believes that the Commission's proposed amendments to Rule 1.20(i)(4), 22.2(f)(6) and 30.7(a), which would require each FCM to maintain at all times a residual interest in each class of customer funds sufficient to exceed the sum of all customer margin deficits, are too conservative in that they are based upon an assumption that all of the FCM's customers will default on the same day and at the same time. The industries capital and margin requirements are specifically risked-based, and to assume a 100 percent risk-based default rate is too conservative.

DISCUSSION:

(1) Proposed Rule 1.32:
The Commission has proposed several amendments to Rule 1.32, which would require FCMs to provide more detailed information regarding the computation of the FCM's segregated account calculation and the holding of customer segregated funds. The Commission seeks to adopt the existing practices of the CME Group, Inc. and the NFA, requiring FCMs to submit detailed information on how they invest customer funds (Segregated Investment Detail Report ("SIDR"), submitted twice a month) and to identify in which depositories a FCM holds customer funds.

Comment:
We do not believe this proposal achieves the objective of improved transparency. FCM customer portfolios should be fully reportable, including all instruments and cash, regardless of location. As we have seen and will continue to see, a portfolio is affected not only by the risk of the instruments it holds, but also by the composition of the portfolio. If cash items are excluded, the customer does not obtain an accurate assessment of the liquidity of the portfolio.

Rule Timeline:
On February 29, 2012, the Commission's staff held a roundtable (the "Commission Roundtable") regarding enhancements to the protection of customer funds. The Commission Roundtable addressed the issue of "greater transparency of where FCMs hold customer funds and their investments of customer funds." Within the discussion were several topics including: 1) requiring FCMs to provide greater detail regarding the investments of customer funds; 2) whether the information should be disclosed solely to the Commission or made available to the public; and 3) how frequently information should be disclosed by FCMs.

Starting in July 2012 (and thereafter twice a month), FCMs began submitting their investment and custodial information to their Designated Self-Regulatory Organization ("DSRO") in a format that is consistent with the NFA SIDR format. Starting in September 2012, investment information became available on the NFA's website. Also in September 2012, Jefferies Bache began to publish on its customer information portal (the "Customer Portal") its segregation and secured funds (Rule 30.7) requirements, investment details and percentage of investments, which are prepared in a format that is consistent with the NFA SIDR format.

Because SIDR reporting excludes various items, including customer-owned securities and amounts due to and from exchanges, there may be a difference between a FCM's investment detail and its reportable segregated funds. For Jefferies Bache, the difference between its reportable segregated funds and the investment details is approximately 10-20 percent, which results in less transparency for Jefferies Bache's customers. Jefferies Bache discloses this difference on the Customer Portal.

On November 13, 2012, Jefferies Bache was advised by its DSRO that cash balances reported by FCMs should no longer include cash on deposit at clearing organizations or carrying brokers as it would provide a more accurate reflection of cash balances held by FCMs. Jefferies Bache interpreted this directive, removing additional items from the reportable investment detail, as a negative change away from the original objective of providing additional transparency. Because of the SIDR reporting exclusions, Jefferies Bache has further disclosed these differences on the Customer Portal. For Jefferies Bache, the difference between reportable segregated funds and the investment details is now approximately 40 percent, which results in less transparency and confusion for our customers.

On the NFA's website where this information is made public to customers, the firm's investment detail percentages are presented together with the firm's reportable segregated funds. As

explained above, because the investment detail percentages are not highly correlated to the firm's reportable segregated funds, the information could be misinterpreted by the firm's customers. Jefferies Bache believes that the inclusion of disclaimer language stating that "the percentages do not include non-invested amounts a FCM has deposited at other FCMs, derivatives clearing organizations and segregated funds on hand" does not enhance transparency for customers.

Jefferies Bache has published its customer investment detail and depositories on the Customer Portal twice a month since September 2012. To date, Jefferies Bache has not received any questions from customers regarding its investment portfolio.

Summary:
The proposed SIDR reporting does not meet the objective of enhancing transparency.

Recommendation:
Jefferies Bache recommends that SIDR reporting should include all investments, including cash and other instruments, regardless of location. We look forward to working with the Commission to make investment information more transparent for our regulators and customers.

(2) Proposed Rule: 1.23, 22.17 and 30.7(g):
The Commission has also proposed amending Rules 1.23, 22.17 and 30.7(g) which provide that: (i) a FCM may not withdraw any of its residual interest from a customer funds account for its own proprietary use until it has completed its daily segregation calculation; (ii) a FCM may not withdraw funds for its own proprietary use from customer funds accounts, if such withdrawal(s) would exceed 25 percent of the FCM's residual interest in such accounts as computed as of the close of business on the previous business day, unless the FCM's CEO, CFO or other senior official approves the withdrawal in writing and the FCM files written notice of the withdrawal with the Commission and with its DSRO immediately thereafter; and (iii) if a FCM withdraws a portion of its residual interest for its own proprietary use, and the withdrawal causes the amount held in the customer segregated account to fall below the FCM's target residual interest, the FCM must either restore the residual interest to the targeted amount by the close of the business on the next business day or, if appropriate, revise the targeted residual interest.

Comment:
While Jefferies Bache generally supports the proposed amendments to Rules 1.23, 22.17 and 30.7(g), we believe that notice to the Commission and the DSRO should be required only if the withdrawals exceed 25 percent of a FCM's targeted residual interest, not 25 percent of the FCM's residual interest as reported on the FCM's most recent daily segregation calculation. We believe this approach is preferable for several reasons:

A FCM should be encouraged to increase or maintain its residual interest above its target level. Basing the calculation on the prior day's actual residual interest increases the regulatory risk of

reporting when the residual interest excess is reduced.[1] Note that a FCM may regularly increase or decrease its residual interest excess in the ordinary course of business (due to market moves, transfers, portfolio settlements, etc.). Jefferies Bache regularly maintains additional residual interest above its reportable target levels to increase its 25 percent reporting thresholds and prevent the regulatory notice that would be required it Jefferies Bache were to fall below its target level.

A DSRO is required to contact a FCM when its residual interest falls below its target level. As stated above, Jefferies Bache regularly maintains excess residual interest over its target level to prevent any regulatory notice requirements. If the Commission were to adopt Jefferies Bache's proposed recommendation, FCMs could regularly stay above their target level while still having the flexibility to conservatively manage their business. Also as mentioned in the Commission Roundtable on February 5th 2013, customers have requested data on how often FCMs fall below their target level. The additional scrutiny by customers could result in FCMs having to maintain an additional buffer on top of their residual interest to avoid any unwarranted negative reaction from customers or the industry.

Jefferies Bache does not believe it would be an effective use of a firm's capital if FCMs needed to maintain additional buffers on top of target residual interests, to avoid regulatory reporting. Jefferies Bache currently spends over $13 million annually supporting its residual interest balances. The industry currently maintains over $15 billion of residual interest (December 2012) at an estimated cost of over $1 billion annually. Maintaining just 5 percent more residual interest above the current target level could potentially cost Jefferies Bache approximately $500,000. Industry-wide, a 5 percent increase could potentially require an additional $772 million in residual interest, at a cost of approximately $50 million. The costs of increasing residual interest will lead to FCMs having fewer resources available which are essential to help implement and comply with the current proposed rules.
(Note: costs are implied as followed: a debt-to-equity ratio of 40%, with a cost of equity of 11% (Price-to-earnings ratio for financial institutions, September 2012) and a cost of debt of 2% (the yield on U.S Government ten year notes). ((60%x11%)+(40%x2%)=7%)

Recommendation:
Jefferies Bache recommends that FCMs should be permitted to: (i) withdraw any residual interest amount in excess of their target level; and (ii) withdraw up to 25 percent of the target before providing notice. If the last calculated residual interest is less than the target level, then the calculation should be 25 percent of the lower of the target level or the last calculated residual

[1] FCMs independently assess and maintain different amounts of excess funds, and 25 percent of residual interest in each respective origin for the top ten firms in the industry on December 31, 2012, for segregated funds, range from a high of $500 million to a low of $26 million, and for secured funds (Rule 30.7), from a high of $200 million to a low of $26 million. Below the top ten firms, amounts may be lower.

interest. This will provide FCMs the flexibility to manage their business more effectively and conservatively, when necessary, without increased regulatory reporting risk.

(3) Proposed Rule 30.7(c):

The Commission has proposed to amend Rule 30.7(c) to provide that a FCM may not deposit or hold the foreign futures or foreign options secured amount with any depository located outside the United States ("US") except to meet margin requirements, including prefunding margin requirements established by rule, regulation or order of a foreign board of trade or clearing organization, or to meet calls issued by foreign brokers carrying the customers' positions. The proposed amendment further provides that a FCM may hold in depositories located outside of the US an additional amount of up to 10 percent of the total amount of funds necessary to meet the margin and prefunding requirements.

Comment:

Jefferies Bache agrees that a FCM should not hold excess funds beyond what is reasonably required to meet its customer obligations in foreign futures and options. However, we believe that a 10 percent limitation is not a practical threshold for the following reasons:

Foreign brokers or clearing organizations traditionally have overfunding requirements to substitute acceptable non-cash products. The proposed amendment could prevent customers from providing "customer-owned" securities to meet margin requirements which would then necessitate a prefunding obligation beyond one day.

Exchange approved banks for foreign settlements are becoming increasing less inclined to extend intraday credit to cover the industry's margins settlements. The industry is therefore required to maintain more collateral to prefund this activity with foreign brokers or clearing organizations. The settlement bank's inability to accept both segregated and secured funds (Rule 30.7) netting arrangements between US banks and foreign branches of US banks, only increases liquidity inefficiencies meeting a FCM's obligations for its customers.

Currently, funds in customer segregation can be maintained at an amount up to 150 percent of its margin requirements with foreign brokers or clearing organizations before any penalty is incurred. The limit on secured funds (Rule 30.7) should be consistent with segregation balances. Jefferies Bache is permitted to hold segregated customer funds at the ICE Clear Europe ("ICE EUR") at an amount up to 150 percent of its requirements. The Commission is proposing that Jefferies Bache, which holds secured funds (Rule 30.7) at the London Clearing House ("LCH"), be limited from holding greater than 110 percent of its requirements in the same location.

Recommendation:

Jefferies Bache recommends that the proposed amendment to Rule 30.7 be revised so that it is consistent with the current rules for segregation, and that the current segregation rule of 150 percent be applied to both segregated and secured funds (Rule 30.7).

(4) Proposed Rule: 1.20(i)(4), 22.2(f)(6) and 30.7(a):
The Commission has proposed amendments to Rule 1.20(i)(4), 22.2(f)(6) and 30.7(a), which would require each FCM to maintain at all times a residual interest in each class of customer funds sufficient to exceed the sum of all customer margin deficits.

Comment:
The proposed amendments to Rule 1.20(i)(4), 22.2(f)(6) and 30.7(a) would impose tremendous operational and financial difficulties on the industry which would significantly alter the existing futures industry model that has been in place for at least the last fifty years. Effectively, the Commission's proposal seeks to shift the industry from a highly regulated market risk-driven industry to a 100 percent default-risk model.

Jefferies Bache agrees that protecting customers from fellow customer default risk would provide enhanced customer protection. However, the proposed amendment would require a FCM to assume that every customer that has a margin requirement will fail to meet that margin requirement on the same day and at the same time. This assumption is neither practical nor based in any historical context. An alternative consideration should be based upon a FCM's write-offs, reserves or allowances for bad debts. It was noted in the Commission Roundtable that the Basel rules are based upon an 8 percent default risk, whereas the Commission's proposal assumes a 100 percent default risk.

The proposed amendments will negatively impact competitiveness within the industry and adversely affect many FCM's ability to operate effectively. The implementation of the proposed amendments could also result in fewer FCMs which results in fewer participants sourcing capital and liquidity in the market in times of distress or in times of expansion. As we have seen in other industries, financial institutions have been under pressure to deleverage their balance sheets, and the Commission's proposed amendments could result in unintended negative consequences in the number of clearing participants.

Implementation of the proposed amendments will result in a tremendous increase in necessary liquidity needed to cover top-day margin call deficits, and result in making trading and risk mitigation significantly more expensive for market participants. Additionally, it is worth noting that increased margining or prefunding requirements will result in more assets held in FCMs' custodial facilities at a time when the Commission has been enacting changes that have been shifting collateral away from FCMs towards DCO facilities, such as exchange gross margining.

In response to the Commission's request for some calculation of additional costs, Jefferies Bache has included below a presentation of estimated increases and associated costs as a result of the increased liquidity requirements (current futures only activity; excludes OTC activity).

Costs-Simplified: (FCMs are currently required to reserve for accounts liquidating to a deficit and accounts with debit balances which are not offset by US Treasuries owned by customers, Unsecured Net Liquidating Value Deficits ("UNLVD"))

Approach:
A FCM with an average unsecured net liquidating value deficit of $3 million in non-peak times may maintain a residual interest of $100 million. Assume that (i) its average beginning of the day margin call deficits is $215 million, (ii) in peak times, unsecured net liquidating value deficits are $44 million, and (iii) during the same period, its average beginning of the day margin call deficits is approximately $400 million.

The following table shows the additional amounts and costs of the proposed residual interest recommendations for both an individual FCM and the collective industry based on the assumptions set forth above:

	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)
FCM:	Current	Supporting	Margin Call	Estimated	RI-%	Annualized	Coverage of	Coverage of
Non-Peak	UNLVD charges	Resdual Interest	Deficits ("MCD")	RI	increase	Addional Cost	UNLVD	MCD
Unsecured NLV deficits (UNLVD):	$ 3,000,000	$ 100,000,000	$ 215,000,000	$ 315,000,000	315%	$ 14,792,000	10500%	147%
Peak								
Unsecured NLV deficits (UNLVD):	$ 44,000,000	$ 100,000,000	$ 440,000,000	$ 540,000,000	540%	$ 30,272,000	1227%	123%
Industry:								
Applied percentages:								
Non-Peak	12/31/2012	$ 15,449,010,947		$ 48,664,384,483	315%	$ 2,285,217,699		
Peak	12/31/2012	$ 15,449,010,947		$ 83,424,659,114	540%	$ 4,676,724,594		

Narrative summary of the calculation:

"FCM" Section: (Non-Peak are regular days and Peak are Maximum days)
Column (A) represents the amount of deficits that a FCM currently has to cover with its residual interest.
Column (B) represents the amount of residual interest that a FCM currently maintains.
Column (C) represents the average daily margin calls amount the FCM starts with at the beginning of the day (and it collects 100% on T+1).
Column (D) represents the estimated amount of additional residual interest (or amount required to be prefunded by a customer) necessary to cover the additional margin call deficits.
Column (E) represents the percentage increase in residual interest (or amount required to be prefunded by a customer)
Column (F) represents the cost of the addition residual interest (as show in Column D) necessary to comply with the Commission's proposed rules.
Columns (G) and (H) represent the percentage of coverage that the total residual interest (as shown in Column D) covers of the UNLVD (as shown in column A) and the margin call deficits ("MCD") (as shown in column C).

"Industry" Section:
The FCM residual interest percentage increases (as shown in column E) is used to approximate how much additional residual interest the industry would be required using the same percentage.

Conclusion:
Jefferies Bache would be required to increase its residual interest by $215 million or $540 million, at a cost of approximately $15 million or $30 million, respectively, depending on whether the market was non-peak or peak. While, the industry would be required to increase its residual interest by $49 billion or $83 billion, at a cost of approximately $2 billion or $5 billion, respectively, depending on whether the market was non-peak or peak. This increase would be required with no expected change in customer defaults.

Recommendation:
Jefferies Bache urges the Commission to reevaluate the proposed amendments to minimize any unintended negative effects on the industry.

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Jefferies Bache appreciates the opportunity to submit these comments on the Commission's proposed amendments to enhance customer protection. Please do not hesitate to contact the undersigned at (212) 336-7167 if you have any questions.

Sincerely,

Kenneth Nehlsen
Senior Vice President, Treasury