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Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, DC 20581

Office of the
Secretariat

COMMENT

Re: Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations (RIN 3038-AD88)

Dear Mr. Stawick:

The Committee on Investment of Employee Benefit Assets ("CIEBA") appreciates this opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission") regarding the recently released notice of proposed rulemaking and request for comments ("NPR")¹ concerning enhanced protection for customers and customer funds held by futures commission merchants and derivatives clearing organizations.

CIEBA represents more than 100 of the country's largest pension funds. Its members manage more than \$1.5 trillion of defined benefit and defined contribution plan assets on behalf of 17 million plan participants and beneficiaries. CIEBA members are the senior corporate financial officers who individually manage and administer Employee Retirement Income Security Act ("ERISA") - governed corporate retirement plan assets.

CIEBA has a strong interest in the adoption of an effective regulatory structure to protect collateral posted in connection with exchange-traded futures and cleared swaps and to protect the assets of the investing public in connection with the implementation of Dodd-Frank. In prior comment letters, CIEBA commended the Commission for seeking to reduce fellow-customer risk by its proposal of the legally separate but operationally commingled model ("LSOC")² for the holding of cleared swap margin provided to a customer's futures commission merchant ("FCM"). CIEBA has also requested that the Commission continue to build on such important measures by adopting regulations to require FCMs to give their customers the option to post margin for cleared swaps into individual physically segregated accounts. Consistent with such prior positions, CIEBA applauds the Commission's current efforts under the proposed regulations to provide further safeguards for customers and their funds held by FCMs and derivatives clearing organizations ("DCOs") and agrees with the proposal to explicitly prohibit

¹ Commission's proposed rule, Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations (RIN 3038-AD88) (the "Proposed Protections Rule"), 77 FR 67866.

² Defined in the final rule, Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 77 FR 6336, as the "Complete Legal Segregation Model".

the use of customers' funds held by an FCM to "purchase, margin, or settle" the transactions of, or to "secure or extend the credit of" any party other than the depositing customer.³

I. CIEBA strongly supports the proposal to require an FCM to maintain a residual interest in segregated funds at least equal to the aggregate gross margin deficits of the FCM's customers.

A. FCMs should not be permitted to use a customer's funds to subsidize margin calls of other customers.

For the reasons stated below, CIEBA supports proposed rules §1.20(i)(4), §22.2(f)(6) and §30.7(g)(2) which specifically require FCMs to cover from their own funds any margin deficits of their individual customers and which supplements the existing requirement that FCMs maintain levels in segregated accounts to prevent under-segregation.⁴ Some FCMs have taken the position that current regulations do not clearly prohibit them from using one customer's excess margin to cover the shortfall of an under-margined customer of the FCM. We support the Commission's action to eliminate such a reading of current regulations. As discussed below, CIEBA believes the proposed regulations are consistent with Congressional intent and CFTC historical interpretations of the Commodity Exchange Act (the "CEA") and sound economic and systemic risk policy. We also support consistency in treatment of customer funds between cleared swaps and futures.

Congressional Intent/CFTC Interpretation - Section 4d(a)(2) of the CEA directs FCMs to keep collateral and funds of each individual customer distinct from that of other customers and the FCM. The purpose of this provision is to protect individual customers and their funds from risks and obligations incurred by other customers of the FCM or the FCM itself. In 1937, soon after the adoption of the CEA, staff of the Commission's predecessor agency wrote that "'provisions of the Commodity Exchange Act ... prohibit the commingling of customers' funds with the funds of the commission merchant and ... prohibit the use of money or property belonging to one customer to margin or secure trades or contract of any other person.'" ⁵ There is no reason to believe that segregation of customer property is any less important today than it was 77 years ago. Indeed, in the current rule proposal, the Commission re-affirmed this intent and stated that §4d(a)(2) "is intended to provide a maximum level of protection to futures customer funds."⁶ Permitting FCMs to use customer funds to cover margin deficits of a different customer and thereby subsidize the FCM's obligation would therefore contravene well-established statutory policy. In addition, nothing in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") allows FCMs to use customer funds in this manner. To the contrary, the Dodd-Frank Act was adopted, in part, to increase, rather than reduce, regulatory protection for customers.

³ See Proposed Protections Rule, §§ 1.22(a) and 22.2(d), 77 FR 67866 at 67942 and 67954, respectively.

⁴ See Proposed Protections Rule §§1.20(i)(4), 22.2(f)(6) and 3.70(g)(2), 77 FR 67866 at 67941, 67955 and 67959, respectively. See also commentary at 67882, 67924 and 67925.

⁵ See Commodity Exchange Administration, Administrative Determination dated Sept. 1, 1937.

⁶ See Proposed Protections Rule, 77 FR 37866 at 67886.

Economic/Systemic Risk Policy – The rules as proposed represent sound policy as they provide proper financial incentives to FCMs and reduce systemic risk. The rules help to reduce systemic risk by prohibiting FCMs from utilizing other customers' excess margin to hide shortfalls of under-margined and potentially failing customers. The proposed rules also level the competitive playing field for FCMs who are acting appropriately and not using their customers' excess margin to meet the FCM's own client guarantee obligations. FCMs that have acted prudently and not cross-margined between customers have been placed at a competitive disadvantage to FCMs who have acted otherwise. The rules as proposed protect customers from FCMs who otherwise would have had a financial incentive to require excess margin beyond the actual credit risk of a customer. The ability to effectively source no-cost funding from customers has likely motivated some FCMs to unnecessarily increase margin requirements on certain customers, even beyond what would be deemed appropriate for the customer's credit risk profile, to such customers' economic detriment. Least sophisticated investors, who most need protection, would be harmed the most because they do not have the resources to determine when the margin requirement is excessive and do not have in place the processes to prevent the FCM from requesting excessive margin or seek return of any excess. The proposed rules also enhance customer protection in the event of an FCM bankruptcy. The use of one customer's funds to meet margin obligations of another customer is essentially short-term lending between customers that would require additional and complicated recordkeeping on the part of the FCM. In the case of an FCM's insolvency, improper or complex recordkeeping, as was seen in the Lehman and MF Global bankruptcies, can jeopardize the ability of a trustee to the bankrupt FCM to facilitate the return of customer funds and/or the porting of their positions to a solvent FCM.

B. CIEBA supports the revisions to §1.20(i)(4), §22.2(f)(6) and §30.7(g)(2) but requests further clarification.

We request that the Commission provide both a clarification and an explanation of §1.20(i)(4), §22.2(f)(6) and §30.7(g)(2) in layman's terms in the release of the final rules. First, the Commission should provide a general statement that margin should be legally segregated in accounts maintained by an FCM. A clear expression of the Commission's general position would remove any uncertainty on this issue. Second, while futures market participants may be familiar with terms such as "residual interest" and the technical features of the proposed rule, other market participants may not appreciate the full scope of the rule and the additional protections provided without further explanation. A clarification of how this requirement is intended to work with examples of its application would more broadly communicate the Commission's intent to bolster the depth of customer protections to minimize customer risk and would promote confidence in the markets.

II. CIEBA urges the CFTC to confirm that nothing in the proposed rules prohibits full physical segregation of customer funds.

CIEBA commends the Commission for the significant progress made by it in customer collateral protection in the swaps market with the adoption of the LSOC model.⁷ We further commend the Commission staff for its ongoing analysis of full physical segregation of swap customer

⁷ CFTC final rule, Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 77 FR 6336 ("LSOC Rule").

collateral. Consistent with the Commission's efforts to adopt customer protections and encourage the industry to voluntarily adopt customer protective measures, a number of clearinghouses and industry groups have been working on various initiatives to provide customers with the option for full physical segregation of their cleared customer funds.⁸ Some of the models being proposed involve an account held in the name of the customer at a third party custodian (which may be a DCO settlement bank) for the benefit of the DCO with the DCO (and in some models the FCM with the consent of the DCO) taking control over the collateral in the event of a default of a customer. In order to encourage the development of such models, we respectfully ask the Commission to confirm that the use of a full physical segregation model when and if approved by the Commission (either by Interpretative Letter or by Rule) would not be a violation of proposed rule §1.20(h)⁹.

III. CIEBA supports the CFTC's proposal to strengthen the protection provided to customers of FCMs and DCOs and customer funds held by FCMs and DCOs.

We appreciate the Commission's continued efforts to establish protections for customers and customer funds in the futures and swaps markets. The rules proposed in the NPR provide additional protection for customer collateral. In particular, we support the proposed rules aimed at protecting customer funds from misuse by other customers, the FCM or DCO.

We agree with the proposal to explicitly prohibit the use of customers' funds held by an FCM to "purchase, margin, or settle" the transactions of, or to "secure or extend the credit of" any party other than the depositing customer.¹⁰ The rule establishes a regulatory firewall around each customer's account, protecting its contents from being drawn away from the account owner and used to meet the obligations of another party.

In addition, we agree with the proposal to bar DCOs and FCMs from commingling funds deposited by futures customers with those deposited by section 30.7 customers or cleared swap customers.¹¹ These rules address issues inherent to global markets and ensure consistent treatment for the different types of DCO and FCM customers.

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We appreciate the opportunity to comment on the NPR. CIEBA would be pleased to provide any further information or respond to any questions that the Commission's staff may have.

THE COMMITTEE ON INVESTMENT OF EMPLOYEE BENEFIT ASSETS

⁸ CIEBA encourages and supports the efforts on the part of DCOs to provide full physical segregation for cleared customer collateral.

⁹ We recognize that use of such segregation would require a revision or repeal of Segregation Interpretation No. 10, as amended, and we respectfully ask the Commission to do so.

¹⁰ See Proposed Protections Rule, §§ 1.22(a) and 22.2(d), 77 FR 67866 at 67942 and 67954, respectively.

¹¹ See Proposed Protections Rule, §§ 1.20(g)(4)(iii) and 30.7(e)(3), 77 FR 67866 at 67941 and 67958, respectively.