MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

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Via Electronic Mail: nframularo@isda.org; emily.gu@ubs.com

Ms. Nichole Framularo,
Director of Trading Infrastructure

Ms. Emily Gu,
Collateral Committee Representative

International Swaps and Derivatives Association, Inc.
360 Madison Avenue, 16th Floor
New York, NY 10017

Re: MFA Comments to the Independent Amounts White Paper

Dear Ms. Framularo and Ms. Gu:

Managed Funds Association ("MFA")[1] has reviewed the latest draft of the Independent Amount White Paper, which was distributed on September 2, 2009 (the "IA White Paper") and is proposed to be jointly published by the International Swaps and Derivatives Association ("ISDA"), MFA and the Securities Industry and Financial Markets Association.

Given that MFA members are frequently required to post independent amounts ("IAs") with their dealer counterparts, the IA White Paper is of particular importance to MFA. MFA commends the ISDA Collateral Committee's effort to address the risks associated with the posting of IAs and has actively supported the effort to produce the IA White Paper. Nevertheless, MFA members have a number of concerns with the latest draft of the IA White Paper, and we have attached a detailed markup to this letter. In summary, we are primarily concerned with the following:

1. Neutral Presentation. As stated in the opening paragraph of the IA White Paper, the first seven sections of Part I are intended to be "educational" and "factual" and should not express any particular viewpoint regarding the use of IA. The dealer and end user viewpoints are supposed to be contained solely in section 8. However, in a number of these sections, we believe that the dealers expressed their viewpoints, and we have noted this throughout our markup. For instance:

(a) Exposure. MFA believes that undue emphasis is placed on the shortcomings of mark-to-market collateral (or variation margin ("VM")) in section 1.2. Although IA can protect against residual losses associated with a close-out, it is also likely in many cases that mark-to-market collateral will be sufficient to cover a party's exposure upon close-out.

[1] MFA is the voice of the global alternative investment industry. Our members include professionals in hedge funds, fund of funds and managed futures funds. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members represent the vast majority of the largest hedge fund groups in the world that manage a substantial portion of the approximately $1.5 trillion invested in absolute return strategies. MFA is headquartered in Washington D.C. with an office in New York, NY.

As a result, IA typically constitutes excess collateral. We should address the purposes of IA solely in section 3 and should not minimize the value and potential adequacy of mark-to-market collateral.

(b) Purported Inability to "Reverse Engineer" IA. The last bullet in section 1.5 of the IA White Paper incorrectly suggests that it is difficult for parties to calculate IA. Although current ISDA documentation provides that IA will be netted with mark-to-market collateral when determining a credit support amount, IA is a separate and distinct component of that determination and fundamental to calculating a margin call. Thus, based on current ISDA documentation, all parties should be able to calculate the total IA requirements under a given master agreement at any time. If it were not possible to separately calculate IA requirements, which are generally fixed/formulaic, then a party would be unable to make an accurate collateral call. If the only point in section 1.5 is that it will be necessary to maintain separate pools of collateral – the IA pool and the VM pool – in order to accord different treatment to IA, then the IA White Paper should simply state that fact and acknowledge that this would not be difficult to do. Moreover, the latest draft of the IA White Paper specifically acknowledges that Appendix C to the User's Guide to the 1994 ISDA Credit Support Annex includes an alternative formulation for credit support amount that results in the separate calculation and treatment of IA. Therefore, we believe that it is highly inappropriate to suggest that "it is not possible to reverse engineer" IA; the fact that the ISDA Credit Support Annexes currently provide for netting of IA against VM should not be presented as a material challenge to treating these components separately.

(c) Risks to Parties Posting IA. MFA believes that section 4 of the latest draft of the IA White Paper seeks to minimize the very real risks associated with posting IAs directly to a dealer counterparty that may go insolvent, as demonstrated by the Lehman Brothers insolvency. In addition, some of the new language in the latest draft seems to take an overly optimistic view of the U.K. client money rules, which did not provide the protection expected in the case of Lehman Brothers International (Europe). The new comments also inaccurately and inappropriately suggest that an end user could have taken steps to ensure priority treatment of their claim in bankruptcy or used different documentation to protect their interests. If the risks associated with posting IAs could be unilaterally resolved by end user actions, then the IA White Paper would not be necessary. In sum, the IA White Paper must properly acknowledge the risks associated with posting IAs directly with dealers and not suggest that end users could resolve these risks independently.

(d) Dealer-Affiliates Holding IA. The second paragraph under section 5.1 improperly asserts that IA held by a dealer's bank affiliate will be equivalent to a third-party custody arrangement. This assertion is at best very misleading and fails to address the fact that the treatment of IA in this circumstance will very much depend on the contractual arrangement governing the holding of that collateral by the affiliate and on the type and titling of the account in which the collateral is held. We suggest revising this paragraph to state that the legal result affecting IA held by a dealer's bank affiliate would depend on, among other things, the name under which the IA is held by such affiliate. If the IA is held in the dealer's name with no acknowledgement of the counterparty's interest in the collateral, then this arrangement would be no different from having the dealer hold the IA directly.

2. End User Perspective. In response to the latest draft, we have expanded on section 8.2 to counter certain assertions made by the dealers in section 8.1. For instance, we have clarified that: (i) while the futures market model provides a good example of how to protect IA, we are not in any way suggesting that the flexibility afforded by the OTC derivatives market to address counterparty credit risk on a case-by-case basis should be reduced; (ii) while the current market practice is to commingle IA with variation margin, we should consider putting IA into a separate pool given with greater protections; and (iii) the dealers' uses of of IA (*e.g.*, as a source of liquidity) are inappropriate. To the extent that further arguments are made by the dealer community that counter the arguments made in the "End User Perspective" section, then MFA would like the opportunity to respond to these arguments before a further draft is widely distributed.

3. Dealer/End User Conclusions. MFA continues to be concerned with the dealer conclusion in section 8.1 that the market should continue to operate on an *ad hoc* basis in addressing the risks associated with IA. The current market practice of negotiating *ad hoc* agreements to segregate IA is inefficient, costly and unfair to many end users that simply do not have the negotiating leverage and resources to negotiate such agreements with their respective dealer counterparties. Additionally, MFA members are concerned that the dealers have concluded that the use of tri-party custodial arrangements is not a viable option, citing various concerns that our members believe are not material in nature. We also believe that through dealer/end user collaborative efforts, we can easily address many of these concerns. From the end user perspective, the use of tri-party custodial arrangements should certainly still be on the table.

It is noteworthy that the regulatory community also recognizes and acknowledges the risks to market stability associated with posting IA directly to dealer counterparties. Most recently, CFTC Chairman Gensler raised the over-collateralization issue in his letter to Congressional leaders dated August 17, 2009 and proposed that mandatory set-aside requirements be imposed with respect to collateral received by swap dealers on all OTC derivatives.[2] Regardless of whether these issues are resolved by legislation or regulation, MFA continues to support achieving a workable industry solution to these issues.

MFA appreciates the opportunity to provide its views on the IA White Paper. We would be pleased to discuss the issues raised in this letter and in the attached markup in greater detail. We are hopeful that we can reach agreement on the content of the IA White Paper so that we can jointly publish it as originally proposed. If you have any comments or questions, please do not hesitate to contact Carl Kennedy or the undersigned at (202) 367-1140.

Respectfully submitted,

\s\ Stuart J. Kaswell

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

[2] *See* Letter from U.S. Commodity Futures Trading Commission Chairman Gary Gensler dated August 17, 2009 to the Honorable Tom Harkin (Chairman, Committee of Agriculture Nutrition and Forestry, U.S. Senate) and The Honorable Saxby Chambliss (Ranking Member, Committee of Agriculture Nutrition and Forestry, U.S. Senate).