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

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

David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Notice of Proposed Rulemaking on Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations (RIN 3038–AD88)

Dear Sir or Madam:

Managed Funds Association ("**MFA**")[1] welcomes the opportunity to provide comments to the Commodity Futures Trading Commission (the "**Commission**") on its notice of proposed rulemaking on "Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations" (the "**Proposed Rules**").[2] We strongly support the Commission's efforts to ensure adequate protection of customers and their funds by amending and augmenting the requirements for futures commission merchants ("**FCMs**") and derivatives clearing organizations ("**DCOs**"), and enhancing the oversight of FCMs by their designated self-regulatory organizations ("**DSROs**"). MFA was very troubled by the MF Global, Inc. ("**MF Global**") and Peregrine Financial Group, Inc. ("**Peregrine**") events,[3] and thus, we applaud the Commission for recognizing the potential weaknesses in the current customer protection regime[4] and proposing thoughtful measures to increase the protection and confidence of customers. Because our members are customers to FCMs, the MF Global and Peregrine events resulted in our members experiencing a delay in the return of their segregated customer assets or incurring material losses of their funds. In addition,

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[1] Managed Funds Association 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, North and South America, and all other regions where MFA members are market participants.

[2] 77 Fed. Reg. 67866 (November 14, 2012), available at http://www.gpo.gov/fdsys/pkg/FR-2012-11-14/pdf/2012-26435.pdf ("**Proposed Rule Release**").

[3] *See id*. at 67868-69, for a summarizing the MF Global and Peregrine insolvency proceedings.

[4] *See id*.

our members are fiduciaries to the investors whose money they manage and we seek to strengthen the protection for those assets. We recognize that there is no perfect solution to these issues and that similar events could happen in the future, but the Proposed Rules commendably address many[5] core customer concerns.

I. Executive Summary

MFA has consistently supported the Commission's efforts to encourage the derivatives market to adopt greater central clearing of over-the-counter ("**OTC**") derivatives,[6] but customer clearing necessitates greater customer interaction with and reliance on FCMs and DCOs. As customers of FCMs and DCOs, we appreciate that the Commission and the Proposed Rules focus on facilitating customers' transition into the clearing market by appropriately increasing regulation of FCMs and DCOs. As a result, in this letter, MFA seeks to assist the Commission in furthering its customer protection goals by providing input on the Proposed Rules from a customer perspective. In particular, we encourage the Commission to:

- require each FCM to make publicly available each month its Segregation Schedule,[7] Secured Amount Schedule,[8] Cleared Swaps Segregation Schedule,[9] summary balance sheet and income statement information for the most recent twelve months, to the extent the FCM's DSRO or the National Futures Association ("**NFA**") does not otherwise make this information public available;

- confirm that the FCM capital charge for undermargined accounts in §§1.17(c)(5)(viii) and (ix) and the FCM residual interest requirement in §1.20(i)(4) offset, such that the two obligations would not be duplicative;

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5 *See* Section III below, where we discuss that one core customer concern that remains is a viable full physical segregation option for collateral posted by a customer for its cleared swap positions ("**Cleared Swaps Customer Collateral**")

6 *See e.g.*, MFA letter to the Commission on "MFA Comments on CFTC Regulatory Initiatives Under the Dodd-Frank Act", dated September 22, 2010, available at 8-9, available at: https://www.managedfunds.org/wp-content/uploads/2010/09/MFA-CFTC-Letter.9.22.10.pdf; MFA letter to the Commissioners on MFA's proposed timeline for adoption and implementation of key Title VII reforms, dated March 24, 2011, available at: http://www.managedfunds.org/wp-content/uploads/2011/06/3.24.11-MFA-Letter-to-Chairman-Schapiro-3-24-11-1.pdf; and MFA letter to the Commission on its notice of proposed rulemaking on "Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA", dated November 4, 2011, available at: https://www.managedfunds.org/wp-content/uploads/2011/11/CFTC-Implementation-Rules-on-Clearing-Execution-Documentation-and-Margining-Final-MFA-Letter.pdf.

7 *See* Proposed Rule Release at 67871, which defines the Segregation Schedule as "statement of segregation requirements and funds in segregation for customers trading on U.S. commodity exchanges".

8 *See id*., which defines the Secured Amount Schedule as "a statement of secured amounts and funds held in separate accounts for foreign futures and foreign options customers".

9 *See id*. at 67872, where the Commission explains that the Cleared Swaps Segregation Schedule includes the necessary information related to funds an FCM holds in cleared swap customer accounts under Section 4d(f) of the Commodity Exchange Act.

- not amend §§1.17(c)(5)(viii) and (ix) to reduce the time period by when an FCM must incur a capital charge for undermargined accounts, but rather retain the existing respective two business and three business day requirements;

- modify the FCM residual interest requirement in §1.20(i)(4) so that it is not a continuous obligation, but instead a "point of time" obligation that requires FCMs to ensure they maintain sufficient residual interest as of the close of business Eastern Time on the business day after the FCM issues a customer's margin call, given that FCM's compliance with the "Net Liquidating Equity Method"[10] ensures that FCMs hold sufficient funds at all times to cover any customer shortfalls;

- reevaluate annually the Proposed Rules' efficacy and the need for additional enhancements to the customer protection regime;

- continue to evaluate the viability of a full physical segregation option for Cleared Swaps Customer Collateral; and

- ensure that the Proposed Rules facilitate portfolio margining and are consistent with existing Commission guidance in that area.

II. Commission Regulations Part 1

A. Support for Part 1 Proposals

MFA applauds the Commission for the robustness of the Proposed Rules related to Part 1 of the Commission Regulations. We support the Commission's proposals that would require FCMs to provide enhanced reporting and disclosure of certain information to the Commission, DSROs, customers and the public. As the Commission knows, increasing the transparency of the Commission and DSROs into the operations, accounts, policies and procedures of FCMs is crucial from an oversight perspective, in particular, as it relates to FCMs' holding and investment of customer funds. Thus, we support the Commission's proposed amendments to §1.32, which would mandate that FCMs to provide the Commission and their DSRO with: (1) daily reporting of the segregation and Part 30 secured amount computations,[11] and (2) semi-monthly reporting of the location of customer funds and how such funds are invested under §1.25.[12]

In addition, MFA appreciates that §1.55 of the Proposed Rules would require FCMs to make greater disclosure to customers and the public than is currently mandated.[13] In particular,

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[10] *See id*. at 67867, describing the "Net Liquidating Equity Method" as the requirement that an FCM hold sufficient funds to meet the total account equities of all of its futures and cleared swaps customers at all times.

[11] *See id*. at 67946, §1.32(d). We also appreciate that the NFA already receives this information from all FCMs on a daily basis.

[12] *See id.* at 67946-47, §1.32(f).

[13] *See id.* at 67951-54, §1.55, where the Commission is proposing enhancements to the FCM Risk Disclosure Statement as well as new provisions to mandate the Firm Specific Disclosure Document.

we support the expansive nature of the proposed Firm Specific Disclosure Document and the requirement that FCMs promptly update it "as and when necessary" taking into account any material change to their business operation and financial condition.[14] We also support mandating that FCMs post their margin segregation calculation on their websites on a daily basis.[15] FCM disclosure of this information would place customers in a better position to assess an FCM's stability, and if customers identify concerns and deem it appropriate, to transfer their positions and funds to a different FCM. Customers also would be in a better position to assist the Commission and DSROs with supervision of FCMs, for example, by alerting the Commission or DSRO to its concerns with the FCM or the FCM's decisions. Therefore, MFA believes that, in the aggregate, the proposed enhanced disclosure in §1.55 will give customers comprehensive information about FCMs' risks, and allow them "to make more meaningful judgments regarding the appropriateness of selecting an FCM".[16]

MFA also believes that by incorporating requirements intended to improve oversight of FCMs the Proposed Rules will bolster FCMs' compliance with Commission regulatory and DSRO obligations. In the Proposed Rule Release, the Commission acknowledges that, "questions have arisen on the system of audits and examinations of FCMs, and whether the system functions adequately to monitor FCMs' activities, verify segregated fund and secured amount balances, and detect fraud".[17] Therefore, we appreciate proposed §1.52, which sets forth certain requirements related to each DSRO's supervisory program and minimum risk management requirements that DSROs must impose on the FCMs under their supervision.[18] Specifically, we believe that §1.52(iv), which requires DSROs to conduct routine periodic on-site examinations of FCM-member registrants at least once every eighteen months,[19] will ensure more vigilant FCM oversight. We also support that the Commission "conducts limited scope reviews of FCMs in a 'for cause' situation".[20]

B. Recommended Additional Information for Public Disclosure

As mentioned above, MFA appreciates that the Proposed Rules represent a marked increase in FCM disclosure to customers and the public. We also believe that public disclosure of certain FCM information (in addition to what the Commission has proposed in the Proposed Rules) will be beneficial to the market. Thus, we recommend that the Commission mandate that each FCM make publicly available each month its Segregation Schedule, Secured Amount Schedule, Cleared Swaps Segregation Schedule, summary balance sheet and income statement

14 *See id*. at 67952, §1.55(i).

15 *See id*. at 67953-54, §1.55(o).

16 *Id*. at 67893.

17 *Id*. at 67869.

18 *See id*. at 67847-51.

19 *See id*. at 67948.

20 *Id*. at 67868.

information for the most recent twelve months, to the extent the FCM's DSRO or the NFA does not otherwise make this information public available.[21]

MFA believes that imposing such a public disclosure obligation on a monthly basis is important because an FCM's financial stability may change significantly in a short amount of time. Therefore, we believe less frequent disclosure to the public, especially as it relates to segregation and secured amounts, is insufficient from a customer protection perspective. Moreover, since FCMs will be providing this information to the Commission and their DSROs on a monthly basis,[22] such frequency is consistent with FCM's existing obligations. In addition, we recommend that FCMs provide the information for the most recent twelve months because, as the Commission knows, that is a standard "look-back" period for financial reports and is useful for purposes of revealing trends in an FCM's performance as well as an FCM's compliance with applicable regulatory requirements (*e.g.*, accounting, policies and procedures).

MFA believes that this information will be of great value to customers and the public in assessing the safety of funds entrusted to the FCM and the ongoing stability of that FCM. For example, disclosure of an FCM's Cleared Swaps Segregation Schedule would reveal, "whether the firm holds excess segregated or secured funds in the segregated or secured accounts as of the reporting date".[23] If an FCM does not hold such excess funds, that could be indicative of capital issues at the FCM or that the FCM is operating with a narrow buffer to protect against unexpected shifts in the market.

MFA does not believe that imposing this public disclosure obligation will create any additional burdens or costs for FCMs. Under the Proposed Rules, the Commission would make the Cleared Swaps Segregation Schedule available to the public but only upon a person's request from the Commission.[24] Thus, our recommendation is that the Commission compel FCMs to make this document publicly available routinely and not place the onus on the public to request it in order to have access. In addition, the other statements and schedules that we are recommending for public disclosure are documents that the current Commission Regulations require, or the Proposed Rules would require, FCMs to provide automatically to the Commission or their DSRO.[25] Therefore, since creation and disclosure of this information would not be a

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21 MFA recognizes that certain DSROs, such as the NFA, have made or will make publicly available much of the requested FCM information whether the Commission compels such public disclosure (*see e.g.*, the National Futures Association's website, which includes links to specific FCM financial reports, available at: http://www.nfa.futures.org/NFA-investor-information/fcm-financial-information.HTML). Therefore, we believe that the Commission should only impose this obligation on FCMs if their DSRO or the NFA has not otherwise made this information publicly available.

22 *See* Commission Regulations, 17 C.F.R. §1.10(b)(1), which requires each FCM to file a Form 1-FR-FCM as of the close of business each month with the Commission and its DSRO. An FCM uses Form 1-FR-FCM to report its unaudited financial information, which includes an income statement as well as, among other things, the Segregation Schedule and Secured Amount Schedule.

23 Proposed Rule Release at 67872.

24 *See id*. at 67932-33, Proposed §1.10(g)(2)

25 *Supra* note 22.

new FCM requirement, but rather expansion of existing or proposed requirements, and there are significant benefits associated with disclosure, MFA believes that cost-benefit analysis would support our recommendations.

C. §1.17(c)(5) FCM Capital Charge and §1.20(i)(4) FCM Residual Interest

From a policy perspective, MFA agrees with the Commission that the "timely collection of margin is a critical component of an FCM's risk management program"[26] and that it is important to require FCMs to hold sufficient funds to protect against insufficient margin in customer accounts.[27] However, from a practical perspective, we are concerned that, whether individually or in the aggregate, the proposed amendments to the FCM capital charge in §§1.17(c)(5)(viii) and (ix) and the proposed FCM residual interest requirement in §1.20(i)(4) will result in greater costs to customers than the corresponding benefits provided. For purposes of an FCM's net adjusted capital requirement, §§1.17(c)(5)(viii) and (ix) of the Proposed Rules would reduce to no more than one business day the period by when an FCM incurs a capital charge on customer, noncustomer and omnibus commodity futures and commodity option accounts that are undermargined.[28] In addition, §1.20(i)(4) of the Proposed Rules would require an FCM to maintain residual interest "in segregated fund sufficient to exceed the sum of all margin deficits that the futures customers of the futures commission merchant have in their accounts".[29]

1. Confirming Requirements are Not Duplicative

MFA appreciates that the FCM capital charge in §§1.17(c)(5)(viii) and (ix) and the proposed FCM residual interest requirement in §1.20(i)(4) are intertwined and that the Commission believes that these two requirements offset each other completely because obligating FCMs promptly to collect customer margin will correspondingly reduce FCMs' residual interest amount.[30] If, in concert, these requirements offset each other the way the Commission envisions, we believe that coupling these requirements would create an appropriate FCM capital buffer that would help ensure FCM's stability and insulate customers from fellow customer risk.[31] However, we are concerned that, if these requirements do not offset completely, they will create duplicative FCM obligations and will greatly increase costs for FCMs, which costs will ultimately be borne by FCMs' customers. For example, to avoid incurring the capital

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26 Proposed Rule Release at 67881.

27 *See id*. at 67882, where the Commission explains its rationale behind the FCM residual interest requirements in Proposed §1.20(i)(4).

28 *See id*. at 67938, Proposed §1.17(g)(5)(viii) and (ix). See also 67881, where the Commission explains that under current Commission Regulations, FCMs incur the capital charge for customer accounts undermargined for three business days, or for noncustomer and omnibus accounts undermargined for two business days.

29 *Id*. at 67941.

30 *See id*. at 67912, where the Commission provides its benefit analysis of Proposed §1.17(g)(5)(viii).

31 "Fellow customer risk" is the risk that a derivatives clearing organization uses assets of a swap dealer's ("**SD**") non-defaulting customers to satisfy losses of that SD's defaulting customer in the event that those losses exceed the margin assets of the defaulting customer and the SD. *See* Section III below where we discuss full physical segregation of customer collateral as a mechanism to protect against fellow customer risk.

charge, an FCM may immediately declare a customer's account to be in default if there is any delay in the customer's margin payment.[32]

In the Proposed Rule Release, the Commission states that, with respect to the capital charge, it "does not have adequate information to estimate the amount of additional capital that FCMs would likely be required to hold, or the cost of that capital, and therefore is not able to quantify this cost".[33] The Commission also acknowledges that it does not have statistics as to the residual interest amount that FCMs typically hold, and thus, does not know the costs of §1.20(i)(4).[34] The Commission's lack of data for purposes of its cost-benefit analysis creates uncertainty as to whether, in the aggregate, the benefits of these provisions actually outweigh the costs. Therefore, to protect customers from incurring excessive costs or FCM due to these FCM obligations, MFA requests that the Commission confirm that the FCM capital charge for undermargined accounts in §§1.17(c)(5)(viii) and (ix) and the FCM residual interest requirement in §1.20(i)(4) completely offset, such that the two obligations would not be duplicative.

2. Not Amending When FCMs Incur the §1.17(c)(5) Capital Charge

In the Proposed Rule Release, the Commission explains that it proposes to amend §§1.17(c)(5)(viii) and (ix) to require FCMs to incur capital charges for accounts undermargined for more than one business day to encourage the timely collection of margin and to reflect that the use of technology has shortened the timeframe for customers' compliance with margin calls.[35] MFA expects that in the ordinary course of business, few margin calls will remain outstanding for two or three business days, and thus, it seems reasonable to discourage FCMs delayed collection of margin by imposing such a capital charge. However, the proposed modifications to these provisions do not account for the various legitimate and practical reasons why an FCM may have a customer, noncustomer or omnibus account that is undermargined for more than one business day, and thus, why the existing two and three business day timeframes are more appropriate.

For example, disputes may arise between an FCM and its customer as to the appropriate amount of margin that the customer owes, and in such cases, the FCM or its customer will need sufficient time to exercise any dispute rights to which they are entitled. Similarly, DCOs and FCMs may make good faith errors in their margin calculations and the related margin calls, and identification and correction of the error and the margin call by the DCOs and FCMs may result in the customer failing to pay its margin requirement within one business day. As discussed herein, the impact of an FCM incurring a capital charge because of an undermargined account will ultimately be borne by its customers. Moreover, if the residual interest requirement and capital charge offset, an FCM's compliance with the residual interest requirement should ensure that the FCM will have sufficient assets to meet the customer's margin obligation, and thus,

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[32] *See* Section II.C.3 below for additional costs arising from the proposed residual interest obligation in §1.20(i)(4).

[33] Proposed Rule Release at 67913.

[34] *See id*. at 67916.

[35] *See id*. at 67881.

prevent the capital charge from applying. As a result, we believe that one business day is too short a timeframe, but that the existing two and three business day requirements are sufficient to ensure the financial integrity of the FCM. Therefore, MFA recommends that the Commission not amend §§1.17(c)(5)(viii) and (ix) to reduce the time period by when an FCM must incur a capital charge for undermargined accounts to one business day, but rather retain the existing two and three business day requirements in current §§1.17(c)(5)(viii) and (ix), respectively.

3. "Point in Time" FCM Residual Interest Requirement in §1.20(i)(4)

As proposed, the residual interest requirement in §1.20(i)(4) requires FCMs not only to comply only with the Net Liquidating Equity Method[36] but also to maintain a sum that exceeds all customer "margin deficits".[37] In addition, proposed §1.20(i)(4) would be a continuous FCM obligation in that the Commission would require FCMs to maintain a sufficient amount of funds "at all times".[38] In the Proposed Rule Release, the Commission requests comment on the questions, "[f]or purposes of margin deficit calculations, should the Commission address issues surrounding the timing of when an FCM must have sufficient funds in the futures customer account to cover all margin deficits? If so, how should the Commission address such issues?"[39]

From MFA's perspective, applying the residual interest requirement continuously to FCMs and not allowing sufficient time for FCMs to collect margin from their customers could significantly increase the operational burdens and costs on FCMs and their customers. In particular, the increased costs to customers could arise from FCM's seeking to ensure compliance with the residual interest obligation by requiring their customers to pre-fund their margin obligations or to meet intraday margin calls. We view both of these outcomes as troubling; however, we believe that any pre-funding obligation is an unacceptable imposition on customers. It would create margin inefficiencies by causing customers to reserve assets to pre-fund their obligations or in anticipation of intraday margin calls, and thus, reduce the amount of assets that customers have to use for investment or other purposes.

MFA is not recommending that the Commission eliminate the residual interest requirement; rather we think that the Commission can avoid these potential negative implications for customers by adjusting the timing of the obligation. Specifically, to reduce the stress on the market of such a continuous requirement, we urge the Commission to modify proposed §1.20(i)(4) so that it is not a continuous real-time obligation, but rather a "point in time" obligation. We believe the appropriate "point in time" is close of business Eastern Time on the business day after the FCM issues a customer's margin call. Incorporating these modifications would result in an FCM having to maintain residual interest for a customer's margin deficits only if that customer failed to post the applicable margin within the one business day period. This

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[36] *Supra* note 10.

[37] Proposed Rule Release at 67882, where the Commission explains that it is proposing to implement the Net Liquidating Equity Method while also proposing to require an FCM to maintain residual interest.

[38] *Id*. at 67941.

[39] *Id*. at 67882-3.

approach would eliminate the need for customer pre-funding or intraday margin calls, while also ensuring that, given FCMs' compliance with the Net Liquidating Equity Method, FCMs will hold sufficient funds to protect against customer shortfalls.

D. Annual Reevaluation of Final Rules

MFA strongly supports the Proposed Rules as an important component to improving the protection and confidence of customers and the proper functioning of the market. However, we cannot be certain that the Proposed Rules will sufficiently protect customers until the Commission finalizes them, the Commission, DSROs and FCMs implement them, and the Commission has had a period to evaluate them. Because the Proposed Rules are the Commission's primary initiative to address FCM disclosure, examination and compliance concerns, we strongly recommend that the Commission reevaluate the final rules annually to determine whether further regulatory enhancements are necessary.

III. Commission Regulations Part 22 – Full Physical Segregation Option for Cleared Swaps Customer Collateral

With respect to the Commission's Part 22 Regulations, MFA appreciates that in adopting final rules on segregation for Cleared Swaps Customer Collateral[40] that the Commission selected legal segregation with operation commingling ("**LSOC**") as the baseline segregation model but continued to actively consider "seeking notice and comment on a proposal to allow individual protection of client assets."[41] We strongly urge the Commission to continue to consider the viability of adopting a full physical segregation option for Cleared Swaps Customer Collateral. As a general matter, we believe that full physical segregation would provide greater protection for customers by insulating their Cleared Swaps Customer Collateral from fellow customer risk and by facilitating the prompt porting of customers' cleared swap positions and collateral in the event of an SD's default (due to either the default of another customer or the SD's independent default). In addition, full physical segregation would establish protections for Cleared Swaps Customer Collateral that are equal to those that the Commission will make available to customers with regard to the collateral they post for uncleared swaps.[42] Many of our largest members have negotiated full physical segregation arrangements in the OTC derivatives market for protection of their collateral, and MFA believes these protections should be available in the cleared swap market for all customers.

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[40] *See* Commission final rule on "Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions", 77 Fed. Reg. 6336, (February 7, 2012), ("**Final LSOC Rule Release**"), available at: http://www.gpo.gov/fdsys/pkg/FR-2012-02-07/pdf/2012-1033.pdf.

[41] *Id*. at 6349.

[42] *See* Commission notice of proposed rulemaking on "Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy", 75 Fed. Reg. 75432, (December 3, 2010), available at: http://www.gpo.gov/fdsys/pkg/FR-2010-12-03/pdf/2010-29831.pdf, which provide for individual segregation with a third-party custodian for customer collateral posted on uncleared swaps.

We recognize that any full physical segregation model would need to be operationally practical, subject to industry support and address issues related to *pro rata* distribution under the Bankruptcy Code.[43] MFA is currently collaborating with other market participants to examine these concerns with the ultimate goal of developing a full physical segregation option that is viable from a legal, operational and cost perspective. We will keep the Commission informed as to the progress of these efforts and would appreciate working with the Commission to explore this matter further as we develop our analysis and proposed solution.

IV. Commission Regulations Part 30 – Permitting Liens Granted by Customers

MFA strongly supports the Commission's efforts to ensure consistent FCM regulation and customer protections across Commission-regulated products. As a result, we support the Proposed Rules related to Part 30 of the Commission Regulations that harmonize the requirements for foreign futures and options with the corresponding provisions for futures and cleared swaps. To further such uniformity, we would appreciate it if the Commission could clarify that its guidance related to customers' authority to grant liens or security interests on its cleared swaps customer account under Part 22 similarly applies to customers on their foreign futures or foreign options secured amount[44] as set forth in the Part 30 proposals in the Proposed Rules. Such clarification would further our efforts to obtain the benefits of portfolio margining.

Specifically, in §30.7(f)(2) related to foreign futures and foreign options, the Commission proposes to prohibit an FCM from imposing or permitting the imposition of "a lien on any funds set aside as the foreign futures or foreign options secured amount, including any residual financial interest of the futures commission merchant in such funds".[45] We note that proposed §30.7(f)(2) for the foreign futures or foreign options secured amount parallels the prohibition that the Commission finalized for cleared swaps customer accounts in §22.2(d)(2).[46] However, with respect to the prohibition on FCM's imposition of liens on cleared swaps customer accounts, the Commission also clarified in the Final LSOC Rule Release that:

> an FCM may not, under any circumstances, grant a lien to any person (other than to a DCO) on its Cleared Swaps Customer Account, or on the FCM's residual interest in its Cleared Swaps Customer Account. On the other hand, a Cleared

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43 Final LSOC Rule Release at 6339, describing the Bankruptcy Code issues for full physical segregation.

44 *See* § 1.3(rr) of the Commission Regulations, which defines "foreign futures or foreign options secured amount" as "all money, securities and property held by or held for or on behalf of a futures commission merchant from, for, or on behalf of foreign futures or foreign options customers as defined in § 30.1 of this chapter:

(1) In the case of foreign futures customers, money, securities and property required by a futures commission merchant to margin, guarantee, or secure open foreign futures contracts plus or minus any unrealized gain or loss on such contracts; and

(2) In the case of foreign options customers in connection with open foreign options transactions money, securities and property representing premiums paid or received, plus any other funds required to guarantee or secure open transactions plus or minus any unrealized gain or loss on such transactions."

45 Proposed Rule Release at 67958.

46 *See* Final LSOC Rule Release at 6373.

> Swaps Customer may grant a lien on the Cleared Swaps Customer's individual cleared swaps account (an 'FCM customer account') that is held and maintained at the Cleared Swaps Customer's FCM.[47]

In addition, to provide greater clarity around the extent to which such liens are permissible under the Commission's Part 22 regulations, Commission Staff issued an interpretive letter that stated:

> Regulation 22.2(d) does not prohibit a Cleared Swaps Customer from granting security interests in, rights of setoff against, or other rights in its own Cleared Swaps Customer Collateral, regardless of whether those assets are held in the Cleared Swaps Customer's FCM customer account. Furthermore, nothing in the rule is intended to inhibit this right of the Cleared Swaps Customer.[48]

In light of the Commission goal of providing the same protections for foreign futures and options customers under proposed §30.7(f)(2) that apply to cleared swaps customers under §22.2(d)(2), we ask the Commission to confirm that the foregoing guidance related to cleared swaps customer accounts also applies to the foreign futures or foreign options secured amount.

MFA believes that it is not the Commission's intent to prohibit customers from granting liens or security interests on the foreign futures or foreign options secured amount. However, a plain reading of proposed §30.7(f)(2) indicates that an FCM has a duty to ensure that no liens are placed on the foreign futures or foreign options secured amount, which would prohibit not only the imposition of liens by FCMs, but also the imposition of liens granted or requested by the FCM's customer. Thus, MFA is concerned that without the requested clarification netting of collateral posted on customers' foreign futures or options positions may be extremely difficult, thus restricting customers' portfolio margining arrangements.

MFA is supportive of the benefits of portfolio margining, and we have submitted various letters to the Commission and other regulators in support of portfolio margining generally as well as in response to industry petitions seeking orders to permit portfolio margining.[49] In those

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[47] *Id*. at 6352.

[48] Commission Staff Letter No. 12-28 (Oct. 17, 2012) at 2, available at: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-28.pdf.

[49] *See* MFA letter to the Commission on ICE Clear Credit LLC's petition dated October 4, 2011 for an order permitting portfolio margining of swaps and security-based swaps, filed with the Commission on December 21, 2011, available at: https://www.managedfunds.org/wp-content/uploads/2011/12/CFTC-Comment-Letter-in-Support-of-ICE-Portfolio-Margining-Petition-Final-MFA-Letter.pdf; MFA letter to the Commission on ICE Clear Europe Limited's petition dated March 8, 2012for an order permitting portfolio margining of cleared swaps and foreign futures contracts, filed with the Commission on April 19, 2012, available at: https://www.managedfunds.org/wp-content/uploads/2012/04/MFA_Comment-Letter-to-CFTC-in-Support-of-ICE-Clear-Europe-Portfolio-Margining-Petition.pdf ("**MFA ICE March Petition Letter**"); MFA letter to the Securities and Exchange Commission on ICE Credit's petition for an order permitting portfolio margining of single-name credit default swaps and broad-based indices, filed with the Commission on June 13, 2012, available at https://www.managedfunds.org/wp-content/uploads/2012/06/SEC-Comment-Letter-in-Support-of-ICE-Portfolio-Margining-Petition-Final-MFA-Letter.pdf: MFA letter to the prudential regulators on the reopening of the comment period on its notice of proposed rulemaking on "Margin and Capital Requirements for Covered Swap Entities" Oct. 2, 2012, filed with the prudential

letters, we explained that the ability "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."[50]

As is the case for cleared swaps customer accounts, a customer's authority to grant a lien or security interest on its foreign futures or foreign options secured amount is important for cross-product, and many multilateral, netting agreements. The customer's FCM or its affiliates rely on such a lien to have recourse to the customer's assets should the customer default. Therefore, a customer's inability to net across its products, in turn, would increase its trading costs, as the FCM would require the customer to fund separate margin obligations on its various positions. To create margin efficiencies and harmonize the Proposed Rules with Commission final rules for cleared swaps, we would appreciate the Commission explicitly confirming in the final rule release that its guidance on cleared swaps customer accounts applies in this context, so that customers are permitted to grant liens or security interest on their foreign futures or options secured amount.

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We thank the Commission for the opportunity to provide comments on the Proposed Rules. We would welcome the opportunity to discuss our views in greater detail. Please do not hesitate to contact the undersigned or Carlotta King 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. Bart Chilton, Commissioner
The Hon. Jill E. Sommers, Commissioner
The Hon. Scott D. O'Malia, Commissioner
The Hon. Mark P. Wetjen, Commissioner

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regulators on November 26, 2012, available at: https://www.managedfunds.org/wp-content/uploads/2012/11/MFA-Portfolio-Margining-Letter-MFA-Final-Letter.pdf; and MFA letter to the Commission on ICE Clear Europe Limited's petition dated May 31, 2012 for an order permitting commingling of customer funds and portfolio margining for swaps and security-based swaps, filed with the Commission on December 14, 2012, available at: https://www.managedfunds.org/wp-content/uploads/2012/12/CFTC-Comment-Letter-in-Support-of-ICE-Clear-Europe-Petition-Final-MFA-Letter.pdf.

[50] MFA ICE March Petition Letter at 2.