

MEMO# 24882

January 18, 2011

ICI Letter to CFTC Regarding Protection of Customer Collateral for Cleared Swaps

[24882]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 5-11
ETF ADVISORY COMMITTEE No. 4-11
EQUITY MARKETS ADVISORY COMMITTEE No. 4-11
FIXED-INCOME ADVISORY COMMITTEE No. 6-11
SEC RULES MEMBERS No. 10-11
SMALL FUNDS MEMBERS No. 6-11 RE: ICI LETTER TO CFTC REGARDING PROTECTION OF CUSTOMER COLLATERAL FOR CLEARED SWAPS

As we previously informed you, the Commodity Futures Trading Commission (“Commission”) has issued an advance notice of proposed rulemaking on the treatment of collateral of cleared swaps customers. [\[1\]](#) Specifically, the Commission has requested comments on the costs and benefits of four models for protecting margin collateral posted by customers clearing swap transactions. The Institute has filed a comment letter with the Commission which is attached and briefly summarized below.

The letter states that the “full physical segregation” and “moving customers to the back of the waterfall” models warrant the most consideration by the Commission. [\[2\]](#) The letter states that the “full physical segregation” model would provide the greatest protection for customers; however, it raises some questions regarding customer costs and other potential issues inherent in the model. Given these concerns, the letter states that, at this time, the “moving customers to the back of the waterfall” model could be an acceptable approach to balance customer protection with costs to customers. The letter ultimately recommends that the Commission and its staff undertake a comprehensive study of the costs and other potential issues of all four models with input from all industry participants.

Specifically, the letter notes that ICI members are familiar and generally comfortable with the existing baseline model for U.S. futures trading and would favor enhancements to this model as an interim step. It states that adjusting the existing baseline model for U.S. futures trading by moving customers to the back of the waterfall would provide customers additional protection without dramatically altering current practices or customer costs in the exchange-traded futures industry. In addition, the letter notes that pursuing very

different regulatory regimes for protecting margin collateral posted by customers for cleared swaps and futures contracts may result in divergent pricing for instruments that are otherwise economically similar and may result in customers favoring one instrument at the expense of the other, as well as introduce other complexities.

The letter briefly comments on the issue of whether individual customer protection should be made available on an optional rather than a mandatory basis. It opposes the concept of “optionality” because of the host of legal, regulatory and operational issues that would arise if different models for customer protection were in effect at the same time. The letter notes, however, that if the Commission determines to further consider an optional approach to customer protection, the cost imposed by a customer obtaining such individual protection should be charged to that customer.

Heather L. Traeger
Associate Counsel

[Attachment](#)

endnotes

[1] See Commodity Futures Trading Commission Advanced Notice of Proposed Rulemaking: Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies, RIN 3038-AD99, 75 FR 75162 (December 2, 2010) available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-29836a.pdf>.

[2] The four models proposed by the Commission to protect customer collateral include: (1) individual segregation of each customer’s collateral at the futures commission merchant (“FCM”), derivatives clearing organization (“DCO”), and custodian levels (“full physical segregation” model); (2) commingling of collateral of multiple customers, but the value of each customer’s collateral is treated on an individual basis; (3) use of collateral of non-defaulting customers in the default of a FCM only after the DCO’s default resources package is used (“moving customers to the back of the waterfall” model); and (4) commingling of collateral of a FCM’s customers on an omnibus basis, as in the current futures model.