

MEMO# 24847

January 10, 2011

Draft Letter on CFTC Request for Comment On Protection of Customer Collateral for Cleared Swaps; Comments Due Jan. 13

[24847]

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 1-11
ETF ADVISORY COMMITTEE No. 2-11
EQUITY MARKETS ADVISORY COMMITTEE No. 2-11
FIXED-INCOME ADVISORY COMMITTEE No. 1-11
SEC RULES COMMITTEE No. 2-11
SMALL FUNDS COMMITTEE No. 2-11 RE: DRAFT LETTER ON CFTC REQUEST FOR COMMENT
ON PROTECTION OF CUSTOMER COLLATERAL FOR CLEARED SWAPS; COMMENTS DUE JAN.
13

As we previously informed you, the Commodity Futures Trading Commission has issued an advance notice of proposed rulemaking ("ANPR") on the treatment of collateral of cleared swaps customers. [1] Specifically, the CFTC has requested comments on the costs and benefits of four models for protecting swaps customer collateral. The Institute has prepared a draft comment letter which is attached and briefly summarized below.

Comments on the proposal are due to the CFTC on Tuesday, January 18. If you have comments on the attached draft letter, please provide them to Heather Traeger via e-mail at htraeger@ici.org or by phone at 202/326-5920 by Thursday, January 13 at noon.

The draft letter states that, of the possible models proposed by the CFTC, the "full physical segregation" and "moving customers to the back of the waterfall" are the two models for protecting margin collateral posted by customers clearing swap transactions that warrant further consideration by the CFTC. [2] The draft letter states that the "full physical segregation" model would provide the greatest protection for customers but for the many unanswered questions it raises associated with customer costs. The letter therefore concludes that, at this time, the "moving customers to the back of the waterfall" model

would be an acceptable approach to balance customer protection with costs to customers.

Specifically, the draft 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 draft 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.

Heather L. Traeger
Associate Counsel

[Attachment](#)

endnotes

[1] CFTC 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>. Comments on the ANPR are due to the CFTC on January 18, 2010.

[2] The four models proposed by the CFTC 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.

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