

Remarks of Charles P. Nastro,  
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My name is Charles Nastro. I am a Managing Director and Co-Head of Global Futures at Lehman Brothers Inc.

I have been employed in the futures industry for over 25 years. During that time, I have been privileged to serve on the boards of several exchanges as well as to serve as chairman of the Coffee, Sugar & Cocoa Exchange and as the first chairman of the Commodity Futures Clearing Corp of New York ("CFCCNY"). I currently serve as Chairman of the Board of Directors of the National Futures Association ("NFA").

To those who may not remember, CFCCNY was one of the industry's first attempts to develop a common clearing entity in the New York futures marketplace, with ownership residing with the then five New York futures exchanges. Governance was to reside on a board of directors whose composition would be comprised of a majority of clearing members. It sounds a lot like the OCC model that has had such great success in the securities markets.

It was far from a perfect solution but it would have been a major step forward for our industry and would have led to greater efficiency, improved risk management and lower costs, especially due to the significant number of clearing members who were clearing members of all or most of those New York markets. Unfortunately, like our Chicago common clearing initiative, it was defeated for much the same reasons that Mr. Damgard has mentioned in his remarks.

But the core principle that was the catalyst for us to attempt such a venture still exists and is even more important today, that is, the need for clearing members, who take the everyday risk of default and without whom there would be no market, to have a real voice and vote in how that risk is managed. Notwithstanding Exchange pronouncements about representation of its constituents in its governing bodies, some exchanges have little or no clearing member representation in the decision making process around the clearing issues that confront the marketplace each day. Serving on a clearing advisory committee and giving advice on how an exchange should manage our assets just does not do it for me or my colleagues in my Treasury Department.

We, as clearing members, need to be able to manage our risks directly and as efficiently as possible. Exchange control of the clearing process has been more an obstacle course than a fast track. Just take a look at a few stark examples that are focusing our attention today. The current unwillingness to accept the fungibility of single stock futures is illogical and should be unacceptable to the clearing members who pay the margin finance cost. No one would disagree that it is a clear example of inefficiency and poor risk management.

We have a similar situation in the Treasury Bond and Note complex. Both the CBOT and BTEX trade these same contracts and, as such, that trading cries out for

cross margin across clearing entities to reduce the cost of margin to the end users and to improve the members' risk management.

It is my premise that direct governance by clearing members who put up the funds to make these exchange marketplaces work and function will assure that the core principles enunciated for DCOs in the CFMA will work and work well.

- 1) We will have financial integrity without political burdens. No clearing house should exist without significant clearing member representation. Independent clearing entities with proper and fair representation afforded to all clearing members will better enable us to assess appropriate risk since it will directly impact the very people and firms that are involved in the decision making process.
- 2) More cooperation will occur between clearing entities where there are similar products and significant commonality of membership because that is in the best interest of those firms and their end users. While I believe in one clearing house for all US products, I also do not oppose competition among them. However, in today's world, there is essentially no competition as it is the exchange that designates where any contracts will clear.
- 3) Financial standards must also be commensurate with the intraday and overnight risks of the market, especially given the explosion of electronic trading 24 hours a day. In today's electronic world, there are little or no meaningful exchange and / or clearing house risk management filters for these electronic trading platforms for obvious and various marketing reasons. Is that right? Rightly or wrongly, that responsibility has resided with clearing member firms.

Clearing entities need to examine this phenomenon separately and away from exchange perceptions and determine what it means to the overall risk of the market we guarantee.

- 4) More efficient risk management will evolve. Today's clearing houses have made some progress such as net margining with the GSCC. But they have not gone far enough and often make decisions based on a perceived protectionism of their execution franchise.

For example, firms were initiating Eurodollar block trades on SGX and then transferring the positions via the Mutual Offset System ("MOS") to the CME. Because this may have been perceived to take business away from the CME floor, this clearing practice was disallowed.

Another example was where the CME Clearing House requested that clearing member firms allot a portion of its margin deposits to certain money market funds. Try to explain this to your Treasury Department that is seeking to manage its firm's overall risk with all credit counterparties.

Such actions are merely an indication that some clearing houses as constituted today do not primarily focus on what's best for the clearing members who fund the guarantees of the clearing houses and the end users whose margin deposits we protect.

- 5) Fair and proper governance with significant clearing member participation will assure that the core principles promulgated under the CFMA will be achieved and will avoid the temptation to use the clearing house as a "restraint of trade" in the competitive marketplace that the CFMA was intended to engender.

I would like to take this opportunity to thank the Commission for creating this Roundtable . These sessions are extremely important for all of us to understand the issues we face on a daily basis in our business.