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March 14, 2005

Ms. Jean A. Webb
Secretary
Commodity Futures Trading Commission
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**Re: Global Clearing Link —
Segregated Funds and Foreign Futures
Secured Amount Requirements**

Dear Ms. Webb:

We are writing on behalf of our client, The Clearing Corporation (“CCorp”), to request that the Commodity Futures Trading Commission (the “Commission”) amend the Order that it issued on October 21, 2004 in connection with Phase I of the Global Clearing Link (the “Link”) between CCorp and Eurex Clearing AG, Frankfurt (“Eurex Clearing”) to permit CCorp and futures commission merchants (“FCMs”) to establish and maintain combined original margin and variation settlement accounts for futures contracts and options on futures contracts in the circumstances described herein.¹

Requested Relief. Section 4d(a)(2) of the Commodity Exchange Act (the “Act”) authorizes the Commission to permit an FCM to commingle and deposit money, securities and property that is otherwise required to be segregated pursuant to Section 4d(a)(2) “with any other funds, money, securities or property received by such futures commission merchant *and required by the Commission to be separately accounted for and treated and dealt with as belonging to the customers of such futures commission merchant*” (emphasis added).

Consistent therewith, the Order issued by the Commission in connection with the Euro Link permits CCorp and FCMs (including, where applicable, CCorp participants) to hold in a

¹ CCorp acts as the derivatives clearing organization (“DCO”) for U.S. Futures Exchange LLC (“USFE”), a designated contract market. Phase I of the Global Clearing Link (the “Euro Link”), which has already been approved by the Commission, permits an FCM to clear certain foreign futures and foreign option contracts that are traded on Eurex Deutschland AG and Eurex Zürich AG (“Eurex”) through CCorp. Subject to Commission approval, Phase II of the Link would extend that concept by permitting contracts that are traded on USFE to be cleared at CCorp, either into the account of a CCorp clearing participant or into Eurex Clearing’s CCorp account.

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single combined account money, securities and other property (“customer funds”) used to margin, guarantee or secure Euro Link (*i.e.*, Eurex) transactions with customer funds that are used to margin, secure, or guarantee trades or positions in futures or commodity option contracts traded on a contract market or derivatives transaction execution facility. In essence, the Order allows CCorp and FCMs to hold in a segregated funds account – as opposed to separate segregated funds and foreign futures secured amount accounts – customer margin deposits and accruals for futures and option contracts that are traded either on a contract market or on Eurex, a foreign board of trade.

The Order that was issued by the Commission in connection with the Euro Link provides that funds used to margin, guarantee or secure Euro Link transactions may be held in a segregated account or accounts maintained in accordance with Section 4d of Act and Commission Regulation 1.20, provided that all such customer funds are accounted for and treated and dealt with as belonging to customers consistently with Section 4d of the Act and Commission Regulation 1.20.² We now request that the Commission amend the Order that it issued in connection with the Euro Link (or issue an additional Order) to make this relief available for Phase II on the same terms that were approved for the Euro Link. In its simplest terms, we are requesting nothing more than that the Commission revise the segregated funds and secured amount relief contained in the Euro Link Order to make it equally applicable to all Link transactions.

All U.S. customers who trade on USFE must have their contracts executed by, and their positions carried through, a registered FCM. Customer property that is deposited with an FCM must be segregated from the FCM’s own proprietary funds, as required by Section 4d of the Act and Commission Regulations. An FCM may deposit customer segregated funds with non-U.S. depositories, however, provided they meet the criteria specified in Commission Rule 1.49. Among other things, Rule 1.49 requires that any non-U.S. depository of customer segregated funds (i) be located in a money center country or in the country of origin of the currency that is being deposited, and (ii) be a bank or trust company that has in excess of \$1 billion in regulatory

² The Order provides in pertinent part as follows:

Subject to the following terms and conditions, and notwithstanding any provision to the contrary in the Commission’s regulations (including, but not limited to, Regulations 1.20(a), 1.22, 1.24 and 30.7), CCorp, its Participants, and other FCMs participating in the Euro Link may commingle money, securities and other property (collectively, “customer funds”) used to margin, secure, or guarantee Euro Link Transactions with other customer funds used to margin, secure, or guarantee trades or positions in commodity futures or commodity option contracts executed on a Contract Market designated pursuant to Section 5 of the Act or a Derivatives Transaction Execution Facility registered pursuant to Section 5a of the Act, in a segregated account or accounts maintained in accordance with Section 4d of the Act (including any orders issued pursuant to Section 4d(a)(2) of the Act) and Commission Regulation 1.20, and all such customer funds shall be accounted for and treated and dealt with as belonging to the customers of the participating FCM consistently with Section 4d of the Act and Commission Regulation 1.20. (footnote omitted)

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capital or whose commercial paper or long-term debt (or that of its holding company) receives one of the two highest ratings by a nationally recognized statistical rating organization.

Section 1.1.1(3) of the Eurex Clearing Conditions effectively authorizes the issuance of “clearing licenses” only to banking institutions that are domiciled in a country of the European Union or in Switzerland.³ An FCM executing transactions on USFE that wishes to carry customer positions in an omnibus basis with a member of Eurex Clearing via the Link therefore will need to take steps to ensure that its customer funds are properly protected by (i) depositing those segregated funds with a member of Eurex Clearing (or that clearing member’s bank) which qualifies as a permissible non-U.S. depository for customer segregated funds under Commission Rule 1.49 and (ii) obtaining an acknowledgment, as required by Commission Rules 1.20, 1.26 and 1.49, that the depository will maintain the funds in a segregated account.

As discussed above, the Euro Link Order permits CCorp, its clearing participants and other FCMs to commingle money, securities and other property (customer funds) used to margin, secure or guarantee transactions executed at Eurex and carried by CCorp participants with other customer funds used to margin, secure or guarantee trades on a contract market. The effect of the modification that we are requesting herein would be (i) to reconfirm that FCMs are permitted to combine their customer’s segregated and secured amount accounts with respect to customers trading on both USFE and Eurex, and (ii) clarify that this relief applies not only to CCorp, its clearing participants and other FCMs, but also to their respective depositories, including members of Eurex Clearing that are permitted by Commission Rule 1.49 to hold customer funds.⁴

The requested relief is well within the scope of the Commission’s discretionary authority. As discussed above, Section 4d(a)(2) of the Act authorizes the Commission to permit an FCM to commingle and deposit money, securities and property that is otherwise required to be segregated pursuant to Section 4d(a)(2) “with *any other funds, money, securities or property* received by such futures commission merchant and *required by the Commission* to be separately accounted for and treated and dealt with as belonging to the customers of such futures commission merchant” (emphasis added). Unlike the Commission’s Regulations, the Act makes no distinction between “customers” and “option customers” on the one hand and “foreign futures and foreign options customers” on the other. The Commission, therefore, is free to construe the provisions of Section 4d(a)(2) to permit the requested combination of accounts where, as here,

³ Switzerland is not a “money center country” for purposes of Rule 1.49. Unless the customer has deposited Swiss Francs or consented specifically to the deposit of its funds in Switzerland, any deposits of U.S. customer funds with a Swiss bank, therefore, will be required to be made with a branch of such a bank that is located in a money center country.

⁴ Eurex Clearing’s Clearing Conditions prohibit its clearing members from depositing customer funds as margin with Eurex Clearing. Thus, unlike CCorp and other U.S. clearing houses, Eurex Clearing requires that its clearing members margin their obligations to the clearing house with the member’s own funds. Eurex Clearing, therefore, will hold no U.S. customer segregated funds or secured amount deposits.

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all funds in such a combined account will be held in accordance with the strict standards that are made applicable to segregated funds accounts, rather than being held partly in segregation and partly under the less rigorous requirements applicable to the foreign futures secured amount.

The advantages of such an arrangement would be considerable. *First*, because all funds in a combined account would be subject to the Commission's segregation requirements, an FCM generally will be required to set aside in the combined segregated account an amount that is greater than would be required if the accounts were to be held separately.⁵ *Second*, allowing customers to hold their domestic and foreign futures and option positions in a single account permits the application of portfolio margining. This benefits customers by reducing the amount that is required when trading in related products. Of greater significance, portfolio margining reduces risk to DCOs, FCMs, and ultimately, the financial system, because highly correlated positions are a better proxy for risk than cash or other forms of margin deposits. *Third*, this approach permits a more efficient use of resources – instead of maintaining separate segregated and secured amount accounts depending on whether a trade was executed on USFE or Eurex, customers and their FCMs will be able to hold all of a customer's Link trades and positions in a single account, thereby making it unnecessary for customers and their clearing brokers to move funds and securities back and forth between segregated and secured amount accounts to satisfy margin requirements.⁶

Bankruptcy Considerations. As discussed more fully below, we believe that the issuance of an Order granting the requested relief would not materially and adversely affect the protections available to customers under applicable law in the unlikely event that an FCM should become insolvent.

The term “commodity broker” is defined by Section 101(6) of the Bankruptcy Code to include a futures commission merchant (as defined in the Act) with respect to which there is a “customer.” See Commission Regulation 190.01(f). The term “customer” is defined for this purpose in Section 761(9) of the Bankruptcy Code essentially to mean an entity for whom the FCM deals and that holds a claim against the FCM on account of a “commodity contract.” See Commission Regulation 190.01(k). With respect to an FCM, a commodity contract means a

⁵ An FCM must hold all “customer funds” in segregation. That latter term is defined by Commission Regulation 1.3(gg) effectively to mean as to any customer all margin *deposits*, plus or minus any trading gains or losses. The “foreign futures secured amount,” by comparison, is defined in Commission Regulation 1.3(rr) effectively to mean the sum of all foreign futures and foreign option customers' margin *requirements*, plus or minus any trading gains or losses. Thus, unlike segregated funds accounts, the secured amount does not include any difference between the amount of required margin and the amount actually deposited by a customer with an FCM.

⁶ Funds transfers are burdensome and expensive, particularly where they involve interbank (as opposed to intrabank) transfers of funds. They also introduce the risk of errors, such as incorrect bank or brokerage account numbers on wire transfer instructions, and of temporary systems failures that can result in customer accounts being undermargined – or worse, undersegregated or undersecured – even though funds were intended to be transferred from the companion segregated or secured amount account to cover that shortfall.

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“contract for the purchase or sale of a commodity for future delivery on, or subject to the rules of, a contract market or board of trade. . . .” 11 U.S.C. § 761(4) (emphasis added); *see* Commission Regulation 190.01(g). Eurex is a “board of trade” within the meaning of the Bankruptcy Code.⁷ Both Dollar-denominated and Euro-denominated contracts, therefore, are “commodity contracts” within the meaning of the Bankruptcy Code.

Commission Regulation 190.08(c) provides that “property held by or for the account of a customer, which is segregated on behalf of a particular account class ... must be allocated to the ... account class for which it is segregated.” The Interpretation issued by the Commission in connection with the Phase I Order accordingly treats all cash, securities and other property, and any proceeds thereof, received by an FCM to margin, guarantee or secure Euro Link trades as “customer property” allocable to the “futures account” class for purposes of Sections 761(10) and 766 of the Bankruptcy Code and Commission Regulation 190.08.⁸ The Interpretation, therefore, puts customers of an insolvent FCM who have traded through the Euro Link in the same position as they would be if they had traded the same contracts on USFE.

The reasoning expressed in the Commission’s Interpretation is equally applicable here. We therefore believe that funds deposited in connection with any type of Link transaction (and not merely Euro Link transactions) that have been held in a segregated funds account should be assigned solely to the “futures account” class – and not reallocated to separate “futures account” and “foreign futures account” classes – in the unlikely event of an FCM insolvency. Most importantly, that treatment would be consistent with the treatment of those accounts prior to bankruptcy, because all trades made through the Link would be held by an FCM in a single, segregated account, thereby making it unnecessary for a bankruptcy trustee to engage in a complicated and contentious reassignment of positions and the associated collateral to those different account classes.⁹

In summary, treating Link transactions and customer funds associated therewith as belonging to the “futures account” class will ensure that customer property that has been held by an FCM subject to the segregation requirements of the Act, Commission Regulations and the Orders of the Commission will be allocated to the customers for whom that property has been held and that those customers will be able to claim their proper share of a bankrupt FCM’s estate.

⁷ *See* 11 U.S.C. § 761(8).

⁸ 69 Fed. Reg. 69510 (November 30, 2004).

⁹ Because Link positions will benefit from portfolio margining and correlated positions in the same account will require less margin than would be the case if they were held in separate segregated funds and secured amount accounts, the enforced separation of customer positions into “futures” and “foreign futures” account classes would likely result in an insufficiency of margin in both account classes. A trustee could, in theory, seek to address this problem by allocating the shortfall in proportion to the margin requirements for each “leg” of the previously combined portfolio. Doing so would be cumbersome and also would almost certainly be inequitable, since the same contract would be subject to differing margin requirements based on the particular combination of positions in a given customer’s account. *Id.* at 69510-11.

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For all of the foregoing reasons, we respectfully request that the Commission amend the Order it issued in connection with the Euro Link, or issue a new Order, to permit the combination of segregated funds and secured amount deposits in the circumstances described herein.

We very much appreciate the Commission's willingness to consider this request. We would be pleased to discuss this further with the Commission or to answer any questions that may arise.

Very truly yours,

/s/

Kenneth M. Rosenzweig

cc: Acting Chairman Sharon Brown-Hruska
Commissioner Walter L. Lukken
Commissioner Michael V. Dunn
Commissioner Fred Hatfield
Gregory Kuserk
James C. Carley
Patrick J. McCarty
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