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COMMENT

June 8, 2009

Mr. David A. Stawick
Secretary to the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581
secretary@cftc.gov

Re: Commodity Futures Trading Commission's Proposed Adjusted Net Capital Requirements for Futures Commission Merchants and Introducing Brokers, 17 CFR Part 1, RIN 3038-AC66

Dear Mr. Stawick:

Newedge USA, LLC ("Newedge USA") is pleased to submit this comment letter on behalf of itself and its parent company, Newedge Group ("Newedge") relating to the proposal by the Commodity Futures Trading Commission ("CFTC") to amend its net capital requirements for futures commission merchants ("FCM") and introducing brokers ("IB").

As an initial matter, we applaud the CFTC for examining ways to strengthen the financial condition of FCMs and IBs, and thereby enable them better to protect their customers' assets and meet their financial obligations. Clearly, in light of current market conditions and the high profile failures of a number of leading financial institutions over the past year or so, this is a topic worthy of strong consideration.[1] However, as we set forth below, we do not believe the CFTC's proposal to increase FCMs' risk-based capital requirements to ten percent of the total risk margin requirement for positions carried in their customer and noncustomer accounts is the most effective means of accomplishing this objective. In fact, we believe increasing capital as proposed would provide only mild relief, at best, while decreasing competition among FCMs and likely driving up customer costs.[2] Rather, we believe customers would be better served by requiring FCMs to disclose certain key information regarding their assets and risk-profiles, and then let the customers decide which FCM would provide the most security for their deposits. Before discussing these matters in more detail, however, we would like to provide a brief background of Newedge and Newedge USA.

BACKGROUND

Newedge, which is one of the world's largest brokerage organizations, offers its customers clearing and execution facilities across multiple asset classes including futures, securities (fixed income and equity), options, FX and various OTC instruments. "Newedge" refers to Newedge Group, a 50%-50% joint venture

[1] We do note, however, that the most significant such failures appear to have involved banks and broker-dealers that had acquired large amounts of "toxic" debt, as opposed to FCMs conducting normal futures brokerage activities.
[2] We are not providing comments at this time on the other proposed amendments set forth in the CFTC's rule proposal.

between Calyon (part of Credit Agricole) and Société Générale, headquartered in Paris, France, and all of its worldwide branches, subsidiaries and other units. Newedge maintains offices in over 15 countries, and is a member of over 80 exchanges worldwide. Newedge estimates that its customers – who are principally institutional – execute 6.4 million lots and clear 7.0 million lots, globally, on a daily basis.[3]

Newedge USA is one of the leading broker-dealer ("BD")/FCMs in the US.[4] Indeed, according to CFTC statistics, Newedge USA holds the second largest pool of customer "segregated" and "secured" assets of all US-based FCMs.[5] Newedge USA's primary function is that of a broker – i.e., to execute and clear customer transactions across multiple asset classes on either an agency or riskless principal basis. Newedge USA conducts only a very limited amount of proprietary trading, and then generally only to hedge positions acquired through customer facilitation. As a result, Newedge USA does not generally hold large positions in inventory.

DISCUSSION

1. The CFTC's Capital Increase Proposal is Not, in Our View, the Most Effective Means of Protecting Customers' Assets

The CFTC's proposal to increase FCMs' risk-based capital requirements to ten percent of the total risk margin requirement for positions carried in their customer and noncustomer accounts is not, in our opinion, the most effective means of increasing customer asset protection. Indeed, the past twelve months have taught us that increasing capital requirements does not necessarily ensure fiscal solvency. For example, at least one of the two high-profile BD/FCMs that failed in 2008 maintained, to our knowledge, substantial excess net capital. Thus, rather than simply raising capital requirements, we believe the key is to identify the primary factors that put an FCM's capital at risk, and then ensure that such factors are disclosed to customers and potential customers so that they can better assess the financial strength of their firm – i.e., "to be able to look behind the capital."

Before discussing such factors, however, we would like to point out two facts which we believe the Staff should consider carefully prior to increasing FCM capital requirements. First, it is well-recognized that the linchpin of FCM financial stability – and thus the key to the protection of customer assets – is the collection and segregation of customer margin on a daily basis. Indeed, it is the maintenance of such funds on a segregated and secured basis, rather than a firm's capital, that most principally ensures that FCMs will be able to meet their basic obligation – the daily clearance and settlement of customer trades. Second, there has never been, to our knowledge, a failure of an FCM that caused a run on segregated funds that left customers with a deficiency. More specifically, since the creation of the FCM structure and the capital rules governing FCMs, no FCM has become fiscally insolvent resulting in a loss of customer segregated funds. Thus, to a certain extent, the FCM's current proposal tries to "fix what is not broken." In short, as a result of the CFTC's customer margin rules, the current capital requirements – i.e., 8% of customer risk margin requirements and 4% of noncustomer risk margin requirements – have worked for many years, including during times of significant market volatility and instability.

Importantly, the capital held by an FCM is generally only implicated when there is a deficiency in customer segregated funds.[6] Indeed, only if some relatively unusual event causes a large deficit in segregated funds – such as a fraud or a default by a customer with a very large percentage of an FCM's segregated funds (greater than the FCM's capital) – does an FCM's capital come into question. Thus, in general, assuming an FCM, as it is required to do, marks its customers' transactions to market and collects the required margin on a daily basis – not to mention conducts daily risk-based analyses of the impact potential market movements could have on such positions – history has shown that it will not be at risk of insolvency based

[3] As of December 31, 2008.

[4] Effective January 2, 2008, Fimat USA, LLC changed its name to Newedge USA, and effective September 2, 2008, Newedge Financial, Inc. – the former Calyon Financial, Inc. – merged into Newedge USA.

[5] As of March 31, 2009.

[6] It should be noted FCM fraud could also cause an inadequacy in segregated funds. Only routine auditing (not capital) can probably help against this.

on current capital requirements.[7] In assessing ways to better protect customer assets, we hope the CFTC does not lose sight of the key role played by customer segregated and secured funds and the long-term success of the current capital requirements.

That being said, even a financially strong FCM's capital can be put at risk based on it conducting a number of permitted activities, such as: (a) conducting a large amount of proprietary trading; (b) having a small number of customers make up a significant percentage of its total customer margin requirement; (c) executing OTC derivative transactions on a principal, non-hedged basis; (d) maintaining a small percentage of liquid assets in relation to its overall equity; (e) relying heavily on unsecured and uncommitted short-term funding to meet its regulatory obligations; and (f) financing a large number of customer transactions involving illiquid financial products for which it is difficult to obtain timely and accurate prices. Accordingly, we believe that the CFTC's objective – namely, increasing the protection of customer assets – would be better served by identifying key risk factors such as these and requiring FCMs to disclose them to customers and potential customers so that they may better assess the true security of their deposits.

For example, FCMs could be required to disclose the following – as well as other possible measures of an FCM's true risk – to their customers in "plain English" on at least an annual basis:

- the FCM's total equity, regulatory capital and net worth;
- the dollar value of the FCM's proprietary margin requirements as a percentage of its segregated and secured customer margin requirements;
- what number of the FCM's customers comprise an agreed significant percentage of its customer segregated funds;
- the aggregate notional value of non-hedged, principal OTC transactions into which the FCM has entered;
- the amount, source and purpose of any unsecured and uncommitted short-term funding the FCM is using;
- the aggregate amount of financing the FCM provides on customer transactions involving illiquid financial products for which it is difficult to obtain timely and accurate prices;
- the percentage of defaulting assets (debits and deficits) the FCM had during the prior year compared to its year-end segregated and secured customer funds, and
- a summary of the FCM's current risk practices, controls and procedures.[8]

Given the importance of "looking behind the capital" to the risk factors more closely indicative of an FCM's true financial stability, we also believe it would be unfair to apply an across-the-board capital increase without taking such risk factors into account. For example, in our view, it would be unfair to subject a firm such as Newedge USA – which conducts only a minimal amount of proprietary trading – to the same capital requirements as a firm that conducts a substantial amount of proprietary trading (and particularly one that conducts a large amount of highly leveraged proprietary trading), since a firm that focuses on brokerage incurs less risk to its capital than a firm that concentrates on proprietary trading.

2. <u>The Rule Proposal Could Have Anticompetitive Results</u>

We also believe the CFTC's proposal would have an anticompetitive impact on the industry by reducing the number of FCMs operating in the US. As the CFTC is aware, there has been a significant trend toward consolidation among FCMs in the US over the past ten years. Indeed, the CFTC notes in its proposal that there were 255 FCMs in the US as of August 31, 1995, but only 134 FCMs as of December 31, 2008. Further, as the Staff is aware, a number of the largest FCMs have merged in recent years, including Fimat USA, LLC and Calyon Financial, Inc., which has resulted in approximately 80% of all global segregated customer funds being held by only six FCMs.

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[7] Consequently, we believe it is somewhat ironic that an FCM's capital requirements generally increase in the first instance as it increases the amount of margin it collects from its segregated and secured customers.
[8] The CFTC should also consider reviewing the adequacy of such disclosures in connection with an FCM's routine examinations.

Raising FCM capital requirements would, in our opinion, exacerbate this trend toward consolidation. We believe that FCMs that do not carry nor have access to large amounts of capital in excess of current requirements – but are otherwise financially stable as a result of customer margin deposits and low-risk business models – would be forced to go out of business, merge into more well-capitalized firms or reduce the number and variety of business activities they perform. Indeed, under the CFTC's proposal, minimum capital requirements for even large international firms such as Newedge USA could increase by as much as 45% without any change in their risk profile, solely because they hold large amounts of required customer margin deposits. Such a percentage increase can translate into FCMs being required to increase their capital by hundreds of millions of dollars. Unfortunately, we believe that such a significant increase will, as noted, reduce the number of FCMs from which customers could choose, decrease competition within the industry and increase transaction costs to customers.[9]

As the Staff is aware, the CFTC must consider the potential anticompetitive impact when promulgating rules, and "take the least anticompetitive means of achieving [its] objectives."[10] We believe the alternative cited above in Section I would constitute a much less anticompetitive (and more effective) means of achieving the CFTC's objective. Indeed, in the proposal we articulate above, it would be the customers themselves – based on the FCM disclosures we have recommended – that would decide which FCM with which to conduct business.

* * *

We appreciate the opportunity to comment on these proposed rules. Feel free to contact the undersigned at (646) 557-8458 or at gary.dewaal@newedgegroup.com if you have any questions.

Sincerely,

Newedge USA, LLC

Gary DeWaal
Senior Managing Director and Group General Counsel

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[9] We are also concerned that increasing capital requirements based on higher risk-based margin percentages could cause FCMs to push out certain unregulated businesses to unregulated entities such as special purpose vehicles, thereby decreasing customer protection relating to such transactions.

[10] See Section 15(b) of the Commodity Exchange Act ("[t]he Commission shall take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of the Act ….. in issuing any order or adopting any Commission rule") and Section 15(a) of the CEA ("Before promulgating a regulation under this Act ….. the Commission shall consider the rule's impact on the "competitiveness ….. of futures markets").