



September 14, 2009

Mr. David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
1155 21<sup>st</sup> Street NW  
Washington DC 20581

**Re: Chicago Mercantile Exchange Petition to Commingle Customer Funds Used to Margin Credit Default Swaps with Other Funds Held in Segregated Accounts**

Dear Mr. Stawick:

The Futures Industry Association (“FIA”)<sup>1</sup> submits this letter in response to the Commodity Futures Trading Commission’s (“Commission’s”) request for comments on the Chicago Mercantile Exchange’s (“CME’s”) petition asking the Commission to issue an order pursuant to section 4d(a)(2) of the Commodity Exchange Act (“Act”) authorizing the CME and futures commission merchants clearing through the CME to commingle customer funds used to margin credit default swaps (“CDS”) with other funds held in customer segregated accounts maintained in accordance with section 4d(a)(2) of the Act and Commission rules.

FIA supports the efforts of the CME and other clearing organizations to develop and provide clearing services for over-the-counter (“OTC”) derivatives, including CDS. Establishing a proper clearing mechanism for standardized OTC derivatives is a critical element of the several regulatory reform proposals that have been submitted by the Obama Administration, members of Congress and the Commission to reduce systemic risk in the financial system. The CME is to be congratulated for taking on this task.

FIA also recognizes the many benefits that may flow from combining cleared customer CDS positions, and the funds deposited to margin such positions, with the customer segregated account maintained in accordance with section 4d(a)(2) of the Act. Customers take special comfort in knowing that their funds are held in segregation and that, in the event of an FCM default, the Bankruptcy Code and the Commission’s bankruptcy rules, 17 CFR Part 190, assure futures customers a priority over general creditors. A combined account could also facilitate the cross-margining of positions, permitting the more efficient use of capital.

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<sup>1</sup> FIA is a principal spokesman for the commodity futures and options industry. FIA’s regular membership is comprised of approximately 30 of the largest futures commission merchants (“FCMs”) in the United States. Among FIA’s associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States contract markets.

However, we also appreciate that commingling exchange-traded futures and cleared OTC derivatives may pose potential risks to the customer segregated account. Cleared OTC derivatives may dilute the pool of assets available to exchange-traded futures customers in the event of an FCM bankruptcy. Further, a combined account could delay or prevent the transfer of exchange-traded positions to a solvent FCM. Because of these risks, FIA does not believe that all cleared OTC derivatives should be permitted to be commingled with the customer segregated funds account.

The Commission appears to share our concerns. In a Federal Register release dated August 13, 2009, the Commission has proposed to amend the Commission's bankruptcy rules to establish a sixth and separate account class for a limited group of "cleared OTC derivatives."<sup>2</sup> This separate account class would seek to provide customers with "cleared OTC derivatives" positions a priority over general creditors without affecting the pool of assets held in the "futures" account, *i.e.*, assets held in accordance with section 4d(2)(a) of the Act and related Commission rules.

By separate letter dated September 14, 2009, FIA commented on the Commission's proposal.<sup>3</sup> In that letter, we supported in concept the Commission's proposal to create a separate account class for "cleared OTC derivatives," while urging the Commission to adopt concurrently with the amendment objective standards by which the Commission will determine which cleared OTC derivatives will be eligible or required to be held in a customer segregated account and which cleared OTC derivatives will be required to be held in separate, *i.e.*, non-section 4d, accounts. We expressed our concern that failure to adopt such objective standards will result in legal uncertainty in the event of an FCM bankruptcy, which may threaten the integrity of the customer segregated account.

In that letter, we also set out, for purposes of discussion only and subject to further consideration, our initial thoughts on the factors that we believe would support a finding that cleared-only OTC derivatives and related margin should be permitted to be held in a customer segregated account: (i) the OTC contract is integrally related with an exchange-traded contract; (ii) the OTC contract is sufficiently liquid to permit offset in the event of a clearing member default; (iii) in the absence of offset, the risk of carrying the positions may be easily hedged; and (iv) the cleared-only OTC contracts provide opportunities for cross-margining with exchange-traded contracts.<sup>4</sup>

We are not convinced that the CDS contracts the CME intends to clear meet any of these standards. Therefore, we cannot support the CME's petition and recommend that action on the petition be deferred. In particular, we are concerned that such contracts may not be easily

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<sup>2</sup> 74 Fed.Reg. 40794 (August 13, 2009).

<sup>3</sup> Letter from John M. Damgard, President, Futures Industry Association, to David A. Stawick, Secretary to the Commission, dated September 14, 2009.

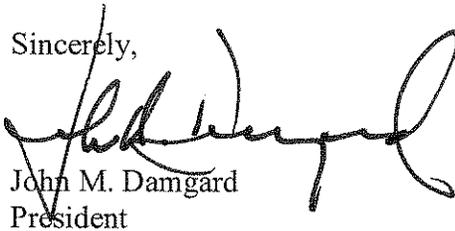
<sup>4</sup> *Id.*, p. 4, fn. 11.

Mr. David A. Stawick  
September 14, 2009  
Page 3

offset or hedged. Therefore, we are unable to assess the potential risk to the customer segregated account in the event of a default. Further, CDS are not integrally related to exchange-traded futures contracts and do not appear to provide any opportunity for cross margining.<sup>5</sup>

We appreciate the opportunity to submit these comments. If the Commission has any questions concerning the matters discussed in this letter, please contact Barbara Wierzynski, FIA's Executive Vice President and General Counsel, at (202) 466-5460.

Sincerely,



John M. Damgard  
President

cc: Honorable Gary Gensler, Chairman  
Honorable Michael Dunn, Commissioner  
Honorable Jill E. Sommers, Commissioner  
Honorable Bart Chilton, Commissioner

Division of Clearing and Intermediary Oversight  
Ananda Radhakrishnan, Director  
Robert B. Wasserman, Associate Director

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<sup>5</sup> In contrast, standardized cleared OTC derivatives involving interest rates or currencies may well meet the standards set out above, *i.e.*, they would be integrally related to exchange-traded futures, sufficiently liquid to permit offset or hedge, and provide opportunities for cross margining. In these circumstances, commingling such positions, and related margin, with the customer segregated account may be appropriate.