



The Pulse of Finance



February 4, 2010

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

Re: Revised Petition to Commingle Customer Funds Used to Margin Credit Default Swaps Cleared by CME with Other Funds Held in Segregated Accounts

Dear Mr. Stawick:

MF Global Inc.¹ (“MF Global”) and Newedge USA, LLC² (“Newedge”) jointly submit these comments regarding the petition of the Chicago Mercantile Exchange (“CME”) that the Commission issue an order under Section 4d of the Commodity Exchange Act that would permit the CME and futures commission merchants clearing through the CME to commingle customer funds used to margin, secure, or guarantee credit default swaps (“CDS”) cleared by the CME with other funds held in the customer segregated account.

¹ MF Global Inc. is a wholly owned subsidiary of MF Global Holdings Ltd. which, through its various affiliates, is a leading broker of exchange-listed futures and options with offices in Bermuda, New York, London, Chicago, Paris, Mumbai, Singapore, Sydney, Toronto, Tokyo, Hong Kong, Taipei and Dubai. We provide execution and clearing services for exchange-traded and over-the-counter derivative products as well as for non-derivative foreign exchange products and securities in the cash market. MF Global operates across a broad range of trading markets, including interest rates, equities, currencies, energy, metals, agricultural and other commodities. MF Global operates in 12 countries on more than 70 exchanges, providing access to the world’s largest and fastest growing financial markets.

² Newedge USA, LLC is a wholly owned subsidiary of Newedge Group SA, a 50/50 joint venture between Credit Agricole Corporate and Investment Bank (formerly Calyon) and Societe Generale. Newedge is also a leader in global brokerage and clearing for institutional clients, with offices in 17 countries and access to more than 85 exchanges. Newedge offers a full range of execution and clearing services for futures and options on listed financial and commodity markets. In addition Newedge provides coverage for a broad range of fixed income, FX, equity and commodity products in both the listed and OTC markets. Newedge also provides a range of value added services, including prime brokerage, asset financing, an electronic platform for trading and order routing, cross margining, and the centralized reporting of client portfolios.

For the reasons set forth below, MF Global and Newedge believe the petition should be denied at this time.

Inadequate Ability to Assess or Manage Risk

Throughout the long history of regulated futures trading in the United States, federal law has mandated the segregation of futures customers' funds held by FCMs and depositories – including clearing houses. Futures customers have come to expect and rely on this protection - especially in the recent past. As the treacherous events of the last 18 months have unfolded, our firms, like many others, have been increasingly pressed by futures customers to reassure them of this critical financial safeguard. The Commission should be extremely wary, therefore, of any developments that could undermine futures customers' confidence that their funds are protected.

As we all know, CDS are relatively new and evolving products that were at the heart of the recent financial crisis. We are aware that clearing CDS and other OTC transactions is viewed by many decision makers in the global financial community as the best possible solution to preventing a repetition of recent events. This has been the position of the Obama Administration and it is embodied in financial reform legislation now being debated in the Congress. As long-time clearing members of all principal US futures exchanges with global clearing access through our various affiliates, MF Global and Newedge are acutely aware of the paramount benefit of central clearing - the elimination of counterparty credit risk. In that connection, we have supported and now clear customer OTC transactions that the CFTC has approved for clearing.

CDS, however, are not OTC corn, coffee or energy swaps. These and other cleared swaps with respect to which the Commission has issued a Section 4d order are closely related, if not identical, to listed futures contracts cleared by the relevant clearing house, thereby affording efficient risk management in the event of default.

Such risk management opportunities do not yet appear to be available in respect of cleared CDS. There are no liquid futures contracts or other assured liquidity pools. Indeed, we understand that firms have declined to clear such products directly for fear they may not yet possess systems and controls to understand and mitigate the relevant risks of such products.³ In these circumstances, we do not believe it would be appropriate for the Commission to now require futures customers to effectively cross guaranty CDS risk, however remote some may suggest the likelihood of a cleared CDS default to be.

As one possible approach, we note that the Futures Industry Association ("FIA") has previously requested that the Commission establish objective standards that could be applied to determine whether funds deposited to margin cleared OTC contracts could be held in a segregated account. The FIA suggested four elements that the CFTC may require: (i) the OTC contract is integrally

³ The Commission seems to share our concerns with respect to the potential risks of cleared CDS products. In its January 25, 2010 order granting ICE Clear Europe ("ICE") registration as a DCO, the Commission is requiring ICE, as a condition to registration, to establish a separate guaranty fund for cleared CDS contracts. It would be incongruous if the Commission were to permit the CME and its clearing member FCMs to commingle CDS margin in a Section 4d account, while requiring ICE to maintain a separate guaranty fund to support such transactions.

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. MF Global and Newedge support the suggestion that the Commission publish for comment appropriate objective standards for any cleared OTC contracts. In this way, perhaps, the Commission, all clearing firms and futures customers may gain greater assurance that risks may be efficiently managed.

Legal Certainty

We also agree with the concerns expressed by the FIA and others regarding possible legal uncertainty as to whether cleared OTC derivative contracts will be viewed as “commodity contracts” within the meaning of Subchapter IV of Chapter 7 of the Bankruptcy Code and Part 190 of the Commission’s regulations in the event of an FCM’s bankruptcy. Specifically, we are concerned that in the event of an FCM default where segregated funds cover both futures and other products accorded 4d treatment, (i) the risk of legal uncertainty may threaten the integrity of the section 4d customer segregated account and (ii) a combined account may delay or prevent the transfer of exchange-traded positions to a solvent FCM. Regardless of how a bankruptcy court may ultimately decide this issue, the legal uncertainty raises the likelihood of complex litigation, inevitably delaying or preventing the return of futures customers’ funds or the transfer of exchange-traded positions from the combined futures/cleared OTC account to a solvent FCM. This may well be exacerbated in the case of cleared CDS because the positions may take longer to unwind than positions in other cleared OTC contracts whose risks may be more efficiently managed. In these circumstances, we would suggest that CFTC must be wholly confident in the bankruptcy code treatment it will be forced to defend when and if recent history repeats itself.

Guaranty Fund

MF Global and Newedge, like all CME clearing member firms, are quarterly assessed a guaranty fund deposit based in part on the member's proportionate share of the aggregate performance bond requirement for the preceding three months, plus the member's proportionate share of the total number of contracts executed during the preceding three months. For clearing firms not engaged in CDS, (i.e., most clearing firms), these calculations are based primarily on futures activity cleared and, ironically, merely executed. In its revised request, the CME reveals that it has already self-certified amendments to its clearing house and security deposit rules. These amendments, which were adopted without full or transparent debate by all affected members, have the effect of organizing the guaranty fund into separate tranches such that a CDS caused default will be initially funded by the tranche funded by CDS clearing members. Nevertheless, it is clear that the entire guaranty fund ultimately remains at risk to a CDS default – including the monies deposited by clearing members who either elect not to participate in CDS cleared products and/or do not qualify to clear CDS products. Indeed, by establishing the tranches in order to ameliorate the effects on FCMs who cannot or will not clear CDS, the CME seems to recognize this as a matter of fundamental fairness.

Needless to say, just as our guaranty funds are at risk regardless of whether we clear CDS, we question the fundamental fairness – in light of the complexity of CDS and its recent history -- of requiring futures customers to cross-guarantee CDS contracts at this point of the products' development without regard to whether or not they trade CDS.

Conclusion

No sector of the financial services industry has withstood the recent painful financial crisis - the ultimate stress test - as well as the US futures industry. This is no accident. The segregation of futures customer funds and the confidence it has engendered are critical reasons for our resilience in these troubled times. At this time, MF Global and Newedge are not satisfied that the risks to futures customers' funds and to our own guaranty deposits - risks we never signed up for – may adequately be assessed or contained. Under all of these circumstances it is fundamentally unfair to expect futures customers to be exposed to these risks. It is for all these reasons that MF Global and Newedge – dynamic competitors in futures and other financial services – come together to respectfully but strongly urge the Commission to deny the CME's petition at this time.

If you would care to discuss or have any questions or comments, please feel free to contact either of the undersigned or our respective general counsels: Laurie Ferber of MF Global at 212 589 6235 or lferber@mfglobal.com and Gary DeWaal of Newedge at 646 557 8458 or at gary.dewaal@newedgegroup.com.

Sincerely,

MF Global, Inc.



Bernard W. Dan
Chief Executive Officer

Newedge USA, LLC



Patrice Blanc
Chief Executive Officer, Newedge
Group, SA

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

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