



December 21, 2011

Via Electronic Submission: <http://comments.cftc.gov>

David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581

COMMENT

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**Re: ICE Clear Credit LLC: Request for Exemptive Relief Pursuant to Section 713(a) of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act re: Maintaining Customer Funds in Single Customer Omnibus Accounts for Positions in Single-Name Credit Default Swaps and Broad-based Credit Indices and Portfolio Margining**

Dear Mr. Stawick:

Managed Funds Association<sup>1</sup> appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the “**Commission**”) regarding ICE Clear Credit LLC’s (“**ICE Clear Credit**”) petition<sup>2</sup> for exemptive relief pursuant to Section 713(a) of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “**Dodd-Frank Act**”) <sup>3</sup>, to permit ICE Clear Credit to: (a) maintain customer funds in single customer omnibus accounts (“**cleared swaps customer accounts**”) for positions in single-name credit default swaps (“**Security-Based CDS**”) and broad-based credit indices (“**Index CDS**”); (b) calculate

<sup>1</sup> Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

<sup>2</sup> ICE Clear Credit LLC – Request for Order Pursuant to Section 4d of the Commodity Exchange Act re: Commingling of Customer Funds and Portfolio Margining, dated October 4, 2011, submitted to the Commission by Michael M. Philipp, Partner, Winston & Strawn LLP, as counsel to ICE Clear Credit LLC (the “**ICE CFTC Petition**”). The ICE CFTC Petition states that ICE Clear Credit is simultaneously seeking similar exemptive relief from the SEC. *Id.* at 3.

<sup>3</sup> Pub. L. 111-203, 124 Stat. 1376 (2010). Section 713(a) of the Dodd-Frank Act amended Section 15(c)(3) of the Exchange Act to require the Securities and Exchange Commission (the “**SEC**”) to adopt rules that permit securities to be held in a portfolio margining account that is regulated as a futures account under Section 4d of the Commodity Exchange Act pursuant to a portfolio margining program approved by the Commission.

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margin for cleared swaps customer accounts pursuant to a portfolio margining program approved by the Commission and the SEC ; and (c) provide similar relief to entities that are dually registered as futures commission merchants (“FCMs”) and securities broker-dealers (“BDs”) (such dually registered entities referred to herein as “BD/FCMs”) that maintain clearing accounts for customers at ICE Clear Credit. ICE Clear Credit has also filed a companion petition with the SEC for similar exemptive relief. Both petitions are together referred to herein as the “ICE Petitions”.

### **Executive Summary**

MFA believes that the ability to calculate margin for cleared swaps customer accounts on a portfolio margin basis is essential to encourage increased clearing of swaps, enhance customer hedging and reduce systemic risk through clearing, and provide capital efficiencies for market participants. Thus, MFA supports the ICE CFTC Petition because of the significant benefits to customers in the form of capital efficiencies and clearing access that result from portfolio margining and netting. MFA also supports the ICE CFTC Petition’s request to hold customer positions in Index CDS and Security-Based CDS, and related assets supporting such positions, in cleared swaps customer accounts to implement its portfolio margining program.

We encourage the Commission to grant the ICE CFTC Petition to enable ICE Clear Credit to offer portfolio margining relief with respect to customer-related CDS transactions as soon as possible. Otherwise, MFA is very concerned that customers, including many MFA members, will not benefit from the same capital relief and access to clearing that BD/FCMs will have when ICE Clear Credit implements its portfolio margining program for clearing participant proprietary positions. Customers would thus be unfairly and unjustifiably disadvantaged by the Commission’s withholding or delaying approval of the ICE CFTC Petition.

We note that treatment of customer collateral posted in respect of customers’ cleared positions remains subject to the Commission’s final rule on segregation requirements for cleared swaps under Section 4d(f) of the Commodity Exchange Act, as amended. Our comments in this letter in respect of portfolio margining do not represent a position with respect to that rulemaking.<sup>4</sup>

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<sup>4</sup> See MFA’s supplemental comments on the Commission’s Notice of Proposed Rulemaking on “Protection of Cleared Swap Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions”, 76 Fed. Reg. 33818 (Jun. 9, 2011) filed with the Commission on December 2, 2011, available at: <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=50006&SearchText=> (the “MFA Supplemental Letter”). In the MFA Supplemental Letter, MFA stated its intent to continue to examine segregation models for cleared swaps collateral in light of the emerging facts surrounding MF Global, Inc., as well as other measures to prevent a re-occurrence of the MF Global customer losses.

**MFA Supports ICE Clear Credit's Petitions Because of the Benefits of Netting and Portfolio Margining to Customers and the U.S. CDS Market as a Whole**

ICE Clear Credit formally filed the ICE Petitions with the Commission and the SEC on October 4, 2011.<sup>5</sup> MFA believes that ICE Clear Credit's portfolio margining program, if approved by the Commission and the SEC, will benefit customers and the U.S. CDS market as a whole by: (1) facilitating systemic risk reduction; (2) providing capital efficiencies; (3) encouraging greater clearing and facilitating the transition to clearing; (4) improving buy-side access to clearing and removing economic barriers to customer clearing; (5) promoting competitive equality; and (6) improving the efficiency and effectiveness of risk management. Without the exemptive relief requested in the ICE Petitions, MFA believes that none of these benefits will be realized.

MFA strongly believes that by granting the requested exemptive relief in the ICE Petitions, the Commission and the SEC will provide customers in the U.S. CDS market with the economic incentives and capital efficiencies necessary to promote clearing of a broader scope of CDS contracts. The requested exemptive relief would thus facilitate the achievement of the systemic risk reduction goal of the Dodd-Frank Act. Customers will be able to expend less capital on margin by virtue of the ability to net customers' offsetting positions in Security-Based CDS and Index CDS in cleared swaps customer accounts under ICE Clear Credit's margin methodology. Moreover, without portfolio margin treatment, many customers may determine that clearing their Security-Based CDS and Index CDS will be prohibitively expensive. MFA believes that such a result would have a continuously limiting effect on both the volume of voluntary clearing prior to the clearing mandate becoming effective, and the breadth of CDS clearing after the clearing mandate becomes effective. These results would be inconsistent with a key Dodd-Frank Act goal to promote greater central clearing of swaps to reduce systemic risk.

Without the exemptive relief requested in the ICE Petitions, ICE Clear Credit and its BD/FCMs would be required to maintain separate accounts subject to the different margin rules of the Commission and the SEC to hold customer collateral relating to Index CDS and Security-Based CDS, respectively. Separate accounts would make clearing significantly more expensive for customers because they would be required to fully margin both accounts. For example, a customer that sells single-name CDS to offset the risk of a correlated Index CDS will, without the ability to net margin under a portfolio margining program, have to post full margin for both assets. The resulting inability of BD/FCMs clearing such transactions on behalf of customers to net the margin of correlated Index CDS and Security-Based CDS held in separate accounts would eliminate the economic efficiencies that can be gained from portfolio margining and that are inherent in a wide range of hedging strategies. MFA believes these inefficiencies will act as an economic disincentive, not only to customers' efficient portfolio risk management, but also to moving the CDS marketplace in the U.S. to central clearing. Any such significant disincentive would be inconsistent with, and would severely undermine, a fundamental objective of the

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<sup>5</sup> See *supra*, note 2.

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Dodd-Frank Act to reduce systemic risk through promotion of greater clearing of swaps and the reduction of systemic risk.<sup>6</sup>

MFA's support for the ICE Petitions is also based on our understanding that the Dodd-Frank Act expressly sought to encourage portfolio netting for the systemic risk management reasons set forth, charging the Commission and the SEC with issuing exemptive orders under Section 713(a) in support of portfolio margining. There is ample regulatory and academic support for the benefits of portfolio margining. For example, in the Federal Reserve Bank of New York Staff Report no. 424, "Policy Perspectives on OTC Derivatives Market Infrastructure," published January 2010 and widely referenced in the deliberations of the Dodd-Frank Act's language, Darrell Duffie, Ada Li and Theo Lubke stated:

Furthermore, because posting margin is a material cost of participating in a CCP, market participants have an additional incentive to clear more if they can reduce the amount of margin to post against their exposures. Regulators should therefore encourage methods for reducing the use of margin whenever this can be done without increasing systemic risk. In particular, the joint clearing of different derivative products in the same CCP improves the opportunity to net positive against negative counterparty exposures, and increases the incentives for market participants to clear their derivatives trades, without increasing systemic risk.<sup>7</sup>

In addition, the SEC and FINRA's Rule 4240 illustrates that the Commission and the SEC appreciate the benefits of portfolio margining, and acknowledge that approved portfolio margining (Rule 4240 included approval of the ICE portfolio margining program in discussion here) is both of benefit to indirect clearing participants and consistent with the risk management requirements of the Dodd-Frank Act.<sup>8</sup>

### Competitive Concerns

ICE Clear Credit currently clears Security-Based CDS and Index CDS proprietary positions for ICE Clear Credit's direct clearing members, the largest swap dealers, and is

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<sup>6</sup> MFA notes that the proposed European Market Infrastructure Regulation ("EMIR") in the European Union ("EU") does not have any such jurisdictional bifurcation regarding collateral segregation requirements for derivatives positions relating to commodities and securities. Thus, the U.S. CDS market could be competitively disadvantaged relative to the CDS markets in the EU, particularly if the requested exemptive relief in the ICE Petitions is not granted by the CFTC and the SEC.

<sup>7</sup> Policy Perspectives on OTC Derivatives Market Infrastructure; Darrell Duffie, Ada Li, and Theo Lubke; Federal Reserve Bank of New York Staff Reports, no. 424; January 2010; revised March 2010, at page 14; [http://www.ny.frb.org/research/staff\\_reports/sr424.pdf](http://www.ny.frb.org/research/staff_reports/sr424.pdf)

<sup>8</sup> FINRA Rule 4240, as revised, Effective Date: July 16, 2011, and [Regulatory Notice 11-31](#) (July 2011) (addressing FINRA approval of margin methodologies used by clearing agencies or derivatives clearing organizations for purposes of Rule 4240, and extending the interim pilot program for CDS margin requirements to January 17, 2012); <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p124089.pdf>.

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prepared to offer portfolio margining for these accounts as soon as ICE Clear Credit obtains regulatory approval, which we understand is forthcoming. Once ICE Clear Credit's direct clearing member proprietary account portfolio margining program becomes effective, such proprietary account holders will gain the significant benefits in capital efficiencies that result from portfolio margining. However, these benefits will not be realized by customers until the Commission and the SEC grant the requested exemptive relief in the ICE Petitions. As a result, the capital required for clearing will be significantly greater for customers than for direct clearing members' proprietary positions. This inequality will put customers at a substantial competitive disadvantage, with no justification, by requiring customer accounts to margin on a gross basis, while permitting such proprietary accounts to margin on a net basis. This inequality will not only create a significant economic barrier to buy-side clearing, but will substantially restrain the healthy evolution of increased liquidity that should develop with increased clearing. Burdened by unequal margining, all participants in the market that are not direct clearing members will be unable to offer competitive bids and offers. Liquidity will thus remain concentrated, as it is today in the bilateral markets, in a relatively small number of the largest swap dealer desks, both undermining price competition and concentrating risk in the swaps markets.

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Without portfolio margining, MFA is concerned that customers will have to dedicate increasing funds to initial margins which are not risk-driven, directly reducing customers' ability to support their trading and hedging activities. Thus, the amount of clearing that customers could implement for all of their CDS contracts will be limited, a result that is inconsistent with the systemic risk reduction goal of the Dodd-Frank Act. Further, the inability of customers to net Security-Based CDS with offsetting Index CDS, and *vice versa*, will inhibit open access to clearing for all market participants. This result is inconsistent with Sections 723 and 763 of the Dodd-Frank Act, which require open access and nondiscriminatory clearing of swaps and security-based swaps for all market participants. Clearing by the "buy-side" remains relatively low because of continuing material structural and economic barriers to clearing access for customers. Removal of this specific excess margin cost barrier will help to level the playing field on margin – between cleared and uncleared, and between customers and dealers – at a critical time in the progress toward enabling and expanding buy-side clearing.

For the reasons set forth above, MFA believes the requested exemptive relief, if granted, will promote greater clearing and more efficient and effective risk management in the U.S. CDS market as a whole. Therefore, MFA respectfully requests that the Commission grant the requested exemptive relief in the ICE CFTC Petition as soon as possible.

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MFA thanks the Commission for the opportunity to provide comments to support ICE CFTC Petition. Please do not hesitate to contact Laura Harper or the undersigned at (202) 730-2600 with any questions the Commission or its staff might have regarding this letter.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell  
Executive Vice President & Managing  
Director, General Counsel

cc: The Hon. Gary Gensler, Chairman  
The Hon. Jill E. Sommers, Commissioner  
The Hon. Bart Chilton, Commissioner  
The Hon. Scott D. O'Malia, Commissioner  
The Hon. Mark P. Wetjen, Commissioner

The Hon. Mary Schapiro, Chairman  
The Hon. Elisse B. Walter, Commissioner  
The Hon. Luis A. Aguilar, Commissioner  
The Hon. Troy A. Paredes, Commissioner  
The Hon. Daniel M. Gallagher, Commissioner