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Ms. Jean Webb, Secretary
Commodity Futures Trading Commission
Three Lafayatte Centre
1155 21st Street, NW
Washington, DC 20581

COMMENT

Mr. Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: Customer Rules Relating to Security Futures [66 FR 50720 (Oct. 4, 2001)]
CFTC: Customer Margin for Security Futures
SEC: File No. S7-16-01

Dear Ms. Webb and Mr. Katz:

SunGard Futures Systems ("SunGard Futures") appreciates the opportunity to comment on the proposed rules ("Proposal") issued by the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") regarding customer margin requirements for security futures. SunGard Futures is an operating unit of SunGard, one of the largest global providers of integrated IT and eprocessing solutions for the securities and broader financial services industry. SunGard Futures has provided back-office processing solutions for the exchange-traded derivatives markets since 1983. Our clients include over 100 futures commission merchants ("FCMs"). The futures processing systems we provide are designed to meet the regulatory and business needs of our FCM clients.

We have a number of concerns, based upon our extensive experience and detailed understanding of our clients' systems operations. Our specific areas of concern are (1) the unnecessarily high trading costs that market users will incur under the proposed strategy based margining system; (2) treatment of open trade equity; (3) imposition of a Regulation T modeled account structure and (4) the disparity between U.S. and non-U.S. treatment of this product. We believe that these features will require prohibitively costly changes to established FCM back-office practices that will inhibit FCMs from offering security futures to their customers, threatening the viability of these new markets.

Strategy-Based Margining

The Proposal defines the initial and maintenance margin requirements as 20% of the current value of a long or short security futures position and also defines the approved strategy-based offsets that would be allowed to reduce the initial and maintenance margin requirements.[1] This approach differs significantly from the way margins (as performance bonds) are calculated in the futures industry, where portfolio margining is the standard. Changing to strategy-based margining will require costly changes to FCM accounting systems.

[1] The Proposal recognizes only one offset opportunity for initial margin requirements: long and short security futures positions on the same security or index. In contrast, a variety of offset strategies are proposed for maintenance margin requirements covering spreads against related securities or security options positions.

More importantly, perhaps, the market inefficiencies that will be caused by strategy-based margining will discourage potential market users, to the detriment of the U.S. markets[2]. Futures markets are global. Many non-U.S. exchanges offer security futures contracts with U.S. underlying shares, and apply portfolio margining. Two examples include the London International Financial Futures and Options Exchange and Hong Kong Futures Exchange, which both use the SPAN risk model to set customer margin levels. We believe that the higher margin levels U.S. markets will have to impose under the Proposal during times of normal market volatility are unnecessary and will serve no purpose other than to drive security futures business abroad, making it difficult for the U.S. markets to attract the liquidity that is so critical to success.[3]

Thus, we strongly recommend that the Commissions modify the Proposal to permit the use of established portfolio margining systems such as SPAN for setting customer margins for security futures.[4] This would place the U.S. markets at parity with foreign exchanges and allow them to compete on an even footing for security futures business. Moreover, since portfolio-based systems are risk-based and recognize differences in the volatility of the underlying positions to determine customer margins, they allow markets to operate more efficiently to the benefit of all participants, by achieving more efficient capital allocation without increasing credit risk.

Open Trade Equity

The Proposal appears to prohibit the use of open-trade equity ("OTE") of security futures positions to margin other positions. The problem[5] is that the Proposal appears to allow firms fully registered with the SEC to journal excess margin associated with mark-to-market settlement gains on security futures positions to a special memorandum account for other use, but not FCMs, even if they are notice-registered as broker-dealers. We believe this disparity puts FCMs at a disadvantage to broker-dealers. In addition, if FCMs cannot recognize OTE of security futures as they can for other futures positions, they will have to make costly changes to their back-office systems. We do not see what regulatory benefits would be served by denying the use of OTE or imposing these costs on FCMs.

Regulation T Account Structure

Another aspect of the Proposal that we believe will be detrimental to the new markets is application of a Regulation T account structure to FCM accounts holding security futures contracts. Under the Proposal, security futures transactions would be recorded in a margin account. The Commissions are also considering whether to require FCMs to establish cash accounts, good faith accounts and special memorandum accounts. However, the account structure used in the futures industry and supported by futures back-office accounting systems allows all customer positions, property and assets to be held in a single account. If FCMs are required to support the Regulation T account structure, they will need to make many costly changes to their existing systems. We do not see how FCM customers will benefit by having their

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[2] Although U.S. investors currently are prohibited from trading single stock futures listed on foreign exchanges, the CFMA has directed the Commissions to adopt rules as necessary to permit the sale of security futures products traded on foreign boards of trade.

[3] At the same time, margin levels would be higher than under the Proposal during times of high volatility, better protecting the financial integrity of the markets.

[4] Similarly, we recommend that the Commissions work with the securities exchanges to implement portfolio margining as soon as possible for comparable exchange-traded security options contracts, since those margins limit how low customer margins may be set for security futures. This would be consistent with the Federal Reserve Board's urging that the Commissions should move the security options and security futures markets to risk-sensitive portfolio margining.

[5] We also note that the Proposal excludes security futures from the definition of margin securities under Regulation T. We are concerned that this feature may also preclude the use of OTE of security futures, though it is unclear whether this is what the Commissions intend.

accounts converted to multiple account types following the Regulation T structure. To the contrary, such changes will likely result in customer confusion as to why their security futures trades are treated in such a different manner than other futures trades.[6] This confusion, like other features of the Proposal, could well discourage traditional futures customers from participating in the U.S. based security futures markets, especially in light of the fact that the single account structure is the normal practice in other global markets where security futures are traded. We believe forcing a Regulation T account structure would again make foreign markets more desirable and push liquidity abroad.

Parity with non-U.S. markets

We believe the proposed regulations will create a disparity between the U.S. and non- U.S. markets trading these products, particularly since security futures on U.S. equities are currently trading overseas. While recognizing that the emphasis of the CFMA is on creating a level playing field between the equity options and security futures products in the U.S., we believe the proposal should not ignore the global nature of the futures industry. More emphasis should be placed on creating a level playing field between security futures in the US and security futures traded on non-U.S. markets, otherwise the U.S. market for this product will be jeopardized.

Conclusion

We believe the customer margin rules as proposed would result in market inefficiencies that would adversely affect the viability of security futures markets in the U.S. We believe the Proposal, if adopted in its current form, will also impose unnecessary costs on FCMs to conform to securities industry practices. To secure the success of U.S. security futures, we recommend that the Commissions adopt final customer margin rules that permit the use of risk-based portfolio margining, apply futures industry OTE concepts to security futures and allow FCMs to book security futures transactions under their standard account structure for futures.

Sincerely,

Stephen P. Auerbach
Chief Operating Officer
SunGard Futures Systems

[6] The prospect for confusion is even greater when one takes account of differences in SEC and CFTC requirements for protection of customer property. The Commissions have issued a companion rulemaking to deal with those differences. See "Applicability of CFTC and SEC Customer Protection, Recordkeeping, Reporting, and Bankruptcy Rules and the Securities Investor Protection Act of 1970 to Accounts Holding Security Futures Products," 66 FR 50786 (Oct. 4, 2001). The proposal would allow firms with full dual registration as FCMs and broker-dealers to choose whether to follow the SEC SIPC approach or CFTC customer segregation approach for security futures accounts. However, the Commissions have not attempted in either that proposal or the current one to reconcile the CFTC customer segregation model with the Regulation T account structure requirements.