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OFC. OF THE SECRETARIAT

To: Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st St. NW
Washington, D.C. 20581

Re: Customer Margin for Security Futures

Rolfe and Nolan is a vendor of back-office and order entry systems for the futures and options industry. Our systems are responsible for processing a significant portion of the total F&O business world-wide.

The proposal for fund segregation and margining of Security Futures seems to be based on the supposition that these contracts are nothing more than equities being traded on a futures exchange. If that was the intent of Congress in passing the CFMA, then there is no significant contribution we can make to the discussion. If, on the other hand, Congress' intent was to allow futures contracts to be traded on individual stocks, then it would seem that they should, in fact, be treated as futures contracts from a risk management perspective.

As a back office system vendor, we have devoted considerable efforts over the last decade or so in developing software that meets the requirements for portfolio margining by the exchanges where it is used. The variant of portfolio margining used on domestic futures exchanges, SPAN, has been employed by our customers and those using our competitors' systems for over 13 years. This system has served the industry well, and because of the way the SPAN data is distributed, it has virtually guaranteed that any changes in margin levels required by the exchanges can be immediately and automatically reflected in both clearing and non-clearing firm margin systems.

The Commissions' proposal seems to be taking a step backward by imposing a rigid, inflexible, equity-based approach to a product whose dominant characteristic is clearly that of a futures contract. While the 20% level mandated by the Commission seems to have been adopted as a compromise between equity and futures margin levels, it may turn out to be too little for a stock experiencing extreme volatility, such as Enron. SPAN margining allows the exchanges to be the judge of the appropriate margin level for a security future in response to the volatility of the underlying equity, whether it be 5% or 50%.

Our main concern about the proposal is the additional burden that it will impose upon back-office systems and processes, both in terms of operational costs and software development costs. We are already anticipating substantial development expenditures to comply with the new infrastructures required by security futures, as well as regulatory reporting and tax reporting requirements whose details have yet to be announced. Adding Reg T margining, fund segregation and disallowing the use of open trade equity will require substantial development, and we estimate that this will additional cost will run well into six figures.

This additional cost must ultimately be borne by our clients, on top of the additional operational costs they will incur by having to train their staff in Reg T margining, and in shifting funds around among accounts to accommodate segregation requirements. The consequence of such costs could well be the failure of security futures as a product class if firms simply decline to trade or clear them because of the additional burden and complexity in processing them in their current systems. In a time of thin operating margins, we believe firms will be very reluctant to expend additional resources for a product whose success is unknown at this time.

An example of this can readily be seen with the cross-margining facility established by the CBT and the CME a few years ago; this facility was seldom, if ever used by the clearing firms. It would have reduced margins for customers trading similar products on the two exchanges; because of the necessity of transferring trades into a cross-margin firm to obtain the margin reduction, clearing firms declined to take advantage of the program's benefits. The advantages of reduced margins were outweighed by the operational disadvantages of using it. We would not want to see the same thing happen to security futures.

We believe the best approach is to allow the futures industry to treat security futures as any other futures product, and allow the continued use of the current portfolio margining and fund segregation method within a structure that has served the industry well for over a decade.

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