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NFA NATIONAL FUTURES ASSOCIATION

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Via E-Mail (secretary@cftc.gov)

Mr. David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

COMMENT

Re: RIN 3038-AC72; Acknowledgment Letters for Customer Funds and Secured Amount Funds, 74 *Fed. Reg.* 7838 (February 20, 2009)

Dear Mr. Stawick:

Segregation is the cornerstone of the futures industry's customer funds protection scheme. The proposed amendments strengthen that scheme and should be adopted.

As you know, the primary purpose of segregation is to protect customer funds in the event of an FCM insolvency.[1] Special provisions in the bankruptcy laws work with the segregation requirement to give customers a priority in the funds in segregation. As a result, when funds are properly segregated, customer funds are protected against insolvency losses.

Segregation also serves a more immediate function, however. In the event of an FCM liquidation or any other situation where open customer positions need to be transferred quickly, the segregation requirements ensure that customers' margin funds transfer along with the positions. Without this protection, customers would be

[1] While this discussion focuses on FCM segregated funds, the rationale is the same for DCO segregated funds and foreign futures and options secured amounts.

required to post duplicative margin or—if unable or unwilling to do so—face forced liquidation of their positions.

The system fails in its second function when a bank or other entity holding the segregated funds refuses to release them so that they can follow customer positions. We understand that this was the case with the recent Lehman insolvency, where the bank holding the FCM's segregated funds account froze the funds several days after the parent filed for bankruptcy and continued the hold for many days, apparently lifting the freeze only under pressure from regulators.

CFTC Regulations 1.20(a) and (b) require an FCM and a designated clearing organization, respectively, to obtain a signed acknowledgment of the nature of the funds from a depository before placing segregated funds there. Proposed new sections (d) and (e) strengthen the language in the acknowledgment to make it crystal clear that the depository has no legal interest in the funds in a segregated account and must release them immediately upon request. Therefore, NFA supports these proposed amendments as well as the proposed amendments to CFTC Regulations 1.26 and 30.7.

NFA does, however, recommend a minor change to proposed Regulations 1.20(d)(3) and 30.7(c)(2)(iii). If the Commission believes that the acknowledgments should be filed with the CFTC, then we request that they be filed with NFA as well when NFA is the firm's DSRO. This will ensure that we have ready access to the same information as the CFTC does.[2] We are also aware that other commentors may recommend standardized language for the acknowledgment letters and a centralized electronic filing system, and NFA would be happy to assist with these initiatives.

We also believe the Commission should clarify when acknowledgment letters should be amended for changes made after the effective date of the proposed rules. For example, if an FCM opens a new segregated account at a bank with which it has an existing relationship, is there a particular time period in which it must amend the acknowledgment letter to add the new account number? If an FCM changes its name or undergoes a legal reorganization that does not negate its contractual obligations (e.g., a merger), must it still obtain new acknowledgment letters?

The law is clear that the funds in a segregated account cannot be used to meet the firm's (or its parent's) obligations to the bank carrying the account, and the bank holding the Lehman funds had presumably signed the acknowledgment currently required by CFTC Regulation 1.20(a). The bank froze the funds in spite of their separate legal ownership and its own contractual commitment, and there is no

[2] NFA does not express an opinion on the need for FCMs to provide the acknowledgments to regulators absent an audit or a specific request, however.

guarantee that the CFTC's current proposal will deter this type of conduct in the future. Nonetheless, the stronger language in the proposed acknowledgment should convince more depositories to release the funds quickly or, where the depository is derelict in its duty, could result in quicker action by a court with jurisdiction over the matter.

Respectfully submitted,

Thomas W. Sexton
Senior Vice President and General Counsel

(kpc/Comment Letters/Seg Funds Acknowledgments)