January 18, 2011

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

RE: RIN 3038-AD99, "Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies"

Dear Mr. Stawick:

Citigroup Global Markets Inc. ("CGMI") welcomes the enhanced transparency and counterparty risk mitigation that the mandatory central clearing of eligible Over the Counter (OTC) derivatives will provide pursuant to the implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

CGMI, which is a registered Futures Commission Merchant (FCM) and member of all major Derivatives Clearing Organizations (DCOs) and Designated Contract Markets (DCMs) in the U.S., has over 60 years of clearing experience, and was among the first major institutions to organize as a global, multi-asset OTC non-participant clearing service, undertaking these changes beginning in 2008 and starting active clearing in December, 2009. Since that time, we have provided our clients "agnostic" connectivity to their choice of viable central clearing counterparties, and have been working with industry participants, DCOs, and regulators in designing efficient central clearing processes to ensure that systemic risk is mitigated to the greatest extent possible.

In its Advanced Notice of Proposed Rulemaking ("ANPR") entitled, "Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies," the Commodity Futures Trading Commission (the "CFTC") outlines four options for structuring the risk waterfall of Derivatives Clearing Organizations to achieve protection of collateral posted by customers clearing swaps: (1) Full Physical Segregation, (2) Legal Segregation with Commingling, (3) Moving Customers to the Back of the Waterfall (models 1, 2, and 3, the "Alternative Models"), and (4) the Baseline model, which is the current model in use in the U.S. futures market.

Following extensive internal analysis, independent research, and dialogue with our clients, global clearing houses and other industry participants, CGMI strongly considers, for the reasons described herein, that the Baseline model should remain, at a minimum, as one of the methodologies available to Futures Commission Merchants ("FCMs") and their customers for the protection of collateral within the OTC Account Class. The Baseline model has withstood the test of time, having successfully protected customer collateral in the futures market for over 30 years, and more recently, functioned successfully during the bankruptcy of Lehman Brothers. There are numerous advantages to retaining this model. First, by retaining non-participant collateral in the risk "waterfall", the clearing house has access to a greater collateral pool in the event of a simultaneous client and FCM default liquidation scenario, and thus, initial margin levels can be maintained at a lower level than in a model where these collateral contributions are not included. This difference in capital efficiency is economically very important to many customers. Second, in the Baseline model, the clearing house, FCMs, and regulators all benefit from operational efficiencies due to the omnibus structure, with the resultant lowered costs accruing to the benefit of customers. Third, FCMs and clearing houses currently have automated infrastructure to support default management under the Baseline model. Lastly, customers of a deteriorating, non-

defaulted FCM have the ability pursuant to CFTC regulation and clearing house rules to move their positions to an alternative FCM, further mitigating the already low probability that they would face mutualization with other customers upon a collateral shortfall.

CGMI is confident in the strength of the Baseline model. Clearing houses must not compete on "risk", and in the context of central clearing, risk is mitigated through accurate pricing and variation margin, initial margin and the guaranty fund. In addition to ensuring that the combined financial safeguards package is robust enough to withstand adequate systemic shocks, further care must be given to the size and structure of each of these pools. We believe, therefore, that the Baseline model could be further strengthened through regulation that requires standardization of the relationship between initial margin and the guaranty fund. For this reason, CGMI strongly supports a "defaulter pays" model. In this model, initial margin is set at a level which, at a high confidence interval in a default scenario, independently mitigates the gap risk between mark to market movements and prior variation margin calculations without reliance on the guaranty fund or the clearing house contribution to the financial resources. The "defaulter pays" model therefore allows the guaranty fund to be set at a correspondingly lower level, and a guaranty fund that is transparent, replicable, and of appropriate (small) size will prevent portability from breaking down as counterparty conditions deteriorate in a dislocated market.

For example, in a situation where a replacement clearing member is asked to accept the transfer of a fully collateralized portfolio of a non-participant in a pre- or post-default situation, if the guaranty fund is too burdensome, the clearing member's ability and desire to accept such portfolio will be constrained—especially as the market further dislocates—due to the large funding requirements of the guaranty fund. Any breakdown in portability will, in turn, have adverse consequences on systemic risk because the most sizeable portfolios with the largest accompanying guaranty funds will find difficulty during the portability process and will be subject to liquidation in accordance with clearing house rules and applicable regulation. Based on the forgoing, CGMI urges the CFTC to consider regulation that would require the standardization of the relationship between initial margin and the guaranty fund through the adoption by clearing houses of the "defaulter pays" model.

Regulation that requires clearing houses to provide enhanced guaranty fund transparency to their members would further mitigate systemic risk. Such transparency would incentivize additional market entrants by giving prospective clearing members the visibility they require to determine the true cost of clearing.

CGMI recognizes that some industry participants are concerned by the possibility of mutualization of loss that exists in the existing segregated account class structure under CFTC Part 190, which is based on use of a client omnibus segregation account, and are apprehensive that the risk "waterfall" as structured in the Baseline model will not mitigate counterparty risk to the degree that is desired. Specifically, they are concerned by the "fellow-customer risk" that arises in the case where a default in the customer account of an FCM forces that FCM into insolvency.

CGMI believes this concern could be addressed if the CFTC amended its rules, including Part 190, to allow Derivative Clearing Organizations ("DCOs") the discretion to offer one of the alternative client protection models for the OTC Account Class. CGMI could be supportive of such a change provided that, at a minimum, all of the following criteria are considered:

- DCOs should be limited to offering no more than two customer collateral segregation models, with one being the Baseline model, due to the operational complexity that would otherwise be introduced into the clearing house default management process. In deciding which of the alternative client collateral protection models is the appropriate alternative, additional time and analysis is required and CGMI urges the CFTC to work with industry participants, DCOs, and

other global regulators in ascertaining the optimal approach through thorough empirical analysis. As forcefully articulated in ISDA's comment letter regarding RIN 3038-AD99 of January 18, 2011, this is a complex issue that requires careful analysis to arrive at a solution that minimizes adverse market impact. Additionally, other regulatory requirements being proposed in parallel with the Dodd-Frank Act, such as the "Capitalisation of bank exposures to central counterparties" proposed in draft by the Basel Committee on Banking Supervision in late December of 2010, may yet intervene and require alterations to the existent waterfall design of DCOs.

- Choice to offer an Alternative Model should be that of the DCO in its commercial discretion, and should not be mandated through regulation.

- If a DCO does offer an Alternative Model in addition to the Baseline model, the FCM should retain discretion on which of the two options it will offer to individual clients.

- If a non-participant desires to subsequently change the model applicable to its transactions to an offered alternative, appropriate regulatory minimum notice periods for such change must be considered, provided the DCO and FCM will permit such flexibility in its rules and business practices, respectively, and such notice periods take into considerations the operational capabilities of each.

- Any future portfolio margin regime offered by a DCO that recognizes offsets between futures and OTC products must take into consideration in its design potential differences regarding the position (or lack thereof) of client collateral in the waterfall.

As a result of our experience in central clearing and through our participation in the Federal Reserve Bank of New York study entitled "REPORT TO THE SUPERVISORS OF THE MAJOR OTC DERIVATIVES DEALERS ON THE PROPOSALS OF CENTRALIZED CDS CLEARING SOLUTIONS FOR THE SEGREGATION AND PORTABILITY OF CUSTOMER CDS POSITIONS AND RELATED MARGIN,"[1] CGMI is of the view that the only feasible Alternative Models are Legal Segregation with Commingling (LSOC) and Moving Customers to the Back of the Waterfall. As illustrated by the extreme increases in margin and operational costs noted in the analysis provided by ISDA in its comment letter regarding RIN 3038-AD99 of January 18, 2011, Full Physical Segregation will impose unsustainable burdens on the OTC derivative markets.

CGMI is eager to continue to work with fellow industry participants, DCOs, and regulators in designing central clearing solutions that provide clients the protections they require while maintaining adequate product liquidity and systemic risk mitigation in the market. In closing, for the aformentioned reasons, Citi remains fully supportive of the Baseline model. However, if the CFTC chose to amend Part 190, it is clear that moving forward with an additional Alternative Model option would create new systemic complexities that would have to be considered quite carefully.

Sincerely,

Michael Zimits
Global Head of Derivatives Clearing

Christopher Perkins
U.S. Head of Derivatives Clearing

---

[1] http://www.newyorkfed.org/newsevents/news/markets/2009/an090713.html)