BY OVERNIGHT MAIL AND E-MAIL

March 29, 2011

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 18th Street, N.W.
Washington, D.C. 20581

Re: Newedge USA, LLC Comment Letter Regarding Risk Management Requirements for Derivatives Clearing Organizations/RIN 3038-AC98

Dear Mr. Stawick:

Newedge USA, LLC ("Newedge USA"), on behalf of itself and its parent company, Newedge Group SA ("Newedge Group"), is pleased to submit this comment letter on the proposed rulemaking by the Commodity Futures Trading Commission ("CFTC") relating to risk management requirements for derivatives clearing organizations ("DCO").[1] As you may know, Newedge USA has been an active participant in the comment process relating to rule proposed by the CFTC in connection with the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") and other important regulatory concerns.

Dodd-Frank mandates that DCOs provide qualifying market participants with fair and open access.[2] The benefits of such fair and open access are that it will promote participation by more

[1] As of the end of December 2010, Newedge USA held the largest pool of customer "segregated" and "secured" funds of all US-based futures commission merchants ("FCM"). Newedge USA's primary function is that of a broker; i.e., to execute and clear customer transactions across multiple asset classes -- including securities, futures and over-the-counter ("OTC") derivatives -- on an agency or riskless principal basis. Newedge USA conducts only a very limited amount of proprietary trading, and then generally only to hedge positions acquired through customer facilitation.

Newedge Group is one of the world's largest brokerage organizations offering its customers clearing and execution facilities across multiple asset classes including futures, securities (fixed income and equity), options, FX and various OTC instruments (Newedge refers to Newedge Group, a 50%-50% joint venture between Credit Agricole-CIB and Société Générale, headquartered in Paris, France, and all of its worldwide branches, subsidiaries and other units. Newedge Group maintains offices in 17 countries, and is a member of over 85 exchanges worldwide).

[2] See Commodity Exchange Act, Section 5b(c)(2)(C)(III).

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brokers in the clearing process, which will (a) disaggregate clearing risk among a greater number of market participants and thereby reduce overall systemic risk, and (b) aid competition and result in lower prices for market users.

Thus, any restrictions on eligibility to DCOs -- such as net capital or ability to manage the portfolios of defaulting clearing members -- must be reasonable and tied directly to minimizing the DCO's risk.[3]

DISCUSSION

1. Dodd-Frank

Section 725 of Dodd-Frank states that:

> Participation and membership requirements of each derivatives clearing organization shall (I) be objective, (II) be publicly disclosed; and (III) permit fair and open access.

See Dodd-Frank, Title VII, Subtitle A, Part II, Section 725(c), Paragraph (2)(C), Part (iii).[4] This requirement is consistent with the recommendations presented recently in the CPSS-IOSCO report entitled Principles for Financial Market Infrastructures (March 2011) ("IOSCO Principles") at p. 81:

> 1. An FMI [which includes centralized clearing entities] should allow for fair and open access .....
>
> 2. Any restrictions in an FMI's participation requirements should be justified in terms of the safety and efficiency to the FMI and the markets it serves, be tailored to its specific risks, and be publicly disclosed.

With such a clear Congressional mandate for requiring fair and open access, to the extent a DCO does establish "eligibility" requirements, it must bear the burden of proving that such standards are absolutely necessary to ensure its financial strength and integrity (i.e., that such criteria are not simply artificial barriers to reduce competition). For example, if a DCO were to establish a $5 billion net capital requirement for members -- which would necessarily exclude all market participants except for the largest banks and dealers -- it must be required to show how such a

[3] We also note the Swaps and Derivatives Market Association (http://www.thesdma.org/) has authorized us to indicate that they concur with all arguments presented in this comment letter. SDMA is a financial markets trade group of US and internationally based broker-dealers, FCMs and investment managers participating in all segments of the exchange-traded and OTC and securities markets. The SDMA was created as a nonprofit organization in January 2010 and today has multiple member institutions representing all facets of derivatives execution and clearing. SDMA members trade, market and/or clear credit, equity and commodity products, including credit default swaps and interest rate swaps, providing improved liquidity, transparency, and reduced transaction costs to the securities and derivatives marketplace. Mission & Objective: the SDMA supports effective reform of the OTC markets.

[4] See also Title VII, Subtitle A, Part II, Section 725, Sub-Section (c), Paragraph (2)(N)(I), Part (ii) ("Unless necessary or appropriate to achieve the purposes of this Act, a derivatives clearing organization shall not (i) adopt any rule or take any action that results in any unreasonable restraint of trade; or (ii) impose any material anticompetitive burden").

requirement is absolutely necessary from a risk perspective.[5] We do not believe a DCO could make such a case considering there exist other less exclusionary and equally if not more effective measures to protect it (other than just mandating onerous capital requirements), including: (a) requiring clearing members to provide adequate margin and default deposits; (b) examining members' credit, risk and compliance procedures and controls; (c) assessing members' customer concentration risks; (d) ensuring that members are adequately supervised, and; (e) ensuring that members have adequate excess net capital.[6]

Similarly, if a DCO were to require that all clearing members be capable of accepting upon the default of another clearing member a percentage of its open interest in certain derivatives and manage the liquidation of such positions only through its own personnel -- which could exclude many market participants not having experienced traders in the products at issue -- it must be required to show why such a requirement is absolutely necessary from a risk perspective. Again, we do not believe a DCO could make such a case considering there exist other less exclusionary and equally effective measures to protect it, including: (a) allowing a member to introduce such positions to an entity that does have experience in trading such products, or; (b) hiring a consultant to manage the positions until liquidation. In any case, brokers should be required periodically to stress test their liquidation capability.

Indeed, it was not any of the so-called "small firms" that contributed to the financial crisis of 2008, rather, it was firms that by objective criteria were substantially capitalized and had internal trading capability. The experience of that year demonstrates these qualities alone do not make a strong clearing member! In short, while Dodd-Frank does allow DCOs to establish admission, fitness and continuing eligibility standards for members – including criteria relating to their financial resources and operational capability -- such standards must be "appropriate," "reasonable," minimize "conflicts of interest" and be related directly to minimizing DCO risk.[7]

In addition, ensuring that qualifying brokers may become clearing members and register and clear eligible OTC transactions with DCOs will promote participation by more brokers in the clearing process which will (a) disaggregate clearing risk among a greater number of market participants and thereby reduce overall systemic risk, and (b) aid competition and result in lower prices for market users (which will in turn enable the US swaps market to remain competitive with its non-US counterparts).[8]

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[5] See IOSCO Principles at 83 ("participation requirements based solely on a participant's size are typically insufficiently related to risk and deserve careful scrutiny").

[6] See IOSCO Principles at 83 ("Where necessary, an FMI can establish less restrictive participation requirements in conjunction with other appropriate risk-management controls").

[7] See IOSCO Principles at 83 (financial eligibility requirements "should be objective and should not discriminate unduly against particular classes of participants or introduce competitive distortions").

[8] See IOSCO Principles at 82 ("Fair and open access to FMI services encourages competition among market participants and promotes efficient and low-cost clearing and settlement. ..... In particular, limiting access to an FMI's services may disadvantage market participants (and their customers), other FMIs, and service providers").

2. The Proposed Regulations

a. General Comment

The proposed regulations appear, in general, to be consistent with Dodd-Frank's mandate for fair and open access to DCO membership, and we commend the CFTC in this regard. For example, proposed Sections 39.12(a)(1)(i)-(ii) state that a DCO shall establish appropriate admission and continuing eligibility criteria for clearing members that are "objective, publicly disclosed, and risk-based," and "participation requirements [that] permit fair and open access."[9] With respect to financial eligibility criteria, proposed Sections 39.12(a)(2)(i)-(iii) state, among other things, that: participation requirements shall set forth capital requirements that are based on "objective, transparent, and commonly accepted standards that appropriately match capital to risk," and; a DCO shall not set a minimum capital requirement of more than $50 million for any person that seeks to become a member in order to clear swaps.

With respect to operational requirements, proposed Section 39.12(a)(3) states that members must have adequate operational capacity to meet their obligations arising from participation in the DCO. In addition the proposed rules states that a DCO must adopt default management procedures that will permit it to take timely action to contain losses and liquidity pressures and which will include, among other things, (a) the actions a DCO may take upon default of a clearing member -- which shall include the prompt transfer, liquidation, or hedging of the customer or proprietary positions of the clearing member, and; (b) any obligations that the DCO will impose on its members to participate in auctions or to accept allocations of a defaulting party's positions (provided that any such allocation shall be proportional to the size of the participating or accepting clearing members' positions at the DCO).

b. Specific Comments

Net Capital Requirement

We believe that the proposed $50 million net worth eligibility requirement is closer to the correct standard than some of the prevailing requirements currently mandated by some clearing houses internationally. And to the extent a clearing house considers this amount too low, it can mitigate its risk by, among other things, imposing position limits and stricter margin and default deposit requirements on lesser capitalized clearing members, as well as robust risk management and compliance procedures for all clearing members. However, any such requirements have to be reasonable and related directly to risk (and should require CFTC approval prior to implementation).

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[9] Proposed Sections 39.12(a)(iii)-(v) also state that a DCO shall: not adopt restrictive member standards "if less restrictive requirements that would not materially increase risk to the [DCO] or clearing members could be adopted;" not exclude or limit membership of certain types of market participants unless the DCO can demonstrate that the restriction is "necessary to address credit risk or deficiencies in the participants' operational capabilities that would prevent them from fulfilling their obligations as clearing members;" not require that members be swap dealers, and; not require members to maintain a swap portfolio of any particular size, or that members meet a swap transaction volume threshold.

The International Swaps and Derivatives Association ("ISDA") recently submitted a comment letter addressing this issue (see ISDA comment letter dated March 21, 2011). ISDA states, among other things, that the $50 million net worth requirement may create "call risk" for a clearing organization because, in its view, most swaps clearing members will be members of multiple clearing organizations. Thus, ISDA states that the CFTC should either require a much higher net worth eligibility standard ($1 billion), or require clearing members and DCOs to engage in substantial reporting, monitoring and testing of the clearing members' ability to cover its potential liability at each DCO. While we certainly support regulations requiring the reasonable and appropriate disclosure, testing and monitoring of clearing members' net worth and potential clearing house liability, we believe ISDA has overstated the amount of additional testing, reporting and monitoring that in its view would be required for clearing members that meet the $50 million net worth threshold but not the $1 billion threshold, perhaps in an effort to encourage the CFTC to simply raise the net worth requirement. Among other things:

- all swaps clearing members of US DCOs will have to be registered FCMs (and many of them are also broker-dealers), and thus, are already subject to numerous internal and external testing, reporting and monitoring requirements relating to their net worth and potential clearing house liability (all of these requirements, to our knowledge, will continue in a swaps environment);

- DCOs always have the option of requiring clearing members to reduce their customer and/or proprietary positions or increase their margin or default deposits in the event they believe a particular member is "spread too thinly," and;

- most FCMs hold substantial excess net capital (and the CFTC can encourage such conduct by opting not to require that the margin of customers of a clearing member be guaranteed by DCOs).

Importantly, this minimum capital requirement should be the threshold regardless of the number of DCOs of which an FCM becomes a member. That being said, we do not believe it would be inappropriate for the CFTC to require FCMs to take appropriate haircuts against their regulatory capital in connection with exposure that may arise from calls on clearing members in connection with possible defaults of other clearing members (as well as counterparties on their proprietary OTC positions). Indeed, it would also not be inappropriate for DCOs to assess what should be the position limit of any clearing member, its guaranty fund deposit, and/or its super margin requirements (if any) after evaluating its regulatory capital compared to the total of its DCO memberships and potential liability (both to clearing houses and in connection with performance on their proprietary positions).[10]

[10] Again, any restrictions on access must be justified by a DCO on the grounds they are among the least restrictive ways to protect the viability of the DCO consistent with the core principle of Dodd Frank: fair and open access.

Default Management

We believe the proposed default management procedures outlined in proposed Section 39.16 are generally consistent with fair and open access to DCOs,[11] but caution the CFTC from, in practice, allowing DCOs to establish artificial barriers to membership in this area. For example, we believe that any proposed DCO requirement that a clearing member have internal trading desks capable of liquidating or hedging a defaulting clearing member's positions should be prohibited. As noted above, there is no need for such an exclusionary rule, since a non-defaulting member can handle such positions in a variety of ways, including having a contingent default manager in place that could: (a) assist the member in an advisory capacity on clearing house default management committees; (b) provide personnel acting in an agency capacity to the member serving on a default committee to execute risk neutralizing hedges and to value and bid on a defaulted then hedged portfolio, and; (c) provide operational support of such an acquired or assigned portfolio. Indeed, we believe that providing clearing members the discretion to manage such swaps positions in the ways they choose -- which is the practice currently followed in the futures markets -- is consistent with Dodd-Frank's mandate to reduce systemic risk since members will have the flexibility needed to manage such complex positions in volatile markets. Additionally, what we believe to be more important than in-house trading personnel is requiring members to test their liquidation capabilities regularly and bringing appropriate swaps onto centralized execution facilities – either designated contract markets or swap execution facilities – which will provide a transparent, liquid marketplace for members to liquidate and/or hedge such positions.

Furthermore, regulatory bodies must recognize that the personnel of any firm's trading desk at the time the firm becomes a clearing member serve at the pleasure of the firm's management. Thus, there are no assurances that such personnel or trading desks will remain in place until the moment of a clearing member default, if for example, the clearing member decides to exit or significantly reduce its activity in swap trading prior to a clearing member's default.

Not surprisingly, there are some contrary views to this position. For example, ISDA has stated that clearing members should not be permitted to outsource their default management obligations to "unaffiliated third-parties," as such arrangements may not be "sufficiently reliable" in times of stress and "through the actions of the unaffiliated third-party, a CM could be assigned an unsuitable part of a defaulting CM's proprietary portfolio and/or at a sub-optimal valuation…." See ISDA Comment Letter to CFTC dated March 21, 2011. Similarly, the Financial Services Authority ("FSA") has stated that the "outsourcing" of a clearing member's default management obligations should not be permitted because it would "present additional risk to the system." We do not find these arguments to be compelling. First, as stated in proposed Section 39.16(c)(2)(iii), a DCO would only assign a defaulting member's positions to another clearing member proportionate to the size of the participating or accepting clearing member's own positions at the clearing house. Thus, even in times of severe market stress, it not likely that a

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[11] For example, proposed Section 39.16: states that a DCO can be responsible for the liquidation of portfolios itself through transfers of full books to other willing clearing members; does not mandate that a DCO allocate to non-defaulting members positions of defaulting members, and; to the extent it does, requires that such allocation must be proportional to the size of the participating or accepting clearing members' positions at the DCO.

clearing member would be allocated a position it could not "handle." Second, clearing members will generally be able to hedge an allocated position, and thus, will be able to carry the position over time without having to take a substantial charge to their capital. Again, the key is pre-planning: no firm should first figure out what it would do in the time of market stress "on the fly." Firms should consider their techniques for handling an allocation of a defaulting member's position in advance, and stress test such techniques periodically.

In addition, and in furtherance of the principles of Dodd-Frank, the DCOs should require, as a condition for continuing eligibility as clearing members, that all clearing members (those that make markets and have internal trading capability as well as those that do not) deal with each other in same manner in times of stress as they are required to do so in other times (i.e., fairly and on a non-discriminatory basis), and not in a manner designed to deny liquidity at such times to members that do not make markets or have internal trading capabilities or otherwise gain advantages resulting from the default at the expense of non-defaulting, non-dealing members, to reduce competition and membership in the DCO or otherwise act in restraint of trade.

In any case, it is important to note again that many of the issues that Dodd Frank was intended to rectify were created by firms that were substantially capitalized and had internal trading capability.[12] These qualities did not help such institutions survive 2008.

Standardization of Swaps

Proposed Rule 39.12(b)(3) states that a DCO be required to select contract unit sizes that "maximize liquidity, open access and risk management." Such contract unit sizes may be "smaller than the contract units in which trades submitted for clearing are executed." And, more recently, the CFTC has proposed that a DCO must adopt rules to establish templates for the terms and conditions of the swaps that it will clear.[13] We support both proposed Rule 39.12(b)(3) and the more recent proposal regarding the creation of templates for swaps terms and conditions, as such requirements go to promote the very heart of Dodd-Frank's purpose; namely, the centralized execution and clearing of swaps. Indeed, without adequate standardization of the terms and conditions of swaps, there can be no significant movement toward centralization (either execution or clearing), which would be completely antithetical to Dodd-Frank. Without a requirement for such standardization, a significant percentage of swaps transactions will continue to be executed and cleared OTC on a bilateral basis, which is not what Congress intended. Standardizing the terms and conditions of swaps will (a) foster greater liquidity and transparency in the swaps market – since more swaps will be executed and cleared on centralized platforms; (b) result in more competitive prices for customers and thereby encourage increased foreign investment in the US swaps markets – as a result of such increase in liquidity and transparency; and (c) allow clearing members (and DCOs) to handle more efficiently allocated positions of defaulting clearing members – since standardization will allow for a more liquid and transparent market through which to hedge or liquidate such positions.

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[12] Indeed, both Bear Stearns and Lehman Brothers were registered as consolidated supervised entities given their significant capitalization.
[13] 76 Fed. Reg. 13101 (March 10, 2011).

In making a final determination as to the proposed rules, as well as other rules relating to the centralized clearing and execution of swaps and other OTC derivatives, we hope the CFTC keeps in mind the following general principles that Newedge USA has supported publicly for some time:

a. that, where appropriate, standardized OTC derivatives should be executed and cleared on centralized platforms;[14]

b. that qualifying market participants should have fair, open and non-discriminatory access to centralized execution and clearing facilities;

c. that investment firms should act in the best interests of their clients and avoid situations that could result in conflicts with their clients, and;

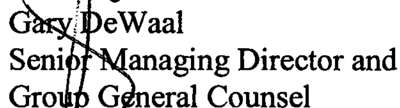
d. that market breaches and other infractions should be vigorously prosecuted.

* * *

We appreciate the opportunity to comment on the proposed rules. Feel free to contact Gary DeWaal at (646) 557-8458, or John Nicholas, US Securities Compliance Director, at (646) 557-8516, if you have any questions.

Sincerely,

Newedge USA, LLC



Gary DeWaal
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[14] That said, it may not be appropriate for illiquid OTC swaps to be centrally cleared.