BY E-MAIL

July 29, 2011

Committee on Payment and Settlement Systems ("CPSS")
Technical Committee of the International Organization ("IOSCO")
Of Securities Commissions
Bank for International Settlements
Communications
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Basel, Switzerland
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Re: CPSS-IOSCO Principles for Financial Market Infrastructure/Newedge Group Comment Letter

Dear Sir or Madam:

Newedge Group SA ("Newedge") appreciates this opportunity to comment on the CPSS-IOSCO Principles for Financial Market Infrastructure ("Principles"). Newedge refers to Newedge Group SA and all of its global subsidiaries. Newedge has been quite active over the years, both in Europe and elsewhere, in working with regulators to develop rules and regulations designed to strengthen our financial markets. In Europe, Newedge has provided input to, among others, the European Commission ("EC"), the Committee on European Securities Regulation and IOSCO in connection with the formulation of various rules and initiatives. Given our broad experience across asset classes as both an executing and clearing broker – including securities, futures and OTC derivatives – we feel we are strongly positioned to provide such input.

In this comment letter, we will address a number of CPSS-IOSCO's high-level principles and supporting commentary (almost all of which we agree with), and focus in particular on the centralized execution and clearing of OTC derivatives. However, before addressing these specific points, we would like to set forth certain fundamental principles that we have consistently advocated, and which we believe any market infrastructure relating to OTC derivatives should encompass. These basic tenets are:

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- To the extent practical, derivative contracts should be traded through a centralized clearing platform ("CCP") and executed, in the first instance, on a regulated, transparent platform, absent important countervailing reasons (e.g., block trades necessary for seamless execution without adversely impacting the market and/or the executing client).

- The mutualization of risk should be preferred over bilateral risk, because this provides the best opportunity to avoid government bailouts. This mutualization must occur at all levels of the clearing process (e.g., clearinghouses and brokers).

- CCPs should have robust and transparent governance structures, and should not permit the issuance of significant rules through self-certification; i.e., without review by a governing regulatory body and opportunity for public comment.

- CCPs work best when they embrace the principle of "open access," and as a result, are supported by the largest number of diverse clearing members.

- CCPs' entry requirements should balance carefully open access with the necessity to have competent clearing members (e.g., with appropriate capital and operational capabilities). However, rules which are clearly exclusionary should not be permitted by any regulator (e.g., too high capital requirements or default management requirements that solely can be met by a single type of clearing member).

- Liquid marketplaces provide the best forum for brokers or CCPs to liquidate defaulting customers' positions, let alone provide customers on an ongoing basis the best opportunities for seamless execution.

- Marketplaces become liquid and maintain their liquidity (e.g., become efficient) by having transparent rules and robust execution facilities, and encouraging trading by multiple customer types.

- Rigid position limits, absent emergency situations, should be avoided. Accountability limits may be appropriate.

- Brokers engaging in customer activities must act in the best interests of their clients; such entities must avoid conflicts of interests. That being said, imposing arbitrary Chinese Walls within an entity or within a group of entities should generally be avoided.

- Fraud and market offenses (e.g., intentionally attempting to manipulate or cause non-bona fide market prices), as well as benefitting from a conflict of interest, must be rigorously prosecuted by regulators.

BACKGROUND

Newedge, which is one of the world's largest brokerage organizations, offers its customers clearing and execution facilities across multiple asset classes including futures, securities (fixed income and equities), options, FX and various OTC instruments.[1] Newedge maintains offices in over 15 countries, and is a member of over 85 exchanges worldwide. As of June 2011, Newedge had an estimated global market share in listed derivatives of 11% (clearing) and 11.9% (execution), and over Euro 50.8 billion of client assets on deposit. Newedge was ranked among the top brokers on most European exchanges for both clearing and execution volume as of the end of 2010. Newedge's primary function is that of a broker; i.e., to execute and clear customer transactions across multiple asset classes on an agency or back-to-back principal basis. Newedge conducts very little proprietary trading, and then generally only as a hedge in connection with the facilitation of customer orders.

Newedge is very active in Europe, Asia and the US in the execution and clearing of OTC derivatives, including financial, commodity and FX based swaps, options and forwards. Newedge executes OTC derivatives on both an agency and back-to-back principal basis, but always acts as a broker in such transactions, and never as a dealer. Newedge has significant experience in the centralized clearing of OTC derivatives as well. For example, Newedge has been a member of CME ClearPort – which provides for the centralized clearing of OTC executed energy, metals, agricultural and FX swaps – since ClearPort's formation in 2002. Newedge is also a member of most clearinghouses globally that provide such clearing services – including ICE Clear Europe, CME Clear Europe, NYSE Euronext Bclear, the International Derivatives Clearinghouse and SGX AsiaClear, as well as many of the leading OTC derivatives execution platforms, including Eris, Nodal and ICE OTC Market.

Indeed, Newedge has been pro-actively involved with the industry for a number of years in promoting the establishment of fair and transparent CCPs for OTC derivative transactions.[2] Newedge has participated in numerous meetings with US regulators relating to the Dodd-Frank Wall Street Consumer Protection and Transparency Act ("Dodd-Frank") – including public roundtables relating to, among other things, the definition of a swaps dealer and the protection of cleared swaps customer collateral – and has submitted numerous comment letters to the US Commodity Futures Trading Commission ("CFTC") and the US Securities and Exchange Commission ("SEC") on such topics on its own and in connection with FIA, SIFMA and ISDA.[3]

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[1] "Newedge" refers to Newedge Group, a 50%-50% joint venture between Credit Agricole Corporate and Investment Bank (formerly Calyon) and Societe Generale, headquartered in Paris, France, and all of its worldwide branches, subsidiaries and other units.

[2] Newedge is also a member of most of the industry associations actively involved in the development of OTC derivatives regulations, such as the Swaps and Derivatives Market Association, the US Futures Industry Association ("FIA"), the Futures and Options Association, the Securities Industry Financial Markets Association ("SIFMA") and the International Swaps and Derivatives Association ("ISDA").

[3] Newedge will be participating on August 1, 2011 in the CFTC-SEC Public Roundtable on International Issues Relating to Dodd-Frank.

DISCUSSION

We address below four basic principles relating to OTC derivatives regulation: (1) that OTC derivatives should, to the extent possible, be centrally executed and cleared; (2) that CCPs should be open to buy side participation through qualifying brokers; (3) that CCPs should have fair and transparent governance structures and not permit the issuance of material rules through self-certification, and; (4) that cleared swap customer collateral should be maintained at CCPs on an omnibus basis.

1. OTC Derivatives Should, To The Extent Possible, Be Centrally Executed and Cleared.

As we have stated on numerous occasions over the past several years, we believe strongly that: (a) OTC derivative transactions should, to the extent possible, be cleared through CCPs and executed, in the first instance, on a regulated, transparent platform -- absent important countervailing reasons (such as a block trade necessary for seamless execution without adversely impacting the market and/or the executing client): (b) to further encourage centralized clearing, capital rules should be adopted that reward investment firms for holding centrally cleared products and penalize them for holding non-centrally cleared ones; (c) to the extent OTC derivatives transactions are not executed and/or cleared centrally, they still must be reported to centralized repositories to ensure adequate transparency as a means of establishing visible prices, volumes and open interest, facilitating market access and decreasing the systemic risks associated with such products, and; (e) to the extent a CCP elects to clear a specific class of OTC product (e.g., interest rate swaps), it should be required to clear all standardized OTC derivatives that fall within that class unless it can establish a valid reason as to why it should not be so required.[4]

These views are supported by regulators globally, including the EC. The EC supports the centralized clearing of standardized OTC derivatives as a means of, among other things, establishing "highly visible prices, volumes and open interest ..... [,] facilitat[ing] market access,"[5] and decreasing the systemic risks associated with such products.[6] In addition, we note that the mutualization of risk should be preferred over bilateral risk because it

[4] Indeed, we believe a CCP may have legitimate reasons – such as a lack of liquidity – as to why it would not want to clear a standardized OTC derivative falling within a class of products it clears generally. Thus, we do not believe a CCP should be forced to clear all relevant standardized products. However, to the extent a CCP determines not to clear a standardized contract that falls within the class of products it clears generally, we believe (a) such determination must be based on non-discriminatory and compelling reasons, (b) the governing authority to which the CCP is subject should be advised of such decisions, and (c) any entities (such as customers or investment firms) impacted by the decision should have an opportunity to to comment on the matter prior to the decision being issued.

[5] See "Regulating Financial Services for Sustainable Growth," 6 February 2010 (EC noting that "[t]ransparency is indispensible for well-functioning markets and trust and mutual confidence between market participants. The lack of transparency regarding certain transactions, products and market participants was one factor that contributed to the recent crises. Consequently, enhancing transparency is one of the overarching objectives of the EU's financial reform").

[6] See "Financial Services: Commission Outlines Ways to Strengthen the Safety of Derivatives Markets" (EC noting that trading derivatives on organized markets would "strengthen risk management").

provides the best opportunity to avoid government bailouts, and that the mutualization of risk must occur at all levels of the clearing process (e.g., clearinghouses and brokers) in order to provide for such systemic relief. For this reason primarily, the centralized clearing of OTC derivatives has been mandated in the US by Dodd-Frank and globally by the G-20.

Although CPSS-IOSCO does not specifically address the points listed in (a) through (e) above, most, if not all of the high-level principles it set forth are consistent with the centralized execution and clearing of OTC derivatives.[7] As a regulatory organization many CCPs will look to for guidance on the regulation of OTC derivatives, however, we would like to see CPSS-IOSCO state explicitly its support of these specific points.

2. CCPs Must Be Open to Buy-Side Participation Through Qualifying Brokers

CPSS-IOSCO states generally that an "FMI should have objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access." Principle 18. This view is shared by the EC, which has stated:

> A CCP should establish categories of admissible clearing members and the admission criteria. These criteria should be non-discriminatory, transparent and objective so as to ensure fair and open access to the CCP...... Criteria that restrict access should only be permitted to the extent that their objective is to control the risk for the CCP.[8]

We also believe that CCPs work best when they embrace the principle of "open access" and, as a result, are supported by the largest number of diverse clearing members, including banks, dealers and brokers.

However, while CPSS-IOSCO does generally support fair and open access, we believe it should specifically recommend that qualifying brokers be eligible for admission to CCPs. Ensuring that qualifying brokers may become clearing members and register eligible OTC transactions with CCPs will create what we call "open" CCPs which, in our experience, have led to increased transparency and liquidity and narrowed spreads in the OTC derivatives market.[9] Liquid marketplaces, in our view, provide the best forum for

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[7] See, e.g., Principle 2 ("[a]n FMI should have governance arrangements that are clear and transparent, promote the safety and efficiency of the FMI, and support the stability of the broader financial system, other relevant public interest considerations, and the objectives of the relevant stakeholders") and Principle 3 ("[a]n FMI should have a sound risk-management framework for comprehensively managing legal, credit, liquidity, operational, and other risks").

[8] See also Section 3.1(3) of Future Policy Actions (EC to propose legislation setting forth "[l]egal protection to collateral and positions provided by clearing members' customers, so as to encourage a wide range of market participants to use central clearing").

[9] Increasing the number and type of clearing members in a CCP – in our view and that of the EC – also reduces the systemic risk associated with OTC derivatives by decreasing concentration risk. See EC Derivative Markets – Frequently Asked Questions ("an additional factor that needs to be taken into account [in assessing the risks of OTC derivatives] is the extreme concentration of some market segments, which entails severe implications in case one of the players defaults").

brokers or CCPs to liquidate defaulting customers' positions, in addition to providing customers on an ongoing basis the best opportunities for seamless execution.

We also believe, as does CPSS-IOSCO, that a CCP's qualifying requirements for brokers and other applicants – i.e., its "admission criteria" – must be fair, objective and based on significant commercial, risk-related or other legitimate needs (and be subject to review by the relevant governing authority).[10] In particular, we believe that qualification requirements resulting in the exclusion of non-dealers without a material basis should be disallowed. Again, given the importance of CPSS-IOSCO in "setting the tone" for CCPs globally, we believe it should clearly state that direct or indirect eligibility requirements that unnecessarily exclude brokers should not be permitted.

For example, if a CCP were to establish a $5 billion net worth 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 requirement is absolutely necessary from a risk perspective. We do not believe a CCP could make such a case considering there exist other less exclusionary and equally if not more effective measures to protect it, 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.[11] This view appears to be shared by the CFTC which recently proposed a rule stating that swaps clearinghouses may not set a regulatory capital eligibility requirement of over $100 million.

Similarly, if a CCP 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 CCP 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 short, a CCP's entry requirements should balance carefully the necessity to have competent clearing members (e.g., with appropriate capital and operational capabilities). However, rules which are clearly exclusionary should not be permitted by any regulator (e.g., too high capital requirements or default management requirements that solely can be met by a single type of clearing member).

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[10] See Principle 18, Key Consideration 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 specific risks, and be publicly disclosed").

[11] Indeed, as we have seen from the fall of Lehman Brothers and Bear Stearns, significant size by itself does not guarantee financial stability. Indeed, large entities often pose a greater risk to clearinghouses than brokers and other market participants because of the large size of their open positions and the manner in which they net their risk exposure.

A recent example of such exclusionary practices involves ICE Clear Credit in the US, which serves as a CCP for credit default swaps. ICE Clear Credit recently issued new eligibility criteria that limit participation to entities having $100 million in regulatory capital (so as to be consistent with the CFTC's proposed rule on CCP eligibility requirements relating to regulatory capital), but also requires that that members have excess regulatory capital of at least 5% of their customer segregated funds. This rule would actually prohibit Newedge USA, LLC ("NUSA") – the largest futures commission merchant ("FCM") in the US – from becoming a member (despite the fact that NUSA holds a very sizeable amount of excess net capital) given the enormous amount of customer segregated funds held by NUSA. Such eligibility criteria are not tied to risk and will serve to keep most brokers that conduct futures activities from becoming members. Newedge plans to address this issue directly with ICE Clear Credit.

3. Fair and Transparent Governance

We believe, as does CPSS-IOSCO, that CCPs must have a fair and transparent governance structure.[12] This view is also shared by the EC.[13] Indeed, we believe that marketplaces become liquid and maintain their liquidity (e.g., become efficient) by, among other things, having transparent rules and robust governance structures.

We do note in this regard, however, that CPSS-IOSCO does not specifically address the manner in which CCPs will issue new rules and, more specifically, whether CCPs will be permitted to issue rules through "self-certification." As we have previously stated, we feel strongly that rule self-certification should not be permitted. Self-certification enables CCPs to issue rules that materially impact the rights and obligations of members without allowing such members, or the governing authorities, the ability to review and comment on such rules and thereby ensure that the interests of all market participants – and the market itself – are adequately protected. In our view, CCPs should be required to obtain approval on new rules from their internal risk committees and governing authorities prior to implementing them. Only then will the rights of all clearing members be fully-protected.[14]

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[12] See, e.g., CPSS-IOSCO Principle 2 ("[a]n FMI should have governance arrangements that are clear and transparent, promote the safety and efficiency of the FMI, and support the stability of the broader financial system, other relevant public interest considerations, and the objectives of relevant stakeholders") and Principle 23 ("[a]n FMI should have clear and comprehensive rules and procedures and should provide sufficient information to enable participants to have an accurate understanding of the risks they incur by participating in the FMI").

[13] See, e.g., Section II(1), (2) and (3) of the EC Derivatives PC (CCPs should: create risk committees "composed of representatives of its clearing members and independent administrators;" notify their governing authorities in cases where they do not abide by their risk committees' decisions, and; allow the clients of clearing members to participate in risk committees or establish an appropriate consultation mechanism that ensures that their interests are adequately represented).

[14] As an example of issues associated with self-certification, in 2010 Newedge and MF Global sent a joint letter to the CFTC and the Chicago Mercantile Exchange ("CME") objecting to CME's establishment of a new rule – issued via self-certification – holding all clearing members responsible for the liabilities of a defaulting member involved in the clearing of credit default swaps ("CDS"), including members who do not participate in CDS clearing.

For the reasons noted above, we believe CPSS-IOSCO should explicitly recommend against rule self-certification, and recommend that all rule proposals be submitted to a regulator and have an opportunity for public comment.

4. Cleared Swaps Customer Collateral Should Be Maintained By CCPs On An Omnibus Basis.

CPSS-IOSCO states generally that customer collateral should be well-protected by CCPs and subject to porting, and discusses the maintenance of such collateral at CCPs on both a segregated and omnibus basis. See Section 3.14. Further, while CPSS-IOSCO notes the merits of both arrangements and does not strongly endorse either, it does state that CCPs "should consider offering individual customer account segregation given the additional customer protection benefits." See Section 3.14.10. We believe that the omnibus model – in which, contrary to most individual segregation models, the collateral of non-defaulting customers of an insolvent clearing member can be used to off-set amounts owed by the clearing member to the CCP – is actually more advantageous to customers for the reasons set forth below.

a. The Omnibus Model Avoids Adding Moral Hazard to Clearing; Indeed, Eliminating Customer Off-Sets Is "Anti-Customer."

As a general matter in the US at least, FCMs routinely maintain substantial excess capital in order to attract significant institutional as well as other customers. This strengthens the entire clearing process. However, to the extent a CCP is required to look through the default of a clearing member and satisfy all non-defaulting customers of that member through other clearing member funds – which would be the case in an individual segregation arrangement providing customers with complete legal segregation – clearing members will be motivated to maintain only the minimum capital required because they will:

- be able to attract large customers without having to maintain substantial excess capital by pointing out that such customers will always be made whole by the clearinghouse regardless of what happens at a defaulting FCM, and;

- want to protect themselves against supplemental calls for guaranty fund deposits by the clearinghouse to satisfy amounts that must be paid to the aggregate "winners" of a defaulting member for which they are not responsible and have no practical way to protect themselves against (e.g., non-defaulting FCMs effectively must guarantee possibly poor risk policies and insufficient capital of other clearing members).

Indeed, individual segregation models that provide full legal protection to customers in effect substitute the so-called inability of customers to protect themselves against "fellow customer risk" by requiring other brokers blindly to assume that risk instead. This introduces a level of moral hazard that is unacceptable. Unlike a customer who can choose its broker, or a broker itself which can conduct risk management on its own

customers, a complete legal segregation model provides that a broker randomly take the risk of a customer at another broker which it does not know and cannot possibly protect itself against.

Similarly, guaranteeing swaps customer collateral at the clearinghouse level could, in our view, result in a "race to the bottom" with respect to clearing members and their risk management practices. Specifically, to the extent such collateral is guaranteed, customers, we believe, are encouraged to select clearing members on the basis of having criteria other than strong risk management practices (e.g., pricing). Consequently, clearing members will be less motivated to spend time on their risk management controls since they will be able to attract customers without them. This is a concern was stated publicly by the CME at a recent CFTC Roundtable on the topic: See, e.g., Testimony of Ms. Kim Taylor, Director of Operations, CME Clearing Inc., Roundtable at 122:

> And that's one of the concerns that I have about moving from a model [the current futures model in the US] that provides an incentive for the clients to care about the credit worthiness of the clearing members. I really think that is a part of the bedrock that has made the futures industry very safe over a very long period of time.

In short, under an individual segregation model that provides customers with complete legal segregation, some customers may benefit – certainly those at defaulting firms – but not customers at the non-defaulting firms who potentially will be put at risk because of the possible strain on their broker's capital – a risk non-defaulting brokers cannot fairly protect themselves against.

In addition, we believe that complete legal segregation is not as "pro-customer" as some may think since it does not eliminate all clearing risks to customers. For example, under such arrangements, customers may continue to bear: (a) position transfer risk (i.e., porting risk) given various jurisdictions' differing bankruptcy laws which may prohibit the transfer of positions to a solvent clearing member in spite of the CCP's own rules (a point noted by the CFTC with respect to US bankruptcy law at the aforementioned Roundtable[15]), and (b) "Madoff" risk; i.e., the risk that the books and records of the defaulting clearing member would not be accurate (either inadvertently or intentionally) thereby inhibiting the proper distribution of customer positions and funds.[16]
Moreover, the fundamental premise of the complete legal segregation model – to prevent non-defaulting customers from being subject to "other customer" risk – was recently challenged by the entity with perhaps the most knowledge in the US regarding the protection of customer collateral; namely, the CME. At the Roundtable, Ms. Taylor testified as follows regarding complete legal segregation:

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[15] See Testimony of Bob Wasserman, Roundtable at 206 (conceding that "there [is] a basis ... to question" bankruptcy treatment regarding the transfer of customer positions under the CLSM).

[16] A risk similarly discussed at the Roundtable. See, e.g., Testimony of Mark Szhycher, General Motors Pension Plan, Roundtable at 13 ("Furthermore, and perhaps even more importantly, the ultimate effectiveness of complete legal seg in a bankruptcy or double-default situation would really rely on the completeness and accuracy of the records that are being held by the FCM to figure out what we're actually holding and, therefore, what we are supposed to receive back").

- "I think that it does not work effectively on a day when we really need it" (Roundtable at 30);

- "it will end up being a coincidence whether or not any particular customer actually gets the benefit of the [complete legal segregation] model, because once a customer has defaulted to the clearinghouse, they no longer have the protection of not having their assets used" (Roundtable at 32);

- "I am afraid [in speaking about complete legal segregation] ... that the customers will walk away thinking that they have a protection that they don't in fact have, because if the clearinghouse does not get paid on losses that are due and owing to it from the clearing member on behalf of the clients that owe money, the clearing member has defaulted ... [a]nd I think by definition all those clients have defaulted" (Roundtable at 41), and;

- "I could do that [port non-defaulting customer positions to another FCM] in the [complete legal segregation] model for the customers who made money the day of the default, but I can't do it for the customers who lost money the day of the default because every one of those customers technically has defaulted and until I find out if I can get more money from any of them, they have all not met their obligations to the clearinghouse" (Roundtable at 223).

b. Implementing Individual Segregation Models Can Increase Customer Costs and Margin, as well as Clearing Member Default Fund Deposits and Infrastructure Changes

To the extent CCPs will not be able to rely on the pool of non-defaulting customer collateral in the event of a clearing member default, they may look to make up that shortfall elsewhere. We believe that CCPs are most likely to manage the additional risks by increasing customer margin and/or clearing member default fund requirements. Increasing margin requirements will decrease the amount of money customers will have to invest, and increasing clearing member default fund requirements will likely result in clearing members increasing fees to their customers. This view appears to be shared by many buy-side customers as well.[17]

In addition, to the extent a legal segregation model is implemented, clearing members may have additional infrastructure and operational changes to make which could further serve to increase customer costs and fees.[18] CCPs may also have operational and other

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[17] See Testimony of Christine Ayotte-Brennan, Fidelity Investments, Roundtable at 64 ("but what I've heard being said is that if we use [complete legal segregation], then we may additional costs that may be put into the margin"); Testimony of Mr. Thum, Roundtable at 93 ("at the end of the day the DCO has to establish margin levels that will meet the risk presented in each bucket. So, for the bucket that is the [complete legal segregation] model, presumably the margin levels would be higher. Perhaps the guarantee fund might be higher, things like that. In the futures model, the margin levels presumably would be less").

[18] See Testimony of Mr. Alessandro Cocco, J.P. Morgan Futures, Inc., Roundtable at 18 ("we think that there are some costs that we will have to face in terms of opening up a large number of accounts for

changes to make in connection with implementing a complete legal segregation model which could also be passed on to clearing members and ultimately customers.[19]

c. Swap Customers Can Limit Their Off-Set Exposure By Choosing Their FCM Wisely.

Rather than establishing a legal segregation model, we believe it would make more sense for regulators to require clearing members to disclose certain additional material financial and risk-related information publicly and then allow prospective swaps customers to minimize their off-set risk by selecting well capitalized clearing members with robust risk policies.[20] This is a position Newedge has consistently proposed. For example, clearing members could be required to disclose the following to their prospective customers on at least an annual basis:

- their total equity, regulatory capital and net worth;
- the value of their proprietary margin requirements as a percentage of its segregated and secured customer margin requirements;
- what number of their customers comprise an agreed significant percentage of its customer segregated funds;
- the aggregate notional value of non-hedged, principal OTC transactions into which the clearing member has entered;
- the amount, generic source and purpose of any unsecured and uncommitted short-term funding the clearing member is using;
- the aggregate amount of financing the clearing member provides for customer transactions involving illiquid financial products for which it is difficult to obtain timely and accurate prices;

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implementing the complete segregation model"), and at 96 ("it would be easier to just implement what we already do for futures"); Testimony of Wasserman, Roundtable at 245 ("Clearly if these guys incur operational costs, those are going to find their way out of your pockets because they're going to impose them on you").

[19] See Testimony of Taylor, Roundtable at 28 ("I think there will need to be changes to reporting requirements that we'll need to work out so that the FCMs can report to the DCOs the status of the accounts ..... I think there might need to be changes to the 1-FR reporting process, as well as related to what needs to reported differently in this environment ..... [a]nd I think we need to review our audit processes, possibly that affects the staffing, and possibly we even need to evaluate a cost pass-through model to the industry if the costs of auditing for this type of activity skyrocket. Right now those are costs we just bear as a benefit to the industry").

[20] Many customers already engage in such reviews futures and securities activities, as well as, apparently, for cleared swaps activities. See Testimony of William C. Thum, The Vanguard Group, Inc., Roundtable at 9 ("we are talking to several FCMs at present to valuate them serving as our FCMs for cleared derivatives. We have been engaged with them in terms of understanding their infrastructure ... [and] their strengths in terms of assessing credit risks presented by clients...")

- the percentage of customer "bad debts" the clearing member had during the prior year compared to its year-end segregated and secured customer funds,[21] and

- a summary of the clearing member's current risk practices, controls and procedures.[22]

In short, sophisticated customers can protect themselves by choosing well-capitalized clearing members with good risk procedures (so long as they are provided with accurate and useful information about them). That's how the system in the US has always worked, and we believe that's how it should work globally. If individual customers want better protection, they can work this out with their brokers; there are creative solutions we can all come up with – and we should! But let's not propose to weaken the system for most everyone. As stated eloquently by the CME:

> Yes, there is an omnibus customer protection model. Yes, theoretically you are all exposed every day to fellow customer risk. But there are so many protections in the system to prevent that from ever becoming a reality that it has a very good track record of being very successful over a long period of time through extreme crises situations.[23]

In light of the above, we believe CPSS-IOSCO should recommend use of the omnibus model for the protection of customer collateral.

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We greatly appreciate CPSS-IOSCO's efforts in soliciting the public's views on these important principles, and for all of its actions in making global financial markets more efficient, transparent, liquid, cost-effective and fair.

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[21] Regulators could consider reviewing the adequacy of such disclosures in connection with an FCM's routine examinations.

[22] As we have stated, however, in order to be effective and useful for customers, CCPs will need to mandate that clearing members disclose information beyond just capital and excess capital levels.

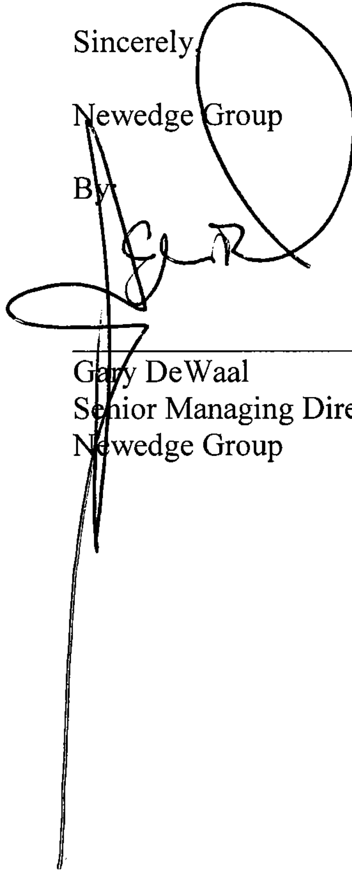
[23] We also believe such "other customer risk" is overstated (see Testimony of Oliver Frankel, Goldman Sachs and Co., Roundtable at 257 (commenting on the Futures Model and noting "[t]he diversification in the client account is so great across customers, in the future as well – in our futures client account, one individual client does not comprise very much at all of that account, and so the fellow customer risk gets shared across so many other clients that it's de minimis loss"), and can be further minimized by CCPs requiring gross margining.

Thank you again for allowing us an opportunity to comment on the PC. If you have any questions regarding the matters discussed herein, please do not hesitate to contact the undersigned at +1 646 557-8458 or John Nicholas, Global Head of New Regulation Monitoring and Implementation, at +1 646 557-8516.

Sincerely,

Newedge Group

By:



Gary DeWaal
Senior Managing Director and Group General Counsel
Newedge Group