The Pulse of Finance

Newedge

BY E-MAIL AND OVERNIGHT MAIL

September 14, 2009

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
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Washington, DC 20581
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Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NW
Washington, DC 20549-1090
Rule-comments@sec.gov

Re: Newedge USA, LLC Written Submission Regarding Harmonization of CFTC and SEC Rules

Dear Mr. Stawick and Ms. Murphy:

Newedge USA, LLC ("Newedge USA"), on behalf of itself and the entire Newedge organization, is pleased to provide these additional comments on the possible harmonization of market regulation under the federal securities and futures laws to supplement our testimony before the September 2, 2009 CFTC/SEC (collectively, the "Agencies") rule harmonization hearings. Again, we greatly appreciate the honor of being invited to testify during the hearing, and to be able to take part in this historic endeavor.

As our long-standing public statements and writings reflect, Newedge has consistently supported efforts to harmonize CFTC and SEC rules. Indeed, given that a single US financial services regulator, which is our preference, appears not likely to be created soon, we believe rule harmonization is the next best course of action. Among other things, harmonization will, in our view, help the CFTC and SEC better manage systemic market risk in the US and be good for business. Indeed, too much of the US's financial services business has already been lost to the UK and other jurisdictions where applicable regulations are more consistent. Such consistency, we have learned, results in regulations that are better understood by institutional customers, making it less cumbersome for them to conduct their global business activities.

In fact, from our vantage point as a global broker, we have long been struck with the inconsistencies between the Agencies' rules. For example, currently, a joint US broker-dealer ("BD") and futures commission merchant ("FCM") could be required to decline a customer's request, based on FINRA suitability grounds, to buy an ETF such as US Oil but be able to offer the same customer an opportunity to buy crude oil futures. Some US intermediaries, such as Newedge USA, have sought to resolve these inconsistencies by applying the more stringent set of standards to their activities, while other brokers, we believe, have sought to benefit from the inconsistencies through rule arbitrage. It is time to level the playing field and make US intermediaries and markets more competitive with our off-shore counterparts.

In our view, for true and effective harmonization to prevail, regulators must begin to focus not on existing financial services categories – e.g., the names of things, such as "securities and futures" or "brokers" and some aspects of "exchanges"[1] – that were put in place years ago by officials dealing with a vastly different marketplace, but rather look behind these "names" at the precise nature and function of the instruments, activities and registrants involved in today's markets. Taking down these artificial boundaries and seeing all financial products through a "time spectrum" (as we discuss below) will, we believe, allow regulators to see the many similarities between futures and securities which will assist in the harmonization process.

In our view, all financial products have essentially two key dates or series of dates: the delivery date and the dates before delivery. On the delivery date, financial products – of whatever type – are delivered,[2] and customers are expected to pay for or finance them. This is the case today whether the products are called securities (and thus either subject to full payment or financing under Regulation T and SRO rules) or futures (and likewise subject either to full payment or financing in whole or part). Before the delivery date, there is an agreement to buy or sell the financial product on the delivery date, and typically this agreement is "guaranteed" through the posting of a good faith deposit that is adjusted daily. Indeed, since as a global broker we offer both securities and futures, we have structured our primary customer agreement, the Global Terms of Business, to reflect this rather simple approach to financial products regardless of the precise type of instrument being bought or sold.

Accordingly, we support fully the President's call to action regarding rule harmonization and, as we have already shown, stand ready to assist the Agencies throughout this

[1] Exchanges increasingly provide not only central marketplaces – which is their traditional core function – but ancillary services which often compete directly with brokers.
[2] Some futures products are settled through cash only, and there is no transfer of title related to the referenced product.

endeavor based on the expertise we have gained from our many years as a joint BD/FCM and global broker.

While we believe that ultimately there are many potential areas for rule harmonization, we are also cognizant of the Agencies' September 30, 2009 deadline to provide initial feedback and recommendations to the President's financial services task force. Thus, we believe the SEC and CFTC should approach their efforts practically; that is, divide potential areas of harmonization between what can be done quickly with minor rule amendments (the "quick wins") and what might take a longer time. The quick wins, which should be dealt with first, are areas that (a) have the general support of both the securities and futures industries -- and which will yield immediate and substantial benefits to the US financial markets – such as portfolio margining, and; (b) can be resolved at the administrative level without the involvement of Congress.

BACKGROUND

As 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. "Newedge" refers to Newedge Group, a 50%-50% joint venture between Calyon (part of Crédit Agricole) and Société Générale, headquartered in Paris, France, and all of its worldwide branches, subsidiaries and other units. Newedge maintains offices in over 15 countries, and is a member of over 80 exchanges worldwide. Newedge estimates that its customers – who are principally institutional – execute 6.4 million lots and clear 7.0 million lots, globally, on a daily basis.[3]

Newedge USA is one of the leading BD/FCMs in the US.[4] Indeed, according to CFTC statistics, Newedge USA holds the second largest pool of customer "segregated" and "secured" assets of all US-based FCMs.[5] Newedge USA's primary function is that of a broker – i.e., to execute and clear customer transactions across multiple asset classes on either an agency or riskless principal basis. Newedge USA, which has been a joint BD/FCM since approximately 1995, conducts only a very limited amount of proprietary trading, and then generally only to hedge positions acquired through customer facilitation. As a result, Newedge USA does not generally hold large positions in inventory. Newedge USA personnel routinely sit on futures and securities industry committees and task forces, participate in industry conferences and seminars, and comment on proposed Agency and self-regulatory organization ("SRO") rules.

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[3] As of December 31, 2008.

[4] Effective January 2, 2008, Fimat USA, LLC changed its name to Newedge USA, and effective September 2, 2008, Newedge Financial, Inc. – the former Calyon Financial, Inc. – merged into Newedge USA.

[5] As of August 2009.

DISCUSSION

1. Portfolio Margining

In our opinion, the most beneficial area for harmonization is in portfolio margining. We believe this view was shared by most of the panelists at the September 2 hearings. For the past three years, Newedge USA has been a leader in providing portfolio margining services to its customers. Portfolio margining reduces customer, broker and market risks, allows for the more efficient use of capital and, in general, more accurately aligns margin requirements with portfolio risk than does traditional strategy-based margining. Currently, under SRO rules, US brokers are entitled to include in portfolio margining accounts certain futures and options on futures products, as well as a variety of securities and OTC derivative products. Unfortunately, certain Agency actions – such as the CFTC's and SEC's refusal to recognize each other's respective customer asset protection locations – have prevented brokers from offering this important service to their multi-asset customers.

Consequently, we urge (a) the CFTC to permit, under its customer segregation rules, customer assets to be maintained in securities accounts of registered BDs, (b) the SEC to deem futures accounts at registered FCMs to be "good control locations" under its customer protection laws, and (c) both the SEC and CFTC to petition Congress to conform bankruptcy laws relating to insolvent BDs and FCMs to allow for the clear and orderly liquidation of assets (including amending the Securities Investor Protection Act to cover futures-related assets) for the benefit of customers and counterparties. And, to the extent establishing a "one pot" approach to portfolio margining is contingent on modifying applicable bankruptcy law – which we realize could be a relatively time-consuming task – we encourage the Agencies to adopt a "two pot" approach as an interim measure, since a two-pot approach will still provide customers with the benefits of available futures off-sets.

We also believe that full portfolio margining is critical in encouraging brokers, such as Newedge USA, to participate in the clearing of credit default swaps ("CDS") and other OTC products. Specifically, CDS and other OTC derivative products are anticipated to have higher margin requirements than traditional futures or securities products. Thus, holding them outright over a long term for customers will generate significant capital requirements for joint BD/FCMs that compute their capital pursuant to the risk-based customer margin method, since such firms' capital requirements increase as the amount of customer margin they hold increases. However, comprehensive portfolio margining will allow brokers' clients to offset their securities and futures positions with CDS and other OTC derivative products, and vice versa, thereby lowering their margin requirements and, consequently, brokers' own capital requirements. And, encouraging registered brokers – which are subject to a host of capital, margin, suitability and other requirements – to become involved in the OTC derivatives market will, in our view, assist in reducing overall market risk.

2. Quick Harmonization Wins

As noted above, we also recommend that the Agencies focus, at least initially, on areas of harmonization that can yield quick wins. Some of our quick win proposals are designed to reduce costs to intermediaries, simplify the regulations and reduce potential gaps between the Agencies such as those relating to books and records retention requirements, client type definitions, customer funds protection, customer disclosures and US customers investing in overseas products. Other of our proposals are designed to advance the public interest in ways that we do not believe will materially impede business, such as those relating to insider trading and suitability. We discuss all of these proposals below.

a. Books and Records Retention Requirements

Both the SEC and CFTC have required books and records retention requirements. Required BD books and records must be held for a minimum of either three or six years – depending on the records involved – while required FCM books and records must be held for a minimum of five years.[6] Both Agencies also have comparable rules relating to the retention of required books and records stored electronically.

We recommend these rules be harmonized, and suggest that the CFTC's five-year requirement be adopted uniformly as an "in the middle" compromise to achieve such harmonization. We also suggest that the FCM electronic storage requirements be modified, to the extent necessary, to conform to BD requirements since, among other things, there are many more BDs than FCMs, and thus, such harmonization would require fewer brokers to change their procedures.[7]

b. Client Type Definitions

We also recommend that the Agencies harmonize their respective customer categories and definitions. This effort, we realize, will also require the Agencies to harmonize their own definitions. For example, on the SEC side, high net worth, experienced investors are defined, depending on the activity in question, either as Qualified Institutional Buyers (under SEC Rule 144A), Major US Institutional Investors (under Rule 15a-6), Accredited Investors (under Regulation D), Qualified Purchasers (under the Investment Company Act), Institutional Investors (under FINRA rules) or Designated Accounts (under NYSE margin rules). Each of these definitions contains different entity and financial categories and tests. On the CFTC side, FCMs have Eligible Contract Participants, the definition of which differs from each of the above-mentioned SEC categories.

We recommend these definitions be simplified to one or two categories, and made consistent across both regulators. Indeed, it is essentially the same entities – i.e., hedge

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[6] Both the SEC and CFTC require current records to be held in a more accessible location for the first two years.

[7] We also recommend that in harmonizing these rules, the Agencies consider other potentially applicable record retention requirements such as those of the Federal Reserve Board and certain comparable foreign jurisdictions.

funds, professional trading organizations, broker-dealers, banks, pension plans, insurance companies and corporations – that transact business across asset classes. In creating such harmonization, we also recommend that the definitions focus on customer (a) net worth, rather than financial assets (since a customer can have, for example, $100 million in financial assets and still be insolvent), and; (b) investment experience.

We also believe natural persons having substantial net worth and investing experience should be considered in the same category as comparable institutional investors. Moreover, we believe the Agencies can and should agree on the definition of "retail" investor, based again on net worth and trading experience standards.[8]

c. Customer Funds Protection

We have already discussed this topic to some extent in the context of portfolio margining; namely, the CFTC's customer segregation requirements should be harmonized with those of the SEC. Indeed, to a great extent, the fundamental principles involved in both sets of rules are the same; namely, BDs and FCMs must ensure that customer assets are available in full promptly upon request of the customer. And, while we acknowledge that the "devil is in the details" in terms of ironing out the differences between the Agencies' respective segregation requirements, we also believe such differences can be resolved quickly and without the intervention of Congress or the Federal Reserve Board.

We also believe the Agencies should consider whether their respective investment of customer funds rules should be harmonized. As a practical matter, joint BD/FCMs should not have to maintain multiple systems, as well as different accounting and operational staffs, in order to meet their routine customer asset protection computation, segregation and investment of funds requirements.

In addition – although it is more of a long term matter – we believe, as noted above, that the Agencies should work with Congress to develop and implement procedures allowing for the clear and orderly liquidation of assets of joint BD/FCMs. We believe the Agencies have been fortunate to date that a bankruptcy of a joint BD/FCM has not implicated substantial commodity customer positions, but that such good fortune, in today's volatile and unpredictable markets, may be short-lived. We also note that as BD/FCMs may be required to book a wider range of products – i.e., CDS products, etc. – it is imperative that the Agencies work with Congress to establish uniform procedures for overseeing the liquidation of insolvent firms. Again., while we cannot characterize such a process as a "quick win," we feel the process should begin soon considering its importance and the current volatility of today's markets.

[8] While we do not at this time recommend a specific minimum net worth requirement for non-retail investors, we suggest to the Agencies that, in arriving at such a number, they consider a number of variable factors including inflation, current market volatility and the potentially changing manner in which assets are valued.

d. Customer Disclosures

We also recommend that securities customer disclosure documents be harmonized with those required under futures laws, and particularly those relating to equity options. In this regard, we believe the basic futures customer risk disclosure document is a good model for harmonization, inasmuch as it is more succinct and, consequently, more understandable. Indeed, the basic futures customer disclosure document is approximately 2-3 pages in length, while the OCC's equity options disclosure document, for example, is over 100 pages in length.

e. US Customers Access to Foreign Markets

In our view, the Agencies' respective rules relating to US customers' access to foreign markets is another area in which harmonization can yield quick and beneficial results. Currently, the SEC allows US customers to access foreign markets primarily through Rule 15a-6 under the Securities Exchange Act, while the CFTC allows US investors to access foreign markets under Part 30 of the Commodity Exchange Act. Unfortunately, the two statutory provisions are based on different fundamental principles.

Part 30, in essence, allows US investors to transact business in non-US futures products listed in foreign markets that have been approved by the CFTC. The CFTC grants such relief, through the no-action process, based primarily on the strength of the regulatory framework of the jurisdiction in which the products are listed; i.e., based on the principle of "mutual recognition." By contrast, SEC Rule 15a-6 and related securities provisions allow US investors to transact business in non-US securities based primarily on whether the activities (a) are solicited or unsolicited, (b) involve specific types of institutional investors, and (c) are "chaperoned" by a US BD. Under its current provisions, Rule 15a-6 does not encompass or embrace a mutual recognition concept.

In our experience as a global broker servicing institutional customers that trade in markets worldwide, these inconsistencies have caused unnecessary confusion for customers and brokers alike, and should be harmonized. In so doing, we recommend that the CFTC's "mutual recognition" approach be adopted as the uniform rule, for a number of reasons. First, mutual recognition limits the investment activities of US customers to jurisdictions that have comparable, or at least adequate, regulatory regimes. Second, in this era of electronic and direct market access trading, the chaperoning provisions contained within Rule 15a-6 have lost some of their meaning and effectiveness. We believe the SEC, in its current proposed amendments to Rule 15a-6, acknowledged both of these points.[9]

f. Insider Trading

Newedge USA believes that rules relating to insider trading should be harmonized between the two Agencies, with certain important caveats. Most importantly, we believe that insider trading laws should not be applied to customers engaging in bona fide futures

[9] We also recommend that access to foreign brokers be restricted to institutional clients.

hedging activities. However, we do believe that the various evolving theories of misappropriation should be applied to professionals and certain other categories of individuals who have access to material, nonpublic information relating to the futures markets but who are not themselves conducting hedging activities.

g. Suitability

As noted above, BDs and FCMs often service the same customers who, whether acting in the securities or futures markets, engage in similar activities – i.e., speculating, hedging, arbitraging, balancing portfolios, etc. In addition, both BDs and FCMs provide recommendations to customers and accept solicited and unsolicited orders. We also note that individual futures and securities products (as well as OTC derivatives) have varying degrees of risk and complexity, and can trade in similar ways. In order to avoid gaps in the customer protection regimes of the Agencies, CFTC and SEC standards regarding suitability should be harmonized.

With respect to harmonizing these differences, we believe aspects of both regulatory regimes should be considered. For example, we believe that suitability requirements should take into account and vary: (a) between retail and institutional investors, (b) depending on whether an order has been solicited or not, and (c) depending on the complexity and risk involved in the particular investment.

3. Long-Term Recommendations

As both the SEC and CFTC continue their discussions regarding rule harmonization, we also believe that both should carefully consider the evolving nature of the participants in the marketplace, and ensure that similar conduct – no matter who it is performed by – be regulated equivalently.

For example, currently, in the futures regulatory environment, some types of entities are subject to a principles-based regime – which we believe to be superior – while brokers are not, even when they perform identical functions. This creates an unlevel playing field that must be evened out. For example, no matter who solicits ultimate customers for electronic access to marketplaces, the rules should be same: brokers should not be required to have their personnel licensed and perform "know your customer" reviews on potential customers (to comply with applicable anti-money laundering requirements) while other types of entities do not.

As a matter of principle, we believe that when the SEC and CFTC seek to harmonize their rules, broad edicts are better than specific rules, because they provide industry participants with the flexibility to implement different solutions and to adapt quickly to changing market conditions. From the regulators' perspective, it requires industry participants to act more cautiously generally and provides less opportunity to find "loopholes."

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We would be pleased to provide further comments and views on the harmonization process and assist the Agencies in any other way we can during this process. As a long-standing FCM/BD, we have considerable experience in navigating not only the securities and futures rules in the US, but also professionals knowledgeable about both matters.

Thank you again for the opportunity to provide this comment and participate in this historic debate about the harmonization of market regulation under the federal securities and futures laws.

Sincerely,

Newedge USA, LLC

Gary DeWaal
Senior Managing Director and
Group General Counsel