J.P.Morgan

March 2, 2010

To: Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE.
Washington, D.C. 20549

Copy: Joshua Kans, Esq.
Office of Market Supervision
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Release No. 34-61119; File No. S7-05-09; Client Clearing – Segregation of Client Collateral

Dear Ms. Murphy:

We are writing in response to your request for comments regarding Securities Exchange Act Release No. 34-61119; File No. S7-05-09, (Order Extending And Modifying Temporary Exemptions Under The Securities Exchange Act Of 1934 In Connection With Request From ICE Trust U.S. LLC Related To Central Clearing Of Credit Default Swaps, And Request For Comments), dated December 4, 2009 (the "Order"). We welcome the opportunity to provide comments. In particular we would like to address the following topics:

I. Initial Margin and Variation Margin

Initial margin ("IM") and variation margin ("VM") perform different economic functions within the collateral framework, both in the bilateral over-the-counter ("OTC") market and in the cleared only market. VM is intended to reflect the increase or decrease in market value of a derivative transaction. A derivative transaction is essentially at the market at the time it is executed, after taking into account any bid/offer spread. This means that the transaction has the same value for each of the parties. Immediately after the transaction is executed, the market will likely move in favor of one party or the other. At each pre-agreed collateral valuation date, one party may call for the delivery of collateral (or return of previously posted collateral) from the other to reflect that variation in value.

The transfer of VM by one party to the other is intended to protect the in-the-money party (in other words, the party in whose favor the market moved) against the risk of the default of the other party. In order to achieve this result, the in-the-money party, who is exposed to the out-of-the-money party due to an increase in value of the transaction, receives collateral in an amount equal to that increase in value such that, if the out-of-the money party defaults, the in-the-money party can realize against the collateral and return to the out-of-the-money party any excess value over the amount of the relevant claim.

In the context of a cleared transaction, clearing houses manage counterparty risk. They do so by requiring upfront collateral and guarantee fund contributions form clearing members. Clearing houses are also designed to avoid taking any market risk: for each "buy" the clearing house will execute an equivalent "sell" in the opposite direction. For this reason, on each transaction, the clearing house will receive VM from one counterparty and pay out the same amount of VM to the other counterparty with which it has the offsetting position. This is a way to bring the existing transaction in line with current market values, so that each party is no longer exposed to market risk in case of a default by the other party.

The economic function of IM is different from that of VM. IM is an amount paid upfront to create a surplus of collateral to protect the clearing house against the risk that a party may default after the most recent date on which the clearing house called for VM but before fresh VM (reflecting a change in market values) is called and received. IM is intended to be held for the duration of the life cycle of a transaction, while VM is intended to flow back and forth between the parties as the mark to market value of a transaction fluctuates.

II. Ability of CDS derivative counterparties to value transactions

The typical participant in the OTC credit default swap ("CDS") market is a sophisticated party seeking to hedge or trade credit risk. Such participants are generally able to calculate the value of their risk positions either on their own or through other sources. In fact, many hedge fund participants need to make such calculation in order to determine their own net asset value on a daily basis so that they can report that value to their investors.

The process of clearing CDS transactions has increased price transparency in the market. Market participants will be able to obtain prices by contacting dealers as well as checking the closing prices used by the clearing house to calculate collateral daily. These values are readily available. By way of example, daily settlement prices for CDS cleared on ICE Trust U.S. LLC can be accessed by the general public through the internet (http://www.markit.com/cds/clearing/markit-ice/index.html).

The mechanism whereby each party calculates the value of its portfolio and calls for the delivery or return of collateral if necessary is the current market practice in the bilateral OTC markets. Market standard documentation provides for a dispute resolution mechanism for valuation disputes. The documentation that will be used for client clearing offered by ICE Trust U.S. LLC ("ICE") contemplates that each party will call for the delivery and return of collateral, with ICE determining the required amounts of IM and VM. Currently there is no requirement that dealers hold VM in a segregated account. We believe that the current market practice in this regard should be maintained.

III. Returning collateral on demand

It has been proposed that a dealer be required to automatically return to a client any excess collateral held in respect of CDS. This is contrary to the general practice in the derivatives market.

In the bilateral OTC market as well as in the ICE client clearing structure, it is the party who has the right to a return of collateral previously posted by it who makes the call for its return. We believe that this approach affords the client the alternative of leaving excess collateral with the dealer and minimizes the risk of untracked payments.

A client should be free to analyze various factors in determining whether to maintain excess collateral with a dealer. Such factors may include the administrative ease and cost-effectiveness of maintaining such excess collateral with a dealer, the return on collateral payable by the dealer, and the relative creditworthiness of the dealer and the client's bank or broker-dealer where it may otherwise maintain an account. In respect of the last factor, it should be noted that depending on the type of collateral, and particularly in the case of cash, the collateral held by a custodian on behalf of a client may not be protected from the risk of default by that custodian any more than the collateral held by a dealer is protected from the risk of default by that dealer. By requiring the automatic return of excess collateral, the client will be denied the opportunity to make its own decision in this regard.

In addition, if a dealer were to return collateral to a client without the client calling for it or expecting it, the collateral transfer may result in untracked payments. This could increase systemic risk and result in additional administrative burdens and costs.

It has also been proposed that threshold limits on delivery of collateral be eliminated. Typically the parties agree to a threshold regarding the minimum transfer amount of collateral. Such threshold is intended to limit transfers of small amounts of collateral back and forth in order to avoid incurring the administrative costs involved. This threshold tends to be in the range of $100,000 to $250,000, which is a relatively small amount in the context of a portfolio of derivative transactions. In our view, such minimum transfer threshold works well in the bilateral OTC markets and would work well in the client clearing model.

A different type of threshold applies when the parties are prepared to take an unsecured exposure to each other. We believe that market participants should be free to determine what level of unsecured exposure they are prepared to accept from each other. Should a dealer wish to put pressure on a counterparty to accept an unreasonable unsecured exposure to that dealer, the counterparty would simply do business with another dealer who does not require the same level of exposure. We note that current market practice for parties active in the CDS market tends to provide for minimal, if not zero, thresholds for unsecured exposure. We believe that the current market practice in this regard should be maintained.

IV. Portfolio Calculations. Collateral required by a clearing member in excess of the ICE calculated collateral requirement

The Order requires an ICE clearing member to post with ICE or a third party custodian any funds or securities that the member receives for the purpose of "purchasing, selling, clearing, settling or holding Cleared CDS Positions" (page 48 of the ICE Order). This requirement would seem to apply to any supplemental IM that the clearing member requires form the client in addition to the minimum collateral requirement calculated by ICE. We do not think that this requirement should apply in the context of portfolio margining.

Performing collateral calculations in respect of IM on a portfolio basis is a well established practice in the OTC markets. In the bilateral OTC framework this would mean that a dealer would calculate its IM collateral requirement by taking into account the whole range of OTC derivatives traded by a counterparty. Typically, this calculation occurs in respect of transactions governed by a single ISDA Master Agreement. A client who puts in place a portfolio of transactions which includes risk offsetting positions will benefit from prudent risk management by receiving an IM collateral call that reflects such risk offsets, while a client who enters into transactions that, taken as a whole, increase the risk within the portfolio will have to post a greater amount of IM collateral.

In the context of client clearing, there will be separate master agreements (including separate collateral agreements) between a clearing member and its client governing cleared transactions (the "Cleared Master") on one hand and non-cleared transactions (the "Non-Cleared Master") on the other hand. The relevant clearing house will stipulate the IM and VM to be posted under the Cleared Master. The clearing member may, however, wish to give the client the benefit of portfolio margining under the Non-Cleared Master that takes into account the full portfolio of both cleared and non-cleared CDS. In such a case, the portfolio margining calculation may result in a lower IM under the Non-Cleared Master if there are CDS governed by the Cleared Master that offset risk resulting from CDS governed by the Non-Cleared Master. If, however, the CDS governed by the Cleared Master increase the risk associated with the portfolio of CDS governed by both the Cleared Master and the Non-Cleared Master, the portfolio margining calculation may result in a higher IM under the Non-Cleared Master than if only non-cleared CDS were taken into account.

The Order may be interpreted as requiring (i) a clearing member to make two portfolio margining calculations, one including the cleared and the non-cleared CDS and the other including only the cleared CDS, and (ii) that, if the former calculation results in a higher IM than the latter calculation, to require the excess to be posted with the clearing house or a third party custodian. This will result in considerable additional expense, time, and administrative burden that may lead clearing members to decide not to offer clients portfolio margining in this context. We do not believe that the relatively minor degree of protection accorded to the client by this interpretation of the Order merits its covering portfolio margining in this context. We believe that allowing clients and clearing members to negotiate bilaterally whether any supplemental IM that the clearing member requires form the client in addition to the minimum collateral requirement calculated by ICE should be held at the clearing house, at a third party custodian or with the clearing member would encourage prudent risk management. Clients would have an incentive to enter into risk offsetting positions in order to receive the full benefits of portfolio margining. On the other hand, we acknowledge that if a clearing member were to apply a fixed multiplier to the minimum IM collateral requirement of the clearing house, then it would seem appropriate for that the additional IM be posted to the clearing house.

Thank you for your consideration. If we can be of further assistance in your consideration of this request, please do not hesitate to contact the undersigned on tel. no.: 212 648 0254, e-mail: Alessandro.Cocco@jpmorgan.com.

Very truly yours,

Alessandro Cocco
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