



August 3, 2009

Marcia E. Asquith  
Office of the Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington, DC 20006-1506

Regulatory Notice 09-30 (Credit Default Swaps)

Dear Ms. Asquith:

The Capital Steering Committee of SIFMA<sup>1</sup> is pleased to provide the following observations on Regulatory Notice 09-30 (“the Notice”) establishing a new FINRA Rule 4240, in conjunction with an interim pilot program establishing margin requirements for transactions in credit default swaps (“CDS”).

General Observations

A number of aspects of the registered, full purpose broker-dealer regulatory framework preclude it from being a commercially viable vehicle for over the counter (“OTC”) derivatives, including CDS. For example, capital charges, use of counterparty collateral, insolvency questions, etc., all present serious obstacles to using broker-dealers for transactions involving OTC derivative instruments. While FINRA’s adoption of a margin rule for CDS transactions addresses one key element of the regulatory framework, until such time as those other issues have been appropriately addressed, as a practical matter we are doubtful that Rule 4240 will have much significance for the securities industry.

Additionally, Rule 4240 provides a special status to CDS transactions that are cleared through the facilities of the Chicago Mercantile Exchange (“CME”) as compared to transactions that are cleared via some other central clearing counterparty or that are cleared on a bilateral basis. We believe that an explanation for this aspect of the Rule should be provided and would be of interest to the industry.

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<sup>1</sup> SIFMA brings together the shared interests of more than 600 securities firms, banks and asset managers locally and globally through offices in New York, Washington, D.C., and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. SIFMA’s mission is to champion policies and practices that benefit investors and issuers, expand and perfect global capital markets, and foster the development of new products and services. Fundamental to achieving this mission is earning, inspiring and upholding the public’s trust in the industry and the markets. More information about SIFMA is available at <http://www.sifma.org>

## Specific Observations

- Rule 4240 would require that if a CDS transaction were to be entered into between two broker-dealers, each of the parties would have to post initial margin. This varies from conventional OTC trading of CDS. In addition, it is unclear if the initial margin posted by a broker-dealer would be regarded as an allowable asset under the Net Capital Rule.
- While the margin requirements set forth in Rule 4240.1 for single name and index CDS seem generally in line with requirements in effect for CDS dealers, some firms report that the numbers for maturities of 7 years and longer are somewhat high. We also suggest that as dealers, regulators, and market participants gain more experience with CDS, that FINRA, in consultation with the industry, revisit the requirements to ensure that they remain appropriate.
- We suggest clarification of the Notice's discussion of the documentation that must be filed with FINRA prior to a member firm's establishing a clearing arrangement for CDS transactions. In particular, we recommend that the paragraph below be clarified with respect to how one would go about calculating "the largest individual exposure." We note our belief that "the largest maximum possible loss" is meant to be read as "the largest maximum loss *reduced by the amount of the expected recovery.*"

Maintaining sufficient margin in each customer and broker-dealer account to protect against the default of the largest individual exposure in the account as measured by computing the largest maximum possible loss;

- Finally, we do not believe that firms currently are reporting customer exposure on the basis of CDS, but on a more consolidated basis. We expect that firms could probably generate reports on such a basis without major difficulty, but at a minimum firms should be granted the necessary time to implement such a change.

If there are any questions concerning our observations or if FINRA wishes the Committee to expand upon them, please do not hesitate to contact me or our Committee staff advisor, Jerry Quinn. Thank you.

Sincerely,

/s/Daniel McIsaac

Daniel McIsaac, Chair  
Capital Steering Committee