

March 26, 2012

David A. Stawick, Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, DC 20581

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve
System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Office of the Comptroller of the Currency
250 E. Street, S.W.
Mail Stop 2-3
Washington, DC 20219

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA45
Federal Housing Finance Agency
Fourth Floor, 1700 G Street, N.W.
Washington, DC 20552

Gary K. Van Meter, Acting Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102

Re: Margin and Capital Requirements for Covered Swap Entities, Board Docket No. R-1415, Docket No. OCC-2011-0008, FDIC RIN 3064-AD79, FHFA RIN 2590-AA45, FCA RIN 3052-AC69; Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, CFTC RIN 3038-AC97; Capital Requirements of Swap Dealers and Major Swap Participants, CFTC RIN 3038-AD54.

Ladies and Gentlemen:

The Commodity Futures Trading Commission (“CFTC”) individually and the several prudential regulatory agencies¹ jointly (the “Joint Agencies”) have proposed rules for margin on uncleared swaps for swap dealers and major swap participants (“swap entities”)² subject to their

¹ The prudential regulatory agencies are the Board of Governors of the Federal Reserve System (the “Board”), the Office of the Comptroller of the Currency (the “OCC”), the Federal Deposit Insurance Corporation (the “FDIC”), the Federal Housing Finance Agency (the “FHFA”) and the Farm Credit Administration (the “FCA”).

² In the context of the Joint Agencies’ Proposed Rules, we use the term “swap entity” to refer also to security-based swap dealers and major security-based swap participants.

respective jurisdictions (the “Proposed Rules”).³ These rules are intended to give effect to provisions of the Dodd-Frank Act.

The CFTC and Joint Agency releases accompanying the Proposed Rules both specifically asked whether the types of eligible collateral should be broadened to include asset-backed or guaranteed securities.⁴ Both the CFTC and the Joint Agencies received numerous comments to the effect that market participants will have difficulty sourcing adequate quantities of the types of assets actually deemed eligible under the Proposed Rules.⁵ The issue is not unwillingness to provide margin. It is simply the costs and difficulties associated with obtaining eligible assets.

It is these comments that have caused Karson Collateral to write at this time. We understand that the comment period with respect to the Proposed Rules expired some time ago. We are hopeful that the CFTC and the Joint Agencies, however, will find our letter to be informative and take it into account in finalizing the Proposed Rules.

Karson Collateral, through its affiliates is an established provider of collateral solutions to the regulated insurance and reinsurance markets. Karson’s form of structured collateral, a K-Note, has been reviewed and approved for use to secure the obligations of offshore reinsurance companies to their domestic insurance clients. A properly structured K-Note should satisfy the goals set out in the releases accompanying the Proposed Rules for eligible collateral that may serve as initial or variation margin.

Furthermore, we believe that an affirmative answer to the question of broadening the types of eligible collateral under the Proposed Rules will ease the concerns of those commenting on the difficulty of sourcing eligible collateral. We can offer an “asset backed structured collateral instrument” that the CFTC and the Agencies will find safe and secure, and that market participants will find easy and attractive to use to satisfy the regulatory mandate. We speak in terms of offering an instrument knowing that the CFTC and the Joint Agencies will be most interested in finding a generic means of achieving the prudential goals of the Proposed Rules in a practical way. Consistently, we ask the CFTC and the Joint Agencies to include in their final rules clear criteria for acceptable structured collateral offerings, or to provide a continuing procedure for staff review and approval of such offerings on a case-by-case basis.

³ The Proposed Rules are included in Margin and Capital Requirements for Covered Swap Entities, Board Docket No. R-1415, Docket No. OCC-2011-0008, FDIC RIN 3064-AD79, FHFA RIN 2590-AA45, FCA RIN 3052-AC69, 76 Fed. Reg. 27654 (May 11, 2011) (the “[PR Release](#)”) and Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, CFTC RIN 3038-AC97, 76 Fed. Reg. 23732 (April 28, 2011) (the “[CFTC Release](#)”).

⁴ See question 59(a) of the PR Release, 76 Fed. Reg. at 27578 (“Should the types of eligible collateral listed be broadened to include other types of assets (e.g. securities backed by high-quality mortgages or issued with a third-party guarantee)?”); CFTC Release, 76 Fed. Reg. at 23741 (same).

⁵ See, e.g., letter of the American Council of Life Insurers to the Joint Agencies and the CFTC, dated July 11, 2011, pp. 4-8; letter of the Committee on Investment of Employee Benefit Assets to the Joint Agencies, dated July 11, 2011, pp. 13-14.

Karson Collateral proposes that the types of securities eligible to be posted as initial or variation margin (by all categories of counterparty, including swap entities and financial and non-financial entities and end users) should include redeemable demand notes, redemption payments under which are jointly supported by the unconditional payment obligations of one or more qualifying financial institutions⁶ and by a pool of readily marketable underlying pledged securities (which securities on their own may not qualify as eligible collateral under the Proposed Rules). The note issuer and the supporting qualifying financial institution or institutions would be legally obligated to make payment to the noteholder in satisfaction of a demand for redemption no later following the demand than the end of a normal settlement cycle for the pledged securities supporting the note.⁷

Obviously, such notes must be issued through a program offering structural and management safeguards appropriate to assure performance in stressed circumstances. Haircuts, monitoring of pledged securities value and multiple overlays of protection are key elements in eliminating risk to the parties and the financial system.

Karson Collateral believes that use of the proposed form of redeemable note would mitigate systemic risk by diversifying the sources of liquidity that could be accessed in a distress scenario. This diversification is twofold -- our proposal not only broadens the types of securities that would ultimately be liquidated but also allows for the potential absorption of liquidity risks through the qualifying financial institutions' own liquidity reserves. Thus, liquidity stresses are shared between the securities markets and qualifying financial institution balance sheets.

An instrument with the characteristics described above exists and as noted above is in use in the insurance markets. Karson Collateral's K-Notes (U.S. patent # 7.769,655) have been approved (or positively opined upon) as a qualifying asset for reserve credit for reinsurance and surplus relief by the Insurance Departments of 4 U.S. states, OSFI in Canada and the FSA in the United Kingdom. Since December 2009, U.S.\$4.8 billion of K-Note transactions have been concluded. The K-Note methodology of course can be varied to meet different credit and logistical requirements.

We note that determining that structured collateral will be acceptable under the Proposed Rules as margin will ultimately not be enough to facilitate the use of structured collateral for its intended purpose. In order to be competitively efficient from the perspective of swap entities, structured collateral must bring capital treatment to those entities on a par with other types of

⁶ Karson Collateral proposes that any of the following be recognized as a qualifying financial institution: an entity authorized by its relevant regulator to undertake the proposed activity that is a bank, as defined in Section 3(a)(6) of the Securities Exchange Act of 1934 ("Exchange Act"), a banking institution organized under the laws of a non-U.S. jurisdiction that maintains at least U.S.\$ 1 billion of regulatory capital, or an insurance or reinsurance company that is subject to supervision as such by the insurance commission (or similar regulatory authority or agency) of a State of the United States, by the United States or an agency or instrumentality thereof or by a financial services regulatory authority of a G20 member government.

⁷ Market participants would of course be free to stipulate a shorter payment timeframe, which K-Notes could be structured to accommodate.

eligible collateral. We ask the agencies to consider this issue simultaneously with consideration of the fundamental eligibility of structured collateral.⁸ We would be delighted to have the opportunity to answer any questions that the CFTC or Joint Agencies may have about structured collateral in general or the K-Note program in particular. Please contact our counsel, Joshua Cohn or Curtis Doty of Mayer Brown LLP (212-506-2500), to arrange such a discussion.

Yours truly,

A handwritten signature in blue ink, appearing to read 'Derrell Hendrix', written over a horizontal line. The signature is stylized and cursive.

Derrell Hendrix

⁸ The Joint Agencies' Proposed Rules address the capital requirements of swap entities. The CFTC has issued a proposed rulemaking separate from its Proposed Rules to address the capital requirements of swap dealers and major swap participants. 76 Fed Reg. 27802 (May 12, 2011).