THE OPTIONS CLEARING CORPORATION
ONE N. WACKER DRIVE, SUITE 500, CHICAGO, ILLINOIS 60606

WILLIAM H. NAVIN
EXECUTIVE VICE PRESIDENT, GENERAL COUNSEL, AND SECRETARY
TEL 312.322.1817 FAX 312.322.1836
WNAVIN@THEOCC.COM

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Via Electronic Mail

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F St., N.E.
Washington, D.C. 20549-1090
rule-comments@SEC.gov

Re: **Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of a Proposed Rule Change to Introduce Cross-Margining of Certain Positions Cleared at the Fixed Income Clearing Corporation and Certain Positions Cleared at New York Portfolio Clearing, LLC (Release No. 34–63361; File No. SR-FICC-2010-09)**

Dear Ms. Murphy:

The Options Clearing Corporation ("OCC") is pleased to submit the comments below in response to the above-referenced proposed rule change (the "Proposal") by the Fixed Income Clearing Corporation ("FICC").[1] The Proposal was submitted to the Commission by FICC pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Rule 19b-4 thereunder. The Proposal relates to the cross-margining in a single portfolio (so-called "single pot margining") of positions in U.S. government securities cleared by FICC with certain positions in futures contracts proposed to be cleared by New York Portfolio Clearing, LLC ("NYPC").

OCC was a pioneer in the development, and has been a vigorous advocate, of cross-margining arrangements between clearinghouses, and in particular those that are designed on a "one-pot" model. Such arrangements reduce systemic risk while facilitating the more efficient use of the capital of clearing members. OCC strongly supports cross-margining arrangements between FICC and derivatives clearing organizations, like itself and NYPC, that clear derivatives contracts that may be used to hedge positions in government securities. . We also welcome the stated intention of FICC to provide "other futures exchanges and DCOs an equal

[1] SEC Release No. 34-63361, 75 FR 74110 (November 30, 2010).

opportunity to benefit from" FICC's proposed cross-margining arrangements. We believe that equal access is indeed the standard that should be applied. Nevertheless, we believe that the Proposal, as currently formulated, does not achieve that stated objective and would, on the contrary, be anti-competitive in its impact on other clearing organizations, including OCC. We believe that certain aspects of the Proposal must be changed to ensure that the goal of equal access is achieved. If such changes are made, we would urge the Commission to promptly approve FICC's proposed rule change.

The Commission has solicited comments from interested persons with respect to all aspects of the Proposal, but in particular has requested comment on (1) the burden on competition of the "single pot cross-margining arrangement" involved in the Proposal, (2) the implementation timeframe for the single pot margining arrangement, including the potential 24 month time period for unaffiliated derivatives clearing organizations ("DCOs") to be admitted to the cross-margining arrangement, and (3) the proposed guarantee fund contribution required of DCOs other than NYPC to participate in the single pot cross-margining arrangement. The first and third questions are closely related, as one of the central reasons we believe the Proposal is anti-competitive is the imposition of an unnecessarily large guaranty fund contribution. In addition, we object to the proposal to the extent that, by forcing other DCOs to access the cross-margining arrangement through NYPC, clearing members of such other DCOs will face higher costs in accessing the arrangement, thereby disadvantaging both the clearing members and the exchanges for which such other DCOs act. OCC would be supportive of the Proposal if access by other clearing organizations were made truly equal on an economic basis to the access granted to NYPC.

Background

About OCC. Founded in 1973, OCC is currently the world's largest clearing organization for financial derivatives. OCC is the only clearing organization that is registered with the Commission as a securities clearing agency pursuant to Section 17A of the Exchange Act and with the Commodity Futures Trading Commission ("CFTC") as a DCO under Section 5b of the CEA. OCC is a regulated public market utility, clearing securities options, security futures and other securities contracts subject to the Commission's jurisdiction, and commodity futures and commodity options subject to the CFTC's jurisdiction. ELX Futures, L.P. ("ELX") is a designated contract market ("DCM") regulated by the CFTC pursuant to Section 5 of the CEA. ELX lists for trading U.S. treasury futures contracts ("Treasury Futures") which are cleared by OCC. Treasury Futures are economically correlated with both U.S. treasury securities ("Treasuries") and the interest rate futures contracts ("Interest Rate Futures") proposed to be traded on NYSE Liffe U.S. ("NYSE Liffe"). ELX is a direct competitor of NYSE Liffe. OCC has, for some time and with the involvement of ELX, been seeking to negotiate a cross-margining arrangement directly with FICC. Such an arrangement would be highly beneficial to clearing members of both OCC and FICC, as it would allow them to make margin payments calculated across all positions held at both OCC and FICC, resulting in a material reduction in their net margin requirements. To date FICC has not been willing to enter into such an arrangement on commercially feasible terms, but has instead focused on establishing an exclusive relationship with its affiliated clearing organization, NYPC.

About NYPC and FICC. On November 1, 2010, NYPC filed an application with the CFTC to be designated as a DCO pursuant to Section 5b of the Commodity Exchange Act ("CEA").

NYPC is seeking initially to accept for clearing U.S. dollar-denominated Interest Rate Futures to be traded on NYSE Liffe. NYSE Liffe, which is a wholly-owned subsidiary of NYSE Euronext ("NYSE"), is a DCM regulated by the CFTC under Section 5 of the CEA. NYPC is a 50/50 joint venture between NYSE and The Depository Trust & Clearing Corporation ("DTCC").[2] NYSE has provided a $50 million guaranty to NYPC (secured by $25 million in cash in the first year of NYPC's operations) in order to "seed" NYPC's guaranty fund and make NYPC a credible central counterparty.

FICC is a securities clearing agency registered with the Commission under Section 17A of the Exchange Act. Through its Government Securities Division ("GSD"), FICC clears cash transactions in U.S. government debt securities, including repurchase agreements. FICC is a wholly-owned subsidiary of DTCC. FICC and NYPC are therefore affiliated entities. Because NYPC is 50 percent owned by NYSE Liffe's parent, NYSE, NYPC is also affiliated with NYSE Liffe.

The Proposed Rule Change

The Proposal would allow a GSD clearing member that is also a member of NYPC (a "Joint Clearing Member"), upon approval of FICC and NYPC, to elect to have its margin requirements with respect to Interest Rate Futures carried in its proprietary account at NYPC and its margin requirements with respect to Treasuries carried at FICC calculated on a "single portfolio" basis, recognizing any offsetting risks between such accounts. The proposed arrangement would also allow a so-called "Permitted Margin Affiliate" to have its positions at NYPC margined together with eligible positions of an affiliate at FICC. This cross-margining arrangement would allow a Joint Clearing Member or Permitted Margin Affiliate to significantly reduce its net margin requirements by taking advantage of the highly correlated nature of Interest Rate Futures and Treasuries. This benefit may be substantial for Joint Clearing Members and Permitted Margin Affiliates. Any clearing organization that seeks a similar cross-margining arrangement with FICC would be required to do so through NYPC on economically disadvantageous terms.

Burden on Competition

The proposed arrangement between NYPC and FICC is, for all practical purposes, an exclusive arrangement between affiliates. For a clearing organization other than NYPC to cross-margin against open interest at FICC, the clearing organization would be required to become a limited purpose participant ("LPP") in NYPC.[3] NYPC Rule 801(b) provides as follows:

> Except as otherwise provided in the LPP Agreement [an agreement to be negotiated between NYPC and each DCO seeking access]: (1) Trades that are within the scope of the LPP Agreement and that would otherwise be cleared by such Limited Purpose Participant shall instead be submitted to the Clearinghouse, which shall act as central counterparty and DCO in respect thereof and shall include such trades in the arrangement that is the subject of the Cross-Margining Agreement [between NYPCC and FICC]; (2) Members of the Limited Purpose Participant shall be bound by the Rules as fully as if they were Clearing Members of the Clearinghouse, and the

[2] *See* Proposal n. 1.
[3] Proposal at p. 14.

> Clearinghouse shall have all of its rights, under the Rules and otherwise, in the event of a Default by a member of the Limited Purpose Participant; (3) A Limited Purpose Participant shall make a contribution to the Guaranty Fund, in form and substance similar to and in an amount that is no less than the amount of, the NYSE Guaranty; (4) The Clearinghouse shall not be required to accept trades in any product that is not eligible for clearing pursuant to the Cross-Margining Agreement; and (5) Clearing fees shall be allocated between the Clearinghouse and the Limited Purpose Participant as may be agreed by the Clearinghouse and the Limited Purpose Participant, taking into account the cost of services (including capital expenditures incurred by the Clearinghouse), technology that may be contributed by the Limited Purpose Participant, the volume of transactions, and such other factors as may be relevant.[4]

The ultimate effect of this rule cannot be determined on the face of it because all of its requirements are modified by the phrase, "[e]xcept as otherwise provided in the LPP Agreement." However, if a DCO were unable to negotiate exceptions to these provisions, a clearing organization other than NYPC seeking to cross-margin against FICC's open interest would be required to give up its own open interest to NYPC, which would become the counterparty to all trades. Clearing members of the other clearing organization would be required, in effect if not in name, to become clearing members of NYPC. This would mean, among other things, that they would be required to deposit margin and make guaranty fund deposits on the same basis as other NYPC members. In addition, the DCO itself would be required to make a $50 million guaranty fund contribution to NYPC. Such a flat contribution obviously bears no relation to any credit risk presented by the DCO. Indeed, if NYPC is to replace the DCO as the counterparty to all contracts that are submitted for cross-margining in the arrangement, it is difficult to understand why the DCO is required to make any guaranty fund contribution at all because NYPC would have no credit exposure to the DCO.

Notwithstanding the foregoing, there is some reason to believe that FICC (at least to the extent that FICC will be in control of these arrangements) actually has a different arrangement in mind that would presumably be negotiated and included in the LPP Agreement with each DCO. After reciting the requirements of NYPC Rule 801(b), FICC states as follows:

> As a basic structure, FICC and NYPC anticipate that the limited purpose participant agreement will encompass the foregoing requirements for limited purpose membership contained in NYPC's rules. Because each DCO could present different operational issues, terms beyond the basic rules provisions will be discussed on a case-by-case basis and reflected in the respective limited purpose participant agreement accordingly. FICC and NYPC envision that a possible structure for DCO limited purpose participation could be an omnibus account, with the DCO limited purpose participant essentially acting as a processing agent for its clearing members vis-a-vis NYPC with respect to the submission of eligible positions of the DCO's clearing members to NYPC for purposes of inclusion in the one-pot arrangement with FICC. In order for their eligible positions to be included

4 Proposed NYPC Rule 801, which appears within Exhibit C to NYPC's application to become a DCO, is available at http://services.cftc.gov/sirt/sirt.aspx?Topic=ClearingOrganizationsAD&Key=19924&Organization=New%20York%20Portfolio%20Clearing,%20LLC&Type=DCO&Status=Pending.

> in the single pot, clearing members of the DCO limited purpose participant would need to authorize the DCO to submit their positions to NYPC. Under such a structure, the DCO would be responsible for fulfilling all margin and guaranty fund requirements associated with the activity in the omnibus account.[5]

This paragraph is somewhat puzzling in that it states that the LPP Agreement will "encompass" the provisions of Rule 801 rather than provide exceptions to them, but it goes on to suggest an omnibus account structure that appears to be inconsistent with NYPC replacing the DCO as counterparty and direct application of the NYPC rules to the DCO's clearing members. We are nevertheless uncomfortable that the default position—which is never clearly rejected—is that a DCO would be subject to the full force of NYPC Rule 801(b) without exception. With this as the default position, what bargaining power would a DCO have?

Most objectionable of all is that a clearing organization would be required to make a $50 million contribution to the NYPC guaranty fund. The Proposal states that ". . . DCOs will be required to contribute to the NYPC guaranty fund in the same manner as NYSE Euronext has done. This provision is essential to ensure that the financial resources supporting NYPC remain robust as the risks of new . . . DCOs are introduced."[6] By comparison, other clearing members of NYPC (including clearing members of the LPP) would be required to contribute to the NYPC guaranty fund amounts calculated based on the recent volume and original margin requirements attributable to the member, with minimum contributions of either $1 million or $3 million, depending on the class of membership. Only 10% of a clearing member's guaranty fund contribution would be required to be in cash, with a minimum cash requirement of $100,000 and a maximum cash requirement of $5 million. Accordingly, the guaranty fund contribution required of a DCO is as much as 50 times larger than those required of NYPC's non-LPP members.

We see the $50 million guaranty provided by NYSE to NYPC as effectively a "seeding" arrangement between affiliates, whereby one of the 50% parent companies of NYPC is infusing the NYPC guaranty fund with sufficient capital to lend financial credibility to NYPC in order to facilitate trading on NYSE Liffe. Requiring a competing clearing organization to further seed NYPC's guaranty fund in the same manner is troubling to us. In defense of this requirement, FICC notes "that exchange contribution to clearing organization default resources is standard practice both in the U.S. and in Europe."[7] But neither OCC nor ELX is an exchange seeking to clear contracts through NYPC. We would also point out that OCC, which itself clears contracts other than interest rate futures for NYSE Liffe, requires only that NYSE Liffe (and other non-stockholder exchanges for which OCC clears) purchase a $1 million note from OCC. Once again, the NYPC requirement is 50 times what OCC requires of NYPC's own affiliate! The effect of the NYPC requirement is anticompetitive and an attempt to leverage FICC's monopoly position in the clearing of U.S. government securities to confer an unfair competitive advantage on its affiliate, NYPC, and NYPC's affiliated exchange, NYSE Liffe.

FICC's rule submission states the following:

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[5] Proposal at p. 15.
[6] *Id.*
[7] Proposal at p. 16.

> FICC does not believe that the proposed rule change will have any negative impact, or impose any burden, on competition. To the contrary, NYPC will be a powerful catalyst for competition by offering all FICC members as well as other futures exchanges and DCOs an *equal opportunity* to benefit from the innovative efficiencies of "one-pot" portfolio margining. Because of these unique and groundbreaking *open access policies*, NYPC will set a new industry standard as the *most fair, open and accessible* DCO in the market.[8]

The proposed arrangement is far from being an "equal opportunity." On the contrary, FICC is granting its affiliate, NYPC, exclusive cross-margining privileges and then permits NYPC to sell access to NYPC's competitors on terms that are certain to provide a substantial competitive advantage to NYPC/NYSE Liffe.

When OCC allows so-called "associate clearinghouses" to enter into cross-margining arrangements with OCC, the associate clearinghouses are treated as clearing members, with each associate clearinghouse holding one or more omnibus accounts with OCC. OCC does not require the associate clearinghouse to give up its open interest to OCC, nor does it require that the members of the associate clearinghouse agree to be bound by OCC's rules. The associate clearinghouses ordinarily pay clearing fees and make margin deposits on the same or a similar basis as other clearing members, and they may or may not be required to contribute to OCC's clearing fund, depending on their creditworthiness. They are not subject to outsized guaranty fund contributions that are unrelated to the risk posed by their clearing activity. To the extent that associate clearinghouses have been subject to terms or requirements not generally applicable to other clearing members, those terms have generally been favorable to the associate clearinghouse.[9] NYPC, by contrast, would impose burdensome terms on clearinghouses seeking to become LPPs.

Timing

FICC has indicated that NYPC will admit and integrate other DCOs as LPPs as soon as feasible, but "no later than 24 months from the start of operations."[10] OCC has been in discussions with FICC for some time, and FICC has provided assurances that integration of additional clearinghouses into the FICC cross-margining arrangement will not be unduly protracted given the extensive efforts already undertaken. We trust that FICC will work with OCC and other clearing organizations to expedite the process and implement other cross-margining arrangements well in advance of the 24 month deadline. It is clearly feasible for FICC to implement additional cross-margining arrangements with OCC well short of the 24 month commitment, and FICC has assured us informally that they are committed to expediting this process.

Fee Sharing

It is unclear to us how clearing fees payable to NYPC pursuant to an agreement between an LPP and NYPC would be split or how such fees would be determined. The Proposal indicates that clearing fees would be allocated between NYPC and an LPP as agreed between them, in

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[8] Proposal at pp. 13 and 29 (emphasis added).
[9] *See* OCC Rule 1303, adopted August 20, 2001; amended May 16, 2002; further amended October 11, 2002.
[10] Proposal at p. 15.

accordance with such "factors as may be relevant."[11] No requirement of the NYPC rules, however, would force NYPC to negotiate fair fee terms with any other clearing organization and NYPC could simply insist on onerous terms to avoid reaching an agreement. The other clearing organization would have no leverage to force NYPC to agree to more reasonable terms. At a minimum, we believe the per trade cost to a clearing organization should be no greater than what NYPC charges to its other clearing members. Higher fees charged to a clearing organization could not be justified as anything other than anti-competitive tolls. It is important to keep in mind that neither OCC, ELX nor their members need or want the services of NYPC in this context. What we want is a cross-margining relationship with FICC. While OCC is willing, albeit reluctantly, to accept an arrangement involving an indirect interface through NYPC, it is unacceptable to OCC—and should be unacceptable to the Commission—for such an arrangement to require, in effect, that OCC's clearing members become clearing members of NYPC, that NYPC be substituted as the clearing organization for futures contracts traded on ELX, and that OCC be required to make a $50 million contribution to NYPC. FICC should be required to remove these anticompetitive features from its rule filing in order to obtain Commission approval.

Conclusion

We appreciate the opportunity to comment on the Proposal. While we are concerned about aspects of the Proposal, particularly the $50 million guaranty fund contribution, we believe the Proposal, with appropriate revisions, should ultimately be approved by the Commission. The benefits of allowing cross-margining with FICC's extensive open interest are undeniable and we look forward to working with FICC, NYPC, and the Commission to ensure that these benefits are made available to market participants in a fair way. The standard should be equal access for OCC (and any other DCO that is similarly situated) to cross-margin with FICC's open interest on terms that are no less favorable than those offered to NYPC so that NYPC is not permitted to leverage FICC's monopoly position for its own competitive advantage and that of its affiliate, NYSE Liffe.

Sincerely,

William H. Navin
Executive Vice President and General Counsel
The Options Clearing Corporation

cc: Mary L. Schapiro
Chairman, Securities and Exchange Commission

Kathleen L. Casey
Commissioner

[11] *See* Proposed NYPC Rules 801(b)(1), (3) and (5).

Luis A. Aguilar
Commissioner

Troy A. Paredes
Commissioner

Elisse B. Walter
Commissioner

Robert Cook
Director, Division of Trading and Markets

Neal L. Wolkoff
Chief Executive Officer, ELX Futures, L.P.

Murray C. Pozmanter
Managing Director, Fixed Income Clearing Corporation

Walter Lukken
Chief Executive Officer, New York Portfolio Clearing, LLC