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Via Electronic Mail

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

Re: RIN 3038-AC98 General Regulations and Derivatives Clearing Organizations

Dear Mr. Stawick:

This letter is submitted by The Options Clearing Corporation ("OCC") in response to the recent release by the Commodity Futures Trading Commission (the "Commission") requesting comment on its proposed rules (the "Proposed Rules")[1] implementing provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")[2] and the Commodity Exchange Act, as amended by Dodd-Frank (the "CEA"). The Proposed Rules establish regulatory standards for compliance with several core principles for derivatives clearing organizations ("DCOs") as well as requirements for DCO chief compliance officers ("CCO"). Among other things, the Proposed Rules would also add requirements for the approval of DCO rules establishing a portfolio margining program for customer accounts carried by a futures commission merchant ("FCM") that is also registered as a securities broker-dealer ("BD"). OCC's comment letter focuses on portions of the Proposed Rules that address customer portfolio margining, requirements for CCOs, the scope of Part 39, and transfer of a DCO registration. OCC generally supports the Proposed Rules, subject to the comments in this letter.

Background

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 Securities and Exchange Commission ("SEC") as a securities clearing agency pursuant to Section 17A of the Securities Exchange Act of 1934 ("Exchange Act") and with the Commission as a derivatives

[1] General Regulations and Derivatives Clearing Organizations, 75 FR 77576 (Dec.13, 2010).
[2] Pub. L. 111-203.

clearing organization ("DCO") under Section 5b of the CEA. OCC clears securities options, security futures and other securities contracts subject to SEC jurisdiction, and commodity futures and commodity options subject to the Commission's jurisdiction. OCC clears derivatives for all nine U.S. securities options exchanges and five futures exchanges.[3]

Procedures for Submitting DCO Rules to Establish a Portfolio Margining Program

OCC is pleased that the Proposed Rules contain specific first steps toward the implementation of customer portfolio margining of securities and futures. OCC has been a vocal proponent of customer portfolio margining of related securities and futures positions for many years because this risk-based approach to margining will provide substantial benefits for qualified customers. By combining potentially offsetting positions in securities and futures products, which may be cleared at separate clearinghouses, into a single portfolio for margin and settlement purposes, the real risk of a customer's entire portfolio can be determined and managed more efficiently. This risk-based approach yields a more appropriate margin requirement for the portfolio than if margins for hedged positions in the account were calculated separately. Portfolio margining both reduces systemic risk by recognizing and capturing the value of offsetting positions and benefits customers by producing lower cash margin requirements for hedged positions.

OCC is very familiar with portfolio margining of related securities and futures positions (often referred to as "cross-margining") because it currently operates three such programs open to clearing members and their affiliates, and market professionals who include market makers and futures locals. OCC partners with the Clearinghouse Division of the Chicago Mercantile Exchange ("CME") on the oldest of these programs which has been in operation since 1989. Last year, the daily average margin savings in the OCC/CME cross-margining program for market professionals was $1.7 billion. OCC operates a similar cross-margining program for market professionals with ICE Clear US as well as offering an internal cross-margin program for products where OCC clears both the SEC- and Commission-regulated contracts. OCC received Commission approval for all of these programs before they began to operate. Based on our analysis of the Proposed Rules, we do not anticipate needing any additional Commission approval for these well-established and successful programs.

OCC agrees with the Commission's assertion that implementing a customer choice approach to portfolio margining involves a number of operational issues that merit thoughtful consideration by all stakeholders. On the other hand, qualified customers should not continue to be denied the substantial benefits of portfolio margining for longer than is necessary to work through these issues in a responsible manner. Section 713(a) of Title VII of Dodd-Frank requires the SEC "pursuant to an exemption granted by the [SEC] under Section 36 of [the Exchange Act] or pursuant to a rule or regulation" to permit the cross-margining of securities and futures products to be effected in futures accounts, and Section 713(b) similarly requires the Commission "pursuant to an exemption granted by the [CFTC] under Section 4(c) of the [CEA]"

[3] The participating options exchanges are BATS Options Exchange, C2 Options Exchange, Inc., Chicago Board Options Exchange, Inc., International Securities Exchange, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX, Nasdaq Options Market, NYSE Amex Options, and NYSE Arca Options. OCC clears futures products traded on CBOE Futures Exchange, NYSE Liffe U.S., NASDAQ OMX Futures Exchange and ELX Futures, as well as security futures contracts traded on OneChicago.

to permit the cross-margining of securities and futures products to be effected in a securities account. The agencies are also required under Section 713(a) and (b) to consult with one another "to adopt rules to ensure that [portfolio margin accounts carried as futures accounts or as securities accounts] are subject to comparable requirements to the extent practical for similar products."

We applaud the Commission's proposed Section 39.4(e) and agree that the proposed procedural requirements through which a DCO would seek approval for a program to carry portfolio margining accounts as futures account are appropriate [*i.e.*, filing of a proposed rule change under Section 40.5 for Commission approval and petition for an order under Section 4d of the CEA]. The Commission correctly notes that its Proposed Rule is only procedural, and that it must consult with the SEC in determining what standards to apply in approving a futures portfolio margining program as well as the standards to apply in granting an exemption under Section 4(c) of the CEA to permit cross-margining accounts to be carried as securities accounts. In response to the Commission's request as to what strategies the Commission and the SEC should follow to facilitate the availability of portfolio margining programs, we urge the agencies to rely primarily upon their existing procedures for review and approval of rule filings by clearing organizations and exchanges rather than to attempt to engage in advance rule-making to set substantive criteria for such programs. The existing cross-margining programs were developed through this process, and future expansion of programs to include a broader range of qualified customers can be accomplished in a similar manner.

Dodd-Frank not only instructed the Commission and SEC to take action to make customer portfolio margining a reality, it also removed one of the major statutory obstacles to this goal. Section 983 of Dodd-Frank amends the Securities Investor Protection Act to provide that futures and options on futures held in a securities portfolio margining account approved by the SEC are covered by Securities Investor Protection Corporation "insurance." However, qualified customers will not be able to take advantage of existing SEC-approved securities portfolio margining programs that authorize futures and options on futures to be held in a securities account until the Commission grants an exemption under Section 4(c) of the CEA and issues an order under Section 4d of the CEA, and portfolio margining accounts cannot be carried as futures accounts without exemption by the SEC under Section 36 of the Exchange Act. The Commission and the SEC should promptly review and approve, and issue such exemptions and orders as are necessary, to implement appropriate portfolio margining programs proposed by clearing organizations.

The Commission and the SEC cannot approve such rule changes and grant such exemptions without an opportunity for public comment. Once the Proposed Rules are finalized, there will be a framework in place for DCOs to file rules to establish a portfolio margining program permitting qualified customers to hold securities positions in a futures account. These rules will have to be approved by the Commission. The comment periods for proposed orders under Section 4d of the of the CEA, the DCO rules, and any necessary rule filings by a designated contract market will provide ample opportunity for all interested stakeholders to provide their perspective on any issues raised by customer portfolio margining. In addition, these comment periods will assist the Commission and SEC in shaping any rules required under Section 713 of Dodd-Frank and will provide a basis for consultation between the agencies on

these rules. Sections 713(a) and (b) of Dodd-Frank expressly permit each agency to use existing exemptive authority to permit portfolio margining accounts subject to the jurisdiction of the other agency. We believe that this provision also authorizes each agency to approve, subject to consultation with the other agency, appropriate rule-filings to establish a portfolio margin program under its own jurisdiction. In OCC's view, any additional rule-making by the Commission or the SEC that may be deemed appropriate or advisable can be done in connection with the process for acting upon applications placed before it.

Requirements for CCOs

OCC believes that the Commission's Proposed Rules on the requirements for CCOs are generally appropriate and consistent with the requirements of Dodd-Frank.[4] OCC does have specific comments on the need for coordination of CCO rules with the SEC, whom a DCO may designate as its CCO, and the Commission's proposed effective date for the CCO requirements.[5]

In the coming months, the SEC will be proposing rules for CCOs of clearing agencies under Section 763(a) of Dodd-Frank. The statutory requirements for CCOs of DCOs and of clearing agencies are substantively identical. As a dually registered DCO and clearing agency, OCC will be subject to the CCO rules of both the Commission and the SEC. We urge the Commission and its staff to coordinate with the SEC and its staff on the respective CCO rules to ensure that these regulations are harmonized to the greatest extent possible.[6] Such coordination will facilitate the ability of OCC (and any other DCOs that may in the future also be registered as a clearing agency under the SEC's jurisdiction) to comply with the CCO rules of the two agencies in a cost effective and efficient manner. Unnecessary differences in the requirements for the CCOs of DCOs and clearing agencies on compliance procedures and the required annual report will impose needless costs on OCC, and any other dually registered clearing organizations, without any regulatory benefit to the Commission or SEC.

The Commission asks whether it should restrict a DCO from designating an attorney who represents the DCO or its board of directors, such as in-house or general counsel, to the CCO position. According to the Commission, the rationale for such a restriction is concern that the interests of defending the DCO would conflict with the duties of the CCO. OCC strenuously opposes such a restriction. Addressing the potential conflict that the Commission identifies does not require a blanket prohibition on appointing the general counsel or other in-house counsel as the CCO of a DCO. In-house counsel commonly have the dual responsibility both of advising

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[4] OCC has concerns about how the Commission plans to interpret the requirement of the Proposed Rules that a CCO "ensure" compliance with the CEA and the Commission's regulations as well as the requirement of the Proposed Rules that a CCO needs to have the authority to "enforce" compliance with appropriate compliance policies and procedures, as defined in the Proposed Rules. OCC agrees with the compelling arguments on these issues made by the CME in its comment letter on the Proposed Rules. Letter from Craig S. Donohue, Chief Executive Officer, to the CFTC at p. 4-6 (Feb. 7, 2011)

[5] Proposed Section 39.10 addresses compliance with core principles and the requirements for DCO CCOs. OCC is pleased that proposed Section 39.10(b) codifies the statutory provision affording a DCO reasonable discretion in establishing the manner in which it complies with each core principle.

[6] OCC understands that complete harmonization of the contents of the CCO's annual report to each agency will not be possible because of the differences between the regulatory frameworks for clearing organizations under the CEA and the Exchange Act. Most notably, the CEA contains core principles for DCOs while the Exchange does not contain core principles for clearing agencies.

the client on how to comply with the law and defending the client against allegations that it failed to do so. As a result, permitting in-house counsel to act as CCO does not pose new or unique challenges for these lawyers. The ability to navigate conflicts in an ethical fashion lies at the heart of a lawyer's professional responsibility and is an inevitable part of the practice of law.[7] All lawyers must address conflicts in their work and resolve these conflicts in accordance with the ethical and professional standards that bind an attorney on a day-to-day basis. Failure to do so can result in disbarment as well as civil and criminal prosecution. Further, DCO in-house counsel or general counsel are well qualified to perform the CCO role. They are intimately familiar with the CEA, the Commission's regulations applicable to DCOs, and the DCO's own rules, policies and procedures. As counsel to the DCO, an in-house counsel often performs duties substantially similar to those that Dodd-Frank and the Proposed Rules envisions being performed by the CCO. Indeed, we believe that the practice of appointing an in-house lawyer as CCO of a regulated entity is common, and that many banks, for example, appoint their general counsel as their CCO with duties similar to the duties that would be imposed on a CCO by the Proposed Rules. The Commission cites no evidence that CCOs who are also in-house counsel have failed for that reason to ensure compliance at any regulated entity in the past. Absent such evidence, the Commission should not restrict the appointment of in-house counsel as CCOs.

The Commission proposes that the requirements for CCOs become effective not more than 180 days after final rules are published in the Federal Register. The Commission asks whether this proposed effective date is appropriate and, if it is not, what alternative effective date would be appropriate and why. OCC generally agrees with the proposed effective date for the CCO Proposed Rules with two important exceptions. OCC does not think that the Proposed Rules on establishing a compliance manual and the annual report should be effective on such an expedited schedule. Developing a compliance manual may require considerable effort even if a DCO already has a robust compliance program in place. The first annual report by the CCO will provide the template for all CCO annual reports to follow and its production is likely to be more time consuming than subsequent annual reports. In addition, if the final rules are published in the Federal Register prior to the end of July 2011, the first annual report of OCC's CCO would be due by March 31, 2012. That is not enough time to prepare the initial version of a report as comprehensive as contemplated by the Proposed Rules. OCC suggests that the final rules requiring development of a compliance manual by the CCO and an annual report should become effective at the end of the DCO fiscal year following the one in which the final rules are adopted.

Scope of Part 39

The Commission states that in a future rulemaking, Part 39 will be reorganized into three subparts with one subpart containing provisions applicable only to systemically important DCOs ("SIDCOs"). Although there are no substantive SIDCO rules presented in the Proposed Rules, OCC believes that it is important to reiterate our positions with respect to SIDCO designation and jurisdiction.

Section 805(a)(2) of Dodd-Frank allows the Commission to prescribe special risk management standards for SIDCOs for which the Commission is the "Supervisory Agency."

[7] See, e.g., Paragraph 9 of the Illinois Code of Professional Conduct. "In the nature of law practice, however, conflicting responsibilities are encountered."

Section 803(8)(A) of Dodd-Frank provides that the Supervisory Agency of a registered clearing agency is the SEC and the Supervisory Agency for a DCO is the Commission. Section 803(8)(B) provides that if a designated financial market utility has multiple Supervisory Agencies, the agencies are to agree on one agency to act as the Supervisory Agency for the financial market utility.

Since over 99% of OCC's business is regulated by the SEC, we expect that the Commission and the SEC will agree that the SEC should act as OCC's Supervisory Agency. If the SEC is designated as OCC's Supervisory Agency, OCC believes that it will not be subject to SIDCO-specific rules proposed by the Commission in any future rulemaking.

Transfer of a DCO Registration

The Commission proposed to add a new paragraph (h) to Section 39.3 that would formalize the procedures that a DCO must follow when requesting the transfer of its DCO registration and positions compromising open interest in anticipation of a corporate change (*i.e.*, a merger, corporate reorganization or change in corporate domicile) which results in the transfer of all or substantially all of the DCO's assets to another legal entity. The Proposed Rules set forth a list of documentation and information that must be presented to the Commission by the DCO requesting the transfer. OCC applauds the efforts of the Commission to formalize the registration transfer process. However, for transparency purposes, OCC also believes that a request to transfer a registration by a DCO should be published in the Federal Register so the public can comment on the proposal. The public comment period could run concurrently with the review period conducted by the Commission so there would be no delay in the review process. Although the Commission may have anticipated it would publish such requests to transfer a DCO registration in the Federal Register, the specific requirement is not set forth in the Proposed Rules.

Conclusion

OCC appreciates the opportunity to comment on the Proposed Rules. We look forward to working closely with the Commission to provide any additional input that might be useful in determining the final form of the Proposed Rules.

Sincerely,

William H Navin

William H Navin
Executive Vice President and General Counsel

cc: Gary Gensler
Chairman
Commodity Futures Trading Commission

Michael V. Dunn
Commissioner

Jill E. Sommers
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