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June 2, 2011

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-AD01, Requirements for Derivatives Clearing Organizations Regarding the Mitigation of Conflicts of Interest

RIN 3038-AC98, Financial Resources Requirements for Derivative Clearing Organizations

RIN 3098-AC98, General Regulations and Derivatives Clearing Organizations

RIN 3038-AC98, Information Management Requirements for Derivatives Clearing Organizations

RIN 3038-AD01, Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest

RIN 3038-AC98, Risk Management Requirements for Derivatives Clearing Organizations

RIN 3038-AC98, Requirements for Processing, Clearing and Transfer of Customer Positions

Dear Mr. Stawick:

This letter is submitted by The Options Clearing Corporation ("OCC") in response to the Commission's recent release[1] (the "Release") reopening the comment periods on a number of proposed rules implementing the provisions of the Dodd-Frank Wall Street Reform and

[1] 76 FR 25274 (May 4, 2011).

Consumer Protection Act (the "Dodd-Frank Act") that establish a comprehensive new framework for the regulation of swaps. OCC commented on seven of the proposed rules for which the Release reopens the comment period.[2] OCC incorporates those letters in their entirety by reference into this current comment letter. OCC urges the Commission to redouble its efforts to coordinate the substantive requirements of and its schedule for adopting final rules affecting derivatives clearing organizations ("DCOs") with the Securities and Exchange Commission ("SEC"). We also believe that, with the July effective date of the Dodd-Frank Act looming, it is unrealistic to believe that market participants will be able to adapt to an entirely new and highly complex regulatory structure in such a short amount of time. We encourage the Commission, as well as the SEC, to provide reasonable phase-in periods for each of the final regulations to minimize the disruption of the derivatives markets.

OCC 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 SEC as a securities clearing agency pursuant to Section 17A of the Securities Exchange Act of 1934 and with the Commission as a DCO under Section 5b of the Commodity Exchange Act. OCC clears securities options, security futures and other securities contracts subject to SEC jurisdiction, and commodity futures and commodity options subject to the CFTC's jurisdiction. OCC clears derivatives for all nine U.S. securities options exchanges and five futures exchanges.[3] OCC has always been operated as a non-profit market utility. Each year OCC returns to its clearing members the excess of clearing fees received over its operating costs plus an amount (if any) reasonably required to be retained as additional capital to support its clearing activities. OCC acts as the clearing organization for multiple exchanges, and identical option contracts traded on more than one exchange and cleared through OCC are fungible in clearing member accounts at OCC.

Need for Regulatory Coordination and Harmonization

In its previous comment letters to the Commission, OCC consistently has stressed the vital importance of coordination among the Commission, the SEC, the Board of Governors of the

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[2] OCC has filed comments on the following proposed rules: Letter from Wayne Luthringshausen to David Stawick on RIN 3038-AD01, Requirements for Derivatives Clearing Organizations Regarding the Mitigation of Conflicts of Interest (Nov. 11, 2010); Letter from Wayne Luthringshausen to David Stawick on RIN 3038-AC98, Financial Resources Requirements for Derivatives Clearing Organizations (Dec. 10, 2010); Letter from William Navin to David Stawick on RIN 3098-AC98, General Regulations and Derivatives Clearing Organizations (Feb. 10, 2011); Letter from William Navin to David Stawick on RIN 3038-AC98, Information Management Requirements for Derivatives Clearing Organizations (Feb. 10, 2011) ; Letter from William Navin to David Stawick on RIN 3038-AD01, Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest (Mar. 7, 2011); Letter from Wayne Luthringshausen to David Stawick on RIN 3038-AC98, Risk Management Requirements for Derivatives Clearing Organizations (Mar. 21, 2011); and, Letter from William Navin to David Stawick on RIN 3038-AC98, Requirements for Processing, Clearing and Transfer of Customer Protections (Apr. 11, 2011).

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

Federal Reserve System (the "Board"), and non-US regulators in the process of promulgating regulations to reduce risk, increase transparency and promote market integrity within the financial system by establishing a comprehensive new regulatory framework for swaps and security-based swaps. These comments reflected OCC's unique experience as the only clearing organization currently registered with both the Commission and the SEC. Conforming operations to the requirements of multiple regulatory agencies requires extensive cooperation and coordination with the applicable regulators. This was true even before the current period of profound and ongoing regulatory change. The Commission, the SEC, the Board, the Financial Stability Oversight Council, CPSS-IOSCO and a number of non-US regulators are all working simultaneously to update numerous regulations to respond to the events of 2008 and we encourage them to do so in as coordinated a fashion as possible.

Based on our experience as a dual registrant, we believe the goals of the Dodd-Frank Act will be compromised and unnecessary costs will be imposed on the users of derivatives if the Commission fails to adequately coordinate both the substance of its regulations and the timetable for implementation with the other regulators. To address those situations where the Commission and the SEC do not adopt identical or nearly identical regulations, we suggest that the agencies develop a mechanism for exempting dually registered DCOs/clearing agencies either from specific rules of the regulator overseeing the minority of the clearinghouse's business or from the entire rule set, if appropriate. To raise the chances of meaningful international regulatory coordination on clearinghouse regulation, the Commission should also defer final action on rules implementing the statutory core principles for DCOs until CPSS/IOSCO adopts final Principles for Financial Market Infrastructures.

Mitigation of Conflicts of Interest

OCC's first comment letter to the Commission on Dodd-Frank rule-making addressed the Commission's proposed rules on mitigation of conflicts of interest in DCO ownership and governance.[4] That comment letter presented a number of arguments addressing the inappropriateness of the Commission's proposed rules to DCOs, such as OCC, that follow a not-for-profit, market utility model. The concerns expressed in that letter were not mitigated by subsequent Commission proposals. We urge the Commission to take a fresh look at the proposed mitigation of conflicts of interest rules now that the full range of proposed DCO oversight rules is public. These proposed rules make clear that the tools at the Commission's disposal to address the mitigation of conflicts of interest are not limited to the governance standards and ownership limitations of the proposed rules. The Commission also can rely on Dodd-Frank's requirements for fair and open access to clearing, the Commission's process for review of DCO rules, and the Commission's oversight of clearing agencies generally. These flexible tools are a more appropriate way for the Commission to mitigate conflicts of interest given that DCOs vary greatly in ownership structures, memberships, and products cleared.

Extent of Defaulting Member Coverage

In OCC's comment letter on the Commission's proposed rules on financial resource requirements for DCOs, we objected to the proposed requirement that Systemically Important DCOs ("SIDCOs") maintain financial resources sufficient to enable them to meet their financial obligations to their clearing members notwithstanding a default by the two clearing members

[4] Letter from Wayne Luthringshausen to David Stawick on RIN 3038-AD01, Requirements for Derivatives Clearing Organizations Regarding the Mitigation of Conflicts of Interest (Nov. 11, 2010).

creating the largest combined financial exposure for the SIDCO under extreme but plausible market conditions.[5] We recommend that the Commission reconsider its approach to this issue, as there does not appear to be U.S. or international regulatory consensus on this issue. The Board recently proposed that designated financial market utilities, other than DCOs and clearing agencies, maintain financial resources to cover the default of their largest member in extreme but plausible market conditions.[6] The SEC proposed the same approach for clearing agencies that do not clear security-based swaps.[7] CPSS-IOSCO's consultative report seeks comment on whether it is appropriate for a financial market utility to have resources sufficient to cover one or two defaulting clearing members, but stops short of imposing a "cover two" requirement.[8] We ask the Commission not to finalize this rule until the CPSS-IOSCO Principles for Financial Market Infrastructures are finalized. Requiring U.S. DCOs to adopt a "cover two" approach, while non-U.S. clearing organizations only adhere to a "cover one" approach, would put U.S. clearinghouses at a disadvantage to their international competitors.

Effective Date of DCO Core Principles

Section 725(c) of the Dodd-Frank Act makes extensive amendments to the fourteen existing Core Principles applicable to DCOs found in Section 5b(c)(2) of the Commodity Exchange Act and also adds four new Core Principles for DCOs. As we have noted in previous comment letters, the amended and newly added Core Principles are more prescriptive than the Core Principles currently in effect. Each DCO will need to ensure that its rules and procedures are in compliance with the post-Dodd Frank Act Core Principles and make any changes necessary to come into compliance. This could involve a lengthy evaluation and rule-writing process.

Pursuant to Section 754 of the Dodd-Frank Act, unless otherwise provided in Title VII, provisions of the Dodd-Frank Act will become effective 360 days after enactment (*i.e.*, July 15, 2011) or, to the extent a provision "requires a rulemaking," not less than 60 days after the Commission publishes final rules or regulations implementing the provision (whichever is later). The Commission has now proposed rules seeking to implement each of the amended and newly added Core Principles for DCOs.[9] We ask that the Commission clarify, as promptly as possible, that the effect of these proposals is to acknowledge that the amended and new Core Principles for DCOs "require a rulemaking," and therefore compliance with the Core Principles will not be required until 60 days after the Commission publishes final rules implementing the Core

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5 Letter from Wayne Luthringshausen to David Stawick on RIN 3038-AC98, Financial Resources Requirements for Derivatives Clearing Organizations (Dec. 10, 2010).

6 76 FR 18445 (Apr. 4, 2011).

7 76 FR 14472 (Mar. 16, 2011).

8 CPSS-IOSCO, Principles for Financial Market Infrastructures, Consultative Report (March 2011).

9 See Risk Management Requirements for Derivatives Clearing Organizations, 76 FR 3698 (January 20, 2011) (implementing Core Principles C, D, E, F, G, and I); Financial Resource Requirements for Derivatives Clearing Organizations, 75 FR 63113 (October 14, 2010) (implementing Core Principle B); Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest, 76 FR 722, (January 6, 2011) (implementing Core Principles O, P and Q); General Regulations and Derivatives Clearing Organizations, 75 FR 77576 (December 13, 2010) (implementing Core Principles A, H, N and R); and Information Management Requirements for Derivatives Clearing Organizations, 75 FR 78185 (December 15, 2010) (implementing Core Principles J, K, L and M).

Principles. Alternatively, we ask that the Commission provide guidance as to the implementation schedule for the Core Principles and whether a DCO will be expected to be in compliance with the statutory DCO Core Principles on July 16, 2011 notwithstanding that the Commission has not finalized its implementing regulations.

We have commented on each of the Commission's proposed rules implementing the DCO Core Principles, and we refer the Commission to those comment letters for a description of the many troubling issues raised by the Commission's implementation, many of which apply as well to the statutory Core Principles themselves.

In addition, specific examples of Core Principles with which DCOs may have difficulty complying by the statutory deadline include:

- Amended Core Principle B will include a new requirement that a DCO "possess financial resources that, at a minimum, exceed the total amount that would . . . enable the [DCO] to cover the operating costs of the [DCO] for a period of 1 year (calculated on a rolling basis)."[10] As we indicated in a comment letter submitted to the Commission on December 10, 2010, the Commission should clarify whether "operating costs" should be interpreted as the costs required to operate the DCO as it winds down, or whether these costs must be calculated based on the ongoing operations of the DCO as a going concern. We believe the genesis of this requirement was concern that a start-up DCO with limited financial backing might go out of business with open positions, leaving members and regulators to step in to ensure an orderly wind-down. In the unlikely event that a mature DCO were to wind down, it would still have revenues from ongoing clearing operations earned while members closed out their positions, and it would immediately curtail non-essential operations, such as systems, technology, infrastructure, investor education and government relations, thereby significantly reducing costs. We believe that it is inappropriate to permit this Core Principle to become effective without clarification as to its intended meaning. Some possible interpretations of the amendments to Core Principle B could require DCOs to raise additional capital, and raising capital requires time. DCOs should not be forced to speculate about whether they need to raise capital and how much additional capital might be required and should instead be given ample time to take any necessary action once the Commission's rule-making has been finalized. Standards that are likely to require capital raising should include a phase-in period.

- Core Principle L is being substantially amended to require DCOs to "provide to market participants sufficient information to enable the market participants to identify and evaluate accurately the risks and costs associated with using the services of the [DCO]." Core Principle L will also require public disclosure and disclosure to the Commission of extensive information about the operations of the DCO. Although OCC believes that it currently complies with the requirements of Core Principle L through information published on its web site, in rule changes filed with the Commission and the SEC, annual reports and audited financial statements, such a conclusion requires interpretation of the requirements and no DCO can be completely certain of its compliance in the absence of guidance from Commission rules. In addition, there is currently no guidance from the Commission on what form disclosure to the Commission should take or the timing of this disclosure. Unless and until contrary interpretations have been adopted through rule-

[10] *See* CEA § 5b(c)(2)(B)(ii)(II).

making procedures, OCC would take the position that all necessary information is currently being made available to the Commission.

- New Core Principle O will require each DCO to "establish and enforce appropriate fitness standards for (I) directors; (II) members of any disciplinary committee; (III) members of the derivatives clearing organization; (IV) any other individual or entity with direct access to the settlement or clearing activities of the derivatives clearing organization; and (V) any party affiliated with any individual or entity described in [the foregoing sub-clauses.]" Core Principle P goes on to require each DCO to "establish and enforce rules to minimize conflicts of interest in the [DCO's] decision-making process . . . and . . . establish a process for resolving [such] conflicts of interest[.]" Core Principle Q requires each DCO to "ensure that the composition of the governing board or committee of the [DCO] includes market participants[.]" OCC submitted a comment letter to the Commission on its proposed rules implementing Core Principles O, P and Q on March 7, 2011. In our comment letter we discussed many aspects of the Core Principles that we found to be ambiguous or to impose improper burdens on DCOs. We continue to view the Commission's proposed rules interpreting these new Core Principles as inappropriate in many respects. Given that the proposed rules and the many comments that have been received by the Commission regarding them are still under review, these proposed rules should not be treated as providing definitive guidance as to the meaning of the statutory Core Principles. In the absence of any such definitive guidance, we strongly request that the Commission delay implementation of the Core Principles themselves until the Commission has had the opportunity to fully consider and resolve the important issues raised by them.

Conclusion

OCC has appreciated the opportunity to comment on the full range of the Commission's proposed rules affecting DCOs. We would be pleased to provide the Commission with any additional information or analysis that might be useful in determining the final form of the Proposed Rules and look forward to working with the Commission on an implementation schedule that will fulfill the goals of the Dodd-Frank Act while avoiding large-scale disruption of the derivatives markets. We respectfully request that the Commission issue an interpretation to the effect that the Core Principles for DCOs, and all other provisions of Title VII of the Dodd-Frank Act for which the Commission has proposed rules that have not yet been adopted, require rule-making to provide interpretive guidance before they can become effective. DCOs and other regulated entities should not be required to speculate about the Commission's interpretation of the statutory provisions and be forced to take actions to comply when those actions may need to be redone or undone when final interpretations are in place. The very significant regulatory changes brought about by Dodd-Frank are straining the resources of the Commission as well as its regulated entities, and it is unnecessary and inappropriate to impose an additional burden of uncertainty and wasted effort when Congress so clearly gave the Commission the discretion to do otherwise.

Sincerely,

William H. Navin

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cc: Gary Gensler
Chairman
Commodity Futures Trading Commission

Michael V. Dunn
Commissioner

Jill E. Sommers
Commissioner

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