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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-AD07 Provisions Common to Registered Entities

Dear Mr. Stawick:

This letter is submitted by The Options Clearing Corporation ("OCC") in response to the Commodity Futures Trading Commission's (the "Commission") recent release requesting comment on its proposed rules (the "Proposed Rules")[1] implementing the new statutory framework for certification and approval for new products, new rules and rule amendments submitted to the Commission by registered entities, as mandated by 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 would amend the CFTC regulations in sections 40.1 through 40.8 and add new regulations in sections 40.10 through 40.12.

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 and with the Commission as a derivatives 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

[1] Provisions Common to Registered Entities, 75 FR 67282 (Nov. 2, 2010).
[2] Pub. L. 111-203.

commodity options subject to the Commission's jurisdiction. OCC clears derivatives for all nine U.S. securities options exchanges and five futures exchanges.[3]

Overview of Comments On the Proposed Rules

OCC believes that the Commission's Proposed Rules are generally appropriate and consistent with the requirements of Dodd-Frank. We particularly applaud those aspects of the Proposed Rules that will facilitate compliance by DCOs with multiple filing requirements under Titles VII and VIII of Dodd-Frank in a single filing. We hope that the Commission and its staff will continue to work with the SEC and its staff in order to facilitate the ability of OCC (and any other DCOs that may in the future also be registered as clearing agencies under the SEC's jurisdiction) to comply with the filing requirements of the two agencies through the submission of essentially the same material to both agencies, as OCC presently does. We recognize that the Commission and its staff have been and continue to be under tremendous time pressure to accomplish an enormous volume of rule-making in a short time, and we hope that our comments will be helpful in contributing to the best product that can be achieved. In that spirit, we have identified below a few areas where we believe the Proposed Rules would be improved by relatively minor, though in some cases quite important, modifications and clarifications that we believe are consistent with the spirit and intent of Dodd-Frank and the regulatory objectives reflected in the Proposed Rules. In some cases, our comments merely reflect how we would interpret the Proposed Rules as drafted in order to provide the Commission with an opportunity to correct any misunderstanding.

Registered Entity Submission Process

Section 745 of Dodd-Frank will amend Section 5c of the CEA, effective July 2011, to substantially alter the way registered entities, including DCOs, introduce new products and adopt new rules and rule amendments. In particular, Dodd-Frank introduces a 10 business day waiting period for self-certified products, rules and rule amendments, which the Commission is proposing to implement through amendments to its Part 40 regulations. While Congress, in adopting a short waiting period for self-certified filings of registered entities, may have struck an appropriate balance between the need for registered entities to be able to adapt quickly to changing circumstances and the need for the Commission to have adequate time to review registered entity self-certified filings to determine whether they present novel issues calling for a fuller review, the Proposed Rules go beyond the Dodd-Frank mandate by adding requirements related to (1) documentation and (2) legal due diligence. Neither of these requirements is inherently burdensome or unreasonable, but we would like to express our views as to how the requirements should be interpreted in practice and to suggest a minor modification in the documentation requirement to eliminate any implication that documentation beyond the registered entity's rule filing itself would always be required.

[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.

Documentation Requirement

The Commission is proposing to amend its regulations in sections 40.2, 40.3, 40.5 and 40.6[4] to require that a registered entity file with both self-certified filings and filings seeking Commission approval "documentation relied on to establish the basis for compliance with the applicable provisions of the [CEA and Commission regulations thereunder], including Core Principles." It is not clear to us what documentation the Commission would expect to be filed in response to these provisions. Ordinarily a registered entity will determine compliance of a filing with the CEA and Commission regulations by reviewing the terms and conditions of a new product or the provisions of a new rule or rule amendment in the context of the CEA and Commission regulations that might impose specific requirements or limitations on the product or rule. There would ordinarily be no external "documentation" relied upon by the registered entity in making this determination. For example, in OCC's case, proposed rule change filings for new products are ordinarily drafted by counsel, often through a collaboration between inside and outside counsel, based on term sheets or other descriptive materials provided by the exchange proposing to trade the new product and/or materials prepared by OCC's staff describing how the product will be cleared. A significant part of counsel's role in preparing the rule filing is to review applicable statutes and regulations to ensure that the filing complies with applicable law. In many or even most cases, a new product or other rule filing will raise no significant legal issues, and compliance with the CEA and Commission regulations will be obvious. No particular documentation would be relied upon in reaching that conclusion.

In cases where substantive legal analysis is required in order to determine compliance, counsel will perform that analysis and both the conclusion and the legal reasoning supporting the conclusion will be presented in the rule filing itself. Although notes and checklists may be drafted and circulated among inside and outside counsel, such materials are merely steps in the due diligence and analytical process and do not, in our view, constitute "documentation relied on" in establishing the basis for compliance. To interpret the Commission's proposed regulation as requiring that such notes, drafts and preliminary work product be submitted along with the rule filing would be burdensome and, we believe, serve no useful regulatory purpose. Accordingly, we believe that the Commission should modify its proposed regulations to make clear that supporting documentation must be included with a rule filing only to the extent that any relevant documentation was, in fact, obtained or prepared and relied upon. We suggest that, at a minimum, the words "if any" be inserted following the word "documentation" in the language of the proposed regulations quoted above. Such a formulation would avoid the implication that supporting documentation is, in all cases, required.

On the other hand, there may be situations where it is necessary for a registered entity to gather factual information in order to form the basis for a legal analysis. For example, characteristics of a particular underlying asset, the market for that asset, or other factual matters may be relevant to establishing whether proposed rules for clearing a new product are in

[4] *See* Proposed Rules § 40.2(a)(3)(v) (requiring such documentation to be filed by registered entities seeking to list or accept products for clearing by certification), 40.3(a)(4) (requiring such documentation to be filed by registered entities voluntarily submitting new products for Commission review and approval), 40.5(a)(7) (requiring such documentation to be filed by registered entities voluntarily submitting rules or rule amendments for Commission review and approval), 40.6(a)(7)(v) (requiring such documentation to be filed by registered entities seeking to adopt new rules or rule amendments by self-certification).

compliance with the CEA and Commission regulations. In some cases, there may be documents that would be appropriate for inclusion along with the filing. In other cases, however, the documentation may be voluminous and/or available online or through other publicly available sources. We suggest that the requirement be modified to require only that the required documentation be "made available" to the Commission. This might be done through the inclusion of appropriate links or internet addresses or appropriate citations. Our point is simply to suggest that the rule be drafted and interpreted to allow flexibility for information to be submitted in an efficient and useful manner.

Legal Due Diligence Requirement

In addition, the Proposed Rules would require that filings made pursuant to section 40.2, 40.3, 40.5 or 40.6 include "a written statement certifying that the registered entity has undertaken a due diligence review of the legal conditions, including conditions relating to contractual and intellectual property rights, that may materially affect the trading of the product [or products to which a rule or rule amendment relates]."[5] We have described above, in general terms, the legal due diligence process that OCC performs in preparing a proposed rule change. While the inclusion in a rule filing of a certification that such a due diligence process has been performed would not necessarily be burdensome, it is less clear to us what useful purpose it serves, as the registered entity is required to abide by the CEA and all applicable laws and regulations whether or not it gives such a certification. In any event, we thought it would be useful to make clear to the Commission that the process described above would be the basis for such a certification if OCC is required to give one.

We note that the proposed due diligence requirement refers specifically to "conditions relating to contractual and intellectual property rights."[6] Such issues are indeed a particular focus of due diligence for certain products, such as derivatives based on an index in which the publisher of the index claims intellectual property rights. In most cases, however, the license to use the intellectual property is obtained by the exchange on which the product is traded and is sufficiently broad to include the clearing of the product by OCC. OCC generally requires that the exchange represent and warrant that it has such a license and that it indemnify OCC against allegations that the trading or clearing of the product as proposed would violate the rights of any party. Such representations, warranties and indemnities would usually form the basis for any due diligence certification by OCC. This seems especially appropriate as, with respect to any product within the Commission's jurisdiction, the exchange would be required to make its own due diligence certification to the Commission.

Terms and Conditions of Products

While we believe that the definition of "terms and conditions" in the Proposed Rules is generally appropriate, we were surprised and troubled by one aspect of it. The definition is proposed to be amended to provide that "[w]henever possible, all proposed swap or contract terms and conditions should conform to industry standards or those terms and conditions adopted by comparable contracts."[7] Beyond the technical objection that a definition is not an appropriate

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[5] 75 FR at 67293, 95-96.
[6] *Id.*
[7] 75 FR at 67292.

place for a substantive requirement such as this one, we do not believe that the requirement itself is appropriate. New products are generally designed by trading markets in response to what the markets believe their members and their ultimate customers want. Almost by definition a new product will include one or more characteristics that do not conform to existing contracts trading on the same or different markets. Innovation, after all, is the essence of a new product, but the Proposed Rules appear to impose a requirement that new products not be innovative. The addition of the words "[w]henever possible" neither ameliorates the problem nor adds clarity. It is presumably always "possible" to avoid introducing any new product that is not simply a copy of an existing product. We doubt the Commission intended to inhibit the development of novel products by proposing this language, which appears to be unsupported by any express authority in the CEA and would be inconsistent with its general spirit and intent. Indeed, the CEA explicitly recognizes, in multiple provisions, that new products may be novel. We think the more likely intent of the provision was to prevent registered entities from creating products that are economically identical to existing products, but that have one or more unique features that serve no apparent purpose but to prevent fungibility. If this was in fact the Commission's intent, we believe the Proposed Rules exceed what would be necessary to preclude this kind of product design and that the Commission should consider a more direct approach to preventing product features whose sole purpose is to prevent fungibility.

Response Time for Requests for Additional Information

Section 40.3(a)(11) of the Commission's regulations, as proposed, would provide that "[a] submission [of a new product] requesting approval shall . . . [i]nclude, if requested by Commission staff, additional evidence, information or data demonstrating that the contract meets, initially or on a continuing basis, all of the requirements of the Act, or other requirements for designation or registration under the Act or the Commission's regulations or policies thereunder. *The registered entity shall submit the requested information by the open of business on the date that is two business days from the date of request by Commission staff.*"[8] Depending on the nature of the additional evidence, information or data requested by Commission staff, this fixed two business day deadline may or may not provide adequate time to respond. It would ordinarily be in the interest of the registered entity to provide the additional materials as soon as possible in order to expedite the staff's review of the new product; however, we believe imposing a fixed and inflexible deadline is not realistic and that a more flexible standard should be adopted. For example, the Commission could provide that the deadline is two business days, "unless the registered entity notifies the Commission that additional time is reasonably required to provide the requested evidence, information or data, in which case the registered entity shall have up to 10 additional business days or such longer period as the Commission determines to be appropriate under the circumstances."

Rules and Rule Amendments Adopted Pursuant to Section 40.6(d)

Section 40.6(d) of the Commission's regulations allows a registered entity to place certain rules and rule amendments into effect without certification or pre-approval by the Commission if such changes are non-substantive, relate to certain changes to grades or standards of deliverables, relate to certain routine changes in the composition, computation, or method of selection of component entities of an index, or relate to certain option contract rules with respect

[8] 75 FR at 67294 (emphasis added).

to strike prices. In order to rely on Section 40.6(d), a registered entity must provide the Commission with a summary of all such rules and rule amendments made pursuant to Section 40.6 no less frequently than weekly. The Proposed Rules would change Section 40.6 to provide that such rules or rule amendments could be put into effect "on the following business day."[9] As Section 40.6 allows a registered entity to put rules and rule changes into effect by merely providing notice to the Commission after the fact (on a weekly basis), the reference to "the following business day" has no apparent meaning. We suggest that the Commission should clarify or delete the language.

Procedures for SIDCOs for which the Commission is not the Supervisory Agency

Section 40.10(a) of the Proposed Rules would require a DCO that has been designated by the Financial Stability Oversight Council (the "Council") as systemically important (a "SIDCO") to provide 60 days advance notice *to the Commission* and the Board of Governors of the Federal Reserve System (the "Board") in advance of "any proposed change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the [SIDCO]."[10] Section 40.10(a) implements Section 806(e)(1)(A) of Dodd-Frank, which requires that "[a] designated financial market utility [must] provide notice 60 days in advance notice to *its Supervisory Agency* of any proposed change to its rules, procedures, or operations that could, as defined in rules of each Supervisory Agency, materially affect, the nature or level of risks presented by the designated financial market utility."[11] The disparity between the two sections of italicized text above is currently a non-issue for all registered entities except OCC. However, the disparity is an important one for OCC and any registered entity that may become a dual-registrant in the future.

Section 803(8)(A) of Dodd-Frank provides that the Supervisory Agency of a registered clearing agency is the SEC and that the Supervisory Agency of a DCO is the Commission. Section 803(8)(B), however, provides that if, like OCC, a designated financial market utility would otherwise have multiple Supervisory Agencies pursuant to Section 803(8)(A), the agencies must agree on one agency to act as the Supervisory Agency. If the agencies are unable to agree, the Council must decide which agency will act as the Supervisory Agency. As over 99% of OCC's business is regulated by the SEC, we presume that the SEC and the Commission will agree that the SEC should act as OCC's Supervisory Agency and that OCC would therefore be subject to SEC advance notice requirements in lieu of section 40.10. As drafted, however, 40.10 would apply to all SIDCOs, and not merely those for which the Commission is the Supervisory Agency pursuant to Title VIII. We believe this is inappropriate and that the Commission should revise section 40.10 to read, in relevant part: "A registered derivatives clearing organization that has been designated by the Financial Stability Oversight Council as a systemically important derivatives clearing organization **and for which the Commission acts as Supervisory Agency pursuant to Section 803(8) of the Dodd-Frank Wall Street Reform and Consumer Protection Act** shall provide notice to the Commission . . . " Making this revision will conform section 40.10 to the requirements of Section 806 of Dodd-Frank and minimize the potential for an inefficient regulatory overlap between the Commission and the SEC.

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[9] 75 FR at 67296.
[10] 75 FR at 67299.
[11] Emphasis added.

Materiality Standard for SIDCO Changes

Proposed section 40.10(b) defines the matters for which a SIDCO must give advance notice under 40.10(a) as those "matters as to which there is a reasonable possibility that the change could affect the performance of essential clearing and settlement functions or the overall nature or level of risk presented by the [SIDCO]." We note that as drafted the Proposed Rules would require a SIDCO to notify the Commission and the Board of proposed changes to its rules, procedures or operations that could materially *decrease* the nature or level of risks of the SIDCO. While we realize that this requirement closely tracks the language of the statutory requirement in Title VIII of Dodd-Frank,[12] we think it would be permissible and appropriate for the Proposed Regulation to interpret the statute to require advance notice as applicable only to those proposed SIDCO changes that could have a material *adverse* effect on the nature or level of risks of the SIDCO. There are many changes that would result in an obvious material reduction of risk, and the goal of systemic risk reduction is not served by requiring that such changes be subject to a 60 day waiting period before implementation. While in theory the applicable regulatory authorities may permit such changes to be implemented within a shorter time period, the realities of limited staff resources and lack of incentive within any agency to take such action makes it unlikely to happen except in unusual circumstances.

SIDCO Emergency Changes

Section 40.10(h) of the Proposed Rules would permit a SIDCO to "implement a change that would otherwise require advance notice under [section 40.10] if it determines that an emergency exists and immediate implementation of the change is necessary for the [SIDCO] to continue to provide its services in a safe and sound manner."[13] SIDCOs would be required to provide such notice as soon as practicable, but no later than 24 hours after implementation. This notice would be required to include all information required for advance notices generally under section 40.10(a) (which would include information required for registered entity filings generally, pursuant to Section 40.6, including the proposed "documentation" requirement of section 40.6(a)(7)(v), discussed above). We do not believe that it is practical or reasonable to require that a SIDCO's emergency filing fully conform to the requirements of section 40.10(a) in all cases if it is required to be filed within 24 hours (particularly with respect to any documentation that is required to be filed). We suggest that a two stage approach be taken – with an initial notice filed within 24 hours and a more extensive filing conforming to section 40.10(a) to follow as soon as reasonably practicable thereafter, but in any case not more than 30 days after implementation of the change.

Tolling of Review Period for Jurisdictional Determinations

The Commission is proposing section 40.12 of the Proposed Rules to toll the review period for new products where there is uncertainty about the jurisdiction over such products as between the Commission and the SEC. Section 40.12(a)(1) provides that "[a] registered entity certifying, submitting for approval, or otherwise filing a proposal to list, trade, or clear an

12 *See* Dodd-Frank § 806(e)(1)(A) (requiring a designated financial market utility to "provide 60 days in advance notice to its Supervisory Agency of any proposed change to its rules, procedures, or operations that could, *as defined in rules of each Supervisory Agency*, materially affect, the nature or level of risks presented by the designated financial market utility." (emphasis added)).

13 75 FR at 67299.

agreement, contract, transaction, or swap having elements of both a security *and a derivative*, including a contract for the sale of a commodity for future delivery, may provide notice of its proposal to the Commission and the [SEC] with a statement that written notice has been provided to both agencies . . . [notifying them of the possible jurisdictional uncertainty.]"[14] We believe the use of the term "derivative" in section 40.12(a)(1) is inappropriate and potentially confusing. "Derivative" is not defined in the Proposed Rules or elsewhere in the Commission's regulations. While the understood meaning of this term in the financial community certainly includes futures, options on futures and swaps, over which the Commission has jurisdiction, it also includes instruments over which the SEC has jurisdiction, such as options on securities and indices of securities. We suggest that the term "derivative" be eliminated and that the Commission instead more clearly describe the products over which the Commission has jurisdiction pursuant to the CEA.

Ambiguity in Section 40.2

The second sentence of section 40.2(a) of the Proposed Rules provides that "[a DCO] must comply with the submission requirements of [section 40.2] prior to accepting for clearing a product that is not *listed or traded* on a designated contract market, [DCO] or a swap execution facility and has not been approved for clearing."[15] We believe that the reference to products being listed or traded on a DCO is an error, as products are not listed or traded on DCOs. If the intention of this language was to allow a DCO to clear a product that is already cleared by another DCO without complying with the submission requirements of section 40.2, then that should be clarified.

Conclusion

OCC appreciates the opportunity to comment on the Proposed Rules. We believe it is vitally important that the Commission's regulations governing new products, rules and rule amendments provide sufficient flexibility to allow markets and clearinghouses to continue to innovate and adapt to changing market conditions. 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
Executive Vice President and General Counsel

cc: Gary Gensler
Chairman
Commodity Futures Trading Commission

[14] 75 FR at 67300 (emphasis added).
[15] 75 FR at 67293 (emphasis added).

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