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December 10, 2010

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 Financial Resources Requirements for Derivatives Clearing Organizations

Dear Mr. Stawick:

This letter is submitted by The Options Clearing Corporation ("OCC") in response to the Commission's recent release (the "Release")[1] requesting comment on its proposed rules (the "Proposed Rules") that would establish financial resources requirements for derivative clearing organizations ("DCOs") for the purpose of ensuring that they maintain sufficient financial resources to enable them to perform their functions in compliance with the Commodity Exchange Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[2] New regulation 39.11, which is adopted pursuant to Title VII of Dodd-Frank, would apply to all DCOs. New regulation 39.29, which is adopted pursuant to Title VIII of Dodd-Frank, establishes enhanced requirements for those DCOs that the Financial Stability Oversight Council ("Council") designates as systemically important ("SIDCOs"). Under the provisions of Title VIII, new regulation 39.29 would apply only to SIDCOs for which the Commission is the "Supervisory Agency." For the reasons discussed below, OCC believes that the Securities and Exchange Commission ("SEC") and not the Commission is likely to be designated as OCC's Supervisory Agency and that new regulation 39.29 will therefore not apply to OCC even though OCC expects that it will be designated as systemically important pursuant to Title VIII. Nevertheless, OCC appreciates this opportunity to comment on all of the Proposed Rules because we recognize that the Commission is coordinating with the SEC to harmonize, to the

[1] Financial Resources Requirements for Derivatives Clearing Organizations, 75 FR 63113 (Oct. 14, 2010).
[2] Pub. L. 111-203.

extent possible, the rule-making of both agencies pursuant to Dodd-Frank, and that similar rules may therefore be proposed by the SEC.

Executive Summary

We have briefly summarized below the comments set forth in more detail in the remainder of our letter. OCC is the world's largest derivatives clearing organization, and our comments are based on over 35 years of experience during which OCC has operated safely and effectively through multiple market crises. We respectfully request that the Commission take that history into consideration when weighing the following comments:

- OCC does not believe that it is appropriate to adopt a rigid requirement that every systemically important clearing organization must maintain resources sufficient to fulfill its obligations following a default by its *two* largest clearing members. While we agree that all clearing organizations should consider possible simultaneous defaults by multiple clearing members, constructing a stress test involves making numerous assumptions, and mandating one particular assumption (the "two largest" assumption) does not necessarily have a beneficial result because it restricts the ability of a DCO to measure its resources against those contingencies that it deems to be the most likely threats to its liquidity and solvency. It also fails to consider the cost that any particular clearing organization would incur in meeting the standard and the risk of driving clearing volume to clearinghouses that are not required to meet that standard.

- While the statutory requirement that a clearing organization have "one year of operating costs" (based on a rolling period) may be a reasonable standard to ensure that a clearing organization is not forced out of business while there is still open interest in the contracts it clears, we believe that the requirement should be calculated based on essential operating expenses for the rolling period. An appropriate wind-down budget would include projected revenues during the wind-down and would not include expenses associated with activities having value only to a clearing organization that intends to remain in business (*e.g.*, product development, technological enhancements, lobbying activities, investor education, etc.).

- OCC believes that an equity capital requirement for DCOs is not appropriate because clearing organizations rely primarily on member-supplied resources, such as clearing fund deposits and margin, to meet their obligations. Most, if not all, clearing organizations have little capital in relation to their obligations. OCC would be unable to substantially increase its capital without changing its status as a non-profit industry utility.

- The requirement that clearing members be able to meet an assessment within the time frame of a normal variation settlement cycle is an aggressive but appropriate standard that we believe our clearing members would be able to meet in most

circumstances. We suggest that clearing organizations should have discretion to extend this deadline on a case-by-case basis where appropriate to avoid severe strains on clearing member liquidity in unusual circumstances.

- The Commission should clarify that a clearing member has the ability to meet its potential assessment if it has net capital equal to or greater than the clearing member's assessment requirement. The requirement that a DCO must monitor ability to meet assessments on a "continual" basis should be clarified, and we believe that periodic review of a clearing member's net capital in relation to its maximum assessment liability is an appropriate standard.

- The Proposed Rules relating to reporting of the haircuts used to value securities held as margin collateral should be modified or interpreted to accommodate the use of a true portfolio margining model that values collateral based on its relationship to an overall portfolio in lieu of applying fixed haircuts on margin collateral.

- We agree that liquidity management is a critical element of DCO risk management. However, the Proposed Rules should be modified or interpreted to provide DCOs some flexibility in determining the means of managing their "cash" liquidity needs by allowing DCOs to use secured credit facilities and tri-party repo facilities in addition to cash held in demand deposit accounts to satisfy the cash requirement.

- The Commission should allow a minimum of two years for DCOs to implement the requirements of the Proposed Rules. In addition, and perhaps most important of all, the Commission should expressly retain waiver authority under the Proposed Rules so that prescriptive rules do not have unintended adverse consequences.

OCC Background Information

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 (the "Exchange Act") and with the CFTC as a DCO under Section 5b of the Commodity Exchange Act (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] OCC does not clear swaps and has no present intention of doing so.

[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.

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 reasonably required to be retained as additional capital to support its clearing activities. OCC acts as the clearing organization for multiple exchanges, and identical contracts traded on more than one exchange and cleared through OCC are fungible in clearing member accounts at OCC.

OCC has operated safely and effectively for over 35 years, including through the market crises in 1987 and 2008, mitigating systemic risk associated with derivatives trading. Its risk management approach includes three principal safeguards – rigorous membership standards, prudent margin requirements, and a sizable clearing fund comprised of highly liquid U.S. Treasuries and cash. OCC fully adheres to the current international best practices applicable to central counterparties, as jointly adopted in 2004 by the Committee on Payment and Settlement Systems ("CPSS") and the International Organization of Securities Commissions ("IOSCO") (together, the "CPSS/IOSCO best practices"). OCC regularly reviews the adequacy of its financial resources, taking into account numerous factors, such as its projected liquidity needs and measured risk exposures covering a diverse mix of clearing members[4] and financial products. We are industry leaders in developing state of the art clearinghouse risk management solutions.

OCC's proprietary margining system, known as STANS, was developed by OCC in house to measure the exposure of portfolios of options, futures and cash instruments cleared and carried by OCC on behalf of our clearing members. STANS includes a net asset value ("NAV") component and a risk component. The NAV component marks all positions to market and nets long and short positions to determine the NAV of every portfolio. The NAV component represents the cost to liquidate the portfolio at current prices by selling the net long positions and buying in the net short positions. The risk component is estimated by means of an expected shortfall risk measure obtained from "Monte Carlo" simulations designed to measure the additional asset value required in any portfolio to eliminate an unacceptable level of risk that the portfolio would liquidate to a deficit. STANS generates a set of 10,000 hypothetical market scenarios intended to provide a realistic statistically consistent evaluation of risk at the level of each portfolio. These simulated scenarios incorporate information extracted from the historical behavior of each individual security (risk group) as well as its relationship to the behavior of other securities (risk groups). Scenarios are generated for over 7,000 risk groups, including a broad range of individual equities, exchange traded funds, stock indices, currencies, interest rates, bond prices, Treasury and Eurodollar futures prices, variances, volatilities, and several commodity products. OCC's "collateral in margins" system, which is implemented through STANS, differs from the systems used by most other clearing organizations in that it takes account of the identity of non-cash margin assets rather than merely looking to the current market value of the assets less a fixed haircut. OCC believes that this system is superior in that it

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[4] OCC currently has 121 clearing members, with net capital ranging from \$2.2 million to \$11.1 billion. Clearing members are restricted to clearing only those products for which they have adequate operational expertise and financial resources. OCC restricts each firm's financial exposure to OCC in part through its margining policy, which is designed to ensure that a firm always has sufficient liquid collateral to meet a very extreme and immediate loss in its account (beyond what is covered by OCC's standard margins). It does this through a mechanism that collects extra margin in instances where a firm's net capital is less than the loss it could face in an extreme market move. This mechanism ensures that a firm either has available liquidity to meet an extreme move or OCC holds margin that covers such a move. This serves as an effective form of credit cap on OCC clearing activity.

takes account of the fact that the market value of margin collateral may be correlated (positively or negatively) to the value of other assets and liabilities in the portfolio. OCC believes its collateral in margins program generates portfolio risk estimates that are more accurate than those used by other clearinghouses and represents a true portfolio margining system.

Discussion

Higher Standards for SIDCOs

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" (as defined in Section 803(8) of Dodd-Frank). 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) provides that if, like OCC, a designated financial market utility would otherwise have multiple Supervisory Agencies pursuant to Section 803(8)(A), the agencies are to 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.

Given that 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 new regulation 39.29 would therefore be inapplicable to OCC. Nevertheless, we expect that the SEC and the Commission will harmonize their standards to the extent possible, and we will therefore comment on the Commission's proposed standards for SIDCOs for the purpose of making our views known to both agencies notwithstanding our presumption that regulation 39.29 will not apply to OCC.

Covering a Default of the Two Largest Clearing Members

As noted above, the Proposed Rules require that a SIDCO maintain financial resources sufficient to enable it to meet its financial obligations to its clearing members notwithstanding a default by the two clearing members creating the largest combined financial exposure for the SIDCO during extreme but plausible market conditions. The justification given for this requirement is that the "size and complexity of the OTC derivatives markets may increase the chance that more than one clearing member could default simultaneously."[5] The Commission also recognizes, however, that "no U.S. futures clearinghouse has ever had more than one clearing member default at a time."[6] The same is also true of securities clearing agencies. We generally agree that the clearing of OTC derivatives presents unique risk management concerns, and, depending on the particular product and applicable risk management framework, perhaps even heightened concerns that warrant special regulatory treatment. Yet proposed regulation 39.29 would apply to *all* SIDCOs, regardless of whether a particular SIDCO clears swaps or other OTC derivatives.

[5] 75 FR at 63116.

[6] *Id.*

We agree that all clearing organizations should consider possible simultaneous defaults by multiple clearing members. However, a simultaneous default of a clearing organization's two largest clearing members, at least in the context of how that might occur within OCC, seems to us an extremely implausible occurrence that does not warrant being grafted into permanent and inflexible rules. While OCC's two largest firms, from a risk perspective, shift occasionally among several members, our two largest firms are always among the largest, most elite, well capitalized global firms. While the 2008 financial crisis proved that large firms can indeed fail, we believe subsequent reforms, including higher capital standards for banks and new OTC derivatives trading and clearing requirements, greatly reduce the likelihood of the kind of catastrophic scenario contemplated by the proposed stress test. The Commission offers no empirical basis or extended analysis in support of imposing this "two largest" rule, nor does it make any effort at estimating the potential impact of this aspect of the Proposed Rules on SIDCOs, clearing members and their customers. If heightened risk management standards are imposed on a DCO in such a way as to substantially increase the costs for clearing members and their customers to clear transactions through a SIDCO rather than a non-SIDCO, there is risk of undermining the goals of both Titles VII and VIII of Dodd-Frank by driving clearing volume to less-regulated clearinghouses.

The "single largest" coverage requirement for non-SIDCOs is consistent with the current CPSS/IOSCO best practices. Although the Commission points out that CPSS/IOSCO is considering adopting a "two largest" stress test as a revised standard, no consensus has yet been reached on this issue. We also observe that the Working Party on Financial Services of the European Union has proposed (but the European Parliament has not yet adopted) a "two largest" test. While such a test may ultimately be adopted, we remain of the view that a "single largest" coverage rule should remain the applicable standard. We urge the Commission not to pre-judge this question and impose a requirement that we fear will have adverse unintended consequences for SIDCOs and the goal of systemic risk reduction.

There is a certain inconsistency in the Commission's approach to stress testing. On the one hand, the Proposed Rules appropriately recognize the complexity and business judgment involved in establishing appropriate stress test scenarios, deferring largely to DCOs to develop appropriate stress tests. Yet, on the other hand, the Proposed Rules would dictate a singularly important stress test input by prescribing the "two largest" stress test. We believe the Proposed Rules are reasonable in requiring a DCO to perform stress testing on a monthly basis, based on a methodology that it has reasonable discretion to determine (provided that the methodology takes into account both historical data and hypothetical scenarios, all subject to potential review by the Commission). Stress tests involve many important assumptions and modeling decisions. With respect to stress tests that involve multiple simultaneous defaults, an assumption must be made as to the level of volatility in the market prior to the defaults. Our modeling assumptions for simultaneous default scenarios reasonably assume heightened volatility. By contrast, the stress test we apply to our "single largest" firm incorporates a very conservative assumption that volatility could be low prior to default (a "bolt out of the blue" or surprise event) but would increase very significantly immediately after the default. The significance of elevated volatility prior to a default is that collected margins would be much higher when the default occurred, greatly minimizing the risk of loss to OCC. We have not constructed a "two largest" stress test, but we believe it is reasonable to assume that a simultaneous default of OCC's two largest

clearing members, in the highly unlikely event that it were to occur, could only occur against a backdrop of elevated market volatility. We make this point primarily to illustrate that while it might appear intuitive that a "two largest" stress test would require a materially higher amount of financial resources than a "single largest" stress test, that might not necessarily be the case when legitimate distinctions among various scenarios are taken into account. Similarly, we are aware of speculation by some regulators as to the possibility that a "two largest" stress test might actually result in lower financial resource requirements than "single largest" stress tests where the ability to net out open positions across the two defaulting members is taken into account. Our current stress tests do not take such netting possibilities into account, but the concept appears reasonable provided a clearinghouse has legal authority to do such netting. The point is that mandating one particular assumption in a stress test does not have a predictably beneficial result on a test that ultimately must be based on many different assumptions. It merely restricts the ability of a DCO to implement those stress tests that it deems to be the most critical ones in protecting itself and the financial system against defaults.

One Year of Operating Costs Requirement

The Proposed Rules would require a DCO to maintain sufficient financial resources to cover its operating costs for at least one year, calculated on a rolling basis. We recognize that this requirement is mandated by Dodd-Frank and closely tracks the language of the statute.[7] We believe the genesis of this requirement, and the one that prompted its ultimate inclusion in Dodd-Frank, was the 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, established DCO were to wind down its business, it would still have revenues because it would continue to earn clearing fees as participants closed out their positions. Moreover, it would immediately curtail nonessential operations, thereby substantially reducing expenses. Clearinghouses are constantly upgrading their systems, technologies, and infrastructure. They may also conduct ancillary activities, such as investor education and government relations. All of these operations and activities would promptly be terminated or drastically curtailed in the event of a wind-down, with concomitant expense reductions.

We therefore believe that the "operating costs" required to be covered by established DCOs should not be calculated based on historical operating expenses, but rather on projected wind-down budgets that reflect the continuing revenues and substantially reduced operating costs associated with a wind-down scenario. It would be appropriate for the Commission to review such budgets. We believe this position is consistent both with the applicable language and the spirit of Dodd-Frank on this topic.

We support proposed §39.11(b)(2), which would allow a DCO to meet the operating costs requirement not only with its own capital, but also with "[a]ny other financial resource deemed acceptable by the Commission."[8] OCC may propose to meet the operating costs requirement with resources provided for that purpose by members rather than investors.

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[7] *See* Commodity Exchange Act § 5b(c)(2)(B) (as amended by Dodd-Frank § 725(c)).

[8] 75 FR at 63118.

Potential Equity Capital Requirement

The Release solicits comment on whether the Commission should adopt equity capital requirements for DCOs. It seems to us that the critical question from a safeness and soundness standpoint is whether DCOs have adequate financial resources, not the form in which such resources are held. A large equity capital requirement would be impossible for OCC to meet without changing its status as a non-profit industry utility, which has greatly benefited investors. And even if OCC were to substantially increase its equity, any such increase would be trivial relative to the magnitude of OCC's obligations.[9] Dodd-Frank says nothing about equity requirements for clearinghouses, and we respectfully suggest that the Commission should not impose such requirements on its own.

Meeting of Assessments by Clearing Members / DCO Monitoring Requirement

The Proposed Rules would require that DCOs have rules requiring their clearing members to meet an assessment within the time frame of a normal variation settlement cycle. As applied to OCC's current settlement scheme, where we conduct a single daily morning settlement, we interpret this requirement to mean that a clearing member must have sufficient liquid resources to meet an assessment within a twenty-four hour period. If our interpretation is correct, we think that is an aggressive but reasonable standard. Most active OCC clearing members have margin requirements significantly higher than their clearing fund and clearing fund assessment requirements. Clearing members need to have sufficient liquid assets (or at least immediate access to such assets) to meet a potentially large increase in margin requirements. Thus, we believe that under most foreseeable circumstances our clearing members are already prepared to meet an assessment within a twenty-four hour period. However, we believe a DCO should have the ability to waive this requirement on a case-by-case basis if warranted. For example, if the assessment were to coincide with a significant increase in margin requirements and the combined strain on clearing member liquidity was severe, a DCO might prefer to collect the assessment separate from the normal variation settlement cycle (*e.g.*, later in the day).

We are opposed to certain aspects of the proposed requirement that DCOs must monitor on a "continual" basis the financial and operational capacity of their clearing members to meet potential assessments. The Proposed Rules provide no guidance as to how the Commission expects DCOs to determine whether a clearing member has the financial capacity to meet potential assessments. OCC periodically reviews whether its clearing members have adequate net capital to indicate they would likely be able to meet an assessment equal to their current clearing fund contribution requirement (*i.e.*, net capital equal to or greater than the firm's maximum assessment). These reviews lead us to be generally comfortable with our members' ability to meet their potential clearing fund assessments. Indeed, the large majority of our clearing members have net capital at least several times the amount necessary to meet their maximum assessments. Some weight might also be properly afforded to the ability of clearing members to draw resources from parents or affiliates if necessary. On the other hand, we also recognize that a clearing member's capital can evaporate quickly in a financial crisis. We

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[9] On December 8, 2010, OCC held aggregate margin and cover in the amount of $96 billion.

understand there would likely be competing demands for a clearing member's capital if the assessment were made during a financial crisis. While this might call into question reliance on available net capital as an appropriate measure of members' ability to meet assessments, one needs to consider the role of assessments within the overall risk management scheme of the DCO. For OCC, assessments are a final contingent backstop, only to be used if margin and clearing fund assets, which are assets on deposit and within our exclusive control, prove inadequate. Under these circumstances we think it is appropriate to impose an easy to administer bright line standard keyed to the net capital of the firm. We therefore request that the Commission clarify that a DCO may determine that a clearing member has the financial ability to meet its potential assessment if it has net capital equal to or greater than the clearing member's assessment requirement.

We also object to the requirement that DCOs must monitor "on a continual basis" a clearing member's ability to meet potential assessments. "Continual" monitoring implies daily or perhaps even real time monitoring. We think the proposed "continual" monitoring requirement is overly burdensome and difficult to administer. Given that OCC currently gives zero value to assessments in stress tests, such a requirement would also be of highly limited utility to us and other similarly situated DCOs. We believe a monthly review is reasonable and adequate.

Determining and Reporting Haircuts on Margin Collateral

We request that the Proposed Rules be altered or interpreted in such a way as to accommodate the manner in which OCC values certain securities margin collateral. The Proposed Rules would require DCOs to compute the current market value of "each financial resource" used to meet its obligations, reducing the value of each financial resource "to reflect market and credit risks, as appropriate and evaluated on a monthly basis."[10] DCOs would be required to submit quarterly reports to the Commission stating the value of each resource available to meet its calculated financial resources requirement.[11] While we believe that monthly evaluation and reporting of collateral held and valuation methods is appropriate, some interpretation of this requirement will be required in OCC's case in order to identify the information that would be meaningful to report. OCC calculates the value of most securities margin collateral such as stock, ETFs, and U.S. Treasuries through the operation of its STANS portfolio margining system. As described above, OCC's collateral in margins program does not utilize fixed haircuts, but instead values margin collateral on a basis that takes account of the nature of the collateral and its correlation with the positions in a given portfolio.

Managing a DCO's Liquidity Needs

While we wholeheartedly agree with the Commission's view that the liquidity of financial resources is a critical element of sound DCO risk management, we believe the Proposed Rules should provide DCOs with flexibility to manage their "cash" requirements. We

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[10] 75 FR at 63119.

[11] We interpret the Proposed Rules to require DCOs to calculate and submit to the Commission the value of margin collateral held for each clearing member. Reporting aggregate margin collateral amounts would not be useful since normally margin can only be used to cover losses of the member that deposits the collateral.

also perceive some ambiguity as to what the Proposed Rules are intended to require. The Proposed Rules require a DCO to have sufficient capital "in the form of cash" to meet the average daily settlement variation pay per clearing member over the last fiscal quarter. If this requirement is interpreted to refer only to daily variation settlements on futures contracts, OCC currently meets this standard easily. Even if the proposed requirement were applied to the average daily settlement arising from all cleared contracts, it is relatively lenient insofar as it imposes a cash requirement relating to "average" settlement amounts.[12] OCC sets as its objective the ability to meet, without delay, its daily settlement needs based on historical and projected "peak" settlement amounts. It also takes into account any liquidity that would be needed to liquidate a defaulting member's portfolio. All DCOs should meet these important standards.

We also perceive some ambiguity in the requirement that assets be held in "cash."[13] If read literally to mean cash in a demand deposit account and to exclude "cash equivalents" such as U.S. Treasury securities, then we think the standard is inappropriate. OCC meets its liquidity needs primarily via a $2 billion secured credit facility maintained with a consortium of banks that allows OCC to borrow funds on one hour's notice, backed by Treasuries held in OCC's sizable clearing fund.[14] OCC is also developing the ability to convert U.S Treasuries held in the clearing fund (or submitted as margin) into cash via tri-party repurchase transactions. Both approaches (credit facility and tri-party repo transactions) allow OCC to hold a significant portion of its financial resources in the form of U.S. Treasuries, perhaps the safest and most liquid of all financial resources, with the ability to convert the Treasuries to cash as needed. Cash must generally be held at banks, which presents a credit risk. Of course, tri-party repo transactions and secured credit facilities also present certain risks, insofar as performance of banks is necessary. OCC believes its current approach strikes an appropriate balance between safety and liquidity. Accordingly, OCC requests that the Proposed Rules allow DCOs to manage their liquidity needs through use of any combination of: 1) cash held at a bank; 2) secured credit facilities that allow DCOs to borrow on a near-immediate basis against U.S. Treasuries and other high quality collateral; and 3) U.S. Treasuries that can be converted to cash on a same-day basis through tri-party repo transactions.

<u>Implementation of the Proposed Rules</u>

The Release requests comment on an appropriate effective date for final rules. If the Proposed Rules are approved in their current form, DCOs will need time to determine the extent to which their current practices are in compliance with the rules. This would include, at a minimum, developing and testing new stress test scenarios; projecting operating expenses in a

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[12] Because OCC clears securities options and stock loan transactions as well as futures transactions, its daily cash settlements include not only variation margin on futures, but also options premiums, stock loan mark to market payments, and exercise settlement payments for cash-settled options.

[13] While this provision requires that the "average daily settlement" amount must be in the form of cash, there are also provisions in the rule stating the manner in which cash deposits may be invested. It is unclear to us whether cash invested in the highly liquid, secure and cash-equivalent investments permitted under the rule would continue to be counted as cash for purposes of the "average daily settlement" test.

[14] As of December 8, 2010, the size of OCC's clearing fund was $3 billion, comprised mostly of U.S. Treasuries (approximately 93%), with the remainder in cash.

wind-down scenario, developing and executing plans to raise necessary funds, drafting, proposing and obtaining necessary rules, such as rules requiring clearing members to meet assessments within the time frame required by the Commission; making any required changes to comply with financial resource liquidity requirements; and developing processes to meet new reporting requirements imposed by the Proposed Rules, while at the same time taking the necessary steps to comply with other rules adopted under Dodd-Frank. In OCC's case, to the extent we might be required to increase our financial resources as a result of the Proposed Rules, we would need to look to our clearing members to fund such increase. This might occur in the form of an increase to the size of OCC's clearing fund, new margin requirements, new collateral requirements (*e.g.*, a minimum cash requirement), a new clearing fee policy, or a new fee rebate policy. Some of these expedients would require regulatory approval, and the process of gaining such approval could be protracted. Assuming, as we do, that OCC will be designated by the Council as systemically important, the "two largest" test and one year of operating expenses requirement each could result in very significant increases in the financial resources OCC is required to maintain. DCOs should be afforded a reasonable amount of time to raise any material amount of additional resources. We believe that the Proposed Rules should not become effective until at least two years after their approval. At a minimum, compliance with the "two largest" test and one year of operating expenses requirements should be afforded the two-year delayed implementation schedule.

Regulatory Flexibility and Waiver Authority

We recognize that the highly prescriptive nature of the Proposed Rules is to a significant degree mandated by Dodd-Frank. Nevertheless, we regret the unfortunate move away from the more flexible approach followed by the Commission and the SEC that has allowed each clearing organization to develop, subject to the principles-based oversight of the agencies, financial and risk management standards tailored to its particular needs. These individually tailored solutions have proven successful in protecting clearing organizations, clearing members and customers against loss, and have been responsible for the confidence now being placed in regulated clearing organizations, as reflected in the clearing requirements of Dodd-Frank. We believe it would be unwise to hold clearing organizations to mandates that may seem sensible *ex ante* and in the abstract but that may stifle innovation or lead to unintended consequences as applied to a particular clearing organization. We therefore encourage the Commission to retain as much flexibility as possible by retaining the express authority to waive any requirement of proposed regulations 39.11 and 39.29 whenever the Commission believes that doing so would be consistent with the purposes of the CEA and Dodd-Frank.

Coordination with Other Regulators

OCC strongly encourages the Commission to coordinate its actions regarding the Proposed Rules to the maximum extent possible with those of other financial regulators within the U.S. and abroad, and especially the SEC. Given that over 99% of OCC's business is regulated by the SEC and OCC has no present intent to clear swaps, we believe it is appropriate to encourage the CFTC to work closely with the SEC to develop consistent financial resource requirements that will allow both agencies to meet their respective policy objectives, including compliance with Dodd-Frank, and also appropriately take into account the extent to which a

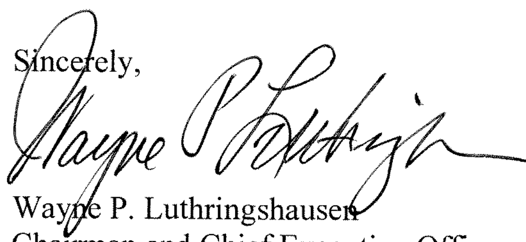
DCO with an extremely limited amount of business under Commission jurisdiction should be subject to rules possibly at odds with those of its primary regulator.

Dodd-Frank recognized that international harmonization of regulation of the OTC derivatives markets is vital to ensuring "effective and consistent global regulation" of these markets.[15] OCC therefore also encourages the Commission to coordinate with foreign regulators and CPSS/IOSCO to ensure harmonious clearinghouse financial resource requirements. We strongly encourage the Commission to avoid taking final action on the Proposed Rules prior to receiving greater clarity in terms of the positions and proposals that European and U.K. legislators and regulators and CPSS/IOSCO eventually adopt on many of the important topics in this rulemaking proposal. Consistent international regulation is extremely important to ensure that real and potential clearinghouse competitors are subject to strong yet substantially similar financial standards.

Conclusion

OCC believes it has substantially more than adequate financial resources to conduct its current clearing business. It has a superb history of successfully managing its business, serving as an important anchor to the financial markets, one that held strong through many episodes of market turmoil. Given OCC's experience and track record, OCC believes substantial weight should be afforded to the comments and requests made in this comment letter. In addition, given that OCC has no present intention of clearing swaps and its current CFTC-regulated futures business is limited in relation to its substantial securities options business, we respectfully urge the Commission to agree with the SEC that the SEC should be OCC's Supervisory Agency. We look forward to working closely with the Commission and the SEC to provide any additional input that might be useful to the agencies in determining the final form of the Proposed Rules and the corresponding rules of the SEC.

Sincerely,



Wayne P. Luthringshausen
Chairman and Chief Executive Officer

cc: Gary Gensler
Chairman
Commodity Futures Trading Commission

Michael V. Dunn
Commissioner

[15] *See* Dodd-Frank § 752(a).

Jill E. Sommers
Commissioner

Bart Chilton
Commissioner

Scott D. O'Malia
Commissioner

Ananda Radhakrishnan
Director
Division of Clearing and Intermediary Oversight

Mary L. Schapiro
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