



**KANSAS CITY
BOARD OF TRADE**
CLEARING CORPORATION

December 13, 2010

SENT VIA E-MAIL
DCOSIDCOfinres@cftc.gov

Mr. David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Financial Resources Requirements for Derivatives Clearing Organizations
RIN 3038-AC98, 3038-AD02

Dear Mr. Stawick:

In response to your request for public comment on Financial Resources Requirements for Derivatives Clearing Organizations, the Kansas City Board of Trade Clearing Corporation ("KCC") offers the following:

1. Proposed Regulation – Types of Financial Resources. Should the CFTC adopt capital requirements for DCOs?

KCC is of the opinion that a capital requirement for DCOs is unnecessary. It is KCC and clearing member capital at risk in the event of a default. Accordingly, KCC is in the best position to determine what financial resources of KCC and clearing members are necessary and adequate. KCC has never experienced a default in its over 100-year history and we see no need for prescriptive capital requirements. The language of Core Principle B makes quite clear that a DCO must demonstrate that it has adequate financial resources to discharge its responsibilities. Proposed Regulation 39.11(a)(1) would require a DCO to maintain sufficient financial resources to meet its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible market conditions. Therefore, a separate capital requirement would be redundant. In addition, onerous capital requirements placed on DCOs could have an anti-competitive effect.

DCO's solely act as the intermediary to all transactions submitted to them – the buyer to every seller and the seller to every buyer. Thus the risk of a

counterparty default is greatly reduced. The risk of default is determined by the financial strength of each individual clearing member. Each clearing member is subject to Exchange, Clearing and CFTC capital requirements. KCC staff perform extensive financial reviews of clearing members on a daily basis in order to provide an "early warning" indication of any clearing member that might pose a financial risk to KCC.

One of these daily financial surveillance procedures include the review of clearing member pay/collects. Pay/collect information is reviewed to identify clearing members experiencing large pay-ins, the effect of which may be adverse to the firm's available capital. During volatile markets, KCC staff assess risk exposure to KCC by identifying those clearing members who have a large concentration of KCBT positions opposite the volatile market. In addition, KCC staff review large trader information and contact clearing members to ascertain if the clearing member is experiencing any difficulties and to determine if the clearing member is capable of meeting its continued financial obligations with respect to the positions being carried.

Financial statements of Futures Commission Merchants are reviewed on a monthly basis to ensure that firms remain properly capitalized and segregated. Financial statements of Non-Futures Commission Merchants are reviewed on a semi-annual basis to ensure compliance with the minimum capital requirements. The financial statement reviews may also alert us to any adverse trends in the firm's financial condition.

KCC staff performs daily stress testing of clearing members based on actual and major hypothetical market price movements, comparing the results against each clearing members' margin on deposit. During volatile markets, KCC makes intra-day margin calls to collect funds prior to the close of the market from clearing members with a net position opposite the market move. These active financial surveillance procedures serve to safeguard the financial integrity of KCC.

2. Proposed Regulation – Valuation of Financial Resources. Should the CFTC allow assessment powers to be considered a financial resource?

Assessment powers are currently allowed as a financial resource under Core Principle B, and KCC is of the opinion that assessment powers should continue to be allowed as a financial resource. The inclusion of assessment powers as financial resources are necessary for KCC to meet our obligations in the unlikely event of a default. KCC agrees that a "reasonable" haircut on the value of a DCO's assessment power may be a prudent measure. However, to propose a

30 percent haircut on the value of a DCO's assessment power and only allow the assessment to meet up to 20 percent of the resources requirement is unreasonable and excessive. In certain situations this would have the effect of taking a haircut far in excess of 50% of the assessment power. The proposed 30% haircut on the assessment and the proposed 20% allowance of the assessment for the resource requirement seem arbitrary. KCC would appreciate a better understanding of the rationale for these percentages.

Instead of a flat haircut percentage across every clearing member, a better approach would be for the DCO to be allowed the latitude to determine clearing member assessment haircuts on an individual basis, based on each clearing member's financial capabilities. A DCO is in the best position to determine if a clearing member is capable of meeting their assessment obligation based on the DCO's daily and/or monthly financial surveillance as described above.

By having their own capital at risk, clearing members have a strong financial incentive to pay an assessment. Failing to pay an assessment would put a non-defaulting clearing member's own positions and capital at risk. Having "skin in the game" so to speak, provides a strong financial incentive for clearing members to preserve the financial integrity of KCC and assist with the liquidation or transfer of positions of a defaulting clearing member.

3. Proposed Regulation – Liquidity of Financial Resources. Should a DCO have sufficient capital in the form of cash to cover the average daily settlement variation pay per clearing member over the last fiscal quarter?

KCC finds the language in proposed Regulation 39.11(e) to be ambiguous. KCC has interpreted the average daily settlement variation pay per clearing member over the last fiscal quarter to mean the cumulative average of the pay-ins per each clearing member divided by the number of clearing members. As an example, if you have three clearing firms with average daily variation pays over the last fiscal quarter of \$3M, \$2M and \$1M, the DCO would be required to have sufficient capital in the form of cash of \$2M. $((3M+2M+1M)/3 = 2M)$. Furthermore, if a clearing member only has one pay-in during the fiscal quarter then under the proposed regulation, the average pay-in would equal the one pay-in. We agree that collects during the period should not be included in the calculation, however KCC feels a more reasonable approach would be to divide the total pay-ins during the fiscal quarter by the total number of business days in the fiscal quarter.

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A line of credit with same-day drawing rights should be considered as liquid as cash and therefore should be allowed to be used by the DCO to fulfill its financial obligations during a one-day settlement cycle. We consider margin on deposit, which is predominantly pledged in U.S. government securities, as meeting the liquidity standards as proposed. Additionally, the financial resource of security deposits can be treated in the same manner to meet the liquidity requirement. KCC is of the opinion that the liquidity requirement should cover no more than one day of market price movement.

4. Proposed Regulation - Reporting Requirements

KCC does not prepare a statement of cash flows report on a monthly basis. The statement of cash flows report is prepared on an annual basis by our independent CPA firm as part of our audited financial statements. Currently, CFTC regulations only require a statement of cash flows to be prepared in conjunction with an audited financial statement. KCC is of the opinion that a monthly profit/loss statement is sufficient for determining KCC's financial operating needs.

Kansas City Board of Trade Clearing Corporation appreciates the opportunity to comment on the Financial Resources Requirements for Derivatives Clearing Organizations currently being proposed. If you have any questions please feel free to contact me at 816-931-8964 or csavage@kcbt.com.

Sincerely,



Charles M. Savage
Assistant Vice President and Manager