



December 13, 2010

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

**Re: Financial Resource Requirements for Derivative Clearing Organizations –
75 Fed. Reg. 63113 (October 14, 2010)**

Dear Mr. Stawick:

The Futures Industry Association (“FIA”)¹ is pleased to submit this letter in response to the request for comment with respect to the rules that have been proposed by the Commodity Futures Trading Commission (the “Commission”) that would establish financial resource requirements for derivatives clearing organizations (“DCOs”) pursuant to DCO Core Principle B (Financial Resources).

The proposed rules are the first of several anticipated proposals to enhance the financial integrity of DCOs and strengthen the protections afforded clearing members and their customers. In addition to the contemplated rulemaking on DCO Core Principle D (Risk Management),² the Commission has published an advanced notice of proposed rulemaking requesting comments on alternative mechanisms for the segregation of customer funds.³ Adoption of any of the suggested segregation alternatives other than the “baseline model” is likely to have far-reaching consequences for the modeling of risk by the DCOs. In particular, the adoption of rules that change the current treatment of customer margin deposits to provide some form of enhanced segregation will necessarily influence (among other things) how the DCOs calculate house and customer margin requirements and individual clearing member and aggregate guaranty fund requirements. As the Commission moves forward on these proposals, FIA urges the Commission to bear in mind that these subjects are interconnected and that, much like the

¹ FIA is a principal spokesman for the commodity futures and options industry. FIA’s regular membership is comprised of approximately 30 of the largest futures commission merchants in the United States. Among FIA’s associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States contract markets.

² See 75 Fed. Reg. 63113, 63115 n.15 (October 14, 2010).

³ See 75 Fed. Reg. 75162 (December 2, 2010).

individual legs of a stool, it is important that any rules that may be adopted by the Commission that affect the DCOs' ability to discharge their responsibilities in the event of a clearing member default remain in balance at all times.

Default Resource Requirements. Consistent with Core Principle B, proposed Commission Regulation 39.11 would require a DCO to maintain financial resources sufficient to cover its exposure to the risk of default with a high degree of confidence. More particularly, proposed Regulation 39.11(a)(1) would require a DCO to maintain financial resources that are sufficient, at a minimum, to enable the derivatives clearing organization to meet its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the derivatives clearing organization in extreme but plausible market conditions. The Commission has separately proposed to apply a more rigorous standard to DCOs that are deemed by the Financial Stability Oversight Council to be systemically important ("SIDCOs"). Specifically, proposed Regulation 39.29 would require a SIDCO to meet its obligations to its clearing members notwithstanding the default of the two clearing members that present the greatest risk of loss to the SIDCO.

FIA appreciates that the standard that has been proposed for DCOs pursuant to Regulation 39.11 is consistent with the Recommendations for Central Counterparties promulgated by the Task Force on Securities Settlement Systems that were established by the Committee on Payment and Settlement Systems ("CPSS") and the Technical Committee of the International Organization of Securities Commissions ("IOSCO"). FIA believes, however, that the inability of any DCO – whether or not it is a SIDCO – to honor its obligations timely and in full would likely call into question the integrity of the clearing system, to the detriment of other DCOs, their members and market participants. FIA further believes that a two-tier system, in which SIDCOs are held to a stricter standard, could have the unintended effect of putting SIDCOs at a competitive disadvantage to the extent that they need to increase margin or guaranty fund requirements to cover the additional cost of covering the risk of loss resulting from the default of the second largest clearing member.⁴ FIA accordingly recommends that all DCOs, including SIDCOs, be required to maintain resources sufficient to withstand the default of the two clearing members representing the largest financial exposure to the DCO, but that the Commission give DCOs that currently meet the CPSS-IOSCO standard reasonable time to come into compliance with the enhanced requirement.

Stress Testing: The Commission has not proposed specific stress testing requirements that would have to be applied by the DCOs to model their exposure to the risk of default other than to indicate its expectation that the DCOs should take into account both historical and hypothetical situations. This is consistent with DCO Core Principle A, which gives a DCO reasonable discretion in establishing the manner in which it complies with the Core Principles. FIA

⁴ In this regard, FIA would urge the Commission to bear in mind that original margin requirements must be the first line of defense in a well-constructed risk management system. While FIA believes that the DCOs must retain the ability to establish and modify margin requirements as they deem appropriate (but consistent with the Core Principles), FIA further believes that it would be inappropriate for a DCO to rely on its guaranty fund, assessment power or other resources as a substitute for original margin.

nonetheless believes it would be appropriate for the Commission to issue guidance to the DCOs regarding minimum standards for stress testing. In particular, FIA recommends that the Commission make clear its expectation that the DCOs will, at a minimum, conduct a range of stress tests that reflect the DCO's product mix; include the most volatile periods that have been experienced by the markets for which the DCO provides clearing services; take into account the distribution of cleared positions between clearing members and their customers; and test for unanticipated levels of volatility and for breakdowns in correlations within and across product classes.

Operating Resources: The Commission has separately proposed that DCOs, including SIDCOs, be required to have financial resources sufficient to allow them to meet their operating expenses for at least one year, calculated on a rolling basis. FIA supports this aspect of the Commission's proposal, including the requirement that a DCO or SIDCO not be permitted to "double-count" its resources to cover both this and the default resource requirement.

DCOs, including SIDCOs, would be required to meet the operating resource requirement through the use of the DCO's own capital or other financial resources deemed acceptable by the Commission. FIA understands this requirement to permit a DCO to apply its undistributed operating profits and retained earnings, in addition to paid-in capital, and on that basis also supports this aspect of the Commission's proposal.

Permitted Financial Resources: The Commission proposal would permit a DCO to satisfy the default resource requirements of proposed Regulation 39.11(a)(1) through the use of the margin deposits of a defaulting clearing member, the derivatives clearing organization's own capital, guaranty fund deposits, default insurance, potential assessments for additional guaranty fund contributions, and any other financial resource deemed acceptable by the Commission.

The Commission's proposal would require the DCOs (including SIDCOs) to apply a 30% "haircut" to the value of potential clearing member assessments and additionally prohibit a DCO (or SIDCO) from using the value of any such haircutted assessments to meet more than 20% of its default resource obligations. The same rule would apply to SIDCOs, with the qualification that a clearinghouse's assessment power could be counted only when calculating the resources available to satisfy obligations arising from the default of the clearing member creating the second largest financial exposure to the DCO. FIA believes that the 30% haircut and 20% cap are reasonable and prudent safeguards. FIA further believes, however, that these measures are sufficient to ensure that a DCO, including a SIDCO, does not unduly rely on its assessment power. FIA accordingly recommends that the Commission permit all DCOs, including SIDCOs, to be able to count their assessment powers, limited as described above, to satisfy the default resource requirement for both the largest and second-largest clearing member default exposures.⁵

⁵ The Commission's proposal separately provides that the rules of a DCO (including a SIDCO) must require that its clearing members have the ability to meet an assessment within the time frame of a one-day variation settlement cycle. The Commission's proposal would further require that the DCO (including a SIDCO) monitor, on a continual basis, the financial and operational capacity of its clearing members to meet potential assessments. FIA
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Subject to the foregoing, FIA supports this aspect of the Commission's proposal with the following additional qualification. FIA has reservations about the ability of a DCO to be paid promptly under the terms of a default insurance policy. FIA, therefore, recommends that default insurance coverages be subjected to a 30% haircut and a 20% cap, similar to the policies that the Commission has proposed to apply to a DCO's assessment power.

Liquidity Requirements: Proposed Regulation 39.11 would require that a DCO (including a SIDCO) have sufficient capital in the form of cash to cover the average daily settlement variation pay per clearing member over the last fiscal quarter. FIA recommends that the Commission clarify this point to make clear that this requirement is intended to measure the average (and not the aggregate) clearing member variation margin requirement.

FIA further recommends that the Commission permit a DCO to satisfy this requirement through the use of cash or cash equivalents, including U.S. government securities and repurchase agreements involving highly liquid securities if such repurchase agreement ("repo") matures within one business day or is reversible upon demand. Any such securities would, of course, be subject to the haircuts set forth in the Commission's net capital rule or, if greater, in the rules or policies of the relevant DCO. FIA additionally recommends that this aspect of the Commission's proposal be modified to clarify that the DCOs are permitted to satisfy the liquidity requirement through the establishment of committed repo facilities.

Proposed Regulation 39.11 further provides that a DCO may obtain a committed line of credit or similar credit facility to cover the remainder of its default resources requirement. FIA supports this proposal in principle, but recommends that it be strengthened by the diversification of credit providers, with concentration limits of 25% per provider.

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supports these requirements. FIA further suggests that the Commission evaluate whether the Commission or the Unified Clearing Group should take steps to monitor the exposures of clearing members across the various DCOs.

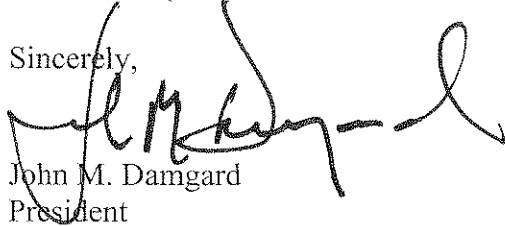
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FIA appreciates the opportunity to submit these comments regarding the financial resource requirements for DCOs. If the Commission has any questions concerning the matters discussed in this letter, please contact Barbara Wierzynski, FIA's Executive Vice President and General Counsel, at (202) 466-5460.

Sincerely,

A handwritten signature in black ink, appearing to read 'John M. Damgard', written over a white rectangular box.

John M. Damgard
President

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner

Division of Clearing and Intermediary Oversight
John C. Lawton, Deputy Director and Chief Counsel
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