

THE OPTIONS CLEARING CORPORATION

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February 10, 2011

Via Electronic Mail

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

**Re: RIN 3038-AC98 Information Management Requirements for
Derivatives Clearing Organizations**

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 to implement certain core principles for derivatives clearing organizations (“DCOs”) as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)². The Proposed Rules would establish standards for compliance with DCO Core Principles J (Reporting), K (Recordkeeping), L (Public Information) and M (Information Sharing).

The rulemaking is one in a series of rulemakings resulting from the Dodd-Frank Act that will propose regulations to implement all 18 of the DCO Core Principles. For example, Core Principle J requires a DCO to provide the Commission with all information that the Commission determines to be necessary to conduct oversight of the DCO. Core Principle K requires a DCO to maintain records of all activities related to the business of the DCO as a DCO, in a form and manner that is acceptable to the

¹ Information Management Requirements for Derivatives Clearing Organizations, 75 FR 78185 (Dec. 15, 2010)

² Pub. L. 111-203

Commission for a period of 5 years. Core Principle L requires a DCO to provide market participants sufficient information to enable the market participants to identify and evaluate accurately the risks and costs associated with using a DCO's services. Core Principle M requires a DCO to enter into and abide by the terms of each appropriate and applicable domestic and international information-sharing agreement and use relevant information obtained under such agreements in carrying out its risk management program.

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 DCO under Section 5b of the Commodity Exchange Act ("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 appreciates the opportunity to provide the Commission with comments on the Proposed Rules. We recognize that the Commission and its staff have been under extreme time pressure to draft and publish an enormous number of rule-makings in a short period of time and we hope that our comments will be beneficial to the process. Accordingly, since several of the Proposed Rules implement rules and regulations that codify policies and practices that are already in place at OCC, we will limit our comments to several areas we believe need clarification or modification. Our comments are focused on the Proposed Rules related to Core Principle J, Reporting.

Discussion

A. Reporting and Recordkeeping Requirements

As a clearing organization registered with both the Commission and the SEC, OCC clears some products that are under the sole jurisdiction of the Commission, other products under the sole jurisdiction of the SEC and still other products that are under the jurisdiction of both regulatory agencies. In addition, OCC's clearing members consist of entities that are registered as either futures commission merchants ("FCMs") or broker-dealers ("BDs") or entities that are dually registered as FCM-BDs. Given our unique

³ The participating options exchanges are BATS Options Exchange, C2 Options Exchange, Inc., Chicago Board Options Exchange, Inc., International Securities Exchange, 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 traded on OneChicago.

dual registration status, OCC seeks clarification from the Commission as to the applicability of the reporting and recordkeeping requirements in the Proposed Rules to the trading activity and payment flows of OCC clearing members that are only registered as BDs and only clear securities products under the jurisdiction of the SEC.

The proposed reporting and recordkeeping requirements are of particular interest and importance to OCC because approximately 99% of OCC's business is regulated by the SEC. OCC, as well as any clearing organization that may be dually registered in the future, will have vastly different reporting and recordkeeping requirements if clearing members that are only registered as BDs and only clear securities under the jurisdiction of the SEC are included in the requirements set forth in the Proposed Rules. Since the Proposed Rules are silent on this issue, OCC requests that the CFTC clarify this point in the final rules. In addition, since OCC is currently the only dually registered clearing organization, we would be willing to meet with the Commission to discuss in greater detail our unique perspective on the reporting and recordkeeping requirements set forth in the Proposed Rules.

OCC encourages the Commission to coordinate with the SEC on the final version of the Proposed Rules so that the reporting and recordkeeping requirements are consistent across the regulatory agencies. Coordinating efforts between the Commission and the SEC will eliminate duplicate work and also reduce costs and expenses for clearing organizations. OCC believes that its costs to comply with the Proposed Rules will be significant. Although a large amount of the data required by the Proposed Rules is currently available to OCC, new automated systems and reports must be developed and tested for what we believe will be limited regulatory benefit. Accordingly, we encourage the Commission to review the comments set forth below while also considering the additional costs the Proposed Rules will impose on DCOs.

B. Event Specific Reporting-Decrease in Financial Resources

Section 39.19 of the Proposed Rules requires reports to be made by the DCO to the Commission: 1) on a periodic basis (daily, quarterly or annually), 2) where the reporting requirement is triggered by the occurrence of a significant event, and 3) upon request of the Commission.

Specifically, proposed section 39.19(c)(4)(i) requires the Commission be alerted in a timely manner of a significant decrease in the value of a DCO's financial resources and the reason for the decrease, *e.g.*, whether such a decrease is an indicator of inadequate financial resources or if it is merely the result of a corresponding decrease in the margin requirements of the DCO.⁴ A DCO would be required to file a report with the Commission when there is a decrease in its financial resources as follows: (a) a 10

⁴ 75 FR at 78188

percent decrease from the total value of the financial resources reported on the last quarterly report submitted under proposed section 39.11(a), or (b) a 10 percent decrease from the total value of the financial resources as of the close of the previous business day. The rulemaking states that, “reporting a decrease from the last quarterly report is intended to capture a situation where a DCO has a gradual decrease of financial resources. Reporting a decrease from the previous business day is intended to capture a situation where the DCO would experience a sudden decrease in financial resources over a short period of time.”⁵

OCC has several concerns associated with the proposed rule language of section 39.19(c)(4)(i) as well as the implementation of the section. The Commission proposes that DCOs must provide notice in a timely manner of a significant decrease in the value of a DCO’s financial resources and the reason for the decrease even if the decrease is “merely the result of a corresponding decrease in the margin requirements of the DCO.”⁶ OCC believes this standard is problematic. The margin requirements of a DCO fluctuate on a regular basis and, from a pure risk management perspective, a reduction in a DCO’s margin requirements is a risk reducing environment for a DCO. It is counterintuitive to require a DCO to file a report with the Commission when there is a significant decrease in its financial resources that is a result of a decrease in the DCOs margin requirements and overall risk profile. In light of the numerous additional reporting and recordkeeping requirements imposed on DCOs as a result of the Dodd-Frank Act, OCC does not believe that a special report to the Commission is warranted in the situation described above.

OCC also believes that the proposed reporting threshold of 10% for other “significant events” is too low and should be increased to 25%. Under the current proposal, it is likely OCC would be required to file reports with the Commission on a monthly basis under circumstances that are not actually risk management concerns. For example, the 10% threshold would likely be crossed each month on the day after monthly expirations occur at OCC. A 25% reporting threshold would be more appropriate in order to reduce unnecessary reporting obligations and eliminate the reporting of situations that are not actually risk management concerns.

C. Event Specific Reporting-Decrease in Ownership Equity/Change in Working Capital

Proposed section 39.19(c)(4)(ii) requires a DCO to notify the Commission no later than two days prior to an event which the DCO knows or should reasonably know will cause a decrease of 20 percent in ownership equity from the last reported ownership equity balance. For events which the DCO did not know would cause a decrease of 20 percent prior to the event occurring, the DCO would be able to provide notice of the

⁵ *Id.*

⁶ 75 FR at 78188

triggering event no later than two days after the decrease in ownership equity.⁷ The reporting requirement in each of these circumstances requires the filing of financial statements (*i.e.*, pro forma or current, respectively) with the Commission by the DCO.

Similarly, proposed section 39.19(c)(4)(iv) requires a DCO to notify the Commission no later than two business days after a DCO's working capital becomes negative.⁸ The notice requirement includes the filing of a balance sheet with the Commission that reflects the DCO's working capital and an explanation as to the reason for the negative balance.

The reporting time frames in proposed sections 39.19(c)(4)(ii) and (iv) are problematic for OCC given the requirement that financial statements must be included in the notification to the Commission. On a monthly basis, OCC closes its books and runs its financial statements. Accordingly, depending on when the notification triggering event occurs during the month, OCC may not be in a position to run financial statements for the required notification to the Commission within two days. We believe a more practical approach would be to maintain the current notification requirement. However, the notification would only require notice to the Commission that the triggering event occurred. A DCO experiencing a triggering event would then be required to provide the Commission with the required financial statements either 30 days from the day of the triggering event, or when the DCO's financial statements are prepared, whichever occurs first.

D. Event Specific Reporting-Intraday Initial Margin Calls to Clearing Members

Proposed section 39.19(c)(4)(v) requires a DCO to report to the Commission any intraday initial margin calls made to clearing members no later than one hour following the margin call. In addition, the DCO would have to separately list each such request and include the name of the clearing member, the amount requested and the account origin.⁹ The rulemaking states that these reports would assist the Commission in determining whether certain clearing members' positions could affect the ability of a DCO to meet its end-of-day financial obligations in a timely manner. The rulemaking also states that "this is especially important given that intraday initial margin calls are unusual and are often due to increasing position size."¹⁰ It is true that intraday initial margin calls would normally be associated with increases in positions of clearing members that are registered FCMs. However, intraday initial margin calls to BDs are not identified as "initial" and typically are more likely the result of market movements affecting pre-existing positions than the establishment of new positions. As such, we do not believe that intraday initial margin calls on securities positions should be reported to the Commission. With respect

⁷ *Id.*

⁸ 75 FR at 78189

⁹ *Id.*

¹⁰ *Id.*

to intraday initial margin calls to clearing members that are FCMs, we believe that a two hour reporting requirement is more appropriate given the potential size of the information requested and the manual nature of the reporting process.

E. Event Specific Reporting-Delay in Collection of Initial Margin

Proposed section 39.19(c)(4)(vi) requires a DCO to provide immediate notice to the Commission when the DCO has not received additional initial margin that it requested from a clearing member in the time frame allowed by the rules and procedures.¹¹ OCC concurs with the proposed notification provision from the Commission when there are delays in a clearing member's ability to meet an additional initial margin call. However, there are situations that are purely technical in nature that may result in the delay of a clearing member meeting the additional initial margin call that are not related to a risk management or financial resources issue. Accordingly, in an effort to minimize the number of new reports that DCOs are required to file with the Commission, OCC proposes that the report required under proposed section 39.19(c)(4)(vi) contain a carve-out for clearing member initial margin call delays that are less than 30 minutes and are solely the result of a system issue or error. A DCO will know soon after an additional initial margin call is not satisfied by a clearing member as to whether the delay is due to a technical system issue or a real financial or risk management issue.

F. Event Specific Reporting-Rule Enforcement

Proposed section 39.19(c)(4)(xiii) requires a DCO to report to the Commission regarding rule enforcement activities and sanctions imposed against clearing members.¹² A DCO would be required to notify the Commission after it: 1) initiates a rule enforcement action against a clearing member, or 2) imposes sanctions against a clearing member. The Commission notes that under current regulations, an exchange has 30 days to notify the Commission of a decision pursuant to which a disciplinary action has become final, however, it states that an action by a DCO against a clearing member is less common thereby justifying the two day notification requirement.

As an initial jurisdictional matter, OCC does not believe that a reporting obligation to the Commission should exist for DCO enforcement actions involving a clearing member that is only registered as a BD. A clearing member registered as a BD and not as an FCM is under the jurisdiction of the SEC and not the Commission. The Proposed Rule is silent on this point and OCC believes that the Commission and the SEC should coordinate on this notification requirement to avoid duplication of work by dually registered clearing organizations.

¹¹ *Id.*

¹² 75 FR at 78191

Notification to the Commission within 30 days following a final decision in a disciplinary matter involving a clearing member registered with the Commission as an FCM is appropriate for several reasons. Under the proposed rule, a DCO would be required to report to the Commission within two days if the DCO initiated a rule enforcement action against a clearing member. The initiation of a rule enforcement action is merely the beginning of the disciplinary process, occurs prior to the time the clearing member offers any defense or mitigation, and is not a determination that a clearing member has violated any DCO rules. In addition, requiring notification after the imposition of a sanction would not be appropriate because a clearing member could appeal a finding made against it and have the decision reversed by an appellate panel. As a practical matter, and based on past practice, if a clearing member was having serious financial issues, a DCO would be in regular contact with the Commission. The Commission would have notice of any serious financial situation affecting a clearing member through various other reports set forth in the Proposed Rules as well as through conversations with the applicable DCO. Further, the initiation of a rule enforcement action or the imposition of sanctions against a clearing member will generally occur after a serious financial situation affecting the clearing member is concluded and would not be an effective early warning device for the Commission.

G. Event Specific Reporting-Financial Conditions and Events

Proposed section 39.19(c)(4)(xiv) is designed to alert the Commission of certain events and situations that may affect the financial integrity of a DCO.¹³ The proposed rule requires a DCO to immediately notify the Commission if, among other things, there is any material adverse change (“MAC”) in the financial condition of any clearing member that would not otherwise be reported under section 39.19. OCC understands the desire of the Commission to be notified of a material change in the financial condition of a clearing member; however, we question whether a general, catch-all provision is the most straight-forward and effective way to achieve that goal. Clearing members are currently required to notify the Commission immediately if they know or should know that the total amount of funds on deposit in segregated accounts on behalf of customers is less than the total amount required by the Commission.¹⁴ Clearing members are also required to notify the Commission within two business days of an event resulting in the reduction of its net capital in an amount of 20% or more.¹⁵ In addition, clearing members are required to file unaudited financial reports directly with the Commission on a monthly basis.¹⁶ We believe any material changes in a clearing member’s financial condition would already be demonstrated in these reports or in other existing reporting requirements, which makes the new reporting requirement duplicative. Also, for clearing

¹³ *Id.*

¹⁴ *See Title 17, Chapter 1 CFR §1.12 (CFTC Regulation Section 1.12)*

¹⁵ *Id.*

¹⁶ *See Title 17, Chapter 1 CFR §1.10 (CFTC Regulation Section 1.10)*

members that are members of multiple DCO's, the proposed section 39.19(c)(4)(xiv) reporting standard will lead to many additional reports being sent to the Commission. However, notwithstanding the above, if the Commission decides to maintain the new notification requirement, OCC appreciates the language in the rulemaking that permits a DCO to exercise discretion in determining which events rise to the level of requiring notification to the Commission.

H. Effective Date

The rulemaking currently provides that the requirements proposed would become effective 180 days from the date the final are published in the Federal Register.¹⁷ In addition, with respect to the reporting requirements set forth in the Proposed Rules, the rulemaking also provides that each DCO “would have to submit the information required by this section to the Commission electronically and in a form and manner prescribed by the Commission.”¹⁸ OCC believes that the proposed 180 day implementation period does not provide DCOs sufficient time to have all of the automated systems in place to comply with the many new reporting requirements. As set forth in the rulemaking, the Commission has not yet prescribed the form and manner required for the transmission of the reports in question. Accordingly, OCC will not even know what it is required to build or modify from a systems perspective until the final rules are published.

In addition, since much of the data and many of the requested reports are not currently set up as requested by the Commission, the responsive reports will need to be created and tested to ensure they comply with the Commission's requirements. This will be a time-consuming process and we believe an effective date 12 months after the publication of final rules would be more appropriate for a DCO to become compliant with the Commission's new reporting requirements.

Conclusion

OCC appreciates the opportunity to comment on the Proposed Rules. In light of the many new reporting and recordkeeping requirements imposed on DCOs as a result of the Dodd-Frank Act, OCC believes its comments will assist in offering our perspective on the necessity for certain reports as well as the filing timeframes associated with the filing of reports proposed by the Commission. We look forward to working closely with

¹⁷ 75 FR at 78192

¹⁸ 75 FR at 78187

the Commission to provide any additional input that might be useful in determining the final form of the Proposed Rules.

Sincerely,

A handwritten signature in black ink that reads "William H. Navin". The signature is written in a cursive, slightly slanted style.

William H. Navin
Executive Vice President and General Counsel

cc: Gary Gensler
Chairman
Commodity Futures Trading Commission

Michael V. Dunn
Commissioner

Jill E. Sommers
Commissioner

Bart Chilton
Commissioner

Scott D. O'Malia
Commissioner