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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-AD01 Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest

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 Governance Rules") imposing substantive requirements on the resolution of conflicts of interest by derivatives clearing organizations ("DCOs"). The Proposed Governance Rules further implement DCO core principles added to the Commodity Exchange Act ("CEA") by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[2] The Proposed Governance Rules build on proposed structural governance requirements and limits on voting proposed by the Commission in the fall of 2010 (the "Proposed Conflicts Rules").[3]

We appreciate the efforts of the Commission in continuing the task of implementing Dodd-Frank. However, we also believe that the Commission must be cognizant of the regulatory burdens being imposed on DCOs relative to the benefits expected to be realized through its

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[1] Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest, 76 FR 722 (January 6, 2011).

[2] Pub. L. 111-203.

[3] Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 FR 63732 (October 18, 2010).

proposed regulations. In the case of the Proposed Governance Rules, we believe the Commission's proposals impose too great a burden relative to their potential benefits. The Proposed Governance Rules are unnecessarily bureaucratic and compliance by DCOs will be tedious and expensive. We believe the potential benefits to the public and to the markets of many of the Proposed Governance Rules are limited. In enacting Dodd-Frank, Congress recognized the benefits of centralized clearing to the safety and soundness of the U.S. derivatives markets by making central clearing a centerpiece of Title VII. Imposing excessive regulatory compliance obligations on clearinghouses will make it more costly for the clearinghouses to fulfill this central role. It may also discourage would-be DCO applicants from entering the market.

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 Securities and Exchange Commission ("SEC") as a securities clearing agency pursuant to Section 17A of the Securities Exchange Act of 1934 (the "Exchange Act") and with the Commission as a 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 commodity options subject to the Commission's jurisdiction. OCC clears derivatives for all nine U.S. securities options exchanges and five futures exchanges.[4] 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 (if any) 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.

Transparency

DCO Core Principle O requires that each DCO "establish governance arrangements that are transparent . . . to fulfill public interest requirements, and to permit the consideration of the view of owners and participants."[5] Core Principle O is an important new provision of the CEA added by Dodd-Frank. OCC fully supports transparency in DCO governance, however, we believe certain transparency requirements under the Proposed Governance Rules are duplicative of requirements already applicable to DCOs and merely add unnecessary layers of administrative bureaucracy. For example, section 39.24(a)(2) of the Proposed Governance Rules would require each DCO to "make available to the public and to the relevant authorities, including the Commission, a description of the manner in which its governance arrangements permit the consideration of the views of its owners, whether voting or non-voting, and its participants, including, without limitation, clearing members and customers." This description would be

[4] 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.

[5] CEA § 5b(c)(2)(O) (as amended by Dodd-Frank).

required to include "[t]he general method by which the derivatives clearing organization learns of (A) the views of owners, other than through their exercise of voting power, and (B) the views of participants, other than through representation on the Board of Directors or any committee of the derivatives clearing organization [as well as] [t]he manner in which the derivatives clearing organization considers such views." Section 40.9(d)(1)(vii) further requires each DCO to make available to the public and the Commission "[s]ummaries of significant decisions implicating the public interest." We view these requirements as being entirely duplicative of the existing regulatory framework for DCOs under the CEA and Commission regulations. Virtually all material decisions made by OCC, including those "implicating the public interest," already require OCC to make a public rule filing. The rulemaking process is well-established and gives members of the public, as well as our owners and participants, ample opportunity to comment on proposed rules and rule amendments. In addition, the structure of OCC's Board of Directors is a matter of public record and includes representation of OCC's owners and clearing members, as well as a public director. This structure was implemented through the same public rulemaking process and interested parties have already had an opportunity to review and comment on these arrangements. Both the Commission and the public have already received the information that appears to be required by Sections 39.24(a)(2) and 40.9(d)(1)(vii) and we therefore do not view these proposed rules as providing any net benefit. At the same time, compliance with these rules will be costly for DCOs. If the Commission intends Section 39.24(a)(2) to require DCOs to make available to the Commission and the public information not already required to be made available, then we believe such an expansion is unwarranted and unlikely to yield tangible benefits to the public or the Commission and that the Commission should reconsider its approach.

DCO Core Principle O requires only that a DCO establish transparent governance arrangements as necessary "to fulfill public interest requirements." In drafting this provision, Congress realized that public disclosure of certain information about DCO governance may not fulfill any legitimate public interest. We encourage the Commission to distinguish between the information that a DCO makes publicly available and the information that it provides to regulators, with a broader array of information provided to regulators than to the public. We believe that many of the public disclosures required to be made under the Proposed Governance Rules are more appropriately made only to regulators. Section 40.9(d)(1) of the Proposed Governance Rules lists seven types of information that a DCO would be required to make publicly available and to provide to relevant authorities, including the Commission. We believe that all of these categories are potentially relevant to the Commission and other regulators in fulfilling their obligations to the public, but we have serious reservations about whether most of this information is of any direct interest to the general public. For example, Section 40.9(d)(1)(vii)(B) of the Proposed Governance Rules would require each DCO to make available to the public and to relevant authorities, including the Commission, information on "decisions relating to open access [and] membership." In interpreting this provision, we think it would be appropriate for the Commission to distinguish between a DCO's membership *policy* decisions (as embodied in the DCO's rules) and a DCO's *application* of those policy decisions to any given applicant for clearing membership. The acceptance of a new clearing member is necessarily a public act, as the list of a DCO's clearing members is a matter of public record. However, we believe that the rejection of any particular applicant for clearing membership is not an appropriate matter for public disclosure by the DCO. We believe such disclosure should only be made by a DCO to regulators or by the rejected clearing member to the public (if it chooses to

make such disclosure or is otherwise required to make such disclosure). A DCO should not be required to make this public disclosure. By contrast, a DCO's policy-making decisions regarding open access and membership are clearly appropriate matters for public disclosure. Such decisions are already the subject of DCO rulemaking and are therefore transparent to the public and the Commission. We see little purpose to be served by adopting a rule that is entirely duplicative of the existing regulatory regime.

In addition, we believe that information concerning "[t]he lines of responsibility and accountability for each operational unit of [a DCO]"[6], as required by Proposed Governance Rule Section 40.9(d)(1)(vi), is already made available to the Commission routinely or upon request in the ordinary course of the Commission's oversight of the DCO. We see little use in a DCO routinely making this information public or in adopting another duplicative compliance rule. A DCO's lines of responsibility and accountability are internal administrative matters and such lines can, and often do, change periodically as a DCO's business develops. Making the public aware of every such change would provide a level of minute detail that would be of interest to very few people outside of the Commission. This requirement therefore strikes us as wholly unnecessary.

Requiring a DCO to routinely disclose to the public a wide array of information that is of limited or no interest to the public will merely serve to clutter a DCO's channels of communication and make it more difficult for the public to determine which information really is relevant and which is of no interest. Given the extremely burdensome scope of the information the Commission is proposing to require a DCO to publicly disclose, we ask that the Commission carefully consider whether the very limited public benefit is worth the substantial costs involved.

Fitness Standards

Section 39.24(b)(1) of the Proposed Governance Rules would require each DCO to "establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the derivatives clearing organization, *any other individual or entity with direct access to the settlement or clearing activities of the derivatives clearing organization*, and *any party affiliated with any individual or entity described in this paragraph*."[7] Section 39.24(b)(3) would further require each DCO to "specify and enforce fitness standards for its clearing members *and affiliates thereof*; *persons with direct access to its settlement and clearing activities*; natural persons who, directly or indirectly, own greater than ten percent of any one class of equity interest in the derivatives clearing organization; *and parties affiliated with*

[6] *See* Proposed Governance Rules Section 40.9(d)(1)(vii). We also note that Section 39.24(a)(1)(ii) of the Proposed Governance Rules would require each DCO to "establish governance arrangements that are well-defined and include a clear organizational structure with *consistent lines of responsibility* and effective internal controls." We believe that the use of the term "consistent" in this context is ambiguous and potentially subject to multiple interpretations. We would prefer that the commission use the term "clear" in this provision, as we think that term would provide greater certainty to DCOs. Alternatively, we ask that the Commission clarify what it means by "consistent lines of responsibility."

[7] Emphases added. We note that although the term "party affiliated with" is not defined in the Proposed Governance Rules, we assume that the Commission means this term to be interpreted as equivalent to the term "affiliate", which is proposed to be defined in Section 1.3(aaa) of the Commission's rules as "a person that directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, another person."

[directors, members of any Disciplinary Panel, and members of the DCO's Disciplinary Committee]."[8] At a minimum the fitness standards described above would be required to include those bases for refusal to register a person under Section 8a(2) of the CEA.[9]

The requirements of the Proposed Governance Rules with respect to a DCO's fitness requirements for parties affiliated with a DCO's directors, members of any disciplinary committee, members of the DCO, or any other individual or entity with direct access to the DCO's settlement or clearing activities are a serious concern to OCC. First, it does not appear that the Commission has attempted to define what it means for one party to be "affiliated with" another party. Does the Commission mean for this to be interpreted in an identical manner to the term "affiliate", which the Commission proposes to define as "a person that directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, another person"?[10] If that is the case, then Section 39.24 is internally inconsistent in that it uses both "any party affiliated with . . ." and "affiliate." Are these terms interchangeable? Even if they are interchangeable, we note that the Proposed Governance Rules would require a DCO to impose fitness requirements on a broad array of persons whose connection and involvement with the DCO is limited to the affiliation that brings them within the scope of the rule. These persons may be entirely remote from the operations of the DCO. For example, any member of the corporate family of an OCC clearing member would be subject to OCC's fitness requirements if the rule is adopted as proposed. This could include clearing member affiliates that are engaged in businesses that have no real connection with the business of the clearing member. It may also include non-US affiliates that don't even do business in the United States. We see no conceivable justification for a DCO's fitness requirements to reach so deeply and pervasively into a clearing member's corporate structure (or that of any other person connected with the DCO that is subject to its fitness requirements). Section 5b(c)(2)(O)(ii)(V) of the CEA, as amended by Dodd-Frank, requires only that a DCO establish and enforce "appropriate" fitness standards for parties affiliated with the individual and entities described in Section 5b(c)(2)(O)(ii)(I) through (IV). As the Commission has the authority, pursuant to Section 5c(a)(1) of the CEA, to issue interpretations describing acceptable business practices of a DCO in complying with the core principles, we encourage the Commission to reevaluate the extent to which it is "appropriate" for a DCO's core principles to apply to affiliates.

Persons with which a DCO does business may belong to enormous global financial institutions with far-flung affiliations across the globe. Certain affiliates may be entirely removed from the futures business or may have no or only limited contact with the United States. DCOs have limited resources and asking them to expend those resources to police potentially remote affiliates we believe serves no purpose.

The SEC has addressed a similar issue previously and we think that experience is informative on this issue. Although not perfectly analogous to the provisions at issue here, under

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[8] Emphasis added.

[9] *See* Proposed Governance Rule Section 39.24(b)(2).

[10] *See* Proposed Governance Rules Section 1.3(aaa).

the Federal securities laws, the rights and obligations of a self-regulatory organization[11] ("SRO") to regulate and oversee the activities and qualifications of its members' affiliates was the subject of some considerable prior debate. Recognizing the unwarranted burdens that would be imposed on the SROs themselves, as well as the SROs' members and members' affiliates, if the SROs were tasked with overseeing and examining all associated persons[12] of their member organizations, the SEC adopted Exchange Act Rule 19g2-1 in 1976.[13] Among other things, the rule narrows registered national securities exchanges' and associations' enforcement obligation to the subset of associated persons who are either "securities persons"[14] or "control persons"[15] of a member. In addition, the rule relieves them of their obligation to "conduct examinations as to qualifications of, require filing of periodic reports by, or conduct regular inspections (including examinations of books and records) of, members' associated persons, other than securities persons whose functions are not solely clerical or ministerial."[16] We encourage the Commission

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[11] The term "self-regulatory organization" is defined in Section 3(a)(26) of the Exchange Act to include "any national securities exchange, registered securities association, or registered clearing agency."

[12] Section 3(a)(21) of the Exchange Act provides that the term "associated person of a member," when used with respect to a member of a national securities exchange or registered securities association, means "any partner, officer, director, or branch manager of such member (or any person occupying a similar status or performing similar functions), any *person* directly or indirectly controlling, controlled by, or under common control with such member, or any employee of such member." (emphasis added). "Person" is defined in Section 3(a)(9) of the Exchange Act to include not only natural persons but legal entities.

[13] SEC Release No. 34-12994 (November 18, 1976). Noting that "associated persons include, for example, a member's corporate parent or affiliates, regardless of whether they are engaged in securities activities or where their activities are carried out," the SEC acknowledged that this definitional breadth could lead to "confusion between necessary and appropriate regulatory measures, on the one hand, and improperly restrictive regulatory (or quasi-regulatory) schemes, on the other." *Id.* In adopting Rule 19g2-1, the SEC sought to focus "self-regulatory responsibility more precisely through an exemptive rule." *Id.* In addition, as to an exchange's or association's review of associated persons as contemplated by Exchange Act Sections 6(c)(3) and 15A(g)(3), respectively (which sections provide for the denial of membership to a broker-dealer which has associated with it natural persons who do not meet prescribed standards of training, experience or competence), the SEC stated that "it should not be necessary to make extensive inquiries concerning all the many possible persons associated with a broker-dealer applying for membership. As a general matter, in passing on applications for membership and association, exchanges and associations need only be particularly concerned with persons who are or will become securities persons or persons who control the member." *Id.*

[14] For purposes of Rule 19g2-1, a "securities person" is defined generally to include any person who "is a general partner or officer (or person occupying a similar status or performing similar functions) or employee of a member." Other registered broker-dealers that are affiliated with the member (regardless of whether such other broker-dealer is itself a member of the exchange or association), as well as the general partners and officers (and persons occupying similar status or performing similar functions) and employees of the affiliated broker-dealer, will also be deemed "securities persons" in relation to the member if they directly or indirectly effect transactions in securities through the member by use of facilities maintained or supervised by the exchange or association.

[15] Rule 19g2-1 defines "control" to mean "the power to direct or cause the direction of the management or policies of a company whether through ownership of securities, by contract or otherwise." The rule further provides that "any person who, directly or indirectly, (A) has the right to vote 25 percent or more of the voting securities, (B) is entitled to receive 25 percent or more of the net profits, or (C) is a director (or person occupying a similar status or performing similar functions) of a company shall be presumed to be a person who controls such company" and equally emphasizes that any other person not falling into one of the foregoing categories "shall be presumed not to be a person who controls such company."

[16] Exchange Act Rule 19g2-1.

to consider similar and reasonable constraints on the scope of affiliated parties to which DCOs' fitness standards will apply.

If the Commission elects not to limit the application of the proposed fitness provisions with respect to affiliates, we nevertheless ask that the Commission put in place a straightforward compliance mechanism for DCOs. Section 39.24(b)(4) of the Proposed Governance Rules would require each DCO to "collect and verify information that supports compliance with the [DCO's fitness standards]." The rule further allows such information to "take the form of a certification based on verifiable information, an affidavit from the general counsel of the derivatives clearing organization, registration information, or other substantiating information. We see none of these options as being practical. A certification based on "verifiable information" is likely the least troubling option and may be selected by many DCOs, but it is not clear what "verifiable" means in this context. The disqualifiers in Section 8a(2) of the CEA include certain events that are inherently difficult to verify without extraordinary efforts. It seems unlikely that the general counsel of a DCO would be willing to provide an affidavit of compliance given that the facts underlying compliance are so difficult to confirm (especially if compliance is required with respect to affiliates). "Other substantiating information" may be an appealing option, but absent guidance about what type of information would satisfy the requirement a DCO may be hesitant to rely on this option. We propose that DCOs should instead be entitled to rely exclusively on a certification (whether or not based on verifiable information) from the relevant clearing member, director, etc. (*i.e.*, the person whose relationship with the DCO triggers application of the fitness requirement to its affiliates) that, to the best of such person's knowledge, none of its affiliates is subject to disqualification pursuant to the DCO's fitness standards and that such person will notify the DCO if at any time any such affiliate fails to meet the applicable fitness standards. It would be virtually impossible for a DCO itself to perform any meaningful verification with respect to affiliates and our proposed certification process would put the onus of verification on those persons most readily able to comply.

In addition, we think the Proposed Governance Rules are unclear about what the remedy must be if an affiliate were to fail to meet a DCO's fitness standards. Would the DCO be required to discipline or expel the applicable director, committee member, clearing member or person with direct access to settlement or clearing? That seems highly impractical and to serve no legitimate purpose, particularly where the disqualified affiliate has no connection to the DCO. We think the more reasonable approach would be for the DCO to merely require the person connected to the DCO whose affiliate is disqualified to notify the DCO of the fitness standard breach by its affiliate and to certify to the DCO that the affiliate in breach will not have any involvement in the decision-making of the DCO-connected person with respect to its business with the DCO.

The requirement in Section 39.24(b)(1) that a DCO establish and enforce fitness standards for "any other individual or entity with direct access to the settlement or clearing activities of the of the derivatives clearing organization, and any party affiliated with [any such] individual or entity" is potentially ambiguous and subject to differing interpretations. We encourage the Commission to clarify the provision in order to provide increased legal certainty to DCOs. First, we do not read this language as applying to employees of a DCO, as we do not think that this particular provision was meant to impose fitness standards on such employees (of

course, DCO employees may be subject to fitness standards in their roles as directors or members of a disciplinary committee, if applicable). Second, we think that the language was not intended to refer to a DCO's settlement banks, although they arguably have "direct access" of a sort and may be covered under a highly literal reading of the proposed language. OCC certainly wouldn't be in any position to impose its own fitness standards on its settlement banks and these banks are already subject to their own fitness standards under applicable regulations. Requiring a DCO to impose fitness standards on these banks is therefore inappropriate and we doubt it was the Commission's intention to do so. It would be helpful if the Commission would clarify its interpretation of these provisions, or modify the provisions to eliminate the ambiguities.

DCO Regulatory Programs

Section 40.9(e)(1)(ii) of the Proposed Governance Rules would require each DCO to establish, maintain, and enforce certain written procedures designed to assist the DCO in minimizing conflicts of interest. These procedures would be required to include "rules regarding the recusal, in applicable circumstances, of parties involved in the making of decisions."[17] This requirement is overly prescriptive. Recusal is only one method among many of addressing conflicts of interest.[18] We appreciate that the Commission has limited the recusal requirement to only "applicable circumstances", but we believe that a DCO should be given the latitude to determine whether to include recusal provisions at all and that a DCO with no rule requiring recusal in any circumstance should not automatically be treated as being in violation of this regulation. A DCO may have disclosure or other mechanisms in place for handling conflicts of interest and those mechanisms may actually be far more effective than a recusal mechanism. We ask that the Commission reconsider this requirement or clarify that the words "applicable circumstances" are sufficiently broad that they could allow a DCO to provide that there is no circumstance in which recusal is required. Section 40.9(e)(1)(ii) goes on to require that a DCO's chief compliance officer, "in consultation with the Board of Directors of the entity, an equivalent body, or a senior officer of the entity, *resolve* any such conflicts of interest."[19] We believe that requiring all identified conflicts to be "resolved" is too strict and unreasonable a standard, potentially creating violations even where every possible stop was taken to mitigate a conflict of interest. A more appropriate standard would be for the CCO to be required to "take reasonable measures to mitigate, to the extent practicable, any such conflicts of interest."

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[17] *See* Proposed Governance Rules Section 40.9(e)(1)(ii).

[18] For example, Section 144(a) of the Delaware General Corporation Law provides that a transaction entered into by a corporation in which a director has a financial interest is not void or voidable solely on account of the financial interest if (1) the material facts as to the director's financial interest are disclosed to or are known by the board of directors and the board of directors in good faith authorizes the transaction by a majority vote of disinterested directors (even if the disinterested directors do not themselves constitute a quorum), (2) the material facts as to the director's financial interest are disclosed to or known by the stockholders entitled to vote on the transaction and the transaction is specifically approved in good faith by vote of the stockholders, or (3) the transaction is fair to the corporation at the time it is authorized, approved or ratified by the board of directors, a committee thereof or the stockholders.

[19] Emphases added.

DCO Submissions Following Board Elections

Section 40.9(b)(1)(iii)(D) of the Proposed Governance Rules would require a DCO to submit, to the Commission, within 30 days after each election of its Board of Directors "[a] description of how the composition of the Board of Directors and each of the committees allows the registered entity to comply with applicable core principles, regulations, as well as the rules of the [DCO]." As OCC's Board of Directors and committee structures are hard-wired into OCC's rules and by-laws, each of which are the subject of public rulemaking under existing Commission regulations, it seems that the information required to be submitted to comply with Section 40.9(b)(1)(iii)(D) would already have been provided to the Commission in applicable rule filings and that resubmitting the same "boilerplate" information following each election, notwithstanding whether anything relevant has changed since the last disclosure, is a superfluous exercise with no tangible benefit to the public or to the Commission.

Involvement of Customers in DCO Governance

It its Proposed Conflicts Rules, the Commission proposed requiring each DCO to have a risk management committee ("RMC") comprised of at least 35% Public Directors and at least 10% representatives of customers. Based on input on the Proposed Conflicts Rules, the Commission is now reconsidering and re-proposing for comment the portion of the Proposed Conflicts Rules that would have required 10% customer representation on the RCM.[20] The Commission is further proposing either (1) the foregoing RMC 10% customer representation requirement or (2) a requirement that a DCO's Board of Directors be comprised of at least 10% customer representatives.[21] The release indicates that the Commission currently expects that it would adopt *either* of the foregoing requirements, but likely *not both* of them.[22] We have previously argued, in a comment letter submitted to the Commission on the Proposed Conflicts Rules,[23] that customer representation on a DCO's RMC is inappropriate. We believe this is especially true where the customer representation requirement applies only to a sub-committee of the RMC with the limited function of determining product and membership eligibility. Involving customers in decisions about appropriate margin levels is potentially troubling because clearing margin requirements can be reflected in customer margin requirements, and customers have an economic interest in minimizing their own margin requirements. While DCO members similarly may have an interest in keeping margin requirements low, this interest is balanced by the fact that they may be assessed to make up losses resulting from the failure of other members. While customers and members alike share an interest in ensuring that the clearinghouse remains solvent, this interest is much more remote than the interests of members in not having to make up losses resulting from the default of an inadequately margined member. In addition, in a clearing organization such as OCC, which clears for a wide variety of securities and futures products that are used by different groups of customers, it would be difficult to define any meaningful customer representation. On the other hand, OCC strongly supports customer involvement in decision-making with respect to OTC derivative products. We believe that the most appropriate

[20] *See* Proposed Governance Rule Section 39.13(g)(3)(i).

[21] *See* Proposed Governance Rules Section 39.26(b))

[22] *See* 76 FR at 729.

[23] *See* Comment Letter from The Options Clearing Corporation to the Commission, dated November 17, 2010.

means of achieving this is through the creation of an advisory committee that would include end-users of those products, as well as dealers. This committee could address on an advisory basis a wide range of topics, including but not limited to those issues that are addressed by a DCO's RMC. Indeed, OCC's current plan is to create such a committee in connection with its plans to clear OTC index options.

We also believe that customer involvement on a DCO's Board of Directors is inappropriate. OCC's board of directors makes decisions vital to the ongoing health and stability of the clearing organization and OCC takes very seriously its role as a market utility. OCC believes that it is necessary that each member of its Board of Directors have adequate experience and knowledge to make critical decisions, particularly during times of crisis. We believe that representatives of customers are simply too far removed from the business of OCC to serve in this vital role and that customer involvement in an advisory committee would be a more appropriate mechanism by which OCC could consider the views of customers. We also previously proposed to the Commission a "fair representation" model that we believe would serve customer interests through maximum openness and good risk management. This model would include balanced representation of large and small firms and some public directors and we believe such a model would be sufficient to protect customers' interest without having customers represented on the RMC or the Board of Directors.

If the Commission does adopt a customer representation requirement for either the RMC or the Board of Directors, we believe the Commission must address what we see as a serious oversight in the definition of "customer," as such definition is applied to OCC. As described in further detail above, OCC is unique in that it is currently the only clearing organization that is registered with both the SEC and the Commission. The definition of "customer" under the Proposed Governance Rules, however, includes only futures customers. Absent relief for OCC or a change to the proposed rules, OCC would be precluded from fulfilling its customer representation requirement (whether on the RMC or the Board of Directors) by including representatives of securities customers that are not also futures customers. As over 99% of OCC's business consists of clearing securities products as a registered clearing agency, and not clearing futures products as a DCO, this would be entirely inappropriate. If the Commission adopts a customer representation requirement, the Commission should alter the proposed rules to allow dual registrants, like OCC, to fulfill any such requirement by including representatives of either futures or securities customers.

In addition, we find Section 39.26 of the Proposed Governance Rules to be somewhat convoluted and confusing in that it requires, in Section 39.26(a)(1), that each DCO ensure that its Board of Directors include "market participants", but then, in Section 39.26(b), imposes a separate 10% Board of Directors customer representation requirement. The Commission defines "market participants" to include both members of a DCO and the customers of such members. Does the Commission intend that compliance with Section 39.26(b) would fulfill the requirements of Section 39.26(a)(1)? If that is the case, then what is the purpose of Section 39.26(b)? Or does the Commission view the two requirements as separate? If that is the case, then we have difficulty imagining a scenario in which compliance with Section 39.26(b) would not fulfill the requirements of Section 39.26(a)(1). We understand that Section 39.26(a)(1) merely copies, in substance, the language of Core Principle Q, but that does not justify the ambiguity in the relationship between Section 39.26(a)(1) and Section 39.26(b). We encourage

the Commission to provide guidance on how the provisions should be interpreted or revise the provisions to resolve the ambiguity. In addition, we reiterate that there appears to be a serious oversight in the structure of the Proposed Governance Rules, as applied to dual registrants, such as OCC. We believe OCC should be able to fulfill the "market participant" requirements of Section 39.26(a)(1) and the customer representation requirement in Section 39.26(b) by including representatives of securities market participants or securities customers, respectively, in addition to futures market participants and futures customers.

Other Comments

While OCC is dually registered with both the Commission and the SEC, the overwhelming majority of OCC's clearing activities relate to its role as a securities clearing agency. OCC's current governance structure was carefully worked out with the active participation of the SEC to meet the fair representation standards of Section 17A of the Exchange Act, taking into consideration OCC's unique ownership structure and the expectation that OCC would be operated as a market utility. The interests of the participant exchanges, members and the public were all taken into consideration, and the model has endured and thrived for many decades. It would be unreasonable, as well as unnecessary, to disrupt this model by imposing on OCC a rigid set of prescriptive rules, such as the Proposed Governance Rules.

Even if the Commission chooses to impose the Proposed Governance Rules in the form proposed, the Commission should ensure that it has retained sufficient flexibility to waive or modify the rules where necessary or appropriate to carry out the purposes of the CEA, as amended by Dodd-Frank. This is particularly important for OCC in order to avoid a situation in which Commission and SEC conflict of interest and governance requirements may overlap or even flatly contradict each other, as OCC would otherwise be required to comply with both sets of regulations, if it is even possible to do so. The rule should be modified to give the Commission express authority to waive its governance rules. These rules will certainly lead to unintended consequences if the Commission does not provide itself with adequate flexibility.

Conclusion

OCC has generally been regarded as a model clearing organization. Operated as a public market utility for the benefit of its participating exchanges, clearing members and the investing public, OCC is effectively a non-profit organization. We have a proud history of providing safe, reliable and low cost clearing services for increasing volumes of transactions through turbulent markets and market crises since 1973. Congress in effect acknowledged the success of OCC and other clearing organizations in mitigating systemic risk and contributing to the safety of financial markets by making central clearing of OTC derivatives a central tenet of Dodd-Frank. We strongly believe there is no justification for the Commission to require substantial changes in OCC's governance structure, which has served OCC and the markets very well. OCC is therefore respectfully requesting that the Commission agree that the OCC should be governed by the conflict of interest rules of the SEC. OCC also encourages the Commission to continue to collaborate with the SEC in enacting rules regarding the structure and governance of clearing organizations.

Given OCC's experience and track record, OCC believes substantial weight should be afforded to the comments and requests made in this comment letter. We look forward to working closely with the Commission to provide any additional input that might be useful to the Commission in determining the final form of the Proposed Governance Rules.

Sincerely,

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

Ananda Radhakrishnan
Director
Division of Clearing and Intermediary Oversight