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By Electronic Mail

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David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581
secretary@cftc.gov

Re: RIN 3038–AC98 "Risk Management Requirements for Derivatives Clearing Organizations"

Dear Mr. Stawick:

New York Portfolio Clearing, LLC ("NYPC") appreciates the opportunity to comment on the notice of proposed rulemaking ("NPR") published by the Commodity Futures Trading Commission (the "Commission") regarding regulations intended to establish the regulatory standards for compliance with derivatives clearing organization ("DCO") Core Principles C (Participant and Product Eligibility), D (Risk Management), E (Settlement Procedures), F (Treatment of Funds), G (Default Rules and Procedures) and I (System Safeguards) (collectively the "Proposed Rules").

NYPC is a DCO owned equally by NYSE Euronext and The Depository Trust & Clearing Corporation ("DTCC"). NYPC has established a cross-margining arrangement with DTCC's subsidiary the Fixed Income Clearing Corporation ("FICC"), pursuant to which joint members of NYPC and FICC (as well as certain affiliates) may, at the discretion of NYPC and FICC, and in accordance with the provisions of the NYPC and FICC rules, elect to have their margin requirements in respect of positions in their proprietary accounts at NYPC and their margin requirements in respect of eligible positions at FICC calculated by taking into consideration the net risk of such eligible positions at both clearing organizations. Utilizing a uniform risk methodology across clearinghouses, this "one-pot" cross-margining arrangement provides increased margin and operational efficiencies for market participants and enhances market and regulatory transparency with respect to the clearing of fixed income portfolios.

NYPC is registered with the Commission as a DCO pursuant to Section 5b of the Commodity Exchange Act (the "Act") and Part 39 of Commission Regulations. NYPC and FICC have also received the necessary regulatory approval from the Commission and the Securities and Exchange Commission ("SEC"), respectively, with respect to the "one-pot" cross-margining arrangement described above.

NYPC provides specific comments on various aspects of the Proposed Rules below. However, at the outset, NYPC would like to join other commenters in respectfully encouraging the Commission to coordinate implementation of the Proposed Rules to the maximum extent possible with other financial regulators, particularly the SEC. Such regulatory coordination is critical for NYPC in light of the integration of the "one-pot" cross-margining arrangement with FICC, an SEC-registered clearing agency, with NYPC's risk management, operational and other systems.

Proposed Rule 39.13 (Risk Management)

Margin Requirements—Methodology and Coverage

As described in its DCO application, NYPC calculates initial margin requirements using a full valuation historic simulation Value at Risk methodology ("VaR methodology"). The VaR methodology is intended to predict the maximum loss at the 99% confidence level in any given portfolio over a specified timeframe and confidence level. This prediction is accomplished by using historical information from the past 250 days for futures positions cleared by NYPC and the past 252 days for cash positions cleared by FICC, including prices, spreads and market variables, such as Treasury zero-coupon yield curves and London Interbank Offered Rate curves. This information is used to calculate a profit and loss ("P&L") for each instrument in a given portfolio, taking into account the specific characteristics of such instrument. P&Ls are calculated using a 1-day liquidation period for futures positions cleared by NYPC and a 3-day liquidation period for cash positions cleared by FICC. The individual P&Ls for each instrument in a portfolio are then aggregated so that a VaR estimate for the entire portfolio can be estimated. Because a P&L is calculated for each instrument individually within a portfolio, correlations within a portfolio will be reflected in the final VaR estimate.

Proposed Rule 39.13(g)(2)(ii) would require that a DCO "use a liquidation time that is a minimum of five business days for cleared swaps that are not executed on a designated contract market . . . and a liquidation time that is a minimum of one business day for all other products that it clears . . . ." The Commission requested comments on whether the proposed minimum liquidation times are appropriate. NYPC believes that liquidation time horizons should be based on the unique characteristics of each product that a DCO clears, particularly such product's complexity and liquidity, rather than based on the execution venue on which the product was traded. NYPC, therefore, concurs with other commenters who recommend that the Commission avoid adopting minimum liquidation times based strictly on mode of execution.

Proposed Rule 39.13(g)(2)(iii) requires that the "actual coverage of the initial margin requirements produced by [DCO] models, along with projected measures of the models' performance, [must] meet an established confidence level of at least 99%, based on data from an appropriate historic time period, for: (A) Each product (that is margined on a product basis); (B) Each spread within or between products for which there is a defined spread margin rate, as described in [Proposed Rule 39.13(g)(4)]; (C) Each account held by a clearing member at the DCO, by customer origin and house origin; (D) Each swap portfolio, by beneficial owner." Similar to the comment made by The Options Clearing Corporation ("OCC") with respect to its System for Theoretical Analysis and Numerical Simulations, NYPC does not understand subparagraphs (A) and (B) of this Proposed Rule to be applicable to NYPC, given that its historical VaR-based margin model calculates initial margin requirements at the portfolio level, rather than on a product or a spread basis.

NYPC, therefore, respectfully requests that the Commission clarify Proposed Rule 39.13(g)(2)(iii) to indicate that with respect to models that calculate initial margin requirements for all positions in a particular account on the basis of the net risk of those positions, including NYPC's historical VaR-based margin model, the 99% confidence level would be applied at the account level, rather than to individual products or spreads. Similarly, NYPC requests that the Commission clarify that Proposed Rules 39.13(g)(4), (g)(6) and (g)(7)(i)–(ii) (regarding the calculation of spread margins and review and back testing of products margined on a product basis) would not be applicable to margin models, including

NYPC's historical VaR-based margin model, that calculate initial margin requirements at the account level.

In addition, although NYPC does not currently clear swaps and subparagraph (D) of Proposed Rule 39.13(g)(2)(iii) would not currently be applicable to it, NYPC concurs with OCC that the language of the Proposed Rule would appear to require that swap portfolios be margined separately from non-swap positions, which could significantly limit the availability of cross-margining, including the NYPC-FICC "one-pot" cross-margining arrangement, with respect to swaps. Such a limitation would not only be disadvantageous to the beneficial owners of swap portfolios from a capital efficiency perspective, but could also potentially reduce regulatory and market transparency and increase systemic risk. NYPC, therefore, concurs with OCC in recommending that Proposed Rule 39.13(g)(2)(iii) be modified to indicate that the 99% confidence level need not be applied separately to the swap positions when swaps are permitted to be commingled in the same account with other positions.

Margin Requirements—Customer Margin

Proposed Rule 39.13(g)(8)(i) would require DCOs to collect initial margin on a gross basis for each clearing member's customer omnibus account in an amount equal to the "sum of the initial margin amounts that would be required by the [DCO] for each individual customer within that account if each individual customer were a clearing member." NYPC is concerned that the Commission may not fully appreciate the consequences of adopting such a requirement.

Proposed Rule 39.13(g)(8)(i) would require that every customer's account be margined separately. This would, in turn, require that every customer's trades be reported to the DCO in a form that attributes that trade to that customer and further identifies whether that trade is establishing a new position or liquidating an existing position.[1] NYPC has no mechanism to capture individual customer positions. As a consequence, the adoption of Proposed Rule 39.13(g)(8)(i) would require NYPC to make a number of significant changes to its systems, including the following:

- NYPC would need to provide clearing members with the ability to create individual customer accounts within its account structure, which was designed to comply with existing (and longstanding) legal and regulatory requirements and which does not contemplate this level of granularity.

- NYPC would need to require that its clearing members assign every transaction to these individual accounts and calculate and report open interest on an account-by-account basis.

- NYPC would need to calculate initial margin requirements individually for each customer account.

[1] Without that latter information, a DCO would have to assume that every trade is additive to the customer's existing position, even if the new trade is the opposite of the customer's existing position. *See* Commission Regulation 1.46(a) (customer permitted to instruct its carrying futures commission merchant not to close out open long and short positions); Commission Regulation 1.46(c)–(d) (long and short positions not subject to automatic close-out if they are bona fide hedges, day trades, sales during a delivery month or made for an error account).

- NYPC would need to perform all position maintenance and clearing processes, including deliveries, option exercise and assignment and give-up and other position transfers on a customer-by-customer basis.

We are not aware of any other DCO that has the ability to capture customer-specific trade and position information in real time. It is, therefore, our understanding that other DCOs would similarly need to make comparable programming, risk modeling and other systems changes to accommodate such a requirement. Any such changes would require a significant increase in system capacity and performance and a large development investment to achieve the contemplated changes in functionality. Further, any such changes could not be effected in isolation, and would require the participation and cooperation of every clearing member and the service bureaus, such as SunGard and ION, that are an integral part of clearing members' day-to-day margin collection and account management processes.

NYPC, therefore, respectfully urges the Commission not to adopt Proposed Rule 39.13(g)(8)(i).

Large Trader Reports

Proposed Rule 39.13(h)(2) would require a DCO to obtain from its clearing members copies of the daily large trader reports that are filed with the Commission by clearing members pursuant to Part 17 of the Commission's Regulations. Proposed Rule 39.13(h)(2) would further require a DCO to review those reports on a daily basis, across all clearing members, to ascertain the risk of the overall portfolio of each large trader.

It is NYPC's understanding that the Commission has expended considerable resources over the last several years to modify its own internal programs and processes in order to glean potentially relevant financial and risk management information from the vast amount of large trader data that it receives from clearing members and contract markets. Even if DCOs had comparable and readily available financial and human resources that they could deploy for such a purpose, the information that they would obtain from such an exercise would frequently be fragmented and inconclusive, given that—unlike the Commission—no single DCO will ever have access to information relating to the futures, option and swap positions that are cleared by other DCOs or to swaps that are traded in the over-the-counter market and reported to a swap data repository. NYPC, therefore, respectfully recommends that the Commission not adopt Proposed Rule 39.13(h)(2).

Clearing Members' Risk Management Policies and Procedures

Proposed Rule 39.13(h)(5) would require a DCO to adopt rules that require its clearing members to maintain current written risk management policies and procedures. Proposed Rule 39.13(h)(5) would further require that a DCO review the "risk management policies, procedures, and practices of each of its clearing members on a periodic basis and document such reviews." NYPC is concerned that the Commission may be underestimating the immensity of such a task. An effective risk management plan is not going to be neatly segmented and encapsulated to address solely the risks associated with clearing membership. To the contrary, a clearing member's risk management plan will be integrated and cover the broad spectrum of risks, including market, credit, liquidity, capital and operational risk, that are associated with the entirety of the clearing member's securities, banking and futures business, much of which will have nothing whatever with doing business through the DCO.

NYPC is also concerned that such a requirement would impose substantial burdens on the resources of the DCOs and on clearing members, many of whom are members of multiple DCOs. Under this Proposed Rule, a clearing member would be required to make its risk management personnel available for meetings with each DCO of which it is a member, in addition to the reviews that already are conducted by the clearing member's designated self-regulatory organization, securities-side designated examining authority and, as applicable, the bank regulatory authorities. NYPC, therefore, respectfully recommends that the Commission modify its proposal to allow DCOs to use their discretion regarding the timing and scope of any such review and allow DCOs to take into account, where applicable, the review of a clearing member's risk management policies by a governmental entity or by a self-regulatory organization.

Proposed Rule 39.14 (Settlement Procedures)

Proposed Rule 39.14(c) would require that a DCO adopt criteria for the selection of settlement banks, including capitalization, creditworthiness, access to liquidity, operational reliability and regulation or supervision, and require that a DCO monitor each of its approved settlement banks on an ongoing basis to ensure that it continues to meet those criteria. Proposed Rule 39.14(c) would further require a DCO to monitor the full range and concentration of its exposures to its settlement banks and assess its own and its clearing members' potential losses and liquidity pressures in the event that the settlement bank with the largest share of settlement activity were to fail. Moreover, Proposed Rule 39.14(c) would require that a DCO take any of the steps prescribed in the Proposed Rule to "eliminate or strictly limit" its and its clearing members' exposures to a settlement bank. Specifically, Proposed Rule 39.14(c) would require a DCO to maintain settlement accounts at additional settlement banks or approve additional settlement banks for use by its clearing members, impose concentration limits with respect to its settlement banks and/or take "any other appropriate actions".

NYPC agrees with the aspect of the Commission's proposal that would require the DCOs to articulate the standards that they apply to the selection of settlement banks. If the Commission decides to retain the portion of this Proposed Rule that would require a DCO to monitor the settlement banks' compliance with those criteria "on an ongoing basis", NYPC respectfully recommends that the Commission modify this Proposed Rule to reflect the fact that, other than operational reliability, which, by itself, would cause a DCO to reassess or terminate its relationship with a settlement bank, the only criteria that are likely to be susceptible to observation, are a bank's regulatory capital[2] and the rating of its parent bank holding company.

NYPC also has reservations about the aspect of this Proposed Rule that would require a DCO to monitor "concentration of its exposures to its own and its clearing members' settlement banks and assess its own and its clearing members' potential losses and liquidity pressures in the event that the settlement bank with the largest share of settlement activity were to fail." First, variation settlement and initial margin requirements are not static. To the contrary, they fluctuate daily across clearing members, and a DCO's exposure to any one settlement bank will similarly fluctuate. In effect, therefore, Proposed Rule 39.14(c)(3) would require the DCOs to monitor their exposure to all—and not merely the largest—of their settlement banks.

[2] National banks, state banks that are members of the Federal Reserve System and insured non-member banks that are insured by the Federal Deposit Insurance Corporation are required to file a "Call Report" as of the last day of each calendar quarter. This information is made publicly available by the Federal Financial Institutions Examination Council. *See* https://cdr.ffiec.gov/public/.

More importantly, Proposed Rule 39.14(c)(3) would require a DCO to "(i) maintain settlement accounts at additional settlement banks; (ii) approve additional settlement banks for use by its clearing members; (iii) impose concentration limits with respect to its own or its clearing members' settlement banks; and/or (iv) take any other appropriate actions, if any such actions are reasonably necessary in order to eliminate or strictly limit such exposures," whether or not the DCO even had a concentrated exposure to one or more of its settlement banks. NYPC recognizes that the Commission is concerned that the failure of a settlement bank could have profound effects upon the ability of a DCO to timely settle its obligations with its clearing members. NYPC believes, however, that it may simply not be practical to require the DCOs to establish additional settlement bank relationships. As the Commission is aware, only a relatively small number of banks are prepared to make the resource commitments that are required of settlement banks. Those banks that provide this service typically do so as an adjunct to the lending and other commercial banking services that they provide to clearing members and the DCOs themselves. NYPC, therefore, believes that it may be unrealistic to think that other well-capitalized and well-managed financial institutions are necessarily poised and willing to step into the role of acting as settlement banks. NYPC also questions whether the banks that currently provide that service would be willing to continue to do so if Proposed Rule 39.14(c)(3) were to require DCOs and some of their clearing members to transfer their business to other banks, leaving the existing settlement banks with expensive infrastructure that is supported by fewer client accounts.

Proposed Rule 39.18 (System Safeguards)

Proposed Rule 39.18(k)(3) requires that a DCO "to the extent practicable . . .[e]nsure that its business continuity and disaster recovery plan takes into account the plans of its providers of essential services, including telecommunications, power, and water." If a service provider ceases to provide a service essential to NYPC performing its functions as a DCO, NYPC intends to invoke its business continuity and disaster recovery plan, irrespective of the reason that such essential service has ceased to be provided, or whether such service provider has invoked all or a part of its business continuity and disaster recovery plan. NYPC, therefore, does not believe that it is necessary for the Commission to require DCOs to obtain the details of the business continuity and disaster recovery plans of their service providers, as such information would not necessarily give DCOs any additional insight into their own business continuity and disaster recovery planning, and, as other commenters have noted, obtaining such proprietary information from a DCO's service providers would likely be impractical for a host of reasons. NYPC, therefore, respectfully recommends that the Commission not adopt Proposed Rule 39.18(k)(3).

Effective Date

The Commission proposes to make Proposed Rules 39.12 through 39.16 and 39.18 effective 180 days from the date on which the final regulations are published in the Federal Register, with the exception of the provisions of Proposed Rule 39.15(b)(2) relating to the commingling of customer futures, options on futures and swaps positions, which would become effective 30 days after the date of publication of the final regulations. In the NPR, the Commission indicates that it "believes that period of 180 days would give DCOs adequate time to implement any additional technology and enhanced procedures that may be necessary to fulfill the proposed requirements related to participant and product eligibility, risk management, settlement procedures, treatment of funds, default rules and procedures, and system safeguards (insofar as they would apply to all DCOs)." Given the sheer number of changes that DCOs would need to make to their operational, risk management and other systems, rules, policies and procedures in order to come into compliance with this and other regulations currently being proposed

by the Commission with respect to DCOs, NYPC believes that a more realistic implementation of the regulations as proposed would be at least 12 months, and at least 24 months if the Commission decides to adopt Proposed Rule 39.13(g)(8)(i) and to require gross margining on a customer-by-customer basis.

Conclusion

NYPC appreciates the opportunity to comment on the Proposed Rules. If the Commission has any questions regarding the matters discussed in this letter, please contact me or Laura C. Klimpel, NYPC's Chief Compliance Officer & Counsel at 212-855-5230 or lklimpel@nypclear.com.

Very truly yours,

Walter Lukken

cc: Gary Gensler, Chairman

Michael Dunn, Commissioner

Jill E. Sommers, Commissioner

Bart Chilton, Commissioner

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Ananda Radhakrishnan, Director, Division of Clearing and Intermediary Oversight