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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-AC98 Requirements for Processing, Clearing and Transfer of Customer Positions

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 proposed rules that would (i) establish timeframes for swap dealers ("SDs"), major swap participants ("MSPs"), futures commission merchants ("FCMs"), swap execution facilities ("SEFs") and designated contract markets ("DCMs" and together with SEFs, "Exchanges") to process and submit contracts, agreements or transactions to a derivatives clearing organization ("DCO") for clearing; (ii) establish certain product standards and a time frame for a DCO to clear such contracts, agreements and transactions; and (iii) facilitate a DCO's transfer of open positions from a carrying clearing member to another clearing member without unwinding and re-booking the positions. We applaud the Commission's efforts to carry out the statutory mandate of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")[2] and support the adoption of the Proposed Rules, subject to the comments set forth below. Our comments focus on a few areas where we believe the Proposed Rules would be improved by modifications and/or clarifications that we believe are consistent with the spirit and intent of Dodd-Frank and the regulatory objectives reflected in the Proposed Rules. In some cases, our comments merely reflect how we would interpret the Proposed Rules as drafted in order to provide the Commission with an opportunity to correct any misunderstandings.

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[1] Requirements for Processing, Clearing and Transfer of Customer Positions, 76 FR 13101 (March 10, 2011).

[2] Pub. L. 111-203.

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 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 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.

Manner of Routing Swaps to DCOs

Proposed Rules § 23.506(a)(1) and § 37.702(b)(1) would require (i) each SD and MSP to ensure that it has the ability to route swaps not executed on an Exchange to a DCO[4] and (ii) each SEF to ensure that, for transactions cleared by a DCO, it has the ability to route transactions to the DCO,[5] in each case "in a manner acceptable to the DCO for the purposes of risk management." We believe the phrase "for the purposes of risk management" creates ambiguity. A DCO may have established routing requirements for reasons unrelated to risk management, such as requirements designed to increase efficiency or decrease administrative costs. We believe a party that submits transactions to a DCO for clearing should be required to ensure that it has the ability to route the transactions to the DCO in a manner that meets all of the DCO's legitimate requirements, and not only those that are related to risk management. Therefore, we suggest that the Commission delete the phrase "for the purposes of risk management" from § 23.506(a)(1) and § 37.702(b)(1) and substitute the phrase "for clearing."

Time Frame for Submitting Swaps to DCOs

With respect to swaps that are not subject to a mandatory clearing requirement pursuant to section 2(h)(1) of the CEA but that are accepted for clearing by a DCO and for which both counterparties to the swap have elected to clear the swap, Proposed Rule § 23.506(b)(2) would require the SD or MSP to submit the swap for clearing no later than the business day after

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[3] The participating options exchanges are BATS Exchange, Inc., C2 Options Exchange, Inc., Chicago Board Options Exchange, Inc., International Securities Exchange, LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX, Inc., NASDAQ Options Market, NYSE Amex LLC and NYSE Arca, Inc. OCC clears futures products traded on CBOE Futures Exchange, LLC, ELX Futures, LP, NASDAQ OMX Futures Exchange and NYSE Liffe US, as well as security futures contracts traded on OneChicago Exchange and options on futures contracts traded on NYSE Liffe US.

[4] *See* Proposed Rule § 23.506(a)(1), 76 FR at 13109.

[5] *See* Proposed Rule § 37.702(b)(1), 76 FR at 13109.

execution of the swap (or the agreement to clear, if later than execution).[6] While we support the Commission's efforts to limit the delay between execution of a swap and its submission to a DCO, we encourage the Commission to confirm with market participants that the proposed deadline could readily be met. If the deadline is unrealistic or difficult to meet, § 23.506(b)(2) could have the unintended effect of actually discouraging counterparties from submitting such swaps for clearing.

Non-Discriminatory Clearing of Swaps

Proposed Rule § 39.12(b)(3) would require a DCO to provide for non-discriminatory clearing of a swap executed bilaterally or on or subject to the rules of an unaffiliated Exchange.[7] While we support the principle of non-discrimination in clearing, we believe that it should not be deemed a violation of § 39.12(b)(3) for a DCO to require an Exchange desiring to transmit swaps to the DCO for clearing to enter into a non-exclusive clearing agreement with the DCO on non-discriminatory terms similar to those offered by the DCO to other Exchanges for clearing of similar products. Such clearing agreements are necessary and appropriate for purposes of addressing matters between the parties such as information sharing and furnishing of pricing data by the Exchange to the DCO. We think it unlikely that the Commission intended to prohibit such agreements, but it would be helpful for the Commission to clarify the point in the Proposed Rules or the adopting release.

Acceptance and Clearing of Swaps by DCOs

The Proposed Rules would establish a time frame for clearing of transactions by DCOs. Subject to the conditions that the executing parties have clearing arrangements in place with clearing members of the DCO and the executing parties have identified the DCO as the intended clearinghouse, a DCO would be required to accept for clearing:

- immediately upon execution, all transactions that are listed for clearing by the DCO that are entered into on an Exchange;[8]
- upon submission to the DCO, all swaps that are listed for clearing by the DCO that are not executed on an Exchange but are subject to mandatory clearing;[9] and
- no later than the close of business on the day of submission to the DCO, all swaps that are listed for clearing by the DCO that are not executed on an Exchange and are not subject to mandatory clearing.[10]

First of all, we believe the Commission should clarify that the foregoing provisions of the Proposed Rules are limited to the clearing of swaps. We are not aware of any problems in the

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[6] *See* Proposed Rule § 23.506(b)(2), 76 FR at 13109.

[7] *See* Proposed Rule § 23.506(b)(2), 76 FR at 13109.

[8] *See* Proposed Rule § 39.12(b)(7)(ii), 76 FR at 13110.

[9] *See* Proposed Rule § 39.12(b)(7)(iii), 76 FR at 13110.

[10] *See* Proposed Rule § 39.12(b)(7)(iv), 76 FR at 13110.

existing infrastructure, systems and procedures used in the clearing of futures or other non-swap products that would justify the adoption of a new standard for the acceptance of such products for clearing by DCOs.

Secondly, we object to the apparently unconditional requirement that DCOs must accept a transaction for clearing merely because it is of a type that the DCO has agreed generally to clear. A DCO's acceptance of a transaction for clearing is ordinarily understood to mean the DCO's novation or guarantee of the transaction and substitution as the central counterparty, and not merely the receipt of the transaction into the DCO's system for processing. From both the operational perspective and the risk management perspective, a DCO should have the right to specify the conditions that need to be satisfied before it accepts a transaction for clearing (such conditions may require, for example, that the transaction terms as reported to the DCO do not contain any errors or omissions, that the relevant clearing member meets any applicable initial payment or margin requirements imposed by the DCO, and that the relevant clearing member is not suspended by the DCO) and to reject the transaction if any such condition is not met. Imposing an unconditional transaction acceptance requirement on DCOs, as appears to be contemplated by the foregoing provisions of the Proposed Rules, could lead to more erroneous transactions being accepted and cleared by the DCO as well as expose the DCO to unnecessary credit risk with respect to its clearing members. This would increase, rather than decrease, systemic risk. We believe that the determination of appropriate conditions for transaction acceptance is a subject matter more suitable for the DCO rule-making process than for the agency rule-making process and that the Commission should defer to a DCO's reasonable discretion in determining what those conditions should be. We urge the Commission not to include any such unconditional transaction acceptance requirement in the Proposed Rules and to clarify in the Proposed Rules or the adopting release that a DCO's decision to accept or reject a transaction may be contingent on the satisfaction of those conditions as specified by the DCO in its rules.

Finally, we believe that both the time frame specified in Proposed Rule § 39.12(b)(7)(ii) (*i.e.*, that DCOs must accept certain types of transactions "immediately upon execution") and the time frame specified in Proposed Rule § 39.12(b)(7)(iii) (*i.e.*, that DCOs must accept certain other types of transactions "upon submission to the DCO") are not practicable if interpreted literally. With respect to transactions entered into on an Exchange, a DCO does not have direct knowledge of when the transaction was executed between the original executing parties. The Exchange may not submit the transaction immediately upon execution to the DCO for clearing, which would make it impossible for the DCO to accept such transaction "immediately upon execution." In addition, as discussed above, we believe that a DCO should be able to specify the conditions that need to be met before it accepts a transaction for clearing. Given that the DCO would need a certain amount of time to validate the submitted transactions, it would not be possible for the DCO to accept the transactions either "immediately upon execution" or "upon submission to the DCO." We believe that the determination of appropriate time frame for transaction acceptance (including, with respect to transactions submitted for same-day acceptance, the determination of the appropriate cut-off time by which such transactions must be submitted to the DCO) is also a subject matter more suitable for the DCO rule-making process than for the agency rule-making process. Again, we urge the Commission to defer to a DCO's reasonable discretion in such matter and not to impose on DCOs an impractical time frame for transaction acceptance.

Written Confirmation for Cleared Swaps not Executed on a SEF or DCM

With respect to any swap that is not executed on an Exchange but is submitted to a DCO for clearing, Proposed Rule § 39.12(b)(7)(v) would require the DCO to provide to the counterparties of such swap "written documentation that memorializes all of the terms of the transaction and legally supersedes any previous agreement."[11] The Release explains that the purpose of such written documentation is to serve as a confirmation of the cleared swap and § 39.12(b)(7)(v) aims to facilitate the timely processing and confirmation of swaps not executed on an Exchange by allowing parties to confirm their transaction by submitting it to a DCO for clearing.[12] Neither § 39.12(b)(7)(v) nor the Release discusses whether such confirmation must take a particular form. We note, however, that Proposed Rule § 39.12(b)(2) would require a DCO to adopt rules to establish templates for the terms and conditions of swaps that it will clear[13] and Proposed Rule § 39.12(b)(6) would require the DCO to adopt rules providing that, upon its acceptance of a swap for clearing, all terms of the cleared swap must conform to templates established by the DCO under its rules.[14] As the terms and conditions applicable to a cleared swap will already be specified in the DCO's rules or templates, we do not think it necessary for the DCO to provide a confirmation that is in the form of detailed trade documentation such as an ISDA Master Agreement, confirmation or similar document. Instead, we believe that the term "written documentation" should be interpreted broadly to mean any documentation that sufficiently memorializes the agreement of the counterparties with respect to the terms of a swap, which may, for example, consist of a confirmation (electronic or otherwise) that confirms the values agreed upon for terms that can be varied by the parties. We would appreciate confirmation that the Commission agrees with our interpretation by providing clarification in the Proposed Rules or the adopting release.

Transfer of Customer Positions and Related Funds

Proposed Rule § 39.15(d) would require a DCO to have rules providing that, upon the request of a customer and subject to the consent of the receiving clearing member, the DCO will promptly transfer all or a portion of such customer's portfolio of positions and related funds from the carrying clearing member of the DCO to another clearing member of the DCO, without requiring the close-out and re-booking of the positions prior to the requested transfer.[15] As explained in the Release, the purpose of § 39.15(d) is to ensure that DCOs do not impose economic or operational obstacles to the prompt transfer of customer positions and related funds from one clearing member to another upon the request of a customer, and the Commission seeks to accomplish that goal by formalizing and applying to swaps clearing the current futures clearinghouse practice of transferring customer positions and related funds without close-out and re-booking of positions.[16] While we support the Commission's efforts to protect the safety of

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[11] *See* Proposed Rule § 39.12(b)(7)(v), 76 FR at 13111.

[12] 76 FR at 13106.

[13] *See* Proposed Rule § 39.12(b)(2), 76 FR at 13110.

[14] *See* Proposed Rule § 39.12(b)(6), 76 FR at 13110.

[15] *See* Proposed Rule § 39.15(d), 76 FR at 13111.

[16] 76 FR at 13103.

customer positions and related funds, we find § 39.15(d), as drafted, to be flawed in certain respects.

First of all, we request that the Commission clarify that § 39.15(d) is limited to transfer of customer positions in swaps. On its face, § 39.15(d) would apply to all positions cleared by a DCO. Secondly, § 39.15(d) could be read as requiring a DCO to adopt rules that would permit a customer to submit transfer instructions directly to the DCO. Neither OCC nor, to our knowledge, most other DCOs, have a mechanism in place to process such requests received directly from a customer. Indeed, a DCO would have no way, short of asking the clearing member that the customer claimed was holding the customer's position, of verifying that the clearing member's account with the DCO in fact included a position held for that customer. [17] A customer seeking to transfer its positions and related funds from one clearing member to another would normally give its instructions to the clearing member carrying such positions and funds and arrange with the receiving clearing member to accept the transfer. In light of this fact, we suggest that the Commission revise § 39.15(d) to the extent necessary to require, at most, that a DCO have rules requiring its clearing members to promptly seek to transfer customer positions and related funds to another clearing member upon customer request and requiring the DCO to process such transfers promptly, subject to compliance by the transferring and receiving clearing members with applicable rules of the DCO. Finally, § 39.15(d) could be read to mean that a DCO must process a transfer of customer positions and related funds so long as the receiving clearing member consents to the transfer. However, we believe that any such transfer must be subject to all legitimate conditions or restrictions established by the DCO in connection with its clearing of swaps. For example, the DCO should not be required to transfer positions to a clearing member if it determines that such clearing member does not have the capability (whether financially, operationally or otherwise) to safely manage the transferred positions. In addition, any such transfer must also be subject to the DCO's rules governing the liquidation of insolvent clearing members' open positions because permitting customers of an insolvent clearing member to freely transfer their positions out of the insolvent clearing member's account could delay the liquidation process and expose the DCO to unwarranted risks. To address our concerns, we again suggest that the Commission revise § 39.15(d) to the extent necessary to require, at most, that a DCO have rules requiring its clearing members to promptly seek to transfer customer positions and related funds to another clearing member upon customer request and requiring the DCO to process such transfers promptly, subject to compliance by the transferee and transferor clearing members with applicable rules of the DCO.

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

[17] If the proposed rule covered futures as well as swaps, processing a customer's transfer request could be even more complicated. The customer's position could be held in an omnibus account maintained by a non-clearing FCM, in which case even the clearing member carrying the position would not know the customer's identity.

markets by making central clearing of OTC derivatives a central tenet of Dodd-Frank. 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 Rules.

Sincerely,

William H. Navin
Executive Vice President and General Counsel

cc: Gary Gensler
Chairman
Commodity Futures Trading Commission

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