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**By Electronic Mail**

June 3, 2011

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

**Re: RIN 3038-AC98: Financial Resources Requirements for Derivatives Clearing Organizations (75 Fed. Reg. 63113 (October 14, 2010)), Information Management Requirements for Derivatives Clearing Organizations (75 Fed. Reg. 78185 (December 15, 2010)), Risk Management Requirements for Derivatives Clearing Organizations (76 Fed. Reg. 3698 (January 20, 2011))**

Dear Mr. Stawick:

New York Portfolio Clearing, LLC (“NYPC”) appreciates the opportunity, afforded by the extended comment period,<sup>1</sup> to submit the following comments regarding the above-referenced notice of proposed rulemakings (“NPRs”) by the Commodity Futures Trading Commission (the “Commission”).

NYPC is a derivatives clearing organization (“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.

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<sup>1</sup> Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 25274 (May 4, 2011).



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

In addition to the comment letters submitted by NYPC on December 13, 2010 and on March 30, 2011 with respect to the Commission's NPRs regarding financial resource requirements for DCOs and risk management requirements for DCOs, NYPC provides further comments below on issues relating specifically to the implementation of certain proposed regulations and areas we believe need further clarification or modification.

**Proposed Regulation 39.11—Financial Resource Requirements.**

*1. Assessment of Clearing Members/DCO Monitoring.*

Under proposed regulation 39.11(d)(2), if assessments for additional guaranty fund contributions are permitted under a DCO's rules in calculating the financial resources available to the DCO to meet its financial obligations to its clearing members notwithstanding a default by the clearing member and its affiliates creating the largest financial exposure for the DCO in extreme but plausible market conditions, the DCO must have rules requiring that its clearing members (i) have the ability to meet an assessment within the time frame of a normal variation cycle; (ii) monitor "on a continual basis" the financial and operational capacity of its clearing members to meet potential assessments; (iii) apply a 30 percent haircut to the value of potential assessments; and (iv) only count the value of potential assessments, after the haircut, to meet up to 20 percent of those obligations.

With respect to the proposed requirement that a DCO's clearing members be able to meet an assessment within the time frame of a normal variation margin cycle, we respectfully request that the Commission clarify how such requirement would be imposed on DCOs, like NYPC, that conduct both end-of-day and intraday settlements each business day. In order to ensure that a uniform standard is applied across clearing members of all DCOs, whether the DCO conducts one or two settlements per business day, we respectfully recommend that the Commission clarify that a DCO's rules should require clearing members to have the ability to meet an assessment within one business day.

With respect to the proposed requirement that a DCO monitor the financial and operational capacity of its clearing members to meet a potential assessment "on a continual basis," NYPC first respectfully requests that the Commission provide guidance as to how it expects DCOs to determine whether a clearing member has the capacity to meet a potential assessment. In addition, like certain other commenters, NYPC is concerned that "continual" monitoring of clearing members' ability to meet potential assessments, which implies daily or even real-time monitoring, would be extremely difficult, if not in fact impossible, to administer. Like all other



DCOs, NYPC receives regular periodic financial reports from its clearing members through which each clearing member's financial status is monitored, and we believe that, rather than imposing a "continual" monitoring requirement, it would be reasonable and more practicable for the Commission to require that monitoring of clearing members' ability to meet potential assessments be included as mandatory component of the periodic financial reviews of clearing members that DCOs already conduct in the ordinary course of business.

## 2. *Liquidity of Financial Resources.*

Proposed regulation 39.11(e)(1) requires that the financial resources allocated by a DCO to withstand a default by the clearing member and its affiliates creating the largest financial exposure for the DCO in extreme but plausible market conditions be sufficiently liquid to enable the DCO to fulfill its obligations as a central counterparty during a one-day settlement cycle, and that the DCO have sufficient capital "in the form of cash" to meet the average daily settlement variation pay per clearing member over the last fiscal quarter. NYPC has two concerns about this proposal. First, to the extent the proposed requirement is intended to exclude cash equivalents, such as U.S. Treasury securities, NYPC believes the standard is inappropriate. Second, to satisfy its liquidity needs, NYPC maintains a secured credit facility that allows NYPC to borrow funds with 60 minutes' notice, as well as repurchase agreements. Taken together, NYPC's credit facility and its repurchase agreements allow NYPC to hold a significant portion of its financial resources in the form of U.S. Treasury securities, possibly the most secure and liquid of all financial resources. Given the reliability of such arrangements and the potential amount of cash at issue, NYPC concurs with certain other commenters in respectfully recommending that the Commission allow DCOs to satisfy their liquidity needs through use of any combination of cash held in demand deposit accounts, bank accounts meeting the requirements of Interpretative Letter 03-36<sup>2</sup> as well as secured credit facilities and repurchase agreements that allow DCOs to convert U.S. Treasury securities and other high quality collateral into cash on a same-day basis.

### **Proposed Regulations 39.11(f) and 39.19—Reporting.**

#### 1. *Daily Reporting.*

As set forth in proposed regulation 39.19(c)(1)–(3), DCOs would be required to report to the Commission certain information on a daily, quarterly and annual basis. Daily reporting requirements under proposed regulation 39.19(c)(1) would include information relating to end-of-day positions, initial and variation margin requirements and related cash flows by customer origin and house origins. Based on preliminary analysis, NYPC estimates<sup>3</sup> that designing,

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<sup>2</sup> Comm. Fut. L. Rep. (CCH) ¶129,576 (Aug. 25, 2003).

<sup>3</sup> Estimates included in this letter were determined based on internal software models historically utilized by DTCC to design, build and test new initiatives. NYPC would be pleased to provide the Commission and Commission staff with additional detail regarding how such estimates were derived.



building and testing the application necessary to automate the process of producing such daily reports would require, in the case of NYPC, approximately **5,200 hours and \$582,000**.<sup>4</sup>

## 2. *Event Specific Reporting—Decrease in Financial Resources.*

Proposed regulation 39.19(c)(4)(i) would require timely reporting by a DCO if there is a decrease of 10 percent in the total value of the financial resources required to be maintained by the DCO under proposed regulation 39.11(a). NYPC has several interpretative questions and concerns about proposed regulation 39.19(c)(4)(i).

First, it is unclear from the language of the proposed regulation and the accompanying description in the NPR whether the proposed reporting requirement is intended to apply only to a DCO's default risk financial resources or to its operating financial resources as well.<sup>5</sup> To the extent such proposed reporting is intended to extend to a DCO's operating financial resources, NYPC believes that such a requirement as currently drafted would be extremely impractical to implement in practice for the reasons discussed further below.

Second, based on the language of the proposed regulation, it is unclear whether the Commission's objective is to require DCOs to track 10% or greater decreases in the financial resources that DCOs are required to maintain under proposed 39.11(a), or 10% or greater decreases in the financial resources that DCOs have available to satisfy the requirements of proposed 39.11(a). The reference in the proposed regulation to "financial resources required to be maintained by the derivatives clearing organization under §39.11(a)" would appear to indicate that a DCO should be using the minimum financial resource requirements under proposed regulation 39.11(a) as a baseline against which to measure 10% decreases. To the extent proposed regulation 39.19(c)(4)(i) is intended to require reporting based solely on daily fluctuations in a DCO's financial resources without regard to whether such fluctuations would affect the DCO's ability to comply with minimum requirements, NYPC concurs with certain other commenters that such a requirement would not be an effective way of achieving the Commission's goal of "monitor[ing] the financial health of the DCO"<sup>6</sup> because the proposed

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<sup>4</sup> Note that this estimate does not include the costs associated with customer gross margining and related reporting, which we discuss further below in the context of proposed regulation 39.13(g)(8)(i).

<sup>5</sup> Although the example given in the NPR (75 Fed. Reg. at 78188) refers to a decrease in the DCO's default risk resources ("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"), proposed regulation 39.11(a) as currently drafted would prescribe mandatory minimums with respect to both a DCO's default risk resources (proposed regulation 39.11(a)(1)) and its operating financial resources (proposed regulation 39.11(a)(2)).

<sup>6</sup> 75 Fed. Reg. at 78187.



reporting requirement could be triggered even if the DCO's financial resources are more than sufficient.<sup>7</sup>

NYPC is also concerned that applying the proposed reporting requirement to a DCO's operating financial resources would be unworkable in practice. By requiring a DCO to track decreases in its operating financial resources from the close of the previous business day, proposed regulation 39.19(c)(4)(i) would appear to require a DCO to close its books on a **daily basis** in order to be able to estimate any potential 10% or greater decrease. Such a daily closing of its books would require a tremendous effort on the part of the DCO in that all of its revenues and expenses would need to be calculated every single day and booked to the general ledger. In the case of NYPC, such an effort would require the financial reporting staff supporting the clearinghouse to increase by a significant multiple.

Moreover, NYPC does not believe that synthesizing a DCO's default risk financial resources and operating financial resources into a single daily calculation, as appears to be required under proposed regulation 39.19(c)(4)(i),<sup>8</sup> would be particularly useful to the Commission in that they are separate pools of resources that, as a general matter, are used by a DCO for different purposes, *i.e.*, protecting against the risk of clearing member defaults, on the one hand, and supporting the business operations of the DCO, on the other hand.

In addition to the impracticality of certain aspects of proposed regulation 39.19(c)(4)(i) and the questionable benefit of the proposed regulation in effectively monitoring the financial health of a DCO, from an implementation perspective, NYPC has preliminarily estimated that, on top of the additional financial reporting staff that would be required to comply with the proposed regulation, designing, building and testing the application required to automatically capture and combine NYPC's default risk financial resources and operating financial resources in a single daily calculation for purposes of satisfying the reporting requirements of proposed regulation 39.19(c)(4)(i) as currently drafted would require approximately **15,000 hours and \$1.7 million**.

In light of the foregoing, NYPC respectfully recommends that the Commission instead consider an "early warning" reporting requirement similar to the requirement currently imposed on futures commission merchants ("FCMs") as an alternative to the reporting requirement of proposed regulation 39.19(c)(4)(i). As the Commission is aware, the "early warning" requirement of Commission Regulation 1.12(b)(2) requires an FCM to give 24 hours' notice to the Commission if it "knows or should have known" that its adjusted net capital is at any time

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<sup>7</sup> For example, as certain other commenters point out, the margin requirements of DCOs typically fluctuate on a regular basis and a decrease in a DCO's financial resources resulting from a decrease in the DCO's margin requirements generally translates to a lower overall risk profile for the DCO, as margin requirements generally fluctuate based on the size and volatility of the positions the DCO clears, and is not typically a situation that presents an actual risk management concern that should warrant the Commission's attention.

<sup>8</sup> In relevant part, the proposed regulation would require reporting of 10% or greater decreases in the "total value" of the financial resources required to be maintained by a DCO under proposed regulation 39.11(a).



less than 110% of the amount required by the Commission's net capital rule. The purpose of the 110% early warning requirement is to give the Commission advance notice ("early warning") of the possibility that the FCM in question will cease to be in compliance with the regulatory capital requirements set forth in Commission Regulation 1.17.<sup>9</sup>

Similar to the "early warning" reporting requirement imposed on FCMs, NYPC recommends that the Commission require that a DCO timely report if it knows or has reason to know that either its default risk financial resources or its operating financial resources fall below 110% of the minimum financial resources required to be maintained by the DCO under proposed regulation 39.11(a)(1) and 39.11(a)(2), respectively. With respect to a DCO's operating financial resources, NYPC recommends that the Commission clarify that such "early warning" reporting requirement should ordinarily be keyed off the computation of the estimated 12 months of operating costs that the DCO would be required to prepare at the end of each month under proposed regulation 39.11(c)(2), unless the DCO knows or has reason to know that its operating financial resources have dropped below the minimum requirement under proposed regulation 39.11(a)(2) during the course of the month.

Based on its preliminary estimates, NYPC anticipates that adopting such an alternative reporting requirement would require **less than half** the time and resources necessary for NYPC to satisfy the reporting requirement of proposed regulation 39.19(c)(4)(i) as currently drafted.

### 3. *Event Specific Reporting—Intraday Margin Calls.*

Under proposed regulation 39.19(c)(4)(v), DCOs would be required to report to the Commission any intraday margin call to a clearing member not later than 1 hour following the call. As certain other commenters have noted, for some DCOs, like NYPC, intraday margin calls are routine and not indicative of "unusual"<sup>10</sup> activity or issues presenting a risk management concern. Requiring DCOs that conduct intraday settlements in the ordinary course of business to report within 1 hour each intraday margin call to a clearing member would result in a significant amount of additional work for such DCOs with questionable benefit to the Commission's objective of monitoring DCOs' financial health. Therefore, NYPC respectfully recommends that the Commission consider clarifying that for DCOs that conduct intraday settlement in the ordinary course of business, reporting within 1 hour is only required for intraday margin calls made outside of the regular intraday settlement process. Alternatively, if the Commission determines it necessary to receive information regarding each intraday margin

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<sup>9</sup> Commission Regulation 1.12(b) includes additional triggers relating to FCMs whose minimum net capital requirement is a fixed dollar amount, to "forex dealer members" of the National Futures Association and to FCMs that are also securities broker-dealers. See Commission Regulation 1.12(b)(1), (3) and (4). Those other triggers serve the same purpose—to give the Commission an opportunity "to respond with a heightened degree of surveillance, as may be necessary or prudent, in light of the possibility of deteriorating operating or financial conditions at a firm." 69 Fed. Reg. 49784, 49788 (August 12, 2004).

<sup>10</sup> 75 Fed. Reg. at 78189.



call, NYPC concurs with certain other commenters who recommend that such intraday margin call information be added to the daily reporting requirements of proposed regulation 39.19(c)(1) that DCOs are required to submit by 10 a.m. the following business day.

#### 4. *Event Specific Reporting—Financial Conditions and Events.*

Under proposed regulation 39.19(c)(4)(xiv), a DCO is required to immediately notify the Commission if, among other things, there is a material adverse change (“MAC”) in the financial condition of any clearing member that would not otherwise be reported under proposed regulation 39.19. Like certain other commenters, NYPC questions whether such a reporting requirement is the most efficient and effective way for the Commission to be notified of such an MAC. As described above and certain other commenters note, FCMs are already required under Commission Regulation 1.12 to notify the Commission if they know or should know that their adjusted net capital falls below certain prescribed thresholds and are required by Commission Regulation 1.10 to file unaudited financial reports directly with the Commission on a monthly basis. In light of the fact that material changes in an FCM clearing member’s financial condition would in all likelihood appear in the reports already submitted to the Commission under such existing reporting requirements, NYPC believes the new reporting requirement under proposed regulation 39.19(c)(4)(xiv) to be largely duplicative.

As an alternative, NYPC respectfully recommends that the Commission instead propose amendments to Commission Regulations 1.10 and 1.12 to require all clearing members, whether or not they are registered with the Commission as FCMs, to file financial statements with the Commission on the same terms and in the same circumstances as are required of FCMs by Commission Regulations 1.10 and 1.12.

#### 5. *Quarterly Reporting.*

Proposed regulation 39.11(f)(4) would require that the quarterly reports that a DCO would be required to submit to the Commission regarding its financial resources be filed not later than 17 business days after the end of the DCO’s fiscal quarter, or at such later time as the Commission may permit, in its discretion, upon request by the DCO. NYPC believes that in light of the scope of information required to be submitted in the proposed quarterly report (*i.e.*, information regarding default risk financial resources and operating financial resources), the Commission should require that such reports be filed not later than 30 calendar days, rather than 17 business days, following the end of the DCO’s fiscal quarter.

#### **Proposed Regulation 39.13 (Risk Management)**

To supplement the comments submitted by NYPC to the Commission on March 31, 2011, NYPC provides below additional detail regarding the time and resources that NYPC estimates would be required to implement certain sections of proposed regulation 39.13 as currently drafted.



### *Customer Gross Margining*

Proposed regulation 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; and for customer origin, separately, the gross positions of each beneficial owner." As described in its comment letter of March 31, 2011, NYPC is concerned that the Commission may not fully appreciate the consequences of adopting such a requirement.

Proposed regulation 39.13(g)(8)(i) would effectively require that the margin requirements for every customer's account be calculated separately by the DCOs. 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.<sup>11</sup> NYPC has no mechanism to capture individual customers' positions on a customer-by-customer basis. As a consequence, the adoption of proposed regulation 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.
- 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

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<sup>11</sup> 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).





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.

### *Large Trader Reports*

Proposed regulation 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 regulation 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.

### *Implementation Costs*

From an implementation perspective, in addition to the increase in personnel that would be required for NYPC to comply with the customer gross margin and large trader report requirements respectively contained in proposed regulations 39.13(g)(8)(i) and 39.13(h)(2), all of NYPC's clearing systems would need to be re-platformed to achieve the performance and storage capacity necessary to accommodate the risk management of potentially thousands of customer and large trader portfolios that would be required by the proposed regulations. Our preliminary estimate is that such a build would require approximately **128,650 hours and \$14.5 million**.<sup>12</sup>

Such massive implementation costs would significantly deter new clearinghouses like NYPC from launching, thus further limiting competition in this industry and further concentrating

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<sup>12</sup> Note that such estimate would be in addition to the considerable time and resources that would be required to make the necessary changes to the NYSE Liffe U.S. trade registration and clearing processing systems (*i.e.*, the systems through which post-trade processing and position management of NYPC-cleared contracts occurs) in order to comply with proposed regulation 39.13(g)(8)(i) as currently drafted.



counterparty risk in existing clearinghouses. This public policy and monetary cost clearly outweighs any potential benefits of these proposed requirements.

In light of the foregoing, NYPC, therefore, respectfully urges the Commission not to adopt proposed regulations 39.13(g)(8)(i) and 39.13(h)(2).

**Effective Date.**

NYPC believes that staggering the implementation of those of the Commission's proposed rules that would require substantial technology builds would be most practicable for DCOs and would have the effect of providing the Commission with as much data as possible as quickly as possible. NYPC believes, for example, that it would be reasonable for the Commission to provide for a one-year implementation period with respect to the daily reporting requirements under proposed regulation 39.19(c)(1). NYPC believes, however, that it would need at least two additional years, after the design, building, testing and implementation of daily reporting systems, to design, build and test the applications necessary to automate the process of complying with the other proposed regulations as currently drafted, excluding the customer gross margining and large trader report requirements under proposed regulations 39.13(g)(8)(i) and 39.13(h)(2) discussed below. However, NYPC believes, for example, that the time needed to implement the proposed financial resource reporting requirements under proposed regulation 39.19(c)(4)(i) could be significantly reduced if the Commission were to adopt an alternative requirement along the lines described above.

Given the enormity of the technology builds associated with complying with the customer gross margining and large trader report requirements under proposed regulations 39.13(g)(8)(i) and 39.13(h)(2), NYPC does not believe it is yet in a position to estimate the implementation periods that would be required to come into compliance with those proposed regulations as currently drafted. However, we do anticipate that the required implementation periods for such proposed regulations would extend beyond those described above.

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NYPC appreciates the opportunity to submit these comments in connection with the proposed rules. If the Commission has any questions concerning the matters discussed in this letter, please contact the undersigned (at 212-855-5210 or [wlukken@nypclear.com](mailto:wlukken@nypclear.com)) or Laura C. Klimpel, NYPC's Chief Compliance Officer and Counsel (at 212-855-5230 or [lklimpel@nypclear.com](mailto:lklimpel@nypclear.com)).

Very truly yours,

A handwritten signature in blue ink that reads "Walt L. Lukken". The signature is written in a cursive, flowing style.

Walter Lukken  
Chief Executive Officer

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

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