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125 S. Franklin Street, Suite 1200
Chicago, IL 60606
312 322 6200 | theocc.com

September 13, 2019

VIA CFTC PORTAL

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: RIN 3038-AE66 Derivatives Clearing Organization General Provisions and Core Principles

Dear Mr. Kirkpatrick,

The Options Clearing Corporation ("OCC") appreciates the opportunity to provide the Commodity Futures Trading Commission ("CFTC" or "Commission") with its comments on the Commission's proposed regulations amending requirements for derivative clearing organizations ("DCOs") to, among other things, address certain risk management and reporting obligations, clarify the meaning of certain provisions, simplify processes for registration and reporting, and codify existing CFTC staff relief and guidance (collectively, "Proposed Rules").[1]

About OCC

OCC, founded in 1973, is the world's largest equity derivatives clearing organization. In addition to clearing other products, OCC clears exchange-listed securities options as the sole clearing agency for all U.S. options exchanges. OCC operates under the jurisdiction of both the Securities and Exchange Commission ("SEC") and the CFTC. In July 2012, the Financial Stability Oversight Council designated OCC as a systemically important financial market utility ("SIFMU") under Title VIII of the Dodd-Frank Act. As a SIFMU, OCC is also subject to oversight by the Board of Governors of the Federal Reserve System.

Summary

We support the Commission's efforts to review its "rules, regulations, and practices to make them simpler, less burdensome, and less costly"[2] pursuant to Project KISS, and we recognize the need for the Commission to make progress on G-20 regulatory reforms by mitigating certain risks associated with the central clearing of derivatives through DCOs. Generally, we agree with the approach taken by the Commission in the Proposed Rules, and with many of the proposed amendments. Particularly, we support the Commission's efforts to codify existing practices and expectations, update regulation text to more specifically express the Commission's expectations, and align the Commission's regulations with those of other regulators. However, we offer comments on certain amendments that would place significant new requirements on DCOs, request clarification on the language and intent of certain amendments,

[1] RIN 3038-AE66 Derivatives Clearing Organization General Provisions and Core Principles (April 29, 2019), 84 FR 22226 (May 16, 2019) ("Release").
[2] Release at 4.

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and suggest changes to certain amendments to reduce operational and administrative burdens on DCOs without compromising the Commission's policy objectives. Our specific comments on the Proposed Rules are discussed in more detail below.

Enterprise Risk Management

I. A DCO's Chief Risk Officer should be permitted to serve as the enterprise risk officer, and the enterprise risk officer should be permitted to report to a DCO's board of directors, a board committee, or the senior officer responsible for the DCO's clearing activities

The Commission has proposed new § 39.10(d)(4), which would require a DCO to identify as its enterprise risk officer an appropriate individual that exercises the full responsibility and authority to manage the DCO's enterprise risk management function, and who would be required to have the authority, independence, resources, expertise, and access to relevant information necessary to fulfill the responsibilities of such position.[3] The Commission further requested comment on whether the enterprise risk officer should be required to report directly to the board of directors of the of the organization for which the enterprise risk officer is responsible for managing the risks.

We support identifying an enterprise risk officer and believe that, generally, the enterprise risk officer should report directly to the board of directors of the organization for which the enterprise risk officer is responsible for managing the risks, or to an appropriate committee of the board of directors (such as a risk committee). This helps to ensure the independence of the enterprise risk officer and supports the "three lines of defense" enterprise risk model that has become an industry standard, while enabling a DCO's board of directors to have informed, independent assessments of the DCO's enterprise risk in discharging the board's fiduciary responsibilities.

However, we also believe the Commission should consider these reporting lines in conjunction with its view on proposed § 39.10(b), in which the Commission stated that it "does not intend to be overly prescriptive by requiring specific standards and methodologies. A DCO should develop an enterprise risk management program that works best for its specific risk exposures, product types, customer base, market segment, and organizational structure, among other things, as long as the program meets the proposed minimum standards and any other legal and regulatory requirements."[4] Viewed in this context, we believe a DCO should have the discretion to determine whether the enterprise risk officer should report directly to the board of directors, a committee of the board, or the senior officer responsible for a DCO's clearing activities, similar to the proposed reporting lines for a DCO's chief compliance officer under proposed § 39.10(c)(1)(ii).[5] We believe this is appropriate given that each DCO has a separate organizational structure and risk management framework that could make any of these alternatives reasonable.

The Commission further requested comment on whether a DCO's chief risk officer ("CRO") should be permitted to also serve as its enterprise risk officer. We believe a DCO's CRO should be permitted to also serve as its enterprise risk officer. Consistent with the Commission's expectations regarding proposed § 39.10(d)(4), a DCO's CRO is typically the individual with the greatest authority, independence, resources, expertise, and access to relevant information necessary to fulfill the responsibilities of managing the DCO's enterprise risk management function. Furthermore,

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[3] *Id.* at 27.
[4] *Id.* at 26.
[5] *See Id.* at 21.

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a DCO's CRO typically reports to the DCO's board of directors or a committee of the board, which is consistent with the Commission's proposed reporting lines we describe above. Accordingly, we believe that a DCO's CRO should be permitted to serve as the enterprise risk officer. However, consistent with the Commission's stated intent to not be overly perspective, we also note that a DCO may determine someone other than the CRO should serve as the enterprise risk officer, and a DCO should have the flexibility to determine the appropriate individual.

Calculation of Largest Financial Exposure and Stress Tests

II. A DCO should calculate its largest financial exposure net of the clearing member's required initial margin, and other required margin the clearing member may have on deposit

The Commission has proposed new § 39.11(c)(2)(i)(A) that would require a DCO to calculate, for purposes of satisfying § 39.11(a)(1), its largest financial exposure net of the clearing member's required initial margin amount on deposit; i.e., a DCO may not take into account excess collateral on deposit or initial margin not yet received.[6] The Commission has further proposed removing § 39.11(b)(1)(i), "which permits margin to be used to satisfy the requirements of § 39.11(a)(1), because the required initial margin on deposit for the clearing member will be applied before determining the largest financial exposure for the DCO in extreme but plausible market conditions. Therefore, the margin would not be available to also cover the exposure."[7]

We support the Commission's proposal and believe this calculation should also be net of any required margin on deposit that is related to position exposure (i.e., any required margin other than variation margin), whether or not such margin is classified as "initial margin." A DCO may require a clearing member to deposit margin resources that, while not classified as "initial margin" per se, are nonetheless required margin resources on deposit (as opposed to variation margin). We believe that taking such resources into consideration when calculating a DCO's largest financial exposure aligns with the Commission's intent to "focus a DCO's analysis on the resources that would actually be available to the DCO during times of stress," since these additional resources are in fact currently on deposit and would be available to a DCO during times of stress, and would still allow a DCO to "take into account only prefunded financial resources and ignore voluntary excess contributions."[8] Accordingly, we suggest the final regulation text state that a DCO should calculate its largest financial exposure net of a clearing member's "required margin, excluding variation margin" – rather than "initial margin" – on deposit. Furthermore, while we support excluding excess margin on deposit as a conservative measure in calculating a DCO's largest financial exposure under § 39.11, we also assert that a DCO maintains, and must continue to maintain, the ability to hold such "excess margin" as an additional margin requirement pursuant to its rules when it deems necessary.

We also support the removal of § 39.11(b)(1)(i), which would correspond with netting margin resources prior to calculating the financial resources available to a DCO under § 39.11(a)(1), under the assumption that, as described above, a DCO could also net other margin it requires a clearing member to have on deposit when calculating its largest financial exposure. This would ensure that all a DCO's currently available resources are accurately accounted for in such calculations. If the Commission does not believe a DCO should net such additional required margin on deposit, we request the Commission interpret such additional required margin on

[6] *Id.* at 29.
[7] *Id.*
[8] Release at 29.

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deposit as "[a]ny other financial resource deemed acceptable by the Commission" under current § 39.11(b)(1)(vi) and proposed § 39.11(b)(1)(v). Furthermore, we suggest that the Commission clarify that a DCO should not include margin on deposit when determining whether it must report a decrease in financial resources under § 39.19(c)(4)(i) or a decrease in liquidity resources under proposed § 39.19(c)(4)(ii), which we discuss further below in Item XIII.

Margin Requirements

III. The Commission should not require each DCO to collect and report customer-level futures information daily, which could entail significant, industry-wide technological, operational, and rule changes

Currently, § 39.13(g)(8)(i)(B) provides that, for purposes of calculating the gross initial margin requirement for clearing members' customer accounts, a DCO may require its clearing members to report the gross positions of each individual customer to the DCO, or it may permit each clearing member to report the sum of the gross positions of its customers to the DCO. Regulation 39.13(g)(8)(i)(C) further provides that for purposes of paragraph (g)(8), a DCO may rely, and may permit its clearing members to rely, upon the sum of the gross positions reported to the clearing members by each domestic or foreign omnibus account that they carry, without obtaining information identifying the positions of each individual customer underlying such omnibus accounts. Related § 39.19(c)(1)(i) requires a DCO to report to the Commission daily margin, cash flow, and position information for each clearing member, by house origin and by each customer origin. The Commission has proposed amending § 39.13(g)(8)(i)(B) to require a DCO have rules that require its clearing members to provide reports to the DCO each day setting forth end-of-day gross positions of each beneficial owner within each customer origin of the clearing member,[9] and proposed amending § 39.19(c)(1)(i) to require a DCO additionally report to the Commission margin, cash flow, and position information by individual customer account,[10] noting that this "is information the DCOs currently provide."[11] The Commission has further proposed amending § 39.19(c)(1)(i)(D) "to specify that, with respect to end-of-day positions, DCOs must report the positions themselves (i.e., the long and short positions) as well as risk sensitivities and valuation data for these positions."[12]

We disagree with these proposed amendments, and believe they would introduce a significant shift in the burden to maintain customer-level records, which is the responsibility of Futures Commission Merchants ("FCMs") and Introducing Brokers, to a DCO. CFTC regulations make clear that FCMs and Introducing Brokers are responsible for maintaining records of their customers, and of those customers' transactions.[13] Conversely, a DCO has no direct exposure to these individual customers; rather, a DCO's direct exposure is to its clearing members. Should the Commission wish to obtain information on every position for every futures customer, it should introduce such requirements through its regulations applicable to FCMs and Introducing Brokers. Absent a compelling public policy reason to instead impose this significant new burden on each DCO, we do not believe the Commission should do so. Furthermore, as a practical matter virtually every FCM utilizes multiple DCOs, directly or indirectly, in the conduct of its business. Consequently, requiring a DCO to collect and report this information to the CFTC does not in fact

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[9] *Id.* at 43.
[10] *Id.* at 59.
[11] *Id.*
[12] *Id.*
[13] *See, e.g.,* 17 CFR §§ 1.20, 1.35, 1.37(a).

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allow the Commission to appropriately understand the risks associated with individual customers without further aggregating the data that various DCOs receive from an individual FCM.

Though the Commission states that DCOs currently provide it with margin, cash flow, and position information by individual customer,[14] OCC does not provide the Commission with margin and position information for each individual futures customer, and it does not provide cash flow information for any individual futures customer. If the Commission would expect a DCO to obtain this information from the DCO's clearing members and in turn provide it to the Commission, OCC and its clearing members would need to make significant operational changes to obtain this information and report it daily, and OCC would need to make corresponding rule changes. If the Commission would expect a DCO to implement systems to independently aggregate, validate, and calculate this information for each individual customer, OCC would also need to implement technological and operational changes that it anticipates being a costly, long-term effort. In either case, we do not believe the Commission should introduce these proposed regulations for the reasons we state herein. Alternatively, we request that the Commission consider the effective date of these proposed regulations in context of the significant changes they would require, clarify how it would expect a DCO to calculate cash flows[15] and valuation data, and clarify whether it would generally expect a DCO to provide the Commission with customer data in a different format than it currently does. We also disagree that a DCO should calculate risk sensitivities on the Commission's behalf.

For futures positions, OCC obtains customer information from our clearing members through our Customer Gross Margining ("CGM") process. Through CGM, our clearing members submit customer position data on a customer-level gross basis. This process does not identify positions by beneficial owner for each individual customer account. In many cases, our clearing members also do not have information on the individual customer positions because they receive omnibus position data from Introducing Brokers, which does not identify individual customer positions. To be able to identify futures positions by individual customer, our clearing members and their Introducing Brokers would have to change their current operating models for daily customer information reporting. We would also have to change our rules and processes regarding position reporting and CGM for all futures positions submitted by our clearing members, whether obtained from an Introducing Broker or directly from a customer. Furthermore, and as noted above, if a DCO would be expected to independently aggregate, validate, and calculate this information for each individual customer we would have to implement substantial technological and operational changes to connect this position information to individual customers across clearing members, then perform daily calculations on this data in some format specified by the Commission. This is in addition to the practical challenges the Commission would face in somehow connecting individual FCMs, Introducing Brokers, and customers across DCOs

As the Commission notes in the proposal,[16] in the Commission's previous attempts to introduce required daily reporting of individual customer positions, including in the adopting release of these reporting requirements under Part 39 of the Commission's regulations, the industry has expressed the same concerns we express above; for those reasons the Commission

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[14] *Id.*

[15] Specifically, we request the Commission specify whether "cash flows" would include customer-level (i) initial margin, (i) mark-to-market changes in value and (iii) changes in collateral value; or some other combination of components.

[16] *Id.* at 42.

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has opted to not require this level of reporting.[17] As a result, the Commission adopted § 39.19(c)(5)(iii), requiring DCOs to provide this information to the Commission upon request, in a manner and format specific by the Commission.[18] In the same adopting release, the Commission noted how in the past it had worked cooperatively with DCOs to obtain such information related to cleared swap positions, and described how it might, for example, work with DCOs on a case-by-case basis to obtain such information "with respect to a particular clearing member, customer, . . . product[,] . . . day, month, or until further notice by the Commission."[19] In the eight years since the adoption of § 39.19(c)(5)(iii), the Commission has not requested this information from OCC; however, we remain ready to work cooperatively with the Commission to provide this information upon request in a manner and format specified by the Commission.

Though other DCOs are required to report daily on individual customer-level information through other CFTC regulations, such as those related to swaps,[20] OCC does not clear swaps or engage in activities that would subject us to any such reporting obligations. Therefore, we have not been required to implement systems to collect and report customer-level information daily. Furthermore, while some DCOs may currently collect and report customer-level data on swaps participants, the regulatory requirements imposed on swap participants largely preclude retail investors, and the swap participant market is comprised of a relatively small number of sophisticated customers, many of which are institutional. Conversely, there is a much larger market of exchange-traded futures customers, many of which are retail investors.

The Commission states in the Proposed Rules that it intends to use this customer-level information "to implement a range of different methodologies to conduct risk surveillance of cleared derivatives exposures, some involving full revaluation of portfolios and others relying on delta ladders and other risk sensitivities," and that the information "will enable Commission staff to run stress tests; identify concentration and risk in currencies and in maturity buckets; perform back testing; validate guaranty funds; and validate variation margin."[21] OCC, a self-regulatory organization that already conducts these types of risk monitoring activities, understands why the Commission would find value in also conducting such activities, and with customer-level data. However, we request the Commission further evaluate the costs and benefits associated with requiring DCOs, their clearing members, and other upstream participants to implement the changes necessary to provide the Commission with this information so that the Commission can perform this enhanced surveillance and stress testing on top of what DCOs and their clearing members already perform. Alternatively, we request the Commission consider the timeline for adopting these requirements with respect to when it would implement such additional surveillance and stress testing activities. As stated above, we also request the Commission clarify the format in which it expects a DCO to provide this information.

Specifically regarding the risk sensitivities that the Commission would request under proposed § 39.19(c)(1)(i)(D), we disagree that a DCO should calculate such information on the Commission's behalf. Risk sensitivities may be calculated in a variety of ways, and such calculations are largely dependent on the choice of assumptions underlying these calculations. Under the Proposed Rules, each DCO would be already be providing the Commission with the underlying data it needs to calculate risk sensitivities based on its own choice of assumptions,

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[17] Derivatives Clearing Organization General Provisions and Core Principles, RIN 3038-AC98, 76 Fed Reg. 69376-77.
[18] *Id.* at 69377.
[19] *Id.*
[20] *See* Release at 42-43.
[21] *Id.* at 60.

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and the Commission has stated it would use this data in connection with the Commission's own risk surveillance and stress testing systems. Therefore, the Commission would be able to utilize these systems to calculate risk sensitivities from the underlying data in a consistent fashion, without requiring each DCO to separately provide this information.

In the estimated cost-benefit analysis on proposed § 39.13(g)(8)(i)(B), the Commission notes that DCOs and their clearing members may incur "nominal" costs but does not specify the basis for determining that such costs are "nominal."[22] In the estimated cost-benefit analysis on proposed § 39.19(c)(1)(i), the Commission notes that such changes may entail DCOs incurring "costs associated with making technical changes to accommodate these updates," and requests estimates from DCOs on such costs.[23] We disagree with the Commission's statement that the costs associated with proposed § 39.13(g)(8)(i)(B) are merely nominal. As described above, OCC, our clearing members, and their Introducing Brokers and/or customers would be required to make significant operational changes and associated rule changes to implement and enforce daily collection of this information. Additionally, we may be required to build the infrastructure necessary to independently aggregate, validate, and calculate this information if so expected by the Commission. As for proposed § 39.19(c)(1)(i), we would be required to build the infrastructure necessary to support this daily reporting. To provide a realistic estimate of the costs OCC would incur and the timeline to implement these changes, the Commission must first clarify its expectations on the aspects we describe above, which would determine the extent of the infrastructure OCC would be required to implement.

We are concerned that the significant changes OCC and other industry participants would be required to undertake because of the proposed amendments, and the significant expected costs associated therewith, are not the spirit of the Commission's "Project KISS" initiative, the intent of which we understand is generally to make the CFTC's rules, regulations, and practices simpler, less burdensome, and less costly; streamline and clarify existing regulations; and codify existing expectations and practices. Accordingly, we suggest the Commission remove these proposed amendments from the Proposed Rules, if not based on our objections and concerns described above, then based on the stated intent of the Proposed Rules, from which these proposed amendments significantly deviate. Instead, the Commission should introduce any such proposed amendments as a separate proposed rulemaking in consideration of these objections and concerns, after a more extensive cost-benefit analysis, and after the Commission has completed development of the risk surveillance and stress testing systems that would enable it to use the additional information each DCO would be reporting daily. If the Commission chooses to adopt the proposed amendments presently, we request an extended time for the amendments to become effective to allow for the requisite technological, operational, and rule changes.

IV. A DCO should only be required to report customer legal entity identifiers to the extent it receives this information from its clearing members, and should not be expected to independently validate this information

The Commission has proposed amending § 39.19(c)(1)(i) to require a DCO to provide any legal entity identifiers ("LEIs") and/or internally-generated identifiers within each customer origin for each clearing member.[24] While we support providing such information to the Commission to the extent we receive this information from our clearing members, we note that CFTC regulations do not require that our clearing members obtain LEIs from their customers, nor do CFTC

[22] *Id.* at 135-136.
[23] *Id.* at 146-147.
[24] *Id.* at 59.

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regulations require that the customers of our clearing members obtain LEIs. Therefore, we do not require that our clearing members provide customer LEIs along with the margin and position information they are currently required to provide us, nor are we in a position to require that our clearing members provide an LEI for every customer. In fact, because the Commission does not require an LEI for most futures customers, we believe many futures customers of our clearing members do not have an LEI.

Furthermore, because we must rely on our clearing members to provide optional LEI data, we do not independently validate that clearing members have provided the correct LEI for each individual customer. We are concerned that any expectation by the Commission for a DCO to independently validate the LEIs provided by a DCO's clearing members would be impractical, since DCOs do not have direct relationships with their clearing members' customers. Attempts to obtain and validate customer identifiers could also expose a DCO to personal information that would subject the DCO to privacy requirements that are otherwise inapplicable to it.

Accordingly, we suggest the final regulation clarify that a DCO must only provide the Commission with an LEI to the extent the DCO's clearing members provide it with such information. We recognize that this proposed amendment may assume that each customer account will already have an individual identifier – whether an LEI or some internal identifier – because of the proposed amendments to § 39.13(g)(8)(i)(B) and § 39.19(c)(1)(i), which would require a DCO to collect and report on customer-level information. However, as discussed above, we do not believe that such collection and reporting requirements should be introduced presently. Furthermore, even if all customer accounts would be associated with either an LEI or some internal identifier provided by clearing members, we believe the Commission should clarify that it would not require a DCO to obtain an LEI for each customer or independently validate this information.

V. A DCO should only be required to collect customer gross margin on an end-of-day basis

The Commission has proposed amending § 39.13(g)(8)(i) to require a DCO to collect customer initial margin from its clearing members on a gross basis only during its end-of-day settlement cycle, in light of the operational issues that may arise intraday, while strongly encouraging DCOs to collect customer initial margin from their clearing members on a gross basis during any intraday settlement cycle in which the DCOs collect customer initial margin, if they are able to calculate the margin accurately.[25] The Commission further requested comment as to whether this is the correct approach.[26] We support the Commission's approach to make this regulation focused on a DCO's end-of-day settlement process.

VI. The Commission does not need to add standards or further direction on how a DCO must establish customer initial margin requirements, or further clarify what would be considered "commensurate with the risk presented"

The Commission has proposed various amendments to § 39.13(g)(8)(ii) "to permit DCOs to continue the practice of establishing customer initial margin requirements based on the type of customer account and by applying prudential standards that result in FCMs collecting customer initial margin at levels commensurate with the risk presented by each customer account;" in doing

[25] *Id.* at 41.
[26] *Id.*

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so eschewing the application of any "bright-line test to determine the appropriate percentage by which customer initial margin requirements must exceed clearing initial margin requirements with respect to any particular types of customer accounts" and noting that "the circumstances for each DCO and the nature of its clearing members and their customers vary."[27] The Commission further requested comment as to whether it should add standards or further direction on how DCOs must establish customer margin requirements under § 39.13(g)(8)(ii), or should further clarify what would be considered "commensurate with the risks presented" by each customer account.

We support these proposed amendments and agree with the Commission's assessment that "one size fits all" criteria would not be appropriate, given that the circumstances of each DCO and the nature of its clearing members and their customers vary. Accordingly, DCOs are in the best position to determine in their reasonable discretion appropriate initial customer margin requirements, subject to certain minimum thresholds established by the Commission. We also believe that further clarification on what would be considered "commensurate with the risks presented" is unnecessary, and DCOs are able to use their own risk management tools and existing rules and regulatory guidance to determine how the risks presented by each customer account should be translated into initial margin requirements.

Other Risk Control Limits

VII. Difficult-to-liquidate positions should be addressed by a DCO's risk-based margin methodology rather than by risk limits

The Commission has proposed amending § 39.13(h)(1)(i) to clarify that the risk limits a DCO must currently impose on each clearing member should, in part, address positions that may be difficult to liquidate.[28] While we believe that a DCO's risk management framework should account for difficult-to-liquidate positions, the risk of difficult-to-liquidate positions is best addressed by a DCO's margin methodology. For example, OCC maintains a margin methodology that calculates a clearing member's margin requirements based on econometric modeling techniques. We believe that the margin requirements calculated by this methodology can more effectively account for the liquidity risk associated with specific positions held by specific clearing members, because these margin requirements can be tailored to the risks and particular attributes of each relevant product, portfolio, and market. These margin requirements can then serve as one input a DCO uses in determining the appropriate risk limits.

Cross-Margining Programs

VIII. The Commission's regulations should not be overly prescriptive in reviewing cross-margining programs, and particularly as relating to existing cross-margining programs

The Commission has proposed new § 39.13(i) to require a DCO seeking to implement a cross-margining program file rules for Commission approval under § 40.5 that contain, at a minimum: "(i) identification of the products that would be eligible for cross-margining, including product specifications or criteria that would be used to define eligible products; (ii) analysis of the risk characteristics of the eligible products; (iii) analysis of the liquidity of the respective markets for the eligible products, including the ability of clearing members and the [DCO] to

[27] *Id.* at 45.
[28] *Id.* at 48.

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offset or mitigate the risk of such products in a timely manner and proposed means for addressing insufficient liquidity; (iv) analysis of the availability of reliable prices for each of the eligible products; (v) financial and operational requirements that would apply to clearing members participating in the program; (vi) a description and analysis of the margin methodology that would be used to calculate initial margin requirements, including: (A) any margin reduction applied to correlated positions; and (B) information regarding the correlations between eligible products, including the stability of the relationship among the eligible products and the potential impact a change in the correlations could have on setting initial margin requirements; (vii) procedures the [DCO] would follow in the event of a clearing member default, including any loss-sharing arrangements; (viii) a description of the arrangements for obtaining daily position data with respect to products in the account; (ix) whether funds to support the cross-margined positions will be maintained together in one account or in separate accounts at each participating clearing organization; and (x) a copy of the agreement between the clearing organizations participating in the cross-margining program."[29] If one of the participant cross-margin clearing organizations is not a registered DCO or is organized outside of the United States, the Commission would also consider other factors.[30] The Commission further requested comment on whether there are other factors the Commission should consider or other information the Commission should request when evaluating cross-margining programs, and on whether it should follow a more or less detailed process in reviewing cross-margining programs than the rule submission process established under § 40.5.[31]

We support the Commission's intent to set clear expectations for the information it needs in reviewing cross-margining programs, and we recognize that the Commission, pursuant to its authority under Part 40 of the CFTC's regulations, already has the authority to request from a DCO any information the Commission deems necessary when reviewing a cross-margining program. However, we disagree that the Commission should specify certain criteria in its regulations, which reduces the Commission's flexibility to determine what types of information are necessary for it to review in specific circumstances. Particularly, we do not believe a DCO should be required to provide each of these types of information when it is requesting the Commission's approval to update an existing cross-margining program. Requiring a DCO to conduct analysis on factors unrelated to the change for it is requesting approval would create an unnecessary burden.

We are also concerned that certain of these proposed filing requirements may place undue burdens on DCOs. Specifically, proposed §39.13(i)(1)(i) would require a DCO to provide "identification of the products that would be eligible for cross-margining, including product specifications or criteria that would be used to define eligible products."[32] We request that the Commission clarify whether proposed §39.13(i)(1)(i) would define "product" the same as it would be defined in proposed § 39.19(c)(4)(xxvi), or if it would independently establish the expectation that a DCO file a proposed rule change each time it clears, for example, a new tenor of a futures product that is eligible for cross-margining. If the former, our comments on proposed § 39.19(c)(4)(xxvi) regarding the definition of "product" also apply here. If the latter, we believe this requirement would place an undue burden on a DCO to file a proposed rule change each time it plans to clear, for example, a new futures tenor that is eligible for cross-margining.

[29] *Id.* at 194-195.
[30] *Id.* at 50.
[31] *Id.*
[32] *Id.* at 194.

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We also note that the types of information the Commission would request pursuant to proposed § 39.13(i) are redundant to existing reporting and rule filing requirements under the Commission's other regulations. For example, proposed §39.13(i)(1)(ii)-(iv) would require a DCO to provide: "[a]nalysis of the risk characteristics of the eligible products;" "[a]nalysis of the liquidity of the respective markets for the eligible products, including the ability of clearing members and the [DCO] to offset or mitigate the risk of such products in a timely manner and proposed means for addressing insufficient liquidity;" and "[a]nalysis of the availability of reliable prices for each of the eligible products . . ."[33] A derivatives contract market ("DCM") is currently required to report to the Commission any new product it plans to list,[34] which would include this information on every product, including those eligible for cross-margining. Proposed § 39.13(i)(1)(vi) would require a DCO to provide a "description and analysis of the margin methodology that would be used to calculate initial margin requirements, including: (A) any margin reduction applied to correlated positions; and (B) information regarding the correlations between eligible products, including the stability of the relationship among the eligible products and the potential impact a change in the correlations could have on setting initial margin requirements . . ."[35] To the extent a new product requires a DCO to update its rules or the margin-setting methodology it has filed as a rule, a DCO is currently required to submit such changes to the Commission as a proposed rule change, so the Commission would have already received information on the product(s) through this method.[36] Proposed § 39.13(i)(1)(vii) would require a DCO to provide "[p]rocedures the [DCO] would follow in the event of a clearing member default, including any loss-sharing arrangements . . ."[37] A DCO's default management procedures are currently part of a DCO's rules, which are publicly available and filed with the Commission under Part 40 of the CFTC's regulations; further, any proposed changes to these procedures must currently be filed with the Commission for approval under Part 40.

Accordingly, we do not believe the Commission should specify certain criteria in proposed § 39.13(i) that a DCO must provide each time it wishes to implement a cross-margining program, particularly when a DCO is simply requesting to change an existing cross-margining program. Instead, the Commission should issue guidance on what information it may require in its review of a cross-margining program, which it now practically has through the Proposed Rules. Should the Commission nonetheless choose to specify such criteria in proposed § 39.13(i), such criteria should only apply when the Commission reviews a new cross-margining program, and not apply when the Commission reviews changes to an existing cross-margining program.

We also note that, historically, a DCO has been permitted to request approval of a cross-margining program through the Commission's self-certification process under § 40.6. However, proposed § 39.13(i) would require a DCO to submit such requests through a longer review process under § 40.5. We believe a DCO should continue to have discretion to determine whether to request approval under § 40.5 or § 40.6. Alternatively, while the Commission may desire additional time to review a new cross-margining program under § 40.5, we believe the more expedited process under § 40.6 is more appropriate for a DCO seeking to change an existing cross-margining program and request that the Commission only apply the § 40.5 review process to a new cross-margining program.

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[33] *Id.*
[34] *See* 17 CFR § 40.2-40.3.
[35] Release at 195.
[36] *See* 17 CFR § 40.5-40.6.
[37] Release at 195.

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Default Rules and Procedures

IX. The Commission should require that clearing members participate in a DCO's default testing, but a DCO should have broad discretion to determine whether a "sufficient portion" of clearing members is participating

The Commission has proposed amending § 39.16(b) to require that a DCO include clearing members in a test of the DCO's default management plan on at least an annual basis and, in doing so, ensure that a "sufficient portion of its clearing membership participates in such testing and is therefore prepared to support the DCO's default management efforts."[38] We support this proposal. However, we believe a DCO should have broad discretion to determine whether a "sufficient portion" of its clearing membership is participating in default testing. For example, the number of clearing members that participate in a default management test is not necessarily indicative of whether a DCO's default management plan has been "tested effectively" in accordance with the Commission's expectations around proposed § 39.16(b).[39] Other factors, such as selecting clearing members that will most likely be active participants in the default test and will therefore add the most value, must also be considered. Accordingly, "sufficient portion" should not be based solely on the number of clearing members participating in the default test, and the DCO conducting a default test is in the best position to determine what constitutes participation by a "sufficient portion" of its clearing membership.

X. The Commission should not define exchange-traded products as "substantial or complex positions" that would trigger convening a default committee

The Commission has proposed amending § 39.16(c)(1) "to require a DCO to have a default committee that would be convened in the event of a default involving substantial or complex positions to help identify market issues with any action the DCO is considering."[40] Furthermore, such default committee "would be required to include clearing members and could include other participants to help the DCO efficiently manage the house or customer positions of the defaulting clearing member."[41] We do not believe such a default committee would enable a DCO to more efficiently manage exchange-traded products in a default; therefore, "substantial or complex positions" under proposed § 39.16(c)(1) should not include exchange-traded products. Furthermore, the Commission should not define exchange-traded products[42] as "substantial" positions based solely on the volume of defaulted positions. As described below, we believe the default management tools currently available to a DCO enable a DCO to efficiently manage a defaulting clearing member's exchange-traded products.

For exchange-traded products, OCC maintains two primary tools to close-out a defaulting clearing member's positions: (i) conducting an auction in which clearing members may competitively bid on a defaulting clearing member's position(s), and (ii) a relationship with a liquidation agent that specializes in obtaining the best price in the most efficient manner possible for a defaulting clearing member's positions(s). These two tools are designed to obtain fair prices for such positions based on the current prices the market is willing to bear. Accordingly, we do not believe a cross-representational default committee for listed products would better enable a DCO

[38] *Id.* at 55.
[39] *Id.*
[40] *Id.* at 55-56
[41] *Id.* at 56.
[42] We would interpret "exchange-traded products" to also include cleared stock loan positions.

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to close-out such positions.

When testing OCC's default management tools – and particularly auctions – we have also found that such tools can efficiently facilitate large closeouts of positions in listed products. OCC has conducted default management tests assuming the defaults of our larger clearing members that, based on their relative sizes, would likely be considered to have "substantial" positions in many listed products. We have not found that effective close-out of such positions creates issues that are peculiar to the number and size of the positions. However, we believe that such testing remains the most efficient and effective way to identify issues that may arise in closing out exchange-traded products.

We also note that listed products typically assume a two-day margin period of risk, and therefore a DCO is expected to close-out defaulted positions within this two-day horizon. In the proposal, the Commission states that such default committees are intended to "efficiently manage the house or customer positions of the defaulting clearing member."[43] We are concerned that convening a default committee with various external stakeholders, especially in a stressed or highly volatile market, would more likely promote inefficiency due to the logistical difficulties involved in assembling the committee, then obtaining and incorporating its feedback while conducting all other close-out activities within a two-day period.

XI. A DCO should be required to publish a public notice on its website following a clearing member default, but such notice should be provided "promptly" rather than "immediately" following

The Commission has proposed amending § 39.16(c)(2)(ii) to require a DCO provide immediate public notice on the DCO's website of a declaration of default.[44] The Commission further requested comment on whether the timing of an immediate public announcement by a DCO following a clearing member default would potentially impact the market or the DCO's ability to manage the default.[45] We support the Commission's goal of providing the public with timely notice following a clearing member default. However, we suggest the Commission consider whether "prompt" notice would be more appropriate, to match the timing of other activities a DCO must perform pursuant to a default management plan[46] and the responsibility of a clearing member to provide a DCO with prompt notice if its becomes insolvent.[47] Generally, we note that a DCO must engage in several activities in the wake of a clearing member default, which include determining the cause of the default and the expected impacts on the market. A requirement for a DCO to provide immediate public notice may result in a DCO notifying the public of a default while the DCO still has incomplete information on the default, which may trigger market panic before the DCO is able to understand the circumstances giving rise to the default and the impact of the default on the market.

[43] *Id.*
[44] *Id.*
[45] *Id.*
[46] 17 CFR § 39.16(c)(2)(ii).
[47] 17 CFR § 39.16(d)(1).

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XII. A DCO should take into consideration other indicators of active participation in a market when determining whether a clearing member may be forced to bid for a portion of, or accept an allocation of, a defaulting clearing member's positions

The Commission has proposed amending § 39.16(c)(2)(iii)(C) to clarify that a DCO cannot require a clearing member to bid for a portion of, or accept an allocation of, a defaulting clearing member's positions that are not proportional to the size of the bidding or accepting member's positions in the same product class at the DCO, and that a DCO should use a clearing member's initial margin requirements to determine such proportionality.[48] The Commission has further requested comment on whether the Commission should require a DCO to take into consideration other indicators of active participation in a market, such as open interest, volume, and/or other criteria.[49]

While we support the Commission's stated intent that a "clearing member that wishes to voluntarily bid for or accept more than its proportional share should be allowed to do so, provided that the clearing member has the ability to manage the risk of the new positions,"[50] we believe that the amount of initial margin a firm holds at a DCO for a given product or product class is not always a good indicator of that firm's qualification to bid on or accept an allocation of certain products or product classes. Specifically, we note that many firms have sophisticated trading methods in place that are designed to minimize their one-sided exposures to certain positions, and accordingly their initial margin requirements. Therefore, a clearing member's initial margin on deposit for a product or product type may belie the firm's capacity to bid for or be allocated certain positions. Accordingly, we believe that a DCO should be given discretion to consider several criteria, including a clearing member's initial margin for a given product or product class, open interest, volume, and risk management capabilities. Alternatively, should the Commission choose not to provide a DCO with discretion to consider any number of factors, we believe the Commission should at least add a clearing member's risk management capabilities to the indicators a DCO should take into consideration.

<u>Other Reporting</u>

XIII. Decrease in financial resources reporting under § 39.19(c)(4)(i) and decrease in liquidity resources reporting under proposed § 39.19(c)(4)(ii) should not include changes in margin on deposit, or alternatively should account for changes in the clearing member group with the highest projected stress test losses

Current § 39.11(a)(1) requires that a DCO maintain sufficient financial resources to meet its financial obligations to its clearing members notwithstanding a default by the clearing member group creating the largest financial exposure for the DCO in extreme but plausible market conditions. Current § 39.19(c)(4)(i) further requires that, should a decrease of 25 percent or more in the total value of financial resources available to satisfy the requirements of § 39.11(a)(1)[51] occur from the value as of the close of the previous business day, or from the last quarterly report of financial resources a DCO must submit under § 39.11(f), the DCO must report such decrease within one business day after the 25 percent threshold is breached. The Commission has proposed new § 39.19(c)(4)(ii) to introduce essentially the same reporting requirement for liquidity

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[48] Release at 56-57.
[49] *Id.* at 57.
[50] *Id.* at 56.
[51] A proposed amendment to § 39.11(c)(4)(i) would also reference the financial resources requirements under § 39.33(a), which is applicable to systemically important DCOs ("SIDCOs") and Subpart C DCOs.

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resources available to satisfy the requirements under § 39.11(a)(1) (for DCOs) or § 39.33(c) (for SIDCOs and Subpart C DCOs). While we support these reporting requirements in principle, we suggest the calculations of financial and liquidity resources that determine the reporting requirements under current § 39.19(c)(4)(i) and proposed (c)(4)(ii) should account for the potential large variations in initial margin among a DCO's largest clearing members, and therefore not include margin on deposit, consistent with the Commission's proposed changes to § 39.11. Should the Commission determine that such reporting must account for margin on deposit, we alternatively suggest that a DCO compare the financial and liquidity resources of the clearing member group with the highest projected stress test losses to that same clearing member group's resources on the previous day or quarter-end (as applicable), rather than whichever clearing member group had the highest projected stress test losses on the previous day or quarter-end.

We believe the Commission's intent in promulgating § 39.19(c)(4)(i) and proposed (c)(4)(ii) was to require a DCO to notify the Commission when the financial and/or liquidity resources it has available to manage a clearing member default have substantially decreased from the previous day, or from the previous quarter-end on a cumulative basis. We agree with this intent, and that a DCO should be required to timely notify the Commission in the event it experiences a significant decrease in the resources it has available to manage a default in a projected stress scenario. However, the way a DCO must determine the resources it has available to manage its largest exposure does not consider that from day-to-day different clearing member groups may produce the highest stress test losses on any specific day. This is particularly true if a DCO's largest clearing member groups are relatively similar in size, which may mean that the clearing member group with the highest projected stress test losses fluctuates on a regular basis because of ordinary changes in market activity.

These calculations also do not consider that clearing member groups of similar size may have significantly different initial margin requirements, based on the specific positions held by those clearing member groups and the initial margin requirements the DCO has set for those positions based on their projected risk characteristics under ordinary market conditions. The clearing member group producing the highest projected stress test losses on any particular day may have significantly lower initial margin requirements – and thus significantly less initial margin on deposit at the DCO – as compared to the clearing member group that was identified on the previous day or at the previous quarter-end. These initial margin deposits are currently used in the calculations of resources available to a DCO under § 39.11(a)(1) (which the Commission has proposed to change and which we discuss above), and in many cases constitute a significant part of those calculations. Because the current and proposed reporting requirements do not consider that a DCO may be comparing the resources held for clearing member groups with potentially large differences in initial margin, DCOs are therefore required to report "false positives" under current § 39.19(c)(4)(i) and proposed (c)(4)(ii). We expect that proposed § 39.19(c)(4)(ii) would create the same problem in relation to a DCO's decrease in liquidity resources reporting, as clearing member groups with higher initial margin on deposit would, generally, similarly deposit more liquid resources as margin for the DCO to use in managing a potential default.

However, by making these reporting requirements consistent with the Commission's proposal to net margin on deposit prior to determining the financial/liquidity resources available to a DCO to meet its requirements under § 39.11(a)(1) and (e)(1), the Commission could eliminate this reporting issue and align § 39.19(c)(4)(i) with the Commission's intent when it promulgated the regulation, and similarly align proposed § 39.19(c)(4)(ii) with what we believe is the Commission's intent in promulgating the proposed regulation. We also request that the Commission update its Part 39 reporting templates to correspond with the proposed changes to §

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39.11. Alternatively, should the Commission determine that a DCO must include margin on deposit when determining whether it must report under § 39.19(c)(4)(i) or proposed (c)(4)(ii), we believe the Commission could also prevent the issues we identify above by specifying that a DCO should compare the resources of the clearing member group with the highest projected stress test losses to that same clearing member group's resources on the previous day or quarter-end (as applicable). This would result in a DCO not being required to compare the total financial and liquidity resources of clearing member groups with potentially large differences in initial margin.

XIV. A DCO should only report to the Commission when it changes settlement banks, and should have broad discretion to determine what settlement bank issues are "material"

The Commission has proposed new § 39.19(c)(4)(xiv), "which would require a DCO to report a change in its arrangements with any settlement bank used by the DCO or approved for use by the DCO's clearing members."[52] The Commission has also proposed new § 39.19(c)(4)(xv), "which would require a DCO to report to the Commission no later than one business day after learning of any material issues or concerns regarding the performance, stability, liquidity, or financial resources of any settlement bank used by the DCO or approved for use by the DCO's clearing members."[53]

While we support proposed § 39.19(c)(4)(xiv) generally, we believe a DCO should only be required to report under the proposed regulation if the DCO either begins using a new settlement bank or ceases to use an existing settlement bank. We do not believe a DCO should be required to report on any change in its arrangements with an existing settlement bank, because this could result in routine operational changes triggering a reporting requirement, which would impose an administrative burden on each DCO while having a negligible effect on the Commission's policy objective of "monitoring a DCO's compliance with §39.14(c)."[54] For example, proposed § 39.19(c)(4)(xiv) as drafted could result in a DCO being forced to report to the Commission each time a list of the DCO or bank operational personnel authorized to act on behalf of each party is updated; or each time such individuals' contact information is updated. We do not believe such reporting would aid the Commission in conducting its oversight and would only serve to waste DCO and CFTC resources involved in compiling, submitting, and reviewing such reports. Accordingly, we believe that only requiring a DCO to report when it changes the settlement banks it uses helps the Commission achieve its stated policy objective while not introducing unnecessary reporting requirements.

We also support § 39.19(c)(4)(xv) and suggest that a DCO should have broad discretion to determine what is a "material" issue or concern with a settlement bank. A DCO may encounter routine operational issues with settlement banks that do not ultimately affect the DCO's beliefs on the "performance, stability, liquidity, or financial resources" of those banks, and accordingly should not be expected to report to the Commission on such issues.

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[52] Release at 65.
[53] *Id.* at 65-66.
[54] *Id.* at 65.

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XV. We support the Commission's proposed requirement to report on margin model issues, and request the Commission clarify the proposed reporting requirement

The Commission has proposed new § 39.19(c)(4)(xxiv), which would require a DCO to report to the Commission within one business day "any issue that occurs with a DCO's margin model, including margin models for cross-margined portfolios, that affects the DCO's ability to calculate or collect initial margin or variation margin."[55] We support this proposal, and the Commission's goal to be timely notified of unanticipated issues with the functioning of a DCO's margin model that impacts the DCO's ability to calculate or collect initial margin or variation margin.

We also request the Commission's clarify its expectations on what a DCO should report to the Commission under proposed § 39.19(c)(iv)(xxiv). Specifically, we note that OCC, a DCO that is also regulated by the SEC, must currently report significant issues related to its margin model to the SEC under Regulation Systems Compliance and Integrity ("Reg SCI").[56] Furthermore, OCC must report such issues under Reg SCI immediately upon "having a reasonable basis to conclude" that an event occurred which would trigger such reporting obligation,[57] then within 24 hours following the initial notice submit a written report to the SEC containing certain information describing the event and OCC's assessment thereof.[58] We request the Commission clarify whether submitting to the Commission the same "24 hour notice" we must currently submit to the SEC under Reg SCI would satisfy the Commission's expectations on proposed § 39.19(c)(4)(xxiv).

XVI. A DCO should not be required to provide 30 days' prior notice to the CFTC for new products

The Commission has proposed new § 39.19(c)(4)(xxvi), which would require a DCO to provide notice to the Commission at least 30 days prior to accepting a new product for clearing. Such notice would include: "(1) a brief description of the new product; (2) the date on which the DCO intends to begin accepting the new product for clearing; (3) a statement as to whether the new product will require the DCO to submit any rule changes pursuant to §§ 40.5 or 40.6; (4) a statement as to whether the DCO has informed, or intends to inform, its clearing members and/or the general public of the new product and, if written notice was given, a web address for or copy of such notice; and (5) an explanation of any substantive opposing views received from such outreach and how the DCO addressed such views or objections."[59] The Commission further requested comment on whether it should define "product" in the context of the proposed regulation.[60]

We do not believe the Commission should introduce this reporting requirement. The listing of a new product is a process driven entirely by each DCM; as such, each DCM is traditionally responsible for providing notice of the new product to the Commission. Currently, each DCM follows a certification process under § 40.2 (or an alternative, voluntary process under § 40.3) to list a new product for trading. To the extent listing a new product would require a DCM to change its rules, the DCM must also submit a proposed rule change to the Commission under § 40.5 or §

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[55] *Id.* at 67.
[56] *See* 17 CFR § 242.1000 *et seq.*
[57] 17 CFR § 242.1002(b)(1).
[58] 17 CFR § 242.1002(b)(2).
[59] Release at 68.
[60] *Id.* at 68-69.

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40.6. Together, these regulations enable a DCM to submit a new product between one (if no rule change) and ten (if a rule change) days before it would list the product, which provides the Commission with notice of a new product a DCM plans to list while also providing a DCM with flexibility to list its products in an efficient and timely manner. However, proposed § 39.19(c)(4)(xxvi) would require a DCO to notify the Commission, on average, three to four weeks before a DCM must first notify the Commission of its own product. This would effectively override the listing certification process under §§ 40.2-40.3 and the self-certification process under § 40.6 for new products, hinder a DCM's ability to bring new products to market in a timely and efficient manner, and shift a DCM's business discretion to determine an efficient timeline for its new products to a DCO's regulatory requirement.

Furthermore, while we do not believe the Commission should introduce this reporting requirement for the reasons we list above, should the Commission choose to nonetheless adopt this requirement, we believe it should define "product" narrowly. Specifically, we believe the Commission should define "product" under any such reporting requirement as a new type of underlying for which futures products have never been traded. We believe such a definition would mitigate the undue burden this proposed requirement would place on each DCO and DCM, while serving to provide a longer notice period for the launch of products on new types of underlyings such as bitcoin futures that were launched at the end of 2017, stated in the Proposed Rules by then-Chairman Giancarlo as the basis for the Commission's proposed reporting requirements.[61]

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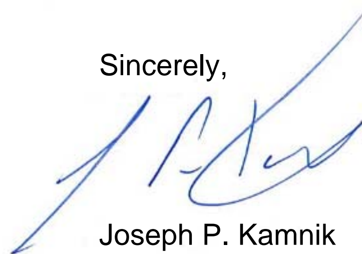
We thank the Commission for the opportunity to provide comment on the Proposed Rules. If you have any questions, please do not hesitate to contact me at 312.322.7570, or JKamnik@theocc.com. We would be pleased to provide the Commission with any additional information or analyses that might be useful in determining the content of the final regulations.

Sincerely,



Joseph P. Kamnik

[61] *Id.* at 268. *See also Id.* at 6 (stating that new reporting requirements are in response to "recent events").