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November 17, 2010

Re: Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest - 75 Fed. Reg. 63732 (October 18, 2010);

Financial Resources Requirements for Derivatives Clearing Organizations - 75 Fed. Reg. 63113 (October 14, 2010); and

Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps Under Regulation MC -75 Fed. Reg. 65882 (October 26, 2010).

We welcome the opportunity to provide comments to the Commodity Futures Trading Commission ("**CFTC**") and the Securities and Exchange Commission ("**SEC**") ((each "**the Commission**" and together the "**Commissions**") with respect to requirements applicable to (a) Designated Contract Markets and National Securities Exchanges (referred to in this letter as "**exchanges**"); (b) Swap Execution Facilities and Security Based Swap Execution Facilities (referred to as "**SEFs**" in this letter); and (c) Derivatives Clearing Organizations and Security Based Swap Clearing Agencies (referred to as "**clearing houses**" in this letter).

J.P. Morgan is committed to clearing OTC transactions and in fact we have been clearing dealer to dealer OTC transactions for a decade. We have made significant investments in our client clearing franchise and we employ several hundred people in support of our client clearing service.

We strongly support regulation aimed at mitigating conflicts of interest. We also support full implementation of the open access core principles set out by Congress in the Wall Street Reform and Consumer Protection Act. We note that the Lynch amendment was not part of the final text of the Act passed by Congress and signed by the President. Sections 724 and 726 of the Wall Street Reform and Consumer Protection Act require the Commissions to conduct a review prior to issuing final regulations regarding the matter of conflict of interest. We respectfully submit that it would be appropriate to conduct further review with respect to the subject matter prior to finalizing the rulemaking activity. We believe that an important part of the review would be the analysis of whether the imposition of the limits, as they are currently being proposed would be required or beneficial to mitigate conflicts of interests. [1]

We believe that all clearing houses should provide open access to whoever meets certain minimum objective criteria. In our view the fact that a clearing house relies almost exclusively on the capital of its

[1] It would be very useful to have a better sense of whether a curtailment of the ability of clients to chose whether accessing a dealer owned platform or a third party vendor platform would increase competition or merely increase end user cost. In other markets where clients have the option of choosing between dealer direct access platforms and intermediaries, clients often chose dealer direct platforms.

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members places a great emphasis on the ability of a member to absorb any losses resulting from: (a) the house and client risk that that clearing member introduces into the clearing house; and (b) mutualization of the risks introduced by every other clearing member and that clearing member's clients. Given the loss mutualization feature of clearing houses, we believe that the financial stability of clearing houses depends on the requirements that must be satisfied for a member to qualify as a clearing member. Those criteria, however defined, should require clearing members to hold a minimum amount of capital. In addition it is our view that the way to provide open access to new clearing members while promoting the safety and soundness of clearing houses would be to provide clearing members with the ability to clear house and client risk in proportion to the amount of capital available to them as well as to funded margin and guarantee fund contributions. We do not support any exclusionary practices.

Interaction of corporate governance and risk management

We support regulations requiring the creation of a risk committee at all clearing houses. In addition, we believe it would be appropriate for regulations to provide for the separation of the corporate governance function (Board of Directors) from the risk management function (Risk Committee) within a clearing house.

Risk Committee

We believe that the risk committee should be comprised of a majority of clearing member representatives, with the remainder open to client participation. We support a requirement to for at least 10 per cent of the risk committee to be composed of client representatives with relevant expertise, and the remainder to be open to participation by independent representatives. We believe that the main focus of the risk committee should be the preservation of the guarantee fund that is utilized to safeguard the clearing house and its members against defaults, taking into account prudent risk management standards, including mitigation of systemic risk. The main focus of the Board would be to promote the commercial interests of the clearing house. We expect that in most cases the risk committee and the board would be able to achieve a productive balance between those two interests. We support a requirement for the Board to consult with the appropriate regulator prior to rejecting a recommendation by the risk committee on matters of risk. In our view all matters relating to risk would fall within the purview of the risk committee. This would include all matters related to margin and the sizing of the guarantee fund; membership criteria and membership application, and the enumeration of products eligible for clearing. The CFTC identified sound risk management standards as well as open access as key factors that must be addressed in determining whether a particular type of swap is suitable for clearing[2].

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[2] Please refer to CFTC draft regulations regarding the Process for Review of Swaps for Mandatory Clearing, 75 Fed. Reg. 67277 (November 2, 2010). The draft regulations refer to "information regarding the swap, or group, category, type, or class of swaps that is sufficient to provide the Commission a reasonable basis to make a quantitative and qualitative assessment of the following factors: (A) The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data; (B) The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded; (C) The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the DCO available to clear the contract; (D) The effect on competition, including appropriate fees and charges applied to clearing; and (E) The existence of reasonable legal certainty in the event of the insolvency of the relevant DCO or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property; (iii) Product specifications, including copies of any standardized legal documentation, generally accepted contract terms, standard practices for managing any life cycle events associated with the swap, and the extent to which the swap is electronically confirmable; (iv) Participant eligibility standards, if different from the derivatives clearing organization's general participant eligibility standards; (v) Pricing sources, models, and procedures, demonstrating an ability to obtain sufficient price data to measure credit exposures in a timely and accurate manner, including any agreements with clearing members to provide price data and copies of executed agreements with third-party price vendors, and information about any price reference index used, such as the name of the index, the source that calculates it, the

Board of Directors

With respect to the corporate governance function of SEFs, exchanges and clearing houses, we support encouraging a balance of views being represented on the Board of Directors. We think that a 35% requirement for independent directors will be problematic to implement in practice because it will be difficult to identify a sufficient number of individuals who are not already involved in the industry and who have appropriate level of practical market experience. In our view the desired balance between different interests can be achieved by identifying different classes of interested parties and encouraging a diverse representation of those interests in the Board of Directors. This would be done by requiring that no single class of interested parties achieves more than a 65% of the seats on the board. Each SEF, exchange and clearing house should be able to determine how to fill the remainder of the seats. The Commissions would monitor compliance with the letter and the spirit of this provision. In our opinion the different classes of interest parties vary depending on the type of entity:

In the case of Clearing Houses the classes would be: (a) clearing members whose capital is at risk if another clearing member or one of its clients fail; (b) end users, who have an interest in protecting their collateral and in keeping clearing costs low; and (c) other investors and infrastructure providers (e.g. technology providers, SEFs, exchanges and clearing houses), who have an interest in increasing profitability.

In the case of SEFs the classes would be: (a) liquidity providers; (b) liquidity takers; and (c) other investors and infrastructure providers (e.g. technology providers, exchanges and clearing houses), who have an interest in increasing profitability.

In the case of exchanges the classes would be: (a) liquidity providers; (b) liquidity takers; and (c) other investors and infrastructure providers (e.g. technology providers, SEFs and clearing houses), who have an interest in increasing profitability.

These limitations would have the added benefit of promoting competition and discouraging vertical integration of exchanges, SEFs and clearing houses.

Regulatory Oversight Committee

We support having significant independent representation on the Regulatory Oversight Committee, and we note that some clearing member and client representation on the Regulatory Oversight Committee would be appropriate. Both these categories of clearing users have a vested interest to ensure compliance with all appropriate regulations.

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methodology used to calculate the price reference index and how often it is calculated, and when and where it is published publicly; (vi) Risk management procedures, including measurement and monitoring of credit exposures, initial and variation margin methodology, methodologies for stress testing and back testing, settlement procedures, default management procedures, and an independent validation of the scalability of the derivatives clearing organization's risk management policies, systems, and procedures, including the margin methodology, settlement procedures, and default management procedures; (vii) Measures of market liquidity and trading activity, including information on the sources of such measures; (viii) An analysis of the effect of a clearing requirement on the market for the group, category, type, or class of swaps, both domestically and globally, including the potential effect on market liquidity, trading activity, use of swaps by direct and indirect market participants, and any potential market disruption; (ix) Applicable rules, manuals, policies, or procedures; (x) Terms and trading conventions on which the swap is currently traded; (xi) A description of the manner in which the derivatives clearing organization has provided notice of the submission to its members and a summary of any opposition to the submission expressed by the members."

To avoid duplication, we believe that exchanges, SEFs and clearing houses should have the option to choose, in coordination with their regulators, whether they will implement a structure relying on a Chief Compliance Officer or one relying on a Regulatory Oversight Committee, but we do not recommend requiring both.

All those who bring risk into the clearing house or profit from the operations of the clearing house should have "skin in the game"

We think it is essential to the development of a sound clearing infrastructure that those whose capital is at risk can participate in the risk management of clearing houses. Clearing houses rely almost exclusively on the margin and guarantee fund contribution of clearing members to manage systemic risk and counterparty risk. In a vertically integrated model, shareholders in a holding company that owns clearing houses, exchanges (and in the future may also own SEFs) are exposed to a fraction of the risk that clearing members are exposed to through loss mutualization. There is no current requirement for clearing houses to provide a first loss piece to the financial waterfall package and in most structures the clearing house "skin in the game" contribution is minimal compared with the overall size of the guarantee fund. For this reason the large majority of the capital at risk of a clearing house is composed of the margin and guarantee fund contributed by clearing members. In addition to the financial resources required to satisfy the financial safeguards core principles set out in the Wall Street Reform and Consumer Protection Act[3] we support introducing a requirement for clearing houses to carry a first loss risk component in the waterfall of financial safeguards. In our view this would incentivize clearing houses to manage risk in a prudent manner. We would also support limits on the ability of clearing houses to upstream dividends resulting from clearing fees to their holding companies when a clearing member defaults. The introduction of a first loss position and the introduction on limits on the upstreaming of dividends for clearing houses would result in significant benefits from a systemic stability point of view.

Limitations on voting rights

The best way to promote a successful implementation of the clearing trading requirement is to ensure that clearing houses are fully equipped to manage risk in a prudent manner, while providing open access to clients and clearing members. In order to achieve this purpose, clearing houses should be able to attract financial and intellectual capital from those who have experience in the products that the clearing house intends to clear, as well as from new participants into the market. We note that the OTC derivatives market is sufficiently diversified at present. A market survey published by ISDA on Monday, October 25, 2010[4] shows that the five largest US-Based dealers hold 37 percent of the outstanding derivatives market (equity, rates, credit). In our view this data is more representative of the global nature of the OTC derivatives market than other data[5] that has been quoted out of contest in the debate regarding conflict of interest. That data was focused exclusively on a restricted number of US institutions and was not intended to represent a survey of the OTC market, which is global by virtue of buy side, sell side, regulators and execution venues. To assume that dealers would acquire shareholdings in a clearing house or otherwise gain influence over a clearing house with a view to impede or narrow the implementation of the clearing requirement would be inconsistent with the reality of today's markets. On the contrary some participants in the OTC markets have made significant

[3] Also see draft CFTC § 39.11, 75 Fed. Reg. 63118
[4] (ISDA Mid-Year 2010 Market Survey, available on www.ISDA.org)
[5] http://www.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq210.pdf

investments into the capital of clearing houses well in advance of a legal requirement to clear being introduced or proposed in the US or in Europe.

At this point in the development of market infrastructure it is essential to promote competition between clearing houses, exchanges and SEFs. With respect to clearing houses, we note that in today's markets there are a maximum of three clearing houses per asset class that are able to clear OTC derivatives. In some asset classes there is no clearing house currently clearing. There is no specific reason to apply limits only to those who have the expertise and the funds to finance a clearing house and who are exposed to losses if the risk management of the clearing house fails. We believe that preventing those whose capital is at risk from acquiring the right to vote on the governance of the entities that perform a key role in the OTC markets is not necessary to achieve the policy objectives set out by Congress in the Wall Street Reform and Consumer Protection Act. For this reason we support a limit on voting rights that would apply to each class of market participants irrespective of whether they are clearing members, SEFs, exchanges, enumerated entities, other types of entities or individuals. This would promote open access and greater competition among clearing houses.

In addition, rather than the proposed 5% we would support a 10% cap on voting rights for each entity (irrespective of whether they are clearing members, SEFs, Exchanges, enumerated entities, holding companies, other types of entities or individuals) with no limit on the voting rights that any one class of investors can hold.

The Commissions solicited views on whether ownership limitations should apply to shares that do not carry voting rights. Given that preference shares and other types of non voting shares are a way to provide liquidity into the clearing house and have no effect on corporate governance, we believe that it would not be appropriate to apply limitations on the ownership of non voting shares.

Risk management - Financial Resources Requirements for Derivatives Clearing Organizations

We note that it is not appropriate to make determinations regarding any one portion of a clearing house risk management framework in isolation, since each portion must be assessed in the context of how such portion interacts with the remaining components of the risk management framework of that clearing house and the particular asset class or classes to be cleared under that framework. Making determinations with respect to one portion of the risk management framework of a clearing house in isolation has the potential to leave the overall structure incomplete with the resulting systemic risk. For this reason, we appreciate this opportunity to offer our initial comments regarding Financial Resources Requirements for Derivatives Clearing Organizations. We are sharing these comments with both CFTC and SEC as we believe that the same reasoning applies to CFTC regulated swaps as it applies to SEC regulated security based swaps.

We strongly agree with the underlying premise enunciated in the proposed CFTC §39.11, namely that a derivatives clearing organization must maintain sufficient resources to cover its exposures with a high degree of confidence and to enable to perform its functions in compliance with the core principles set out in section 5b(c) of the Commodity Exchange Act, as amended by the Wall Street Reform and Consumer Protection Act.

We believe it is essential that clearing houses are equipped with the tools to manage that risk in a safe and sound manner. This requirement is particularly acute as we prepare to transfer the risk for the majority of the OTC markets through interconnected clearing houses rather than through bilateral agreements. The effect of this change in market structure is that the ability of a market participant to manage their counterparty risk on a counterparty by counterparty basis has been replaced with the that market participant's obligation to mutualize losses in support of the clearing house and of other clearing members. Market participants who are clearing members will be exposed to the risk of default by other clearing members as well as being exposed to a risk of default by the clients of those other clearing members. Unless clearing houses are deemed too big to fail, market participants would also be exposed to a risk of default by clearing houses themselves.

No free riding – clearing member resources

We do not believe that there should be a two tiered approach to membership, where some clearing members are subject to loss mutualization and others are not. A clearing house will rely on the financial resources waterfall set out in CFTC proposed §39.11. This includes funded guarantee fund contributions by a clearing member. CFTC proposed §39.11 also contemplates the ability of a clearing organization to assess a clearing member for additional default fund contributions. We believe that it is important to make sure that a clearing member will have sufficient liquid capital to fund additional guarantee fund assessments, in proportion to house and client business cleared by that clearing member.

We believe it would be appropriate to require that clearing members have the ability to provide daily executable binding quotation for all points in the curve for all products cleared. Clearing Houses must be able to mark risk to market at the end of each trading day. Clearing members must provide daily prices for all points of the maturity curve rather than relying on whether the cleared product trades on an exchange or a SEF on that day.

In our view it would be appropriate to require that clearing members have the operational ability to sustain the flow of client and house positions into the clearing house, including porting books of liquid and illiquid positions at times of market distress. We think third party pricing and outsourced default management services can disappear quickly in a crisis. For this reason we recommend a requirement that clearing members or their affiliates be able to participate in the default management process.

Guarantee fund assessments. Need to ensure members have appropriate liquidity to meet potential capital calls in a crisis.

We support the CFTC proposal requiring clearing houses to haircut the value of unfunded assessment and to cap the percentage of the financial resources package that can be met by the value of assessments.

We note that CFTC proposed §39.11 also refers to the own capital contribution of a clearing house as a component of the financial resources package. We believe that it would be appropriate for the Commission's Regulations to provide greater granularity and require that if a clearing house enumerates its own capital as part of the waterfall, that clearing house must provide sufficient assurances that its the capital will be available to meet those obligations and will not be reallocated to serve other purposes at the discretion of that clearing house.

It should be noted that a clearing member may have committed to additional assessments at more than one clearing house. We believe it would be appropriate for Regulators to adopt a risk based analysis to determine the likelihood that a clearing member will be able to meet its assessment obligations across all clearing houses.

Liquidity of Financial Resources

We share the view that it is crucial to ensure that a clearing house has adequate liquidity in a crisis. We understand the proposed §39.11(e) to mean that a clearing house must hold: (i) financial resources that are sufficiently liquid to meet its obligations as a central counterparty during a one day settlement cycle, and (ii) sufficient capital in the form of cash to meet the average daily variation pay per clearing member over the last fiscal quarter.

We note that §39.11(e)(1) also provides that if any portion of the remainder of the financial resources is not sufficiently liquid, the derivatives clearing organization may take into account a committed line of credit or similar facility for the purpose of meeting this requirement.

We understand §39.11(e) to mean that a clearing house must hold sufficient cash and/or highly liquid securities to meet at least six months' operating costs, and that if any of those resources are not liquid, a clearing house may take into account a committed line of credit or similar facility for the purpose of meeting this requirement.

In our view if a clearing house has in place a committed line of credit or similar liquidity facility, it would be appropriate for all clearing members who introduce a significant amount of risk into the clearing house to share in that commitment, and for the commitment to be open to non clearing members. It is worth noting that greater participation by clearing members in a committed line of credit or similar liquidity facility at times of market distress is a key component of providing liquidity in the settlement system, with clear benefits for systemic stability.

If a clearing house receives illiquid collateral and uses that collateral under the terms of the committed line of credit or similar liquidity facility that could affect the ability of members to access sufficient liquidity to meet collateral calls and guarantee fund assessments. For this reason we believe it is appropriate to diversify broadly the risk and reward of providing such liquidity.

We would be grateful for a clarification of the commentary to these provisions that is set out in the CFTC Notice of proposed rulemaking. The commentary states that a committed line of credit or similar facility cannot be used for purposes of the financial safeguards set out in §39.11(b)(1) or the operating costs set out in §39.11(b)(2)[6]. The commentary states that a DCO may only use a committed line of credit or similar facility to meet the liquidity requirements set forth in proposed §39.11(e)91) and §39.11(e)(2). Given that §39.11(e)(1) refers to the minimum amount of cash or liquid assets that a DCO must maintain to meet the requirements of one day settlement cycle and average daily variation margin and six moths operating costs respectively, we interpret the Regulations to provide that a committed line of credit or similar facility for the purpose of meeting this requirement may be used to meet obligations in excess of that minimum requirement. In addition, given the express language in §39.11(e)(2) we interpret the regulations to mean that a committed line of credit or similar facility can be used to meet the liquidity requirements related to six months operating costs as well as one years of operating costs. We believe it would be very helpful to have further clarification on these requirements. If our understanding of he Regulations is correct, our view is that these requirements are adequate to meet the financial stability requirements set out in the Wall Street Reform and Consumer Protection Act.

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[6] This is referred to as 39.8(b)(2) in the Notice. We think this is a typographical error and the text was intended to refer to 39.11(b)(2).

Gross margin

We are in favor of requiring clearing houses to hold margin on a gross basis (each client posting the net of their aggregate position, each clearing member posting to the clearing house the gross amount of all clearing house required client collateral) rather than net. This requirement would apply at a minimum to systemically important clearing houses.

SIDCOs and other systemically important clearing houses

We believe that in the new market structure landscape there should be no too big to fail. In our view this principle applies equally to clearing members, clearing houses and clients. Given the loss mutualization feature of clearing, it is only by requiring each participant to have skin in the game that we can ensure all the parties involved in bringing risk into the system have an incentive to act in a manner that is prudent, safe and sound. This principle is of particular relevance for those entities that are deemed systemically important by the Financial Stability Oversight Council pursuant to Title VIII of Dodd Frank.

We welcome the active involvement of our regulators in the CPSS-IOSCO working groups. We believe that as part of the designation of systemic importance, a clearing house should be required to adhere to CPSS-IOSCO standards. With respect to emergency powers, the consultative report "Guidance on the application of the 2004 CPSS-IOSCO Recommendations for Central Counterparties to OTC derivatives CCPs" published by CPSS/IOSCO in May 2010 provides that emergency powers of clearing houses should not be used by a clearing house to change the economic of a transaction that has been cleared already. [7] By way of example, we do not believe a clearing house (whether or not designated as systemically important) should be able to decide that the recovery on a trade is, by way of example, 90% exclusively in order to avoid incurring a loss at the clearing house. Systemically important clearing houses need the ability to take emergency action in a crisis if there is no time to consult the Risk Committee, the Board of Directors or Regulators. However, we believe that SIDCOs should be required to revert to the Risk Committee, the Board of Directors or Regulators as soon as possible after such action for ratification, well within the "no later than 24 hours" deadline set out in Title VIII of the Wall Street Reform and Consumer Protection Act.

Regulatory Coordination

In our view, coordination between regulators who have authority over clearing houses will be a key component of systemic stability. One significant element will be the ability of regulators to look across clients, clearing members, exchanges, SEFs and clearing houses for any factors that could increase systemic risks. We think it is appropriate to monitor the activity of clients, clearing members exchanges, SEFs and clearing houses for undue concentration with a view to identify

[7] Web link: http://www.bis.org/publ/cpss89.pdf
In particular please refer to page 32: "In principle, a CCP's use of emergency powers should have an economically neutral effect on its participants, or, if that is not possible, should maintain the relative mutualization of risk that its participants expect from the Regulations. Therefore, economic consequences that result from the use of emergency powers should be mitigated to preserve the economic terms of the affected trades and the original Regulations to the fullest practical extent. Since CCPs must maintain balanced positions and be profit neutral, they should mandate or otherwise mediate the transfer of any windfall directly acquired as a result of their decision from the beneficiaries to the losers of the decision."

those that pose a systemic risk and take action to de-risk problematic situations before they exert a significant impact on the financial systems.

Conclusion

We believe that no institution, including clearing members and clearing houses should be too big to fail. The policy objectives of the Wall Street Reform and Consumer Protection Act would be well served by promoting systemic stability and ensuring safety and soundness of exchanges, SEFs and clearing houses, and by requiring that these institutions have adequate capital to absorb losses and sufficient liquidity to safeguard the system.

Thank you for the opportunity to comment publicly on these important matters. Please contact J.P. Morgan should you wish to discuss these matters in greater detail.

Sincerely,

Barry L. Zubrow
EVP & Chief Risk Officer

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

Honorable Mary L. Schapiro, Chairman
Honorable Elisse B. Walter, Commissioner
Honorable Kathleen L. Casey, Commissioner
Honorable Luis A. Aguilar, Commissioner
Honorable Troy A. Paredes, Commissioner