January 4, 2011

Via Electronic Mail
Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090
Rule-comments@SEC.gov

Re: Self-Regulatory Organizations; Fixed Income Clearing Corporation (Release No. 34-633161; File No. SR-FICC-2010-09)

We are writing on behalf of our client, the Fixed Income Clearing Corporation (**FICC**), in response to the letters from ELX Futures LP dated December 15, 2010 (**ELX Letter**), The Options Clearing Corporation dated December 21, 2010 (**OCC Letter**), Ronin Capital LLC dated December 10, 2010 (**Ronin Letter**) and NASDAQ OMX dated December 21, 2010 (**NASDAQ Letter**) (together, the **Letters**) submitted in response to the proposed rule change filed by FICC to amend the FICC rules to allow for a proposed cross-margining arrangement with New York Portfolio Clearing, LLC (**NYPC Arrangement**).[1] Much of the discussion in the Letters focuses on the mistaken claim that the NYPC Arrangement is a burden on competition that does not meet the standard required of clearing agencies pursuant to Section 17A of the Securities Exchange Act of 1934, as amended (**Exchange Act**). To the contrary, FICC's rule proposal and the NYPC Arrangement are entirely pro-competitive and comply with the requirements of the Exchange Act. We also wish to take this opportunity to respond to additional issues raised in the Letters, including in particular the provisions of proposed NYPC Rule 801 regarding contributions to the NYPC guaranty fund and the allocation of clearing fees for limited purpose participants (**LPPs**).

1. EXCHANGE ACT—BURDEN ON COMPETITION

Standard. Section 17A of the Exchange Act requires that the rules of a clearing agency do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

- <u>The NYPC Arrangement is pro-competitive</u>.

  The market for clearing U.S. dollar-denominated interest rate futures contracts is currently dominated by one entity. Multiple largely unsuccessful attempts have been made in recent years by other exchanges and clearinghouses to introduce competition in products such as Eurodollar and U.S. Treasury futures. These ventures failed to introduce meaningful competition in part because the key clearinghouse in this market is able to offer substantial risk offsets between interest rate futures, making scale at the clearing level a considerable barrier to entry into the U.S. interest rate futures market.

  To address this issue and to offer a competitive option, the Depository Trust & Clearing Corporation (**DTCC**) and NYSE Euronext joined forces in 2009 to build an innovative new clearinghouse intended to deliver "single pot" margin efficiency across fixed income securities and repurchase agreements on fixed income securities cleared by FICC, on the one hand, and U.S. dollar-denominated interest rate futures contracts, on the other hand.

  However, unlike the traditional "vertical" relationship between futures exchanges and their affiliated derivatives clearing organizations (**DCOs**), NYPC has been uniquely structured, consistent with the principles of both the Exchange Act and the Dodd-Frank Wall Street Reform and Consumer

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[1] SEC Release No. 34-63361, 75 Fed. Reg. 74110 (November 30, 2010).

Protection Act (**Dodd-Frank Act**), to allow unaffiliated DCOs and designated contract markets (**DCMs**) "open access" to the benefits of the "single pot" cross-margining arrangement as soon as operationally feasible, subject only to certain objective, reasonable and non-discriminatory criteria.[2] This commitment ensures that the benefits of the "single pot" cross-margining arrangement with FICC will be made available to unaffiliated DCOs as well as to unaffiliated DCMs, which can participate in the "single pot" cross-margining arrangement by either directly clearing through NYPC or by clearing through another DCO that joins NYPC as an LPP.

Such a "single pot" approach to margining across asset classes has eluded the market for many years despite significant customer demand because of the inherent operational, risk and regulatory complexities associated with delivering such efficiency to the market. Instead, the market to-date has relied on less efficient "two pot" cross-margining arrangements in which each clearinghouse applies its own margin methodology first before making its clearing members' resulting net positions available for cross-margining. Historically, such "two pot" arrangements have provided limited benefit to market participants.

By contrast, the "single pot" cross-margining arrangement between FICC and NYPC is premised on a common margin system and risk management methodology whereby cash and derivatives positions are netted at the same time in order to maximize risk offsets, offering market participants substantial margin efficiency across asset classes.[3] The NYPC Arrangement also offers other important benefits to market participants, including a streamlined delivery process for U.S. Treasury futures that improves operational efficiency and decreases systemic settlement risk. Through such margin and operational efficiencies, the NYPC Arrangement provides market participants with a viable competitive alternative, which should not only drive down costs but also increase liquidity by providing market participants an alternative venue for the trading of U.S. dollar-denominated interest rate futures contracts. As described above, the NYPC Arrangement will also benefit market participants by providing open access to all qualifying DCOs and DCMs. As more and more DCMs and DCOs join the NYPC Arrangement, the potential for significant risk offsets and for significantly enhanced competition in this industry will increase.

Furthermore, it should be noted that in the years prior to the formation of NYPC, FICC at various times held informal discussions with a number of established DCOs, including OCC, regarding the establishment of a "single pot" cross-margining arrangement for U.S. dollar-denominated interest rate futures contracts. Such other DCOs were uniformly unwilling to adopt the FICC VaR methodology or agree to other operational pre-conditions that are necessary for FICC to effectively form a "single pot" margin system. It is because of the unwillingness on the part of such other DCOs to partner with FICC on terms necessary to allow FICC to prudently manage its risk that FICC chose instead to develop a new, purpose-built DCO—NYPC. Following the announcement of NYPC, FICC, the NYPC management team and senior management of NYSE Euronext have repeatedly reached out to OCC, as well as other DCOs and DCMs, to initiate the process of integrating such other organizations into the "single pot". While those efforts have not yet been productive, FICC and NYPC remain committed to expanding the "single pot" to include other DCOs and DCMs.

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[2] DCMs clearing through NYPC (including NYSE Liffe U.S.) are required to: (i) be eligible under the rules of NYPC; (ii) contribute to NYPC's guaranty fund; (iii) demonstrate that they have the operational and technical ability to clear through NYPC; and (iv) enter into a clearing services agreement with NYPC. DCOs will be able to access the "single pot" cross-margining arrangement as LPPs of NYPC, subject to pre-defined, objective, non-discriminatory criteria set forth in NYPC's rules. ELX cites a June 2009 press release from DTCC that references an "exclusive" arrangement between NYPC and FICC. While that was accurate at the time, NYPC's arrangements with FICC have long since been modified, in consultation with the Commission and the Commodity Futures Trading Commission (**CFTC**), to create the unique "open access" model described above and in NYPC's application for DCO registration.

[3] FICC and NYPC have chosen to base their common margin system on the time-tested and proven Value-at-Risk (**VaR**) methodology employed by FICC. The FICC margin system currently handles the collection of more than $20 billion per day.

- Any purported burdens on competition are "necessary and appropriate" to furthering the purposes of the Exchange Act.

The Letters argue that the NYPC Arrangement serves as a burden on competition because access to the NYPC Arrangement by unaffiliated DCMs and DCOs must go through NYPC rather than through a direct linkage with FICC and because the NYPC Arrangement will not be available to unaffiliated DCMs and DCOs during a limited initial transition period.

As recounted above, it is important to note that the Exchange Act does not prohibit *all* burdens on competition. To the contrary, the Exchange Act prohibits only those burdens that are not "necessary and appropriate" to furthering the purposes of the Exchange Act.[4] The purposes of Section 17A of the Exchange Act include, in pertinent part, "to facilitate the establishment of linked or coordinated facilities for clearance and settlement of transactions in securities, securities options, contracts of sale for future delivery and options thereon, and commodity options". FICC believes that the NYPC Arrangement is consistent with the Exchange Act in that it promotes the *de novo* establishment of coordinated facilities for the clearance and settlement of securities and futures transactions in a manner that is consistent with FICC's obligation to ensure prudent risk management practices and to safeguard the funds and securities for which it is responsible.

More particularly, FICC's ability to deliver "single pot" margin efficiencies depends on its ability to manage its risk, something that FICC believes can only be achieved by utilizing NYPC as a standardized portal for the "single pot" cross-margining arrangement and by providing for an operationally necessary initial transition period prior to which unaffiliated DCOs and DCMs may join the "single pot." In addition, for reasons discussed further below, FICC does not believe it is feasible to establish more than one "single pot" cross-margining arrangement, which is why, as described above, FICC and NYPC are committed to providing unaffiliated DCOs and DCMs with open access to the NYPC Arrangement as soon as operationally feasible.

- Linking other DCOs directly into the "single pot" is not practical and would increase risk.

The OCC Letter argues that FICC should be required to accommodate OCC by allowing it to link directly with FICC. If FICC was required unconditionally to connect all interested DCOs directly into the "single pot" cross-margining arrangement, FICC and each such DCO would have to undertake the complex, costly, time-consuming and significantly cumbersome process of integrating their respective rules as well as their technology, risk and other systems. The process of integration between NYPC and FICC has taken nearly two years and has required a substantial and continuing expenditure of financial, intellectual and other resources on the part of NYPC's owners, DTCC and NYSE Euronext, even though NYPC was created specifically to act as a cross-margining clearinghouse opposite FICC, with its rules, technology, risk and other systems crafted from the ground up with such purpose in mind. Even assuming that OCC or another DCO was prepared to adopt FICC's VaR margin methodology, attempting to integrate a pre-existing clearinghouse directly into the "single pot" cross-margining arrangement would by necessity be even more difficult and likely more costly than the integration between NYPC and FICC. Any such endeavor would, in any

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4 *E.g., Bradford Nat'l Clearing Corp. v. SEC*, 590 F.2d 1085 (1978).

Although not determinative of applicable Exchange Act requirements, the antitrust laws expressly allow joint ventures that serve a pro-competitive purpose to contain ancillary exclusivity and restrictive covenant provisions, absent evidence that the joint venture holds market power or will substantially foreclose competition in some relevant market. *See Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284 (1985). Even if some anticompetitive effect is demonstrated, these provisions withstand scrutiny if, on balance, the efficiencies and pro-competitive rationale for the arrangement predominate. *See, e.g., Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977). In this context, the relevant market is the market for the cross-margining of fixed income securities and related futures contracts.

event, impose a significant burden on FICC and create unnecessary strains on its risk controls and resources.[5]

FICC additionally believes that it is neither operationally feasible nor prudent to establish a framework of multiple, competing "single pots" with multiple, competing DCOs. Among other things, such an arrangement would result in FICC clearing members that are members of multiple DCOs cross-margining their futures positions against different segments of their portfolios at FICC, rather than having the risk of their positions being measured comprehensively. FICC believes that the attendant risk of delays and errors in processing would substantially increase systemic risk as clearing members continuously moved positions at FICC from one cross-margin pot to another in order to maximize their margin savings.

Finally, and perhaps most importantly, FICC believes that the existence of multiple "single pots" would likely greatly complicate the liquidation of a cross-margining participant that was in default at FICC and NYPC, thereby increasing systemic risk. FICC and NYPC have engaged a common investment adviser with extensive experience in the fixed income and related derivative markets to manage the liquidation of a defaulting cross-margining participant. The adviser has been instructed, in the case of a participant default, to hedge exposed portions of a defaulting cross-margining participant's cash and futures portfolios and to liquidate such portfolios in a coordinated and integrated manner in order to minimize losses, a process that would be made substantially more complicated if the adviser additionally had to respond to potentially conflicting instructions from another clearinghouse, or if such other clearinghouse were to assert competing claims under its cross-margining agreement with FICC to the collateral that was held by FICC for the account of the defaulting cross-margining participant.

Third parties should not be permitted to "free ride" on FICC's and NYPC's combined efforts.

Courts typically uphold limited exclusivity arrangements when they are shown to preclude "free riding" on the investments, innovations and promotional efforts of a pro-competitive joint venture and its investors.[6] Given FICC and NYPC's commitment to open access, as described above, FICC and NYPC do not believe that the NYPC Arrangement is "exclusive". However, even if it were deemed to arguably contain certain limited exclusive elements, to contend that the NYPC Arrangement should not be approved unless other DCOs and DCMs are given direct linkage with FICC on their preferred terms, instead of on the objective, non-discriminatory terms contemplated by NYPC's rules, is to argue that other DCOs and DCMs should be permitted to "free ride" on the efforts and innovation of FICC and NYPC.

The limited initial transition period is prudent and necessary.

Finally, the Letters argue that the NYPC Arrangement is a burden on competition on the grounds that other DCOs and DCMs will not be able to participate in the "single pot" cross-margining

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[5] Moreover, even if it were practical to link other DCOs directly into the "single pot", Section 725(h) of the Dodd-Frank Act amended the Commodity Exchange Act to provide that "[i]n order to minimize systemic risk, under no circumstances shall a derivatives clearing organization be compelled to accept the counterparty credit risk of another clearing organization". Requiring FICC to admit a DCO as an equal participant with NYPC in the "single pot" cross-margining arrangement would compel both NYPC and FICC to assume the credit risk of such other DCO because, in such a circumstance, NYPC and FICC would collect less margin than they would in the absence of the third-party DCO. Subsequently, in the event of a default of a cross-margining participant, NYPC and FICC would be required to look to the other DCO to recoup or offset losses on the liquidation of the defaulter's positions, precisely the forced assumption of credit risk that Section 725(h) of the Dodd-Frank Act is intended to prohibit.

[6] *See, e.g., Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977) (upholding exclusive dealing agreements, reasoning that certain services might not be provided "in a purely competitive situation" due to "'free rider' effect"); *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210 (D.C. Cir. 1986) (upholding restriction to counter the menace that free riding poses).

arrangement during a limited initial transition period. The limited initial transitional period that will be in place prior to unaffiliated DCOs and DCMs being admitted to the "single pot" cross-margining arrangement is designed to give FICC and NYPC the time needed to complete the complex implementation phase with a single set of products from a single exchange before opening the NYPC Arrangement up to other clearinghouses and exchanges. FICC and NYPC have pledged to open the NYPC Arrangement as soon as operationally feasible. This implementation phase includes substantial operational tasks, including integrating and testing the connectivity of the front-end and core processing systems of cross-margining participants and third-party vendors with the FICC and NYPC systems. Achieving a well-functioning cross-margining mechanism is essential to NYPC's viability and its ability to foster meaningful competition in this industry. Thus, placing limited operationally necessary restrictions on the timing within which unaffiliated DCOs and DCMs may access the NYPC Arrangement is entirely consistent with the Exchange Act.

- <u>Approving FICC's rule proposal would be consistent with prior Commission determinations of what constitutes "appropriate" burdens on competition</u>.

  The Commission has previously accepted an assertion by a party proposing to change a rule that the rule change's equal application to parties subject to the rule demonstrated that it would not have an inappropriate burden on competition. The Commission allowed the Municipal Securities Rulemaking Board (**MSRB**) to change a rule involving the automated confirmation and acknowledgment of customer transactions.[7] In its proposal to change the rule, the MSRB contended that the rule change would not have any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act because it would apply equally to all brokers, dealers and municipal securities dealers involved in such customer transactions.[8] Similarly, FICC's rule proposal to enable the NYPC Arrangement should not be seen as imposing an inappropriate burden on competition because, as both FICC and NYPC have stated repeatedly—and have reaffirmed in this letter—they are committed to an "open access" model whereby the "single pot" cross-margining arrangement will be available all unaffiliated DCMs and DCOs that meet certain objective, reasonable and non-discriminatory criteria, as described above.

- <u>The Commission staff's "Clearing Corporation for Options and Securities" Exemptive Order supports the structure of the NYPC Arrangement</u>.

  The ELX Letter offers as support for its contention that the Commission has historically frowned upon "exclusive" cross-margining arrangements the 15-year-old exemptive order granting the Clearing Corporation for Options and Securities a conditional exemption from clearing agency registration (**CCOS Letter**).[9] At the outset, we question whether an exemptive order from clearing agency registration serves any precedential value concerning a cross-margining arrangement that involves FICC, every facet of whose operations are subject to comprehensive oversight and supervision by the Commission. In any event, the ELX Letter points to the staff's statement that the linkage of CCOS to other clearing agencies was "vital to the satisfaction of the statutory goals of Section 17A". This quotation is taken somewhat out of context: the staff insisted that CCOS, a relatively small and unregistered clearing agency wishing to clear government securities for a subsidiary of the Chicago Board of Trade, establish linkages with the Government Securities Clearing Corporation (a forerunner of FICC) in order to prevent the fragmentation of the clearance system for government securities. The ELX Letter does not suggest (nor can it) that the NYPC Arrangement would have the effect of fragmenting the market for the clearance of government

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7 SEC Release No. 34-41378, 64 Fed. Reg. 25940 (May 13, 1999).

8 SEC Release No. 34-39833, 63 Fed. Reg. 18055 (April 13, 1998).

9 SEC Release No 34-36573, 60 Fed Reg 65076 (December 18, 1995).

securities. The "vital" need for linkages that was relevant in the CCOS letter, therefore, is simply not applicable to the current set of facts.

We further note in this regard that the staff suggested that the Congressional imperative for creating a national system of clearance and settlement could be achieved via "one-account settlement", including specifically an arrangement whereby clearing agencies admit other clearing agencies as members to facilitate such "one-account settlement". The CCOS Letter therefore provides direct support for the NYPC Arrangement and the preference of FICC and NYPC to achieve their cross-margining goals through the admission of unaffiliated DCOs to the "single pot" through NYPC.

- The applicable Exchange Act standard applies to burdens on competition, not burdens on competitors.

Finally, we note that the ELX Letter implies that the NYPC Arrangement has been responsible for ELX's limited success in attracting business, which is similar to the assertion made by ELX in its letter dated December 1, 2010 to the CFTC in respect of NYPC's DCO application. We consider this claim to be curious, especially given that ELX's members include Bank of America Merrill Lynch, Barclays Capital, Cantor Fitzgerald, Citibank, Credit Suisse, Deutsche Bank, Getco, Goldman Sachs, J.P. Morgan, MF Global, Newedge, Nomura, RBS and Interactive Brokers. Clearly, there are significant market participants who are able to trade on ELX should they want to do so. We do not wish to speculate on the reasons for ELX's failure to expand its business other than to note that considerations of anti-competitive impact focus on a person's overall impact on *competition*, not on *competitors*. Therefore, any impact, direct or indirect, on ELX as a competitor to NYSE Liffe U.S. is irrelevant to the consideration of whether the NYPC Arrangement is an unjustified burden on competition.

2. NYPC RULE 801

- **Contributions to the NYPC guaranty fund.**

FICC also wishes to address several apparent misunderstandings raised in the Letters regarding the intent of proposed NYPC Rule 801 with respect to guaranty fund contributions and fee-sharing arrangements by unaffiliated DCMs and/or DCOs as limited purpose participants of NYPC. Most importantly, no merit should be given to the suggestion that a \$50 million contribution to the NYPC guaranty fund is an exclusionary requirement that would inhibit unaffiliated DCMs or DCOs from being able to participate in the NYPC Arrangement. This requirement is reflective of the practices of other newly formed clearinghouses.[10] A requirement that DCMs and DCOs contribute \$50 million to the NYPC guaranty fund, therefore, is a prudent and measured step that will help to ensure that NYPC's guaranty fund is at all times appropriately scaled to reflect the risks being guaranteed by the clearinghouse. Moreover, if other DCOs were admitted to NYPC without having to contribute fairly and equally to the NYPC guaranty fund, it would allow such other DCOs to "free ride" on the risk capital of NYSE Euronext, unreasonably requiring that the shareholders of NYSE Euronext underwrite the business activity of third parties.[11]

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[10] For example, IntercontinentalExchange, Inc., the parent of ICE Trust and ICE Clear U.S., agreed to contribute \$50 million to each of its clearinghouses' guaranty funds when those clearinghouses were being formed. *See* https://www.theice.com/publicdocs/ICE_CDS_Fact_Sheet.pdf, at 2.

[11] We also wish to correct the misapprehension in certain of the Letters concerning NYSE Euronext's role as 50% owner of NYPC and its contribution of equity capital to NYPC *versus* its contribution to the NYPC guaranty fund. NYSE Euronext has issued a guarantee of up to \$50 million as a contribution to the NYPC guaranty fund on behalf of its subsidiary, NYSE Liffe U.S., which will be a participating DCM in NYPC. Such guaranty fund contribution is intended to fulfill NYSE Liffe U.S.'s obligation to contribute to the NYPC guaranty fund, an obligation that, as described above, applies equally to all DCMs participating in NYPC, and should, therefore, be considered separate and distinct from the significant contribution of equity capital that NYSE Euronext has also made to NYPC as a part-owner.

In any event, despite claims to the contrary in the ELX Letter and the OCC Letter, the $50 million contribution is not a fixed number but rather serves as an appropriate, risk-based starting point. As was made clear in FICC's rule proposal, FICC and NYPC anticipate that as NYPC's business grows over time and more participants join NYPC and contribute to the guaranty fund, the contribution from NYSE as well as from other unaffiliated DCMs and DCOs could be reduced across such entities on a *pro rata* basis as concentration risk is reduced. The $50 million initial requirement, therefore, is a reasonable and prudent sum that is based on the estimated risk posed to NYPC and is not intended to discourage participation by unaffiliated DCMs and DCOs in NYPC.[12]

Furthermore, FICC wishes to clarify that there is no intention that NYPC Rule 801 would give rise to "double dipping". In other words, while a guaranty fund contribution would be required of any LPP joining NYPC, NYPC would not then generally require further guaranty fund contributions from the members of such LPP, unless such members were also direct clearing members of NYPC. Therefore, requiring a DCO to contribute an amount which appropriately reflects the risk guaranteed by NYPC, which would increase as a result of the DCO's admission as an LPP, is entirely appropriate. In effect, the guaranty fund contribution of the LPP would serve as a proxy for the guaranty fund contributions that would otherwise have been required of the members of the LPP had they become clearing members of NYPC directly.

- <u>Fee-Sharing Arrangements</u>.

The Letters also raise questions regarding the fees to be charged to unaffiliated DCOs coming into NYPC as LPPs. While any such fees will be determined on a case-by-case basis, they are intended primarily to recoup the costs (operational and otherwise) that may be incurred by NYPC in integrating a new LPP. The NYPC resources that will be required for each LPP cannot be determined at this time, but will obviously vary. FICC and NYPC accordingly wish to avoid taking an overly prescriptive approach and instead intend to work with each LPP to tailor the fee structure to reflect the facts and circumstances applicable to that LPP. Furthermore, in effort to approach the process of admitting additional LPPs in as flexible a manner as possible, FICC and NYPC are also open to the possibility of the capital and other expenses related to integrating an LPP into NYPC's existing systems being absorbed directly by the LPP itself, rather than such expenses necessarily having to be passed through to the LPP's clearing members in the form of clearing fees.

Finally, although NYPC Rule 801 nominally requires all members of LPPs clearing through NYPC to abide by NYPC's rules as though they were clearing members of NYPC, there is no intention to impose on such members any obligations (including margin deposits and guaranty fund contributions) in addition to those already owed to their existing LPP. Instead, NYPC Rule 801 is designed to permit maximum flexibility in structuring the admission of LPPs, as it is contemplated that any such admission would be subject to substantial negotiation between NYPC and the prospective LPP regarding the operational mechanics of margin deposits and related subjects. In no event, however, will there be separate requirements (including with respect to margin deposits and guaranty fund contributions) applied to both an LPP and its members, unless NYPC and the LPP separately agree to allocate those amounts to the LPP and its members, or a clearing member of NYPC is also a clearing member of an LPP.

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[12] A prospective LPP would not in any event be required to make a cash deposit of $50 million. Pursuant to NYPC Rule 801, LPPs are required to make a contribution to the NYPC guaranty fund in the same manner and in an amount no less than the contribution made by NYSE. NYSE's contribution to the NYPC guaranty fund is in the form of a guaranty, which is initially backed by a deposit of $25 million in cash. Therefore, it is anticipated that up to half of a creditworthy LPP's contribution to the NYPC guaranty fund could come in the form of a guaranty, rather than a cash deposit.

3. THE NYPC ARRANGEMENT VS. THE OCC/CME "ONE-POT" CROSS MARGINING PROGRAM

FICC would also like to make an observation regarding the claim in the Ronin Letter regarding "the successful operation of the OCC/CME 'one-pot' cross margining program" for over 20 years. We agree that this was an important innovation, and the fact that this arrangement has been in place for over 20 years points out the value of what NYPC and FICC seek to achieve in delivering the next generation of margin efficiency. While OCC's arrangement with the CME was undoubtedly a breakthrough at the time, there are product-related differences between OCC/CME cross-margining and the NYPC Arrangement that make attempts to point to this arrangement as the model for open access inappropriate and misleading.

OCC's "one pot" cross margining with the CME and index options applies primarily to futures contracts that are based on the Standard & Poor's (**S&P**) 500 stock price index. Unlike interest rate futures, where new entrants can seek to compete at a relatively low cost, no other futures exchange can list S&P 500 index futures because the CME has an exclusive license for that product from S&P. Further, only CBOE can list options on S&P indices through a similar exclusive license agreement with S&P. Thus, while it is true that Ronin and other market participants benefit from the OCC/CME arrangement, that is only because all S&P based futures and index options *must* be cleared exclusively through the CME and OCC, respectively. Ronin's analogy, therefore, is flawed. The OCC/CME arrangement is contractually exclusive and therefore carries significantly greater anti-competitive potential. It is not an arrangement that could or should be used as a model for open access, where competition and choice are explicit goals of the Dodd-Frank Act.

4. MARGIN METHODOLOGY

The NASDAQ Letter contends that the VaR methodology that NYPC proposes to utilize should be better understood, studied and tested on a pilot basis before being employed by NYPC "to increase the leverage of portfolio accounts that include derivative products". First, the historical simulation method of calculating VaR on which the NYPC-FICC margin model is based is one of the most common methods used by the industry for implementing VaR for the fixed income market. Second, the NYPC-FICC margin model does not necessarily increase leverage and may, in fact, reduce leverage in highly risky portfolios with limited hedges. At the same time, the NYPC-FICC model can offer margin reductions for hedged portfolios because it more accurately estimates true economic risk by taking into account the benefits of highly correlated, offsetting positions in a single portfolio. Third, and most importantly, FICC and NYPC have conducted rigorous risk-related testing on their VaR margin model, including tests of the sensitivity of the model to changing market conditions, back tests of sample portfolios to check model validity and stress tests of sample portfolios to test the sufficiency of the NYPC guaranty fund. Those tests, which were conducted in conjunction with discussions with staffs of the Commission, the CFTC and the Federal Reserve, conclusively demonstrated the validity of the FICC-NYPC margin model.[13]

5. CONCLUSION

FICC's rule proposal and the NYPC Arrangement are pro-competitive and comply with the requirements of the Exchange Act. As noted in one of the supportive comment letters received by the Commission on this proposal: "We believe that NYPC represents a credible attempt to deliver

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13 The NASDAQ Letter goes on to observe that "FICC appears to have discarded the derivatives industry standard in favor of applying an untested method, noting that the Standard Portfolio Analysis of Risk (**SPAN**) model was designed by the CME for derivative instruments and is now used to calculate margin for derivative and non-derivative instruments at 50 exchanges and clearing organizations worldwide, including the CME." The NASDAQ Letter neglects to acknowledge, however, that SPAN is itself a type of VaR methodology and that FICC and NYPC have made the considered decision to use a single margin methodology as a means of increasing efficiency and reducing risk.

more competition in the U.S. futures market—a central goal of the framers of the Wall Street Reform and Consumer Protection Act . . . ."[14] FICC respectfully urges the Commission to approve its rule filing 2010-09 to implement the NYPC Arrangement in an expedited timeframe.

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If the Commission has any questions on the foregoing, please contact Nikki Poulos, FICC's General Counsel, at (212) 855-7633 or npoulos@dtcc.com, or Murray Pozmanter, Managing Director of Fixed Income Clearance and Settlement, at (212) 855-7522 or mpozmanter@dtcc.com.

Very truly yours,

Douglas Landy

Douglas Landy

cc: Mary L. Schapiro, Chairman, Securities and Exchange Commission
Kathleen L. Casey, Commissioner
Luis A. Aguilar, Commissioner
Troy A. Paredes, Commissioner
Elisse B. Walter, Commissioner
Robert Cook, Division of Trading and Markets

Michael Bodson, Executive Managing Director, DTCC
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Murray Pozmanter, Managing Director, DTCC
Nikki Poulos, Managing Director, DTCC, and FICC General Counsel

Walter Lukken, Chief Executive Officer, NYPC
Laura Klimpel, Chief Compliance Officer and Counsel, NYPC

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[14] December 2, 2010 letter from Jack DiMaio, Morgan Stanley to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, Securities and Exchange Commission.