ALEX KOGAN
VICE PRESIDENT & DEPUTY GENERAL COUNSEL
9600 BLACKWELL ROAD
ROCKVILLE, MD 20850
P: +1 301 978 8489
F: +1 301 978 8472
E: alex.kogan@nasdaqomx.com

January 10, 2011

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

Ms. Elizabeth Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: *Comment Letter on the Pending Derivatives Clearing Organization Application of New York Portfolio Clearing, LLC (CFTC Filing Number IF 10-009)*

FICC Proposed Rule Change to Introduce Cross-Margining of Certain Positions (SEC File Number SR-FICC-2010-09)

Dear Mr. Stawick and Ms. Murphy:

We have reviewed the letters[1] submitted to the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") (the CFTC and SEC together may be referred to below as the "Commissions") by the law firms representing, respectively, New York Portfolio Clearing, LLC ("NYPC") and the Fixed Income Clearing Corporation ("FICC") in reply to the criticism of the NYPC/FICC proposal by commenters including NASDAQ OMX.[2] The NYPC/FICC Reply does not meaningfully address the concerns raised in the NASDAQ OMX Comments, but it is not the purpose of this letter to restate those concerns. However, we would like to highlight for the Commissions several additional issues raised by the NYPC/FICC Reply.

<u>Risk Model</u>

The NYPC/FICC Reply mentions a "13 months" period during which the parties were making submissions and having discussions with the staffs of the Commissions and the Federal Reserve

---

[1] Katten Muchin Rosenman LLP, acting on behalf of NYPC, submitted two letters to the CFTC, both dated December 20, 2010 (together, the "NYPC Reply"). Allen & Overy, acting on behalf of FICC, submitted a letter to the SEC dated January 4, 2010 (the "FICC Reply"). (The NYPC Reply and the FICC Reply together may be referred to below as the "NYPC/FICC Reply.")

[2] <u>See</u> Comment Letter from NASDAQ OMX to the CFTC dated December 2, 2010, and Comment Letter from NASDAQ OMX to the SEC dated December 21, 2010. (These two comment letters together are referred to as the "NASDAQ OMX Comments.")

concerning the risk aspects of the proposal. We are pleased to learn that an expert review of risk-related issues may have taken place and that experts from the Federal Reserve may have been involved.

However, we strongly believe that the full record of such a review, including the details of any stress tests and other studies, must be placed in the public record. Whether the NYPC-FICC margin model increases leverage and systemic risk is clearly a key issue for the Commissions in this proceeding.[3] In addressing this issue, the Commissions would benefit from input from the broadest range of experts both inside and outside of government, in addition to any secret input provided by unnamed members of the Federal Reserve staff. Yet, unless the record is made public, meaningful review and comment by non-government experts is simply not possible. In fact, as explained in the NASDAQ OMX Comments, based on the information actually included in the public record, it appears that the proposed arrangement may needlessly increase systemic risk.

As the Commissions are undoubtedly aware, many questions have been raised in recent years about reliance by financial institutions on the VaR methodology and how this reliance might have contributed to the 2008 financial crisis.[4] As you are considering the extension of VaR methods to the clearing of financial derivatives, we urge you to obtain meaningful comments from a broad range of disinterested industry and academic experts, perform the needed stress testing, and accord extra care to a decision that may have far reaching consequences years from now.

Competition

The NYPC/FICC Reply still does not explain why a system of hub-and-spoke agreements, which FICC previously extolled as "the most efficient and appropriate approach,"[5] no longer qualified as such. Instead, both NYPC and FICC rely on the well-worn "free rider" argument, which has been the classic response of last resort for monopolists in every industry since the advent of the antitrust laws. Calling potential competitors "free-riders" is particularly ironic when the investment on which potential competitors would supposedly be "free-riding" was financed with monopoly profits,[6] and when the

---

3 The FICC Reply says that "the NYPC-FICC margin model does not *necessarily* increase leverage." FICC Reply at 8 (emphasis added).

4 See, e.g., Joe Nocera, Risk Mismanagement, New York Times Magazine (January 2, 2009) ("Given the calamity that has since occurred, there has been a great deal of talk, even in quant circles, that this widespread institutional reliance on VaR was a terrible mistake.") See also David Einhorn, Private Profits and Socialized Risk, Global Association of Risk Professionals 10 (June-July 2007) (analyst who predicted the demise of Lehman asks "how do the investment banks justify such thin capitalization ratios? And the answer is, in part, by relying on flawed risk models, most notably value at-risk (VaR).").

5 See NASDAQ OMX Comment Letter to the SEC dated December 21, 2010, at 6, citing SEC Release No. 34-45335, File No. SR-GSCC-2001-03 (January 25, 2002), 67 FR 4768 (January 31, 2002).

6 On December 21, 2010, the FICC filed with the SEC a proposal for a massive increase in fees for FICC's existing services. See SEC Rel. No. 34-63612 (File No. SR-FICC-2010-10) (December 29, 2010). As proposed, the FICC would raise its various fees by 12.5% to 50%. The proposal does not include any explanation of the purpose of or the basis for the fee increase. It is reasonable to surmise that the increase is economically feasible for FICC because it is a

monopoly in question was established through a government order, and not by dint of any patentable creative genius.[7]

As explained in our previous letter to the SEC, we continue to believe that FINRA's participation in TRFs is an appropriate analogy to FICC's proposal, and that FICC should grant market participants equal access to its facilities, and not exclude competitors in favor of its own affiliates.

* * * *

Thank you again for considering our views in this critically important matter.

Sincerely,

---

monopoly, and that the proceeds would be used, at least in part, to support FICC's outside investments, such as NYPC.

[7] NYPC and FICC do not allege that the prospect of competitor free-riding is actually causing them to reconsider their proposed arrangement. A useful precedent mentioned in the NASDAQ OMX Comments is FINRA's Trade Reporting Facility ("TRF") structure, which was originally conceived by FINRA and NASDAQ and then made available by FINRA to other exchanges.