NYPC NEW YORK PORTFOLIO CLEARING

DTCC
The Depository Trust & Clearing Corporation
55 Water Street
New York, NY 10041-0099

February 7, 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)

Dear Ms. Murphy,

The Fixed Income Clearing Corporation (**FICC**) and New York Portfolio Clearing, LLC (**NYPC**) are writing with respect to the proposed rule change filed by FICC to amend the FICC rules to allow for a proposed cross-margining arrangement with NYPC (**NYPC Arrangement**).[1] We wish to provide additional information with respect to the NYPC Arrangement.

Specifically, FICC and NYPC represent that they are committed to fair and open access on a non-discriminatory basis to the NYPC Arrangement. In addition, each agreement that is established between NYPC and a prospective NYPC Limited Purpose Participant (LPP) will be individually negotiated and are permitted to contain alternative requirements than those set forth in NYPC Rule 801(b) and Section 14(b) of the proposed Cross-Margining Agreement between FICC and NYPC.[2] In addition, the Guaranty Fund contribution that will be required by NYPC from any Limited Purpose Participant will be determined by risk-

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

[2] NYPC Rule 801(b) is set forth directly below and permits such alternative arrangements. Section 14(b)(i) through (v) of the proposed Cross-Margining Agreement between FICC and NYPC is essentially identical.

> *Except as otherwise provided in the LPP Agreement* (emphasis added):
>
> (1) Trades that are within the scope of the LPP Agreement and that would otherwise be cleared by such Limited Purpose Participant shall instead be submitted to the Clearinghouse, which shall act as central counterparty and DCO in respect thereof and shall include such trades in the arrangement that is the subject of the Cross-Margining Agreement;
>
> (2) Members of the Limited Purpose Participant shall be bound by the Rules as fully as if they were Clearing Members of the Clearinghouse, and the Clearinghouse shall have all of its rights, under its Rules and otherwise, in the event of a Default by a member of the Limited Purpose Participant;
>
> (3) A Limited Purpose Participant shall make a contribution to the Guaranty Fund, in form and substance similar to and in an amount that is no less than the amount of, the NYSE Guaranty;
>
> (4) The Clearinghouse shall not be required to accept trades in any product that is not eligible for clearing pursuant to the Cross-Margining Agreement; and
>
> (5) Clearing fees shall be allocated between the Clearinghouse and the Limited Purpose Participant as may be agreed by the Clearinghouse and the Limited Purpose Participant, taking into account the cost of services (including capital expenditures incurred by the Clearinghouse), technology that may be contributed by the Limited Purpose Participant, the volume of transactions, and such other factors as may be relevant.

based factors without regard to whether such contribution amount is more or less than the amount contributed to the NYPC Guaranty Fund by NYSE Euronext.

In addition, NYPC wants to provide additional clarity about its decision to utilize a historical Value-at-Risk (**VaR**)-based risk model to calculate margin requirements for derivatives, as opposed to the Standard Portfolio Analysis at Risk (**SPAN**) method commonly used to measure the risk associated with futures and options on futures positions.

As discussed in FICC's response letter dated January 4, 2011,[3] the historical simulation method of calculating VaR is one of the most common methods used by the industry for implementing VaR for the fixed income market[4] and has been utilized by FICC for several years, serving that clearinghouse through the recent financial crisis. Moreover, rigorous risk-related testing conducted in conjunction with discussions with staffs from the Commission, the Commodity Futures Trading Commission and the Federal Reserve demonstrated that the NYPC-FICC margin model tested at or above the 99th confidence level for both single pot and NYPC futures-only portfolios and provided strong evidence that the model is sensitive to changing market conditions.

With respect to utilizing historical VaR to calculate margin requirements for derivatives as opposed to SPAN, NYPC and FICC need to measure the risk of combined portfolios of futures and cash positions and believe that their historical VaR-based margin model provides a more accurate estimation of such portfolio risk than SPAN. In fact, we are unaware of other clearinghouses that have used SPAN to model combined portfolios of cash and derivatives positions, or cash positions alone.

NYPC recognizes, however, that it is standard practice in the futures industry for clearing members to calculate and monitor margin requirements for customers using SPAN. NYPC, therefore, intends to make available SPAN-formatted calculations of its VaR-based customer risk parameters available to clearing members and their customers. The SPAN-formatted arrays provided by NYPC are exclusively for the operational convenience of clearing members' existing back office systems, as such arrays will enable clearing members to charge customers initial margin levels using their existing technology. It should be noted that these SPAN-formatted arrays do not affect the actual original or variation margin obligations of clearing members to NYPC.

NYPC has previously provided comparative data to regulators, comparing on two separate dates in 2010 Chicago Mercantile Exchange (**CME**)-set SPAN margin requirements and SPAN-formatted input parameters generated based on outputs from the NYPC-FICC historical VaR-based margin model. Such parameters would be one factor used by NYSE Liffe U.S., the exchange initially listing NYPC-cleared contracts, in establishing minimum customer initial margin requirements for each NYPC-cleared interest rate contract and intra- and inter-commodity spreads.

It is important to note, however, that such minimum customer initial margin requirements, which will be set by the risk committee of NYSE Liffe U.S. in consultation with NYPC, will be informed by a variety of factors in addition to the SPAN-formatted input parameters, including the actual historical VaR-based charges applied by NYPC to its clearing members, concentration risk, the number of participants and volatility in the particular contract, market conditions, *etc*. For this reason, Designated Contract Markets (DCMs) typically impose customer initial margin requirements that are higher by a specific percentage than the initial margin requirements imposed on clearing members by its Derivatives Clearing Organization (DCO).[5] For this reason, it is difficult to make an "apples to apples" comparison between the raw VaR-based SPAN-formatted input parameters, which will inform, but not dictate, the minimum customer initial margin

[3] *See* Doug Landy, Allen & Overy LLP, on behalf of Fixed Income Clearing Corporation (January 4, 2011).
[4] *See* Deloitte, "Global Risk Management Survey: Sixth Edition Risk management in the spotlight" (2009).
[5] Customer initial margin requirements typically have been between 125% and 140% of a DCO's initial margin requirements. *See CFTC Proposed Rule on Risk Management Requirements for DCOs, 76 Federal Register 3698 (January 20, 2011).*

requirements set by NYSE Liffe U.S. in consultation with NYPC, and the SPAN margin requirements ultimately set by CME.

Margin requirements based on SPAN will also sometimes vary from margin requirements based on a historical VaR-based model due to the differences in the inputs and sensitivities of the different models and, as the comparative data described below illustrate, such variation may be in either direction. Even with such variations, the most important measure of a risk model remains its coverage of historical price moves and the NYPC-FICC historical VaR-based model has been shown to provide such margin coverage 99 percent of the time.

For example, when looking at the average percentage difference in margin requirements for speculators/hedgers as between CME SPAN and NYPC's SPAN-formatted input parameters on one particular date in 2010, CME's margin requirement was, on average, approximately seven percent higher for the five contracts that NYSE Liffe U.S. plans to list and clear through NYPC at NYPC's launch.[6] The differences range from the NYPC SPAN-formatted input parameter being approximately 29 percent higher to approximately 25 percent lower than CME SPAN margin requirements. On another date in 2010, CME's average margin requirement was approximately twenty-five percent higher than NYPC's SPAN-formatted input parameter, ranging from approximately 40 percent higher to approximately 4 percent lower for the five interest rate contracts analyzed.

When analyzing Eurodollar spreads, for example, differences in spread margins were minimal for the two sample dates in 2010, with NYPC's SPAN-formatted input parameters being on average approximately 10 percent higher than CME SPAN margin requirements on one of two dates in 2010, and approximately 1.5 percent lower on another date in 2010. When analyzing more complicated spread trades (*e.g.,* Butterflies and Condors), on one of the dates in 2010, the spread trades studied resulted on average with approximately 58 percent higher margin requirements being charged under NYPC's SPAN-formatted input parameters than by CME SPAN. On another date in 2010, CME SPAN charged on average approximately 2.5 percent more on margin than the NYPC SPAN-formatted input parameters.

It is important to emphasize that, as described above, NYPC SPAN-formatted input parameters would be one of several factors considered by NYSE Liffe U.S. in consultation with NYPC in setting minimum customer initial margin requirements. As noted above and typical with these DCM-set margin amounts, the customer margin minimums for both of the points in time in question would likely be set higher than the raw values generated by the VaR-based NYPC SPAN- formatted input parameters. It should also be noted that the percentage differences cited above between NYPC's SPAN-formatted input parameters and CME SPAN margin requirements are indicative samples only, looking at two distinct points in time, and may not be representative of future results.

In sum, exchange-determined minimum customer margin requirements may vary due to the fact that exchanges consider a variety of factors in establishing such requirements, including, but not limited to, their respective risk models. They may also vary due to the differences in the inputs and sensitivities of the underlying models themselves, and such variation may be in either direction. While a comparison of SPAN and the NYPC-FICC historical VaR-based margin model may be informative, the most important aspect of any risk model is whether it adequately protects a clearinghouse from market risk, and, although there are times when its outputs may differ from those of other models, like SPAN, the NYPC-FICC historical VaR-based model has been shown through rigorous risk-related testing to be sensitive to changing market conditions and to provide margin coverage 99 percent of the time, thereby clearly demonstrating its ability to adequately protect NYPC from market risk.

[6] At NYPC's launch, NYSE Liffe U.S. plans to list and clear through NYPC Eurodollar futures and 2-year, 5-year and 10-year U.S. Treasury Note futures and U.S. Treasury bond futures.

* * *

In closing, FICC and NYPC believe that FICC's rule proposal and the NYPC Arrangement will result in more efficient use of participant collateral and promote efficiencies in the marketplace. FICC and NYPC respectfully urge the Commission to approve FICC Rule Filing 2010-09 to implement the NYPC Arrangement.

If the Commission has any questions on the foregoing, please contact Nikki Poulos, at 212-855-7633 or npoulos@dtcc.com, or Laura Klimpel, at 212-855-5230 or lklimpel@nypclear.com.

Very truly yours,

Michael C. Bodson

Walt L. Lukken

Michael Bodson
Executive Managing Director
Fixed Income Clearing Corporation

Walt Lukken
Chief Executive Officer
New York Portfolio Clearing, LLC

cc: Mary L. Shapiro, 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

Larry Thompson, Managing Director and General Counsel, DTCC
Murray Pozmanter, Managing Director, DTCC
Nikki Poulos, Managing Director, DTCC, and FICC General Counsel

Laura Klimpel, Chief Compliance Officer and Counsel, NYPC