SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-63986; File No. SR-FICC-2010-09)

February 28, 2011

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Granting Approval of a Proposed Rule Change to Introduce Cross-Margining of Certain Positions Cleared at the Fixed Income Clearing Corporation and Certain Positions Cleared at New York Portfolio Clearing, LLC

I. Introduction

On November 12, 2010, Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-FICC-2010-09 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act").[1] Notice of the proposed rule change was published in the Federal Register on November 30, 2010.[2] The Commission initially received thirteen comments to the proposed rule change.[3] FICC, as well as one of the commenters,

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[1] 15 U.S.C. 78s(b)(1).

[2] Securities Exchange Act Release No. 63361 (November 23, 2010), 75 FR 74110 (November 30, 2010) (FICC-2010-09). In its filing with the Commission, FICC included statements concerning the purpose of and basis for the proposed rule change. The text of these statements are incorporated into the discussion of the proposed rule change in Section II below.

[3] Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010); Letter from Douglas Engmann, President, Engmann Options, Inc. (December 6, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); Letter from John C. Hiatt, Chief Administrative Officer, Ronin Capital (December 10, 2010); Letter from Richard D. Marshall, Ropes & Gray on behalf of ELX Futures, LP (December 15, 2010); Letter from John Willian, Managing Director, Goldman Sachs (December 17, 2010); Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS Securities, LLC (December 20, 2010); Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010); Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010); Letter from Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC (December 21, 2010); Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel, LLC

submitted letters responding to the comments.[4] For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

The proposed rule change allows FICC to offer cross-margining of certain positions cleared at its Government Securities Division ("GSD") and certain positions cleared at New York Portfolio Clearing, LLC ("NYPC").[5] GSD members will be able to combine their positions at GSD with their positions at NYPC, or those positions of certain permitted affiliates cleared at NYPC, within a single margin portfolio ("Margin Portfolio"). The proposed rule change also makes certain other related changes to GSD's rules.

A. Cross-Margining with NYPC

Under the proposed rule, a member of FICC that is also an NYPC clearing member ("Joint Clearing Member") could in accordance with the provisions of the GSD and NYPC Rules, elect to participate in the cross-margining arrangement. FICC's rules permit a GSD netting member that is a member (or that has an affiliate that is a member)

(December 21, 2010); Letter from William H. Navin, Executive Vice President and General Counsel, The Options Clearing Corporation (December 21, 2010); and Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX (December 21, 2010).

[4] Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011); Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011); Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011); and Letter from Alex Kogan, Vice President and Deputy General Counsel, NASDAQ OMX (January 10, 2011).

[5] NYPC is jointly owned by NYSE Euronext and The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the parent company of FICC. On January 31, 2011, the Commodity Futures Trading Commission ("CFTC") approved NYPC's registration as a derivatives clearing organization ("DCO") pursuant to Section 5b of the Commodity Exchange Act and Part 39 of the Regulations of the CFTC.

of one or more Futures Clearing Organizations ("FCO"),[6] such as NYPC, to become a cross-margining participant in a cross-margining arrangement between FICC and one or more FCOs with the consent of FICC and each such FCO. A netting member shall become a cross-margining participant upon acceptance of FICC and each applicable FCO of an agreement executed by such cross-margining participant in the form specified in the applicable cross-margining agreement.[7]

Participating in the cross-margining arrangement would permit a Joint Clearing Member to have its margin requirement calculated taking into account both its positions at FICC and NYPC, which should provide a clearer picture of its risk exposure and generally facilitate better risk assessment by FICC. Specifically, each Joint Clearing Member would have its margin requirement with respect to Eligible Positions (i.e., positions in certain securities netted by FICC or certain futures contracts cleared by an FCO)[8] in its proprietary account at NYPC and its margin requirement with respect to

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6 "FCO" is defined in GSD Rule 1 as a clearing organization for a board of trade designated as a contract market under Section 5 of the Commodity Exchange Act that has entered into a Cross-Margining Agreement with FICC.

7 See GSD Rule 43, Cross-Margining Arrangements, Section 2. The cross-margining agreement between FICC and NYPC as well as the cross-margining participant agreements for joint and permitted affiliates are attached to FICC's filing of proposed rule change SR-FICC-2010-09.

8 The term "Eligible Position" is currently defined in GSD's rules as a position in certain Eligible Netting Securities netted by FICC, or certain Government securities futures contracts or interest rate futures contracts cleared by a FCO as identified in a Cross-Margining Agreement as eligible for cross-margining treatment.

"Eligible Netting Security" is defined in GSD Rule 1 as an Eligible Security that FICC has designed as eligible for netting.

"Eligible Security" is defined generally in GSD Rule 1 as a security issued or guaranteed by the United States, a U.S. government agency or instrumentality, a U.S. government-sponsored corporation, or any other security approved by FICC's board of directors from time to time, or one or more categories of such

Eligible Positions at FICC calculated as a single portfolio, which would factor in the net risk of such Eligible Positions at both clearing organizations. In addition, an affiliate of a member of FICC that is also a clearing member of NYPC ("Permitted Margin Affiliate")[9] could similarly elect to participate in the cross-margining arrangement and have its margin requirement with respect to Eligible Positions in its proprietary account at NYPC calculated as a single portfolio with the Eligible Positions of the FICC member.

The proposed rule allows (i) Joint Clearing Members and (ii) members of FICC and their Permitted Margin Affiliates to have their margin requirements for positions at FICC and NYPC determined as a single portfolio, with FICC and NYPC each having a security interest in such members' and Permitted Margin Affiliates' margin deposits and other collateral to secure their obligations to FICC and NYPC.

The following types of FICC members will not be eligible to participate in the cross-margining arrangement ("NYPC Arrangement"), in order to allow FICC to maintain segregation of certain business or member types that are treated differently for purposes of loss allocation: (i) GSD Sponsored Members,[10] (ii) Inter-Dealer Broker

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securities as represented by a generic CUSIP number, that FICC has listed on the Eligible Securities master file maintained by it pursuant to GSD Rule 30.

[9] The term "Permitted Margin Affiliate" is being added to GSD Rule 1 and is defined as an affiliate of a Member that is (i) also a member of GSD, and/or (ii) a member of an FCO with which FICC has entered into a Cross-Margining Agreement that provides for margining of positions between FICC and the FCO as if such positions were in a single portfolio and that directly or indirectly controls such particular member, or that is directly or indirectly controlled by or under common control with such particular member. Ownership of more than 50% of the common stock of the relevant entity (or equivalent equity interests in the case of a form of entity that does not issue common stock) will be conclusive evidence of prima facie control of such entity for purposes of this definition.

[10] A "Sponsored Member" of GSD is any person that has been approved by FICC to be sponsored into membership by a "Sponsoring Member" pursuant to GSD Rule 3A. A "Sponsoring Member" is a member of GSD's comparison and netting system whose application to become a sponsoring member has been approved by

Netting Members,[11] and (iii) Dealer Netting Members[12] with respect to their segregated brokered accounts. In addition, in order for a Bank Netting Member[13] to combine its accounts into a Margin Portfolio with any other accounts, it will have to demonstrate to the satisfaction of FICC and NYPC that doing so will comply with the regulatory requirements applicable to the Bank Netting Member (e.g., by providing an opinion of counsel or otherwise outlining compliance with relevant statutory provisions).[14]

In order to distinguish the NYPC Arrangement from an existing cross-margining arrangement between the Chicago Mercantile Exchange ("CME") and FICC ("CME Arrangement"), the proposed rule amends the definition of "Cross-Margining Agreement" in the GSD rules to mean an agreement entered into between FICC and one or more FCOs pursuant to which a Cross-Margining Participant,[15] in accordance with the

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the FICC's board of directors pursuant to GSD Rule 3A. See GSD Rule 1, Definitions.

11 The definition of "Inter-Dealer Broker Netting Member," as revised by the proposed rule change, is an inter-dealer broker admitted to membership in GSD's netting system. See GSD Rule 2A, Initial Membership Requirements.

12 The definition of a "Dealer Netting Member," as revised by the proposed rule change, is a registered government securities dealer admitted to membership in GSD's netting system. See GSD Rule 2A, Initial Membership Requirements.

13 Under GSD Rule 2A, a person shall be eligible to apply to become a "Bank Netting Member" of GSD if it is a bank or trust company chartered as such under the laws of the United States, or a State thereof, or is a bank or trust company established or chartered under the laws of a non-U.S. jurisdiction, and participates in FICC through its U.S. branch or agency. A bank or trust company that is admitted to membership in GSD's netting system, the netting system, pursuant to these Rules, and whose membership in the netting system has not been terminated, shall be a Bank Netting Member. See GSD Rule 2A, Initial Membership Requirements, Section 2.

14 See GSD Rule 4, Clearing Fund and Loss Allocation, Section 1a as proposed to be amended by the proposed rule change.

15 The term "Cross-Margining Participant" is defined in GSD Rule 1 as a Netting Member that is authorized by FICC to participate in the Cross-Margining Arrangement between FICC and one or more FCOs pursuant to a Cross-Margining Agreement. GSD Rule 1 defines the term "Cross-Margining

provisions of the GSD Rules and otherwise at the discretion of FICC, could elect to have its Required Fund Deposit[16] with respect to Eligible Positions at FICC, and its (or its Permitted Margin Affiliates' Required Fund Deposit, if applicable) margin requirements with respect to Eligible Positions at such FCO(s), calculated either (i) by taking into consideration the net risk of such Eligible Positions at each of the clearing organizations or (ii) as if such positions were in a single portfolio. The CME Arrangement falls into clause (i) of the definition, whereas the NYPC Arrangement will fall into clause (ii). Conforming changes will be made to GSD Rule 1, Definitions, relating to cross-margining. GSD Rule 43, Cross-Margining Arrangements, also will be amended to add provisions regarding single-portfolio margining (i.e., the proposed NYPC Arrangement). To implement this proposal, FICC and NYPC will enter into a cross-margining agreement ("NYPC Agreement"). The NYPC Agreement was filed with the Commission as part of proposed rule change SR-FICC-2010-09 and will be appended to the GSD Rules and made a part thereof.

Pursuant to the NYPC Agreement, and consistent with previous approvals of cross-margining arrangements involving DCOs,[17] cross-margining with certain NYPC positions will be limited to positions carried in proprietary accounts of clearing members of NYPC. Customers of NYPC clearing members will not be permitted to participate in

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Arrangement" as the arrangement established between FICC and one or more FCOs pursuant to Cross-Margining Agreements and GSD Rule 43.

[16] The definition of "Required Fund Deposit," as revised by the proposed rule change, is the amount that a Netting Member is required by a GSD rule to contribute to GSD's clearing fund. See GSD Rule 1, Definitions.

[17] See, e.g., Securities Exchange Act Release No. 44301 (May 11, 2001), 66 FR 28207 (approving a proposed rule change establishing cross-margining between FICC and CME) and Securities Exchange Act Release No. 27296 (September 26, 1989), 54 FR 41195 (approving a proposed rule changes establishing cross-margining between The Options Clearing Corporation and the CME).

the NYPC Arrangement, as their participation would require the resolution of additional issues associated with fund segregation and operations. Neither FICC nor NYPC rules require their members to participate in the NYPC Arrangement, and any such participation by FICC and NYPC members will be voluntary. Joint Clearing Members and members of FICC and their Permitted Margin Affiliates will be required to execute the requisite cross-margining participant agreements.[18]

FICC will be responsible for performing the margin calculations in its capacity as the Administrator under the terms of the NYPC Agreement. Specifically, FICC will determine the combined FICC clearing fund and NYPC original margin requirement for each participant.[19] FICC will calculate those requirements using a Value-at-Risk ("VaR") methodology, with a 99 percent confidence level and a 3-day liquidation period for cash positions and a 1-day liquidation period for futures positions. In addition, each cross-margining participant's "one-pot" margin requirement will be subject to a daily back test, and a supplemental risk-related charge referred to as a coverage component that will be applied to the participant in the event that the back test reflects insufficient coverage. The "one-pot" margin requirement for each participant would then be allocated between FICC and NYPC in proportion to the clearing organizations' respective "stand-alone" margin requirements – in other words, an amount reflecting the ratio of what each clearing organization would have required from that participant if it was not participating in the cross-margining program ("Constituent Margin Ratio"). The NYPC Agreement provides that either FICC or NYPC can, at any time, require additional

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[18] The NYPC Agreement and the cross-margining participant agreements for Joint Members and Permitted Affiliates were filed with the Commission as part of the proposed rule change.

[19] Original margin is the NYPC equivalent of the FICC clearing fund.

margin to be deposited by a Cross-Margining Participant above what is calculated under the NYPC Agreement based upon the financial condition of the participant, unusual market conditions, or other special circumstances (e.g., in the event of regulatory or criminal proceedings). The standards that FICC proposes to use for these purposes are the standards currently contained in the GSD rules, so that notwithstanding the calculation of a Cross-Margin Participant's clearing fund requirement pursuant to the NYPC Agreement, FICC will retain its rights under the GSD rules to charge additional clearing fund contributions under the circumstances specified in the GSD rules. For example, the GSD rules provide that if a Dealer Netting Member falls below its minimum financial requirement, it shall be required to make additional clearing fund contributions equal to the greater of (i) $1 million or (ii) 25 percent of its Required Fund Deposit.

FICC will utilize the same VaR methodology for calculating margin for futures and cash positions. Under this method, the prior 250 days of historical information for futures positions and the prior 252 days of historical information for cash positions, including prices, spreads and market variables such as Treasury zero-coupon yields and London Interbank Offered Rate curves, are used to simulate the market environments in the forthcoming 1 day for futures positions and the forthcoming 3 days for cash positions. Projected portfolio profits and losses are calculated assuming these simulated environments will actually be realized. These simulations will be used to calculate VaR. Historical simulation is a continuation of the FICC margin methodology.

With respect to the confidence level, FICC currently utilizes extreme value theory[20] to determine the 99th percentile of loss distribution. Upon implementation of the

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[20] Extreme value theory is used to analyze outcomes beyond the 99 percent confidence interval used for VaR and provides an assessment of the size of these events.

NYPC Arrangement, FICC will utilize a front-weighting mechanism to determine the 99th percentile of loss distribution. This front-weighting mechanism will place more emphasis on more recent observations. Additionally, FICC's VaR methodology will be enhanced to accommodate more securities; as a result, certain CUSIPs, which are now considered to be "non-priceable" (because, for example, of a lack of historical information regarding the security) and subject to a "haircut" requirement (i.e., fixed percentage charge) where offsets are not permitted, will be treated as "priceable" and therefore included in the core VaR calculation.

Based on preliminary analyses, FICC expects that the FICC VaR component of the clearing fund requirement may be reduced by as much as approximately 20 percent for common FICC-NYPC members as a result of the NYPC Arrangement. In order to help ensure that this reduction in clearing fund is appropriately correlated to more precise assessment of exposures associated with considering offsetting positions and will not result in increased risks to the clearing agency, FICC has performed back testing analysis to verify that there will be sufficient coverage after the FICC-NYPC cross-margining reductions are applied.

In the event of the insolvency or default of a member that participates in the NYPC Arrangement, the positions in such participant's "one-pot" portfolio, including, where applicable, the positions of its Permitted Margin Affiliate at NYPC, will be liquidated by FICC and NYPC as a single portfolio and the liquidation proceeds will be applied to the defaulting participant's obligations to FICC and NYPC in accordance with the provisions of the NYPC Agreement.

The NYPC Agreement provides for the sharing of losses by FICC and NYPC in the event that the "one-pot" portfolio margin deposits of a defaulting participant are not

sufficient to cover the losses resulting from the liquidation of that participant's trades and positions. This loss-sharing arrangement can be summarized as follows:

- If either clearing organization had a net loss ("worse-off party"), and the other had a net gain ("better-off party") that is equal to or exceeds the worse-off party's net loss, then the better-off party pays the worse-off party the amount of the latter's net loss. In this scenario, one clearing organization's gain will extinguish the entire loss of the other clearing organization.
- If either clearing organization had a net loss ("worse-off party") and the other clearing organization had a net gain ("better-off party") that is less than or equal to the worse-off party's net loss, then the better-off party will pay the worse-off party an amount equal to the net gain. Thereafter, if such payment did not extinguish the net loss of the worse-off party, the better-off party will pay the worse-off party an amount equal to the lesser of: (i) the amount necessary to ensure that the net loss of each clearing organization is in proportion to the Constituent Margin Ratio or (ii) the better-off party's "Maximum Transfer Payment" less the better-off party's net gain. The "Maximum Transfer Payment" will be defined with respect to each clearing organization to mean an amount equal to the product of (i) the sum of the aggregate margin reductions of the clearing organizations and (ii) the other clearing organization's Constituent Margin Ratio – in other words, the amount by which the other clearing organization reduced its margin requirements in reliance on the cross-margining arrangement. In this scenario, one clearing organization's gain does not completely extinguish the entire loss of the other clearing organization, and the better-off party will be required to make an

additional payment to the worse-off party. This potential additional payment will be capped as described in this paragraph.

- If either clearing organization had a net loss, and the other had the same net loss, a smaller net loss, or no net loss, then:
  - In the event that the net losses of the clearing organizations were in proportion to the Constituent Margin Ratio, no payment will be made.
  - In the event that the net losses of the clearing organizations were not in proportion to the Constituent Margin Ratio, then the clearing organization that had a net loss which was less than its proportionate share of the total net losses incurred by the clearing organizations ("better-off party") will pay the other clearing organization ("worse-off party") an amount equal to the lesser of: (i) the better-off party's Maximum Transfer Payment or (ii) the amount necessary to ensure that the clearing organizations' respective net losses were allocated between them in proportion to the Constituent Margin Ratio.
- If FICC had a net gain after making a payment as described above, FICC will pay to NYPC the amount of any deficiency in the defaulting member's customer segregated funds accounts or, if applicable, such defaulting member's Permitted Margin Affiliate held at NYPC up to the amount of FICC's net gain.
- If FICC received a payment under the Netting Contract and Limited Cross-Guaranty ("Cross-Guaranty Agreement")[21] to which it is a party (i.e., because

[21] FICC's predecessors, the Government Securities Clearing Corporation ("GSCC") and the MBS Clearing Corporation ("MBSCC"), filed rule filings in 2001 to enter into the Cross-Guaranty Agreement with The Depository Trust Company,

> FICC had a net loss), and NYPC had a net loss, FICC will share the cross-guaranty payment with NYPC pro rata, where such pro rata share is determined by comparing the ratio of NYPC's net loss to the sum of FICC's and NYPC's net losses. This allocation is appropriate because the "one-pot" combines FICC and NYPC proprietary positions into a unified portfolio that will be margined and liquidated as a single unit. FICC will no longer need to share the cross-guaranty payments with NYPC once NYPC becomes a party to the Cross-Guaranty Agreement.

The GSD rules will further provide that FICC will offset its liquidation results in the event of a close out of the positions of a Cross-Margining Participant in the NYPC Agreement first with NYPC because the liquidation will essentially be of a single Margin Portfolio and then will present its results for purposes of the multilateral Cross-Guaranty Agreement.

B. Access to NYPC Arrangement

FICC has represented that the NYPC Arrangement has been structured in a way that access to, and the benefits of, the "one-pot" are provided to other futures exchanges and DCOs on fair and reasonable terms as described below. The proposed "one-pot" cross-margining method is expected to allow members to post margin that should more accurately reflect the net risk of their aggregate positions across asset classes, thereby releasing excess capital into the economy for more efficient use. By linking positions in fixed income securities held at FICC with interest rate products traded on NYSE Liffe

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National Securities Clearing Corporation, Emerging Markets Clearing Corporation, and The Options Clearing Corporation. Securities Exchange Act Release No. 45868 (May 2, 2002), 67 FR 31394. Under the agreement, if the assets of a defaulting member at one clearing agency exceed its liabilities to that clearing agency, those excess assets may be made available to satisfy the liabilities of that defaulting common member to another clearing agency.

U.S. and other designated contract markets ("DCMs"), the NYPC Arrangement has the potential to create a substantial pool of highly correlated assets that are capable of being cross-margined. This pool will deepen as more DCOs and DCMs join NYPC, creating the potential for even greater margin and risk offsets.

The proposed "one-pot" is required to be accessed by other futures exchanges and DCOs via NYPC.[22] FICC stated that this is done to ensure the uniformity and consistency of risk methodologies and risk management, to simplify and standardize operational requirements for new participants and to maximize the effectiveness of the one-pot arrangement.

FICC stated that NYPC will initially clear certain contracts transacted on NYSE Liffe U.S. and that NYPC will clear for additional DCMs that seek to clear through NYPC as soon as it is feasible for NYPC do so. Such additional DCMs will be treated in the same way as NYSE Liffe US, i.e., they must: (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.

Moreover, NYPC has also committed to admit other DCOs as limited purpose participants as soon as it is feasible, thereby allowing such DCOs to participate in the

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[22] Section 16 of the NYPC Agreement provides that FICC covenants and agrees that, during the term of the NYPC Agreement: (i) NYPC-cleared contracts shall have priority for margin offset purposes over any other cross-margining agreement; (ii) FICC will not enter into any other cross-margining agreement if such agreement would adversely affect the priority of NYPC and FICC under the NYPC Agreement with respect to available assets; and (iii) FICC will not, without the prior written consent of NYPC, amend the CME Agreement, if such further amendment would adversely affect NYPC's right to cross-margin positions in eligible products prior to any cross-margining of CME positions with FICC-cleared contracts or adversely affect the priority of NYPC and FICC under the NYPC Agreement with respect to available assets.

one-pot margining arrangement with FICC through their limited purpose membership in NYPC.[23] Such DCOs will be required to satisfy pre-defined, objective criteria set forth in NYPC's rules.[24] In particular, such DCOs must: (i) submit trades subject to the limited purpose participant agreement between NYPC and each DCO that would otherwise be cleared by the DCO to NYPC, with NYPC acting as central counterparty and DCO with respect to such trades,[25] (ii) be eligible under the rules of NYPC and agree to be bound by the NYPC rules,[26] (iii) contribute to NYPC's guaranty fund,[27] (iv) provide clearing services to unaffiliated markets on a "horizontal" basis (i.e., not limit their provision of clearing services on a vertical basis to a single market or limited number of markets),[28] and (v) agree to participate using the uniform risk methodology and risk management

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23 See NYPC Agreement, Section 14.

24 NYPC's rules can be viewed as part of NYPC's DCO registration application on the CFTC's website (www.cftc.gov), as well as on NYPC's website (www.nypclear.com).

25 See NYPC Rule 801(b)(1).

26 See NYPC Rule 801(b)(2).

27 The NYPC Agreement provides that except as otherwise provided in a limited purpose participant agreement, a limited purpose participant shall make a contribution to the NYPC Guaranty Fund in form and substance similar to and in an amount that is no less than the amount of the NYSE Guaranty, which will initially consist of a $50,000,000 guaranty secured by $25,000,000 in cash during the first year of NYPC's operations. FICC and NYPC have subsequently clarified and affirmatively represented that the limited purpose participant agreements will be individually negotiated and that "the Guaranty Fund contribution that will be required by NYPC from any Limited Purpose Participant will be determined by risk-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." See Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011). See also Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011).

28 See NYPC Rule 801(c)(1)(i).

policies, systems and procedures that have been adopted by FICC and NYPC for implementation and administration of the NYPC Arrangement.[29] Reasonable clearing fees will be allocated between NYPC and the limited purpose participant DCO as may be agreed by NYPC and the DCO, taking into account factors such as the cost of services (including capital expenditures incurred by NYPC), technology that may be contributed by the limited purpose participant, the volume of transactions, and such other factors as may be relevant.

FICC and NYPC anticipate that the limited purpose participant agreement will encompass the foregoing requirements for limited purpose membership contained in NYPC's rules. Because each DCO could present different operational issues, terms beyond the basic rules provisions will be discussed on a case-by-case basis and reflected in the respective limited purpose participant agreement accordingly. FICC and NYPC envision that a possible structure for DCO limited purpose participation could be an omnibus account, with the DCO limited purpose participant essentially acting as a processing agent for its clearing members vis-a-vis NYPC with respect to the submission of eligible positions of the DCO's clearing members to NYPC for purposes of inclusion in the one-pot arrangement with FICC. In order for their eligible positions to be included in the "one-pot," clearing members of the DCO limited purpose participant would be required to authorize the DCO to submit their positions to NYPC. Under such a structure, the DCO would be responsible for fulfilling all margin and guaranty fund requirements associated with the activity in the omnibus account.

With respect to both the clearance of trades for unaffiliated DCMs and the admission of DCOs as limited purpose participants, FICC has indicated that NYPC has

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[29] See NYPC Rule 801(c)(1)(ii).

committed that it will complete the process to allow one or more DCMs or DCOs to be admitted and integrated into the "one-pot" cross-margining arrangement as soon as feasible, but no later than 24 months from the start of operations. FICC has represented that this provision is necessary to the effective implementation of the one-pot cross-margining methodology and that this window of time is required to allow for refinement and enhancement of certain systems after operations commence, to allow time for the possible simultaneous integration with multiple major clearing members so that fair market access is assured, and to allow time for the completion of the material operational challenge of connecting and integrating NYPC with the separate technologies of other DCMs and/or DCOs. However, during this interim period, NYPC may engage, and FICC has represented in its filing to the Commission that NYPC is engaging, in discussions with other DCMs and DCOs. FICC has also represented in its filing that NYPC anticipates that it will be able to complete the integration of additional DCMs and/or DCOs in advance of this two-year period.

C. Other GSD Proposed Rule Changes

The proposed rule filing allows FICC to permit margining of positions held in accounts of an affiliate of a member within GSD, akin to the inter-affiliate margining in the CME Arrangement and the proposed NYPC Arrangement. Thus, as in those arrangements, if a GSD member defaults, its GSD clearing fund deposits, cash settlement amounts and other available collateral will be available to FICC to cover the member's default, as will the GSD clearing fund deposits and available collateral of any Permitted Margin Affiliate with which it cross-margins.

1. Loss Allocation

Under the current loss allocation methodology in GSD Rule 4, Clearing Fund and

Loss Allocation, GSD allocates losses first to the most recent counterparties of a defaulting member. The proposed changes to GSD Rule 4 will delete this step in the loss allocation methodology in order to achieve a more even distribution of losses among GSD members without a focus on recent counterparties.

Under the proposed rule change any loss allocation will be made first against the retained earnings of FICC attributable to GSD in an amount up to 25 percent of FICC's retained earnings or such higher amount as may be approved by the Board of Directors of FICC.

If a loss still remains, GSD will divide the loss between the FICC Tier 1 Netting Members and the FICC Tier 2 Netting Members. The terms "Tier 1 Netting Member" and "Tier2 Netting Member" have been introduced in the GSD Rules to reflect two different categories of membership, which have been designated as such by FICC for loss allocation purposes. Currently, only investment companies registered under the Investment Company Act of 1940, as amended, (which companies are subject to regulatory requirements restricting their ability to mutualize losses) will qualify as Tier 2 Netting Members. Tier 2 Netting Members will only be subject to loss to the extent they traded with the defaulting members and will not be responsible for mutualizing losses with participants with which they do not trade, in order to account for regulatory requirements applicable to such registered investment companies.

Tier 1 Netting Members will be allocated the loss applicable to them first by assessing the Clearing Fund deposit of each such member in the amount of up to $50,000, equally. If a loss remains, Tier 1 Netting Members will be assessed ratably in accordance with the respective amounts of their Required Fund Deposits based on the average daily amount of the member's Required Fund Deposit over the prior twelve months.

Consistent with the current GSD rules, GSD members that are acting as inter-dealer brokers will be limited to a loss allocation of $5 million with respect to their inter-dealer broker activity.

2. Margin Calculation—Intraday Margin Calls

GSD proposes to calculate Clearing Fund requirements twice per day. GSD will retain its regular calculation and call as set out in the GSD rules. An additional daily intra-day calculation and call ("Intraday Supplemental Clearing Fund Deposit") are being added to GSD's rules.[30] The intra-day call will be subject to a threshold that will be identified in FICC's risk management procedures.[31] In addition, GSD will process a mark-to-market pass-through twice per day, instead of the current practice of once daily. The second collection and pass-through of mark-to-market amounts will include a limited set of components to be defined in FICC's risk management procedures. All mark-to-market debits will be collected in full. FICC will pay out mark-to-market credits only after any intra-day clearing fund deficit is met.

Since GSD will be recalculating and margining a GSD member's exposure intra-day, the margin calculation methodology set forth in GSD Rule 4, Clearing Fund and Loss Allocation, will be revised to eliminate the "Margin Requirement Differential" component of the FICC clearing fund calculation. In addition, GSD Rule 4 will be revised to provide that in the case of a Margin Portfolio that contains accounts of a Permitted Margin Affiliate, FICC will apply the highest VaR confidence level applicable

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30 See GSD Rule 4, Clearing Fund and Loss Allocation, Section 2a as proposed to be amended by the proposed rule change.

31 Id. FICC shall establish procedures for collection of an amount calculated in respect of a Member's Intraday Supplemental Fund Deposit, including parameters regarding threshold amounts that require payment, and the form and time by which payment is required to be made to FICC.

to the GSD member or the Permitted Margin Affiliate, in the event that multiple confidence levels are used to determine margin. Application of a higher VaR confidence level will result in a higher margin rate. Consistent with current GSD rules, a minimum Required Fund Deposit of $5 million will apply to a member that maintains broker accounts.

3. Consolidated Funds-Only Settlement

The funds-only settlement process at GSD currently requires a member to appoint a settling bank that will settle the member's net debit or net credit amount due to or from GSD by way of the National Settlement Service of the Board of Governors of the Federal Reserve System ("NSS"). Any funds-only settling bank that will settle for a member that is also an NYPC member or that will settle for a member and a Permitted Margin Affiliate that is an NYPC member will have its net-net credit or debit balances at each clearing corporation, other than balances with respect to futures positions of a "customer" as such term is defined in CFTC Regulation 1.3(k), aggregated and netted for operational convenience and will pay or be paid such netted amount. The proposed rule change makes clear that, notwithstanding the consolidated settlement, the member will remain obligated to GSD for the full amount of its funds-only settlement amount.

4. Submission of Locked-In Trades from NYPC

The current GSD rules allow for submission of "locked-in trades" (i.e., trades that are deemed compared when the data on the trade is received from a single source)[32]

[32] The term "Locked-In Trade" means a trade involving Eligible Securities that is deemed a compared trade once the data on such trade is received from a single, designated source and meets the requirements for submission of data on a locked-in trade pursuant to GSD's rules, without the necessity of matching the data regarding the trade with data provided by each member that is or is acting on behalf of an original counterparty to the trade. The data regarding a locked-in

submitted by a locked-in trade source on behalf of a GSD member. Currently, designated locked-in trade sources are Federal Reserve Banks on behalf of the Treasury Department, Freddie Mac, and GCF-Authorized Inter-Dealer Brokers for GCF Repo transactions. Under the proposed rule change, GSD Rule 6C, Locked-In Comparison, will be amended to include NYPC as an additional locked-in trade source. This is necessary because there will be futures transactions cleared by NYPC that will proceed to physical delivery. NYPC will submit the trade data as a locked-in trade source for processing through FICC, identifying the GSD member that had authorized FICC to accept the locked-in trade from NYPC. Once these transactions are submitted to FICC, they will no longer be futures, but rather will be in the form of buys or sells eligible for processing by GSD. As will be the case with other locked-in trade submissions accepted by FICC, the GSD member designated in the trade information must have executed appropriate documentation evidencing to FICC its authorization of NYPC.

5. Deletion of the Category 1/Category 2 Distinction

The proposed rule change will delete the legacy characterization of certain types of members as either "Category 1" or "Category 2," a distinction that currently applies to "Dealer Netting Members," "Futures Commission Merchant Netting Members" and "Inter-Dealer Broker Netting Members" at GSD. Historically, the two categories were used to margin lower capitalized members (i.e., Category 2) at a higher rate. Following FICC's adoption of the VaR methodology for GSD in 2006,[33] FICC has determined that the distinction between Category 1 and Category 2 members is no longer necessary. Rather than margin netting members at higher rates solely due to a single static

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trade are provided to FICC by a locked-in trade source that has been authorized by a member that is a party to the trade to provide such data to FICC.

[33] Securities Exchange Act Release No. 55217 (January 31, 2007), 72 FR 5774.

capitalization threshold, FICC is able, by use of the VaR margin methodology, to margin netting members at a higher rate by applying a higher confidence level against any netting member, which, regardless of size, FICC has determined poses a higher risk.

With the deletion of the Category 1/Category 2 distinction, Section 1 of GSD Rule 13, Funds-Only Settlement, is proposed to be changed to provide that all netting members could receive forward mark adjustment payments, subject to FICC's general discretion to withhold credits that would be otherwise due to a distressed netting member.

6. Amendment of CME Agreement

The proposed NYPC Arrangement will necessitate an amendment to the CME Agreement to clarify that the NYPC Arrangement will take priority over the CME Arrangement when determining residual FICC positions that will be available for cross-margining with the CME. As a result, only those FICC positions that are not able to be cross-margined with NYPC positions under the NYPC Arrangement will generally be considered for cross-margining with the CME. In addition, when calculating and presenting liquidation results under the CME Agreement, the amendment will provide that FICC's liquidation results will include FICC's liquidation results in combination with NYPC's liquidation results because the NYPC Agreement will provide for a right of first offset between FICC and NYPC. The CME Agreement showing the proposed changes was filed as an attachment to the proposed rule change as part of Exhibit 5.

D. Summary of Other Proposed Changes to Rule Text

In GSD Rule 1, Definitions, the following definitions are proposed to be added, revised or deleted:

The terms "Broker Account" and "Dealer Account" will be added to the text of the GSD Rules. A "Broker Account" is an account that is maintained by an inter-dealer

broker netting member, or a segregated broker account of a netting member that is not an inter-dealer broker netting member. An account that is not a Broker Account is referred to as a Dealer Account.

"Coverage Charge" will be revised to refer to the additional charge with respect to the member's Required Fund Deposit (rather than its VaR Charge) which brings the member's coverage to a targeted confidence level.

"Current Net Settlement Positions" will be corrected to clarify its current intent, that it is calculated with respect to a certain business day and not necessarily on that day, since it may be calculated after market close on the day prior to its application (i.e., before or after midnight between the close of business one day and the open of business on the next day).

"Excess Capital Differential" will be corrected to refer to the amount by which a member's VaR Charge exceeds its excess capital, instead of by reference to the amount by which its required clearing fund deposit exceeds its excess capital.

"Excess Capital Premium Calculation Amount" will be deleted because, with the introduction of VaR methodology, the calculation is no longer applicable. The terms "Excess Capital Differential" and "Excess Capital Ratio" will be amended to delete archaic references to "Excess Capital Premium Calculation Amount" and to refer instead to the comparison of a member's capital calculation to its VaR Charge. In addition, the text of Section 14 of GSD Rule 3 will be amended to provide that the "Excess Capital Premium" charge applies to any type of entity that is a GSD netting member rather than limiting its applicability to only the specified types formerly identified in the text.

"Excess Capital Ratio" will be amended to mean the quotient resulting from dividing the amount of a member's VaR Charge by its excess net capital.

"GSD Margin Group" will be added to refer to the GSD accounts within a Margin Portfolio.

"Margin Portfolio" will be added to refer to the positions designated by the member as grouped for cross-margining, subject to the rules set forth in GSD Rule 4. "Dealer Accounts" and "Broker Accounts" cannot be combined in a common Margin Portfolio. A "Sponsoring Member Omnibus Account" cannot be combined with any other accounts.

"Unadjusted GSD Margin Portfolio Amount" will be added to define the amount calculated by GSD with regard to a Margin Portfolio, before application of premiums, maximums or minimums. It includes the VaR Charge and the coverage charge for GSD. In the case of a Cross-Margining Participant of GSD, the Unadjusted GSD Margin Portfolio Amount also will include the cross-margining reduction, if any.

The terms "Category 2 Gross Margin Amount," "Margin Adjustment Amount," "Repo Volatility Factor," and "Revised Gross Margin Amount" will be deleted from GSD Rule 1 since they are no longer used elsewhere in the GSD Rules. The Schedule of Repo Volatility Factors will be deleted because it is no longer applicable.

In Section 2 of GSD Rule 3, Ongoing Membership Requirements, the requirement that GCF counterparties submit information relating to the composition of their NFE-related accounts,[34] will be amended to require the submission of such information periodically, rather than on a quarterly basis. GSD currently requires this information

[34] The term "NFE-Related Account" means each securities account and deposit account maintained by a GCF Clearing Agent Bank for an Interbank Pledging Member in which the GCF Clearing Agent Bank has, pursuant to agreement with the Interbank Pledging Member or by operation of law, a security interest or right of setoff securing or supporting the payment of obligations of such Interbank Pledging Member to the Bank, including each such account to which such Interbank Pledging Member's Prorated Interbank Cash Amount is debited. See GSD Rule 1, Definitions.

every other month and by this change, FICC could institute periodic reporting on a schedule that is appropriate at such time, in response to current conditions. This has the potential to help tailor the frequency of reporting based on market conditions and thereby facilitate the risk management of the clearing agency.

In Section 9 of GSD Rule 4, Clearing Fund and Loss Allocation, concerning the return of excess deposits and payments, FICC's discretion to withhold the return of excess clearing fund to a member that has an outstanding payment obligation to FICC will be changed from being based on FICC's determination that the member's anticipated transactions or obligations over the next 90 calendar days may be reasonably expected to be materially different than those of the 90 prior calendar days, under the current rule, to being based on FICC's determination that the member's anticipated transactions or obligations in the near future may be reasonably expected to be materially different than those in the recent past. In addition, technical and clarifying changes are proposed to be made to the rules and cross-references to rule sections contained throughout. The rules have been reviewed by FICC and proposed to be corrected as needed to reflect the correct rule section references as originally intended.

III. Comments

The Commission received thirteen comments to the proposed rule change and four response letters responding to comments.[35] Nine commenters supported the proposed rule.[36] Of this group, seven commenters generally stated that the cross-

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[35] See supra notes 3 and 4.

[36] Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel, LLC (December 21, 2010); Letter from Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC (December 21, 2010); Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010); Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010); Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS

margining proposal benefits competition by permitting "open access" to cross-margining.[37] In addition, six commenters argued that the proposed rule change permits risk minimization[38] and promotes transparency.[39]

Three commenters opposed the proposed rule, absent changes to mitigate what they identified as anti-competitive features.[40] One commenter recommended further

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Securities, LLC (December 20, 2010); Letter from John Willian, Managing Director, Goldman Sachs (December 17, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); Letter from Douglas Engmann, President, Engmann Options, Inc. (December 6, 2010); and Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010).

37 Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); Letter from John Willian, Managing Director, Goldman Sachs (December 17, 2010); Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS Securities, LLC (December 20, 2010); Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel, LLC (December 21, 2010); Letter from Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC (December 21, 2010); and Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010).

38 Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010); Letter from Douglas Engmann, President, Engmann Options, Inc. (December 6, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010); Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS Securities, LLC (December 20, 2010); and Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010).

39 Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS Securities, LLC (December 20, 2010); Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel, LLC (December 21, 2010); Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010); and Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010).

40 Letter from William H. Navin, Executive Vice President and General Counsel, The Options Clearing Corporation (December 21, 2010); Letter from Richard D. Marshall, Ropes & Gray on behalf of ELX Futures, LP (December 15, 2010); and

study of the rule and its risk methodology, but agreed with the commenters opposing the proposed rule change on the grounds that the rule should permit only non-exclusive arrangements that promote competition.[41] The commenters against the proposed rule change generally stated that the cross-margining scheme is anti-competitive and raises risk management issues. These commenters raised concerns or provided comments related to the following major aspects of the cross-margining proposal: (1) the effect on competition; (2) risk management; and (3) the effect on efficiency and costs. FICC responded to these comments in three comment letters that it submitted.[42]

A. Effect on Competition

Many of the commenters' concerns with respect to competition stemmed from FICC having an exclusive agreement to enter into a direct arrangement for "one-pot" cross-margining with NYPC.[43] NYPC is jointly owned by NYSE Euronext and DTCC. DTCC is the parent company of FICC. NYSE Liffe is the global derivatives business of the NYSE Euronext. These affiliations combined with the exclusive nature of the direct

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Letter from John C. Hiatt, Chief Administrative Officer, Ronin Capital (December 10, 2010).

41 Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX (December 21, 2010).

42 Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011); Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011); and Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011).

43 Letter from William H. Navin, Executive Vice President and General Counsel, The Options Clearing Corporation (December 21, 2010); Letter from Richard D. Marshall, Ropes & Gray on behalf of ELX Futures, LP (December 15, 2010); Letter from John C. Hiatt, Chief Administrative Officer, Ronin Capital (December 10, 2010); and Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX (December 21, 2010).

arrangement raised concerns for these commenters.

With regard to allowing other parties direct access to cross-margining, FICC argued that it is neither operationally feasible nor prudent to establish a framework of multiple, competing "one-pots" with multiple, competing DCOs under this arrangement.[44] 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.[45] FICC stated that it 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.[46] For example, there is the potential that operational issues of managing such movements across multiple systems would create risks in the settlement process by adding complexities associated with linking and monitoring the use of multiple one cross-margin pot arrangements. Furthermore, FICC stated that the existence of multiple "one-pots" would likely greatly complicate the liquidation of a cross-margining participant that was in default at FICC and NYPC, thereby increasing systemic risk.[47]

Commenters recognized that other DCOs (i.e., DCOs other than NYPC) will have the ability to obtain indirect access to the cross-margining arrangement by entering into a Limited Purpose Participant ("LPP") agreement and becoming an LPP of NYPC.

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44 Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011).

45 Id.

46 Id.

47 Id.

Commenters raised concerns about the potential for this type of indirect access, citing concerns about the requirements to agree to be bound by the rules of NYPC, agree to an allocation of clearing fees, and contribute to the NYPC guaranty fund in an amount equal to the contribution made by NYSE Euronext.[48]

FICC responded to these comments.[49] Specifically, FICC stated that, while DCOs that are LPPs clearing through NYPC would need to abide by NYPC's rules, NYPC's intention is that there would be separate requirements (including with respect to margin deposits and guaranty fund contributions applied) to the LPP, on the one hand, and the LPP's members, on the other, unless: (i) NYPC and the LPP separately agree to allocate those amounts to the LPP and its members, or (ii) a clearing member of NYPC is also a clearing member of an LPP.[50] FICC and NYPC also represented that the NYPC rules would apply to a LPP but not to the members of the LPP, unless such members are otherwise clearing members of NYPC.[51] In addition, FICC noted that 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

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48 Letter from William H. Navin, Executive Vice President and General Counsel, The Options Clearing Corporation (December 21, 2010); Letter from Richard D. Marshall, Ropes & Gray on behalf of ELX Futures, LP (December 15, 2010); Letter from John C. Hiatt, Chief Administrative Officer, Ronin Capital (December 10, 2010); and Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX (December 21, 2010).

49 Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011) and Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation; Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011); and Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011).

50 Id.

51 Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011).

between NYPC and the prospective LPP regarding the operational mechanics of margin deposits and related subjects.[52]

In addition, FICC has represented to the Commission that the fees NYPC charges LPPs will be determined on a case-by-case basis based on the services provided to recoup operational and other costs that NYPC incurs in integrating the new LPP.[53] Moreover, FICC and NYPC clarified and affirmatively represented that the limited purpose participant agreements will be individually negotiated and that "the Guaranty Fund contribution that will be required by NYPC from any Limited Purpose Participant will be determined by risk-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."[54]

Three commenters also noted that under the proposed structure, it may take up to two years before other DCMs are permitted to clear at NYPC or before other DCOs might be given indirect access in order to participate in the NYPC Arrangement, which

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52 Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011) and Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011).

53 Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011); Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011); and Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011).

54 Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011) and Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011).

may cause commercial impairment.[55] Two other commenters, however, argued that the delay is not unduly burdensome on competition,[56] with one in particular explaining that "[a]ny new arrangement needs the requisite time to ensure that it satisfies all of the underlying concerns and issues that may occur with any new concept."[57] FICC responded, saying that the transition period is necessary to complete implementation, systems integration, and testing, among other things, and that it and NYPC have pledged to open the arrangement to other participants as soon as operationally feasible.[58] FICC also stated that attempting to integrate a pre-existing clearinghouse directly into the "one-pot" cross-margining arrangement would by necessity be even more difficult and likely more costly than the integration between FICC and NYPC, which was created in order to cross-margin positions with FICC.[59] In addition, FICC has previously stated that NYPC

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[55] Letter from Richard D. Marshall, Ropes & Gray on behalf of ELX Futures, LP (December 15, 2010); Letter from William H. Navin, Executive Vice President and General Counsel, The Options Clearing Corporation (December 21, 2010); and Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX (December 21, 2010).

[56] Letter from Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC (December 21, 2010) and Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010).

[57] Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010).

[58] FICC represented that "[f]ollowing the announcement of NYPC, FICC, the NYPC management team and senior management of NYSE Euronext have repeatedly reached out to [The Options Clearing Corporation], 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." Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011). See also supra Section II.B., at 16.

[59] Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011); and Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt

has committed that it will complete the process to allow one or more DCMs or DCOs to be admitted and integrated into the "one-pot" cross-margining arrangement as soon as feasible, but no later than 24 months from the start of operations.

The nine commenters in favor of the proposed rule change generally argued that the rule change will increase competition in trade execution and clearing which, in turn, will encourage innovation, efficiency, and improved choices.[60] Furthermore, FICC also indicated that its proposal promotes competition. Specifically, FICC stated that "[u]nlike the traditional 'vertical' relationship between futures exchanges and their affiliated …DCOs…, NYPC has been uniquely structured... to allow unaffiliated DCOs and … DCMs… 'open access' to the benefits of the 'single pot' cross-margining arrangement as soon as operationally feasible, subject to only certain object, reasonable and non-discriminatory criteria."[61] FICC also stated that the current market for clearing U.S. dollar-denominated interest rates is dominated by one entity and that its approach has the potential to introduce competition in this market.[62]

Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011).

60 See, e.g., Letter from John Willian, Managing Director, Goldman Sachs (December 17, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); and Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel, LLC (December 21, 2010).

61 Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011).

62 Id.

B. Risk Management

Five commenters believed that the proposal would increase the transparency of risks across asset classes and allow regulators to better monitor and assess risk.[63] These commenters supported the proposed rule's use of the Value at Risk (VaR) methodology, because it is well understood, has been extensively tested, and relies on historical information to simulate the market.[64] Moreover, two commenters noted that "one-pot" margining decreases the risk for market participants because it allows for the offset of risk between U.S. Treasury futures and U.S. Treasury cash bonds.[65] Additionally, two commenters believed that the proposal allows for a greater portion of financial instruments to be centrally cleared, which, among other things, reduces overall risk.[66]

Two commenters, however, raised concerns about risk management, stating that because cross-margining allows for greater leverage than standard margining, in particular during periods of market stress and extreme volatility, the proposed rule may

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63 Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010); Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010); Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS Securities, LLC (December 20, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); and Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010).

64 Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010); Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010); Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS Securities, LLC (December 20, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); and Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010).

65 Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010) and Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010).

66 Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel, LLC (December 21, 2010) and Letter from John A. McCarthy, General Counsel, GETCO (December 21, 2010).

increase systemic risk.[67] FICC responded by stating that "the NYPC-FICC margin model does not necessarily increase leverage and may, in fact, reduce leverage in highly risky portfolios with limited hedges."[68] FICC further explained that, "[a]t 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."[69]

One commenter suggested that the VaR method for calculating margin requirements should be tested further.[70] This commenter also suggested that the scenario-based Standard Portfolio Analysis of Risk ("SPAN") method be considered and tested in comparison to VaR. FICC's response noted that the proposed VaR methodology is based on a common method of historical simulation and that it has conducted risk-related testing, including sensitivity tests, back testing of the model's validity, and stress tests of the sufficiency of the guaranty fund.[71]

One commenter requested that documentation of previous consideration of the risk aspects of the proposal be made public.[72] In response, FICC provided a discussion

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[67] Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX (December 21, 2010) and Letter from John C. Hiatt, Chief Administrative Officer, Ronin Capital (December 10, 2010).

[68] Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011).

[69] Id.

[70] Letter from Joan C. Conley, Senior Vice President & Corporate Secretary, NASDAQ OMX (December 21, 2010).

[71] Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011).

[72] Letter from Alex Kogan, Vice President and Deputy General Counsel, NASDAQ OMX (January 10, 2011).

and analysis of its VaR methodology compared to SPAN.[73] FICC explained that because it needs to measure the risk of combined portfolios for futures and cash positions, it believes that a historical VaR-based margin model provides a more accurate estimate of portfolio risk than SPAN.[74] FICC noted, however, that because it is standard practice for the futures industry to use SPAN to calculate and monitor margin requirements, it will make available SPAN formatted calculations of its VaR-based customer risk parameters to clearing members and their customers. FICC also noted that in initially listing NYPC-clearing contracts, NYSE Liffe U.S. will use, among other factors, SPAN-formatted input parameters to establish minimum customer initial margin requirements for each NYPC-cleared interest rate contract and intra- and inter-commodity spreads.[75]

C. Effect on Efficiency and Costs

Four commenters stated that the proposal promotes the reduction of risk that will lead to margin and capital efficiencies and lower costs.[76] One commenter believed that

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[73] Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 7, 2011). The public record contains information regarding testing that went to the subject of risk management. The Commission also received from FICC proprietary, highly confidential information, including information about individual portfolios. This non-public information, in addition to the public information submitted in support of the rule proposal, supported the Commission's conclusion that the proposal is consistent with the Act, but was not included in the public record because of its sensitivity.

[74] Id.

[75] Letter from Alex Kogan, Vice President and Deputy General Counsel, NASDAQ OMX (January 10, 2011).

[76] Letter from Gary DeWaal, Senior Managing Director and Group General Counsel, Newedge USA, LLC (December 21, 2010); Letter from Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel, LLC (December 21, 2010); Letter from Ronald Filler, Professor of Law and Director of the Center on Financial Services Law, New York Law School (December 8, 2010); and Letter from James B. Fuqua and David Kelly, Managing Directors, Legal, UBS Securities, LLC (December 20, 2010).

"one-pot" margining would increase cash flow and margin efficiencies for certain clearing members.[77] Two commenters also stated that the "one-pot" approach will reduce delivery costs because it offers direct delivery of expiring futures contracts into cash bonds held at FICC, which will minimize fails and squeezes and improve price convergence and stress on the settlement system.[78] Additionally, two commenters that were opposed to the cross-margining agreement as proposed also expressed their general support for "one-pot" cross-margining on the ground that it reduces risk while facilitating more efficient uses of capital markets.[79]

According to FICC's response, the proposed rule streamlines the delivery process for U.S. Treasury futures, which will improve operational efficiency and decrease systemic settlement risk.[80] FICC also stated that the proposal should increase liquidity by providing market participants with an alternate venue for trading U.S. dollar-denominated interest rate futures contracts.[81]

IV. Discussion

The Commission has carefully considered the proposed rule change and the comments thereto and the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder, including

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[77] Letter from John Willian, Managing Director, Goldman Sachs (December 17, 2010)

[78] Letter from Jack DiMaio, Managing Director, Morgan Stanley (December 2, 2010) and Letter from Donald J. Wilson, Jr., DRW Trading Group (December 21, 2010).

[79] Letter from John C. Hiatt, Chief Administrative Officer, Ronin Capital (December 10, 2010) and Letter from William H. Navin, Executive Vice President and General Counsel, The Options Clearing Corporation (December 21, 2010).

[80] Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011).

[81] Id.

Sections 17A(a)(2)(A)(ii)[82] and 17A(b)(3)(A), (F) and (I) of the Act.[83]

The proposed rule change provides for modifications to certain risk management related processes and definitions under GSD's rules, including changes to the loss allocation methodology, intraday margining, categories of membership, and related definitional changes. The Commission believes that these changes to GSD's rules are consistent with Sections 17A(b)(3)(A) and (F) of the Act because they should help facilitate and promote the prompt and accurate clearance and settlement of securities transactions, and help assure the safeguarding of securities and funds under FICC's control or for which it is responsible. In particular, the Commission believes that these changes to GSD's rules, by virtue of strengthening FICC's risk management and related operations, should result in a more timely, accurate, and efficient system of settlement..

In addition, the proposed rule change would provide for a cross-margining arrangement between certain positions in GSD and NYPC. The Commission's staff has closely evaluated the proposed cross-margining arrangement including the risk management, competition and efficiency issues raised by the proposed rule change (as discussed below) against the requirements of the Act, including Sections 17A(b)(3)(F) and (I) of the Act. Based on our staff's analysis, and taking into consideration the matters discussed throughout, including the representations discussed below, the Commission finds the proposed rule change is consistent with the Act.

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82 15 U.S.C. 78q-1(b)(2)(A)(ii). This provision directs the Commission to use its authority to facilitate the establishment of coordinated facilities for clearance and settlement of transactions in securities and contracts of sale for future delivery.

83 15 U.S.C. 78q-1(b)(3)(A), (F) and I. In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

A. Risk Management

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and assure the safeguarding of securities and funds in the custody or control of the clearing agency or for which it is responsible.[84] The Commission has historically supported and approved cross-margining at clearing agencies and has previously recognized the potential benefits of cross-margining systems, which include freeing capital through reduced margin requirements, reducing clearing costs by integrating clearing functions, reducing clearing organization risk by centralizing asset management and harmonizing liquidation procedures.[85] The Commission has encouraged cross-margining arrangements as a way to promote more efficient risk management across product classes.[86] Cross-margining arrangements may be consistent with Section 17A(b)(3)(F) in that they may strengthen the safeguarding of assets through effective risk

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[84] 15 U.S.C. 78q-1(b)(3)(F).

[85] See, e.g., Securities Exchange Act Release No. 27296 (September 26, 1989), 54 FR 41195 (approving proposed rule changes establishing cross-margining between The Options Clearing Corporation and the Chicago Mercantile Exchange) and Securities Exchange Act Release No. 26153 (October 3, 1988), 53 FR 39561 (approving proposed rule changes concerning cross-margining between The Options Clearing Corporation and the Intermarket Clearing Corporation). Previously, the Interim Report of the President's Working Group on Financial Markets (May 1988) recommended that the SEC and CFTC facilitate cross-margining programs among clearing organizations. In addition, the Bachmann Task Force, which was formed by the Commission in response to the 1987 Market Break, presented its findings to the Commission in May 1992 that included, among other things, a recommendation that cross-margining programs among clearing agencies be implemented or expanded. See Securities Exchange Act Release No. 31904 (February 23, 1993), 58 FR 11806 (March 1, 1993).

[86] See Securities and Exchange Act Release No. 44301, 66 FR 28297 (May 11, 2001) (order approving a "two- pot" cross -margining proposal between FICC's predecessor and CME). In addition, the Interim Report of the President's Working Group on Financial Markets (May 1988) also recommended that the SEC and CFTC facilitate cross-margining programs among clearing organizations.

controls that more broadly take into account offsetting positions of participants in both the cash and futures markets, and promote prompt and accurate clearance and settlement of securities through increased efficiencies.

As set forth in the proposal, FICC will perform margin calculations using VaR methodology with a 99 percent confidence level and 3-day liquidation for cash positions and 1-day liquidation for futures, using historical information for the prior year (250 trading days for futures and 252 for cash positions) and the margin calculations will employ a front weighted mechanism that places a greater emphasis on more recent observations. FICC will also conduct daily back testing and assess an additional coverage component charged to participants if the back tests show insufficient coverage. In the event of unusual market conditions, FICC or NYPC could at any time require additional margin provided such requirements are consistent with the standards in Section 17A of the Exchange Act. The Commission believes these actions assist in the promotion under the proposed cross-margining arrangement of prompt and accurate clearance and settlement of securities transactions and help assure the safeguarding of securities and funds consistent with the requirements under Section 17A(b)(3)(F) of the Act because they would facilitate appropriate risk management by FICC by providing flexibility and promoting ongoing monitoring of risk.[87]

The proposal also contains provisions for managing risk in the event of a member default. The NYPC Agreement provides for the sharing of losses by FICC and NYPC in the event that the "one-pot" portfolio margin deposits of a defaulting participant are not sufficient to cover the losses resulting from the liquidation of that participant's trades and positions. In the event of a member default, the proposal requires that FICC and NYPC

[87] 15 U.S.C. 78q-1(b)(3)(F).

would liquidate posted margin as a single portfolio, which will allow them to preserve the value of the assets posted as collateral. In addition, FICC and NYPC are providing financial guarantees to each other in the event the available collateral is insufficient. These features of the proposed rule change would help to ensure that FICC is able to meet its settlement obligations in the event of default. As a result, the Commission believes that the proposal would promote the prompt and accurate clearance and settlement of securities transactions and assure the safeguarding of securities and funds in a manner consistent with Section 17A(b)(3)(F) of the Act.[88]

The Commission has previously noted that cross-margining systems entail certain risks.[89] For instance, even in normal market conditions, products that have been highly correlated in the past may diverge and may diverge even more so in extreme market conditions. Such a breakdown in correlation might lead to inadequate clearing margins or losses upon a liquidation. To address these concerns, as noted in the description of the proposed rule change and in FICC's response letters, FICC has performed testing of the VaR margining model. This included sensitivity tests of the model to changing market conditions, back tests of sample portfolios to check model validity, stress tests of sample portfolios to test the sufficiency of the NYPC guaranty fund, and back tests to verify the sufficiency of coverage after the FICC-NYPC cross-margining reductions are applied.

The Commission takes commenters' concerns about risk management seriously. As discussed below, to provide the Commission with enhanced ability to monitor FICC's risk management, FICC has represented and undertaken to make continuing risk analysis reports, discussed below, to the Commission. This ongoing reporting should also help

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88 15 U.S.C. 78q-1(b)(3)(F).

89 Securities Exchange Act Release No. 26153 (October 3, 1988), 53 FR 39561.

FICC conduct its own monitoring of the NYPC Arrangement. In addition, FICC is subject to the Commission's ongoing examination program, which examines registered clearing agencies with respect to their risk management systems and other aspects of their operations. The Commission believes FICC's prior analysis, as discussed above, as well as FICC's commitment to provide additional reports on a periodic basis will promote the prompt and accurate clearance and settlement of securities transactions and help assure the safeguarding of securities and funds in a manner consistent with Section 17A(b)(3)(F) of the Act.

B. Competition

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency are not designed to permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency.[90] Section 17A(b)(3)(I) of the Act requires that the rules of the clearing agency do not impose any burden on competition not necessary and appropriate in furtherance of the purposes of the Exchange Act.[91]

The Commission has carefully considered the comments and the responses submitted to the Commission. With respect to commenters' concerns regarding the exclusive nature of the agreement to enter into a direct arrangement for "one-pot" cross-margining with NYPC, the Commission believes that FICC has raised valid concerns regarding the potential for greater risk arising from connections to multiple DCOs. The Commission believes that the NYPC Arrangement, and FICC's representations in its responses, discussed above, regarding how indirect access would operate in practice, would provide increased potential for indirect access to the cross-margining arrangement

[90] 15 U.S.C. 78q-1(b)(3)(F).

[91] 15 U.S.C. 78q-1(b)(3)(I).

by entering into a LPP agreement and becoming an LPP of NYPC.

The Commission believes that the proposed FICC indirect access arrangement would provide a viable option for those seeking to access the “one-pot” cross-margining arrangement because it would be open to all DCOs and DCMs and would contain membership criteria that are commensurate with risks associated with accessing the “one-pot” cross-margining arrangement. Accordingly, the Commission believes the proposed cross-margining arrangement is not designed to permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency consistent with Section 17A(b)(3)(F).[92]

The Commission acknowledges that the admission and integration of other DCMs or DCOs will not be immediate. However, the Commission believes that, in light of existing technological limitations, FICC has raised valid concerns regarding the operational feasibility of providing multiple links for direct access to the cross-margining arrangement at this time. These potential operational risks associated with managing such an arrangement, such as maintaining appropriate account of the positions of participants and calculating appropriate margin, must be weighed against the desire for greater direct access immediately.

The Commission notes that FICC has previously indicated that NYPC has committed that it will complete the process to allow one or more DCMs or DCOs to be admitted and integrated into the “one-pot” cross-margining arrangement as soon as feasible, but no later than 24 months from the start of NYPC’s operations. FICC has stated that the transition period is necessary to complete implementation, systems integration, and testing, among other things, and that it would open the arrangement to

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[92] 15 U.S.C. 78q-1(b)(3)(F).

other participants as soon as operationally feasible.[93] The Commission believes that the operational issues, including those cited by FICC, would need to be resolved prior to admitting a DCM or DCO as an LPP. The Commission believes that this aspect of the proposal would not impose any burden on competition not necessary and appropriate in furtherance of the purposes of the Exchange Act consistent with Section 17A(b)(3)(I) of the Act.

Moreover, the Commission notes that FICC has stated that the proposal would provide market participants with an alternate venue for trading U.S. dollar-denominated interest rate futures contracts, thereby potentially helping to increase competition in this market. The Commission believes that these pro-competitive features of the proposal are consistent with the Act.

The Commission takes seriously commenters' concerns regarding competition. As discussed below, FICC has represented and undertaken to provide the Commission with information about the LLP agreements concerning the proposed cross-margining arrangements.

The Commission believes FICC's commitment to provide ongoing information with respect LLP agreements would help to evaluate its efforts to facilitate indirect access and would thereby help to ensure that the proposal would not impose any burden on competition not necessary and appropriate in furtherance of the purposes of the Exchange

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93 FICC represented that following the announcement of NYPC, FICC, the NYPC management team and senior management of NYSE Euronext have been in discussions with other DCOs and DCMs to initiate the process of integrating such other organizations into the "one-pot." While those efforts have not yet been productive, FICC and NYPC remain committed to expanding the "one-pot" to include other DCOs and DCMs. Letter from Douglas Landy, Allen & Overy on behalf of the Fixed Income Clearing Corporation (January 4, 2011).

Act, consistent with Section 17A(b)(3)(I) of the Act.[94] The Commission anticipates that this information will be primarily used for the limited purpose of identifying any instances in which there is potential non-compliance with the terms of this order or the representations made by FICC.

The Commission has considered the concerns presented by commenters and has determined that the benefits of the proposal outweigh any anti-competitive effects of the proposal. The Commission believes that the proposal would not impose any burden on competition not necessary and appropriate in furtherance of the purposes of the Exchange Act consistent with Section 17A(b)(3)(I) of the Act.[95]

C. Effect on Efficiency and Costs

As previously discussed, both FICC and those commenting on the proposed rule change expect that the cross-margining proposal will reduce costs, including delivery costs, and increase cash flows through margin efficiencies. The Commission believes that the NYPC Arrangement has the potential to increase efficiencies by allowing clearing agencies to streamline the delivery process, employ common and coordinated risk management and margin methodologies, and lower costs for market participants.

A "two-pot" arrangement allows for offsets and lowered margin based on correlations in a members' cleared positions at different clearinghouses; however, there is not a unified arrangement for risk management or loss allocations.[96] The "two-pot" cross-margining arrangements approved by the Commission in the past, including one between FICC and CME, have allowed clearinghouses to allow credit against the margin

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94 15 U.S.C. 78q-1(b)(3)(I).

95 15 U.S.C. 78q-1(b)(3)(I).

96 See Securities and Exchange Act Release No. 44301, 66 FR 28297 (May 11, 2001) (approving a "two-pot" cross-margining proposal between FICC's predecessor and CME).

requirement for offsetting positions cleared at another clearinghouse, but each clearinghouse maintained and managed separate pools of collateral. The "one-pot" arrangement would offer greater margin reductions than a "two-pot" arrangement.

As result of these benefits in facilitating a more accurate and cost-effective system for settlement, the Commission believes that the proposal would promote the prompt and accurate clearance and settlement of securities transactions and help assure the safeguarding of securities and funds in a manner consistent with Section 17A(b)(3)(F) of the Act.[97]

D. Additional Reporting

As noted above, FICC has represented that it will provide certain information and reports to the Commission on an ongoing basis in order to facilitate ongoing monitoring of the cross-margining arrangement and thereby help ensure compliance with the standards in Section 17A of the Act.[98] In particular, with respect to information pertaining to risk matters, the Commission believes that these reports would assist the Commission in its efforts to monitor risk management practices under the cross-margining arrangement by providing information to help confirm that the actual performance of the models and systems are consistent with those anticipated during tests prior to launch. Specifically, FICC has agreed to provide the following information upon the proposed rule change becoming effective:

- For the first 250 trading days upon the proposed rule change becoming effective, FICC will provide the Commission staff with quarterly reports

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97 15 U.S.C. 78q-1(b)(3)(F).

98 Letter from Michael Bodson, Executive Managing Director, Fixed Income Clearing Corporation and Walt Lukken, Chief Executive Officer, New York Portfolio Clearing, LLC (February 27, 2011).

that itemize divergences between CME prices and NYSE Liffe prices for "look-alike contracts."[99]

- Semi-annually, FICC will provide the Commission staff with reports summarizing the sensitivity of the model used for the NYPC Agreement and the collected margin to the model's assumptions and established parameters.
- Quarterly, FICC will provide the Commission staff with detailed portfolio analyses of members participating in the NYPC Arrangement.
- Monthly, FICC will provide the Commission staff with reports summarizing the details of: (1) any instances in which the account of a member participating in the NYPC Agreement experienced a loss that exceeded its margin requirement and the magnitude of such loss; (2) FICC's analysis of the sufficiency of NYPC's guaranty fund in conjunction with NYPC; and (3) FICC's analysis of daily correlations between the futures and cash products that are subject to the NYPC Arrangement.
- FICC will provide the Commission staff with DTCC's periodic default simulations that factor in members' participation in the NYPC Agreement.
- For 24 months upon the proposed rule change becoming effective, FICC will provide the Commission staff with information on a quarterly basis regarding potential LPPs, including progress on negotiations and discussions of agreements or potential agreements with potential LPPs.

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[99] "Look-alike contracts" refers to contracts that have similar economic features but are traded separately on CME and NYSE Liffe.

- FICC will provide the Commission all agreements entered into between NYPC and any LPPs, as well as all amendments to such agreements, including, but not limited to, those regarding changes in the fee arrangements.

V. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular Section 17A of the Act[100] and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-FICC-2010-09) be, and hereby is, approved.

Elizabeth M. Murphy

Secretary

[100] 15 U.S.C. 78q-1.