



Government Securities Clearing Corporation

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August 8, 2000

COMMENT

VIA ELECTRONIC MAIL

Ms. Jean A. Webb
Secretary to the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

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Re: Clearing Organizations Reinvention: A New Regulatory Framework for Clearing Organizations, 65 Fed. Reg. 39027

Dear Ms. Webb:

Enclosed please find a hard copy of the comment letter on clearing organizations reinvention that GSCC filed with your office via electronic mail on August 7, 2000.

If you have any questions or comments concerning the enclosed please do not hesitate to call me at (212) 412-8552.

Very truly yours,

John Petrofsky
Legal Assistant

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Jeffrey F. Ingber
*Managing Director
General Counsel and Secretary*

August 7, 2000

VIA ELECTRONIC MAIL

Ms. Jean A. Webb
Secretary to the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Clearing Organizations Reinvention: A New Regulatory Framework for Clearing Organizations, 65 Fed. Reg. 39027

Dear Ms. Webb:

The Government Securities Clearing Corporation ("GSCC") is pleased to submit this letter in response to the request by the Commodity Futures Trading Commission (the "CFTC") for comments on a new Part 39 of its rules that would apply to clearing organizations.

GSCC is a securities clearing agency registered with and regulated by the Securities and Exchange Commission (the "SEC"). GSCC is the central clearing organization for the U.S. Government securities and financing marketplaces. On average each business day, GSCC processes almost \$1 trillion in buy-sell, repo, and original issue transactions in U.S. Treasury and Agency securities (and certain general collateral repo trades involving mortgage-backed securities). Virtually all of the major U.S. Government market participants, mostly broker-dealers and banks, are members of GSCC (90 netting members, 28 comparison-only members). Also, GSCC processes the activity of 424 non-member "executing" firms, which clear through its members. Industry participants own the majority of shares of GSCC, and a board of directors composed primarily of representatives of its members governs GSCC.

BENEFITS OF CENTRALIZED CLEARING ARRANGEMENTS

GSCC wishes to express its strong support for the modernization of the Federal regulation of commodity futures and option markets and clearing organizations. GSCC believes that there have been in recent years, and will continue to be, dramatic changes in the nature of

the financial marketplaces for cash, over-the-counter (“OTC”) derivatives and futures products and that clearing organizations should be given the opportunity to meet the challenge of responding to these changes.

The changes in the financial marketplaces for fixed-income and interest rate products include the increase in the types and complexity of such products; the increasingly hybrid nature of such products (i.e., having both cash and derivatives features); the growth of trading away from “traditional” marketplaces; the shift to trading on a fully automated, electronic basis; and the integration of markets around the world.

The CFTC’s proposal states that the benefits of a clearing organization could be enhanced if it could clear both cash and futures products. GSCC agrees that there is a growing need for the clearing and risk management processes for the cash, futures, and OTC derivatives marketplaces to be coordinated and consolidated, for the benefit of existing marketplaces as well as for new electronic trading systems and platforms that are being introduced. This will result in a number of significant benefits, including the following:

- (1) Combined cash-futures-OTC derivatives clearing: a coordinated clearing organization process that will provide a consolidated set of services for marketplaces offering trading in an array of buy-sell, repo, swap, options, futures, and other products;
- (2) Open access: a clearing organization that is not tied to a single marketplace but, rather, is truly an open one that is available to clear products offered on competing marketplaces;
- (3) Fungibility of products: a clearing organization that clears and manages the risk related to similar products traded on different marketplaces in a uniform manner;
- (4) Maximization of cross-margining: a clearing organization that optimizes the availability of cross-margining among all participating marketplaces;
- (5) Maximization of operational and cost savings and efficiencies: common or linked margining, banking, and operational arrangements will lead to the realization of greater savings and efficiencies for market participants; and
- (6) Enhanced risk management: overall risk management will be enhanced, due to better knowledge of a member’s overall trading activity, effective availability of an internal cross-guaranty between cash and futures activity, and the potential to offset cash and futures settlement obligations in a liquidation scenario.

We note that Europe has already embraced common clearing, and that entities such as The London Clearing House Limited currently clear a large array of different transactions under a single regulatory scheme.



A CLEARING ORGANIZATION SHOULD NOT BE SUBJECT TO DUPLICATIVE AND CONFLICTING REGULATION

The CFTC seeks comment with respect to the obstacles that exist to combining the clearing functions of various marketplaces. GSCC believes that uncoordinated regulation of a clearing organization by more than one regulator would significantly impede the ability of a clearing organization to effectively clear multiple products. One of the stated goals of the President's Working Group in its consideration of the OTC derivatives market is to maintain U.S. competitiveness to promote the continued leadership of American capital markets. A United States clearing organization that is unable to introduce new services for one or more marketplaces in a timely manner will be unable to help meet this goal.

GSCC strongly supports safety and soundness of the clearance and settlement functions. Accordingly, GSCC agrees that all clearing organizations should be subject to regulatory oversight. However, duplicative regulation by multiple regulators will not enhance the financial integrity of the system and, without coordination, will likely result in the inability to respond to the changing clearing needs of the financial marketplace.

As previously indicated, GSCC is regulated by the SEC. If GSCC were to clear futures transactions that are not exempt from the Commodity Exchange Act (the "CEA") in addition to cash products, then under proposed Part 39, it would also need to register with the CFTC. Since the two regulatory agencies remain separate, it would be crucial to the success of the venture that the two regulators harmonize their regulation of the clearing organization. If GSCC were to determine that business concerns and/or this legal concern necessitated the establishment of affiliated organizations to clear transactions from various marketplaces, there could still be the need for coordination by the two regulatory agencies. Even questions as to whether certain transactions are or are not covered by the CEA could necessitate the coordination of the two agencies. Although GSCC fully appreciates that this will be a challenging task, we ask that the CFTC and the SEC develop guidelines by which they would jointly regulate in an efficient manner a clearing organization or affiliated organizations that clear transactions from different marketplaces.

The CFTC notes that nothing in the proposed rules would prohibit a registered clearing organization (an "RCO") from clearing any other type of cash market or derivative instrument. The proposed rules state that any transaction effected on a designated contract market, recognized futures exchange or derivatives transaction facility, if cleared, shall be cleared by an RCO. There is no reason why transactions that are not subject to the CEA must be cleared by an RCO, and GSCC assumes that this requirement only applies to futures transactions that are not exempt from the CEA. We request that the CFTC clarify this issue in the rules or the adopting release.

GSCC supports the CFTC's conclusion that transactions described in Parts 35 or 36 may be safely cleared by certain entities already subject to regulatory oversight. However, the introductory comments state that the CFTC would defer to the clearing organization's primary regulator in connection with the clearance of such exempt transactions. Again, if the transactions are exempt from the CEA and the clearing organization does not need to register with the CFTC



to clear the transactions, then the CFTC should not have any oversight function over the clearing organization. GSCC requests that this clarification be made in the rules or the adopting release.

GSCC believes the fact that a transaction is cleared should not subject it or the parties to that transaction to additional regulatory requirements that are appropriately addressed by the transaction facility. Specifically, Rule 39.6 could be read to apply a fraud standard to a transaction merely because the transaction is cleared. If a particular transaction is subject to a fraud standard by the marketplace or CFTC rules, there should be no need to apply that standard at the clearing level. We request that the CFTC clarify in the rule or the adopting release that this is not the intended result.

CORE PRINCIPLES SHOULD OPERATE AS GUIDANCE AND NOT PROSCRIPTIVE REGULATION

Subject to the following suggested changes, GSCC does not object to the core principles stated in the proposed rules that would be applicable to an RCO. However, principles such as these are necessarily vague and should serve only as guidance and not effectively operate as prescriptive rules that would be a barrier to the entry of new clearing organizations.

The CFTC states that currently existing futures clearing organizations will automatically become RCOs. We strongly believe that, should GSCC, as an SEC-registered clearing organization, choose or be required to become an RCO, there would be a presumption that it would fully meet the requirements of the core principles. We do understand that certain requirements not applicable to the cash fixed-income markets (such as customer segregation requirements) might need to be addressed.

Additionally, GSCC questions the purpose and intent of Core Principal 7-3. This introduces an unnecessary, significant burden on a clearing organization. The principle states that the applicant should have arrangements and resources for the resolution of disputes between customers and its members and between members. This dispute resolution is an important one that is appropriately required at the transaction facility level. It is not the role or the function of a clearing organization to resolve trade disputes.

A CLEARING ORGANIZATION AS A CONTRACT MARKET

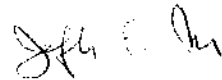
Proposed Rule 39.1(b)(2) states that a clearing organization shall be deemed a contract market for purposes of the CEA. GSCC believes that a clearing organization does not function as a contract market. In addition, we note that the Congressional bills currently being negotiated to reauthorize the CEA do not recognize a clearing organization as such. The CFTC also seems to recognize this fact since it exempts clearing organizations from certain provisions of the CEA and the rules. We are uncertain of the consequences of including a clearing organization in a category in which it does not appear to fit and suggest that the CFTC consider tailoring all rules applicable to clearing organizations specifically for clearing organizations.



CONCLUSION

GSCC greatly appreciates the significant effort undertaken by the CFTC and would be willing to discuss any aspect of this comment letter or other areas in which GSCC would provide assistance. If you have any questions, please contact Diane Waller at 212-412-8693 or dwaller@gsc.com, or the undersigned at 212-412-8637 or jingber@gsc.com.

Very truly yours,



Jeffrey F. Ingber
Managing Director,
General Counsel and
Secretary

cc: Larry E. Bergmann, Securities Exchange Commission
Lee Sachs, Department of the Treasury
Joyce M. Hansen, Federal Reserve Bank of New York
Paul Saltzman, The Bond Market Association
GSCC Board of Directors

