



ROPES & GRAY LLP
1211 AVENUE OF THE AMERICAS
NEW YORK, NY 10036-8704
WWW.ROPESGRAY.COM

December 1, 2010

Richard D. Marshall
T +1 212 596 9006
F +1 646 728 1770
richard.marshall@ropesgray.com

Mr. David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Comments on the Application by New York Portfolio Clearing (“NYPC”) to become a Designated Clearing Organization (Filing Number IF10009)

Dear Secretary Stawick:

On behalf of ELX Futures, L.P. (“ELX”), we respectfully submit these comments in connection with the application dated November 1, 2010 of New York Portfolio Clearing (“NYPC” or “Applicant”) with the Commodity Futures Trading Commission (the “Commission” or “CFTC”) for an order approving its request to be a derivatives clearing organization (“DCO”). For the reasons described below, the application should not be approved.

The application fails to meet the following Commission standards for approval of a DCO because the Applicant fails to satisfy the requirements of DCO Core Principle N – Antitrust Considerations, 7 USC §7a-1 (c) (2) (N), of the Commodity Exchange Act (“Act”), through the tie-up by NYPC of Depository Trust Clearing Corporation (“DTCC”) and its affiliate, Fixed Income Clearing Corporation (“FICC”), that excludes other firms from a similar arrangement. This tie-up is also in violation of various provisions of the Securities Exchange Act of 1934 (“Exchange Act”).

Anti-Competitive Discussion

Congress directed that a DCO “shall avoid,” among other things, “imposing any material anticompetitive burden on trading on the contract market” unless “appropriate to achieve the purposes” of establishing derivative clearing organizations.¹ Avoiding the imposition of such “anticompetitive burden[s]” is one of the “core principles” that “an applicant shall demonstrate to the Commission” to obtain and maintain its registration.² The application of NYPC, as it stands, threatens to impose precisely the anticompetitive burden that warrants its denial.

1. The application admits that NYPC “initially will provide clearing services solely for [NYSE Liffe U.S.],”³ an exchange owned by NYPC’s 50% owner, the New York Stock Exchange, Inc. (“NYSE”). What the application does not disclose is that NYPC will be the *de facto* exclusive clearing agent permitted to engage in one pot margining of U.S. Treasury and Eurodollar futures. The FICC essentially enjoys a government-granted monopoly in clearing U.S. government debt securities. A clearing arrangement with FICC accordingly is essential for an exchange to offer one pot margining. But in announcing NYPC’s formation, DTCC – which owns 50% of NYPC – announced that “NYSE Euronext and DTCC have entered into *an exclusive arrangement*.”⁴ Regardless of whether that arrangement remains *de jure* exclusive, it remains *de facto*: Despite ELX’s numerous requests that DTCC authorize FICC to enter into a one pot margining agreement

¹ 7 U.S.C. § 7a-1(c)(2)(N).

² *Id.* § 7a-1(c)(2)(A).

³ Application for Registration of Derivatives Clearing Organization, at 29 (Nov. 1, 2010) (“NYPC Application”), available at <http://services.cftc.gov/sirt/sirt.aspx?Topic=ClearingOrganizationsAD&Key=19924&Organization=New%20York%20Portfolio%20Clearing.%20LLC&Type=DCO&Status=Pending>.

⁴ <http://www.dtcc.com/news/press/releases/2009/nypc.php> (June 18, 2009) (emphasis added).

with other clearing houses such as The Options Clearing Corporation (“OCC”), ELX understands that FICC will not permit any clearinghouse other than NYPC to engage in one pot margining.⁵

By seeking to obtain approval of an application that appoints it as the sole clearinghouse able to enter into a one pot margining agreement with FICC, NYPC seeks to impose an “anticompetitive burden” on trading in U.S. Treasury and Eurodollar futures. The only alternative to the dominant Chicago Mercantile Exchange (“CME”) that traders in U.S. Treasury and Eurodollar futures have today is ELX, a relatively new entrant that accounts for 2-3% of that business. ELX, however, clears trades through OCC – a clearinghouse that, due to FICC’s decision only to enter into a one pot margining agreement with NYPC, cannot offer one pot margining.

The ability to offer one pot margining would enable ELX to enhance competition against the dominant CME. One pot margining, as DTCC explains on its website,⁶ would enable investors in U.S. Treasury and Eurodollar futures to lower their collateral requirements by netting out opposing positions. If ELX could offer one pot margining through its clearinghouse partner, ELX could lower the effective costs to its customers of investing in these futures. One pot margining, therefore, would enable ELX to enhance competition against CME and benefit overall market efficiency by providing customers a better product. The de facto exclusivity between FICC and NYPC, however, precludes ELX from offering these competition-enhancing benefits. Accordingly,

⁵ FICC has made clear to ELX CEO Neal Wolkoff on several occasions that it will not enter into a one pot margining agreement with ELX. Moreover, FICC’s proposed modifications to its rules submitted to the Securities and Exchange Commission (“SEC”) pursuant to Rule 19b-4 under the Exchange Act on November 12, 2010 states that “[t]he proposed single pot is required to be accessed by other futures exchanges and DCOs via NYPC” and makes clear that (i) FICC shall grant NYPC-cleared contracts “priority for margin offset purposes over any other cross-margining agreements” and (ii) “FICC will not enter into any other cross-margining agreements if such agreement would adversely affect the priority of NYPC.” Form 19b-4, at 13 & n.4 (“Form 19b-4”) (submitted Nov. 12, 2010). Plainly, FICC will not enter into a one pot margining agreement with OCC, let alone one that gives OCC the same priority as NYPC.

⁶ See http://www.dtcc.com/products/fi/fixd_income_gsd/cross_margining.php.

approval of NYPC’s application absent a change in the exclusive nature of the DTCC/NYPC relationship imposes an “anticompetitive burden.”⁷ The CFTC should not approve an application that is a device for extending a government-granted monopoly at one level (clearing U.S. government debt securities) to another (clearing interest rate derivatives).⁸

In 2008, the Antitrust Division of the United States Department of Justice (“DOJ”) made the following comment in a letter to the Department of the Treasury:

More specifically, the Department believes that the control exercised by futures exchanges over clearing services — including (a) where positions in a futures contract are held (“open interest”), and (b) ***whether positions may be treated as fungible or offset with positions held in contracts traded on other exchanges (“margin offsets”)*** — has made it difficult for exchanges to enter and compete in the trading of financial futures contracts.⁹

Ironically, the FICC, as a clearinghouse regulated by the SEC as a utility, is reaching for CFTC approval of its 50% owned DCO to shelter its U.S. Treasury notes and bonds from equal access by different exchanges looking for a cross margining benefit. Granting this application would realize the same concerns that DOJ expressed in its 2008 letter.

2. The application’s representation – that “[t]he Clearinghouse initially will provide clearing services solely for [NYSE Liffe U.S.] for a limited transitional period” but “intends to make those services more broadly available to other designated contract markets, including contract markets

⁷ See, e.g., *United States v. Microsoft Corp.*, 253 F.3d 34, 58 (D.C. Cir. 2001) (en banc) (*per curiam*) (“anticompetitive” means conduct that harms consumers by impairing the competitive process); see also, e.g., *Spanish Broad. Sys. of Fla., Inc. v. Clear Channel Communications, Inc.*, 376 F.3d 1065, 1072-73 (11th Cir. 2004) (same); see also *Town of Concord, Mass. v. Boston Edison Co.*, 915 F.2d 17, 21-22 (1st Cir. 1990) (Breyer, J.) (explaining that a practice is “anticompetitive” if it “harms the competitive process” by “obstruct[ing] the achievement of competition’s basic goals – lower prices, better products, and more efficient production methods”).

⁸ As the Supreme Court once wrote in the context of the Sherman Act: “If monopoly power can be used to beget monopoly, the Act becomes a feeble instrument indeed.” *United States v. Griffith*, 334 U.S. 100, 109 (1948).

⁹ Comment letter from the United States Department of Justice entitled Review of the Regulatory Structure Associated with Financial Institutions, to the United States Department of the Treasury, TREAS-DO-2007-0018, at 1 (Jan. 31, 2008) (emphasis added), available at <http://www.justice.gov/atr/public/comments/229911.pdf>.

that desire to participate in the NYPC-FICC one pot margining program¹⁰ – does not alleviate these anticompetitive burdens for several reasons, all of which demonstrate that the NYPC’s application should not be approved until FICC has provided ELX with a means of offering one pot margining through a DCO other than NYPC.

First, the application concedes that NYSE Liffe U.S. will have exclusive access to NYPC (which in turn, as explained, enjoys an exclusive relationship with FICC for one pot margining) for a period of time. In other words, the application admits that, even if ELX wanted to clear through NYPC to offer its customers one pot margining, the structure contemplated by the application denies ELX that option. Because, as explained, one pot margining would benefit traders in U.S. Treasury and Eurodollar futures, NYSE Liffe U.S.’s exclusive access to this service could give NYSE Liffe U.S. a significant competitive advantage over ELX, and limit ELX’s ability to compete against the CME. Plainly, competition would be better served by two exchanges with access to one pot margining competing against each other and the CME rather than one. Accordingly, NYSE’s admitted exclusive access to one pot margining with FICC imposes an “anticompetitive burden” in violation of applicable law.

Second, the application’s statement that such exclusivity extends “for a limited transitional period” is a chimera. For one thing, the application does not explain what the “period” of “transition” is. Does it mean three days or three years? For another, NYSE and DTCC announced NYPC’s formation and NYPC’s exclusive access to FICC one pot margining over a year ago. Futures traders thus have known for over a year that ELX faces a significant handicap (compared to NYSE Liffe U.S.) when NYPC begins operations, and during that period ELX’s ability to attract

¹⁰ NYPC Application, *supra* note 3, at 29 (Part X.E).

customers has accordingly been retarded. Simultaneously, the time-table for NYPC initiating operations has continued to slip. Accordingly, what the application describes as a “limited transitional period” – whatever that means – has effectively placed a long-term handicap on ELX. Offering the marketplace the benefits of one pot margining does not require giving ELX’s rival, NYSE Liffe U.S., this time-to-market advantage.

Third, even if the “limited transitional period” expires before ELX is commercially hurt, putting ELX to the choice of one pot margining through NYPC, an affiliate of ELX’s competitor NYSE Liffe U.S., or no one pot margining at all, imposes an anticompetitive burden. If ELX cannot offer one pot margining, as explained, ELX will continue to suffer a significant competitive disadvantage that impairs its ability to provide significant competition to the CME. If ELX must clear through NYPC (rather than OCC) to offer customers one pot margining, competition also will suffer. For one thing, ELX would need to disclose sensitive information to an affiliate of its competitor, NYSE Liffe U.S.; this could deter ELX from launching new initiatives that benefit consumers. Further, the priority that FICC intends to offer NYPC customers¹¹ would make ELX an inferior choice for customers to select in order to achieve the benefits of one pot margining with FICC. For another, if NYPC is not sufficiently capitalized to prove attractive to customers, competition to CME plainly would be impaired compared to circumstances where ELX could offer one pot margining directly with FICC. In addition, because NYPC’s 50% owner, NYSE, also owns NYSE Liffe U.S., if ELX customers clear trades through NYPC rather than OCC with FICC, antitrust economics predicts that NYSE Liffe U.S. would pull *its* competitive punches, thereby

¹¹ “FICC will not enter into any other cross-margining agreements if such agreement would adversely affect the priority of NYPC.” Form 19b-4, *supra* note 5, at 13 & n.4.

causing prices to consumers to rise relative to circumstances where ELX customers clear through OCC.¹² None of these outcomes benefit consumers, and all impose an anticompetitive burden.

3. Last, no circumstances suggest that exclusivity between FICC and NYPC, or between NYPC and NYSE Liffe U.S., meets the statute's narrow exception for anticompetitive burdens that are "appropriate"¹³ to achieve Congress's objectives. FICC has articulated no persuasive reason for entering into a one pot margining agreement with NYPC and no other clearinghouse. Nor has NYPC identified a reason for "providing clearing services solely for [NYSE Liffe U.S.] for a limited transitional period."¹⁴ The application identifies no technical reason why FICC can support one pot margining for only one clearinghouse or exchange. In fact, OCC offered a one pot margining system to both CME and CBOT concurrently before they merged that allowed for cross margining between equity options on stocks listed on both the S&P 500 and the Dow Jones Indices.

There is, at bottom, no sound policy reason for the CFTC to approve an application that gives NYSE Liffe U.S. a competitive advantage over ELX, a competitive-advantage DTCC itself identifies.¹⁵ On the contrary, permitting NYSE Liffe U.S. to offer one pot margining through its clearinghouse of choice when ELX cannot threatens to deprive investors of one of the few

¹² See, e.g., United States Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* § 13, at 33-34 (Aug. 19, 2010) (explaining that holding a minority position in a rival can blunt incentives). As applied here, if an ELX client cleared through a clearinghouse 50% owned by NYSE, NYSE could have an incentive to raise the fees that NYSE Liffe U.S. charges its clients, because NYSE can "recapture" through NYPC losses from any customers switching to ELX from NYSE Liffe U.S.

¹³ 7 U.S.C. § 7a-1(c)(2)(N).

¹⁴ NYPC Application, *supra* note 3, at 29 (Part X.E).

¹⁵ See <http://www.dtcc.com/news/newsletters/dtcc/2010/apr/AprilNews.pdf>, at 3 (Apr. 2010) (extolling how cross-margining will benefit participants that transact on NYSE Liffe U.S.).

ROPES & GRAY LLP

alternatives to CME – ELX – in derogation of Congress’s policy of developing well-functioning financial marketplaces through the “least anticompetitive means.”¹⁶

* * *

We are available to answer any follow-up questions.

Sincerely,



Richard D. Marshall

cc: Hon. Gary Gensler, Chairman
Hon. Michael Dunn, Commissioner
Hon. Jill Sommers, Commissioner
Hon. Bart Chilton, Commissioner
Hon. Scott O'Malia, Commissioner
Ananda K. Radhakrishnan, Director, Division of Clearing and Intermediary Oversight
Dan Berkovitz, General Counsel

¹⁶ 7 U.S.C. § 7a-1(c)(3).