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- **17 CFR Parts 1 and 39**
- **RIN Number 3038-AC98**
- **General Regulations and Derivatives Clearing Organizations**

Dear Mr. Stawick.

Thank you for giving us the opportunity to comment on your notice of proposed rulemaking: General Regulations and Derivatives Clearing Organizations.

You are proposing regulations to implement Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). These proposed amendments would establish the regulatory standards for compliance with derivatives clearing organization (DCO) Core Principles A (Compliance), H (Rule Enforcement), N (Antitrust Considerations), and R (Legal Risk), as well as DCO chief compliance officer (CCO) requirements set forth in Section 5b of the Commodity Exchange Act (CEA). The proposed amendments would also revise procedures for DCO applications, clarify procedures for the transfer of a DCO registration, add requirements for approval of DCO rules establishing a portfolio margining program for customer accounts carried by a futures commission merchant (FCM) that is also registered as a securities broker-dealer (FCM/BD), and make certain technical amendments. The CFTC is also proposing amendments to update the definitions of "clearing member" and "clearing organization", and to add definitions for certain other terms.

I support the proposed regulations. They strike the right balance between a principle-based and a rules-based approach. I agree that some bright-line regulations are necessary to facilitate DCO compliance, and ultimately to protect the integrity of the US clearing system. I hope that the following comments will be helpful to you.

Proposed definitional amendments

§ 1.3 proposes definitions for various terms, including for Initial margin in § 1.3(III). This definition covers initial margin for futures, options or swaps, and is very similar to the definition proposed in Part 23.600 for Initial margin for swaps.¹ As I have already commented, I would recommend that you should specifically reference that Initial Margin is posted at the commencement or outset² of the futures, option or swap transaction in order to distinguish it from Variation Margin.

§ 39.1(b) also proposes definitions, including for Stress test. This definition refers to “a potential price move, change in option volatility, or change in other inputs that affect the value of a position”. Stress testing is a very useful tool in order to manage expectations and to help the DCO to anticipate financial resources requirements in extreme conditions. But it is only useful if the testing covers such extreme conditions. I would recommend that you should add wording to reference that the potential changes should be expected to occur in “extreme but plausible market conditions”.³

Chief compliance officer

I fully support the intent of the proposed regulations here. The CCO role is the single most important compliance role in a DCO and it is critical that its job description, the rules and the entity’s structures and procedures, act to secure and maintain the CCO’s independence. For example the CCO should have a single compliance role and no other competing role or responsibility that could create conflicts of interest or threaten its independence, and therefore I would suggest that you should promulgate rules that restrict the CCO position from being held by an attorney who represents the DCO or its board of directors, such as an in-house or general counsel. Furthermore the remuneration of the CCO must be specifically designed in such a way that avoids potential conflicts of interest with its compliance role.

Given the pressures that bear on the CCO with regard to managing conflicts of interest and maintaining independence, I would strongly recommend one specific change to the proposed rules. I would recommend that you amend the wording under § 39.10 such that the authority and sole responsibility to designate or remove the CCO, or to materially change its duties and responsibilities, only vests with the independent directors and not the full board. This would help to ensure the independence of the CCO within the entity, and would possibly

¹ See 75 FR 75438 in CFTC Notice of proposed rulemaking: Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy (covering 17 CFR Parts 23 and 190), RIN 3038-AD28, December 2010, and my comment letter thereon.

² This is how initial margin is usually defined. For example see Notice of proposed rulemaking: Margin and Capital Requirements for Covered Swap Entities, Agencies, April 2011; “Initial margin means eligible collateral that is pledged in connection with **entering into a swap...**” (my emphasis).

³ This would be more consistent with your proposed rules on: Financial Resources Requirements for Derivatives Clearing Organizations, RIN 3038-AC98, 3038-AD02, CFTC, October 2010 (and my comment letter thereon); and would be more consistent with principle 4 in the latest CPSS-IOSCO consultative report on Principles for financial market infrastructures - March 2011, which states that: “A CCP should also maintain additional financial resources to cover a wide range of potential stress scenarios ... in extreme but plausible market conditions”.

Please note that the comments expressed herein are solely my personal views

mitigate the need for you to promulgate rules requiring the DCO to insulate the CCO from undue pressure and coercion or to address the potential conflict between and among compliance interests, commercial interests and ownership interests of a DCO.⁴

Summary

The proposed regulations are a good starting point for implementing the required compliance with DCO core principles. However I would strongly recommend that you should amend the proposed regulations in order to strengthen the CCO's independence, and to provide greater protection from conflicts of interest here.

Yours sincerely

Chris Barnard

⁴ These comments are similar to my comment letter on your proposed rule: Designation of a Chief Compliance Officer; Required Compliance Policies; and Annual Report of a Futures Commission Merchant, Swap Dealer, or Major Swap Participant, RIN 3038-AC96, CFTC, November 2010.