THOMSON REUTERS

July 25, 2016

Christopher J. Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Comment Letter on Certain Swap Clearing Requirement Submissions for Foreign Exchange Non-Deliverable Forwards

Dear Mr. Kirkpatrick:

Thomson Reuters (SEF) LLC ("**TR SEF**" or "**we**") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "**CFTC**" or "**Commission**") with comments and recommendations regarding the CFTC Regulation 39.5(b) swap submissions from certain registered derivatives clearing organizations ("**DCOs**").[1] In particular, TR SEF is writing to encourage the Commission to issue a Notice of Proposed Rulemaking to require the clearing of certain foreign exchange ("**FX**") non-deliverable forwards ("**NDFs**") on 12 currency pairs (the "**Identified NDFs**")[2] identified in petitions by LCH.Clearnet Limited ("**LCH**"), the Chicago Mercantile Exchange ("**CME**"), ICE Clear Europe ("**ICE**") and the Singapore Exchange Derivatives Clearing Limited ("**SGX**" and, together with CME, LCH and ICE, the "**Identified DCOs**").

Thomson Reuters supports the expansion of the Commission's clearing requirement (the "**clearing requirement**") in order to improve market liquidity and integrity. We believe that, overall, the clearing requirement has been well-received by market participants and that it has been beneficial to the markets for interest rate swaps ("**IRS**") and credit default swaps ("**CDS**").

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[1] *See* Press Release, CFTC Requests Public Comment on Swap Clearing Requirement Submissions (June 23, 2016).

[2] LCH's clearing requirement submission to the CFTC covers NDFs settled in U.S. dollars where the reference currency is Brazilian Real ("**BRL**"), Philippine Peso ("**PHP**"), Malaysian Ringgit ("**MYR**"), Indian Rupee ("**INR**"), Korean Won ("**KRW**"), Chinese Renminbi Yuan ("**CNY**"), Indonesian Rupiah ("**IDR**"), Taiwan Dollar ("**TWD**"), Chilean Peso ("**CLP**"), Colombian Peso ("**COP**"), and Russian Ruble ("**RUB**"). *See* LCH.Clearnet Limited Submission under § 39.5 (Aug. 14, 2012). The CME's submission also covers Peruvian Sol ("**PEN**"). *See* CME Submission No. 13-151 (April 24, 2013). *See* CME Submission No. 11-360 (Sept. 22, 2011) (listing NDF contracts offered for clearing). The ICE and SGX submissions did not include any additional currency pairs other than those already included in the LCH and CME submissions. *See* ICE Submission of New Swaps for Clearing (Nov. 29, 2012); SGX Submission of Swaps Contracts for the Commission's Mandatory Clearing Determination (Feb. 28, 2014).

We believe that expanding the clearing requirement to certain highly-traded NDFs would result in similar benefits to the FX market.

More specifically, we believe that the Commission should require NDFs to be cleared because: (i) NDFs satisfy the criteria that the Commission is directed to take into account when making clearing determinations under Section 2(h)(2)(D) of the Commodity Exchange Act ("**CEA**") and the additional factors applicable to clearing determinations under CFTC Regulation 39.5(b)(3); and (ii) market participants are already regularly clearing NDFs. We therefore urge the Commission to require that NDFs be cleared.

I. NDFs Satisfy the Statutory Factors for the Clearing Requirement

Section 2(h)(2)(D) of the CEA directs the Commission to take into account certain factors when reviewing a clearing determination submitted by a DCO.[3] Commission Regulation 39.5(b)(3) restates these factors and includes certain other requirements that DCOs must satisfy when submitting new swaps that they intend to accept for clearing.[4] We believe that NDFs satisfy these statutory factors based on data submitted by the Identified DCOs and certain data that has become available since the Identified NDFs were initially submitted for a clearing requirement determination.

A. Data Submitted by the Identified DCOs Demonstrates that NDFs Satisfy the Statutory Factors

The Identified DCOs filed separate submissions for the clearing requirement of the Identified NDFs between 2012 and 2014. These submissions each contain an analysis demonstrating that the Identified NDFs satisfy all of the factors included in Section 2(h)(2)(D) of the CEA and CFTC Regulation 39.5(b)(3). Although this analysis has already been provided to the Commission, we are providing a brief summary below of pertinent points raised in the Identified DCOs' submissions that demonstrate the market is prepared for the clearing requirement of the Identified NDFs:

> **(I) The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data**. Based on studies from the Bank of International Settlements ("***BIS***"), CME stated that the entire FX market traded an average of $4.0 trillion per market day in April 2010, and LCH identified this number as $4.3 trillion in April 2011. LCH also stated that FX NDFs account for

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[3] *See* CEA Section 2(h)(2)(D)(ii), 7 U.S.C. § 2(h)(2)(D)(ii) ("In reviewing a swap, group of swaps, or class of swaps pursuant to subparagraph (A) or a submission made under subparagraph (B), the Commission shall take into account the following factors: (I) The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data. (II) The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded. (III) The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the derivatives clearing organization available to clear the contract. (IV) The effect on competition, including appropriate fees and charges applied to clearing. (V) The existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or 1 or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property.").

[4] *See* 17 C.F.R. § 39.5(b)(3).

approximately $110 billion notional per day, based on data published by the Bank of England, and that the 11 NDFs chosen for clearing by LCH (*i.e.*, excluding Peruvian Sol, which CME included in addition to LCH's 11 currency pairs) account for 95% of NDF trading. LCH also noted that ForexClear, LCH's clearing service for NDFs, cleared an average total notional amount of $2.4 billion per day in July 2012, and that ForexClear cleared a total of 6,000 trades representing a total notional in excess of $80 billion by the end of July 2012.

ICE included a confidential submission with data describing the outstanding notional exposure and trading liquidity of FX products, but represented that trading liquidity and pricing data are adequate for ICE to manage its risk effectively in clearing such products.

(II) The availability of rule framework, capacity, operational expertise and resources. The Identified DCOs explained that the Identified NDFs would be cleared under rule frameworks established by such DCOs, and that they have established operational models and risk controls regarding such NDFs. We note that the Identified DCOs are established DCOs and that some of them are already clearing NDFs, as well as swaps in other asset classes.

(III) The effect on the mitigation of systemic risk. LCH noted that a clearing requirement would reduce the interconnectedness of the NDF market, and CME noted that centralized clearing would enhance customer risk management and create operational efficiencies. ICE noted that clearing reduced systemic risk, and SGX noted that there are many benefits to clearing, including standardization of key terms, ease of position adjustment, reduction of counterparty risk and the provision of efficiencies through the centralized consolidation of collateral management.

(IV) The effect on competition. CME, ICE and SGX stated that clearing NDFs would not have a negative effect on competition, and LCH noted that it would increase competition among DCOs.

(V) The existence of reasonable legal certainty. CME and LCH explained that the insolvency of a clearing member or the DCO itself would be governed by identified procedures and laws. ICE and SGX noted that they have previously provided the Commission with information regarding the treatment of customer positions in the event of a clearing member's bankruptcy.

Indeed, based on this data, the Commission publicly expressed its intent to impose a clearing requirement on NDFs in a Global Markets Advisory Committee ("**GMAC**") meeting on October 9, 2014.[5] In that meeting, Commission staff reported that between October 2013 and April 2014, data collected pursuant to part 43 of the Commission's regulations indicated an aggregate notional value of approximately $7.4 trillion in uncleared and cleared swaps involving the Identified NDFs. Despite the growing trading activity and its stated intent to impose a clearing requirement on NDFs, though, the Commission later opted to delay such a requirement.

[5] *See* Press Release, CFTC's Global Markets Advisory Committee Releases Agenda for Upcoming Public Meeting (Oct. 8, 2014), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr7030-14.

B. Data from Other Sources Demonstrates Significant Growth in NDF Clearing

As LCH and CME noted, there was a significant amount of volume in the NDF market in 2010 and 2011. Since then, the volume has increased even further. For example, the most recent BIS study shows that NDFs account for approximately $127 billion notional per day,[6] compared to $110 billion in 2011.[7] 94% of this volume takes place against the U.S. dollar.[8] Additionally, as noted above, LCH had cleared more than 6,000 NDFs representing a total notional value of more than $80 billion by July 2012.[9]

While data regarding the volume of cleared NDFs is not readily available,[10] LCH announced in 2015 that it alone had cleared more than $3 trillion notional in NDFs since ForexClear's launch.[11] And while some commentators have pointed out that most of this volume has been inter-bank clearing rather than client clearing,[12] the same was generally true before the Commission required the clearing of CDS. In the period from September 1, 2012 through March 29, 2013, for example, DTCC reported that only 3% of the dealer to non-dealer volume of CDS was cleared, compared to 42% of the dealer to dealer CDS volume.[13] Despite this relatively low degree of client clearing for CDS, the Commission stated in its clearing requirement determination for CDS that "[t]he swap market has made a smooth transition into clearing CDS on its own initiative."[14]

II. A Clearing Requirement for NDFs would Benefit the Market

In its determination to require clearing for CDS and IRS, the Commission identified several benefits of clearing that would be equally applicable to mandatory clearing of NDFs. These benefits included:

(i) mitigation of counterparty risk generally due to the increased number of market participants facing a highly creditworthy counterparty;

(ii) mitigation of counterparty risk during the latency period due to the requirement to submit mandatorily cleared swaps for clearing as soon as technologically practicable; and

[6] *See* Robert N. McCauley, Chang Shu, and Guonan Ma, *Non-deliverable forwards: 2013 and beyond*, BIS Quarterly Review at 76 (March 9, 2014), *available at* http://www.bis.org/publ/qtrpdf/r_qt1403h.pdf [hereinafter Non-deliverable forwards: 2013 and beyond].

[7] *See* LCH.Clearnet Limited Submission under § 39.5 (Aug. 14, 2012).

[8] *See* Non-deliverable forwards: 2013 and beyond at 76.

[9] *See* LCH.Clearnet Limited Submission under § 39.5 (Aug. 14, 2012).

[10] For example, the Commission has not started including data regarding any FX transactions in its weekly swap report.

[11] *See ForexClear Breaks Through $3 Trillion*, Markets Media, *available at* http://marketsmedia.com/forexclear-breaks-through-3-trillion/ (Sept. 16, 2015).

[12] *See, e.g.*, Robert Mackenzie Smith, *NDF liquidity in doubt as clearing approaches*, FX WEEK (May 14, 2014).

[13] *See* DTCC, Centrally Cleared Credit Trade Analysis (June 3, 2013), *available at* http://www.dtcc.com/~/media/Files/Downloads/Settlement-Asset-Services/DerivSERV/CDS_Clearing_Volume_Sep_2012_Mar_2013_Final.ashx.

[14] Clearing Requirement Determination Under Section 2(h) of the CEA; Final Rule, 77 Fed. Reg. 74284, 74330 (Dec. 13, 2012).

(iii) mitigation of systemic risk.[15]

Following the October 9, 2014 GMAC meeting mentioned above, the GMAC Foreign Exchange Markets Subcommittee (the "**GMAC Subcommittee**") submitted a report to the Commission generally agreeing that clearing NDFs would provide certain of the benefits listed above. According to the GMAC Subcommittee, for example, "a CFTC clearing mandate for FX NDFs would result in a system-wide reduction of counterparty credit risk. . . ."[16] The GMAC Subcommittee ultimately did not make a specific recommendation as to whether the Identified NDFs should be subject to a clearing requirement, instead advising the Commission that "should the Commission decide to proceed with a clearing mandate for NDFs, such mandate should contain a clear timeline and method of implementation to ensure that market participants have appropriate opportunity to address the issues outlined in the rest of this paper."[17]

In addition to the benefits of clearing identified by the Commission and the GMAC Subcommittee, we note that increased clearing would improve price competition because market participants engaging in cleared NDFs would not be limited to transacting with counterparties with whom they have a credit and master or settlement arrangement.[18] Instead, market participants trading cleared NDFs would be able to interact and trade with all other market participants on a given swap execution facility ("**SEF**"), regardless of whether such participants have a relationship with one another. The elimination of the requirement to execute credit and master or settlement arrangements would also increase efficiency for market participants trading NDFs because they would no longer need to negotiate such agreements with all potential counterparties.

For these reasons, we believe many market participants would be in favor of mandatory clearing for a broader array of swaps, including NDFs. We note, for example, that of the 10 comment letters filed in response to the Commission's recent Notice of Proposed Rulemaking to require the clearing of certain additional IRS, only one commenter opposed the Commission's proposal.[19] Further, many panelists at the Commission's April 26, 2016 Market Risk Advisory Committee meeting generally supported expanded clearing requirements.[20]

Given the benefits of clearing generally, and for NDFs specifically, we do not believe that the Commission should delay proposing a clearing requirement for NDFs until European

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[15] *Id.* at 74330.

[16] *See* Response to request for recommendation on an FX NDF mandate, Foreign Exchange Markets Subcommittee (Dec. 5, 2014), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr7088-14.

[17] *Id.*

[18] *See* Division of Clearing and Risk, Division of Market Oversight and Division of Swap Dealer and Intermediary Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities (Nov. 14, 2013) ("SEFs that apply or support enablement mechanisms that allow certain participants to interact with only certain other participants, or to interact in only certain ways, while other participants have broader abilities to interact, are imposing or allowing different access terms on similarly situated participants and are therefore engaging in prohibited discriminatory treatment.").

[19] *See* Comments for Proposed Rule 81 FR 39506, *available at* http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1711.

[20] *See* Press Release, CFTC's Market Risk Advisory Committee to Meet on April 26, 2016, *available at* http://www.cftc.gov/PressRoom/PressReleases/pr7354-16.

regulators issue a similar clearing requirement. We believe that one reason the Commission has opted to do so is to prevent regulatory arbitrage and protect US market participants from a competitive standpoint. However, we note that margin requirements for uncleared swaps are likely to become effective in the near future in the US and Europe, so the cost difference between trading cleared versus uncleared swaps is likely to be significantly reduced.[21] As a result, even if the Commission were to require clearing for NDFs, the competitive advantage to being able to trade uncleared swaps in Europe will be greatly reduced, if there would be any advantage at all. Further, we have seen the swaps markets become increasingly ring-fenced in recent years as many firms have begun to limit trading to domestic counterparties in order to comply with various regulatory requirements imposed by their home country regulator(s). As a result, we believe there would be limited opportunities for regulatory arbitrage based on the cost of trading NDFs in the US versus Europe.

III. Conclusion

We urge the Commission to issue a proposed determination that the Identified NDFs must be cleared. The submissions from the Identified DCOs demonstrate that the Identified NDFs meet the statutory standards for a clearing requirement, and, as described above, we believe the market is prepared to clear NDFs.

If you have any questions or would like to discuss any of the issues raised in this letter, please contact the undersigned at (202) 572-0198.

Sincerely,

Wayne Pestone
Chief Compliance Officer
Thomson Reuters (SEF) LLC

cc: Nancy Markowitz, Deputy Director, Market Review Branch, Division of Market Oversight
(Commodity Futures Trading Commission)

[21] While the EU Commission has announced that margin requirements for uncleared swaps will be delayed in the EU, European regulators still believe that such requirements will become effective in the first half of 2017. *See, e.g.*, Andrew Ackerman, *Europe Delays Key Swaps Rules*, WASHINGTON POST (June 9, 2016) ("Ms. Mock said the commission now aims 'to deliver the standard before the end of the year and for firms covered by the first wave of the rules to be required to comply before the middle of next year.'"). Thus, even with this delay, margin requirements for uncleared swaps would likely be effective by the time the Commission is able to propose and finalize a clearing mandate for NDFs.