ISDA Safe, Efficient Markets

October 12, 2018

Mr. Christopher Kirkpatrick
Secretary
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Exemption from Derivatives Clearing Organization Registration (RIN 3038-AE65)

Dear Secretary Kirkpatrick:

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] appreciates the opportunity to provide comments to the U.S. Commodity Futures Trading Commission ("**CFTC**" **or** "**Commission**") regarding the Commission's Notice of Proposed Rulemaking*: Exemption from Derivatives Clearing Organization Registration* (the "**Proposal**"). ISDA strongly supports the codification of the policies and procedures that the Commission currently follows to grant orders of exemption from Derivatives Clearing Organization ("**DCO**") registration. Codifying existing CFTC procedures will provide central clearing counterparties ("**CCPs**") and other derivatives market participants with legal certainty and transparency regarding DCO registration and the CFTC's regulation of CCPs. It will also eliminate the existing burdens on CCPs that must each separately inquire about the CFTC's procedures for granting orders of exemption from DCO registration and on CFTC staff who must respond to these inquiries.

However, as explained below, we strongly believe that the CFTC should permit exempt DCOs to clear swaps for any U.S. person, including customers of futures commission merchants ("**FCMs**") and non-U.S. clearing members of exempt DCOs that meet certain requirements. On this point, we support the positions regarding registration of non-U.S. CCPs in Chairman Giancarlo's October 2018 white paper, *Cross-Border Swaps Regulation version 2.0*.[2] We also offer a number of technical comments on the Proposal and request that the CFTC permit U.S. persons to clear swaps that are not subject to the CFTC's clearing mandate at any CCP, regardless of whether it is registered or exempt from registration as a DCO.

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

[2] https://www.cftc.gov/sites/default/files/2018-10/Whitepaper_CBSR100118.pdf.

Cross-Border Harmonization

We strongly support the Commission's proposal to use the CPMI-IOSCO *Principles for financial market infrastructures* ("**PFMI**") as a framework for comparability determinations with respect to a foreign jurisdiction's supervisory and regulatory regime for CCPs.[3] We agree with the Commission that the PFMIs address major elements critical to the safe and efficient operations of CCPs and are comparable in purpose and scope to the CFTC's core principles for DCOs. Given that derivatives markets are global in nature, we appreciate the Commission's recognition that a foreign jurisdiction's supervisory and regulatory scheme may differ from the CFTC's in certain respects, but should still be recognized as comparable if the foreign jurisdiction's rules "achieve the same underlying goals" as the CFTC's rules. We agree with the Commission that this approach would strike a proper balance between addressing risk to the United States and promoting cross-border harmonization.

As we have stated in the past, a lack of recognition of foreign regulatory regimes and market infrastructure requires U.S. and U.S.-affiliated firms to build-out duplicative compliance systems in order to meet both U.S. and non-U.S. requirements. Requiring U.S. and U.S.-affiliated firms to comply with overlapping sets of regulations and clear through only CCPs that comply with the full set of the CFTC's DCO regulations would increase operational costs, decrease the competitiveness of U.S. firms abroad and lead to market fragmentation. The Proposal's use of the PFMI framework as a baseline for comparability among U.S. and non-U.S. CCPs would avoid such outcomes in many instances.

We note that outside of the United States, the European Commission in July 2017 proposed amendments to the European Market Infrastructure Regulation that could in certain instances apply significant parts of the EU clearing regime to U.S. CCPs without deference to the CFTC's regime. Under the proposed amendments, if a U.S. CCP's clearing activities are systemically important to EU markets, the application of EU law would extend to the CCP's entire clearing business, even business that occurs entirely outside of the EU. This outcome would ignore the fact that while EU laws and U.S. laws are not identical, they are both based on the PFMI framework and have been determined to achieve the same underlying goals. We commend the CFTC for not taking such an approach in the Proposal but urge the CFTC to continue the dialog with its counterparts and other policy makers in the EU to ensure that the EU ultimately maintains its deference to the CFTC's supervision of U.S. CCPs pursuant to principles of comparable compliance.[4]

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[3] *See* ISDA Cross-border Harmonization of Derivatives Regulatory Regimes: A Risk-based Framework for Substituted Compliance via Cross-border Principles, *available at* https://www.isda.org/a/VsiDE/cross-border-harmonization-whitepaper-press-release-final.pdf.

[4] *See* ISDA A Case for Supervisory Cooperation, *available at* https://www.isda.org/2018/04/18/the-case-for-ccp-supervisory-cooperation/.

Customer Clearing

In response to the Commission's question about customer clearing, ISDA strongly believes that the CFTC should permit exempt DCOs to clear swaps for customers. We have made this point in the past[5] and are encouraged by the Commission's question considering the issue and by the positions of Chairman Giancarlo in his October 2018 white paper, *Cross-Border Swaps Regulation version 2.0*.[6]

Under the CFTC's interpretation of the current rules, U.S. persons that are not themselves members of CCPs are *only* permitted to clear swaps with CCPs that are registered with the CFTC as DCOs (and not CCPs that are exempt from DCO registration). These requirements ultimately prevent U.S. firms from providing liquidity and hedging for customers in non-U.S. markets where local CCPs have obtained a CFTC order of exemption from DCO registration (or, if the Proposal is finalized, are exempt from DCO registration pursuant to the CFTC's rules). This outcome is inconsistent with the Proposal's objective of cross-border harmonization.

In the Proposal, the CFTC notes that in order for a swaps customer to receive protection under the Commodity Exchange Act ("**CEA**"), particularly in an insolvency context, the customer's funds must be carried by an FCM and deposited with a registered DCO. The Proposal explains that absent such a chain of registration, the swaps customer's funds may not be treated as customer property under the U.S. Bankruptcy Code and the CFTC's regulations. This is because Section 761(2) of the U.S. Bankruptcy Code defines a "clearing organization" as a DCO that is registered under the CEA, and CFTC Regulation 190.01(f) states that for purposes of the CFTC's Part 190 bankruptcy rules, "clearing organization" has the same meaning as that set forth in section 761(2) of the U.S. Bankruptcy Code.

The provisions in Section 5b(h) of the CEA that contemplate exemptions from DCO registration were enacted in 2010, after Section 761(2) of the U.S. Bankruptcy Code was enacted. Therefore, we believe that the reference to registered DCOs, but not DCOs that are exempt from registration in Section 761(2) of the U.S. Bankruptcy Code, is because the exemption concept did not exist when Section 761(2) was enacted, not because of a deliberate decision to exclude exempt DCOs from the definition of "clearing organization". Accordingly, the CFTC could amend its Part 190 bankruptcy rules to provide that "clearing organization" has the same meaning as that set forth in section 761(2) of the U.S. Bankruptcy Code but "registered under the CEA" in that statute should be read to mean "registered *or exempt from registration* under the CEA". Such a reading would be consistent with the CEA as it exists today (*i.e.*, the CEA as amended to contemplate exemptions from DCO registration) and would increase the likelihood that a

[5] *See* ISDA's response to the CFTC's Project Kiss, *available at* https://www.isda.org/a/nVKDE/ISDA-KISS-Response_29-September-2017_Appendix_Links_version_FINAL.pdf.

[6] https://www.cftc.gov/sites/default/files/2018-10/Whitepaper_CBSR100118.pdf.

swaps customer's funds would be treated as customer property under the U.S. Bankruptcy Code and the CFTC's regulations for swaps cleared at exempt DCOs.[7]

As an alternative to the approach described above, the CFTC could codify the proposed policies and procedures for exempt DCOs so that exempt DCOs are a "class" or "type" of registered DCOs. We are also open to other approaches that would enable exempt DCOs to clear for U.S. customers through FCMs while maintaining the protections afforded to customer property under the U.S. Bankruptcy Code and the CFTC's regulations. We continue to analyze the legal and other implications of these issues and would welcome the opportunity to work with CFTC staff to address this and any other impediments to customer clearing at exempt DCOs through FCMs.

We also support the positions set out in Chairman Giancarlo's October 2018 white paper, *Cross-Border Swaps Regulation version 2.0*.[8], which would permit U.S. persons to clear through non-U.S. clearing members of exempt DCOs that are not registered as FCMs. We believe that such arrangements would be appropriate provided that the non-U.S. clearing members of the exempt DCO demonstrate that they are supervised, regulated and licensed to provide clearing services under a regime that is comparable to the CFTC's and consistent with the PFMIs. Among other things, a non-U.S. clearing member must be able to demonstrate that customer property would be subject to protections comparable to those that would apply to customers of an FCM under the U.S. Bankruptcy Code and consistent with PFMIs (to the extent relevant).

We would welcome the opportunity to work with CFTC staff to fully analyze these issues and develop an appropriate regime for allowing non-U.S. clearing members of exempt DCOs to clear for U.S. person customers. As noted above, we believe that processes for permitting swaps customers to clear at exempt DCOs is necessary to fully achieve the Proposal's objective of cross-border harmonization.

Technical Comments

MOUS. Proposed Regulation 39.6(a)(2) would require a memorandum of understanding ("**MOU**") or similar arrangement satisfactory to the CFTC to be in effect between the CFTC and the CCP's home country regulator(s), pursuant to which, among other things, the home country regulator agrees to provide the CFTC any information that the CFTC deems necessary to evaluate the CCP's initial and continued eligibility for exemption or to review compliance with any conditions of such exemption. We urge the CFTC to provide additional clarity regarding what information it may require to perform such an evaluation so that home country regulator(s) can ensure that providing the information would not violate any local laws in the home country. We believe that additional *ex ante*

[7] In this scenario, the customers would still access the exempt DCO through an FCM that is a clearing member of the exempt DCO or that clears through a broker that is a clearing member of the exempt DCO. Note that additional analysis would be required to address any legal or regulatory conflicts between U.S. law and the laws relevant to the exempt DCOs and its other clearing members.

[8] https://www.cftc.gov/sites/default/files/2018-10/Whitepaper_CBSR100118.pdf.

clarity regarding the type of information that the CFTC expects to require would strike the right balance between the CFTC's need for information from home country regulators and any prohibitions on providing certain types of information under local laws.

Inspections. Proposed Regulation 39.6(b)(5) would require an exempt DCO to make all documents, books, records, reports and other information related to its operation as an exempt DCO open to inspection and copying by any CFTC representative, and to promptly make its books and records available and provide them directly to CFTC representatives, upon the request of a CFTC representative. We recognize that the CEA requires such inspections for exempt DCOs and that the CFTC must maintain the authority to review information related to an exempt DCO's dealings with U.S. persons. However, similar to the points above regarding MOUs with home country regulators, we urge the CFTC to provide additional *ex ante* clarity regarding how and when it would undertake inspections of exempt DCOs. We also encourage the CFTC to consider obtaining consent from, or at least providing prior notice to, an exempt DCO's home country regulator in connection with any inspections of the exempt DCO. These measures would help assure non-U.S. CCPs that any such inspections would not be overly burdensome or in violation of any local laws. Finally, we believe the CFTC should consider including an exempt DCO's home country regulator in inspections to assist in interpreting and analyzing the contents of the information reviewed.

Automatic Termination of Exemption. In the Proposal, the CFTC asks whether any of the conditions imposed on an exempt DCO should result in an automatic termination of the exemption if it is not met. We believe that an automatic termination of exemptions could result in market disruption and legal uncertainty, particularly for U.S. persons clearing through the exempt DCO. However, we recognize that the CFTC must ensure that exempt DCOs continue to operate safe and efficient clearing operations under a regime that is consistent with the PFMIs. Therefore, we believe that the CFTC should first commit to working with the exempt DCO and its home country regulator(s) to resolve the breach. If such work is not successful, termination of the exemption may be necessary but, if it is, the CFTC should allow for an appropriate transitional period so that affected clearing members and customers may migrate to other CCPs in an orderly manner.

Swaps Not Subject to the CFTC's Clearing Mandate

We believe that non-U.S. CCPs should not be required to be registered or exempt from registration as a DCO solely due to the fact that they permit clearing members (or affiliates of clearing members) that are U.S. persons to clear swaps that are not subject to the CFTC's clearing mandate. Such clearing is strictly voluntary and U.S. persons should therefore have more flexibility with regard to the CCP they select. As noted in the Proposal, in some cases non-U.S. CCPs that are not registered or exempt from registration as a DCO clear products that are not cleared at CCPs that are so registered or exempt from registration. We agree with the CFTC that clearing in such products should be encouraged.

The benefits of permitting U.S. persons to clear products not subject to the CFTC's clearing mandate at additional CCPs also include wider access to clearing for more products and diversification of risk. We believe that these benefits outweigh any consequences of allowing U.S. persons to clear these products at CCPs that are not registered or exempt from registration as a DCO. As these products are not subject to the CFTC's clearing mandate, they should be considered of less systemic importance to the United States than products that are subject to the mandate. In the event that the CFTC expands its clearing mandate to cover these products, the non-U.S. CCPs would not be required to register or obtain an exemption from registration as a DCO because they cleared the products before the mandate was expanded, but they would no longer be able to clear new transactions in the products for U.S. persons once the expanded mandate takes effect.

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We appreciate the opportunity to comment on the Proposal and look forward to working with the CFTC as it continues to consider issues related to exempt DCOs. Please contact Ann Battle (abattle@isda.org; 202-683-9333) if you have any questions.

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