CITADEL

November 18, 2019

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

Re: Registration with Alternative Compliance for Non-U.S. DCOs

Dear Mr. Kirkpatrick:

We appreciate the opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission") on its proposal to amend the regulatory framework for certain non-U.S. derivatives clearing organizations ("DCOs") (the "Proposal").[1]

Under the Proposal, a non-U.S. DCO would be eligible for a "DCO-lite" framework if the Commission determines that (a) the DCO does not pose substantial risk to the U.S. financial system and (b) its home country regulatory framework satisfies the DCO Core Principles contained in the Commodity Exchange Act ("CEA"). The proposed "DCO-lite" framework would only require the non-U.S. DCO to comply with the Commission's reporting, recordkeeping, and customer protection (including collateral segregation) requirements.[2]

While we recognize the Commission's objective to streamline the regulatory framework applicable to non-U.S. DCOs by expanding the deference granted to foreign regulators, the proposed "DCO-lite" framework does not appear to be specifically contemplated in the CEA.[3] In addition, it appears that the primary beneficiaries will be non-U.S. DCOs that are already registered with the Commission (and not clearinghouses that are currently unregistered).[4] The lack of clear statutory guidance and the concern that the "DCO-lite" framework may allow already-registered DCOs to remove certain protections that U.S. market participants rely upon suggest that the Commission should proceed cautiously.

To the extent the Proposal is finalized, we recommend that the Commission reserve sufficient flexibility to conduct a case-by-case analysis of each DCO application to utilize a "DCO-lite" framework. In addition, market participants should be provided with an opportunity to comment on each application. The associated cost-benefit analysis, including the impact on U.S. market participants, may vary greatly depending on the specific application and the associated foreign regulatory regime. Prior to granting a non-U.S. DCO's application to utilize a "DCO-lite" framework, the Commission should carefully consider the topics detailed below.

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[1] 84 FR 34819 (July 19, 2019), available at: https://www.cftc.gov/sites/default/files/2019/07/2019-15262a.pdf .

[2] Proposal at 34823.

[3] In contrast, Section 5b(h) of the CEA does contemplate the Commission exempting a DCO from registration if the Commission determines that the DCO is subject to comparable, comprehensive supervision and regulation.

[4] Six of the sixteen DCOs registered with the Commission are located outside of the U.S. (Proposal at 34820)

1. Whether the foreign regulatory regime is comparable and comprehensive

While a foreign regulatory regime should not be required to precisely replicate the U.S. framework in order to be considered comparable and comprehensive, the Commission should take into account more than just the relatively high-level DCO Core Principles when conducting this analysis. Several aspects of the Commission's regulations, which implement the DCO Core Principles, provide critical protections to U.S. market participants. For example:

- **Non-discriminatory access**. Part 39 prohibits a DCO from excluding or limiting clearing membership to certain types of market participants and from setting a minimum capital requirement of more than $50 million for any person that seeks to become a clearing member in order to clear swaps.[5] These requirements are critical to facilitating diversity and fair competition not only among clearing members that provide client clearing services but also among clearing members that act as liquidity providers and self-clear their proprietary positions.

- **Straight-through-processing**. Part 39 requires a DCO to coordinate with trading venues and clearing members in order to facilitate prompt, efficient, and accurate processing of all transactions submitted for clearing, including accepting or rejecting transactions as quickly as would be technologically practicable if fully automated systems were used.[6] The Commission has interpreted this requirement to mean that DCOs must accept or reject transactions within 10 seconds of receipt.[7] These straight-through-processing requirements have reduced market, credit, and operational risks for U.S. market participants and have promoted multilateral trading by enabling clients to seamlessly trade cleared swaps with a wider range of trading counterparties without complex bilateral documentation.

- **Public rule filings**. Part 40 requires DCOs to publicly disclose rule filings. This is critical in order to provide U.S. market participants with sufficient transparency into a DCO's governance and operations, including around the DCO's risk management and default management frameworks.

In each case, failing to require a DCO registered with the Commission to provide these fundamental protections to U.S. market participants risks negatively impacting market transparency, liquidity, and competition. Swaps cleared by such a DCO may be accessible to only certain types of market participants, impairing market access and choice of trading counterparties. The Commission recognized the importance of key aspects of its underlying regulations when

[5] §39.12(a). Among other related requirements, §39.12(b)(4) prohibits a DCO from requiring that one of the original executing parties be a clearing member in order for a product to be eligible for clearing and §39.12(a)(1)(vi) prohibits a DCO from requiring a clearing member enter into an arrangement with a customer that discloses the customer's original executing counterparty.

[6] §39.12(b)(7).

[7] "Staff Guidance on Swaps Straight-Through Processing" (Sept. 26, 2013), available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/stpguidance.pdf.

assessing the comparability of the EU regulatory framework for DCOs,[8] and we urge the Commission to maintain this approach for purposes of other jurisdictions.

2. Whether the proposed criteria for assessing systemic risk lead to a sensible result

Under CEA section 2(i), the Commission has jurisdiction over activities that "have a direct and significant connection with activities in, or effect on, commerce of the United States." In the Proposal, the Commission introduces a new test designed to identify DCOs that pose a "substantial risk to the U.S. financial system."[9] According to the Commission, (a) such a DCO will hold 20% or more of the required initial margin of U.S. clearing members for swaps across all registered and exempt DCOs, and (b) 20% or more of the initial margin requirements for swaps at that DCO will be attributable to U.S. clearing members, with the Commission retaining some discretion where at least one of these thresholds is close to 20%.[10]

We recommend that the Commission provide further information regarding how these criteria were developed, and the expected practical impact. For example, how many non-U.S. DCOs currently registered with the Commission would be expected to be identified as posing a "substantial risk to the U.S. financial system"? Given the relative size of the interest rate swap market, could a DCO clearing swaps in another asset class (such as CDS) ever be considered to pose a "substantial risk to the U.S. financial system" under these criteria? We submit that it would be a strange outcome if only non-U.S. DCOs clearing interest rate swaps would be subject to the Commission's full regulatory framework for DCOs.

In light of the above, we recommend that the Commission retain sufficient discretion to conduct a thorough analysis of the systemic risks associated with each DCO seeking to utilize a "DCO-lite" framework, taking into account both U.S. participation on that DCO (including clearing members, customers, and affiliates of U.S. firms) and the DCO's market position within the relevant asset class.

3. Whether U.S. DCOs have been provided reciprocity

Permitting certain non-U.S. DCOs to utilize a "DCO-lite" framework means that these DCOs will be able to provide clearing services to U.S. market participants without complying with as many U.S. regulatory requirements as U.S. DCOs. This could create an unlevel competitive playing field, where lower operational and regulatory costs allow non-U.S. DCOs to increase market share at the expense of U.S. DCOs. Such a concern may be particularly relevant where the home jurisdiction of the non-U.S. DCO has failed to grant similar deference to U.S. DCOs. As a result, we recommend that the Commission assess the foreign jurisdiction's treatment of U.S. DCOs prior to granting a non-U.S. DCO's application to utilize a "DCO-lite" framework.

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[8] *See* Proposal at 34822, FN 25.

[9] Proposal at 34821.

[10] *Id.*

We appreciate the opportunity to provide comments on the Commission's Proposal. In light of the issues identified above, it is important that market participants be provided with an opportunity to comment on each non-U.S. DCO application to utilize a "DCO-lite" framework. Please feel free to call the undersigned at (646) 403-8200 with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger
Managing Director
Global Head of Government & Regulatory Policy