November 18, 2019

By Electronic Submission

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Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations (RIN 3038-AE87)

Ladies and gentlemen,

Better Markets, Inc. ("Better Markets")[1] appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC") notice of proposed rulemaking setting forth a new exemption from certain U.S. regulations for certain derivatives clearing organization ("DCO") organized outside of the United States.[2]

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[3] mandates and encourages migration of significant over-the-counter derivatives risks to U.S. and non-U.S. clearinghouses, making comprehensive supervision and regulation of clearinghouses, clearing practices, and interconnected clearing intermediaries critical to U.S. financial stability. Far from addressing those concerns, the CFTC's proposed unlawful and excessive deference to foreign regulations and foreign regulators would be irresponsible, create competitive disparities between DCOs engaged in the same, or very similar, swaps clearing activities involving U.S. persons, and encourage, if not guarantee, regulatory arbitrage.

Despite the proposed naming convention, the CFTC's "alternative compliance" proposal is not a means for DCOs to comply with U.S. law at all but rather, an explicit and unlawful exemption from most regulatory DCO requirements combined with a de facto and unlawful exemption from most statutory DCO requirements. For this reason, and others, the CFTC must promptly withdraw the proposal, along with

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[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

[2] Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819 (July 19, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-07-19/pdf/2019-15262.pdf.

[3] Pub. L. 111–203, 124, Stat. 1376 (2010).

companion proposals to further exempt non-U.S. clearing organizations and intermediaries facilitating swaps clearing for U.S. customers from U.S. statutory and regulatory requirements.

I. The CFTC's proposal would institute a DCO regulatory framework that contravenes the Commodity Exchange Act and over time, would create competitive disparities and differences in DCO risk management and other practices.

The CFTC has issued three related clearing organization proposals in two years,[4] along with four previous exemptive orders,[5] that collectively create an unnecessarily complex U.S. statutory and regulatory framework for DCOs. Under the new proposed framework, DCOs organized in the U.S. that facilitate swaps clearing would continue to be required to register with the CFTC and maintain DCO registration by complying with the Commodity Exchange Act ("CEA")[6] and applicable CFTC regulations. DCOs organized outside of the U.S.[7] that facilitate proprietary or customer swaps clearing for U.S. persons and determined by the CFTC to pose "substantial risk to the U.S. financial system"[8] similarly would be required to register with the CFTC and maintain DCO registration by complying with the CEA and applicable CFTC regulations.

However, if a non-U.S. clearing organization facilitates swaps clearing for U.S. persons and has not been determined by the CFTC to pose "substantial risk to the U.S. financial system," it would have the

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[4] In addition to this proposal, the CFTC issued two proposals in 2018 and 2019 to exempt certain non-U.S. clearing organizations providing swaps clearing services from U.S. DCO registration and most otherwise applicable statutory and regulatory DCO requirements. See Commodity Futures Trading Commission, Exemption from Derivatives Clearing Organization Registration, 84 Fed. Reg. 35456 (July 23, 2019) ("2019 Exempt DCO Proposal"), available at https://www.govinfo.gov/content/pkg/FR-2019-07-23/pdf/2019-15258.pdf. See also Commodity Futures Trading Commission, Exemption from Derivatives Clearing Organization Registration, 83 Fed. Reg. 39923 (Aug. 13, 2018) ("2018 Exempt DCO Proposal"), available at https://www.govinfo.gov/content/pkg/FR-2018-08-13/pdf/2018-17335.pdf. See also Better Markets, Inc. Letter on Exemption for Non-U.S. Derivatives Clearing Organizations, RIN 3038-AE65 (Nov. 22, 2019). Better Markets requests that the CFTC incorporate that comment letter into the rulemaking record for the present proposal and incorporate the present comment letter into the rulemaking records for the 2018 Exempt DCO Proposal and the 2019 Exempt DCO Proposal as well.

[5] The CFTC has exempted four non-U.S. DCOs from registration requirements with respect to the clearing of proprietary swaps for U.S. persons and FCMs. See ASX Clear (Futures) Pty Amended Order of Exemption from Registration, In the Matter of the Petition of ASX Clear (Futures) Pty Limited for Exemption from Registration as a Derivatives Clearing Organization (Jan. 28, 2016); Korea Exchange, Inc. Order of Exemption from Registration, In the Matter of the Petition of Korea Exchange, Inc. for Exemption from Registration as a Derivatives Clearing Organization (Oct. 26, 2015); Japan Securities Clearing Corporation Order of Exemption from Registration, In the Matter of the Petition of Japan Securities Clearing Corporation for Exemption from Registration as a Derivatives Clearing Organization (Oct. 26, 2015); OTC Clearing Hong Kong Limited Order of Exemption from Registration, In the Matter of OTC Clearing Hong Kong Limited for Exemption from Registration as a Derivatives Clearing Organization (Dec. 21, 2015).

[6] See 7 U.S.C. 1 et seq.

[7] Better Markets identifies DCOs "organized outside of the United States" as "non-U.S. DCOs" throughout this comment letter. The CFTC's proposed regulations would not use or define the term, "non-U.S. DCO," but rather would limit de facto and explicit exemptive relief to clearinghouses "organized outside of the United States." See Proposed § 39.3 ("An entity that is organized outside of the United States, is seeking to register as a derivatives clearing organization for the clearing of swaps, and does not pose substantial risk to the U.S. financial system may apply for registration . . . .") (emphasis added); See also Proposed § 39.2 ("*Good Regulatory Standing* means, with respect to a derivatives clearing organization that is organized outside of the United States, and is licensed, registered, or otherwise authorized to act as a clearing organization in its home country . . . .") (emphasis added).

[8] See Proposed § 39.2 (defining "Substantial risk to the U.S. financial system"). See also Better Markets comments on the CFTC's proposed "substantial risk" determinations in section III below, which apply equally to the identical test proposed in the 2019 Exempt DCO Proposal.

option to apply for an exemption from DCO registration.[9] Non-U.S. DCOs facilitating swaps clearing with U.S. customers and that have not been determined by the CFTC to pose "substantial risk to the U.S. financial system" also would be permitted to comply with the CEA's DCO core principles through compliance, in part, with foreign regulations, subject to certain conditions and limitations. Under this additional option, non-U.S. DCOs would be required to facilitate U.S. clearing through registered futures commission merchants ("FCMs"), likely providing U.S. customers the benefit of the U.S. customer protection framework.[10]

The CFTC's proposed "alternative compliance" framework would enact only the last option in this byzantine regulatory structure. Although it is not a comprehensive exemption from the DCO statutory and regulatory framework, the proposal is fatally flawed in numerous respects. It would unlawfully rely on explicit and implicit exercises of exemptive authority under CEA sections 5b(h) and 4(c).[11] It would envision a DCO registration and U.S. regulatory framework that, in essence, eliminates U.S. oversight of critical aspects of operating certain non-U.S. DCOs. And, in combination with the concurrent proposed exempt clearing organization proposals, it would create unfair competitive disparities and differences in critical DCO risk management and other practices, dividing markets for U.S. clearing services between the following:

(1) U.S. and non-U.S. DCOs subject to the full panoply of U.S. statutory and regulatory requirements;

(2) Non-U.S. DCOs subject to certain but not all U.S. statutory and regulatory requirements; and

(3) Non-U.S. clearing organizations subject entirely or primarily to foreign statutes and regulations.

The CFTC's "alternative compliance" proposal does, however, at least contemplate exceptions from the otherwise overweening deference to foreign regulators for specified requirements under CEA section

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[9] Non-U.S. clearing organizations currently can choose to facilitate U.S. swaps clearing solely in proprietary swaps pursuant to an exemptive order from U.S. registration. See fn. 5 supra.

[10] The proposed "alternative compliance" framework would require compliance with CFTC regulations protecting customer funds. Industry commenters no doubt will suggest that the CFTC permit DCOs to facilitate U.S. customer clearing without requiring FCMs to intermediate transactions. That recommendation would be unlawful and irresponsible. First, CEA section 4d(f) quite clearly provides that "[i]t shall be unlawful for any person [that is not registered as an FCM] to accept any money, securities, or property (or to extend any credit in lieu of money, securities, or property) from, for, or on behalf of a swaps customer to margin, guarantee, or secure a swap cleared by or through a [**DCO**]." 7 U.S.C. § 6d(f) (emphasis added). Moreover, the FCM framework—in particular as improved in the aftermath of the Peregrine Financial and M.F. Global failures—is designed to ensure proper safeguarding of U.S. customer margin. However legally and otherwise flawed the proposal in other respects, if the CFTC chooses to proceed with the proposal, these critical provisions must continue to protect U.S. customers clearing in DCOs subject to the "alternative compliance" framework.

[11] 7 U.S.C. § 7a–1(h). 7 U.S.C. § 6(c).

4d(f)[12] and part 1,[13] part 22,[14] part 45,[15] subpart A and § 39.15[16] of the U.S. DCO regulatory framework.[17] Less technically stated, DCOs would continue to be subject to critical customer protections, FCM intermediation, and regulatory reporting requirements, in addition to standard conditions in orders granting a non-U.S. DCO the right to avail itself of "alternative compliance."[18]

The CFTC's present proposal would be available to six DCOs and any new entrants that might be encouraged to register as a DCO in the future on account of the proposed "alternative compliance" framework, if finalized. While the latter group of potential registrants is speculative, six of the 16 DCOs registered with the CFTC are presently organized outside of the United States and have a similar regulatory status as DCOs in their home countries.[19] Those six DCOs, in theory, could avail themselves of the CFTC's proposal. However, based on our understanding of the CFTC's criteria for granting orders for "alternative compliance" with home country regulations, we believe that it highly likely that the CFTC would determine that at least one of these six clearinghouses poses "substantial risk to the U.S. financial system" (as discussed below).

Nevertheless, the CFTC's "alternative compliance" proposal, in theory, would be available to the following six non-U.S. DCOs, each registered with and regulated by the home country regulator(s) listed below:

CFTC-Registered Derivatives Clearing Organizations
Organized in Non-U.S. Jurisdictions (2019)

Non-U.S. Derivatives Clearing Organizations	Home Country Regulator(s)
Eurex Clearing AG	BaFin and Deutsche Bundesbank
ICE Clear Europe Ltd.	Bank of England
ICE NGX Canada Inc.	Alberta Securities Commission

12 7 U.S.C. § 6d(f).

13 17 C.F.R. part 1.

14 17 C.F.R. part 22.

15 17 C.F.R. part 45.

16 17 C.F.R. Subpart A—General Provisions Applicable to Derivatives Clearing Organizations; 17 C.F.R. § 39.15 (setting forth requirements for the treatment of customer funds).

17 The CFTC also proposes a number of proposed periodic and event-specific reporting requirements, which Better Markets supports should the CFTC proceed with the "alternative compliance" framework (which it should not).

18 Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34823-24 (July 19, 2019). Note that the CFTC proposes to revise the already proposed revisions to § 39.9 to provide that "the provisions of subpart B apply to any DCO, except as otherwise provided by Commission order." Proposed § 39.9.

19 Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34829 (July 19, 2019). However, an independent analysis of those statuses may reveal material differences from U.S. DCO registration.

LCH Limited	Bank of England
LCH SA	Autorité de contrôle prudentiel et résolution, the Autorité des marchés financiers, and the Banque de France
Singapore Exchange Derivatives Clearing Limited	Monetary Authority of Singapore

Interestingly, however, the CFTC estimates that only a single DCO respondent may submit a near-term application for "alternative compliance" but that "approximately three existing registered DCOs may choose to convert to alternative compliance" over a period of time.[20] **Thus, it appears that the CFTC's proposal is a solution in search of a problem.** It is also an unlawful one seeking to codify a significant departure from the longstanding CFTC and Division of Clearing and Risk (and previously, Division of Clearing and Intermediary Oversight) policy. In a 2016 staff no-action letter, the Division of Clearing and Risk affirmed, for example, that the "**dual registration system has been a foundation on which the cleared swaps market grew to be a global market**" and confirmed that there were "five other registered foreign-based DCOs that [were] subject to the dual registration of the Commission and their home country regulator(s),"[21] some dating back to the years immediately following the enactment of the Commodity Futures Modernization Act.[22]

The CFTC should be reluctant to propose numerous unnecessarily complex and technical exemptions, explicit and de facto, that abandon well-considered and well-settled policy views and replace them with a new DCO framework that makes comprehensive oversight of clearing organizations with U.S. clearing members or U.S. customers more difficult and a cessation of critical services during a systemic event more likely. Dual registration and U.S. regulatory oversight of non-U.S. DCOs have served U.S. financial markets, U.S. taxpayers, U.S. customers, and U.S. clearing members well, including during the 2008 financial crisis.[23] Indeed, that is precisely why Congress viewed the migration of swaps into the

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[20] Id at 34827.

[21] Commodity Futures Trading Commission, Division of Clearing and Risk, CFTC Letter No. 16-26, No Action Relief for EU-Based Registered Derivatives Clearing Organizations that are Authorized to Operate in the European Union, from Certain Requirements under Part 22 and Part 39 of Commission Regulations (March 16, 2016), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/16-26.pdf.

[22] See Commodity Futures Modernization Act of 2000 ("CFMA"), Appendix E of Pub. L. 106–554, 114 Stat. 2763 (2000). The CFMA "fundamentally alter[ed] the regulation of [DCOs]." Commodity Futures Trading Commission, A New Regulatory Framework for Clearing Organizations, 66 Fed. Reg. 24308 (May 14, 2001), available at https://www.govinfo.gov/content/pkg/FR-2001-05-14/pdf/01-12084.pdf.

[23] The CFTC indicates that "the proposed regulations would promote and perhaps encourage international comity by showing deference to non-U.S. regulators in the oversight of non-U.S. DCOs that do not pose substantial risk to the U.S. financial system." Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34830 (July 19, 2019). It fails even to mention that dual registration is possibility, and good one. Dual registration, by its nature, promotes and encourages international coordination to an even greater degree and without the risks of regulatory arbitrage.

clearing system—through incentives[24] and mandates[25]—as a cornerstone financial reform in the aftermath of the 2008 financial crisis. Continued dual registration is not only the most prudent but, in fact, the only practical way to ensure that non-U.S. DCOs facilitating U.S.-related swaps clearing are not just registered—but *operating*—pursuant to safety and soundness safeguards, customer protections, and other sensible precautions codified in the CEA and CFTC regulations.

II. To validly exercise exemptive authority, the CFTC is statutorily required to determine that a non-U.S. clearing organization is subject to supervision and regulation that is comparable to, and as comprehensive as, the U.S. supervision and regulation that otherwise would apply to such organization.

Non-U.S. clearing organizations facilitating swaps clearing for U.S. persons are required to register as DCOs. CEA section 5b(a) of the Commodity Exchange Act provides that "it shall be unlawful for a [DCO], directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce to perform functions of a DCO with respect to . . . a swap."[26] CEA section 2(i) provides that activities outside of the U.S. are subject to the CEA's swap-related provisions if they have a direct and significant connection with activities in, or effect on, U.S. commerce, or contravene CFTC regulations established to prevent evasion of provisions enacted by the Dodd-Frank Act.[27] Read together, these CEA provisions require DCO registration of any non-U.S. clearing organization whose swaps clearing activities have a direct and significant connection with activities in, or effect on, U.S. commerce, for example where an organization's clearing activities involve or have effects on U.S. counterparties or U.S. intermediaries.[28] Under CEA section 5b(c), "[t]o be registered and maintain registration as a [DCO],"[29] non-U.S. DCOs, like others, must comply with the CEA's DCO core principles and "**any [DCO] requirement that the [CFTC] may impose by rule or regulation**,"[30] which would include applicable part 39 and other CFTC regulations.[31]

CEA section 5b(h) provides the CFTC authority to exempt a non-U.S. clearing organization from DCO registration, conditionally or unconditionally, with respect to swaps clearing, provided such organization is subject to "comparable, comprehensive supervision and regulation" by an appropriate governmental authority in its home country.[32] However, this statutory exemptive authority is not without

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[24] For example, the capital and margin requirements applicable to non-cleared swaps are a primary means for encouraging central clearing through DCOs. See, e.g., Basel Committee on Banking Supervision, Board of International Organization of Securities Commissions, Margin requirements for non-centrally cleared derivatives, 3 (March 2015), available at https://www.bis.org/bcbs/publ/d317.pdf ("Margin requirements on non-centrally cleared derivatives, by reflecting the generally higher risk associated with these derivatives, will promote central clearing, making the G20's original 2009 reform programme more effective. This could, in turn, contribute to the reduction of systemic risk.").

[25] CEA section 2(h)(1)(A) prohibits any person from entering into swap subject to a CEA section 2(h)(2) clearing mandate, unless that person submits such swap for clearing to a registered DCO or to an exempt DCO.

[26] 7 U.S.C. § 7a–1(a)(1)(B).

[27] 7 U.S.C. § 2(i).

[28] See 7 U.S.C. 7a–1(c)(2).

[29] 7 U.S.C. 7a–1(c)(2)(A)(i).

[30] Id.

[31] See, e.g., 17 C.F.R. Part 39; see also Commodity Futures Trading Commission, Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69334 (Nov. 8, 2011), available at https://www.govinfo.gov/content/pkg/FR-2011-11-08/pdf/2011-27536.pdf.

[32] 7 U.S.C. § 7a–1(h).

limit or subject to the CFTC's unfettered discretion. In accordance with CEA section 5b(h)'s plain language, DCO registration exemptions require the following elements be met as part of any exemptive determination:

- First, there must be supervision and regulation of the non-U.S. clearing organization;
- Second, such non-U.S. clearing organization must be supervised and regulated by an appropriate governmental authority;
- Third, such appropriate governmental authority must be in the home country of the clearing organization;
- Fourth, supervision and, separately, regulation must be comparable to supervision and regulation of U.S. registered DCOs; and
- Fifth, such supervision and, separately, regulation must be comprehensive, meaning each must cover the full panoply of clearing areas and requirements applicable to CFTC-registered DCOs.

The CFTC must have a reasonable basis to conclude that each of these elements has been met for any exercise of exemptive authority to be valid. Most critically, though, the CFTC must have a reasonable basis to conclude that requirements in a non-U.S. DCO's applicable foreign regulatory framework are comparable to, and as comprehensive as, requirements in the **U.S. statutory and regulatory** framework applicable to DCOs. Congress makes no distinction between U.S. statutory and U.S. regulatory requirements with respect to CEA section 5b(h) exemptive authority; it simply uses the phrase, "supervision and regulation," to encompass all DCO **requirements** under the CFTC's DCO regulatory framework and permits the CFTC to condition exemptions on continued compliance with U.S. DCO requirements as necessary.

In the present proposal, CFTC fails to properly cite to and rely upon its CEA section 5b(h) exemptive authority to establish the "alternative compliance" framework for non-U.S. DCOs. That, in itself, requires the CFTC to withdraw or at least re-propose the "alternative compliance" framework with necessary elements. The CFTC does not have the authority to implicitly exercise CEA section 5b(h) exemptive authority without so much as a reference to or analysis of a non-U.S. clearing organization's home country laws relative to U.S. statutory and regulatory requirements. As mentioned, CEA section 5b(h) requires a finding that supervision and, separately, ***regulation*** would be comparable to supervision and ***regulation*** of U.S. registered DCOs, which logically must include consideration of U.S. DCO requirements imposed by ***regulation***. No such finding, analysis, or consideration is referenced anywhere in the proposed rulemaking.

The CFTC's interpretation of CEA section 5b(h) exemptive authority is explained in the 2018 Exempt DCO Proposal. There, the CFTC states that it has "construed 'comparable, comprehensive supervision and regulation' to mean that the home country's supervisory and regulatory framework should be consistent with, and achieve the same outcome as, the statutory ***and regulatory*** requirements applicable to registered DCOs."[33] Thus, the CFTC plainly proposes to effect a de facto exemption from DCO

[33] See Commodity Futures Trading Commission, Exemption from Derivatives Clearing Organization Registration, 83 Fed. Reg. 39923, 39924 (proposed Aug. 13, 2018) (emphasis added). That "consistency" standard and "outcomes-based" analysis is itself a recharacterization of CEA section 5b(h)'s exemptive standard. To be sure, it requires an assessment of a foreign regulatory framework relative to U.S. law in certain respects. However, Congress could and undoubtedly would have provided the interpretive

regulatory requirements without meeting its own interpretation of the legal standard for such exemptions set forth in the CEA.

The CFTC cannot be excused from the analysis required by CEA section 5b(h). In the first instance, CEA section 5b(h) is applicable only if a non-U.S. clearing organization is subject to CEA section 5b(a)'s DCO registration requirement and therefore is required to comply with the full panoply of U.S. statutory and regulatory DCO requirements. That is why Congress, in setting forth the required CEA section 5b(h) exemptive analysis, logically instructed the CFTC to consider whether a foreign clearinghouse's regulatory framework is comparable to, and as comprehensive as, U.S. statutory and regulatory requirements *otherwise applicable* to the organization**.** If the CFTC is determined to effect shortsighted policy, it must at least do so pursuant to statutorily required processes.

Perhaps most indefensibly, though, the CFTC repeatedly reserves the right to have an eligible non-U.S. DCO meet U.S. regulatory requirements through conditions in orders permitting "alternative compliance"[34] rather than independent, cognate legal requirements in the home country of the non-U.S. DCO. The CFTC emphasizes, for example, that "[u]nder proposed § 39.51(a)(2), ***if the DCO's home country regulatory regime lacks legal requirements that correspond to those DCO Core Principles less related to risk, the [CFTC] may, in its discretion, grant registration*** subject to conditions that would address the relevant DCO Core Principles."[35] Differently stated, the CFTC proposes that it could cure via conditional orders known deficiencies and gaps in the foreign regulatory regime the alternative compliance registrant seeks to rely upon. Thus, although the CFTC states that "[h]ome country 'legal requirements' would include those standards or other requirements that are legally binding in the applicant's home country,"[36] it also contemplates potential recognition of non-U.S. DCOs in jurisdictions that do not have legally binding requirements comparable to U.S. law, or even wholly lack regulations to comply with certain elements of the CEA's core principles.

III. The CFTC's proposed "substantial risk" test for excluding non-U.S. DCOs from eligibility for "alternative compliance" is too discretionary and likely would permit all non-U.S. DCOs, except LCH Limited, to avoid the U.S. DCO framework.

The CFTC explains in the proposal that there are "meaningful differences in the extent to which U.S. persons clear trades through the[] six [current] non-U.S. DCOs."[37] For example, it states that "half of the swaps business at LCH Limited, if measured on the basis of required initial margin, is attributable to U.S. persons."[38] It also emphasizes, "[i]n contrast, [that] certain other non-U.S. DCOs, such as LCH SA and Eurex Clearing AG, for example, hold significantly less initial margin from U.S. persons, both in

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flexibility attendant to the "consistency" and "outcomes-based" standards if it determined it necessary or advisable; it instead provided a statutory standard focused on comparable, comprehensive supervision and regulation, which is not necessarily consistent with the CFTC's formulation. Nevertheless, the CFTC's key acknowledgement, for present purposes, is that U.S. statutory and regulatory requirements are relevant to CEA section 5b(h).

[34] Proposed § 39.51(b)(4) is a general provision that would require a DCO to comply, and demonstrate compliance as requested by the Commission, with any condition of the DCO's registration order.

[35] Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34824 (July 19, 2019) (emphasis added).

[36] See Id at 34821 fn. 16.

[37] Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34820 (July 19, 2019).

[38] Id.

absolute terms and as a percentage of the total required initial margin at the DCO."[39] This heterogeneity in the extent of U.S. clearing at various non-U.S. DCOs is intended to suggest that the CFTC's explicit and implicit exercises of exemptive authority would excuse compliance with U.S. regulatory requirements only in cases where the exempted DCOs do not pose the same "substantial risk[s] to the U.S. financial system" as LCH Limited.

The "alternative compliance" proposal, as mentioned, would exempt from certain U.S. regulations only those non-U.S. DCOs that the CFTC has not determined to pose "substantial risk to the U.S. financial system."[40] The "substantial risk" determination would depend on the CFTC's discretionary assessment of specified factors—none of which are dispositive—including the extent of a non-U.S. DCO's U.S. clearing activity as measured by the required initial margin of U.S. clearing members. The CFTC more specifically proposes to define the phrase, "Substantial risk to the U.S. financial system," to mean the following in this context:

- The non-U.S. DCO holds 20 percent or more of the required initial margin of U.S. clearing members for swaps across all registered and exempt DCOs ("Risk Proportion Test");[41] and

- Twenty percent or more of the initial margin requirements for swaps at the non-U.S. DCO is attributable to U.S. clearing members ("Risk Predominance Test").[42]

If these criteria are met but ***one or both*** of the thresholds remain close to 20 percent,[43] the CFTC proposes to retain discretion to determine "whether" the non-U.S. DCO poses a "substantial risk to the U.S. financial system."[44] Thus, the CFTC retains discretion to determine that non-U.S. DCOs ***above*** both thresholds do not pose "substantial risk to the U.S. financial system" and therefore remain eligible for "alternative compliance." In other words, the CFTC's factor-based proposed "substantial risk" definition is one that intentionally does not define.[45]

Moreover, the CFTC emphasizes that the "substantial risk" tests constitute one "indication" of how the CFTC *might* consider eligibility for "alternative compliance." Factors that "mitigate the DCO's risk" or even "other [unmentioned] factors" that the CFTC simply believes provide a "better indication of the DCO's risk" apparently could justify making a non-U.S. DCO that fails both the Risk Proportion Test and the Risk Predominance Test eligible for "alternative compliance," or vice versa. That seems to justify determinations based on almost any criteria or factors—again, none of which would be dispositive—and

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39 Id.

40 See Proposed § 39.3(a)(3). The "substantial risk" determination would be made in connection with the CFTC's consideration of a non-U.S. DCO's application for "alternative compliance."

41 Proposed § 39.2.

42 Id.

43 Id.

44 Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34821, 34832 (July 19, 2019) (emphasis added).

45 The CFTC "stresses," in fact, "that this is not a bright-line test" and that it is "instead seeking to offer some indication of how it would assess the meaning of the term 'substantial' in the test." Id at 34822. Accordingly, the CFTC proposes "to retain discretion in determining whether a non-U.S. DCO poses substantial risk to the U.S. financial system" and emphasizes that it "may look to **other factors** that may reduce or mitigate the DCO's risk to the U.S. financial system or **provide a better indication** of the DCO's risk to the U.S. financial system." Id.

asks the public to foresee the discretionary application of vague regulations with a potentially wide range of possible outcomes.

If the CFTC nevertheless chooses to proceed with the proposal, it must at least remedy deficiencies in the "substantial risk" tests. The Risk Proportion Test, for example, is a ***relative*** measure of risk based on the amount of swaps-related required initial margin a non-U.S. DCO's U.S. clearing members have compared to the overall amount of swaps-related required initial margin by all U.S. clearing members at registered and exempt DCOs. The Risk Proportion Test therefore would permit *significant* required initial margin—directly attributable to U.S. clearing members and commensurate with one important risk measure, gross potential future exposure—to be considered *insignificant* for purposes of the "substantial risk" exclusion. This is because the total amount of swaps-related initial margin attributable to all U.S. clearing members across all registered and exempt DCOs and clearing organizations is itself likely to be a substantial number.

The CFTC neither provides any data with respect to the amount of required initial margin relevant to the Risk Proportion Test nor provides a data-based rationale for choosing 20% as the appropriate risk threshold in one of only two primary indicia of "substantial risk." This makes the implications of the Risk Proportion Test highly speculative and limits, if not eliminates, the ability of the public to meaningfully comment on the proposal. Furthermore, the CFTC does not mention the "substantial risk" tests at all in considering the costs and benefits of its proposal, failing even the minimal requirements of CEA section 15(a).[46]

The total required initial margin attributable to U.S. clearing members across U.S. and non-U.S. registered and exempt DCOs is likely to be substantial. For example, according to a 2018 International Swaps and Derivatives Association, Inc. ("ISDA") survey of the 20 largest market participants, $217.9 billion in initial margin had been posted to major clearinghouses for cleared interest rate and credit default swaps alone (although the figures include derivatives under the Securities and Exchange Commission's jurisdiction).[47] The distribution of this $217.9 billion in swaps-related initial margin is noteworthy as well. The below chart indicates that LCH, which we presume to include both LCH Ltd. and LCH SA, holds as much as 64% of the initial margin for interest rate and credit default swaps across seven global clearinghouses:

46 7 U.S.C. § 19.

47 International Swaps and Derivatives Association, Inc., ISDA Margin Survey, Year-End 2018, ISDA Research Study (April 2019), available at https://www.isda.org/a/nIeME/ISDA-Margin-Survey-Year-End-2018.pdf.

Initial Margin for Interest Rate Derivatives and Credit Default Swaps
(April 2019)

Source: International Swaps and Derivatives Association, Inc.[48]
Based on BCBS-IOSCO Central Clearing Party Disclosures

To demonstrate the flaw in the proposed conception of "substantial risk" under the "alternative compliance" framework, based on the figures above, ICE Clear Credit LLC, a U.S. clearinghouse designated as "systemically important" by the Financial Stability Oversight Council ("FSOC"), could be viewed as not posing "substantial risk to the U.S. financial system."[49] ICE Clear Credit LLC would not eligible for the "alternative compliance" framework (as a *U.S.* DCO). However, the fact that it could be significantly below the 20% threshold in a proposed "substantial risk" calculation emphasizes a fatal flaw in the Risk Proportion Test. It also demonstrates why FSOC relies on aggregate, rather than relative, factors in making its Title VIII designations.

The ISDA figures are generally consistent with the Futures Industry Association's $122 billion figure for FCM cleared swaps accounts as well:[50]

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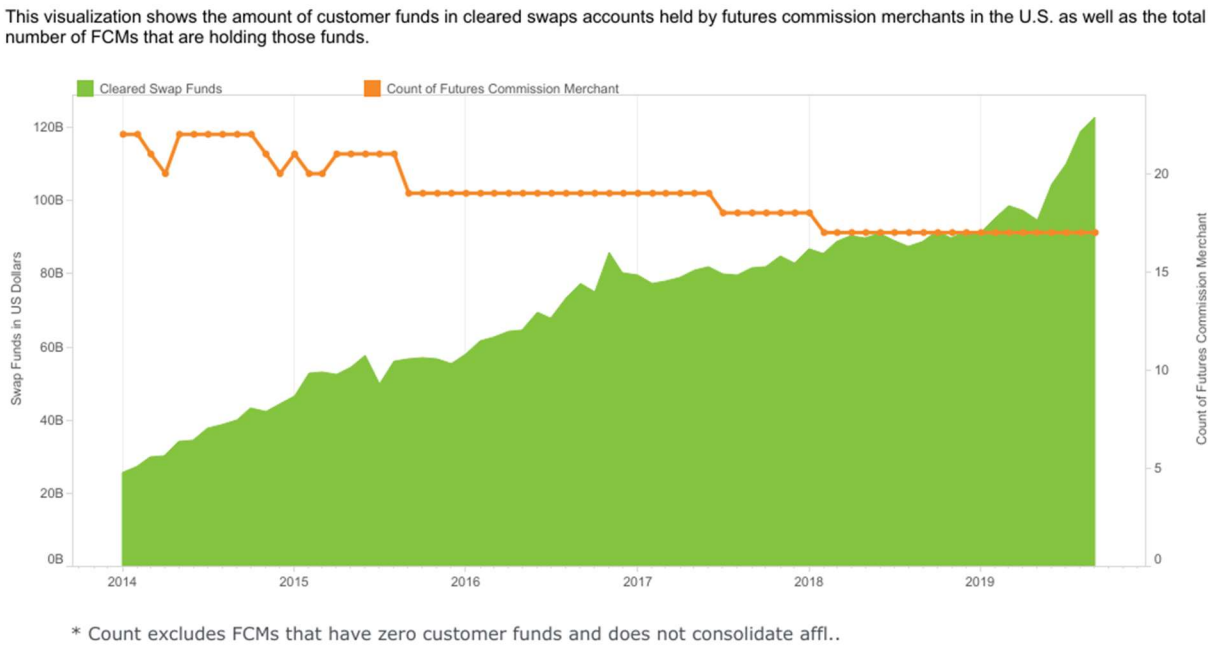
48 Id at 9.

49 FSOC designated eight financial market utilities ("FMUs"), including ICE Clear Credit LLC, as "systemically important" under Title VIII of the Dodd-Frank Act. FSOC is authorized to designate FMUs as "systemically important" based on any of the following factors: (1) the aggregate monetary value of transactions processed by the FMU; (2) the aggregate exposure of the FMU to its counterparties; (3) the relationship, interdependencies, and other interactions of the FMU with other FMUs or payment, clearing, or settlement activities; and (4) the effect that the failure of or a disruption to the FMU would have on critical markets, financial institutions, or the broader financial system.

50 FCMs constitute only a subset of the total "U.S. clearing member" population, as proposed to be defined. See Proposed § 39.2. Specifically, the CFTC proposes a definition of "U.S. clearing member" that includes any "clearing member organized in the United States or whose ultimate parent company is organized in the United States, *or an FCM*." Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34822 (July 19, 2019) (emphasis added).

Cleared Swap Funds and FCM Count Over Time
(September 2019)



Source: Futures Industry Association[51]

The $122 billion figure for only one component of the Risk Proportion Test's "U.S. clearing member" calculation, FCMs, suggests that the CFTC's test is intended, or perhaps simply has the effect, to exclude perhaps as few as **one** non-U.S. clearinghouse from eligibility for "alternative compliance," LCH Ltd. Even that is difficult to ascertain with certainty, however, because the Risk Proportion Test's denominator may be inflated by the inclusion of future exempt clearing organizations, which would only further mask the systemic importance of **each** non-U.S. DCO.

The second prong of the "substantial risk" framework, the Risk Predominance Test, measures whether 20 percent or more of swaps-related initial margin requirements at a particular non-U.S. DCO is attributable to U.S. clearing members. The CFTC explains that this ensures that a non-U.S. DCO would be eligible for the "alternative compliance" framework only if a "large enough proportion of its clearing activity were attributable to U.S. clearing members such that the U.S. has a substantial interest warranting more active oversight."[52] The CFTC emphasizes that it was "guided by principles of international comity" in crafting this element of the proposal, which "counsel[s] due regard for the important interests of foreign sovereigns."[53]

The CFTC's reliance on principles of international comity in setting forth the Risk Predominance Test as part of an unlawful exercise of de facto exemptive authority is not statutorily permitted, much less

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[51] Futures Industry Association, FIA FCM Tracker, Customer Funds in Swap Accounts (Sept. 2019), available at https://fia.org/fcm-customer-funds.

[52] Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34822 (July 19, 2019).

[53] Id. See also Restatement (Third) of Foreign Relations Law of the United States (the Restatement).

commanded. CEA section 5b(a), as noted, provides that "it shall be unlawful for a [DCO], directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce to perform functions of a DCO with respect to . . . a swap."[54] CEA section 2(i) provides that activities outside of the U.S. are subject to the CEA's swap-related provisions if they have a direct and significant connection with activities in, or effect on, U.S. commerce.[55] These CEA provisions together require DCO registration of any non-U.S. clearing organization whose swaps clearing activities have a direct and significant connection with activities in, or effect on, U.S. commerce, for example where an organization's swaps clearing activities involve or have effects on U.S. counterparties or U.S. intermediaries.[56] Non-U.S. DCOs in all such cases must comply with the CEA's DCO core principles and applicable part 39 and other CFTC regulations.[57]

Recognizing the need for "due regard" to the important interests of foreign governments, CEA section 5b(h) provides the CFTC authority to exempt a non-U.S. clearing organization from U.S. DCO registration with respect to its swaps clearing, provided such clearing organization is subject to "comparable, comprehensive supervision and regulation" by an appropriate governmental authority in its home country.[58] As we explained above, the CFTC does not rely on this exemptive authority in the proposal and in any event, would have to develop a reasonable basis to conclude that each of the statutory elements for valid exercise of CEA section 5b(h) exemptive authority has been met. If the CFTC is concerned about international comity, it has failed to rely upon the exemptive authority expressly provided to the agency for that purpose.

Moreover, the Restatement cited to support the CFTC's proposal[59] explicitly does not preclude concurrent regulation by multiple jurisdictions, a fact the CFTC fails to mention and analyze in consideration of the paramount U.S. interests in preserving U.S. financial stability, protecting U.S. customers, and ensuring the safety and soundness of clearinghouses with U.S. clearing members. These U.S. interests more than satisfy the Restatement's basis for jurisdiction where, for example, activities have a "substantial, direct, and foreseeable effect upon or in the territory,"[60] there are "connections, such as . . . economic activity . . . between the regulating state and the persons principally responsible for the activity to be regulated,"[61] or "a regulation is important to the international . . . economic system."[62] The CFTC attempts no analysis of any such factors affecting shared U.S. and international regulatory interests and indeed, ignores its own staff's longstanding policy views with respect to dual registration based on similar considerations.

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54 7 U.S.C. § 7a–1(a)(1)(B).

55 7 U.S.C. § 2(i). See our more detailed analysis of DCO registration in section II supra.

56 See 7 U.S.C. 7a–1(c)(2).

57 See, e.g., 17 C.F.R. Part 39.

58 7 U.S.C. § 7a–1(h).

59 Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34822 (July 19, 2019).

60 Id at 34822. See also Restatement (Third) of Foreign Relations Law of the United States (the Restatement), section 403.

61 Id.

62 Id.

The CFTC claims that "the proposed framework would help preserve the benefits of an integrated, global swap market by reducing the degree to which a DCO would be subject to multiple sets of regulations, while ensuring protection for U.S. customers," and would "encourage[] collaboration and coordination among U.S. and foreign regulators in establishing comprehensive regulatory standards for swaps clearing."[63] In truth, however, the proposed framework would simply facilitate forum shopping and regulatory arbitrage, deferring to non-U.S. DCOs to determine for themselves how they comply with U.S. requirements. The adverse implications likely would reveal themselves in unexpected ways and only over a period of time.

The CFTC's proposed "substantial risk" analysis is critically flawed in other respects as well.[64] For example, the CFTC acknowledges that "a test based solely on initial margin requirements may not fully capture the risk of a given DCO."[65] We agree. The systemic risk of a non-U.S. DCO does not turn solely on the percentage of U.S. clearing member initial margin posted as a percentage of the clearing market as a whole. It must account other critical systemic risk factors, for example the prominence of a particular clearinghouse in a particular market (e.g., credit-related swaps) and the potential for correlated losses to occur across U.S. and non-U.S. DCO clearing members participating in that and other markets. For this reason, we do not agree that the "substantial risk" framework addresses the "primary systemic risk-related concern."[66]

But even if we did agree, the CFTC cannot overcome its lack of authority to decide for itself whether to require compliance with the full panoply of U.S. regulatory requirements applicable to DCOs, at least absent the valid exercise of CEA section 5b(h) exemptive authority. In short, the CFTC seeks to "advance a territorial, risk-based approach to the regulation of clearing organizations" in clear violation of the CEA and congressional intent, not to mention in a manner that is unresponsive to factors in the very Restatement it cites.[67]

IV. The CFTC's unlawfully relies on CEA section 4(c) exemptive authority to abandon review of certain non-U.S. DCOs' self-regulatory rules, a process that is critically important to DCO oversight.

The self-regulatory rule filing and review process is a primary supervisory means by which the CFTC oversees DCO activities and practices. Nevertheless, Proposed § 39.4(c) would exempt DCOs that are subject to "alternative compliance" from the requirement that they submit and certify rules pursuant to CEA section 5c(c)[68] and CFTC Reg. § 40.6,[69] where such rules do not relate to compliance with specified

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63 Id.

64 See Request for Comment, question 5, Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34826 (July 19, 2019).

65 Id at 34822.

66 Id.

67 Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34820 (July 19, 2019).

68 7 U.S.C. § 7a–2(c).

69 Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34827 (July 19, 2019). 17 C.F.R. § 40.6. The term "rule" is defined in CFTC regulations to include any constitutional provision, article of incorporation, bylaw, rule, regulation, resolution, interpretation, stated policy, advisory, terms and conditions, trading protocol, agreement or instrument corresponding thereto, including those that authorize a response or establish standards for responding to a specific emergency, and any amendment or addition thereto or repeal thereof,

customer protection, data reporting, and other provisions.[70] This element of the CFTC's proposal would all but eliminate DCO oversight in critical respects.

The CFTC contends that this exemption would allow it "to focus on reviewing those critical rules that relate to areas where the [CFTC] exercises direct oversight rather than review other rules for which duplication of review with the home country regulator is not necessary."[71] The CFTC also concludes that "the review of any new or amended rule unrelated to the [CFTC]'s customer protection regime would be more appropriately handled by the DCO's home country regulator."[72] The CFTC's logic is fatally and legally flawed. First, that which constitutes an "area where the CFTC exercises direct oversight" is itself a determination made in the proposal, so the CFTC contends, in part, that the proposal is justified simply because it focuses on what it proposes to focus on. But more problematically, the CFTC fails to condition the exemption on the **existence** of a cognate self-regulatory rule review process. If the CFTC permits "alternative compliance" with a regulatory framework that does not have a rule-filing and review process commensurate with at least the part 40 certification process, it proposes the equivalent of a black hole in DCO oversight.[73]

That, in itself, constitutes a violation of CEA section 5b(h)—the provision that the CFTC should have relied upon to validly execute an exemption from DCO registration and related requirements—because the CFTC fails to base its determination on the existence of a comparable, comprehensive supervisory and regulatory framework in the home country of the non-U.S. DCO, as statutorily required.[74] This is all the more concerning, moreover, because "[a]lthough the [CFTC] would retain the right to conduct site visits," it emphasizes that "it would not expect to conduct routine site visits to such DCOs."[75] Deliberately codifying a blind spot in non-U.S. DCO oversight where U.S. customers are involved, and perhaps to benefit single current non-U.S. DCO, is an astonishing retreat from the CFTC's statutory responsibilities

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made or issued by a registered entity or by the governing board thereof or any committee thereof, in whatever form adopted. 17 C.F.R. § 40.1(i).

70 See fn. 12-16 supra.

71 Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34823 (July 19, 2019).

72 Id.

73 The CFTC fails to consider less concerning (though still objectionable) alternatives to the exemption. For example, a limited exemption requiring a notice filing—demonstrating that rules are being filed with the home country regulator and revealing the nature and content of such rules—would be an eminently reasonable, minimal, and far more responsible requirement to impose on DCOs eligible for "alternative compliance."

74 The CFTC's exemption from rule-filing requirements was not properly executed based on the required statutory analysis under CEA section 5b(h). It instead relies upon the general public interest exemptive authority in CEA section 4(c). 7 U.S.C. § 6(c). However, CEA section 4(c)'s exemptive authority cannot be used to exempt non-U.S. DCOs from rule filing procedures, as doing so would impermissibly expand the CFTC's general exemptive authority beyond its plain language and in a manner that unlawfully supersedes the CEA's more specific exemptive authority, CEA section 5b(h), and without specific, required statutory analyses. For a more detailed analysis of the limits of CEA section 4(c), see Better Markets, Inc. Letter on Exemption for Non-U.S. Derivatives Clearing Organizations, RIN 3038-AE65 (Nov. 22, 2019), which we request to be incorporated in the current rulemaking record.

75 Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34824 (July 19, 2019). The CFTC essentially states that eligible non-U.S. DCOs need not concern themselves with U.S. examiners: "The [CFTC] notes that **it does not anticipate conducting routine site visits to DCOs subject to alternative compliance.** However, the [CFTC] may request a DCO to provide books and records related to its operation as a DCO subject to alternative compliance in order for the [CFTC] to ensure that, among other things, the DCO continues to meet the eligibility requirements for alternative compliance as well as the conditions of its registration." Id.

to ensure "effective self-regulation . . . of clearing systems," "the financial integrity of all transactions . . . and the avoidance of systemic risk," and "fair competition," among the CEA's other public interest mandates.[76]

VI. If the CFTC proceeds with the "alternative compliance" proposal, it must at least require full compliance with supposedly comparable, comprehensive non-U.S. regulatory frameworks applicable to non-U.S. DCOs.

Proposed § 39.51(b)(6) would require that a DCO request and that the CFTC receive an annual written representation from a home country regulator that the DCO is in good regulatory standing, within 60 days following the end of the DCO's fiscal year.[77] However, the CFTC proposes a definition of "good regulatory standing" that would include, among other things, even a "finding of material non-observance of the relevant home country legal requirements" as long as "it has been or is being resolved to the satisfaction of the home country regulator by means of corrective action taken by the DCO."[78] The CFTC states that it "believes that the proposed definition, as it relates to DCOs subject to alternative compliance, establishes a basis for providing the [CFTC] ***with a high degree of assurance as to the DCO's compliance with the relevant legal requirements*** in its home country."[79] **In fact, it does exactly the opposite.** It recognizes as in "good regulatory standing" even those non-U.S. DCOs that have been found non-compliant with the very regulations they supposedly must comply with to avoid the imposition of U.S. law. At a minimum, a non-U.S. DCO must be able secure a representation from its regulator that it remains in good regulatory standing without the proposed permission to also be in "material non-observance" of applicable law.

IV. Conclusion

The CFTC's "alternative compliance" proposal would effect an explicit and unlawful exemption from most regulatory DCO requirements in combination with a de facto and unlawful exemption from most statutory DCO requirements. Those exemptions would eliminate or limit critical oversight responsibilities with respect to certain non-U.S. DCOs and essentially outsource supervision and enforcement to foreign regulators in violation of the CEA and in a manner that is unnecessary or even harmful to the CFTC's stated policy objectives.

The CFTC nevertheless states that the proposed changes would "make more effective use of its resources by focusing its oversight almost exclusively on those DCOs that are either organized in the United States or pose substantial risk to the U.S. financial system."[80] Restated, the CFTC has proposed to determine that oversight of certain non-U.S. DCOs, with U.S. customers, is simply not worth the resources

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[76] 7 U.S.C. § 5(b). Indeed, at times, the CFTC appears to conflate the interests of the very small handful of non-U.S. DCOs (and maybe even just one) benefiting from its proposal with the CEA's public interest mandates. For example, the CFTC states that the proposed exemption would "reduce the time and resources necessary for DCOs to file rules unrelated to the [CFTC]'s customer protection or swap data reporting requirements." Commodity Futures Trading Commission, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819, 34823 (July 19, 2019). The CFTC then concludes that "[i]n light of the foregoing, the [CFTC] believes the proposed exemption would be consistent with the public interest and purposes of the CEA." Id. But neither the general public interest nor CEA's specific public interest mandates would be served merely by "reducing the time and resources necessary for DCOs to file" their rules, especially without any consideration of the oversight purposes of self-regulatory filing requirements.

[77] Id at 34825.

[78] Id at 34821.

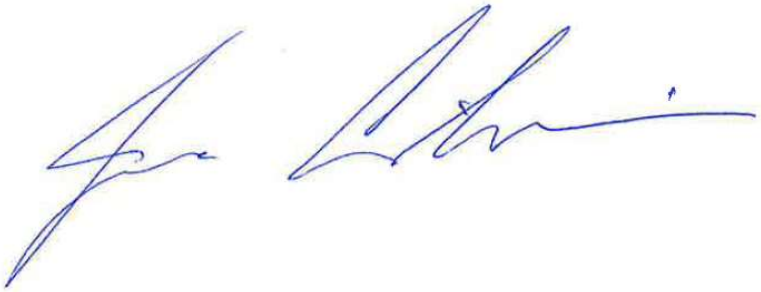
[79] Id (emphasis added).

[80] Id at 34820.

and time. As such, the CFTC's proposal represents a shocking and unlawful retreat from the CFTC's statutory mandate and an unreasonable, if not reckless, capitulation to foreign regulatory and commercial interests. For these reasons, any final regulations arising from the proposal would not only be susceptible to legal challenge—they would demand it.

For the reasons discussed above, the CFTC must ensure that U.S. clearing members, the U.S. financial system, U.S. taxpayers, and U.S. customers continue to receive the benefit of appropriate U.S. regulatory oversight and enforcement by withdrawing or at least re-proposing the unlawful "alternative compliance" framework.

Sincerely,



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