ISDA Safe, Efficient Markets

November 22, 2019

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); Supplemental Notice of Proposed Rulemaking

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 Supplemental Notice of Proposed Rulemaking: Exemption from Derivatives Clearing Organization (**"DCO"**) Registration (the **"Supplemental Proposal"**) published on July 23, 2019.[2] We note that the Supplemental Proposal provides amendments to the Commission's exempt DCO proposal published in August 2018 (**"Initial Proposal"**).[3]

ISDA supports the Commission's Supplemental Proposal to permit exempt DCOs to clear swaps for U.S. customers through foreign intermediaries.[4] The proposed rules would provide U.S. persons with more options with respect to clearing, and has the potential to reduce the concentration of U.S. customer funds in a small number of Future Commission Merchants (**"FCMs"**). In this regard, to provide U.S. persons with greater flexibility and more clearing choices, we believe the Commission should also extend the CFTC's part-30 type regime to swaps, enabling U.S. customers to access exempt DCOs for swaps clearing under an aligned framework. Permitting FCMs to use an omnibus clearing structure for foreign cleared swaps similar to the one used in the futures markets would potentially eliminate the need for U.S.

[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 70 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, clearing houses and depositories, as well as law firms, accounting firms and other service providers. Additional information on ISDA is available at http://www.isda.org.

[2] Exemption from Derivatives Clearing Organization Registration, Supplemental notice of proposed rulemaking, 84 Fed. Reg. 35456 (July 23, 2019), https://www.govinfo.gov/content/pkg/FR-2019-07-23/pdf/2019-15258.pdf.

[3] Exemption from Derivatives Clearing Organization Registration, Notice of proposed rulemaking, 83 Fed. Reg. 39923 (Aug. 13, 2018); ISDA filed a comment letter in response to such proposal, available at: https://comments.cftc.gov/PublicComments/CommentList.aspx?id=3009. We note that the Supplemental Proposal does not alter the Initial Proposal in many respects and thus many of the issues raised in such comment letter continue to exist with respect to the Supplemental Proposal.

[4] Supplemental Proposal at 35457.

customers to enter into new or duplicative relationships with alternative non-U.S. affiliated clearing members.[5]

We also support the Commission's reliance on the CPMI-IOSCO Principles for Financial Market Infrastructures (**"PFMI"**) as a framework for comparability determinations for non-U.S. central clearing counterparties (**"CCPs"**) and deference to foreign regulatory regimes.[6] As we stated in our comments to the Initial Proposal, the European Commission's amendments to the European Market Infrastructure Regulation (**"EMIR"**) could, in certain instances, apply parts of the EU clearing regulatory regime directly to U.S. CCPs. We encourage the CFTC to continue its dialogue with foreign regulators in the EU and other jurisdictions to ensure that CCP supervision is based on deference to home country regulations and compliance with the PFMI. We note that applying inconsistent and duplicative regulatory frameworks to CCPs will lead to the fragmentation of global cleared derivatives markets.[7]

Below we provide comments on three aspects of the Supplemental Proposal: (1) the 20/20 threshold test for determining substantial risk; (2) the treatment of swaps not subject to the CFTC's clearing mandate; and (3) the CFTC's authority regarding inspections of exempt DCOs.

1. 20/20 Threshold Test for Substantial Risk Should be Revised

We appreciate the Commission's efforts to establish a bright-line test for eligibility for the exemption from DCO registration. Under the Supplemental Proposal, to be exempt from the CFTC registration regime, the CFTC must determine that a non-U.S. CCP does not "pose substantial risk to the U.S. financial system." A DCO is determined to pose "substantial risk" where: (1) the DCO holds 20% or more of the required initial margin of U.S. clearing members for swaps across all registered or exempt DCOs; and/or (2) 20% or more of the initial margin requirements for swaps at that DCO is attributable to U.S. clearing members.[8]

In addition, as we indicated in our response to the European Securities and Markets Authority's proposed approach to determining the systemic importance of third country CCPs under EMIR,[9] it is important to establish a consistent, global approach to assessing systemically important CCPs that would ensure comparability across jurisdictions and minimize the risk of divergences between various regimes in addressing CCP-related systemic risk concerns. We are concerned, however, that the second prong of the test does not gauge the risk of the relevant CCP to the U.S. financial system, but rather signifies the importance of U.S. clearing members to a particular CCP. Therefore, it may capture smaller-sized exempt DCOs due to the large global presence of

[5] 17 CFR Part 30. We note however that any changes to Part 30, including changes to the clearing structure of FCMs for foreign cleared swaps, should not delay the finalization of the Supplemental Proposal.
[6] We believe that the Commission should take a similar territorial, risk-based approach with respect to other aspects of the CFTC's cross-border regime. *See* the ISDA Cross-Border Harmonization White Paper, https://www.isda.org/a/9SKDE/ISDA-Cross-Border-Harmonization-FINAL2.pdf.
[7] Regulatory-Driven Market Fragmentation (Jan. 2019), https://www.isda.org/2019/01/30/regulatory-driven-market-fragmentation/.
[8] Supplemental Proposal at 35460.
[9] *See* ISDA's response to the EMIR consultation, *available at* https://www.isda.org/2019/07/31/final-response-to-tiering-and-comparable-compliance-esma/.

U.S. banking groups, including foreign branches of U.S. banking groups. A small CCP with very few clearing members and minimum exposure to the U.S. financial system may be deemed as having "substantial risk" simply because 20% or more of the initial margin collected is attributed to U.S. clearing members.[10]

For example, a DCO may have a total of $100 million in initial margin with $21 million initial margin attributed to a U.S. clearing member. In this case, the U.S. clearing member's position does not pose systemic risk to U.S. markets, but may incentivize non-U.S. CCPs to limit, or put a cap on, clearing for U.S. persons for fear of being designated as posing significant risk to the U.S. financial system and thus coming into full scope of the DCO regime. This situation would be disadvantageous for U.S. banking groups, and could be viewed as violating the spirit of the PFMI requirement to provide non-discriminative treatment toward all clearing members.[11]

For these reasons, the second prong of the test should be eliminated. At a minimum, the test should permit the Commission to determine whether a CCP poses "substantial risk" only if both of the two thresholds exceed 20%. This would more accurately capture the risks to the U.S. financial system and the CFTC's intent to provide U.S. persons with more options for clearing.

In addition, we believe that the final rule should be revised to exclude foreign subsidiaries of U.S. swap dealers from the definition of U.S. clearing members to align with the treatment of foreign subsidiaries under the CFTC Cross-border Guidance.[12] U.S. clearing members are defined in the Supplemental Proposal as "clearing member[s] organized in the United States or whose ultimate parent company is organized in the United States, or an FCM."[13] Under CFTC Cross-border Guidance, however, subsidiaries of U.S. swap dealers are not considered U.S. persons simply by virtue of being a part of a U.S. banking group.

Including subsidiaries in the definition would disincentivize non-U.S. DCOs from accepting significant levels of business from such subsidiaries in order to remain below the threshold, thus, as stated above, putting U.S. banking groups at a competitive disadvantage. To ensure a consistent regulatory approach to the cross-border treatment of foreign subsidiaries and allow market participants continued access to global liquidity pools, the Commission should amend the proposed definition of U.S. clearing members to exclude foreign subsidiaries of U.S. swap dealers.

Another concern with respect to the proposed "substantial risk" test relates to the CFTC's intent to "retain discretion in determining whether a non-U.S. DCO poses substantial risk to the U.S. financial system, particularly where the DCO is close to 20 percent on both prongs of the test. In

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[10] We provide similar comments to the Commission's Alternative Compliance Proposal, Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, Notice of Proposed Rulemaking, 84 Fed. Reg. 34819 (July 19, 2019), https://www.govinfo.gov/content/pkg/FR-2019-07-19/pdf/2019-15262.pdf.

[11] Principle 18 (access and participation requirements) of the PFMI.

[12] *See* Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations; Rule (July 26, 2013), *available at* https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2013-17958a.pdf

[13] Exemption from Derivatives Clearing Organization Registration, Supplemental notice of proposed rulemaking, 84 Fed. Reg. 35456 (July 23, 2019), https://www.govinfo.gov/content/pkg/FR-2019-07-23/pdf/2019-15258.pdf.

these cases, in making its determination, the Commission may look at 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."[14] We believe that the Commission's intent to rely on other factors in making its determination undermines the Commission's objective to provide a bright-line test and may lead to legal and compliance uncertainty. We therefore ask the Commission to identify what "other factors" might reduce or increase a DCO's risk to the U.S. financial system.[15]

Finally, we ask the Commission to affirm that the CFTC will monitor the 20% threshold test by analyzing the data required to be reported to the CFTC, and that the relevant exempt DCO has no other obligations with respect to the monitoring of the 20% threshold apart from such reporting requirements.

2. U.S. Persons, Including Foreign Branches of U.S. Persons, Should be Allowed to Voluntarily Clear at Non-U.S. CCPs

As we stated in our comments to the Initial Proposal,[16] we believe that non-U.S. CCPs should not be required to register as a DCO or apply for an exemption from registration solely because they permit clearing members that are U.S. persons, including foreign branches of U.S. persons, to clear swaps that are not subject to the CFTC's clearing mandate. Such clearing is voluntary; thus, U.S. persons should have more flexibility with regard to the CCP they select.

Allowing U.S. persons, including foreign branches of U.S. persons,[17] to voluntarily clear products at non-U.S. CCPs would allow U.S. persons wider access to clearing for more products, thus increasing their ability to diversify risk. These benefits are consistent with the Commission's intent to promote central clearing in an efficient and scalable manner and outweigh any potential consequences of allowing U.S. persons to clear these products at CCPs that are not registered or exempt from DCO registration. Separately, in order to encourage more centralized clearing, the Commission should not dictate where voluntarily cleared contracts must be cleared.[18]

In this same vein, we also ask the Commission to allow non-U.S. CCPs to accept foreign branches of U.S. bank swap dealers as members, for the purposes of clearing proprietary accounts or on behalf of non-US clients, without requiring such non-U.S. CCPs to register with the Commission or obtain an exemption from registration. This would bring the treatment of

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[14] Supplemental Proposal at 35460.

[15] We also ask the Commission to provide transitional relief to foreign CCPs that currently operate under the CFTC's no-action relief to allow these clearing organizations to continue to clear proprietary trades of U.S. clearing members. In the event of an exempt DCO exceeding the threshold, we believe time-limited relief should be provided to allow market participants to take the necessary steps to migrate their business and operations.

[16] ISDA Letter to the CFTC (Oct. 12, 2018), *available at* https://comments.cftc.gov/PublicComments/CommentList.aspx?id=3009.

[17] In the case of foreign branches of U.S. banks, prohibiting such entities to access non-U.S. CCPs for voluntarily cleared swaps creates competitive disadvantages vis-a-vis non-U.S. subsidiaries of U.S. banks.

[18] Should the CFTC expand its clearing mandate to cover more products, we believe that non-U.S. CCPs should not be required to register or obtain an exemption from registration as a DCO because they cleared such products before the mandate was expanded; however, we understand that such CCPs would no longer be able to clear new transactions in the products for U.S. persons once the expanded mandate takes effect.

foreign branches of U.S. banks in line with that of foreign subsidiaries and eliminate existing competitive disadvantages between foreign branches and subsidiaries of U.S. banking groups. We note that this is particularly important now that other jurisdictions have implemented local clearing mandates. U.S. banks operating overseas have an increased need to access non-U.S. CCPs in order to comply with local jurisdictions' clearing mandates.

3. CFTC Should Revise its Authority to Inspect Exempt DCOs and Clarify its Expectations regarding Memorandums of Understanding (MOUs)

We continue to believe that the proposed inspection requirement is overly broad. Under both the Initial and Supplemental Proposals, an exempt DCO is generally expected to (1) make all documents and records related to its operation as an exempt DCO open to inspection by any CFTC representative, and (2) promptly make its books and records available to CFTC representatives, upon the request of a CFTC representative. As we noted in our comments to the Initial Proposal, the Commission should specify how and when it would undertake inspections of exempt DCOs.

Furthermore, to foster cross-border regulatory cooperation, the CFTC should consider obtaining consent for inspections from an exempt DCO's home country regulator prior to conducting on-site inspections. At a minimum, the CFTC should provide prior notice to an exempt DCO's home country regulator in connection with any inspections of the exempt DCO or ask the home country regulator for the required information. Not only would this promote comity and coordination, but it would also ensure that such inspections are not overly burdensome or in violation of local laws.

In addition, in the spirit of supervisory cooperation, we believe the CFTC should consider including an exempt DCO's home country regulator during inspections. This would assist the CFTC in interpreting and analyzing the exempt DCO's books and records in the context of the regulatory requirements of a particular jurisdiction.

Finally, we believe that Commission should identify the type of information that the CFTC expects to require under MOUs. As we stated in our comments to the Initial Proposal, it is important for the Commission to provide additional clarity regarding what specific information the CFTC will require to evaluate the CCP's initial and continued eligibility for the DCO exemption to ensure that providing such information would not violate any local laws. Doing so would allow the CFTC to access necessary information, while, at the same time, take into account any prohibitions on providing certain types of information under local laws.

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We support the Commission's efforts to amend its rules for exempt DCOs and address longstanding concerns regarding the availability of clearing options for U.S. persons. Our members are strongly committed to maintaining the safety and efficiency of global derivatives markets and hope that the Commission will consider our recommendations, as they reflect the extensive knowledge and experience of industry professionals within our membership.

Please feel free reach out to Bella Rozenberg, Senior Counsel and Head of Regulatory and Legal Practice Group, (202)-683-9334, if you have questions.

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