CITADEL

November 22, 2019

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

Re: Exemption from DCO Registration

Dear Mr. Kirkpatrick:

We appreciate the opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission") on its proposal to amend the process for granting certain derivatives clearing organizations ("DCOs") an exemption from registration with the Commission (the "Proposal").[1]

Under the Commodity Exchange Act ("CEA"), the Commission may exempt a DCO from registration if it determines that the clearinghouse is subject to "comparable, comprehensive supervision and regulation."[2] While we support the Commission's efforts to provide further clarity regarding the exemption process, we disagree with how the statutory standard is proposed to be implemented. We focus on three key areas below.

1. The Commission's Regulatory Framework is the Relevant Baseline for Determining Comparability

In order for a clearinghouse to be eligible for an exemption from DCO registration, the CEA requires the Commission to determine that the clearinghouse is subject to comparable regulation vis-à-vis registered DCOs. Therefore, the Commission should be comparing its own regime for regulating DCOs with the home-country regulatory regime of the clearinghouse seeking an exemption.

However, the Proposal instructs the Commission to ignore its own regulatory regime when conducting the comparability assessment, and to instead use the "Principles for financial market infrastructures" ("PFMIs") published by CPMI-IOSCO as a proxy for U.S. regulatory requirements.[3] Unfortunately, the PFMIs do not address a number of important elements of the Commission's regulatory framework for DCOs. Examples include:

[1] 84 FR 35456 (July 23, 2019), available at: https://www.cftc.gov/sites/default/files/2019/07/2019-15258a.pdf .

[2] CEA Section 5b(h).

[3] We note that this approach is less robust than even the comparability assessment process suggested in the companion proposal to establish a "DCO-lite" framework for certain non-U.S. DCOs, which includes an analysis of the CEA (84 FR 34819 (July 19, 2019), available at: https://www.cftc.gov/sites/default/files/2019/07/2019-15262a.pdf).

- **Non-discriminatory access**. Commission regulations prohibit 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.[4] The PFMIs do not include similarly detailed requirements.

- **Straight-through-processing**. Commission regulations require 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.[5] The PFMIs do not include similar requirements.

- **Gross margining**. Commission regulations require a DCO to collect initial margin on a gross basis for each clearing member's customer account.[6] The PFMIs do not include similar requirements.

- **Public disclosure of rule filings**. Commission regulations require a DCO to publicly disclose all rule filings.[7] The PFMIs do not include similarly comprehensive requirements.

- **Public information**. Commission regulations require a DCO to provide various information to market participants, including daily settlement prices, volume, and open interest for each cleared instrument.[8] The PFMIs do not include similarly detailed requirements.

While the home-country regulatory regime of the clearinghouse seeking an exemption should not be required to precisely replicate the Commission's regulatory framework for DCOs, it must be comparable. This comparability assessment requires the Commission to take into account the key elements of its regulatory framework for DCOs, as set forth in the CEA and Commission regulations.[9]

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[4] §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 to enter into an arrangement with a customer that discloses the customer's original executing counterparty.

[5] §39.12(b)(7). The Commission has interpreted this requirement to mean that DCOs must accept or reject transactions within 10 seconds of receipt ("Staff Guidance on Swaps Straight-Through Processing" (Sept. 26, 2013), available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/stpguidance.pdf).

[6] §39.13(g)(8).

[7] Part 40 of the Commission's regulations.

[8] §39.21.

[9] We note this is consistent with the Commission's approach for assessing the comparability of the EU regulatory regime for clearinghouses (81 FR 15260 (March 22, 2016), available at: https://www.govinfo.gov/content/pkg/FR-2016-03-22/pdf/2016-06261.pdf).

2. U.S. Customers Should Be Able to Meaningfully Access Exempt DCOs

We agree with the Proposal that U.S. customers should be permitted to access clearinghouses that have been granted an exemption from DCO registration. The current approach of granting registration exemptions but limiting permitted U.S. business to proprietary swaps [10] can disadvantage U.S. customers, as these liquidity pools can then only be accessed by self-clearing U.S. dealers. As a result, U.S. customer access should be considered as part of the overall comparability assessment of a clearinghouse seeking a registration exemption.

However, the Proposal does not ensure meaningful U.S. customer access to exempt DCOs. This is because the Proposal prohibits U.S. customers from accessing exempt DCOs through FCMs, in direct contradiction to current market practice, where U.S. customers are required to use FCMs to access registered DCOs. Instead, U.S. customers would only be allowed to clear at exempt DCOs through foreign intermediaries that are not subject to the same customer protection requirements as FCMs, including with respect to minimum capital, collateral segregation, and financial reporting.

The Proposal does not fully consider the practical impacts of this approach. In order to access an exempt DCO, a U.S. customer would be required to forfeit the customer protection regime set forth in the CEA which applies to all of its other swaps clearing activities.[11] The Proposal does not cite any U.S. customer interest in doing so. In turn, the asserted benefits appear speculative:

- While U.S. customers would have to clear though non-FCM firms in order to access an exempt DCO, these foreign intermediaries are likely to be affiliates of swap clearing FCMs, meaning that overall clearing concentration levels across bank groups are unlikely to materially change.[12]

- In addition, instead of providing access to entirely new and innovative products, exempt DCOs appear likely to compete for U.S. customer business in swap instruments that are already cleared by registered DCOs.[13]

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[10] *See* Proposal at 35457, FN 5.

[11] We note that implementing this approach also requires the Commission to grant additional statutory exemptions to foreign intermediaries, which are not specifically contemplated in the CEA and which raise important questions about the section 4(c) public interest exemption provisions (*see* Proposal at 35481).

[12] It is important to note that, while expanding access to clearing should be encouraged, (a) concentration levels have remained relatively constant since the start of client clearing in swaps (see "Incentives to centrally clear over-the-counter (OTC) derivatives: A post-implementation evaluation of the effects of the G20 financial regulatory reforms" (19 Nov 2018), available at: https://www.fsb.org/wp-content/uploads/R191118-1-1.pdf at page 22) and (b) the Herfindahl-Hirschman Index, a commonly accepted measure of market concentration, does not indicate extremely high levels of concentration (*see* "Final 2017 FCM Rankings & Concentration," Clarus Financial Technology (28 Feb 2018), available at: https://www.clarusft.com/final-2017-fcm-rankings-concentration/ and "Herfindahl-Hirschman Index," available at: https://www.justice.gov/atr/herfindahl-hirschman-index).

[13] We note that the Proposal did not provide specific examples of new and innovative products cleared by exempt DCOs and instead requested examples from market participants (Proposal at 35465).

- Finally, the Proposal does not consider the possibility that certain already-registered DCOs may de-register and instead apply for an exemption, thereby impairing U.S. customer access to these liquidity pools for the reasons detailed above.

In light of these considerations relating to U.S. customer access, we recommend that the Commission reconsider the proposed approach with a view to finding a solution that is more compatible with the existing CEA framework for swaps customer clearing. While this solution may require legislative changes,[14] it is preferable to compelling U.S. customers to forfeit the customer protection regime set forth in the CEA in order to access an exempt DCO.

3. DCOs That Pose A "Substantial Risk" Should Not Be Eligible for an Exemption

We agree with the Proposal that clearinghouses posing a "substantial risk to the U.S. financial system" should not be eligible for an exemption from DCO registration. However, we recommend that the Commission provide further information regarding how the criteria for evaluating this standard were developed, and the expected practical impact. For example, how many non-U.S. DCOs 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 interest rate swaps clearinghouses could ever be considered to pose a "substantial risk to the U.S. financial system." And finally, how would U.S. customer business cleared through foreign intermediaries, as allowed in the Proposal, factor into the proposed criteria?

In light of the above, we recommend that the Commission retain sufficient discretion to conduct a thorough analysis of the risks associated with each clearinghouse seeking to obtain an exemption from registration, taking into account both U.S. participation in that clearinghouse (including U.S. clearing members and affiliates, and U.S. customers) and the clearinghouse's market position within the relevant asset class.

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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 clearinghouse application to obtain an exemption from registration.[15] Please feel free to call the undersigned at (646) 403-8200 with any questions regarding these comments.

[14] *See* Proposal at 35464.

[15] We note that, to the extent an exemption is granted, the Commission should ensure that Part 43 and Part 45 reporting requirements continue to be fulfilled in an accurate manner for in-scope transactions, including the "Cleared or uncleared" field in Part 43 and the "Clearing indicator" and "Clearing venue" fields in Part 45.

Respectfully,

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