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Via Electronic Submission

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

Re: Notice of Proposed Rulemaking on (1) Exemption from Derivatives Clearing Organization Registration (RIN number 3038–AE65) and (2) Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations (RIN 3038–AE87)

Dear Mr. Kirkpatrick:

The Futures Industry Association (**FIA**)[1] appreciates the opportunity to comment on the Commodity Futures Trading Commission's (**CFTC** or **Commission**) Notice of Proposed Rulemakings on the (1) Exemption From Derivatives Clearing Organization Registration (the **Exempt DCO Proposal**)[2] and (2) Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations (the **Alternative Compliance DCO Proposal**, and together with the Exempt DCO Proposal, the **Proposals**).[3] Both Proposals would provide U.S. customers access to non-U.S. DCOs. As such, we have chosen to submit a single comment letter on the two Proposals.

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[1] FIA is the leading trade organization for the global futures, options and over-the-counter cleared derivatives markets. Its mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system and to promote high standards of professional conduct. FIA's core constituency consists of futures commission merchants, which provide clearing and execution services for clients active in financial markets around the world. FIA's FCM members play a critical role in managing systemic risk in the global financial markets. They provide the majority of the funds that support clearinghouses and commit a substantial amount of their own capital to safeguard customer transactions. FIA's membership also includes the major global exchanges, clearinghouses, trading platforms, technology vendors, legal services, and consulting firms representing the futures and derivatives industry.

[2] Exemption from Derivatives Clearing Organization Registration, 84 Fed. Reg. 35456 (July 23, 2019).

[3] Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 84 Fed. Reg. 34819 (July 19, 2019).

FIA broadly supports the Commission's efforts to combat market fragmentation by facilitating U.S. customer[4] access to global derivatives markets and clearinghouses. The Proposals attempt to provide new avenues for U.S. customers to access foreign cleared swaps, a product set that is of increasing importance to market participants, but for which the markets have struggled to find practical and cost-effective clearing structures under existing regulatory requirements. FIA's principal concern is that taken together, the Proposals still do not create a comprehensive framework to facilitate appropriate access to foreign cleared markets by U.S. customers. The Exempt DCO Proposal unduly limits the choice of U.S. customers of the intermediaries through which they may access exempt non-U.S. DCOs and will work to deprive such customers of the numerous benefits that flow from FCM relationships. These benefits include business efficiencies, such as cost savings, working with a trusted broker and having the brokerage relationship governed by familiar documentation. Benefits also include regulatory protections that customers should be able to choose, such as FCM disclosure, transparency, recordkeeping, net capital and reporting requirements. In practice this may harm U.S customers, who would need to establish client relationships with both an FCM and its affiliated foreign clearing intermediary and create barriers to entry for new FCMs. The Commission has expressed concern that only 17 FCMs clear swaps for customers and that there is substantial concentration in terms of transactions cleared even among these entities.[5] If adopted in its current form, the Exempt DCO Proposal risks further concentrating market share amongst those FCMs with affiliated foreign clearing intermediaries. Separately, the Proposals create the wrong incentives for how non-U.S. DCOs elect to grant access to U.S. customers, with customer protection not being a key focus.

Any limitations on a new customer access model for swaps cleared on non-U.S. DCOs (**Foreign Swaps**), which as proposed relies heavily and correctly on disclosure, should rest, first and foremost, on the principle that sophisticated U.S. swaps customers are best situated to evaluate whether and how to access Foreign Swaps markets. Indeed, we respectfully submit that market fragmentation will be meaningfully addressed only insofar as the regulations allow firms to access non-U.S. markets in a manner that is most efficient and free from unnecessary regulatory impediments and costs. Operating with these first principles in mind, we believe U.S customers should be able to clear through FCMs (if they deem it most beneficial to do so), regardless of whether access is provided through registered DCOs (including foreign DCOs relying on alternative compliance) or exempt DCOs, and regardless of whether the FCM is a clearing member of a registered or exempt DCO or has a clearing relationship with a non-U.S. clearing member of a registered or exempt DCO.

There is a tried and tested approach for balancing access and protection of U.S. customers in non-U.S. markets: Part 30 of the Commission's regulations governing foreign futures. We see no compelling reason to adopt a different framework for swaps. The Commission should model the clearing of swaps on non-U.S. DCOs on the Part 30 regime for clearing foreign futures. This will respect customer choice, and encourage open, transparent and competitive markets, all while preserving customer protections. We understand that the Commission has questions about the

[4] U.S. customers refers to that class of customers that are currently unable to access exempt DCOs.

[5] Exempt DCO Proposal, at 35459.

applicability of U.S. bankruptcy protections to U.S. customers that clear swaps on exempt foreign DCOs through a chain of intermediaries that includes FCMs. Those questions merit consideration and we have attempted to respond to them here. We believe the most reasonable reading of the applicable bankruptcy law and regulations supports application of those protections to U.S. customers. We feel strongly that any lingering questions do not justify the Commission adopting a regime that completely excludes FCMs from supporting clearing for U.S. customers on exempt DCOs.

Cross-border access to swaps markets is a critical issue for U.S. customers, FCMs and, ultimately, the health of global commerce and markets. Providing access for U.S. customers to non-U.S. DCOs is now an urgent priority. While sub-optimal, if the Commission requires more time to work through adopting a Part 30-like regime for Foreign Swaps, we ask that the Commission undertakes a two-step process, the first step being adoption of rules permitting U.S. customers to clear only directly through foreign intermediaries, and the second being adoption of rules permitting FCMs to form part of the clearing chain. We urge the Commission to harness the opportunities provided in the U.S. Bankruptcy Code, and to be bold in prioritizing customer access and customer choice in finalizing the Proposals by allowing FCM intermediation. However, if the two-step process above is the only way to address the pressing needs of the market it is of utmost importance that the final rules facilitate the inclusion of FCMs in the clearing chain once the Commission has completed its work.

We also support the Alternative Compliance DCO Proposal, which is consistent with prior CFTC practice, although we have some comments on features of the Alternative Compliance DCO Proposal that are discussed below in sections 5 and 7.2 of this comment letter.

We also refer the Commission to, and expresses our support for, the comment letter submitted in response to the Proposals by the Securities and Financial Markets Association (**SIFMA**).

1. Overview of Letter

Section 2: Reiterates our support for the Commission's attempt to provide new avenues for U.S. customers to access swaps cleared on non-U.S. DCOs and sets out why action is of critical importance.

Section 3.1: Explains how the Exempt DCO Proposal unduly limits the choice of U.S. customers of the intermediaries through which they may access exempt non-U.S. DCOs and will deprive such customers of the numerous benefits that flow from FCM relationships. We believe that sophisticated U.S. swaps customers are best situated to evaluate whether and how to access foreign swaps markets and make their own risk assessment of bankruptcy risks of clearing through an FCM.

Section 3.2: Explains why the U.S. Bankruptcy Code extends to swaps cleared at exempt foreign DCOs, since the term "commodity contract" includes swaps cleared at an exempt foreign DCO. In addition, we explain how treating such swaps as "commodity contracts" would not adversely impact customers clearing such swaps, nor customers that do not clear such swaps.

Section 3.3: Argues that the Commission should model the clearing of swaps at exempt foreign DCOs on Part 30 of the Commission's regulations governing foreign futures.

Sections 4-6: Responds to some of the Commission's other requests for comment.

Section 4 addresses whether it is viable to have a non-FCM affiliate act as a "traditional" member that guarantees the FCM's obligations to the DCO.

Section 5 outlines some of our reservations with the proposed test for substantial risk to the U.S. financial system.

Section 6 responds to whether the Commission should permit non-U.S. customers to clear futures and swaps through non-FCMs at U.S.-registered DCOs.

Section 7: Concludes by requesting the Commission to clarify two areas of uncertainty.

2. FIA Supports The Broad Policy Objectives of Regulatory Deference and Avoiding Market Fragmentation

We support the broad policy objectives of regulatory deference and avoiding market fragmentation underlying the two Proposals. Cross-border access to derivatives is critically important for market participants, including end-users, allowing them to find the product that allows them to most efficiently transact and manage their risk, which in turn mitigates risk and supports economic growth. The Commission's rules should facilitate access to foreign markets while preserving the integrity of markets and market participants. Derivatives markets must protect and advance market participants' access to cross-border central clearing by supporting regulatory deference to the home country rules, benchmarked to internationally-agreed upon standards where appropriate.[6] By contrast, duplicative and contradictory regulatory regimes breed fragmented derivatives markets that can impose artificial, and inefficient, barriers to entry. These barriers to entry in turn, lead to fewer market participants that are able to mutualize risk and collectively withstand future periods of market stress, which could effectively undo many of the protections enacted by global regulators after the 2008 financial crisis.[7]

Regulatory deference mitigates the risk of market fragmentation and invites reciprocal treatment of U.S. firms by foreign regulators. Our white paper published together with SIFMA in December 2017,[8] supported robust mutual recognition of comparable regulation. We welcomed the increased deference to home country regulation of non-U.S. DCOs for which former Commission Chairman Giancarlo advocated in his October 2018 white paper,[9] and the evaluation of the extent to which

[6] *See* Mitigating the Risk of Market Fragmentation (Mar. 2019), https://fia.org/articles/fia-warns-increased-market-fragmentation-caused-regulation.

[7] *Id.*

[8] Promoting U.S. Access to Non-U.S. Swaps Markets: A Roadmap to Reverse Fragmentation (Dec. 14, 2017), https://fia.org/articles/fia-and-sifma-release-white-paper-us-access-non-us-trading-venues-and-ccps.

[9] J. Christopher Giancarlo, Chairman, Commodity Futures Trading Commission, Cross-Border Swaps Regulation 2.0: A Risk-Based Approach with Deference to Comparable Non-U.S. Regulation (Oct. 1, 2018), https://www.cftc.gov/sites/default/files/2018-10/Whitepaper_CBSR100118.pdf.

the risk of the activities of foreign DCOs are already adequately addressed by existing regulation. More recently Commission Chairman Tarbert acknowledged that deference not only facilitates greater cooperation between regulators, but also promotes stability, resiliency, and growth in global derivatives markets[10]. We reiterated these positions in in our joint comment letter with SIFMA[11] concerning the Notice of Proposed Rulemaking on the Exemption from Derivatives Clearing Organization Registration.[12]

It is especially important that the Commission work to facilitate access for U.S. customers to global clearinghouses in light of the recent and forthcoming global uncleared margin requirements. These new requirements will serve to encourage market participants to clear more of their trades. As the Commission notes in the Exempt DCO Proposal, [13] limited access to non-U.S. clearinghouses may become a more acute issue as margin rules for non-cleared swap transactions come fully into effect. Full implementation of the non-cleared margin rules may incentivize market participants not currently subject to them to engage in more cleared swap transactions and fewer non-cleared swap transactions. This will reduce liquidity in the non-cleared markets, and while it would likely produce greater liquidity in more standardized, cleared contracts, absent Commission action, U.S. customers would be limited either to clearing through only U.S. registered DCOs or to transacting on the relatively less liquid non-cleared market. This would create significant economic disadvantages for U.S. customers.

3. The Exempt DCO Proposal Unnecessarily Limits the Ability of U.S. Customers to Access Exempt Non-U.S. DCOs through FCMs

In the Exempt DCO Proposal, the Commission explains that it believes that the proposed exemption is consistent with the purposes of the CEA because it would provide U.S. persons with additional options regarding the trading and clearing of swap transactions[14]. But the Exempt DCO Proposal unnecessarily limits those options. The Exempt DCO Proposal permits U.S. customers to clear at an exempt DCO only through a foreign intermediary and not directly or indirectly through an FCM. We agree with Commissioner Stump's concerns regarding the exclusion of FCMs from the Exempt DCO Proposal, namely that the Proposals may be too rigid to facilitate

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[10] Opening Statement of Chairman Heath P. Tarbert Before the Open Commission Meeting on October 16, 2019, available at https://www.cftc.gov/PressRoom/SpeechesTestimony/heathstatement101619?utm_source=govdelivery.

[11] FIA and SIFMA comment letter dated October 12, 2018.

[12] Exemption from Derivatives Clearing Organization Registration, 83 Fed. Reg. 39,923 (Aug. 13, 2018).

[13] Exempt DCO Proposal, at 35459 n.26.

[14] *Id.* at 35458.

increased swaps clearing by U.S. customers, as the Commission is committed to do by the original G–20 and Congressional directives.[15]

3.1 U.S. Customers Should Be Permitted to Clear Through FCMs At Exempt DCOs

(a) Choice Should Be in The Hands of The U.S. Customer, Not the DCOs

In practice, each foreign DCO will choose whether to register as a DCO and avail itself of the Alternative Compliance DCO Proposal, or whether to secure an exemption from registration and avail itself of the Exempt DCO Proposal. Given that the test as to whether a DCO poses substantial risk to the U.S. financial system is identical in each Proposal, a DCO that does not pose such a risk will be afforded the choice as to whether to register or become exempt. Because an exemption is likely the easier route for a DCO in terms of the compliance burden, we fear that U.S. customers will be forced to clear through foreign intermediaries pursuant to the Exempt DCO Proposal rather than through FCMs pursuant to the Alternative Compliance DCO Proposal. Two clearinghouses that FCMs consider to be key access points for U.S. customers have already been reported as preferring to retain exempt status rather than seek registration due to the legal costs involved[16]. The choice of through whom to clear will thereby be transferred from U.S. customers to foreign DCOs. We see no policy rationale that supports that position.

The Exempt DCO Proposal would require U.S. customers (most of whom already have pre-existing relationships with one or more FCMs) to set up separate parallel accounts and relationships with foreign intermediaries to access exempt DCOs. There is a cost for customers to establish relationships with many different foreign intermediaries, as they will need to thoroughly diligence new relationships and new regulatory frameworks. Indeed, U.S. customers will need to weigh foreign jurisdiction bankruptcy risk considerations, as well as the burden of setting up new relationships and accounts against the need to access the foreign DCO to hedge their risk. Ultimately, smaller customers may not be in a position to justify the risks and costs of on-boarding at foreign intermediaries and will therefore be priced out of clearing at foreign DCOs. Local affiliates of FCMs will not be able to become members of every exempt DCO due to regulatory compliance and capital burdens, ultimately leading to limited customer choice of through whom to clear. Given the importance of ensuring that customer choice is not curtailed, FIA believes the Commission must permit FCMs to be part of the clearing infrastructure for U.S. customers at exempt DCOs.

(b) FCMs Are Subject to Disclosure, Transparency, Recordkeeping, Net Capital and Reporting Requirements, And Offer Other Efficiencies That Could Benefit U.S. Customers

The Exempt DCO Proposal overlooks the benefits that customers could prefer in using an FCM over which the CFTC exercises direct supervision. While the Commission's focus may be on U.S.

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[15] Alternative Compliance DCO Proposal, at 34836.

[16] Risk.net article on September 25th, 2019 entitled *CFTC's equivalence plan divides clearing houses and clients.*

bankruptcy protections, U.S. customers assess the benefit of clearing through a U.S. FCM holistically. There are significant non-bankruptcy related benefits that may contribute towards U.S. customers preferring to deal with an FCM. FCMs are subject to disclosure, transparency, recordkeeping, net capital and reporting requirements to which foreign intermediaries would not necessarily be subject, because the Exempt DCO Proposal exempts foreign intermediaries from registration as FCMs. An FCM must furnish its customers with monthly statements that show all transactions occurring in the month, all charges and credits to the account, and the account balance.[17] The monthly statement must include, for each cleared swaps customer position, the cleared swaps carried by the FCM, the net unrealized profits or losses in all cleared swaps marked to the market and any cleared swaps customer collateral carried with the FCM. All FCMs are subject to recordkeeping requirements that oblige them to keep full, complete, and systematic records, together with all pertinent data and memoranda, of all transactions.[18] Each FCM is required to maintain adjusted net capital of the greatest of $1,000,000, the FCM's risk-based capital requirement, the amount of adjusted net capital required by a registered futures association of which it is a member, and for securities brokers and dealers, the amount of net capital required by Rule 15c3-1(a) of the Securities and Exchange Commission.[19] Should an FCM become undercapitalized at any time, it must provide immediate notice to the CFTC. In addition, FCMs must file monthly unaudited financial reports and certified annual financial reports with the Commission.[20] U.S. customers should be afforded the choice of whether, all factors considered, they would prefer to clear through an FCM and take advantage of these regulatory protections, or to clear directly through a foreign intermediary, which is not subject to such requirements.

In addition to the non-bankruptcy related regulatory protections, there are a number of efficiencies that U.S. customers enjoy when clearing through an FCM, including better visibility into global cleared positions and access to ancillary reporting services provided by the FCM. The Commission does not anticipate that the proposal would impose costs on non-FCM clearing members or customers and believes that non-FCM clearing members and customers may face reduced costs as a result of this proposal[21]. We feel strongly that this is not the case. Direct clearing through a foreign intermediary could subject U.S. customers to increased compliance costs due to foreign regulatory requirements such as reporting, as well as other burdens and costs, receiving different margin statements, and executing new documentation. In addition, it may be the case that taking on client clearing may result in increased guarantee fund contributions which push the foreign intermediary beyond internally approved levels, resulting in the need for another foreign intermediary to join the clearing house. It is also likely to be very costly for FCMs' foreign affiliates to switch to a model where they clear directly for U.S. swaps customers, due to significant

[17] 17 CFR § 1.33.

[18] 17 CFR § 1.31.

[19] 17 CFR § 1.17.

[20] 17 CFR § 1.10.

[21] Exempt DCO Proposal, at 35469.

documentation and on-boarding costs, including signing new clearing brokerage agreements and adjusting operational build-ups. There are also netting benefits for the customer in having all of its trades cleared through one entity as opposed to having its trading broken up with different clearing brokers. Customers of FCMs also experience day to day operational efficiency in only needing to effect margin transfers with one FCM as opposed to multiple brokers in multiple jurisdictions. Breaking these flows and netting portfolios up could create systemic operational and legal risk during times of global financial distress. If FCMs were admitted to the clearing chain, there would be initial costs including development of the indirect clearing model and securing necessary opinions, but we would expect these costs to be shouldered by, and spread across, the industry.

(c) The Exempt DCO Proposal Subjects FCMs To an Unjustifiable Competitive Disadvantage

The Exempt DCO Proposal subjects FCMs to an unjustifiable competitive disadvantage in prohibiting them from clearing, indirectly, U.S. customer trades at an exempt DCO. Implementation of a direct clearing model would be more costly for FCM's foreign affiliates than for foreign brokers. As the Commission recognizes, to the extent that FCMs' customers shift their clearing activity from registered DCOs to exempt DCOs, or otherwise reduce their clearing activity at registered DCOs as a result of this proposal, FCMs would lose business.[22]

(d) The Exempt DCO Proposal Will Exacerbate FCM Concentration and Disadvantage Smaller FCMs

The Commission claims that the Exempt DCO Proposal has the potential to increase the number of market intermediaries clearing for U.S. persons and reduce the concentration of U.S. customer funds in a small number of FCMs.[23] But, expanding the Exempt DCO Proposal to include FCMs may ultimately give U.S. customers more options to diversify where their funds are held. Currently, the top five and the top ten FCMs carry 76 percent and 98 percent of the total cleared swaps customer funds, respectively.[24] The Exempt DCO Proposal may create a barrier to entry for new FCMs that are unable to direct U.S. customer business in Foreign Swaps to an affiliated foreign intermediary or that may not have the means to work within the strictures of the proposed regulatory framework. Restricting U.S. customers to only clearing through foreign intermediaries results in fewer options to mutualize risk and ultimately more risk to customers. As Commissioner Berkovitz points out,[25] it is a topsy-turvy argument that efforts to increase competition and reduce concentration amongst FCMs in the U.S. swaps markets is best accomplished by prohibiting U.S. FCMs from participating in non-U.S. markets and enabling non-registered foreign intermediaries to take this business away from those FCMs.

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[22] *Id.* at 35469.

[23] *Id.* at 35459.

[24] See Financial Data for FCMs (as of March 31, 2019), available at [*https://www.cftc.gov/MarketReports/financialfcmdata/index.htm*](https://www.cftc.gov/MarketReports/financialfcmdata/index.htm).

[25] Exempt DCO Proposal, at 35481.

(e) U.S. Customers Can Make Their Own Risk Assessment of Bankruptcy Risks of Clearing Through An FCM

The Commission states that it is not currently proposing to permit an FCM to clear U.S. customer positions at an exempt DCO (either directly or indirectly through a foreign member of the exempt DCO) due to what it considers to be uncertainty regarding the protection of U.S. customer funds in these circumstances in the event of an insolvency of the FCM, but invited comment on this issue. We draw the Commission's attention to section 3.2 of this letter, which analyzes the relevant provisions of the U.S. Bankruptcy Code and demonstrates that the Commission's concerns with respect to permitting clearing through FCMs are not well founded.

Even if there may, *arguendo*, be a small measure of uncertainty about the application of the U.S. Bankruptcy Code to commodity contracts cleared through an FCM on an exempt DCO, sophisticated U.S. customers trading swaps should be free to take on this risk, as made clear to them through adequate disclosures. There should not be a blanket prohibition on clearing through an FCM at an exempt DCO. Instead, as the CFTC proposed to permit in respect of a foreign intermediary, the FCM could be required to provide written notice to a U.S. person that there may be ambiguity as to whether swaps cleared by U.S. customers through an FCM at an exempt DCO would constitute "commodity contracts" under the Code and therefore to what extent U.S. customers are protected in an FCM's insolvency proceedings.

When investors choose to clear swaps through non-US intermediaries at non-US CCPs, they weigh the economic benefit of accessing products against the risk of using a non-FCM intermediary.[26] They could equally assess the risk of using an FCM intermediary. Consistent with this judgment, the Exempt DCO Proposal provides[27] that an Exempt DCO must require a foreign intermediary to provide written notice to, and obtain acknowledgement from, a U.S. person prior to clearing any swaps for such person that the protections of the U.S. Bankruptcy Code do not apply to the U.S. person's funds. The notice also must explicitly compare the protections available to the U.S. person under U.S. law and the laws of the exempt DCO's home country regulatory regime. The Exempt DCO Proposal is premised on the adequacy of disclosure of the risks.

If for a U.S. customer using a non-FCM intermediary disclosure of risks is a satisfactory replacement for the full protection afforded by the U.S. Bankruptcy Code, surely disclosure of risks can play that same role in respect of a U.S. customer that clears through an FCM. Although the Commission perceives there to be a small uncertainty regarding the customer protections upon a bankruptcy of the FCM, the FCM's disclosure of that perceived uncertainty to the U.S. customer should likewise be regarded as sufficient, and the U.S. customer should be afforded the choice of whom it wishes to clear through.

In the foreign futures context, before FCMs may open a commodity futures account for a customer, the customer must receive a written disclosure statement and send back to the FCM a signed and

[26] Exempt DCO Proposal, at 35475-6.

[27] *Id.* at 35459.

dated acknowledgment that the customer has received and understood the statement.[28] The statement informs the customer of some of the risks inherent in futures trading and asks the customer to consider carefully whether it is in a financial position to take such risks. A retail customer trading on non-U.S. markets must be provided with additional disclosures concerning foreign markets, such as differences in the laws and regulations that may apply and the impact of foreign exchange rates. If disclosures are suitable in the foreign futures context, a market in which retail customers participate, there should be no reason why they cannot be employed as an effective customer protection tool in the context of the Exempt DCO Proposal, given that only eligible contract participants may participate in Foreign Swaps markets, and we submit that in the context of more sophisticated customers, no formal acknowledgement of the disclosure should be necessary. [29]

3.2 The U.S. Bankruptcy Code Extends to Swaps Cleared at Exempt Foreign DCOs

Swaps cleared on an exempt DCO should constitute "commodity contracts" under Subchapter IV and Part 190 and thus be afforded CFTC customer asset protection.

(a) "Commodity Contract" Includes Exempt DCO Swaps

Subchapter IV of Chapter 7 of the U.S. Bankruptcy Code (**Subchapter IV**) and the Part 190 bankruptcy regulations promulgated by the CFTC (**Part 190**), together, govern the bankruptcy and liquidation of FCMs. Subchapter IV and Part 190 generally afford a defaulted FCM's "customers" priority to the ratable distribution of the FCM's "customer property."

For purposes of this regime, a "customer" includes an "*entity for or with whom such futures commission merchant deals and that holds a claim against such futures commission merchant on account of a commodity contract made, received, acquired, or held by or through such futures commission merchant in the ordinary course of such futures commission merchant's business as a futures commission merchant from or for a commodity contract account of such entity*."[30] "Customer property" includes "*cash, a security, or other property, or proceeds of such cash, security, or property, received, acquired, or held by or for the account of the debtor, from or for the account of a customer[.]*"[31]

Both terms ultimately turn on the definition of "commodity contract" set forth in section 761(4) of the U.S. Bankruptcy Code, which provides that a "commodity contract" includes, among other things, "*any other contract, option, agreement, or transaction that is similar to a contract, option,*

[28] 17 CFR § 1.55.

[29] We are assuming that Foreign Swaps would, by definition, not be entered into on a board of trade designated as a contract market.

[30] 11 U.S.C. § 761(9).

[31] 11 U.S.C. § 761(10).

agreement, or transaction referred to in [the definition]" (the **Similar Transaction Prong**)[32] as well as "*with respect to a futures commission merchant or a clearing organization, any other contract, option, agreement, or transaction, in each case, that is cleared by a clearing organization.*" (the **Clearing Organization Prong**).[33]

Because a "clearing organization" is defined only as "*a derivatives clearing organization registered under the [CEA]*,"[34] swaps cleared on an exempt DCO (**Exempt DCO Swaps**) do not expressly constitute "commodity contracts" under the Clearing Organization Prong. But the analysis does not end there. There are numerous compelling reasons why Exempt DCO Swaps should constitute "commodity contracts" eligible for customer protection under Subchapter IV and Part 190.[35]

First, the Similar Transaction Prong has always been intended to ensure that the "commodity contract" definition is flexible enough to account for future changes in the derivatives markets without the need to further amend the statute.[36] And although the substance of the Similar Transaction Prong predates the Dodd-Frank Act and has been part of the U.S. Bankruptcy Code since at least 2005, it was retained and modified as part of the Dodd-Frank Act as part of the effort to establish the "Bankruptcy Treatment of Cleared Swaps."[37] Thus, Congress not only retained the

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[32] 11 U.S.C. § 761(4)(F)(i).

[33] 11 U.S.C. § 761(4)(F)(ii).

[34] 11 U.S.C. § 761(2).

[35] While we believe that under the Bankruptcy Code and the CEA these transactions already qualify as "commodity contracts" for the purposes of Subchapter IV and Part 190, the most effective way to resolve any ongoing ambiguity would be to make clarifying changes to the Bankruptcy Code.

[36] *See* H.R. Rep No. 109-31, Part 1, at 128 (2005) ("The definition of 'swap agreement' originally was intended to provide sufficient flexibility to avoid the need to amend the definition as the nature and uses of swap transactions matured. To that end, the phrase 'or any other similar agreement' was included in the definition. (The phrase 'or any similar agreement' has been added to the definitions of 'forward contract,' 'commodity contract,' 'repurchase agreement,' and 'securities contract' for the same reason.)").

[37] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 724(b), 124 Stat. 1376, 1684 (2010). This section provides, in pertinent part, that:

(b) BANKRUPTCY TREATMENT OF CLEARED SWAPS. —Section 761 of title 11, United States Code, is amended—

> *(1) in paragraph (4), by striking subparagraph (F) and inserting the following:*
>
> *"(F)(i) any other contract, option, agreement, or transaction that is similar to a contract, option, agreement, or transaction referred to in this paragraph; and*
>
> *"(ii) with respect to a futures commission merchant or a clearing organization, any other contract, option, agreement, or transaction, in each case, that is cleared by a clearing organization[.]"*

Similar Transaction Prong when revising the U.S. Bankruptcy Code to account for cleared swaps, but specifically amended and restated the language of the prong when doing so,[38] which shows that it intended for the prong to continue serving as a source of flexibility in the new regulatory landscape created by the Dodd-Frank Act. It also shows that Congress intended that Subchapter IV and Part 190 could cover more than just swaps cleared at a registered DCO, as those transactions would already be covered by the Clearing Organization Prong. The Similar Transaction Prong, as well as the fact that the Dodd-Frank Act more generally contemplates the clearing of swaps through non-registered DCOs, suggests that the Clearing Organization Prong was not intended to be preclusive. Indeed, the legislative history endorses a broad construction of the scope of cleared swaps under Subchapter IV and Part 190:

> In amending both the Commodity Exchange Act (CEA) and the Bankruptcy Code to clarify that cleared swaps are "commodity contracts," Section 724 makes explicit what had been left implicit under the Commodity Futures Modernization Act of 2000. Specifically, we have clarified that: 1) title 11, Chapter 7, Subchapter IV of the United States Bankruptcy Code applies to cleared swaps to the same extent that it applies to futures; and 2) the CFTC has the same authority under Section 20 of the CEA to interpret such provisions of the Bankruptcy Code with respect to cleared swaps as it has with respect to futures contracts.[39]

Given this, and the fact that Congress concurrently granted the CFTC the authority to exempt foreign DCOs that are subject to comparable regulation in their home jurisdictions – and by extension the authority to determine how swaps should be cleared – Exempt DCO Swaps should be considered sufficiently "similar" to a swap cleared through a registered DCO to qualify as a "commodity contract." Doing so would also be consistent with the express legislative intent of aligning the bankruptcy treatment of cleared swaps with that of futures contracts by ensuring that Subchapter IV and Part 190 apply to non-Exempt DCO Swaps and Exempt DCO Swaps to the same extent that they currently apply to "futures" and "foreign futures."

Second, the Dodd-Frank Act, in the same section, amended the CEA to provide that "*[a] swap cleared by or through a [DCO] shall be considered to be a commodity contract as such term is defined in Section 761 of [the U.S. Bankruptcy Code], with regard to all money, securities, and property of any swaps customer received by a [FCM] or a [DCO] to margin, guarantee, or secure the swap (including money, securities, or property accruing to the customer as the result of the*

While the heading of a statute cannot substitute for the text of the statute itself, it can be used to interpret the statute when, as here, the operative text is ambiguous. *Almendarez-Torres v. United States*, 523 U.S. 224, 234 (1998) ("'[T]he titles of a statute and the heading of a section' are 'tools available for the resolution of a doubt' about the meaning of a statute." (quoting *Bhd. of R.R. Trainmen v. Baltimore & Ohio R.R. Co.*, 331 U.S. 519, 529 (1947))).

[38] Prior to the Dodd Frank Act, section 761(4(F) of the U.S. Bankruptcy Code read "any other agreement or transaction that is similar to an agreement or transaction referred to in this paragraph." 11 U.S.C. § 761(4)(F) (2010).

[39] 156 Cong. Rec. S5902-01, 156 Cong. Rec. S5902-01, S5923 (July 15, 2010).

swap)."[40] Unlike the U.S. Bankruptcy Code amendments, this language in the CEA expressly references cleared swaps, and the relevant statutory definitions do not distinguish between registered and exempt DCOs.[41] Thus, the CEA provides an independent and clear basis to treat all swaps cleared by or through a DCO as "commodity contracts" for purposes of the U.S. Bankruptcy Code regardless of whether the DCO is registered or exempt. A narrow interpretation of "commodity contract" that excludes Exempt DCO Swaps would be inconsistent with this section of the CEA, and to the extent the two statutes could be in conflict, they should be construed harmoniously. In FIA's view, the most natural result that accommodates the text of both states is to construe "commodity contract" to include Exempt DCO Swaps. [42]

Third, the Dodd-Frank Act was intended to create a comprehensive scheme for the regulation of the U.S. swap markets and, to that end prescribes rules for, among other things: the clearing of swaps; the regulation of DCOs; the exemption of foreign DCOs only in circumstances where they are subject to comparable regulatory oversight; and disclosure, transparency, recordkeeping, net capital and reporting requirements for FCMs. Reading "commodity contract" to exclude Exempt DCO Swaps would undermine this scheme by denying U.S. customers who chose to clear on exempt DCOs the carefully crafted customer protections that come with clearing through an FCM, of which Subchapter IV and Part 190 form part. The only outcome consistent with the underlying policy of the statute is to interpret Subchapter IV and Part 190 as comprehensive and covering both domestic and Foreign Swaps cleared by an FCM.

In sum, there are strong textual grounds for concluding that Exempt DCO Swaps constitute "commodity contracts," and doing so would further the Dodd-Frank Act's underlying policies of customer protection and comprehensive oversight of cleared swaps.

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[40] 7 U.S.C. § 6d(f)(5).

[41] 7 U.S.C. § 1a(15)(A) provides that a "derivatives clearing organization" means "a clearinghouse, clearing association, , clearing corporation, or similar entity, facility, system, or organization that, with respect to an agreement, contract, or transaction—

(i) enables each party to the agreement, contract, or transaction to substitute, through novation or otherwise, the credit of the derivatives clearing organization for the credit of the parties;

(ii) arranges or provides, on a multilateral basis, for the settlement or netting of obligations resulting from such agreements, contracts, or transactions executed by participants in the derivatives clearing organization; or

(iii) otherwise provides clearing services or arrangements that mutualize or transfer among participants in the derivatives clearing organization the credit risk arising from such agreements, contracts, or transactions executed by the participants."

[42] *See Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1624, 200 L. Ed. 2d 889 (2018) ("When confronted with two Acts of Congress allegedly touching on the same topic, this Court is not at 'liberty to pick and choose among congressional enactments' and must instead strive 'to give effect to both.'") (quoting *Morton v. Mancari*, 417 U.S. 535, 551 (1974)).

(b) Treating Exempt DCO Swaps As "Commodity Contracts" Would Not Adversely Impact Foreign Swap Customers or Non-Foreign Swap Customers

Treating Exempt DCO Swaps as "commodity contracts" for purposes of Subchapter IV and Part 190 also would not adversely impact either the customers for whom such swaps are cleared (**Foreign Swap Customers**) or fellow customers of the FCM that do not clear Exempt DCO Swaps, whether such customers clear futures, foreign futures, cleared swaps, or physical commodity delivery transactions (**Non-Foreign Swap Customers**).

In the context of an FCM bankruptcy, treating Exempt DCO Swaps as "commodity contracts" would simply allow Foreign Swap Customers to benefit from the same protections to which customers are already generally entitled under Subchapter IV and Part 190. If Exempt DCO Swaps constitute "commodity contracts," (i) Foreign Swap Customers would constitute "customers" with priority to the ratable distribution of customer property over general unsecured creditors of the FCM, and (ii) property held from or for the account of Foreign Swap Customers by the FCM in respect of Exempt DCO Swaps would constitute "customer property" included in the pool of assets subject to such distribution.

To protect Foreign and Non-Foreign Swap Customers that only clear non-Exempt DCO Swaps, the CFTC should exercise its rulemaking authority to create separate account classes for Exempt DCO Swaps and non-Exempt DCO Swaps in a manner that, as appears to have been intended by Congress, parallels the existing account class structure for futures and foreign futures. Both the CEA[43] and the U.S. Bankruptcy Code[44] empower the CFTC to determine how net equity should be calculated in the bankruptcy of a commodity broker such as an FCM, and the CFTC has

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[43] 7 U.S.C. § 24. This section provides that "[n]otwithstanding [the U.S. Bankruptcy Code], the Commission may provide, with respect to a commodity broker that is a debtor under chapter 7 of [the U.S. Bankruptcy Code], by rule or regulation—

(1) that certain cash, securities, other property, or commodity contracts are to be included in or excluded from customer property or member property;

(2) that certain cash, securities, other property, or commodity contracts are to be specifically identifiable to a particular customer in a specific capacity;

(3) the method by which the business of such commodity broker is to be conducted or liquidated after the date of the filing of the petition under such chapter, including the payment and allocation of margin with respect to commodity contracts not specifically identifiable to a particular customer pending their orderly liquidation;

(4) any persons to which customer property and commodity contracts may be transferred under section 766 of title 11; and

(5) how the net equity of a customer is to be determined."

[44] 11 U.S.C. § 761(17).

previously exercised this authority to create separate account classes for "delivery accounts" [45] and "cleared swaps" even though neither is expressly enumerated as a type of "commodity contract" under Subchapter IV.[46] Given the authority to create an account class for cleared swaps, further dividing the cleared swaps account class into separate account classes for swaps cleared on registered and exempt DCOs, coupled with appropriate pre-bankruptcy protections, would be well within the CFTC's authority and would ensure protections for both Foreign Swap Customers and Non-Foreign Swap Customers. Such account classes would be supported by the creation of separate segregation regime for Exempt DCO Swaps that parallels the foreign futures regime under 30.7, as recommended in Section 3.3(d) below.

Further, Part 190 already has a structure in place for mitigating the risk of cross-contamination between product types. Customer claims and property are allocated to separate account classes on the basis of product type and each distinct account class is treated as a separate estate subject to its own ratable distribution of customer property.[47] Even if the CFTC did not create separate account classes for Exempt DCO Swaps and non-Exempt DCO Swaps as suggested above, Exempt DCO Swaps would by default belong to the cleared swaps account class. While the claims of Foreign Swap Customers in the cleared swaps account class would in that scenario be pooled with claims on account of non-Exempt DCO Swaps, they should not impair customer recoveries in other account classes such as the futures or foreign futures account class.[48]

3.3 The Commission Should Model the Clearing of Foreign Swaps on The Part 30 Regime for Foreign Futures

Instead of the proposed exempt DCO model that would prohibit U.S. customers from clearing through an FCM, FIA believes strongly that the Commission should model the clearing of Foreign Swaps on certain features of its rules applicable to the clearing of foreign futures.

(a) Reverse Omnibus Clearing and Direct Clearing and Their Attendant Disclosure and Segregation Requirements

In the foreign futures context, two clearing structures have developed: Reverse Omnibus Clearing and Direct Clearing. Under the first structure, U.S. customers may clear under an omnibus clearing structure, whereby the U.S. customer clears through an FCM that maintains the U.S. customer's

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[45] Commodity Futures Trading Commission, Bankruptcy, Final Rules, 48 FR 41, 8716 (Mar. 1, 1983) (creating "delivery accounts" class on basis of "[t]he Commission's broad authority with respect to deliveries" under 7 U.S.C. § 24).

[46] Commodity Futures Trading Commission, Account Class, Final Rules, 75 FR 17297 (Apr. 6, 2010).

[47] 17 C.F.R. § 190.08.

[48] If, *arguendo*, Exempt DCO Swaps are not "commodity contracts" and Foreign Swap Customers are not "customers," the account class question is less relevant because claims arising from such transactions would not have any priority to the distribution of customer property that competes with the claims of Non-Foreign Swap Customers. FCMs that clear Exempt DCO Swaps would continue to be subject to CFTC oversight and all the protections that entails, in particular if the CFTC were to build a regime for Exempt DCO Swaps that parallels the foreign futures regime under 30.7, as recommended in Section 3.3.

positions and margin with a non-U.S. clearing member that is not registered as an FCM (**Reverse Omnibus Clearing**). CFTC Regulation 30.4(a) permits a foreign futures and options broker not to be registered as an FCM in respect of foreign futures or options activities with U.S. customers as long as such broker only accepts orders from or carries, among others, foreign futures and options customer omnibus accounts of a U.S. FCM. Alternatively, under the second structure, pursuant to CFTC Regulation 30.10, a U.S. customer may clear Foreign Swaps on a non-U.S. DCO by directly facing a foreign entity that is not a Commission-registered FCM, but which has obtained an exemption from registration (**Direct Clearing**) based on an affirmative determination of comparability. In connection with these two clearing structures, Part 30 includes disclosure and segregation requirements designed to address the risks and issues presented by U.S. customers interacting with a non-U.S. clearing member that is not registered as an FCM.

The Exempt DCO Proposal appears modelled on 30.10 in that it permits clearing directly through a foreign intermediary, but it does so without the attendant customer protections. It should be rewritten to provide that the CFTC should diligence whether the foreign intermediary is subject to a comparable regulatory regime in its home jurisdiction. The standard applied when the CFTC considers whether to grant a DCO an exemption from registration is a determination of whether the DCO is subject to a comparable regulatory regime as that of the CFTC; this should be the standard applied when exempting foreign firms from FCM registration. Otherwise, diligence and customer protection has been wholly replaced with disclosure.

(b) Reverse Omnibus Clearing Affords U.S. Customers Greater Choice and Allows Them to Take Advantage of Requirements Incumbent on FCMs

Reverse Omnibus Clearing affords U.S. customers a greater range of FCMs through which they can clear abroad because the structure does not require U.S. customers to clear through an FCM that is a direct member of every non-U.S. DCO through which the customer wishes to transact. At the same time, U.S. customers would benefit from the direct protection of the CEA's customer property segregation rules. As discussed in section 3 of this letter, there are benefits for a U.S. customer in interacting with an entity that is subject to the Commission's disclosure, transparency, recordkeeping, net capital and reporting requirements.

(c) FCMs Are Subject to An Enhanced Framework to Which Foreign Intermediaries Are Not Subject

In its November 2013 rulemaking (**Enhanced Customer Asset Protection Rules**), the Commission enhanced customer protections, risk management programs, internal monitoring and controls, capital and liquidity standards, customer disclosures, and auditing and examination programs for FCMs. The purpose of these enhancements[49] was to afford greater assurances to market participants that customer segregated funds, secured amount funds, and cleared swaps funds are protected; customers are provided with appropriate notice of the risks of futures trading and of the FCMs with which they may choose to do business; FCMs are monitoring and managing

[49] Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations; Final Rule, 78 Fed. Reg. 68506, 68506 (Nov. 14, 2013).

risks in a robust manner; the capital and liquidity of FCMs are strengthened to safeguard their continued operations; and the auditing and examination programs of the Commission and the self-regulatory organizations are monitoring the activities of FCMs in a prudent and thorough manner.

As a result of these enhancements, FCMs are subject to a number of specific requirements.[50] For example, FCMs are required to:

(a) deposit proprietary funds (i.e., residual interest) into futures and cleared swap customer segregated accounts as well as foreign futures and options accounts (30.7 accounts), for purposes of creating a buffer to ensure compliance with segregation requirements;

(b) comply with safeguards concerning withdrawals of residual interest from segregated accounts for futures customers;

(c) limit the extent of Rule 30.7 customer funds held outside the U.S.;[51]

(d) file electronically their segregation calculation with the Commission and their self-regulatory organization each business day;

(e) hold sufficient funds in 30.7 accounts to satisfy the net liquidating equity method (requiring each FCM to hold an amount of funds in segregation sufficient to meet the total account equities of all of the FCM's futures customers and cleared swaps customers) rather than the alternative method (requiring FCMs to maintain an amount of funds sufficient to cover only the margin required on open foreign futures contracts, adjusted by unrealized gains or losses on the open positions and any premiums payable or received on foreign options)

(f) establish a risk management program designed to monitor and manage risks associated with customer funds;[52] and

(g) under amended CFTC Regulation 1.20, conduct due diligence, at least annually, of each of the depositories in which they deposit customer funds.

The Enhanced Customer Asset Protection Rules also increased the amount of information to be disclosed by the FCM in its risk disclosure statement. The CFTC therefore has at its disposal a tried, tested, and enhanced framework that it should leverage in respect of Foreign Swaps. Instead, the Exempt DCO Proposal would have the effect of denying U.S. customers these enhanced customer asset protection benefits.

[50] *See* discussion above of CFTC Regulation 30.7(f) and CFTC Regulation 30.7(c).

[51] *See* CFTC Regulation 30.7(c); *see, also* CFTC Letter No. 14-138 (Nov. 13, 2014).

[52] CFTC Regulation 1.11.

(d) The Commission Should Publish Rules for Foreign Swaps Modelled on Foreign Futures

The foreign futures regime is expressly contemplated by section 4(b)(2) of the Commodity Exchange Act, which authorizes the Commission to adopt rules and regulations requiring the "safeguarding of customers' funds" by any person located inside the United States who engages in the offer or sale of a futures contract made on or subject to the rules of a board of trade, exchange, or market located outside the United States. Although a Foreign Swaps regime is not similarly expressly contemplated, section 2d(f)(2) of the Commodity Exchange Act imposes safeguarding requirements in relation to customer funds "received to margin, guarantee, or secure a swap cleared by or through a derivatives clearing organization" without reference to whether such derivatives organization is registered or exempt, and the creation of rules to implement this general mandate would be well within the Commission's authority. Thusly, the Commission may use its authority pursuant to section 2(a)(1)(A) of the CEA, or take such other action as it deems appropriate, to:

(a) create a separate Foreign Swaps account class under Part 190 to ensure that customer claims and property in relation to Foreign Swaps and domestic swaps will be subject to separate treatment in a bankruptcy of an FCM under Subchapter IV and Part 190;

(b) provide that a Foreign Swaps broker shall not be required to register as an FCM:

    (1) in order to accept orders from or to carry an FCM's Foreign Swaps customer omnibus account;

    (2) in order to accept orders from or to carry an FCM's proprietary account;

    (3) in order to accept orders from or carry a U.S. affiliate account which is proprietary to the Foreign Swaps broker; or

    (4) as proposed under the Exempt DCO Proposal, in order to accept funds from a U.S. customer in order to clear swap transactions at an exempt DCO, provided that the Commission has determined that such Foreign Swaps broker is subject to a comparable regulatory regime in its home jurisdiction[53];

(c) provide that no FCM may open a Foreign Swaps account for a Foreign Swaps customer unless the FCM first furnishes the customer with a written disclosure statement modeled on that provided in the futures context, but that extends to set

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[53] As would be in the case in respect of indirect clearing of foreign futures pursuant to CFTC Regulation 30.10. In assessing comparability, the CFTC reviews whether the home country regulatory regime includes the following minimum elements: (1) registration, authorization or other form of licensing, fitness review or qualification of persons through which customer orders are solicited and accepted; (2) minimum financial requirements for those persons that accept customer funds; (3) protection of customer funds from misapplication; (4) recordkeeping and reporting requirements; (5) minimum sales practice standards, including disclosure of the risks of futures and options transactions and, in particular, the risk of transactions undertaken outside the jurisdiction of domestic law; (6) compliance audits; and (7) information sharing arrangements. Part 30, Appendix A, Interpretive Statement with Respect to the [CFTC's] Exemptive Authority Under [CFTC Regulation 30.10].

out any perceived ambiguities surrounding protection of customer funds upon an insolvency of the FCM;

(d) require an FCM to maintain in a separate account or accounts money, securities and property in an amount at least sufficient to cover or satisfy all of its obligations to Foreign Swaps customers or foreign-domiciled persons who trade in Foreign Swaps through an FCM (together, **Relevant Swaps Customers**) (the **Foreign Swaps Secured Amount**);

(e) limit the depositories with whom the Foreign Swaps Secured Amount may be deposited as is the case with 30.7 customer funds;

(f) limit the holding of the Foreign Swaps Secured Amount outside the U.S. except to meet margin requirements established by rule, regulation, or order of foreign boards of trade or foreign clearing organizations, or to meet margin calls issued by foreign brokers carrying the Relevant Swaps Customers' Foreign Swaps positions (with a 20% buffer permitted as is the case in the foreign futures context); and

(g) prohibit the FCM from opting out of any customer asset protections that are available under the laws and regulations of the foreign jurisdiction[54].

These protections would be more than sufficient for clearing at an exempt DCO through an FCM and in fact would offer protections not available when clearing directly through a foreign intermediary. Moreover, it would have the added benefit of preserving customer choice, which we submit is essential to accomplishing the Commission's goal of mitigating market fragmentation.

We acknowledge that the use of a Part 30 style regime depends on U.S. Bankruptcy Code protection for customers of the FCM. But the Commission's uncertainty does not warrant potentially putting U.S. customers in a worse position than if they had cleared through an FCM.

We acknowledge that adopting this approach will require significant work from Commission staff. We offer our assistance in any capacity in order to help the Commission conduct the legal, operational, and feasibility due diligence necessary to implement our recommendations.

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[54] We propose this prohibition in lieu of the "greatest degree of protection" standard under CFTC Regulation 307(c), since that standard has proven overly burdensome in the futures context. Assessing which laws and regulations would satisfy the greatest degree of protection is an overly difficult task. The CFTC has acknowledged the need to depart from the standard in giving no-action relief (see CFTC No-Action letter 16-88). Instead, given that only eligible contract participants may participate in Foreign Swaps markets, the same standard as in foreign futures need not be adopted, and instead, sophisticated customers should be able to make an informed decision.

4. It Is Not Viable To Have An FCM Act As A "Special Member" of a DCO And Its Non-FCM Affiliate Act as a "Traditional" Member That Guarantees the FCM's Obligations To The DCO

We note that the Commission requested comment as to whether an approach would be viable whereby an FCM would participate as a "special member" of a DCO, and its non-FCM affiliate, acting as a "traditional" member, would guarantee the FCM's obligations to the DCO. All customer funds would flow directly from the FCM to the registered DCO, *i.e.*, they would *not* pass through the non-FCM affiliate. We would not advocate for such an approach other than perhaps permitting an alternative for those who are uniquely placed to avail themselves of such a structure. We note that clearinghouses have proposed similar structures in the past and gained limited to no traction.[55] Banking organizations will face difficulties and regulatory challenges in issuing guarantees in favor of affiliate obligations.[56] This model is also likely to penalize smaller FCMs who will not be able to call on affiliates to issue the necessary guarantees. The model also may not solve the issue of the prohibitive cost to FCMs of facing numerous foreign DCOs. Further, there is of course no way to ensure that such a model is offered by a DCO and therefore it is an unreliable way of including FCMs within the Exempt DCO Proposal.

By contrast, a regime modeled on foreign futures, as described above in section 3.3, will respect customer choice, would enable FCMs to take advantage of the efficiencies of omnibus account structures, and would allow customers to benefit from the enhanced regulatory framework incumbent upon FCMs.

5. The Substantial Risk To The U.S. Financial System Test Creates Uncertainty and Is Overly Broad

We reiterate our support for a principled test that looks at the extraterritorial character of activity by the non-U.S. DCO and the extent to which that activity poses a risk to the U.S. financial system and welcome the increased deference to home country regulation.

The proposed "Substantial Risk" test includes two prongs: the first, the "systemic" prong, is intended to measure whether the exempt or registered non-U.S. DCO is significant in serving U.S.

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[55] CME Group proposed a category of clearing membership, termed a "Direct Funding Participant (**DFP**)." The DFP could clear all of its own CME Group trades directly with the CME clearinghouse but would not be obligated to contribute to CME Group's guaranty fund or otherwise be responsible in case of a default by another clearing member. Instead, all of a DFP's obligations would be guaranteed by another CME Group clearing member – termed a "DFP Guarantor" – that was registered with the CFTC as an FCM. This proposal was ultimately withdrawn. ICE Clear Europe offers a model known as "Individual Segregation through Sponsored Principal Account." Under this model, customers of clearing members may elect to become a direct counterparty of the clearinghouse in connection with their transactions. Under this arrangement, a customer, known as the "sponsored principal," maintains a separate account at ICE Clear Europe, as joint tenant with its clearing member broker, known as the "sponsor," and is jointly liable with its sponsor for all positions in such account.

[56] Sections 23A and 23B of the Federal Reserve Act and Regulation W (12 CFR 223) effectively limit a bank and its subsidiaries from guaranteeing non-bank affiliates. Broker dealers may also face capital obstacles in granting guarantees. In addition, institutions often have strict internal guidelines that limit the granting of guarantees.

clearing members (including those organized in the United States or whose ultimate parent company is organized in the United States, or an FCM), and the second, a "comity" prong, would focus on a non-U.S. DCO 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. The specific test provides that (1) the exempt or registered 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; *and* (2) 20 percent or more of the initial margin requirements for swaps at that DCO is attributable to U.S. clearing members. Although the test is drafted in a way that suggests that both prongs must be satisfied, where one or both of these thresholds are close to 20%, the Commission has reserved discretion to determine that the DCO poses substantial risk to the U.S. financial system. If the Commission can exercise its discretion even when a DCO is approaching satisfaction of only one limb of the test, there is no clarity or certainty regarding whether any particular DCO may satisfy the test.

5.1 The Test Should Exclude Non-U.S. Affiliates and Limit Initial Margin to That Posted in Relation to U.S. Customers

For purposes of the "substantial risk" test, a non-U.S. clearing member whose parent company is organized in the U.S. should be excluded from this definition. Affiliates with parent companies in the U.S. constitute significant participants in the four currently exempt DCOs. It is not clear why all trades cleared by such a clearing member would be considered to pose risk to the U.S. financial system.

5.2 The "Substantial Risk" Test Affords the CFTC Too Much Discretion and Creates Uncertainty

If the Commission reserves broad discretion to deem a DCO to pose substantial risk to the U.S. financial system, there is a risk that a DCO that approaches 20% in respect of only one prong may be reluctant to admit new clearing members that are part of a U.S. group because it may lead to it being unable to offer clearing to U.S. customers. This risk is most acute with respect to the "comity" prong, which potentially brings within its ambit relatively small non-U.S. DCOs solely because they facilitate cleared swaps that have attracted U.S. interest, without regard to whether requiring registration and compliance with the DCO Standards would prove overly burdensome or to the overall size of the DCO creates systemic risk. We submit that discretion should only be exercisable where 20% is approached under the systemic prong. The discretion should, at the least, be subject to some parameters so as to create more transparency and clarity. For example, the Commission should set out what factors it will consider in determining whether a substantial risk is posed. The Commission should also clarify how it will deal with grandfathering existing Exempt DCOs. Without further guidance, the application of the test could create uncertainty for those who may already clear at the relevant DCO.

5.3 The Commission Must Clarify How Changes to The List of DCOs Posing A Substantial Risk Will Be Dealt with In Practice

The status determination that a non-U.S. DCO poses "substantial risk" is also unclear. Because the test is applied on an ongoing basis, the Commission should commit to publishing a list of exempt and alternative compliance non-U.S. DCOs that pose a substantial risk to the U.S. financial system, which should be updated as soon as reasonably practicable after a change in the constituents of the list. This is vital because the ability of a U.S. customer to clear at the relevant DCO under the Proposals will turn on its status under the test. There should be a formal process for addition of a DCO to the list.[57] The frequency of application of the test should also be made clear. This should not be overly frequent, in order to avoid DCOs oscillating between being on and off the list. The Commission should consider and make clear what is expected to occur upon a DCO at which U.S. customers clear joining the list. An appropriate timeframe for the orderly transfer or close out of any accounts held by U.S. customers impacted by the change will be necessary. It is vital that clearing members be given ample notice of a proposed determination by the Commission together with the basis for such determination. The DCO, foreign regulator, and if practicable, other interested parties, should be given the opportunity to provide feedback to the Commission and the DCO should be given a grace period during which time it can attempt to drop under the relevant thresholds.

Market participants' business practices will assume that an exempt or registered DCO that does not currently pose a substantial risk to the U.S. financial system will continue to be able to facilitate U.S. customer clearing. Firms will be better positioned to plan for, and potentially mitigate, the business and market disruptions that could result from such DCO's addition to the list if they have notice of the Commission's intention. We defer to the Commission on the most efficient means to give affected market participants notice and an opportunity to respond to its intention. Given that a determination that a DCO poses substantial risk to the U.S. financial system could lead to market fragmentation and harm U.S. customers, the Commission should exercise its discretion only when there is a compelling need to do so in order to protect U.S. customers.

6. THE COMMISSION SHOULD PAUSE AND CONSIDER POTENTIAL ISSUES BEFORE PERMITTING NON-U.S. CUSTOMERS TO CLEAR FUTURES AND SWAPS THROUGH NON-FCMS AT U.S. REGISTERED DCOS

The Commission requested comment on whether it should permit non-U.S. customers to clear futures and swaps through non-FCMs at U.S. registered DCOs. We would recommend that the Commission, to the extent it has not already done so, considers whether this proposal would have a tangible positive effect and for example, whether local intermediaries actually wish to become subject to indirect regulation by the Commission by virtue of becoming members of U.S. registered DCOs. We believe that the Commission's current proposal relating to U.S. customer access to non-U.S. DCOs, which would address a demonstrated and pressing need and in respect of which much of the complex analysis has been done, merits the Commission's immediate attention with a view to urgent implementation.

[57] Many of the considerations relevant here are the similar to those outlined in FIA's August 5, 2019 comment letter on the Commission's notice of proposed rulemaking on "Foreign Futures and Options Transactions" (84 Fed. Reg. 32105 (July 5, 2019)).

7. NECESSARY CLARIFICATIONS

7.1 The Commission Should Clarify That A Non-U.S. Clearing Organization Clearing Swaps Does Not Trigger Registration as A DCO Solely Because It Permits Participation (Direct or Indirect) By Foreign Branches of U.S. Bank Swap Dealers

We note that the Commission requested comment as to whether it should clarify that a non-U.S. clearing organization clearing swaps does not trigger registration as a DCO solely because it permits participation (direct or indirect) by foreign branches of U.S. bank swap dealers, on the basis that such participation does not involve any U.S. jurisdictional nexus for the CCP. We believe the Commission should so clarify, and we express our support for the position taken on this matter by SIFMA in its comment letter on the Proposals.

7.2 Alternative Compliance DCO Proposal Should Have No Impact on Comparability Determination

We request that the Commission confirm that the Commission's March 22, 2016 comparability determination[58] remains in place and is not replaced or amended in any way by the Alternative Compliance DCO Proposal and market participants may continue to rely on such comparability determination.

8. CONCLUSION

As the Commission considers comments on its Proposals, we urge the CFTC to consider the full range of potential access models by reference to its historically successful and multifaceted approach to foreign futures. The professional nature of the swaps market, with its sophisticated, institutional market participants should be offered the commercial choice of access routes. Only then will the Commission accomplish its core objectives in the Proposals.

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We appreciate your consideration of our comments on this important issue. Please contact me at jmesa@fia.org or 202-772-3040 if you have any questions about this letter.

Respectfully submitted,

Jackie Mesa

Chief Operating Officer and Senior Vice President of Global Policy

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[58] Comparability Determination for the European Union: Dually Registered Derivatives Clearing Organizations and Central Counterparties, 81 Fed. Reg. 55, 15260 (Mar. 22, 2016).

cc: Honorable Dr. Heath P. Tarbert, Chairman
Honorable Brian D. Quintenz, Commissioner
Honorable Rostin Behnam, Commissioner
Honorable Dan M. Berkovitz, Commissioner
Malcolm Clark Hutchison III, Director, Division of Clearing and Risk
Sarah Josephson, Deputy Director, Division of Clearing and Risk