

March 3, 2020

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

Re: Capital Requirements of Swap Dealers and Major Swap Participants (RIN 3038–AD54)

Dear Mr. Kirkpatrick:

Citadel Securities appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the “Commission”) following the re-opening of the comment period on the proposal to establish capital requirements for swap dealers that are not subject to prudential supervision (the “2016 Proposal”).¹

We strongly support the continued efforts of the Commission to promote the safety, stability, and integrity of OTC derivatives markets. Given that the Securities and Exchange Commission (“SEC”) recently finalized its capital requirements for security-based swap dealers (the “SEC final rule”),² it is appropriate for the Commission to solicit additional feedback from market participants and to harmonize these requirements to the extent possible. Below, we provide several recommendations.

I. Harmonization with SEC Capital Requirements

We recommend that the Commission harmonize capital requirements with the SEC to the extent possible, as many entities are expected to register with both the Commission and the SEC as swap dealers and security-based swap dealers, respectively. Greater harmonization will improve market functioning and promote liquidity provision by ensuring that liquidity providers are not subject to overlapping or conflicting requirements. In particular, we recommend that the Commission modify its 2016 Proposal³ to harmonize with the SEC final rule in the following two key areas:

- 1. Minimum Capital Requirements - Scope of Covered Instruments.** To the extent the Commission adopts a minimum capital requirement based on initial margin amounts, it should exclude futures and cleared OTC derivatives held in a proprietary account from this calculation.

¹ 84 Fed. Reg. 69664 (Dec. 19, 2019), available at: <https://www.cftc.gov/sites/default/files/2019/12/2019-27116a.pdf> (“Request for Additional Comment”).

² 84 Fed. Reg. 43872 (Aug. 22, 2019), available at: <https://www.govinfo.gov/content/pkg/FR-2019-08-22/pdf/2019-13609.pdf>.

³ 81 Fed. Reg. 91252 (Dec. 16, 2016), available at: <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2016-29368a.pdf>.

This modification would be consistent with both (a) current FCM capital requirements and (b) the SEC final rule. In addition, it reflects the statutory objectives of promoting central clearing and focusing on uncleared swaps when setting capital requirements.⁴ Finally, we note that this modification would address some, but not all, of the double-counting concerns raised with respect to how minimum capital requirements are calculated under the net liquid assets approach,⁵ as cleared proprietary positions are already subject to market risk and credit risk charges.

- 2. Standardized Market Risk Charges.** Both the 2016 Proposal and the SEC final rule appropriately calculate standardized market risk charges for cleared OTC derivatives based on the initial margin requirements of the relevant derivatives clearing organization (“DCO”).

However, the 2016 Proposal penalizes swap dealers that are not self-clearing members by applying a 150% multiplier to these initial margin amounts.⁶ We recommend that the Commission harmonize with the SEC final rule and remove this penalty on swap dealers that are not self-clearing members. All cleared OTC derivatives positions are secured by initial margin posted by the swap dealer and benefit equally from the risk management and default management frameworks of the DCO. It should therefore be sufficient for all swap dealers to take a market risk charge equal to the DCO’s initial margin requirement. Otherwise, smaller swap dealers, which are less likely to be self-clearing members, will disproportionately be subject to higher market risk charges for identical positions.

In addition, we recommend that the Commission harmonize with the SEC final rule with respect to netting. When calculating capital requirements, swap dealers should be able to take into account risk mitigating hedging transactions that partially or fully offset the market risk of a particular position.

II. Recalibrating Standardized Market Risk Charges for FX NDFs

The 2016 Proposal applies a 20% notional standardized market risk charge to uncleared FX NDFs.⁷ We recommend that the Commission better calibrate this charge in line with the volatility and liquidity conditions in relevant currency pairs. Further, we note the disparity between the proposed 20% notional charge and the Commission’s final rule on uncleared margin requirements, which applied a 6% notional charge to all uncleared FX derivatives in the standardized initial margin schedule.

⁴ Commodity Exchange Act (“CEA”) section 4s(e)(3)(A).

⁵ Request for Additional Comment at 69667.

⁶ 2016 Proposal at 91306 (§1.17(c)(5)(x)(B)).

⁷ 2016 Proposal, §1.17(c)(5)(iii)(C)(ii).

III. Maintaining a Level Competitive Playing Field Among Swap Dealers

As the Commission finalizes its capital rules for swap dealers, we recommend that focus remain on ensuring a level competitive playing field. For example, swap dealers choosing the net liquid assets approach should not be at a competitive disadvantage compared to swap dealers choosing the bank-based approach, and *vice versa*. In addition, the Commission should adopt a compliance schedule that provides sufficient time for all swap dealers to obtain approval of an internal model as necessary. In doing so, the compliance schedule should take into account the fact that some swap dealers may already be using models approved by other regulators, while other swap dealers may be seeking model approval for the first time through a process that will be new for both the Commission and market participants.

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We appreciate the opportunity to provide comments on the Commission's capital rules for swap dealers. Please feel free to call the undersigned at (646) 403-8200 with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger

Managing Director

Global Head of Government & Regulatory Policy