

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
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- **17 CFR Part 39**
- **RIN Number 3038-AF39**
- **Protection of Clearing Member Funds Held by Derivatives Clearing Organizations**

Dear Mr. Kirkpatrick.

Thank you very much for giving us the opportunity to comment on your notice of proposed rulemaking on Protection of Clearing Member Funds Held by Derivatives Clearing Organizations.

The Commodity Futures Trading Commission (CFTC) is proposing regulations to ensure clearing member funds and assets receive the proper treatment in the event the Derivatives Clearing Organization (DCO) enters bankruptcy by requiring, among other things, that clearing member funds be segregated from the DCO's own funds and held in a depository that acknowledges in writing that the funds belong to clearing members, not the DCO. In addition, the CFTC is proposing to permit DCOs to hold customer and clearing member funds at foreign central banks subject to certain requirements. Finally, the CFTC is proposing to require DCOs to conduct a daily calculation and reconciliation of the amount of funds owed to customers and clearing members and the amount actually held for customers and clearing members.

I support that the CFTC is proposing safeguards for proprietary funds to provide protections for clearing members comparable to those applicable to customers as, in the event of a DCO bankruptcy, the existing regulatory regime would protect customer funds but not clearing member funds. The current proposals would certainly protect proprietary funds from misuse

and ensure that the funds would be available when needed by clearing members. This will further enhance risk management practices, reduce operational risk, and improve overall confidence in clearing.

However, the consideration of costs is not entirely complete (e.g. “The total cost of this regulation will depend on a number of factors including the number of clearing members of the DCO and what, if any, investments the DCO currently makes with proprietary funds”, “any initial and recurring compliance costs for any particular DCO will depend on the size, existing infrastructure, level of clearing activity, practices, and cost structure of the DCO”, and “The exact costs will depend on a number of factors including how many accounts a DCO maintains for proprietary funds”¹). The consideration of costs does not really quantify the opportunity costs of change of business, risk management, and investment model, which may be material.

By publishing this notice of proposed rulemaking, the CFTC will surely motivate discussion and raise awareness of the perceived gap in its regulations regarding the stronger protections for funds that belong to customers of a futures commissions merchant than for funds belonging to clearing members of a DCO. This is a positive step, but it is not clear to me that the current proposals are sufficient or complete enough to fully address this and related issues. Therefore, for completeness, I would suggest that it would be useful if the CFTC would consider a wider range of options to address this issue, and consider more broadly the implications and impact on markets of emerging market practices and business models, such as “direct-to-retail” or disintermediated market structures.² A holistic consideration may be preferable to a piecemeal approach.

Yours sincerely

C.R.B.

Chris Barnard

¹ See Cost-Benefit Considerations, notice of proposed rulemaking.

² In its Report on Digital Asset Financial Stability Risks and Regulation, the Financial Stability Oversight Council (FSOC) specifically recommended that “member agencies assess the impact of vertical integration (i.e., direct access to markets by retail customers) on conflicts of interest and market volatility, and whether vertically integrated market structures can or should be accommodated under existing laws and regulations”. See Report on Digital Asset Financial Stability Risks and Regulation, Financial Stability Oversight Council, October 2022. Available at: <https://home.treasury.gov/system/files/261/FSOC-Digital-Assets-Report-2022.pdf>