



June 3, 2011

Via Electronic Submission: <http://comments.cftc.gov>

David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Notice of Proposed Rulemaking on Requirements for Processing, Clearing, and Transfer of Customer Positions (RIN No. 3038-AC98)

Dear Mr. Stawick:

Citadel LLC¹ (“*Citadel*”) appreciates this opportunity to voice its support for and provide comments on the Commodity Futures Trading Commission (the “*Commission*”) notice of proposed rulemaking on “Requirements for Processing, Clearing, and Transfer of Customer Positions”² (the “*Proposed Rules*”) under the Dodd-Frank Wall Street Reform and Consumer Protection Act.³ We are convinced that a sound, transparent and efficient clearing model is the foundation of effective reform of the over-the-counter derivatives markets. We strongly support the Commission’s actions to promote real-time disposition of transactions for clearing, uniform derivatives clearing organization (“*DCO*”) transaction submission standards, portability of customer positions and expanded participant eligibility. We submit that certain clarifications of the Proposed Rules by the Commission in its promulgation of final rules in this area will ensure that a robust clearing framework is achieved, without loopholes that could undermine support for open, transparent, competitive markets. We offer our suggestions for such clarifications below.

I. Real-Time Disposition for Clearing

Citadel strongly supports required real-time clearing disposition of cleared OTC derivatives (i.e. immediate decision by the DCO and relevant clearing member or clearing members as to whether a specific transaction is accepted or rejected for clearing). We believe

¹ Established in 1990, Citadel is a leading global financial institution that provides asset management, investment banking, institutional sales & trading, and market making services. With over 1,200 employees globally, Citadel serves a diversified client base through its offices in the world’s major financial centers including Chicago, New York, London, Hong Kong, San Francisco and Boston.

² 76 Fed. Reg. 13101 (Mar. 10, 2011) (the “*Proposing Release*”).

³ Pub. L. 111-203, 124 Stat. 1376 (2010).



this is essential to a broad, mandatory clearing system and electronic trading.⁴ We believe that real-time clearing disposition renders a number of benefits, including:

- (A) supporting optimal risk management by allowing market participants to hedge more efficiently, including when a trade may be part of a participant's larger strategy involving related or offsetting trades;
- (B) giving immediate certainty to counterparties that they will face the DCO, thus eliminating risk of bilateral counterparty credit risk exposure and the need to individually negotiate bilateral credit arrangements with each counterparty;⁵
- (C) allowing for anonymity between clearing members and the execution counterparties of their customers, because once a trade is cleared and the clearing member faces only its customer and the DCO, it is unnecessary for the clearing member to know the identity of such customer's counterparty. This will in turn allow customers to transact with competing price providers⁶;
- (D) in light of (B) and (C) above, promoting competitive markets, new sources of liquidity and open access to best execution; and
- (E) encouraging the development of swap execution facilities ("SEFs") and eliminating critical operational and legal barriers to the evolution of central limit order book trading on SEFs.

⁴ Under proposed §39.12(b)(7), DCOs would be required to comply with specified timeframes for processing and clearing contracts, agreements and transactions. Such timeframes would vary depending on the execution method used and whether or not the trade is subject to mandatory clearing.

⁵ We see the lack of a need for such documentation as one of the most significant systemic benefits of clearing, as it allows participants to transact with any competitive, eligible counterparty without the need for extensive documentation and credit or guarantee arrangements, thus eliminating barriers to entry for new eligible participants in a market. For further explanation, please see the comment letter to the Commission on the Proposing Release dated April 11, 2011 from the Managed Funds Association ("MFA"), of which Citadel is a member, available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=35520&SearchText=>, in which MFA argues that real-time acceptance for clearing eliminates the need for credit arrangements between transacting counterparties because given real-time acceptance for clearing, such counterparties immediately face the DCO, not one another.

⁶ Removal of anonymity would give clearing members an advantage over competing executing dealers because the clearing member could utilize that knowledge to restrict a customer's range of execution counterparties, or position its affiliated trading desk to the customer in a preferential manner, and thus damage open access to available execution and fair competition in the market.



To maximize realization of these benefits of real-time disposition for clearing, we recommend the Commission make the following clarifications or minor corrections in the final rules:

- (A) Adoption by DCOs of real-time disposition for clearing to all trades submitted for clearing, regardless of execution mode and regardless of whether the trade is subject to mandatory clearing: The Commission should require DCOs to immediately process for acceptance or rejection all trades submitted for clearing, regardless of the execution method used or whether or not the trade is subject to mandatory clearing, so long as the DCO receives a matched trade submission according to reasonable, standardized, non-discriminatory messaging requirements.⁷ We are aware of no justification for distinctions in clearing timeframes, whereas such distinctions will undermine the Commission's goal of encouraging clearing: delay in processing swaps not subject to mandatory clearing will deter parties from clearing them, and thus, slow the progressive expansion of the product set and volumes of cleared trades;
- (B) Prohibition on dealer or clearing member requirements that block best execution and real-time disposition: The Commission should make clear in the adopting release that the absence of a documentation or trade guarantee requirement reflects the Commission's intention that such arrangements should not be a precondition to clearing, as is the case in other cleared markets supervised by the Commission;⁸
- (C) Requirement for real-time disposition of cleared trades by *clearing members* as well as DCOs: The Commission should make explicit the requirement already implicit in the Proposed Rules' real-time disposition requirement that a clearing member must, through real-time automation: (i) immediately accept or reject a trade that its customer has submitted/affirmed for clearing, whether the request is routed from the customer or the SEF/DCM or via other facilities; and (ii) immediately communicate its acceptance or rejection of the trade back to the DCO and/or the trading venue and the customer.⁹ This will ensure that DCOs are

⁷ We do not believe that from the DCO's perspective there is any practical difference between (i) processing a trade subject to mandatory clearing and one that the parties clear voluntarily or (ii) processing a SEF-executed trade and one executed bilaterally using a voice-based system.

⁸ See the discussion in footnote 5.

⁹ There are a range of facilities to enable this real-time clearing disposition, as already performed in other cleared markets the Commission supervises. For example, a DCO may maintain a facility within the DCO that checks each customer trade against limits set and periodically adjusted by the customer's clearing member. Alternatively, the DCO can send the trade details of the customer's trade to the clearing member, but if this path is utilized, it is critical that the disposition be subject to real-time, automated, processing discipline to ensure that real-time clearing is achieved.

capable of complying with the Proposed Rule's requirements by permitting them to confirm that a trade is within the counterparties' credit limits regardless of whether the counterparties are direct clearing members or indirect participants (whose credit limits would need to be verified by the indirect participant's clearing member). Absent such a requirement, clearing member delay in disposition could frustrate DCO compliance with the rule and undermine straight-through-processing; and

- (D) Requirement that DCOs support real-time clearing disposition of transactions executed on SEFs: The Commission should further specify that DCOs have universally disciplined, real-time processes that take standard messages regarding trades from SEFs (including block trades), complete the clearing acceptance process and deliver real-time messages back to the SEFs that the DCO has accepted (or rejected) the trade. By ensuring that DCOs are compliant with the Proposed Rule's real-time requirement for SEF-executed trades, SEFs will be able to compete on equal footing and will also be able to progress unhindered to central limit order book formats where liquidity permits.

II. Submission of Trades for Clearing

To support efficient real-time clearing disposition, consistent with other cleared markets, we urge the Commission in the final rules to specify timeframes for submission to a DCO of all trades not executed on a SEF/DCM. These timeframes should be "as short as technologically practicable" so that the time between a trade and submission for clearing will compress as technology and trade flows become more established and efficient. We do not believe such a requirement is burdensome, as counterparties will enter the vast majority of non-SEF executed trades into automated capture systems simultaneously or very shortly after the execution of the trade in any event, and should be motivated to do so to secure trade certainty for themselves.¹⁰

III. Transfer of Customer Positions

Citadel strongly supports proposed §39.15(d), which would require a DCO to promptly transfer customer positions from one clearing member to another upon customer request, without requiring the close-out and re-booking of the positions prior to the requested transfer. Unencumbered and efficient transfer of customer positions will have several benefits for customers and markets as a whole, including: (A) enhanced risk management options, whereby customers can use more than one clearing member to protect themselves against clearing

¹⁰ We note that many futures exchanges require submission of details of off-exchange or block trades within minutes of execution. For example, under Chicago Mercantile Exchange ("CME") Rule 526, sellers in block trades must report the trade to the CME within five minutes of the time of execution (except certain interest rate futures and options block trades and housing and weather futures and options, which must be reported within 15 minutes).

member default or transfer positions if the current clearing member is at risk of default or insolvency; (B) ability to manage portfolios more efficiently and achieve optimal compression; and (C) increased competition among clearing members for clearing services.

To further support ease and efficiency of transfer of customer positions, we respectfully recommend the Commission clarify that under the final rules the prompt and unhindered transfer of customer positions means:

- (A) Transfers should be permitted at any time: DCO rules must not allow clearing members to hold consent rights over instructions to transfer all or part of a customer's portfolio at any time so long as the customer is not in default and is properly margined. All or part of a portfolio should be freely transferable, without need for explanation, not only when the clearing member is in default, but also when it is not;¹¹
- (B) Associated margin should transfer simultaneously with the transferred positions: DCOs should simultaneously directly transfer associated margin along with transferred positions so as to reduce customer costs and operational risk and eliminate the potential for a requirement for duplicative posting of collateral by the customer;
- (C) Transfers should not be subject to inappropriate charges: Ceding clearing members must be prohibited from imposing excessive or inappropriate charges on transfers that could act as deterrents or hidden consent rights; and
- (D) Transfers should occur "as soon as technologically practicable": DCOs should transfer customer positions within the shortest commercially reasonable time period, *i.e.*, "as soon as technologically practicable", rather than "promptly," since any extended delay could act as a deterrent or hidden consent right.¹²

IV. Expanded Participant Eligibility

Citadel strongly supports proposed §39.12(b)(4), which would prohibit a DCO from requiring one of the original executing parties to a swap to be a clearing member in order for the

¹¹ Clearing members' right to refuse transfer instructions from the DCO should be strictly limited to situations where: (A) positions not transferred by the customer would no longer be "appropriately margined" as calculated by the DCO using either the same methodology utilized previously or other methodology agreed between the customer and its clearing member or (B) there is an ongoing customer event of default that would give the ceding clearing member specific rights, in whole or in part, over the positions and margin being transferred.

¹² Proposing Release at 13107. The Commission expressed that its choice to not specify a particular timeframe is intended to allow flexibility, as future technological advances may permit DCOs to transfer positions more quickly. We think the required timeframe should reflect this rationale, and that the length of time given to DCOs to transfer customer positions should be linked to existing technological capabilities.



transaction to be eligible for clearing. We believe that the proposed rule will significantly expand competition and improve access to clearing and was intended to ensure that indirect trades were not subject to bias. In order to give full effect to this provision in the final rules, we urge the Commission to clarify that this provision equally prohibits DCOs from adopting rules or engaging in conduct that is prejudicial to indirect clearing members as compared to direct clearing members, for example, with respect to product eligibility or the timing of clearing or processing of trades generally.

We appreciate the opportunity to provide comments on the Proposed Rules. Please feel free to call the undersigned at (312) 395-3100 with any questions regarding these comments.

Respectfully,

A handwritten signature in black ink, appearing to read 'Adam C. Cooper', written over the word 'Respectfully,'.

Adam C. Cooper
Senior Managing Director and Chief Legal Officer

- cc: The Hon. Gary Gensler, Chairman
The Hon. Michael Dunn, Commissioner
The Hon. Bart Chilton, Commissioner
The Hon. Jill E. Sommers, Commissioner
The Hon. Scott D. O'Malia, Commissioner

- The Hon. Mary Schapiro, SEC Chairman
The Hon. Kathleen L. Casey, SEC Commissioner
The Hon. Elisse B. Walter, SEC Commissioner
The Hon. Luis A. Aguilar, SEC Commissioner
The Hon. Troy A. Paredes, SEC Commissioner