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 Risk Management Requirements for Derivatives Clearing Organizations (RIN No. 3038-AC98)

Dear Mr. Stawick:

Citadel LLC[1] ("*Citadel*") believes proper implementation of the amended Core Principles C, D, E, F, G and I (collectively, the "*Core Principles*") under the Dodd-Frank Wall Street Reform and Consumer Protection Act[2] is essential to creating a clearing system that is robust and transparent and that permits fair and open access to all participants. We understand that the Commodity Futures Trading Commission (the "*Commission*") proposed rulemaking on "Risk Management Requirements for Derivatives Clearing Organizations" (the "*Proposed Rules*")[3] has generated a vast amount of comment from various stakeholders, and appreciate this opportunity to express our general support for the Commission's approach and our belief that the Proposed Rules would enhance reliability, transparency and consistency within the U.S. clearing regime, while supporting appropriate competition. In this context, we respectfully suggest that the Commission consider including the clarifications to the Proposed Rules described below.

I. Core Principle C: Participant and Product Eligibility

A. Participant Eligibility

Under Core Principle C, the Proposed Rules require derivatives clearing organizations ("*DCOs*") to establish objective, risk-based, publicly disclosed admission and continuing

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

[3] 76 Fed. Reg. 3698 (Jan. 20, 2011) (the "*Proposing Release*").

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eligibility standards that permit fair and open access.[4] Citadel supports this proposal, and in particular, the mandate that a DCO not adopt participation requirements that unreasonably restrict any market participant from becoming a clearing member.[5] We believe that inclusive DCO participation requirements will benefit DCOs and the markets by: (i) reducing DCO concentration risk; (ii) increasing diversity of market participants involved in DCO governance, adding expertise and mitigating conflicts of interest; (iii) enhancing competition and innovation in the provision of clearing services; and (iv) lowering overall costs for all market participants.

Citadel views the $50 million[6] limitation on the maximum net capital requirement as a key component of expanding open access to DCO clearing membership and applauds the proposed scalable capital requirements. Historically, DCO minimum capital requirements have had the effect of excluding all but a small number of the largest banks from becoming clearing members. As has long been demonstrated in other cleared markets, the threshold net capital requirement, while indicative of a minimum level of commitment and financial resource, is not determinative of the strength of a DCO in the event of a default. Rather, the determinative factors relevant to DCO strength in a default scenario are: (i) the effectiveness of the DCO's margin methodology, (ii) the appropriate scaling of the DCO's guaranty fund resources, proportionate to the risk exposure brought by each clearing member to the clearinghouse, and (iii) the proactive and ongoing supervision by the DCO of its clearing members. We believe the Proposed Rules strike a proper balance between open access and risk management by capping the minimum capital requirement while permitting DCOs to ensure the safety of the DCO and fellow clearing members by scaling clearing members' net capital and guaranty fund obligations in proportion to the clearing member's risk exposure.

To further ensure nondiscriminatory access, we urge the Commission to clarify that DCOs must utilize objective, risk-based methodologies based on reasonable stress and default scenarios consistently applied to all clearing members in determining the actual scaling of net capital requirements[7], guaranty fund scaling methodologies[8] and margin methodologies. Specifying that these principles must be applied across each key reserve category – net capital, guarantee fund, and margin obligations – is critical to preventing the scaling requirements from

[4] Core Principle C, as amended by the Dodd-Frank Act, Section 5b(c)(2)(C) of the Commodity Exchange Act.

[5] The current status quo, whereby certain market participants are excluded from clearing membership through the imposition by DCOs of requirements not clearly related to such entity's capacity to discharge its responsibilities, such as excessive capital requirements, minimum thresholds for the entity's existing swap portfolio size or transaction volume, or requirements concerning the entity's designation as a dealer or other particular type of entity, has delayed the adoption of clearing and has stifled competition for clearing services.

[6] Proposed Section 39.12(a)(2)(iii).

[7] In the context of capital requirements, it is particularly important to ban the use of "tiers" that could competitively disadvantage certain classes of participants in ways not related to the risk posed by individual participants.

[8] This approach is consistent with the Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions standards (the "*CPSS-IOSCO Standards*").

being applied in a discriminatory manner. Otherwise, adoption of exclusionary criteria in a single category could threaten open access, *e.g.*, if a DCO imposed an excessive threshold guaranty fund contribution while still complying with the $50 million capital requirement.

B. Product Eligibility

Section 723 of the Dodd-Frank Act requires DCOs to provide for non-discriminatory clearing of a swap executed bilaterally on or subject to the rules of an unaffiliated designated contract market ("*DCM*") or swap execution facility ("*SEF*"). Citadel strongly supports the Commission's implementation of this section in proposed Section 39.12(b), but we believe that to ensure non-discriminatory clearing, the Commission should clarify in the final rules certain additional features that are necessary for DCOs to comply with this requirement. As such, Citadel recommends the Commission make explicit that DCOs must provide highly standardized mechanisms and procedures for establishing connectivity with SEFs and any other permitted trading venues. These mechanisms and procedures must be objective, commercially reasonable and publicly available, and treat all applicant execution facilities in an unbiased manner (including not favoring operational connectivity or support for affiliates, or venues controlled by common shareholders or Enumerated Entities[9] active in the DCO's governance).[10] Otherwise, barriers to clearing connectivity could undermine the competitiveness of SEFs or other execution facilities and result in execution being driven to specific platforms as the market for electronic execution evolves. Further, Citadel urges the Commission to require that DCOs keep the clearing acceptance process anonymous (*i.e.*, without the customer's clearing member knowing the identity of the customer's executing counterparty).[11] If a trade is cleared, the clearing member will not have exposure to its customer's executing counterparty, only to the DCO and its customer. 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. The Commission should indicate in the adopting release that it will review DCOs' application of these criteria in an objective manner as a supervisory matter.

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[9] "Enumerated entities" include: (i) bank holding companies with over $50,000,000,000 in total consolidated assets; (ii) a nonbank financial company supervised by the Board of Governors of the Federal Reserve System; (iii) an affiliate of (i) or (ii); (iv) a swap dealer; (v) a major swap participant; or (vi) an associated person of (iv) or (v). Notice of Proposed Rulemaking by the Commission related to "Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest", 75 Fed. Reg. 63732 (Oct. 18, 2010) at 63732.

[10] For example, the Commission could require DCOs to establish standard two-way protocols for messages indicating that a trade has been executed and accepted for clearing in real time and for post-trade workflow.

[11] For a discussion on how real-time disposition of transactions for clearing further allows for anonymity between clearing members and the execution counterparties of their customers, see our comment letter to the Commission dated June 3, 2011 on "Requirements for Processing, Clearing, and Transfer of Customer Positions."

II. Core Principle D: Risk Management

A. Margin Requirements

Citadel also strongly supports proposed Section 39.13's express requirement that DCOs set margin requirements for clearing members that are risk-based and subject to regular review. Citadel agrees it is crucial for the Commission to set general standards with respect to margin requirements, including that margin "be sufficient to cover potential exposures in normal market conditions"[12] (*e.g.*, as outlined in the CPSS-IOSCO Standards). However, we note that the Commission requested comments as to whether the specific proposals presented by the Commission in the Proposed Rules, *e.g.* with respect to minimum liquidation times and confidence levels, were appropriate.[13] In this context, we respectfully urge the Commission to retain flexibility in the final rules as to specific margin criteria, so that DCO margin criteria can evolve with the markets. Specifically, rather than specifying minimum liquidation times, the Commission could require DCOs to adhere to the CPSS-IOSCO Standards or other similar guidelines, but allow the DCO flexibility as to liquidation horizon or other margin and guaranty fund calculation parameters in reaching those standards. Lack of flexibility in this regard could lead to the imposition of excessive margin requirements relative to risk exposure,[14] which could both adversely affect market liquidity and deter clearing. Similarly, we would urge the Commission to maintain flexibility with respect to other key thresholds, such as confidence levels used. While strict standards are necessary in order to maintain the safety and integrity of the system, margin requirements that are excessive in light of the actual risk of a portfolio could undermine progress in market acceptance of clearing and broader systemic risk reduction through clearing.

If the Commission does mandate minimum liquidation times or other set criteria in the final rules, we respectfully recommend that the Commission clarify that DCOs may apply for exemptions from these rules for specific groups of swaps if market conditions prove that such minimum liquidation times have become excessive, and recommend further that the final rules make it explicit that the Commission may re-evaluate and, if necessary, re-calibrate such minimum liquidation times as markets evolve.

B. Customer Initial Margin Requirements

Citadel respectfully disagrees with the customer initial margin scheme proposed by the Commission in Section 39.13(g)(8)(ii). We believe the proper allocation of responsibility with respect to setting margin requirements, in accordance with established practice in other cleared

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[12] Proposed Section 39.13.

[13] Proposing Release at 3704.

[14] For example, initial margin covering a five-day liquidation horizon may be excessive for highly liquid swaps, even in times of market volatility and even absent a DCM or similar central limit order book execution market.

markets, is for each DCO to set its initial margin requirements for cleared transactions or portfolios and each clearing member to then determine the additional margin ("*additional margin*"), if any, necessary to secure its guarantee obligations for individual customers.[15] In the event of a default, the DCO looks to its direct clearing members to ensure appropriate resources are available to avoid DCO losses. It would not only be impractical for a DCO to perform ongoing counterparty credit risk assessment of indirect clearing participants, but it is also unnecessary – the strict criteria and ongoing surveillance of direct clearing members is the means whereby DCOs ensure adequate reserves in the event of default.

Accordingly, the DCO is the appropriate party to establish initial margin requirements sufficient to protect the clearinghouse, based on an analysis of the relevant cleared instruments and portfolios held or guaranteed by the DCO's direct clearing members. By contrast, the clearing member, who alone is in direct contact and contractual privity with individual customers, is best positioned to assess the level of counterparty credit risk the customer poses to the individual clearing member, and then to determine if additional margin is necessary to protect that clearing member.

Citadel further disagrees with the inclusion in the Proposed Rules of a requirement that customer initial margin be automatically higher than direct clearing members' initial margin for the same portfolio. Customers as a group do not categorically pose greater credit risk. In addition, under the Commission's rules each customer will be required to post margin on a gross basis, ensuring that there is no cross-customer netting and therefore that fully funded, account-by-account, initial reserve for each customer's exposure is held for the benefit of the DCO. Further, because customer obligations are guaranteed by their designated clearing members, it is unnecessary for clearing members to collect customer initial margin for non-hedge positions at a level greater than 100% of the DCO's initial margin requirements. Requiring market participants to comply with DCO additional margin requirements would impair market liquidity, unfairly penalize highly creditworthy participants, and damage market integrity and open access by forcing a competitive disadvantage upon all indirect clearing members versus direct clearing members that will inevitably favor concentrated participants and harm new entrants.

Finally, we respectfully disagree with allocating responsibility to the DCO for collecting additional margin from clearing member customers on the grounds that to do so will eliminate "the need for clearing members to make frequent margin calls to their customers."[16] The markets' extensive experience in a range of cleared markets demonstrates preparedness for regular exchange of margin between clearing members and their customers for cleared OTC derivatives, even where margin calls occur more frequently than once daily. This frequent

[15] It is crucial that the DCOs' procedures for setting initial margin be transparent. To this end, we would respectfully urge that the final rules require DCOs to make available to all market participants, at no cost, a margin calculation utility, so that market participants can replicate with certainty the margin that such DCO will assess.

[16] Proposing Release at 3706.

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exchange of margin is even current market practice for uncleared trades, and so should represent no concern when required through the standardized and efficient operational facilities of organized cleared markets.

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,

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