CITADEL

September 12, 2013

Via Electronic Submission: http://www.esma.europa.eu/consultation/66596/response

European Securities and Markets Authority
103 Rue de Grenelle
75007 Paris France

Re: ESMA Discussion Paper on the Clearing Obligation under EMIR

Dear Sir or Madam:

Citadel LLC[1] ("Citadel") appreciates this opportunity to provide comments to the European Securities and Markets Authority ("ESMA") in response to its Discussion Paper on "The Clearing Obligation under EMIR".[2]

Citadel is an active participant in the global OTC derivatives market, both in the United States and Europe. We believe firmly that central clearing of OTC derivatives will mitigate systemic risk, increase transparency, promote competition, and otherwise improve the safety, stability and integrity of the global financial markets. We have witnessed firsthand, and been an active participant in, the successful implementation of mandatory clearing for wide swaths of the Interest Rate derivative and Index CDS markets in the United States, and look forward to similar achievements in Europe.

As a backdrop to our specific responses that follow, we would like to first highlight the significant advancements in *client* clearing that have occurred this year:

- The buy-side has cleared $52.4 trillion notional in Interest Rate derivatives at LCH, where buy-side open interest now stands at $8.4 trillion and over 1,000 buy-side trades are cleared per day.[3]
- At CME, over $5 trillion notional has been cleared, with open interest standing at over $3 trillion and over 1,200 trades being cleared per day.[4] We understand that most of this volume is driven by the buy-side.
- In the Index CDS market, at ICE Clear Credit, the buy-side has cleared $2.2 trillion notional.[5]

[1] Established in 1990, Citadel is a leading global financial institution that provides asset management and capital markets services. With over 1,100 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] Available at: http://www.esma.europa.eu/system/files/2013-925_discussion_paper_-_the_clearing_obligation_under_emir_0.pdf

[3] See http://www.swapclear.com/what/clearing-volumes.html as of September 11, 2013.

[4] See http://www.cmegroup.com/trading/interest-rates/files/cme-group-otc-clearing-summer-scorecard.pdf

[5] See https://www.theice.com/clear_credit.jhtml as of September 11, 2013.

We believe these statistics demonstrate clearly the viability and scalability of *client* clearing, and are an initial indication of the benefits that buy-side market participants will derive as the implementation of central clearing continues around the globe. Our responses to certain of the questions posed in the Discussion Paper follow.

Question 1 (Series for Index CDS): Please indicate your preference between the options presented. Do you believe that the possibility for a new series to exhibit low liquidity is a risk worth being considered when defining the classes of Index CDS? Under Option C, which criteria do you believe are relevant and how should they be calibrated?

We believe that once a given series of CDS Index is subject to the Clearing Obligation ("CO"), all subsequent series should automatically fall within the scope of the CO. Therefore, Options A or B are preferred.

With respect to Option B, we are comfortable with ESMA having discretion to withdraw the CO for a new series *a posteriori* provided the processes described in the Discussion Paper are carefully followed[6] and there has in fact been a material change in the trading characteristics of the series in question.

We believe that Option C, which requires each new series to be evaluated against a list of predefined criteria, introduces unnecessary complexity and uncertainty into the market. Index CDS typically roll every 6 months, when a new series is created with updated constituents. While the previous series continues trading, the bulk of trading liquidity moves into the new series. It would be disruptive to the smooth functioning of the market if, every 6 months when the Index CDS roll, market participants had to (a) predict whether or not the new series would ultimately be subject to the CO, and (b) possibly shift, even temporarily, from a trading a product subject to the CO to trading a product not subject to the CO (and then potentially shift back again).

Question 3 (Index CDS): Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

We generally believe the series and tenors of iTraxx Main, iTraxx HiVol, iTraxx Crossover, CDX.NA.IG, and CDX.NA.HY listed in Tables 2 and 3 would be the best candidates for the CO.[7] As this list encompasses the most widely and actively traded Index CDS in the marketplace, bringing these contracts into central clearing will best achieve the G-20 and EMIR objectives of materially decreasing interconnectedness and thereby mitigating systemic risk in

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[6] Per paragraph 37 of the Discussion Paper: "Such exclusion should only be possible when the series in question meets certain criteria for exclusion (specified in RTS) and ESMA publishes its rationale and assessment to remove the series from the CO."

[7] However, in the interest of international coordination, we recommend that ESMA align the specific series and tenors subject to the CO with those identified by the CFTC in its initial Clearing Requirement Determination. See http://cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/ClearingRequirement/ssLINK/2012-29211a

the CDS market. These contracts all exhibit ample (a) standardization, (b) volume and liquidity, and (c) availability of pricing information, which are the relevant criteria defined in Article 5(4) of EMIR for consideration when applying the CO.

The very high degree of standardization of contractual terms and operational processes in these Index CDS is evidenced, among others, by the fact that they are today typically quoted and traded on price and size alone (and have been for nearly 5 years), and have successfully migrated onto electronic trading platforms already.

Data from DTCC's Trade Information Warehouse[8] clearly demonstrates the existence of substantial outstanding notional exposures in these contracts. The data on outstanding notional exposures and total open contracts, coupled with the weekly and monthly data on number of trades and total notional traded, together also demonstrate a high level of trading volume and liquidity.

Further, it is our experience that liquidity can, and for these purposes should, be determined on grounds other than trading activity alone. Specifically, current market depth, as evidenced by the number of dealers quoting two-way markets in a product, and the notional sizes of the quoted bids and offers, is an equally instructive indicator of trading liquidity. As a buy-side market participant active in Index CDS, it is our experience that multiple dealers regularly quote two-way markets in the swaps listed in Tables 2 and 3 in meaningful sizes through a variety of mediums, including in periods of market stress. We therefore believe there is ample accessible trading liquidity to support a clearing requirement for these Index CDS.

Our experience and observations regarding trading liquidity further lead us to conclude that there is sufficient data in the market for CCPs to perform required pricing of these classes of Index CDS. The CCPs have processes in place to ensure they have access to adequate pricing data for their risk and default management procedures. Finally, access to reliable pricing data will only improve over time as rules promoting pre- and post-trade transparency are implemented.

Question 5 (Single name CDS): Please indicate your preference between the options presented. Under Option C, which criteria do you believe are relevant and how should they be calibrated?

For Single-Name CDS, we believe, at least initially, that identifying the specific contracts subject to the CO by reference entity will be the most straightforward approach, and therefore support Option A. However, we do believe that the index constituents of the major Index CDS logically constitute the universe of Single Name CDS most appropriate to subject to the CO. Therefore, we would support a migration to Option B once an initial phase-in of the CO for Single Name CDS under Option A has been completed.

Question 7 (Single name CDS): Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article

[8] See http://www.dtcc.com/products/derivserv/data/index.php

5(4) of EMIR?

Consistent with our response to Question 5, we believe that the index constituents of the major Index CDS logically constitute the universe of Single Name CDS that are most appropriate to subject to the CO. Given the correlation between a given Index CDS and those Single Name CDS referencing its constituents, and the fact that many market participants hold risk offsetting positions between the two types of contracts, bringing both Index CDS and the constituent Single Name CDS into central clearing provides better hedging and risk management opportunities and more efficient pricing and margining.

Question 9 (Interest rate derivatives): Do you have preliminary views on the specific items within those classes which would be the best candidates for the clearing obligation, taking into consideration the overarching aim of reducing systemic risk and the criteria defined in Article 5(4) of EMIR?

We recommend that the EUR, GBP, JPY and USD contracts within the Fixed-to-Floating, Basis Swap, Forward Rate Agreement (FRA), and Overnight Index Swaps (OIS) classes should be subject to the CO.[9]

The points we made in response to Question 3 are equally applicable to these Interest Rate derivative contracts, which likewise all exhibit ample (a) standardization, (b) volume and liquidity, and (c) availability of pricing information, and thereby satisfy the criteria identified in Article 5(4) of EMIR for consideration when applying the CO.

The very high degree of standardization of contractual terms and operational processes in these Interest Rates derivative contracts is evidenced, among others, by the fact that (a) central clearing has been growing consistently for over 12 years, (b) over 50% of the global market is now cleared, and (c) in excess of $1 trillion notional is cleared today on a daily basis.[10] In addition, many products have successfully migrated onto electronic trading platforms already, where trades can be executed electronically and routed directly to CCPs for clearing using straight-through-processing.[11]

Data from DTCC's Global Trade Repository[12] and LCH[13] clearly demonstrate the existence of substantial outstanding notional exposures in these contracts. The data on outstanding notional exposures and total open contracts, coupled with the weekly and monthly data on number of trades and total notional traded, together also demonstrate a high level of trading volume and liquidity.

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[9] In the interest of international coordination, we recommend that ESMA align the maturities subject to the CO with those identified by the CFTC in its initial Clearing Requirement Determination. See supra note 7.

[10] See "Key Facts" at http://www.lchclearnet.com/swaps/swapclear_for_clearing_members/

[11] See http://www.bloomberg.com/pressroom/citadel-uses-bloomberg-for-derivatives-trading-clearing-access/

[12] See http://www.dtcc.com/products/derivserv/data/data_table_1.php

[13] See supra note 3.

As with those Index CDS contracts discussed in our response to Question 3, it is similarly our experience that liquidity for these Interest Rate derivative contracts can, and for these purposes should, be determined on grounds other than trading activity alone. Specifically, current market depth, as evidenced by the number of dealers quoting two-way markets in a product, and the notional sizes of the quoted bids and offers, is an equally instructive indicator of trading liquidity. As a buy-side market participant active in Interest Rate derivatives, it is our experience that multiple dealers regularly quote two-way markets in these contracts in meaningful sizes through a variety of mediums, including in periods of market stress. We therefore believe there is ample trading liquidity to support a CO for the Interest Rate derivative contracts specified above.

Our experience and observations regarding trading liquidity further lead us to conclude that there is sufficient data in the market for CCPs to perform required pricing of these Interest Rate derivative contracts. The CCPs have processes in place to ensure they have access to adequate pricing data for their risk and default management procedures. Finally, access to reliable pricing data will only improve over time as rules promoting pre- and post-trade transparency are implemented.

Question 19 (readiness of the classes): Do you agree with this analysis?

We agree with ESMA's analysis and conclusion in Paragraph 105 that the Interest Rate and CDS asset classes are the best initial candidates for the CO. Further, as noted in our introduction to this letter, the clearing mandate has been successfully implemented in the United States for a broad swath of the Interest Rates and CDS asset classes, which provides sound empirical evidence for the viability of applying the CO to these asset classes.

Question 20 (dates, phase in): What would you consider to be the shortest delay to impose a clearing obligation to a class of OTC derivatives when there are several CCPs available? And when there is only one CCP available?

We do not believe that the existence of a single CCP or multiple CCPs should be a determinative factor in the phase-in of the CO. While we welcome competition among CCPs, we also acknowledge that for certain products and markets, only one CCP may exist, and do not believe this fact in and of itself merits any implementation delay. By contrast, the importance of introducing the CO in a timely fashion in order to fulfill EMIR's goal of reducing systemic risk is paramount. In fact, further competition may then follow, as the cleared market in a given product grows following the introduction of the CO, presenting opportunities for a new entrant. Thus, in all cases, we believe it is reasonable to impose the CO on a class of OTC derivatives three months after the CO is announced.

Question 22 (dates, phase in): What should be the assumption regarding market share which the CCP would have to be able to assume? Should it be requested that each CCP be able to handle the whole volume to tackle the worst case scenario?

We believe that CCPs by their nature are designed to accommodate increased volumes and/or clear the entire volume in a given market. For example, CCPs scale initial margin requirements

and clearing member default fund contributions based on clearing volumes, while concentration charges and other risk management techniques are implemented as well. In fact, there are certain natural risk offsets and participant diversification benefits when a CCP clears greater percentages of the market in a given product. As noted in our response to Question 20, while we welcome competition, we also acknowledge that in many listed derivatives markets, only one CCP may exist, and thus handles the whole volume in a given product.

Question 25 (categories of counterparties): Please indicate your preference between the options presented. Would you rather use an option that is not detailed here? Under Options B and C, do you agree to base the clearing access approach on the asset class to which the counterparties have access? What should be the date on which clearing access/threshold calculation should be assessed?

We strongly believe that any phase-in of the CO by category of counterparty should ensure that, at a minimum, large buy-side financial market participants are included in the first phase.[14] Including some buy-side market participants in the first phase is essential (a) because generally speaking, the buy-side accounts for half of the volume in a given class of OTC derivatives and (b) to ensure that as CCPs develop and implement their clearing offerings, that both sell-side and buy-side desires and needs are incorporated in the initial roll out. On this basis, we:

- Support Option A, which would separate financial counterparties (FCs) from non-financial counterparties (NFCs), and phase-in the CO for FCs first

- Do not support Option B, which would segment FCs between clearing members and all other FCs, and phase-in the CO for clearing members first before all other FCs

- Support Option C, provided that the volume thresholds use to categorize counterparties were calibrated at a level that ensured that the first phase would at a minimum capture a representative number of buy-side firms

Question 27 (categories of counterparties): Do you agree that a key factor to take into account when defining the phase in for the counterparties to comply with the clearing obligation will be the number of clearing members offering client clearing services? Is the client clearing capacity of the CCP also a relevant factor? What could be the other criteria?

With respect to the number of clearing members that offer client clearing services, our experience suggests that there are an ample number of clearing members offering client clearing services, and we have seen both new entrants and healthy competition among existing clearing members as the clearing mandate has been phased-in in the United States. As the CO approaches in Europe, we would expect to see similar developments.

We do not foresee the client clearing capacity of CCPs being a limiting factor. By contrast, it is

[14] We note that in the United States, the CFTCs first phase of its three-phased implementation of mandatory clearing included "active funds" as well as swap dealers and major swap participants. See the relevant CFTC rule at http://cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-18383a.pdf.

our experience that CCPs have fully prepared for and are eagerly awaiting the expansion of client clearing. Among other reasons, increased client clearing volumes present a much more attractive revenue growth opportunity for CCPs vis-à-vis increased direct clearing member volumes, since direct clearing members typically have fee caps and/or volume discounts in place that limit CCPs' upside.

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We appreciate the opportunity to provide comments in response to the Discussion Paper. Please call the undersigned at +1-312-395-3100 with any questions regarding these comments.

Respectfully,

/s/ Adam C. Cooper

Senior Managing Director and Chief Legal Officer