CITADEL

March 14, 2018

Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road Central
Hong Kong

Re: Consultation Paper on (1) the OTC derivatives regime for Hong Kong – Proposed refinements to the scope of regulated activities, requirements in relation to OTC derivative risk mitigation, client clearing, record-keeping and licensing matters; and (2) Proposed conduct requirements to address risks posed by group affiliates

Dear Sirs,

Citadel[1] appreciates the opportunity to provide input to the Securities and Futures Commission (the "SFC") on the continued implementation of the G20 reforms to the OTC derivatives markets. We firmly support reforms to improve the integrity, transparency, efficiency, and stability of these markets.

The OTC derivatives markets were notoriously concentrated, opaque, interconnected, and under-collateralized in the years preceding the financial crisis. The ongoing implementation of post-crisis reforms has started to substantially improve the safety and stability of these markets. Nevertheless, it is important to continue to fully implement the G20 reforms, including those relating to central clearing, platform trading, and public transparency, in order to ensure that the OTC derivatives markets are fair, open, competitive, and transparent for all market participants.

In this regard, we wish to provide feedback on Question 15 in the consultation referenced above. The SFC proposes to require licensed corporations providing client clearing services to provide a confirmation to a client that an OTC derivatives transaction has successfully cleared no later than the end of the following business day after the transaction is accepted for clearing by the CCP. Based on our experience with central clearing, and both standard market practices and the regulatory frameworks in other jurisdictions, we respectfully suggest that licensed corporations should instead notify clients as soon as technologically practicable that a transaction has been successfully cleared.

Central clearing of OTC derivatives mitigates systemic risk in a number of ways, including by replacing the complex web of bilateral counterparty credit exposures with a simple model where all market participants face a CCP. However, bilateral counterparty credit risk is only eliminated once market participants have confirmation that a transaction that is intended-to-be-cleared has in fact successfully cleared. Otherwise, transactions remain in an uncertain, pending-clearing state during which the client is unsure whether its exposure is to the CCP or to its original executing

[1] Citadel is a global financial firm built around world-class talent, sound risk management, and innovative market-leading technology. For more than a quarter of a century, Citadel's hedge funds and capital markets platforms have delivered meaningful and measurable results to top-tier investors and clients around the world. Citadel operates in all major asset classes and financial markets, with offices in the world's leading financial centers, including Chicago, New York, San Francisco, Boston, London, Dublin, Hong Kong, and Shanghai.

counterparty. This uncertainty complicates risk management for the client, particularly during times of market stress, and undermines the systemic risk mitigation benefits of central clearing.

For these reasons, both the US and the EU have successfully implemented straight-through-processing requirements for OTC derivatives transactions that are intended-to-be-cleared.[2] These requirements are designed to reduce market risk, credit risk, and operational risk by creating a robust execution-to-clearing workflow. In particular:

(a) Submission timeframes are established for each step in the operational workflow:

1) **Submission to the CCP after execution**. Both US and EU rules require that a transaction executed on a trading platform be submitted to the CCP no later than 10 minutes after execution.[3] EU rules also require off-platform transactions to be submitted to the CCP no later than 30 minutes after execution.[4]

2) **Acceptance or rejection by the CCP**. Both US and EU rules require that a CCP accept or reject a transaction submitted for clearing within 10 seconds of receipt.[5]

(b) For transactions executed on trading platforms, additional enhancements under both US and EU rules include: (1) pre-execution credit checks by the client's clearing member to ensure that both parties are able to successfully clear the transaction,[6] and (2) declaring the trade void in the rare event that it is rejected from clearing by the CCP (in order to prevent the reintroduction of bilateral counterparty credit risk).[7]

These straight-through-processing requirements have been critical in reducing systemic risk by ensuring that there are consistent and robust standards that govern the process from trade execution to clearing acceptance for OTC derivatives. They allow clients to be notified of clearing acceptance in real-time, rather than waiting for hours or days. As the SFC continues to implement the G20 reforms to the OTC derivatives markets, we believe that similar straight-through-processing standards should be considered, as they would benefit Hong Kong market participants and promote global consistency in OTC derivatives clearing frameworks.

---

[2] US: "Staff Guidance on Swaps Straight-Through Processing" (Sept. 26, 2013), available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/stpguidance.pdf; and CFTC Letter No. 15-67 (Dec. 21, 2015), available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/15-67.pdf.

EU: Commission Delegated Regulation (EU) 2017/582, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0582&from=EN.

[3] *See* CFTC Letter No. 15-67 and Article 3 of Commission Delegated Regulation (EU) 2017/582.

[4] *See* Article 4 of Commission Delegated Regulation (EU) 2017/582.

[5] *See* CFTC "Staff Guidance on Swaps Straight-Through Processing" and Articles 3 and 4 of Commission Delegated Regulation (EU) 2017/582.

[6] *See* CFTC "Staff Guidance on Swaps Straight-Through Processing" and Article 2 of Commission Delegated Regulation (EU) 2017/582.

[7] *See* CFTC "Staff Guidance on Swaps Straight-Through Processing" and Article 5 of Commission Delegated Regulation (EU) 2017/582.

*　　　　*　　　　*　　　　*　　　　*

We appreciate the opportunity to provide our perspective to the SFC. Please feel free to call the undersigned at (312) 395-3100 or my colleague, Andrew Fong, our Chief Administrative Officer for Asia Pacific at 3667 5530 with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger

Managing Director, Government & Regulatory Policy