September 30, 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 Customer Clearing Documentation and Timing of Acceptance for Clearing and Notice of Proposed Rulemaking on Clearing Member Risk Management (RIN No. 3038-AD 51)

Dear Mr. Stawick:

Citadel LLC[1] ("Citadel") appreciates this opportunity to voice its support for the Commodity Futures Trading Commission (the "Commission") notice of proposed rulemaking on Customer Clearing Documentation (the "Proposed Documentation Rules") and Timing of Acceptance for Clearing[2] (the "Proposed Timing Rules"), as well as the Commission's notice of proposed rulemaking on Clearing Member Risk Management[3] (the "Proposed Clearing Member Risk Management Rules", and together with the Proposed Documentation Rules and the Proposed Timing Rules, the "Proposed Rules") under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[4]

We unequivocally support the Proposed Rules, and believe they are one of the most important steps towards the successful launch of clearing. We urge the Commission to adopt the Proposed Rules in final form, as presently drafted, at the earliest possible opportunity. The publication of the Proposed Rules has already given the market confidence that an open, competitive market structure is coming. Their prompt final publication will provide additional momentum to market participants presently investing in and building the infrastructure and solutions for widespread clearing of OTC derivatives.

[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] 76 Fed. Reg. 45730 (Aug. 1, 2011).

[3] 76 Fed. Reg. 45724 (Aug. 1, 2011).

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

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We believe strongly that the Proposed Rules – both the requirements for real-time automated processes for accepting trades for clearing and the guidelines for cleared derivatives documentation – will reduce systemic risk and foster an open, level, competitive playing field in the swaps market for *all* market participants. The Proposed Rules will (i) ensure that the optimal market structure evolves, (ii) improve the depth and liquidity of the swaps market, (iii) lead to efficient markets, and (iv) promote competitive SEF offerings. The Proposed Rules are particularly important to buy-side participants because they ensure clients have the freedom to transact with the counterparty of their own choosing, safeguarding access to best execution.

We believe equally strongly that, by contrast, trilateral execution agreements[5] would have a materially adverse impact on the swaps market. Such agreements impose an unjustified documentary and administrative burden, fragment client trading limits (via designation of sub-limits), and sacrifice anonymity by exposing the identity of a client's execution counterparties to its futures commission merchant ("FCM"). Through these constraints, trilateral execution agreements limit a client's choice of execution counterparties, and by extension, its access to best available pricing. The implementation and administration of trilateral execution agreements will only serve to consume and divert resources from finalizing needed market infrastructure. Trilateral execution agreements will fragment a client's clearing limits and drive business to a small group of established swap dealers, thereby imperiling a client's access to best execution and its flexibility to manage risk, particularly in periods of market volatility. From a market-wide perspective, these constraints create an unwarranted barrier to entry for alternative liquidity providers, as well as FCMs not affiliated with a leading swap dealer, and inhibit the development of a true all-to-all market for execution.

A detailed analysis of the market benefits resulting from real-time trade acceptance, as well as the adverse consequences of trilateral execution agreements, have been submitted to the Commission by Citadel and others[6], and support the conclusions set out above. We therefore take the opportunity in this letter to focus on the following:

I. The Dodd-Frank Act both authorizes and compels the Proposed Rules

II. Arguments that dismiss real-time acceptance and attempt to justify trilateral execution agreements are flawed

[5] A trilateral execution agreement is an agreement among two arms-length counterparties that execute swaps intended to be cleared by their respective FCMs and one (or both) of the counterparties' FCMs. Such an agreement is contemplated, for example, by the annexes to the FIA-ISDA Cleared Derivatives Execution Agreement.

[6] See Citadel's comment letter on the Commission's Notice of Proposed Rulemaking on Requirements for Processing, Clearing, and Transfer of Customer Positions (RIN No. 3038-AC98), filed with the Commission on June 3, 2011, as well as the Managed Funds Association (MFA)'s comment letter on the same, filed with the Commission on April 11, 2011, and MFA's comment letter on the Proposed Rules filed with the Commission on September 30, 2011.

III. The Proposed Rules are overwhelmingly justified from a cost-benefit analysis perspective

The Dodd-Frank Act both authorizes and compels the Proposed Rules

A. Documentation standards

Section 731 of the Dodd-Frank Act instructs the Commission to "adopt rules governing documentation standards for swap dealers and major swap participants."

This provision mandates the Commission to prescribe standards that govern the execution agreements and arrangements that swap dealers enter into with clients, including those standards proposed by the Commission in §23.608 of the Proposed Rules.

B. Unreasonable restraint of trade

Section 731 of the Dodd-Frank Act states that a swap dealer "shall not adopt any process or take any action that results in any unreasonable restraint of trade."

Trilateral execution agreements would limit a client's choice of counterparties, restrict a client's freedom and flexibility to trade (particularly in block size), erect barriers to accessing the best bid or offer available in the market, and inhibit the development of an all-to-all market. These results would constitute an unreasonable restraint of trade that justifies adopting the Proposed Rules.

C. Material anticompetitive burden

Section 731 of the Dodd-Frank Act states that a swap dealer "shall not impose any material anticompetitive burden on trading or clearing."

Trilateral execution agreements would drive business to the largest swap dealers by creating unnecessary documentary burdens, advantage swap dealers affiliated with a client's FCM by disclosing the identity of other execution counterparties, erect long-term barriers to entry, and thwart alternative liquidity providers (and by extension, the price competition and liquidity they would bring to the market). These results constitute a material anticompetitive burden that justifies adopting the Proposed Rules.

D. Conflicts of Interest

Sections 731 and 732 of the Dodd-Frank Act require swap dealers and FCMs respectively to "implement conflict-of-interest systems and procedures" that, ensure that "any person within the firm ... acting in a role of providing clearing activities or making determinations as to accepting clearing customers are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of persons whose involvement in pricing, trading, or clearing activities might potentially bias their judgment."

By its very nature, the trilateral execution agreement establishes a framework that allows persons involved in pricing or trading to "potentially bias" the judgment of persons providing clearing services. Specifically, under the trilateral execution agreement, a swap dealer is put in a position to influence the clearing-related decisions of its affiliated FCM, with respect, for example, to the list of a client's permissible execution counterparties, as well as how a client's sub-limits are allocated, administered, and adjusted, with respect to that affiliated swap dealer and other execution counterparties (i.e. the affiliated swap dealer's competitors).[7] The Proposed Rules, which provide further guidance on appropriate conflict-of-interest standards, are thus warranted.

E. Open access and non-discriminatory clearing

Section 723 of the Dodd-Frank Act requires that the rules of a DCO provide for open access and "provide for non-discriminatory clearing of a swap executed bilaterally or on or through the rules of an unaffiliated designated contract market or swap execution facility."

Although the entry into of trilateral execution agreements is not expressly a condition to clearing, when swap dealers who control the majority of liquidity in the swaps market require it as a condition to execution of swaps intended for clearing, and their affiliated FCMs stand among a limited group of eligible clearing members, it has the practical effect of serving as a condition to access to clearing.[8]

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[7] The swap dealer's influence may be direct through management lines, or indirect through bundled pricing arrangements.

[8] The explanatory memo that was published contemporaneously with the FIA-ISDA Cleared Derivatives Execution Agreement states, "It is expected that the execution of this Agreement (or the Annexes thereto) should not be considered by clearing members to be a condition to the clearing of transactions, although execution parties may request that a form of this Agreement (or the annexes thereto) be executed as a condition to entering into transactions intended to be cleared."

F. Promote SEFs

The stated goal of Section 733 of the Dodd-Frank Act is to "promote the trading of swaps on swap execution facilities."

The Proposed Timing Rules are essential to achieving this goal by promoting real-time acceptance of trades for clearing. Clearing certainty, whether provided pre-execution or immediately post-execution, will allow all market participants to trade with confidence on SEFs. This is especially true for central limit order books, one of the primary modes of execution envisioned by the Commission, which are predicated upon both anonymity between executing counterparties and the elimination of bilateral counterparty credit exposure between executing counterparties. A central limit order book cannot function with a window of uncertainty between execution and clearing. Furthermore, all SEFs, regardless of mode of execution, will suffer if real-time acceptance of trades for clearing is not required because clearing certainty and market integrity will not be assured. Finally, the Proposed Documentation Rules help to promote trading on SEFs by safeguarding customers' ability to freely transact with other participants on the SEF, up to their full credit limit.

II. Arguments that dismiss real-time acceptance for clearing and attempt to justify trilateral execution agreements are flawed

The Proposed Rules have prompted a healthy and vibrant debate across the industry and regulatory community about timing of acceptance for clearing and trilateral execution agreements. Our views on a number of recurring themes in this debate follow.

A. Trilateral execution agreements are not "optional"

Absent a prohibition, trilateral execution arrangements will be forced on a wide swath of the market. Few buy-side players have the leverage or bargaining power vis-à-vis the largest swap dealers to object to trilateral execution agreements. In addition, given that liquidity in the swaps market continues to remain concentrated in the hands of a few large swap dealers (who can insist on the trilateral execution agreement as a condition to execution), their preferred documentation approach is likely to dominate the market. Further, certain large swap dealers have already indicated that bid-offer pricing will vary depending on whether or not a trilateral execution agreement is in place with a client.

B. The Proposed Rules are not prescriptive

The Proposed Rules lay out five principles that client clearing and execution documentation must adhere to. These principles support the fundamental tenets of the Dodd-Frank Act and embody free market standards such as the preservation of counterparty choice and anonymity. In so doing, they are neither overly prescriptive, nor do they mark an intrusion into private contract rights. Rather, they articulate standards for documentation as required by the Dodd-Frank Act, and thereby eliminate legal uncertainty and help market participants implement Dodd-Frank-compliant clearing arrangements.

C. Trilateral execution agreements do not represent an "interim" arrangement

First, no "interim" documentation arrangement is necessary, as real-time acceptance for clearing based on straight-through-processing (STP) already exists in other cleared derivatives markets, and is already built or largely built for key cleared OTC derivatives asset classes. Second, it would take longer to create an interim framework for sub-limit administration than to finalize the infrastructure necessary for STP for OTC derivatives clearing and the web of execution agreements among clients, FCMs and swap dealers required by the trilateral execution agreement. Third, the CFTC's phased implementation plan already provides ample time for the market to make final preparations for STP. Fourth and finally, even if the proposed trilateral execution agreement were intended to be an "interim" arrangement, this is not evidenced by its express terms given the absence of a sunset clause. Therefore it would likely remain in place long after its alleged need had ceased to exist.

D. Trilateral execution agreements do not enhance risk management practices

Real-time acceptance of trades for clearing assures all market participants, including swap dealers and FCMs, as well as their clients, of clearing certainty – that is, that a trade that is entered into with the intention to be cleared, will indeed clear. This certainty is far superior to contractual remedies to recover the remote risk of breakage fees.[9]

FCMs closely monitor the limits provided to each customer and are free to (a) reduce those limits at any time, and (b) reject trades that would breach them. This is how FCMs conduct risk management. It is much more efficient for an FCM to

[9] The prospect of breakage in a market with real-time acceptance for clearing is extraordinarily rare, as the prospect for trade failure is remote. Further, if and when it does occur, the actual amount of damages suffered is minimal, since the time that elapsed between execution and when it was discovered that the trade failed (due to its failure to clear) is minimal.

manage each customer against one overall limit through technology, and to operate one central dial to reduce or cut off a customer's activity, than it is for it to manage many individual sub-limits communicated through designation notices.

E. Real-time acceptance for clearing is the best means to ensure access for smaller market participants, while trilateral execution agreements actually hinder smaller market participants' access to the market

The practical constraints that trilateral execution agreements place on clients – limiting their choice of execution counterparties, limiting the number of potential execution counterparties, and imposing sub-limits on trades with a given execution counterparty – hinder market access for all market participants, be they large or small. By contrast, real-time acceptance for clearing opens the door for all market participants, regardless of size, to execute freely and anonymously with any provider of liquidity. In fact, real-time acceptance obviates the need for execution agreements in the first instance.

FCMs necessarily retain the right to unilaterally reduce a client's limit at any point. A "guarantee" of acceptance is therefore always subject to this right, so any guarantee is conditional. The trilateral execution agreement's constraints on market access and range of execution counterparties far outweigh any perceived benefits of having an FCM provisionally "guarantee" clearing capacity. Trilateral execution agreements are not used in other cleared derivatives markets, where small buy-side firms have free and unfettered access.

F. Trilateral execution agreements do not provide certainty during stressed or volatile market conditions

As noted above, FCMs have the right to reduce a customer's limit at any time, and are most likely to do so in stressed or volatile markets. Crucially, during such market conditions, smaller firms most need to be able to seamlessly use their full credit limits, and not be subject to fragmentation of their access to liquidity due to the sub-limits imposed by trilateral execution agreements. Changing a host of sub-limits during a period of market stress also introduces additional operational risk, including notification to and confirmation of such changes by customers and counterparties. These risks do not exist in other cleared derivatives markets, where the FCM adjusts the customer's single limit in real-time. In addition, if under a trilateral execution agreement, an FCM decided to reduce a customer's limit due to market volatility, and issued designation notices to its customer's counterparties to this effect, the market would likely misinterpret this action as a negative reflection on the financial health of the customer, which could have serious adverse consequences for the customer, and potential negative reverberations across the market

G. Trilateral execution agreements are not needed to facilitate post-trade allocations by multi-account asset managers.

Trilateral execution agreements do not solve the allocation issue faced by multi-account asset managers. Clearing certainty during an "allocation window" is best solved by a standby clearing guarantee from a principal FCM, a common practice in the futures market that is successfully used for allocations every day. Having a "standby" clearing member guarantee acceptance for clearing of a bunched trade, prior to allocation, enables real-time acceptance. Without real-time acceptance, moreover, the trade cannot be executed in any anonymous market, or on any electronic platform requiring clearing certainty. Enabling immediate acceptance of a bunched trade thus allows best execution for the asset manager, whereas trilateral execution agreements limit execution counterparties and could be used as a means of making clearing contingent upon execution with the executing counterparty to such a trilateral execution agreement.

H. Real-time acceptance is technologically feasible

Real-time acceptance for clearing is already provided operationally by a number of clearinghouses for a range of established cleared derivatives markets, including futures, listed equity options, and energy swaps, that are templates for today's clearing frameworks for OTC derivatives. Investing industry efforts in ironing out the final and well-understood hurdles to real-time acceptance fosters the objectives of the Dodd-Frank Act and is far preferable to spending money on the administration of sub-limits under a trilateral scheme that is unnecessary, and for which there is no blueprint.

I. Trilateral execution agreements are not analogous to futures give up agreements

The trilateral execution agreement is distinguishable from a futures give up agreement in several fundamental ways. First, a futures give up agreement is an arrangement among a customer and two brokers acting on the client's behalf. Unlike the futures give up agreement, the trilateral execution agreement includes a customer's trading counterparty – i.e., the arm's length, other side of the trade – as a party to the agreement. There is no precedent for this approach in any other cleared market. Second, a futures give up agreement does not place any limitation on the number of counterparties with which a customer may trade and, more importantly, does not set any limit on how much the customer may trade with any given counterparty. In contrast the trilateral execution agreement would place trading limits on each of the customer's permitted trading counterparties.

III. The Proposed Rules are overwhelmingly justified from a cost-benefit analysis perspective

The benefits of the Proposed Rules are significant and multi-faceted. The combination of real-time acceptance for clearing, coupled with preventing trilateral execution agreements from being imposed on the industry, will have the following benefits:

- Reduces systemic risk: Eliminating any window of counterparty credit risk between execution and clearing further reduces systemically risky interconnectedness in the swaps market.

- Promotes competition among FCMs: Decoupling the provision of execution and clearing services ensures that FCMs can compete on a standalone basis based on the robustness, quality, and pricing of their clearing services.

- Promotes competition among swap dealers: Removing barriers to entry for alternative liquidity providers enables smaller swap dealers to compete on more equal terms with the current limited universe of large swap dealers who presently control the vast majority of liquidity in the swaps market.

- Increases market depth and liquidity: Ensuring that more swaps dealers are able to compete for a client's execution business will increase the depth of the market. In addition, the emergence of an all-to-all-market and an environment that allows for new entrants to the market on the buy-side as well as the sell-side will enhance liquidity.

- Narrows bid-ask spreads: Increased competition, the entry of alternative liquidity providers, the development of an all-to-all market, and the emergence of electronic and/or anonymous execution will combine to narrow bid-ask spreads in the swaps market.

- Improves access to best execution: The ability to transact freely with any execution counterparty in the market, unfettered by unwarranted sub-limits on execution size, coupled with narrower bid-ask spreads, improves access to best execution. This applies equally to smaller participants as it does to larger participants, and applies, as noted above, in periods of market stress or volatility.

- Benefits real economy: More competition and better pricing in the swaps market directly benefits investors, including pension funds and endowments, on whose behalf institutional investors manage money. In addition, tighter pricing in the swaps market and a wider variety of liquidity providers ensures that corporate end users can more economically and efficiently conduct their hedging and risk management activities.

Meanwhile, the cost of the Proposed Rules is incrementally minimal and has already been factored into the industry's investment thus far, and projects going forward. In fact, notwithstanding the benefits enumerated above, the Proposed Rules would save the industry money.

- Proposed Rules save money: Prohibiting trilateral execution agreements would actually save the industry substantial unnecessary legal costs that would arise across the industry if clients had to enter into execution agreements with not only each of their execution counterparties, but also an exponentially greater number of trilateral annexes equal to the number of their execution counterparties *multiplied* by their number of FCMs (*multiplied* further perhaps by the number of a clients' individual accounts in the case of multi-account asset managers). In addition to these legal costs, the administration of the trilateral execution agreement requires processes and infrastructure for delivering, tracking, adjusting and monitoring designation notices and sub-limits that not only do not presently exist but also have not been contemplated or designed. Putting this in place alone would be a costly multi-year endeavor that would needlessly hinder the introduction of central clearing for OTC derivatives. Diverting industry resources to both unnecessary legal costs and the construction of a superfluous regime for sub-limit administration is inadvisable and provides an opportunity for cost savings. In contrast, investing such resources to finalize a sound, proven, and forward-looking market infrastructure for OTC derivatives clearing that benefits all market participants makes sense and advances the goals of the Dodd-Frank Act.

- Costs are incrementally minimal: DCOs and FCMs already have systems in place in other cleared derivatives market, including the energy swaps market, that support real-time acceptance for clearing without unnecessary and burdensome trilateral execution agreements. These systems are adapted for the clearing of other OTC derivatives, and this process has been underway for a number of years already.

- Costs have already been factored into industry's investment plans: Swap dealers, FCMs, DCOs and SEFs are already bringing offerings to market, or plan to launch offerings between now and when the mandatory clearing rules are anticipated to come into effect, that will support real-time acceptance.

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. Elisse B. Walter, SEC Commissioner
The Hon. Luis A. Aguilar, SEC Commissioner
The Hon. Troy A. Paredes, SEC Commissioner