



November 4, 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 Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA (RIN 3038-AD60)

Dear Mr. Stawick:

Citadel LLC¹ (“Citadel”) appreciates this opportunity to voice its support for the Commodity Futures Trading Commission (the “Commission”) notice of proposed rulemaking on *Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements* (the “Proposed Rules”)² under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).³

We fully support the Commission’s declaration of a firm implementation timetable. In this letter, we (i) explain why we believe the Proposed Rules are necessary and set out appropriate and achievable milestones, and (ii) provide recommendations that we believe are consistent with the Commission’s goals and will advance the transition of the swaps market to central clearing in a timely and efficient manner. Specifically, we believe that:

- I. The Commission rules related to clearing should be finalized first;
- II. The proposed 270 day phase-in compliance schedule for the clearing requirement based on type of market participant is an appropriate approach and timeframe;

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 Commission Notice of Proposed Rulemaking on “Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA”, 76 Fed. Reg. 58186 (Sept. 20, 2011) (the “Proposing Release”).

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



- III. The transition to central clearing should proceed prior to the implementation of the trade execution requirement;
- IV. The proposed phase-in compliance schedule should only be triggered when a mandatory clearing determination is issued for a new *category* of swaps; and
- V. The Proposed Rules are warranted from a cost-benefit analysis perspective.

I. The Commission rules related to clearing should be finalized first

- In our June 3, 2011 letter to the Commission on implementation timing (the “Citadel June Letter”),⁴ we emphasized that central clearing is the appropriate first step in the sequence of OTC derivatives reforms,⁵ and that the successful implementation of central clearing is a critical prerequisite to the success of further measures, including execution on swap execution facilities (“SEFs”) and pre- and post-trade transparency.
- To ensure that the implementation of central clearing is achieved in a timely, efficient and successful manner, and that the US swaps market can meet the G-20 commitment to clear standardized OTC derivatives contracts through central counterparties by the end of 2012 at the latest, the rules related to clearing should be finalized at the earliest possible opportunity.
- Prioritizing the completion of clearing related rules will (i) ensure that derivatives clearing organizations (“DCOs”) and futures commission merchants (“FCMs”), as well as swap dealers and their customers, can finalize their preparations for clearing that are already well underway, and (ii) support the successful transition to central clearing under the Commission’s proposed phase-in compliance schedule.

⁴ Letter from Adam C. Cooper of Citadel to Chairman Gensler and Chairman Schapiro, dated June 3, 2011, available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=44681>. In the Citadel June Letter, we recommended that the Commission (i) finalize clearing rules first, (ii) establish a date upon which clearinghouses and FCMs would be “open for business” and compliant with the new rules, paving the way for voluntary clearing by all market participants, (iii) segment market participants based on their level of swap activity into three categories, and (iv) phase in the clearing mandate progressively for each such category within a 270 day period.

⁵ In the Citadel June Letter, we wrote “Central clearing is also the appropriate first step in the sequence of comprehensive reforms of the OTC derivatives markets required under Title VII of Dodd-Frank. Both the clearing process and the standardization that it entails are prerequisites to electronic trading and pre- and post-trade transparency regimes. Central clearing will also facilitate data collection and reporting efforts, providing the Commissions and other regulators with the information they need on market liquidity and pricing to effectively finalize further rules, as well as to conduct market supervision and monitoring.”

- In addition to those rules identified by the Commission as prerequisites for requiring compliance with a mandatory clearing determination,⁶ the Commission should also advance into 2011 its consideration of final rules on Customer Clearing Documentation, Timing of Acceptance for Clearing (i.e., Straight Through Processing), and Clearing Member Risk Management. Implementation of these rules will eliminate further key barriers to voluntary clearing access⁷ and provide regulatory certainty to market participants and infrastructure providers, which will in turn facilitate their compliance preparation and related infrastructure investments.
- Other rules that are not core to the implementation of the clearing requirement logically fall further down the prioritization spectrum, and could be considered in due course in 1Q2012.
- In addition, though listed as a Prerequisite Clearing Rule, we note that the Commission need not finalize its rule on the end-user exception prior to issuing its first mandatory clearing determination and triggering the proposed phase-in compliance schedule for clearing, since, by definition, market participants eligible for the end-user exception would not be Category 1 or 2 Entities. The Commission has additional time to finalize the rule on the end-user exception and to clarify the status of such market participants prior to Phase 3 of the proposed phase-in compliance schedule for clearing.
- We thus recommend specific adjustments to the Commission's outline⁸ of when it plans to consider final rules in Appendix A. We believe the Commission's list of Prerequisite Clearing Rules is correct, sufficient, and need not be expanded, subject to our comment above on the timing of the final rule on the end-user exception.

II. The proposed 270 day phase-in compliance schedule for the clearing requirement based on type of market participant is an appropriate approach and timeframe

⁶ In the Proposing Release, the Commission notes that before market participants could be required to comply with a mandatory clearing determination, the Commission must adopt its final rules on (i) the end-user exemption; (ii) entity and product definitions (joint with the Securities and Exchange Commission ("SEC")); and (iii) protection of cleared swaps customer contracts and collateral (collectively, the "Prerequisite Clearing Rules"). The Commission has already finalized its rules on the "Process for Review of Swaps for Mandatory Clearing" and on "Derivatives Clearing Organization General Provisions and Core Principles."

⁷ For an explanation of how these rules will eliminate barriers to buy-side access to clearing, see the Letter from Adam C. Cooper of Citadel to the Commission, dated September 30, 2011, available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48454> (the "Citadel September Letter").

⁸ "Outline of Final Dodd-Frank Title VII Rules the CFTC May Consider in 2011 and the First Quarter of 2012" released by the Commission following its September 8, 2011 meeting, available at: <http://www.cftc.gov/PressRoom/SpeechesTestimony/genslerstatement090811c>.

- We support the Commission’s proposal to phase in the clearing requirement based on type of market participant over a 270 day period, and as noted in the Citadel June Letter, believe that “segmenting firms on the basis of their activity level not only serves as a useful proxy for sophistication and readiness to clear, but will also achieve the principal goal of reducing risk.”
- In the Citadel June Letter, we proposed alternatives for segmenting firms for phase-in purposes and continue to believe that those options provide suitably objective, non-discriminatory, and reasoned criteria to implement the clearing mandate for the most active and best prepared market participants first.⁹ We continue to support the inclusion of the most active buy-side market participants in Category 1, consistent with the Commission’s Proposed Rules.
- We believe that the 90, 180, and 270 day timeframes proposed by the Commission are correct and justified. The initial 90 day window will provide the most active and best prepared market participants with ample time to phase in clearing and ramp up cleared volumes ahead of the clearing requirement applying to them, while the 180 and 270 day windows afford additional time needed by less active market participants, or those who have to navigate additional governance processes, prior to implementation.
- The overall 270 day timeframe should not be extended, as it strikes an appropriate balance between (a) affording the time required by different types of market participants to transition to central clearing and (b) ensuring that there is not so much time between when different types of market participants are subject to new requirements (i.e. a maximum of 180 days) so as to engender material competitive differentiation or potential for regulatory arbitrage.
- Following three years of foundational work in OTC derivatives clearing, the industry is poised to tackle the remaining milestones to enable *all* relevant market participants to clear at scale by mid-2012. The Commission is now in the process of publishing its final rules. By the end of 2011 market participants will have generally had 6-12 months to review and adapt to the rules as proposed, and 18 months since the Dodd-Frank Act was enacted. Central clearing and the rules that will govern it should come as a surprise to no one, and industry preparations for clearing are already at an advanced stage.

⁹ See Appendix of B Citadel June Letter, where we proposed methodologies for segmenting non-dealer market participants, for the purposes of phasing in the clearing requirement, based on either (1) historical turnover and open exposure or (2) going-forward turnover only, within each of IRS and CDS.

- We welcome the Commission’s rule that irrespective of size or activity level, market participants will be able to begin clearing transactions on a voluntary basis earlier than otherwise required, and that their counterparties, if already subject to the clearing requirement, would be required to clear such transactions. In this regard, the following language in the Proposed Rules is essential, and we urge the Commission to retain it in the final rule:
 - *“A swap transaction between a Category 1 Entity and ... any other entity that desires to clear the transaction, must comply with the requirements of section 2(h)(1)A of the Act ... ” (§39.5(e)(2)(i))*
 - *“Nothing in this rule shall be construed to prohibit any person from voluntarily complying with the requirements of section 2(h)(1)(A) of the Act sooner than the implementation schedule provided... ” (§39.5(e)(3))*

III. The transition to central clearing should proceed prior to the implementation of the trade execution requirement

- The successful migration of the OTC derivatives markets to trading on SEFs and/or DCMs depends on a proven and successful clearing infrastructure.
- The Commission’s proposed compliance schedule should thus allow for the three-phase transition to central clearing to be completed prior to introducing the trade execution requirement.
- Implementing the clearing requirement and the trade execution requirement at the same time would impede the implementation process, and delay the phase-in of the clearing requirement, since preparations for central clearing are much more advanced than for execution on SEFs and/or DCMs.
- In addition, once a meaningful volume of swaps is being cleared by different types of market participants, certain SEFs and DCMs are likely to attract trading volume and liquidity even absent the effectiveness of the trade execution requirement. This will smooth the eventual implementation of the trade execution requirement.
- Promoting the transition of the swaps market to central clearing first, and to execution on SEFs and/or DCMs second, parallels the transition of other asset classes from bilateral trading and settlement to central clearing to electronic execution.
- This sequence will allow more prudent business decisions to be made, will encourage fairer and more robust competition among execution venues, and prevent market

participants from having to commit to SEFs and/or DCMs without an adequate voluntary period to test them.

- Further, we echo the more detailed analysis and further supporting arguments contained in Section IV of the Managed Funds Association's comment letter.¹⁰

IV. The proposed phase-in compliance schedule should only be triggered when a mandatory clearing determination is issued for a new category of swaps

- The proposed phase-in compliance schedule for the clearing requirement is appropriate following the Commission's first issuance of a mandatory clearing determination for a given category of swaps, but is not needed following the issuance of subsequent mandatory clearing determinations for any additional group, type, or class of swap within that same category.¹¹ For example, if certain groups, types or classes of IRS are subject to the Commission's first issuance of mandatory clearing determination, then the Commission should trigger the proposed phase-in compliance schedule. However, if a subsequent mandatory clearing determination adds additional groups, types or classes of IRS, then the phase-in compliance schedule should not be triggered.
- The rationale for the proposed phase-in compliance schedule is to provide market participants with the time required to obtain governance approvals, finalize documentation, make operational changes, establish connectivity, and execute test trades. Once this process has been completed for certain swap contracts within a given category of swaps, the addition of other contracts within that category does not give rise to these logistical challenges anew.
- Rather, the public notice and opportunity for comment that the Commission provides during its process for review of swaps for mandatory clearing affords ample time for market participants to prepare for compliance with the clearing requirement for such additional swap contracts that are within an existing category of cleared swaps.

¹⁰ Letter from Stuart J. Kaswell of the Managed Funds Association to the Commission on the Proposed Rules, dated November 4, 2011.

¹¹ With respect to "category of swaps", we are referring to the four broad categories of swaps – Rates, Credit, Equity, and Other Commodity – that the Commission defined in its Joint Proposed Rule with the SEC on *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant"*.

- With respect to the example provided by the Commission in the Proposing Release,¹² we would thus recommend that if certain 5 year CDS have already been subject to the clearing requirement, and subsequently, 10 year CDS are the subject of a further mandatory clearing determination, the proposed phase-in compliance schedule need not be triggered.

V. The Proposed Rules are warranted from a cost-benefit analysis perspective

- Ensuring that a substantial portion of the market transitions to central clearing over a reasonable period of time, as contemplated under the Proposed Rules, will allow the market to begin to realize the full benefits of central clearing, including reduction of counterparty and systemic risk, increased liquidity, competition among clearing members, and the competitive bid-offer spread compression that comes with competitive execution. A protracted implementation timeline, by contrast, would jeopardize these key benefits.
- The publication of the Proposed Rules alone has already given the market greater confidence and led to an increased focus on implementation, as market participants are more prepared to invest resources and compete with greater certainty. Arguably, their publication has even led to a ramp up in voluntary clearing, as certainty has increased in the path to comprehensive clearing and forward looking participants are keen to start testing.¹³
- A firm and final phased implementation plan also lowers costs since it will (i) provide certainty to all market participants as to where and when to allocate resources and make investments, (ii) reduce costs for less active or smaller market participants since more active or large market participants will transition first and iron out any final issues in implementing central clearing, and (iii) promote competition among, and avoid undermining the return on investment of, forward looking clearing infrastructure and service providers.

¹² “For example, if the Commission issues a mandatory clearing determination for 5 year credit default swap products and a new 5 year credit default swap product is offered for clearing based on a new 5 year index, then the proposed compliance schedules may not be triggered. If on the other hand, the Commission has not issued a mandatory clearing determination for 10 year credit default swap products and a new 10 year credit default swap product is offered for clearing, then the compliance schedules could be triggered by the Commission.” Proposing Release at 58192.

¹³ We note, for example, that customer volume in IRS and CDS cleared at CME set new records in the month of September (see <http://cmegroup.mediaroom.com/index.php?s=43&item=3191&pagetemplate=article>)



- However, implementing the trade execution requirement at the same time as the clearing requirement would impede the transition to central clearing and jeopardize the enumerated benefits and savings.
- The market is prepared for the transition to central clearing and the proposed 270 day phase-in process provides ample time. Not only have the clearinghouse facilities for CDS and IRS already been through extensive dealer-to-dealer clearing, but the buy-side has also undertaken significant preparations. “Live” buy-side trades were executed in CDS in December 2009 and in IRS in 2010. Clearing members have been working for several years now on structuring offerings to clients, including smaller clients with limited operational capacity themselves, to support widespread clearing. In addition, in each of the last three year, swap dealers, large FCMs, and buy-side firms have jointly made commitments to global regulators to advance their preparedness for clearing for all market participants. We are confident, in fact, that the industry could fulfill a more aggressive implementation schedule than proposed by the Commission, and at any event are not aware of any basis for extension beyond the proposed timeframe.

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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,

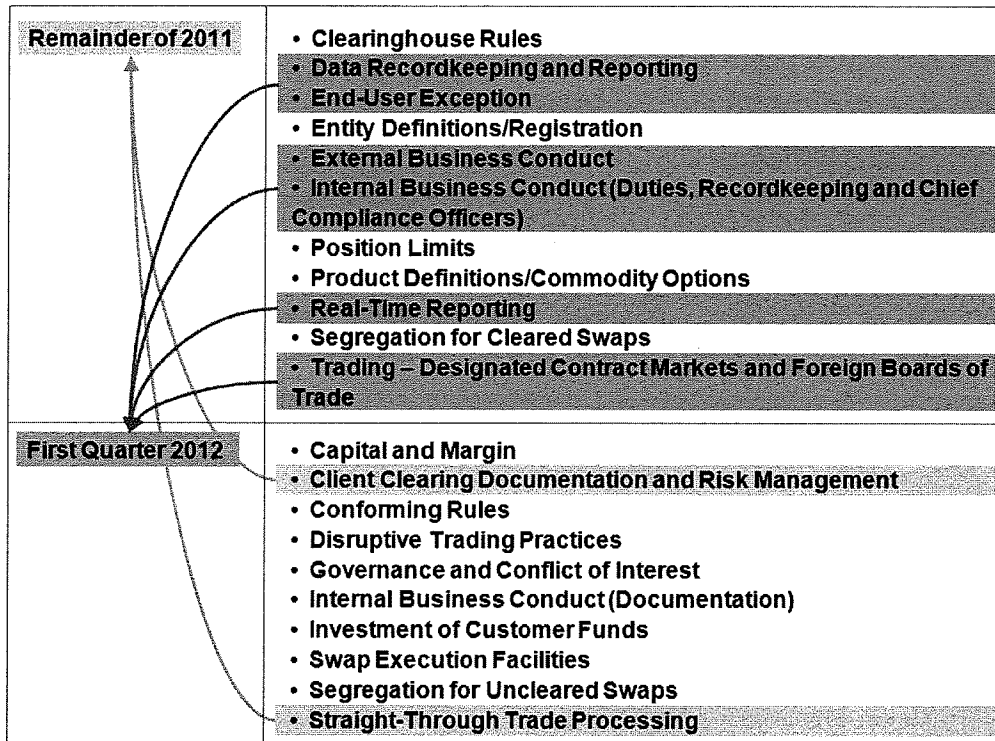
A handwritten signature in black ink, appearing to read "Adam C. Cooper".

Adam C. Cooper
Senior Managing Director and Chief Legal Officer

- cc: The Hon. Gary Gensler, Chairman
The Hon. Mark P. Wetjen, Commissioner
The Hon. Bart Chilton, Commissioner
The Hon. Jill E. Sommers, Commissioner
The Hon. Scott D. O’Malia, Commissioner

Appendix A

Recommended Changes to the Outline of Final Dodd-Frank Title VII Rules the CFTC May Consider in 2011 and the First Quarter of 2012



Resulting Outline

Remainder of 2011	1Q2012	
<p><i>Definitions</i></p> <ul style="list-style-type: none"> • Product Definitions/Commodity Options • Entity Definitions/Registration <p><i>Clearing</i></p> <ul style="list-style-type: none"> • Clearinghouse Rules (Completed) • Segregation for Cleared Swaps • Client Clearing Documentation and Risk Management • Straight-Through Trade Processing <p><i>Others</i></p> <ul style="list-style-type: none"> • Position Limits (Completed) 	<p><i>Capital and Margin</i></p> <ul style="list-style-type: none"> • Capital and Margin • Segregation for Uncleared Swaps <p><i>Execution</i></p> <ul style="list-style-type: none"> • Swap Execution Facilities • Trading – Designated Contract Markets and Foreign Boards of Trade <p><i>Reporting</i></p> <ul style="list-style-type: none"> • Data Recordkeeping and Reporting • Real-Time Reporting 	<p><i>Business Conduct</i></p> <ul style="list-style-type: none"> • Internal Business Conduct (Documentation) • Internal Business Conduct (Duties, Recordkeeping and Chief Compliance Officers) • External Business Conduct • Disruptive Trading Practices <p><i>Others</i></p> <ul style="list-style-type: none"> • End-User Exception • Governance and Conflict of Interest • Investment of Customer Funds • Conforming Rules