March 18, 2024

VIA ELECTRONIC SUBMISSION (Link)
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
USA

Re: Commodity Futures Trading Commission's Notice of Proposed Rulemaking on *Protection of Clearing Member Funds Held by Derivatives Clearing Organizations*

The Global Association of Central Counterparties ("CCP Global")[1] is the international association for central counterparties ("CCPs"), representing 41 members who operate over 60 individual CCPs across the Americas, EMEA, and the Asia-Pacific region.

CCP Global appreciates the opportunity to respond to the Notice of Proposed Rulemaking on *Protection of Clearing Member Funds Held by Derivatives Clearing Organizations*[2] ("the Proposal" or "NPR") proposed by the Commodity Futures Trading Commission (the "CFTC" or the "Commission").

Introductory Remarks

The Commission proposes to mandate certain protections for and restrictions on the use of funds belonging to clearing members („proprietary funds"), which encompass individual market participants and futures commission merchants ("FCMs"), by derivatives clearing organizations ("DCOs") with the purported goal of creating comparability with the CFTC's existing regime for protecting customer funds. CCP Global recognizes the critical importance of ensuring the safety of all funds posted to a DCO, and generally commends the Commission for seeking to establish a level playing field between the traditional, FCM-intermediated clearing model and new DCOs embracing disintermediated or direct clearing models targeted at retail market participants ("disintermediated DCOs")[3]. However, we believe it is important to recognize significant protections already employed by traditional DCOs

[1] Previously known as CCP12.
[2] Federal Register / Vol. 89, No. 2 / Wednesday, January 3, 2024, CFTC, Notice of Proposed Rulemaking, *Protection of Clearing Member Funds Held by Derivatives Clearing Organizations*, available at Link.
[3] The term "disintermediated DCO" refers to both fully-collateralized and margined DCOs that allow retail market participants to clear directly with the DCO without FCM intermediation. Therefore, the comments provided herein address concerns regarding the disintermediated model targeted at retail market participants generally. The margined disintermediated model raises additional questions and concerns that are beyond the scope of this letter and which we highlighted in our response to the CFTC Request for Comment on FTX Request for Amended DCO Registration Order of May 2022: Link.

("prevailing DCOs") to appropriately protect all funds posted to them, including proprietary funds, and therefore question whether the Commission's approach to addressing risks raised by novel, direct clearing models targeted at retail market participants is appropriately tailored. Pursuant to the DCO Core Principles and existing CFTC regulations, DCOs hold all funds (i.e., both customer and proprietary) in a manner that is designed to minimize risk of loss and delay in access, which has provided for a long and successful track record of DCOs protecting the funds posted to them. Below, we provide more targeted comments where we express either support or concern regarding details of the Proposal.

The Regulatory Gap

In the statements of the CFTC Chairman and Commissioners and in the discussion that followed during the Commission's open meeting which took place on December 13, 2023, the Commission repeatedly referenced the regulatory "gap"[4] created by the emergence of disintermediated clearing models, which creates risks not present in the traditional FCM-intermediated clearing model. The NPR itself also refers to "the historical prevailing model in which all or nearly all clearing members of a DCO are FCMs"[5] and compares it to the model in which DCOs "clear directly for market participants without the intermediation of FCMs, including, in most cases, market participants who are natural persons (*i.e.*, individuals)."[6] However, the Proposal broadly applies to both intermediated and disintermediated DCOs, irrespective of the nature of the DCO's membership. In light of the transparency of DCO rulebooks, the sophistication of the FCM and other institutional members, and the effectiveness of the Commission's existing regulatory framework, we question whether there is a need for a rule impacting DCOs with a more traditional structure and no retail investor members. Therefore, we encourage the Commission to, at a minimum, consider tailoring the Proposal to address the "gap" that drove it in the first place, rather than applying rules to all DCOs without distinction for their clearing models. Broadly, we are troubled by the Commission's piecemeal approach to addressing issues raised by disintermediated clearing models and urge that any future rulemaking should holistically address the risks specifically raised by disintermediated clearing models targeted at retail market participants, not just those related to funds protections. We applaud the Commission for recognizing the utility of such a tailored approach in the Proposal where it notes that an obligation to have anti-money laundering ("AML") and know-your-client ("KYC") programs in place is not needed for DCOs that do not offer disintermediated clearing models targeted at retail market participants.

Disintermediated DCOs Should Be Distinguished from Prevailing DCOs

Disintermediated clearing models targeted at retail market participants do not provide the same protections as prevailing DCOs. The Commission should clearly indicate this reality by giving DCOs operating disintermediated clearing models targeted at retail market participants a different name and distinct registration category. The two types of entities are structurally different and provide different levels of risk protection, even if subject to similar regulations, as FCMs provide an additional layer of risk protection.[7] Lumping disintermediated DCOs together with prevailing DCOs may give the false impression that participants, particularly retail market participants, are engaging with an entity that

[4] Notice of Proposed Rulemaking, *Protection of Clearing Member Funds Held by Derivatives Clearing Organizations*, *op. cit.*, p. 302, 303, 306.
[5] *Ibid.*, p. 287.
[6] *Ibid.*
[7] The special functions and features of FCMs were described in much detail by many organisations (i.a., CCP Global, several DCOs, and FIA) in their responses to the CFTC Request for Comment on FTX Request for Amended DCO Registration Order: Link.

has the same protections as a prevailing DCO. Different labels would help alert participants, particularly retail market participants, to the different risks presented when facing a disintermediated DCO and hopefully prompt the participant to familiarize themself with the disintermediated DCO's operations, including cyber risk practices, rulebook, loss mutualization provisions, governance structure, policies regarding conflicts of interest, and the various other important practices of prevailing DCOs that FCMs monitor for their customers. Additionally, a distinct name and registration category for disintermediated DCOs would also help distinguish DCO types should an issue arise at a disintermediated DCO. Distinct naming and registration for disintermediated DCOs would allow the Commission and Congress to provide targeted regulation that better fits the disintermediated clearing model targeted at retail market participants and avoid impairing existing well-functioning regulatory structures.

Specific Comments on the Proposal

DCOs Investment Policies

Having comparable investment standards for customer and house funds seems appropriate and in line with DCOs' current practices. Pursuant to existing rules and the DCO Core Principles, DCOs hold all funds in a manner that is designed to minimize risk of loss and delay in access. Requiring DCOs to comply with existing CFTC Regulation 1.25 would further support that both proprietary and customer funds at DCOs are treated equally and are provided the same level of safety. However, requiring that DCOs "bear sole responsibility for any losses resulting from the investment of proprietary funds" as provided in proposed CFTC Regulation 39.15(e)(3) is restrictive and may be inconsistent with existing DCO practices regarding certain non-default losses. Specifically, some prevailing DCOs are permitted under their rules to exercise their assessment powers in the event of losses arising from the investment of proprietary funds. The Commission should allow such DCOs to continue to use proprietary funds in a manner consistent with their rules.

Holding Customer and Proprietary Funds at Central Banks - § 39.15(b)(3) and § 39.15(f)(2)(vii)

We strongly support the CFTC's consideration of facilitating DCOs to hold customer and proprietary funds at the central bank of a money center country (defined as Canada, France, Germany, Italy, Japan, and the United Kingdom), and therefore allow DCOs to take advantage of the credit and liquidity risk management benefits that central bank accounts provide. In addition, where DCOs hold accounts directly with the European Central Bank, the Commission should also allow euro balances to be held in those accounts. The European Central Bank is the central bank of the Eurozone currency area and coordinates Eurozone monetary policy, and is physically located in a money center country (Germany). Additionally, as certain central banks have requested modifications to the existing template acknowledgment letter for customer funds, we support the Proposal to require that a DCO obtain written acknowledgement from the central bank of a money center country that is holding customer or proprietary funds, opposed to requiring the use of the template written acknowledgement letter used for non-central bank depositories. This further facilitates DCOs to hold these funds at the defined central bank and we welcome the Commission's consideration of this aspect.

At the same time, we have concerns over the proposed requirement for central banks to "**reply promptly** and directly to any request from the director of the Division of Clearing and Risk . . . for

confirmation of account balances or provision of any other information regarding or related to an account"[8] (emphasis **added**). We would urge the Commission to make the language more practical to state "reply **as soon as reasonably practicable** . . ." given the different time zones for foreign central banks.

Additionally, we would like to comment on the Federal Reserve Bank ("Fed") account access. The Commission specifically states in the Proposal that it has required systemically important DCOs with access to Fed accounts and services to use those accounts and services where practical and "as a policy matter seeks to facilitate use of those accounts."[9] We believe the Commission could amend the *Order Exempting the Federal Reserve Banks From Sections 4d and 22 of the Commodity Exchange Act*[10] to expand the application of it to non-systemically important DCOs ("non-SIDCOs"), where non-SIDCOs are subject to the same level of regulatory requirements and supervisory oversight as those DCOs that have accounts and services at the Fed today. This could act as an additional incentive for the Fed to enable access to its customer accounts and other services to non-SIDCOs.

Segregation of Proprietary Funds – § 39.15(f)(1)

Proposed CFTC Regulation 39.15(f)(1) "would require the DCO to, at all times, maintain in the accounts holding proprietary funds enough resources to cover the total value of proprietary funds owed to its clearing members."[11] As it currently stands, the requirement is very broad, while we believe it should clearly state that it refers to non-settlement funds (i.e., margin).

Limitation on use of Proprietary Funds – § 39.15(f)(3)(ii) and § 39.15(f)(4)

With regard to proposed CFTC Regulation 39.15(f)(4), which would permit DCOs and depositories only to use proprietary funds as belonging to clearing members, and proposed CFTC Regulation 39.15(f)(3)(ii), which would forbid the use of proprietary funds to secure obligations of, or extend credit to, the DCO, we are concerned that the Proposal as written would have significant impacts on the risk management programs at prevailing DCOs, which we do not believe was the intention of the Commission. In particular, many prevailing DCOs' rules currently permit uses of proprietary funds beyond the ones enumerated in points (A) and (B) of proposed CFTC Regulation 39.15(f)(4)[12], including some which involve borrowing from or against a DCO's guaranty fund to ensure daily settlement in the event of certain counterparty failures or other liquidity events. Similarly, we believe the proposed requirements under other aspects of the Proposal, such as proposed CFTC Regulation 39.15(f)(3)(ii),[13] could be misinterpreted to inadvertently attempt to restrict a prevailing DCO from using proprietary funds in a manner consistent with its rules. This outcome would be contrary to the Commission's

[8] *Ibid.*, p. 298.
[9] *Ibid.*, p. 289.
[10] Federal Register / Vol. 81, No. 156 / Friday, August 12, 2016 / Notices, available at Link.
[11] NPR, *Protection of Clearing Member Funds Held by Derivatives Clearing Organizations, op.cit.*, p. 290.
[12] "(A) A derivatives clearing organization may use the proprietary funds belonging to a clearing member to guarantee or cover deficits in a customer account of that clearing member in accordance with the derivatives clearing organization's rules and its agreement(s) with the clearing member;"
"(B) A derivatives clearing organization may use non-defaulting clearing members' money, securities, or property that is being held as a guaranty fund to mutualize the losses resulting from a default by a clearing member to cover such losses in accordance with the derivatives clearing organization's rules and its agreement(s) with its clearing members."
[13] "A derivatives clearing organization shall not commingle proprietary funds with the money, securities or property of the derivatives clearing organization, or a customer account of a clearing member of the derivatives clearing organization, or use proprietary funds to secure or guarantee the obligation of, or extend credit to, the derivatives clearing organization."

statement that it "does not intend" that the proposed restrictions on the use of proprietary funds "interfere with or alter DCOs' risk management programs." We implore the Commission to avoid a scenario where a DCO is restricted from using proprietary funds in a manner consistent with its rules in any final rulemaking.

Moreover, the language of proposed CFTC Regulation 39.15(f)(4)(ii)[14] could be read to suggest that it imposes obligations on depositories to verify how DCOs are using proprietary funds. While it is legally questionable whether the CFTC could impose such an obligation via regulation, the language nevertheless creates the potential for friction for DCOs using proprietary funds in a manner entirely consistent with the DCOs' rules, such as default management. Such friction would be detrimental to the DCO and potentially create systemic risk. We believe the language should be modified to make clear that the obligation is on the DCO to ensure that proprietary funds are used in a manner consistent with the DCO's rules.

Daily Reconciliation – 39.15(g)

With regard to proposed CFTC Regulation 39.15(g) related to daily reconciliation, CCP Global believes it requires technical modifications with respect to preparing the daily reconciliations calculations. Under the Proposal, a DCO would be required on a daily basis to conduct reconciliation that would compare the amount of collateral it owes to each clearing member with those same assets it holds across all depositories, by account class. Generally, we believe this approach to reconciliation, where the focus is on funds posted by all clearing members, per account class, across all depositories is sensible. However, the proposed requirement to complete the reconciliation calculation in a manner consistent with the requirements of the CFTC Regulation 1.20(i) is inappropriate given the unique functions of DCOs, as compared to FCMs. In particular, DCOs have a matched book day-over-day, whereas FCMs do not and thus, calculating a net liquidating value for each customer is appropriate. Additionally, a DCO does not reduce the balances of funds owed to its clearing members, whereas, under the CFTC Regulation 1.20(f), FCMs are permitted to use customer funds for lawfully accruing fees or expenses, including commissions, brokerage, interest, taxes, storage, and other fees and charges. Therefore, applying the CFTC Regulation 1.20(i) to DCOs creates unnecessary complexity and uncertainty and thus should not be adopted in any final rulemaking.

Exclusions for Foreign Derivatives Clearing Organizations - 39.15(h)

The Proposal intends to recognize the potential legal conflicts of applying the U.S. Bankruptcy Code to non-U.S. DCOs. However, as proposed, the U.S. Bankruptcy Code would be disapplied only with reference to proprietary funds of clearing members of non-U.S. DCOs and not in the case of the customer funds held by non-U.S. DCOs. This would lead to a situation in which non-U.S. DCOs that use a disintermediated model would get a significant advantage over non-U.S. DCOs using a traditional FCM-intermediated model and thus an inconsistent treatment of DCOs.

Appropriate time for implementation

We believe that there are likely some operational and technical considerations, due to the Proposal's

[14] "No person, including any derivatives clearing organization or any depository, that has received proprietary funds for deposit in a segregated account, as provided in this section, may hold, dispose of, or use any the funds as belonging to any person other than the clearing members of the derivatives clearing organization which deposited the funds."

highly technical nature, which should be taken into account by the Commission and which would merit granting DCOs appropriate time if and when it comes to the implementation of any new requirements imposed on DCOs. By way of example, proposed CFTC Regulation § 39.15(f)(2), regarding the written acknowledgment from depositories, may require DCOs' documentation with depositories to be amended, which may include relating to areas such as account titles, notification procedures for changes, and proprietary fund acknowledgement letters. This will require close and usually time-consuming work with each of the DCO's depositories. Another example would refer to daily reconciliations which many DCOs do today, but the complexity of the Proposal in this regard still requires a fair amount of evaluation and potential operational work. Therefore, CCP Global recommends that any final rulemaking related to the Proposal provide for at least a 12-month implementation period and that due to the technical nature, CFTC staff work closely with DCOs regarding the finalization of any rule to account for their unique practices and operations.

About CCP Global

CCP Global is the international association for CCPs, representing 41 members who operate over 60 individual central counterparties (CCPs) across the Americas, EMEA, and the Asia-Pacific region.

CCP Global promotes effective, practical, and appropriate risk management and operational standards for CCPs to ensure the safety and efficiency of the financial markets it represents. CCP Global leads and assesses global regulatory and industry initiatives that concern CCPs to form consensus views, while also actively engaging with regulatory agencies and industry constituents through consultation responses, forum discussions, and position papers.

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