



September 13, 2019

Via Electronic Submission: <https://comments.cftc.gov>

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Derivatives Clearing Organization General Provisions and Core Principles (RIN Number 3038-AE66)

Dear Mr. Kirkpatrick:

Managed Funds Association (“MFA”)¹ welcomes the opportunity to comment on the Commodity Futures Trading Commission’s (the “Commission”) notice of proposed rulemaking on “Derivatives Clearing Organization General Provisions and Core Principles” (the “**Proposed Rules**”).² MFA strongly supports the Commission’s goals of simplifying Commission regulations and making them less burdensome.³ We believe that the Proposed Rules further that goal by refining the regulatory regime for derivatives clearing organizations (“DCOs”) so that it will be “simpler, less burdensome, and less costly” for DCOs as well as their clearing members and customers.⁴

In particular, MFA applauds the Commission for the proposed amendments to Part 39 that would permit “fair and open access” to DCOs⁵ and allow for customer representation on a DCO’s

¹ Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

² 84 Fed. Reg. 22226 (May 16, 2019) (the “Proposed Rule Release”), available at: <https://www.govinfo.gov/content/pkg/FR-2019-05-16/pdf/2019-09025.pdf>.

³ See Proposed Rule Release at 22226, discussing how issuance of the Proposed Rules is in response to the Project KISS initiative. See also Commission request for information on “Project KISS”, 82 FR 21494 (May 9, 2017); amended by 82 FR 23765 (May 24, 2017), available at: <https://comments.cftc.gov/KISS/KissInitiative.aspx>.

⁴ *Id.*

⁵ See Proposed Rule Release at 22270, proposed § 39.12(a).

board, default committee, and other governing bodies.⁶ Customers are important participants in the cleared derivatives markets. As a result, customers' inclusion in both the membership and governance of DCO is necessary and beneficial to the derivatives market by increasing competition, mitigating potential DCO conflicts of interest, and leading to more effective DCO compliance and risk management generally.

To enhance the efficacy of the Proposed Rules and to ensure that the views of all participants in the cleared derivatives markets are taken into account, MFA respectfully requests that the Commission affirmatively mandate inclusion of customers on DCO default committees and governing bodies. In addition, we strongly support the Commission's proposed "fair and open access" mandate in § 39.12 as a catalyst for breaking down the barriers to customers becoming direct DCO members, and encourage the Commission to retain this requirement in the final rules. We believe that such customer representation and "fair and open access" would strengthen the Proposed Rules and lead to fair, impartial, and balanced DCO decision-making.

I. DCO Governance Requirements

MFA is grateful that the Proposed Rules would amend § 39.16(c) to allow non-clearing members to participate in DCO default committees and would incorporate new § 39.26 to require the composition of a DCO's governing board or committee to include "market participants".⁷ We respectfully request that the Commission facilitate customer representation (separate and apart from other market participants) by affirmatively mandating inclusion of customers on DCO default committees and governing bodies.

MFA believes that customer representation in DCO governance is critical to mitigating conflicts of interest and to ensuring that diverse perspectives are brought into DCO decision-making processes. Customers are important stakeholders whose trading volume is a substantial portion of the cleared derivatives markets. Customers also have invaluable insights to contribute to DCO governance because they:

- (1) Have sophisticated derivatives product and risk management expertise;
- (2) Have significant knowledge about the issues market participants encounter when seeking direct and indirect clearing membership and access to best execution;
- (3) Are able to represent the substantial buy-side component of each market; and
- (4) Can act as a counterbalance to historically aligned and concentrated dealer interests.

We believe that DCOs and market participants in the cleared derivatives market are best served by DCOs' default committees and governing bodies being impartial and balanced, and including fair representation by all stakeholders. The proposals in § 39.16(c) of the Proposed Rules make

⁶ See *id.* at 22278, proposed §§ 39.24, 39.25, and 39.26.

⁷ See *id.*, proposed § 39.26, which defines "market participants" as "any clearing member of the derivatives clearing organization or customer of a clearing member, or an employee, officer, or director of such an entity."

progress towards fulfilling these goals. However, we remained concerned that the Proposed Rules allow for too much discretion with respect to customer inclusion.

In particular, the Proposed Rules permit (but do not mandate) customer inclusion on DCO default committees, whereas clearing member participation is mandatory.⁸ Our understanding is that DCOs already have the authority to voluntarily include customers in their default committees, but they have chosen not to do so. We are not aware of any DCO that has customer representation on its default committees. As a result, we do not believe that any Commission action short of an affirmative mandate will alleviate the bias against customer inclusion on DCO default committees.

Similarly, with respect to DCO governing bodies, the Proposed Rules include a mandate, but that mandate applies to all “market participants”, which is a broad term that extends beyond customers to include clearing members as well as DCO officers, employees, and directors.⁹ Therefore, a DCO could comply with the Proposed Rules by excluding customers from its governing bodies so long as the DCO includes clearing members and/or DCO employees, officers, or directors.

In MFA’s view, Commission measures that require customer representation will foster transparency and confidence in DCOs by leading to greater parity in their governance structure. Customer representation will also further the goal of “fair and open access” because, among other things, DCO governing bodies make decisions as to criteria for DCO membership. In addition, promoting more diverse and dispersed decision-making at DCOs will help to ensure that key decisions result from objective, risk-based criteria intended to enhance the DCO’s business and its ongoing safety and soundness.

As discussed, MFA believes that, as sophisticated market participants and DCO stakeholders, the views and input of customers are unique and their participation in DCOs’ governance essential. Because of the breadth of, and flexibility in, § 39.16(c) and § 39.26, we are concerned that customers could be excluded from DCO default committees and governing bodies without an explicit Commission mandate for customer inclusion that is separate and apart from the mandate for other “market participants”. Therefore, we respectfully urge the Commission to mandate affirmative customer representation on DCO default committees and governing bodies so that DCOs decision-making adequately take the views of all market participants into account.

II. Fair and Open Access

MFA applauds the Commission for proposing amendments to § 39.12, which would require a DCO’s participation requirements to permit “fair and open access”.¹⁰ We believe a “fair and open access” mandate is essential to paving the way for customers to become direct DCO

⁸ See *id.*, § 39.16(c)(1), providing the DCO default committees “shall include clearing members and may include other participants”.

⁹ See *supra* note 7.

¹⁰ See *id.* at 22270, proposed § 39.12(a)(1).

members. As a result, we strongly encourage the Commission to retain this requirement in the final rules.

As the Commission knows, customers are a vital part of the derivatives markets and their full and robust participation is important to the success of U.S. central clearing. At present, customers exclusively access central clearing and DCOs indirectly through clearing members, rather than becoming direct DCO members, for a variety of reasons, both financial and operational. However, such indirect clearing relationships expose customers to counterparty credit risk arising from their clearing member, custodian, and DCO. Indirect clearing also potentially exposes customers to “fellow customer risk” arising from the the *pro rata* sharing of losses resulting from the default of a clearing member’s other customers.¹¹

To mitigate those risks and to address the lack of customer representation on DCO governing bodies as discussed above, some customers would like to become direct DCO clearing members. However, artificial barriers created by DCO membership rules and requirements have presented challenges and limited customers’ ability to do so. Therefore, we strongly support the Commission’s proposed “fair and open access” requirement in § 39.12 and the prohibition on DCOs having “restrictive clearing member standards if less restrictive requirements that achieve the same objective and that would not materially increase risk to the derivatives clearing organization or clearing members could be adopted”.¹² We believe that mandating such access would help to break down these barriers by barring DCO rules that unnecessarily discriminate against customers in respect of clearing membership.

Accordingly, MFA applauds the Commission’s decision to introduce the “fair and open access” requirement in the Proposed Rules. We believe that the inclusion of this requirement demonstrates that the Commission values clearing and customers’ participation in the cleared derivatives market, and we urge the Commission to retain this requirement in the final rules.

¹¹ “Fellow-customer risk” is the risk that a DCO uses assets of a clearing member’s non-defaulting customers to satisfy losses of that clearing member’s defaulting customer in the event that those losses exceed the margin assets of the defaulting customer and the clearing member. While the collateral segregation modeled adopted by the Commission for cleared swaps may reduce “fellow customer risk”, that model has not yet been tested. *See* Commission final rule on “Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions”, 77 Fed. Reg. 6336 (Feb. 7, 2012), available at: <https://www.govinfo.gov/content/pkg/FR-2012-02-07/pdf/2012-1033.pdf>.

¹² Propose Rule Release at 22270.

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MFA appreciates the opportunity to comment on the Proposed Rules. We welcome the opportunity to discuss our views with you in greater detail. Please do not hesitate to contact the undersigned at (202) 730-2600 with any questions the Commission or its Staff might have regarding this letter.

Respectfully submitted,
/s/ Carlotta D. King

Carlotta D. King
Associate General Counsel
Managed Funds Association

cc: The Hon. Heath P. Tarbert, Chairman
The Hon. Brian D. Quintenz, Commissioner
The Hon. Rostin Behnam, Commissioner
The Hon. Dawn DeBerry Stump, Commissioner
The Hon. Dan M. Berkovitz, Commissioner