

## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Parts 3, 39 and 140

RIN 3038-AE65

#### Exemption From Derivatives Clearing Organization Registration

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Supplemental notice of proposed rulemaking.

**SUMMARY:** In August 2018, the Commodity Futures Trading Commission (Commission) proposed regulations that would codify the policies and procedures that the Commission is currently following with respect to granting exemptions from registration as a derivatives clearing organization (registered DCO) (2018 Proposal). The Commission is issuing this supplemental notice of proposed rulemaking to further propose to permit DCOs that are exempt from registration (exempt DCOs) to clear swaps for U.S. customers under certain circumstances. To facilitate this, the Commission also is proposing to allow persons located outside of the United States to accept funds from U.S. persons to margin swaps cleared at an exempt DCO, without registering as futures commission merchants (FCMs). In addition, the Commission is proposing certain amendments to the delegation provisions in part 140 of its regulations.

**DATES:** Comments must be received on or before September 23, 2019.

**ADDRESSES:** You may submit comments, identified by “Exemption From Derivatives Clearing Organization Registration” and RIN number 3038-AE65, by any of the following methods:

- *CFTC Comments Portal:* <https://comments.cftc.gov>. Select the “Submit Comments” link for this rulemaking and follow the instructions on the Public Comment Form.

- *Mail:* Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.

- *Hand Delivery/Courier:* Follow the same instructions as for Mail, above. Please submit your comments using only one of these methods. To avoid possible delays with mail or in-person deliveries, submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <https://>

[comments.cftc.gov](https://comments.cftc.gov). You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act (FOIA), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the Commission’s regulations.<sup>1</sup>

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from <https://comments.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the FOIA.

**FOR FURTHER INFORMATION CONTACT:** Eileen A. Donovan, Deputy Director, 202-418-5096, [edonovan@cftc.gov](mailto:edonovan@cftc.gov); Parisa Abadi, Associate Director, 202-418-6620, [pabadi@cftc.gov](mailto:pabadi@cftc.gov); Eileen R. Chotiner, Senior Compliance Analyst, 202-418-5467, [echotiner@cftc.gov](mailto:echotiner@cftc.gov); Brian Baum, Special Counsel, 202-418-5654, [bbaum@cftc.gov](mailto:bbaum@cftc.gov); August A. Imholtz III, Special Counsel, 202-418-5140, [aimholtz@cftc.gov](mailto:aimholtz@cftc.gov); Abigail S. Knauff, Special Counsel, 202-418-5123, [aknauff@cftc.gov](mailto:aknauff@cftc.gov); Division of Clearing and Risk; Thomas J. Smith, Deputy Director, 202-418-5495, [tsmith@cftc.gov](mailto:tsmith@cftc.gov); Division of Swap Dealer and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.

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<sup>1</sup> 17 CFR 145.9. Commission regulations referred to in this release are found at 17 CFR chapter I (2018), and are accessible on the Commission’s website at <https://www.cftc.gov/LawRegulation/CommodityExchangeAct/index.htm>.

## I. Background

Section 5b(a) of the Commodity Exchange Act (CEA) provides that a clearing organization may not “perform the functions of a [registered DCO]”<sup>2</sup> with respect to swaps unless the clearing organization is registered with the Commission.<sup>3</sup> However, the CEA also permits the Commission to conditionally or unconditionally exempt a clearing organization from registration for the clearing of swaps if the Commission determines that the clearing organization is subject to “comparable, comprehensive supervision and regulation” by its home country regulator.<sup>4</sup> To date, the Commission has exempted four clearing organizations organized outside of the United States (hereinafter referred to as “non-U.S. clearing organizations”) from DCO registration for the clearing of

<sup>2</sup> The term “derivatives clearing organization” is statutorily defined to mean a clearing organization in general. However, for purposes of the discussion in this release, the term “registered DCO” refers to a Commission-registered DCO, the term “exempt DCO” refers to a derivatives clearing organization that is exempt from registration, and the term “clearing organization” refers to a clearing organization that: (a) is neither registered nor exempt from registration with the Commission as a DCO; and (b) falls within the definition of “derivatives clearing organization” under section 1a(15) of the CEA, 7 U.S.C. 1a(15), and “clearing organization or derivatives clearing organization” under § 1.3 of the Commission’s regulations, 17 CFR 1.3.

<sup>3</sup> 7 U.S.C. 7a-1(a). Under section 2(i) of the CEA, 7 U.S.C. 2(i), activities outside of the United States are not subject to the swap provisions of the CEA, including any rules prescribed or regulations promulgated thereunder, unless those activities either have a direct and significant connection with activities in, or effect on, commerce of the United States, or contravene any rule or regulation established to prevent evasion of a CEA provision enacted under the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (Dodd-Frank Act). Therefore, pursuant to section 2(i), the DCO registration requirement extends to any clearing organization whose clearing activities outside of the United States have a direct and significant connection with activities in, or effect on, commerce of the United States.

<sup>4</sup> Section 5b(h) of the CEA, 7 U.S.C. 7a-1(h). Section 5b(h) also permits the Commission to exempt from DCO registration a securities clearing agency registered with the Securities and Exchange Commission; however, the Commission has not granted, nor developed a framework for granting, such exemptions. The Commission has construed “comparable, comprehensive supervision and regulation” to mean that the home country’s supervisory and regulatory framework should be consistent with, and achieve the same outcome as, the statutory and regulatory requirements applicable to registered DCOs. Further, the Commission has deemed a supervisory and regulatory framework that conforms to the Principles for Financial Market Infrastructures to be comparable to, and as comprehensive as, the supervisory and regulatory requirements applicable to registered DCOs. For further background, see 2018 Proposal, 83 FR at 39924.

proprietary swaps for U.S. persons and FCMs.<sup>5</sup>

In the 2018 Proposal,<sup>6</sup> the Commission proposed regulations that would codify the policies and procedures that the Commission currently follows with respect to granting exemptions from DCO registration.<sup>7</sup> The Commission has reviewed the comments received on the 2018 Proposal<sup>8</sup> and is proposing these supplemental regulations in light of those comments.<sup>9</sup> Most significantly, the Commission is now proposing to permit exempt DCOs to clear swaps for U.S. customers<sup>10</sup> under certain circumstances.<sup>11</sup>

<sup>5</sup> See ASX Clear (Futures) Pty Amended Order of Exemption from Registration (Jan. 28, 2016), available at <http://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/asxclearamordercoexemption.pdf>; Korea Exchange, Inc. Order of Exemption from Registration (Oct. 26, 2015), available at <http://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/krxcoexemptorder10-26-15.pdf>; Japan Securities Clearing Corporation Order of Exemption from Registration (Oct. 26, 2015), available at <http://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/jscddcoexemptorder10-26-15.pdf>; OTC Clearing Hong Kong Limited Order of Exemption from Registration (Dec. 21, 2015), available at <http://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/otclearcoexemptorder12-21-15.pdf>.

<sup>6</sup> See Exemption From Derivatives Clearing Organization Registration, 83 FR 39923 (Aug. 13, 2018).

<sup>7</sup> 2018 Proposal, 83 FR 39923.

<sup>8</sup> The Commission received four substantive comment letters: Japan Securities Clearing Corporation (JSCC) comment letter (Oct. 10, 2018); ASX Clear (Futures) Pty comment letter (Oct. 11, 2018); Futures Industry Association (FIA) and Securities and Financial Markets Association (SIFMA) comment letter (Oct. 12, 2018); and International Swaps and Derivatives Association, Inc. (ISDA) comment letter (Oct. 12, 2018).

<sup>9</sup> Procedurally, this supplemental proposal is not a replacement or withdrawal of the 2018 Proposal. Unless specifically amended in this release, all regulatory provisions proposed in the 2018 Proposal remain under active consideration for adoption as final rules. The Commission welcomes comment on both the 2018 Proposal and this supplemental proposal.

<sup>10</sup> See 17 CFR 1.3 for the definition of “customer.” In accordance with Section 2(e) of the CEA, which requires that swaps be transacted on or subject to the rules of a designated contract market unless entered into by an eligible contract participant, such “U.S. customers” must be eligible contract participants. 7 U.S.C. 2(e).

<sup>11</sup> In response to the Commission’s request for comment in Part IV of the 2018 Proposal (83 FR 39923, 39930) as to whether the Commission should “consider permitting an exempt DCO to clear swaps for FCM customers,” three commenters answered in the affirmative. See ASX Clear (Futures) Pty comment letter at 1 (stating that “ASXCF supports the CFTC permitting exempt DCOs to clear swaps for U.S. person customers. ASXCF believes it would be beneficial to allow U.S. person customers to access the broadest possible range of central clearing facilities (“CCPs”) as this would provide U.S. person customers with flexibility and choice in accessing the best commercial solutions for the products that they use subject to those CCPs meeting global QCCP standards under the CPMI-IOSCO Principles for

Specifically, the Commission is proposing to permit U.S. customers to clear at an exempt DCO only through a foreign intermediary and not through an FCM. As discussed below, the Commission is not currently proposing to permit an FCM to clear U.S. customer positions at an exempt DCO (either directly or indirectly through a foreign member of the exempt DCO) due to uncertainty regarding the protection of U.S. customer funds in these circumstances in the event of an insolvency of the FCM.<sup>12</sup> The Commission continues to consider and evaluate this issue, including possible approaches to deal with the uncertainty<sup>13</sup> and the possible risks to customers (both those of registered and exempt DCOs) that may result from that uncertainty, and requests public comment to assist in that regard.

## II. Proposed Amendments to Part 3

The Commission’s current exempt DCO framework permits U.S. persons to clear proprietary swap transactions at an exempt DCO, provided that the U.S. person is a direct clearing member, or an affiliate of a direct clearing member, of the exempt DCO. Thus, a clearing member of an exempt DCO at this time may not clear swap transactions for U.S. persons that are customers of the clearing member.

Financial Market Infrastructures (PFMIs).”); JSCC comment letter at 5 (stating that “JSCC would like the CFTC to consider the potential benefits of allowing U.S. customers to access exempt DCOs, using a similar approach to the correspondent clearing structure adopted for foreign futures markets, by permitting . . . non-U.S. clearing members in an exempt DCO to clear for U.S. customers, without the necessity to register as a FCM, as long as those non-U.S. clearing members can demonstrate that they are properly supervised, regulated, and licensed to provide customer clearing services in their home countries, where the regulatory authority maintains appropriate cooperative arrangements with the CFTC.”); and ISDA comment letter at 3 (stating “[i]n response to the Commission’s question about customer clearing, and ISDA strongly believes that the CFTC should permit exempt DCOs to clear swaps for customers.”).

<sup>12</sup> See Appendix A to Futures Industry Association (FIA) and Securities and Financial Markets Association (SIFMA) comment letter (Oct. 12, 2018), Promoting U.S. Access to Non-U.S. Swaps Markets: A Roadmap to Reverse Fragmentation, at 27 (Dec. 14, 2017) (FIA/SIFMA White Paper) (“The discrepancy between the [Bankruptcy] Code’s ‘clearing organization’ definition (which is limited to registered DCOs) and the DCO definition in the CEA (which includes any CCP for swaps, whether registered or not), as well as the absence of a separate prong in the ‘commodity contract’ definition for ‘foreign cleared swaps’ like the prong for ‘foreign futures,’ creates uncertainty as to whether swaps cleared through a non-U.S. CCP are commodity contracts under the Code if the CCP does not register as a DCO.”).

<sup>13</sup> See, e.g., FIA/SIFMA White Paper at 27–36, attached as Appendix A to FIA/SIFMA comment letter (Oct. 12, 2018).

The Commission is proposing in this release to expand the exempt DCO framework to permit an exempt DCO to clear swap transactions for U.S. persons that are not clearing members, or affiliates of clearing members, of the exempt DCO (*i.e.*, U.S. persons that are customers of a clearing member).

This proposal would further require a foreign intermediary that clears for customers that are U.S. persons to be a direct clearing member of the exempt DCO. As a direct clearing member, the foreign intermediary must comply with any regulations of the home country regulator applicable to the foreign intermediary’s activities as a market intermediary, including regulations addressing the holding and safeguarding of customer funds.

In order to permit foreign intermediaries to clear swaps for U.S. persons, the Commission is proposing to exercise its authority under section 4(c) of the CEA to exempt foreign intermediaries from the prohibition in section 4d(f) of the CEA against accepting customer funds to clear swaps at a registered or exempt DCO without registering as FCMs.<sup>14</sup> Specifically, the Commission is proposing to amend § 3.10(c), which addresses, among other things, exemption from FCM registration provisions for certain persons. Proposed § 3.10(c)(7)(i) would provide an exemption to a person located outside of the United States, its territories, or possessions (*i.e.*, a foreign intermediary) from the requirement to register as an FCM if the foreign intermediary accepts funds from U.S. persons to margin, guarantee, or secure swap transactions cleared by an exempt DCO.<sup>15</sup>

The Commission is further proposing § 3.10(c)(7)(ii) to provide that a foreign

<sup>14</sup> 7 U.S.C. 6(c). Section 4(c) of the CEA provides that, in order to promote responsible economic or financial innovation and fair competition, the Commission, by rule, regulation, or order, after notice and opportunity for hearing, may exempt any agreement, contract, or transaction, or class thereof, including any person or class of persons offering, entering into, rendering advice, or rendering other services with respect to, the agreement, contract, or transaction, from the contract market designation requirements of section 4(a) of the CEA, or any other provision of the CEA other than certain enumerated provisions, if the Commission determines that the exemption would be consistent with the public interest and the purposes of the CEA, and that the agreement, contract, or transaction will be entered into solely between appropriate persons and will not have a material adverse effect on the ability of the Commission or any designated contract market (DCM) to discharge its regulatory or self-regulatory duties.

<sup>15</sup> The Commission is proposing to amend § 3.10(c) by adding a new paragraph (7). The Commission previously proposed a new paragraph (6) to § 3.10(c) which has not been finalized. See Exemption from Registration for Certain Foreign Persons, 81 FR 51824 (Aug. 5, 2016).

intermediary exempt from registering as an FCM under § 3.10(c)(7)(i) is not required to comply with provisions of the CEA and of the rules, regulations, or orders issued by the Commission that are applicable solely to a registered FCM. Proposed paragraph (c)(7)(ii) would provide that a foreign intermediary that is exempt from registering as an FCM under § 3.10(c)(7)(i) would not be required to comply with the Commission's regulations applicable to FCMs, including minimum capital, segregation of customer funds, and financial reporting requirements.<sup>16</sup> The purpose of this proposed provision is to clarify that the foreign intermediary would be exempt not only from the registration requirement of section 4d(f) of the CEA, but also from all other provisions and regulations applicable to FCMs, including regulations regarding the holding of customer segregated funds and FCM capital and financial reporting requirements.

Proposed § 3.10(c)(7)(iii) would prohibit a foreign intermediary exempt from registering as an FCM under § 3.10(c)(7)(i) from engaging in any other activities that would require the foreign intermediary to register as an FCM, and from voluntarily registering as an FCM.<sup>17</sup> This provision is consistent with proposed § 39.6(b)(1)(i) discussed below, which provides as a condition of the exempt DCO's exemption that only a foreign intermediary that is not an FCM may clear U.S. customers' positions.<sup>18</sup> The proposed FCM registration exemption for foreign intermediaries is also consistent with the exempt DCO framework being proposed by the Commission. As noted above, the proposed exempt DCO framework is based on deference to the regulation and supervision of the exempt DCO by its home country regulator.

Proposed § 3.10(c)(7)(iv) would require a foreign intermediary exempt from registering as an FCM under § 3.10(c)(7)(i) to directly clear the swaps of U.S. persons at the exempt DCO. A

foreign intermediary may not use another intermediary to clear U.S. persons' swap transactions. The purpose of this provision is to ensure that the foreign intermediary, as a direct clearing member of the exempt DCO, is subject to the rules and supervision of the exempt DCO. If a foreign intermediary is not a direct clearing member, an exempt DCO may not be in a position to directly monitor the foreign intermediary's activities and ensure that the exempt DCO complies with the conditions of its exemption.

Proposed § 3.10(c)(7)(v) would provide that a foreign intermediary exempt from registering as an FCM under § 3.10(c)(7)(i) may provide trading advice to U.S. persons with respect to swaps cleared by an exempt DCO without registering as a commodity trading advisor (CTA), provided that the foreign intermediary does not engage in any other activity requiring registration as a CTA. The Commission recognizes that a foreign intermediary, in soliciting and accepting orders from U.S. persons for swaps cleared at an exempt DCO, may provide advice regarding those swap transactions, which generally would require the foreign intermediary to register with the Commission as a CTA.<sup>19</sup> The proposed CTA registration exemption for foreign intermediaries is consistent, however, with the exempt DCO framework being proposed by the Commission. As noted above, the proposed exempt DCO framework is based on deference to the regulation and supervision of the exempt DCO by its home country regulator, which would include regulations governing the providing of trading advice.<sup>20</sup>

In proposing the CTA registration exemption, the Commission is removing a potential impediment or disincentive for foreign intermediaries to accept U.S. persons as customers, which would provide U.S. persons with greater access to swap markets while also focusing the Commission's and National Futures Association's resources on markets and registrants that have a greater connection to the U.S. marketplace.<sup>21</sup> In addition, the proposal would limit the availability of the CTA registration exemption to instances where the

foreign intermediary is providing trading advice solely to U.S. persons with respect to its solicitation for, and acceptance of, swap transactions that are cleared by an exempt DCO.<sup>22</sup> A foreign intermediary that engages in any activity that requires CTA registration beyond providing trading advice to U.S. persons solely with respect to swap transactions cleared by an exempt DCO would still be required to register as a CTA, absent another available registration exemption.<sup>23</sup>

The Commission believes the proposed exemption in § 3.10(c)(7) promotes responsible financial innovation and fair competition, while also being consistent with the public interest and the purposes of the CEA. The Commission further believes that the proposal is limited to appropriate persons, as only U.S. persons that are eligible contract participants would be permitted to maintain accounts with a foreign intermediary for swaps cleared at an exempt DCO.<sup>24</sup> Eligible contract participants are generally required to meet certain financial or other standards that are intended to distinguish them from less sophisticated retail investors.

As noted above, the exemption is necessary to effectuate the proposed exempt DCO framework; absent such an exemption, foreign intermediaries would be prohibited from accepting U.S. customer funds to clear swaps at an exempt DCO without registering as FCMs. In this connection, the Commission believes that the proposed exemption is consistent with the purposes of the CEA in that the proposal would provide U.S. persons with additional options regarding the trading and clearing of swap transactions. The ability of U.S. customers (*i.e.*, U.S. persons that are not direct members of exempt DCOs, or the affiliates of such members) to use foreign intermediaries to carry their accounts for clearing at exempt DCOs would potentially expand the number of intermediaries that

<sup>22</sup> The Commission notes that the proposed CTA registration exemption for a foreign intermediary is analogous to the exclusion of an FCM from the definition of a CTA contained in section 1(a)(12) of the CEA.

<sup>23</sup> See, e.g., 17 CFR 4.14(a)(10) (providing an exemption from registration for CTAs that advise 15 or fewer persons within the preceding 12 months and that do not hold themselves out to the public as CTAs).

<sup>24</sup> Section 2(e) of the CEA makes it unlawful for any person, other than an eligible contract participant, to enter into a swap unless the swap is entered into on, or subject to the rules of, a DCM. 7 U.S.C. 2(e). "Eligible contract participant" is defined in section 1a(18) of the CEA and § 1.3. 7 U.S.C. 1a(18); 17 CFR 1.3. The Commission's regulations require any transaction executed on or through a DCM to be cleared at a registered DCO. See 17 CFR 38.601.

<sup>16</sup> See 17 CFR 1.17 for FCM capital requirements; 17 CFR parts 1 and 22 for treatment of customer funds, and requirements for cleared swaps, respectively; and 17 CFR 1.10, 1.12, 1.16, and 1.32 for certain financial and operational reporting requirements.

<sup>17</sup> The Commission is proposing to prohibit a foreign intermediary from voluntarily registering as an FCM due to the uncertainty of how customer funds held by the FCM to margin swaps cleared at an exempt DCO would be treated under a bankruptcy proceeding. See section III.C.2. below for further discussion of potential issues associated with an FCM insolvency proceeding. Proposed § 3.10(c)(7)(i), however, would not prohibit an FCM from clearing proprietary swaps at an exempt DCO.

<sup>18</sup> See the discussion at notes 47–55, below.

<sup>19</sup> A CTA is defined in § 1.3 of the Commission's regulations, 17 CFR 1.3, in relevant part, as any person who, for compensation or profit, engages in the business of advising others, either directly or through publications, writings or electronic media, as to the value of or the advisability of trading in any contract of sale of a commodity for future delivery, security futures product, or swap. See also 7 U.S.C. 1a(12).

<sup>20</sup> See proposed § 3.10(c)(7)(iv).

<sup>21</sup> National Futures Association is the self-regulatory organization with oversight responsibility for CTAs.

currently clear swaps for U.S. persons. Currently, only 17 FCMs clear swaps for customers, with a substantial concentration in a small number of entities (the top five and the top ten FCMs carry 76 percent and 98 percent of the total cleared swaps customer funds, respectively).<sup>25</sup> The expansion of the exempt DCO framework to include foreign intermediaries clearing for U.S. customers has the potential for increasing the number of market intermediaries clearing for U.S. persons and reducing the concentration of U.S. customer funds in a small number of FCMs.

The proposal also furthers the public interest and purposes of the CEA by providing U.S. customers (*i.e.*, U.S. persons that are not direct members of exempt DCOs, or the affiliates of such members) with access to swaps that are cleared in foreign jurisdictions that U.S. customers otherwise would not be able to access. As noted above, U.S. customers are not currently permitted to clear swaps at non-U.S. clearing organizations that are not registered with the Commission, which may impact their ability to effectively hedge certain exposures. This limited access may become a more acute issue as margin rules for non-cleared swap transactions come fully into effect. Full implementation of the non-cleared margin rules may incentivize market participants not currently subject to them to engage in more cleared swap transactions and fewer non-cleared swap transactions. This would reduce liquidity in the non-cleared markets and provide for greater liquidity in more standardized, cleared contracts. To the extent that liquidity develops in contracts cleared at non-U.S. clearing organizations that are not registered DCOs, U.S. customers would not have access to those cleared markets absent the proposed exempt DCO framework.<sup>26</sup>

The risks to U.S. swaps customers from clearing swaps traded on exempt DCOs through foreign intermediaries that are not registered as FCMs would be mitigated under the proposal by requiring exempt DCOs to be in good regulatory standing in their home country jurisdictions, and subject to comparable, comprehensive supervision and regulation by their home country regulators that includes a regulatory structure that is consistent with the PFMI. Furthermore, as discussed

below, the proposal would provide that an exempt DCO must require a foreign intermediary to provide written notice to, and obtain acknowledgement from, a U.S. person prior to clearing any swaps for such person that the clearing member is not a registered FCM, that the exempt DCO is not registered with the Commission, and that the protections of the U.S. Bankruptcy Code (Bankruptcy Code) do not apply to the U.S. person's funds. The notice also must explicitly compare the protections available to the U.S. person under U.S. law and the laws of the exempt DCO's home country regulatory regime.

The Commission also does not believe that exempting foreign intermediaries from FCM registration to clear swap transactions for U.S. persons at exempt DCOs will have a material adverse effect on the ability of the Commission to discharge its regulatory duties. As discussed in section III below, a non-U.S. clearing organization must not pose substantial risk to the U.S. financial system in order to qualify for an exemption from DCO registration. In addition, the proposed exempt DCO framework is based on deference to the regulation and supervision of an exempt DCO by its home country regulator, including the regulation and supervision of the foreign intermediaries that are clearing members of the exempt DCO. The exempt DCO must be organized in a jurisdiction in which it is subject, on an ongoing basis, to statutes, rules, regulations, policies, or a combination thereof that, taken together, are consistent with the PFMI, including principles related to the segregation of customer funds.<sup>27</sup> An exempt DCO also must agree to provide the Commission with information necessary to evaluate its initial and continued eligibility for exemption and its compliance with any conditions of exemption. Accordingly, the Commission believes that the exempt DCO framework provides an effective balancing of regulatory protections with financial innovation to provide U.S. customers with access to cleared swap markets that are otherwise not available to them.

### III. Proposed Amendments to Part 39

#### A. Overview of Supplements to 2018 Proposal

In addition to certain technical revisions, the Commission is proposing certain supplements to its 2018

Proposal. As noted above, the 2018 Proposal would codify existing requirements that exempt DCOs report to the Commission certain information regarding swap clearing by U.S. persons. The Commission proposed these requirements because it recognized that U.S. swap clearing activity at an exempt DCO could grow such that the exempt DCO poses substantial risk to the U.S. financial system. The Commission believes that when the amount of U.S. clearing activity at an exempt DCO reaches that point, the DCO should be registered with, and be subject to oversight by, the Commission. The Commission is issuing this supplemental proposal to require that, for a clearing organization to be eligible for an exemption from registration, the Commission must determine that the clearing organization does not pose substantial risk to the U.S. financial system. The Commission is proposing a test the Commission would use in making this determination, as discussed below. The Commission also is proposing in this release to reduce the daily and quarterly reporting requirements for exempt DCOs to include only information necessary for the Commission to evaluate the continued eligibility of the exempt DCO for exemption under the "substantial risk" test and assess the DCO's U.S. clearing activity.

In addition, the supplemental conditions of exemption would require an exempt DCO to have rules that prohibit the clearing of customer positions, including U.S. customer positions, by FCMs. Furthermore, an exempt DCO would be required to have rules requiring any clearing member seeking to clear for a U.S. customer to provide written notice to, and obtain acknowledgement from, the customer prior to clearing, among other things, that the protections of the Bankruptcy Code do not apply to the U.S. customer's funds and comparing the protections available to the U.S. customer under U.S. law and the exempt DCO's home country regime.

Lastly, the Commission is proposing to add a process and conditions under which the Commission may modify or terminate an exemption upon its own initiative.

#### B. Regulation 39.2—Definitions

##### 1. Principles for Financial Market Infrastructures

The Commission is proposing to modify the definition of "Principles for Financial Market Infrastructures" as

<sup>25</sup> See Financial Data for FCMs (as of March 31, 2019), available at <https://www.cftc.gov/MarketReports/financialfcmdata/index.htm>.

<sup>26</sup> Further, the possible reduction in liquidity in the non-cleared markets for similar contracts could potentially impact execution quality for U.S. customers in the non-cleared markets.

<sup>27</sup> See Principle 14, Segregation and portability, PFMI, issued by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organizations of Securities Commissions, April 2012.

previously proposed in § 39.2.<sup>28</sup> The Commission previously proposed to define this term to mean the “[PFMIs] jointly published by the Committee on Payments and Market Infrastructures and the Technical Committee of the International Organization of Securities and Commissions in April 2012, as updated, revised or otherwise amended.”<sup>29</sup> The Commission proposed the “as updated, revised or otherwise amended” qualifying language to recognize that CPMI-IOSCO could offer further interpretation of or guidance on the PFMIs.<sup>30</sup>

The Commission is proposing in this release to strike the qualifying language from the definition. The Commission notes that, in adopting regulations under subpart C of part 39,<sup>31</sup> the Commission looked to the Principles and Key Considerations in the PFMIs, but it has not adopted subsequent guidance on the PFMIs. While an exempt DCO’s home country regulator may voluntarily adopt or amend its statutes, rules, regulations, policies, or combination thereof to incorporate subsequent interpretations and guidance, the home country regulator is not required to do so to maintain a regulatory regime that is comparable to and as comprehensive as the PFMIs. The Commission believes that striking that portion of the proposed definition would provide exempt DCOs with greater regulatory certainty, as a DCO’s eligibility to remain exempt from registration would not be contingent on whether a home country regulator has adopted CPMI-IOSCO’s latest interpretations or guidance.

## 2. Substantial Risk to the U.S. Financial System

For purposes of this rulemaking, the Commission is proposing to define “substantial risk to the U.S. financial system” to mean, with respect to an exempt or registered non-U.S. DCO, that (1) the DCO holds 20 percent or more of the required initial margin of U.S. clearing members for swaps across all registered and exempt DCOs; and (2) 20 percent or more of the initial margin requirements for swaps at that DCO is attributable to U.S. clearing members; provided, however, where one or both of these thresholds are close to 20 percent, the Commission may exercise discretion in determining whether the DCO poses substantial risk to the U.S. financial system. For purposes of this

definition and proposed §§ 39.6 and 39.51, the Commission is proposing to clarify that “U.S. clearing member” means a clearing member organized in the United States or whose ultimate parent company is organized in the United States, or an FCM.<sup>32</sup>

This definition sets forth the test the Commission would use to identify those non-U.S. DCOs that pose substantial risk to the U.S. financial system, as these DCOs would not be eligible for an exemption from DCO registration. The proposed test consists of two prongs. The first prong, which is directly related to systemic risk, is whether the DCO holds 20 percent or more of the required initial margin<sup>33</sup> of U.S. clearing members for swaps across all registered and exempt DCOs. The Commission notes that its primary systemic risk-related concern is the potential for loss of clearing services for a significant part of the U.S. swaps market in the event of a catastrophic occurrence affecting the DCO. The second prong is whether U.S. clearing members account for 20 percent or more of the initial margin requirements for swaps at that DCO. This prong of the test, intended to respect international comity, would capture a non-U.S. DCO only if a large enough proportion of its clearing activity were attributable to U.S. clearing members such that the U.S. has a substantial interest warranting more active oversight by the Commission.<sup>34</sup>

<sup>32</sup> On July 11, 2019, the Commission approved a separate notice of proposed rulemaking entitled “Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations,” that will be published in the *Federal Register*. In that release, the Commission is proposing an identical definition of “substantial risk to the U.S. financial system.”

<sup>33</sup> In general, initial margin requirements are risk-based and are meant to cover a registered or exempt DCO’s potential future exposure to clearing members based on price movements in the interval between the last collection of variation margin and the time within which the DCO estimates that it would be able to liquidate a defaulting clearing member’s portfolio. The relative risk that a DCO poses to the financial system can be identified by the cumulative sum of initial margin collected by the DCO. As a result, the Commission has found initial margin to be an appropriate measure of risk.

<sup>34</sup> In developing this proposal, the Commission is guided by principles of international comity, which counsel due regard for the important interests of foreign sovereigns. See Restatement (Third) of Foreign Relations Law of the United States (the Restatement). The Restatement provides that even where a country has a basis for jurisdiction, it should not prescribe law with respect to a person or activity in another country when the exercise of such jurisdiction is unreasonable. See Restatement section 403(1). The reasonableness of such an exercise of jurisdiction, in turn, is to be determined by evaluating all relevant factors, including certain specifically enumerated factors where appropriate: (1) The link of the activity to the territory of the regulating state, *i.e.*, the extent to which the activity takes place within the territory, or has substantial, direct, and foreseeable effect upon or in the

The Commission believes that, in the context of this test, the term “substantial” would reasonably apply to proportions of approximately 20 percent or greater. The Commission stresses that this is not a bright-line test; by offering this figure, the Commission does not intend to suggest that, for example, a DCO that holds 20.1 percent of the required initial margin of U.S. clearing members would potentially pose substantial risk to the U.S. financial system, while a DCO that holds 19.9 percent would not. The Commission is instead seeking to offer some indication of how it would assess the meaning of the term “substantial” in the test.

The Commission recognizes that a test based solely on initial margin requirements may not fully capture the risk of a given DCO. The Commission therefore proposes to retain discretion in determining whether a non-U.S. DCO poses substantial risk to the U.S. financial system, particularly where the DCO is close to 20 percent on both prongs of the test. In these cases, in making its determination, the Commission may look at other factors that may reduce or mitigate the DCO’s risk to the U.S. financial system or provide a better indication of the DCO’s risk to the U.S. financial system.

## C. Regulation 39.6—Exemption From DCO Registration

As discussed above, the Commission is proposing to expand its exempt DCO framework to permit exempt DCOs to clear customer positions of U.S. persons through foreign intermediaries that are not registered as FCMs. The Commission is therefore proposing certain changes to § 39.6 as previously proposed to effectuate this approach.

territory; (2) the connections, such as nationality, residence, or economic activity, between the regulating state and the persons principally responsible for the activity to be regulated, or between that state and those whom the regulation is designed to protect; (3) the character of the activity to be regulated, the importance of regulation to the regulating state, the extent to which other states regulate such activities, and the degree to which the desirability of such regulation is generally accepted; (4) the existence of justified expectations that might be protected or hurt by the regulation; (5) the importance of the regulation to the international political, legal, or economic system; (6) the extent to which the regulation is consistent with the traditions of the international system; (7) the extent to which another state may have an interest in regulating the activity; and (8) the likelihood of conflict with regulation by another state. See Restatement section 403(2). Notably, the Restatement does not preclude concurrent regulation by multiple jurisdictions. However, where concurrent jurisdiction by two or more jurisdictions creates conflict, the Restatement recommends that each country evaluate its own interests in exercising jurisdiction and those of the other jurisdiction, and where possible, to consult with each other.

<sup>28</sup> See 2018 Proposal, 83 FR at 39925.

<sup>29</sup> *Id.* at 33934.

<sup>30</sup> *Id.* at n.14.

<sup>31</sup> See Derivatives Clearing Organizations and International Standards, 78 FR 72476 (Dec. 2, 2013).

### 1. Regulation 39.6(a)—Eligibility for Exemption

As previously proposed, § 39.6(a) would provide that the Commission may exempt a non-U.S. clearing organization from registration as a DCO for the clearing of swaps for U.S. persons,<sup>35</sup> and thereby exempt such clearing organization from compliance with the provisions of the CEA and Commission regulations applicable to registered DCOs, if the Commission determines that all of the eligibility requirements listed in proposed § 39.6(a) are met, and that the clearing organization satisfies the conditions set forth in § 39.6(b).<sup>36</sup> As an additional eligibility requirement, the Commission is proposing to require in § 39.6(a)(2)<sup>37</sup> that the clearing organization does not pose substantial risk to the U.S. financial system, as determined by the Commission (as discussed above).

The Commission has found that the existing reporting requirements for exempt DCOs provide the Commission with relevant information in order to analyze the risks presented by U.S. persons clearing at an exempt DCO and to assess the extent to which U.S. business is being cleared by each exempt DCO. As discussed below, the Commission is proposing in this release to modify the daily and quarterly reporting requirements for exempt DCOs to include only information necessary for the Commission to evaluate whether an exempt DCO meets the “substantial risk to the U.S. financial system” definition and to assess the extent to which U.S. business is being cleared by each exempt DCO. Based on this information, to the extent that an exempt DCO’s cleared swaps activity for U.S. persons reaches a level such that the exempt DCO would pose substantial risk to the U.S. financial system, the

<sup>35</sup> The Commission proposes to use the definition of “U.S. person” as set forth in the Commission’s Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 FR 45292, 45316—45317 (July 26, 2013) (2013 Cross-Border Guidance), as such definition may be amended or superseded by a definition of the term “U.S. person” that is adopted by the Commission and applicable to this proposed regulation.

<sup>36</sup> The eligibility requirements listed in proposed § 39.6(a) and the conditions set forth in proposed § 39.6(b) would be pre-conditions to the Commission’s issuance of any order exempting a clearing organization from the DCO registration requirement of the CEA and Commission regulations. Additional conditions that are unique to the facts and circumstances specific to a particular clearing organization could be imposed upon that clearing organization in the Commission’s order of exemption, as permitted by section 5b(h) of the CEA.

<sup>37</sup> To implement the proposed change, the Commission is proposing to renumber previously proposed § 39.6(a)(2) as § 39.6(a)(3).

Commission may find that it does not qualify for an exemption from DCO registration.

### 2. Regulation 39.6(b)—Conditions of Exemption

Proposed § 39.6(b) sets forth conditions to which an exempt DCO would be subject. The Commission is proposing in this release to modify these conditions, as discussed below.

As originally proposed, the effect of § 39.6(b)(1) was to prohibit the clearing of all U.S. customer positions at an exempt DCO. To effectuate clearing of U.S. customer positions at an exempt DCO as set forth in this release, the Commission is proposing to modify the conditions set forth in § 39.6(b)(1) to specify that: (i) An intermediary that clears swaps for a U.S. person may not be registered with the Commission as an FCM; and (ii) an FCM may be a clearing member of an exempt DCO, or maintain an account with an affiliated broker that is a clearing member, for the purpose of clearing swaps for the FCM itself and those persons identified in the definition of “proprietary account” in § 1.3 of the Commission’s regulations.<sup>38</sup>

The proposed modifications to the conditions in § 39.6(b)(1) are due to uncertainty as to whether, in the event of an FCM bankruptcy proceeding, swaps customers funds deposited at exempt DCOs, or margining swaps cleared at exempt DCOs, would be treated as customer property under the Bankruptcy Code to the same extent as if they were deposited at a registered DCO. The CEA and Commission regulations establish a customer protection regime that is intended to ensure that an FCM holds, at all times, a sufficient amount of money, securities, and/or property in specially designated customer segregated accounts with authorized depositories to satisfy the FCM’s total outstanding obligation to each customer engaging in cleared swap transactions.<sup>39</sup> Specifically, section 4d(f)(1) of the CEA provides that it is unlawful for any person to accept money, securities, or property (*i.e.*, funds) from, for, or on behalf of a swaps customer to margin swaps cleared

<sup>38</sup> The text of proposed § 39.6(b)(1)(ii), previously proposed as § 39.6(b)(1)(iii), is unchanged. It is intended to permit what would be considered clearing of “proprietary” positions under the Commission’s regulations, even if the positions would qualify as “customer” positions under the laws and regulations of an exempt DCO’s home country. This provision would clarify that an exempt DCO may clear positions for FCMs if the positions are not “customer” positions under the Commission’s regulations.

<sup>39</sup> See 17 CFR 22.2(f) (setting forth requirements for FCM treatment of cleared swaps and associated cleared swaps customer collateral).

through a registered or exempt DCO (including funds accruing to the customer as a result of such swaps) unless the person is registered as an FCM.<sup>40</sup> In addition, any swaps customer funds held by a registered or exempt DCO are subject to the segregation requirements of section 4d(f)(2) of the CEA and part 22 of the Commission’s regulations, which includes a requirement that the DCO must treat and deal with a swaps customer’s funds as belonging to the swaps customer of the FCM and not as the property of other persons, including the FCM.<sup>41</sup>

The segregation requirements are intended to ensure that customer property in an FCM insolvency proceeding is not subject to the risk of the FCM’s proprietary business operations and is available for distribution to customers. In this regard, section 766 of the Bankruptcy Code provides that the trustee in an FCM liquidation proceeding “shall distribute *customer property* ratably to *customers* on the basis and to the extent of such *customers’* allowed net equity claims,” except for certain administrative expenses.<sup>42</sup>

The Bankruptcy Code definitions of “customer” and “customer property,” in turn, are tied to claims based on a “commodity contract.”<sup>43</sup> The Commission notes that one prong of the Bankruptcy Code’s definition of “commodity contract” requires that a commodity contract be cleared through a “clearing organization,”<sup>44</sup> which the Bankruptcy Code defines as a DCO “registered under the [CEA].”<sup>45</sup> When the CEA was amended by the Dodd-Frank Act to provide for exempt DCOs, the Bankruptcy Code was not similarly amended. Commenters have suggested, however, that another prong of the Bankruptcy Code’s definition of

<sup>40</sup> 7 U.S.C. 6d(f)(1). This provision establishes a customer protection regime for swaps customers that is broadly similar to the regime for futures customers and options on futures customers under sections 4d(a) and (b) of the CEA. 7 U.S.C. 6d(a) and (b).

<sup>41</sup> See 17 CFR 22.3(a) (setting forth requirements for registered DCO treatment of cleared swaps customer collateral).

<sup>42</sup> See 11 U.S.C. 766(h) (emphasis added).

<sup>43</sup> See 11 U.S.C. 766(9)(A).

<sup>44</sup> See Section 761(4)(F)(ii) of the Bankruptcy Code (referring to, “with respect to a futures commission merchant or a clearing organization,” a contract “that is cleared by a clearing organization”).

<sup>45</sup> See Section 761(2) of the Bankruptcy Code, 11 U.S.C. 761(2) (defining a “clearing organization” as a derivatives clearing organization registered under the CEA). See also § 190.01(f) of the Commission’s regulations, 17 CFR 190.01(f) (stating that, for purposes of the Commission’s part 190 bankruptcy rules, “clearing organization” has the same meaning as that set forth in section 761(2) of the Bankruptcy Code).

“commodity contract” may be applicable to exempt DCOs.<sup>46</sup> The Commission continues to consider and evaluate this issue, and, as discussed below, requests public comment to assist in that regard.

The Commission is proposing to require in § 39.6(b)(2) that an exempt DCO have rules that require any clearing member proposing to clear for a U.S. person to provide written notice to, and obtain acknowledgement from, the U.S. person prior to clearing that the clearing member is not a registered FCM, the DCO is exempt from registration, and the protections of the U.S. Bankruptcy Code do not apply to the U.S. person’s funds. The notice must explicitly compare the protections available to the U.S. person under U.S. law and the exempt DCO’s home country regulatory regime. This requirement would serve as notice to U.S. persons of the standards and risks that would apply in the exempt DCO’s home country with respect to clearing through the non-FCM clearing member and the exempt DCO.<sup>47</sup>

Furthermore, § 39.6(b)(6) as previously proposed would require that an exempt DCO provide an annual certification that it continues to observe the PFMI in all material respects, within 60 days following the end of its fiscal year. The Commission is proposing in this release to modify this condition, proposed to be renumbered as § 39.6(b)(7), to specify the information that an exempt DCO must provide to the Commission if it is unable to provide an unconditional certification that it continues to observe the PFMI in all material respects. Specifically, the exempt DCO would be required to identify the underlying material non-observance of the PFMI and explain whether and how such non-observance has been or is being resolved by the exempt DCO. The Commission has encountered issues with conditional certifications and believes this supplemental proposal would provide greater regulatory certainty to an exempt

DCO that has identified an issue with its compliance with the PFMI, while also providing the Commission with the assurance it requires regarding the exempt DCO’s observance of the PFMI.

Lastly, under proposed § 39.6(b)(9), the Commission may condition an exemption on any other facts and circumstances it deems relevant. In doing so, the Commission would be mindful of principles of international comity. For example, the Commission could take into account the extent to which the relevant foreign regulatory authorities defer to the Commission with respect to oversight of registered DCOs organized in the United States. This approach would advance the goal of regulatory harmonization, consistent with the express directive of Congress that the Commission coordinate and cooperate with foreign regulatory authorities on matters related to the regulation of swaps.<sup>48</sup>

### 3. Regulation 39.6(c)—General Reporting Requirements

As previously proposed, § 39.6(c)(1) sets forth general reporting requirements pursuant to which an exempt DCO would have to provide certain information directly to the Commission: (1) On a periodic basis (daily or quarterly); and (2) after the occurrence of a specified event, each in accordance with the submission requirements of § 39.19(b).<sup>49</sup> The Commission is proposing in this release to modify the daily and quarterly reporting requirements for exempt DCOs to include only information necessary for the Commission to evaluate the continued eligibility of the exempt DCO for exemption and to assess the extent to which U.S. business is being cleared by each exempt DCO.

Specifically, proposed § 39.6(c)(2)(i) would require an exempt DCO to compile a report as of the end of each trading day, and submit it to the Commission by 10:00 a.m. U.S. Central time on the following business day, containing with respect to swaps: (A)

Total initial margin requirements for all clearing members; (B) initial margin requirements and initial margin on deposit for each U.S. clearing member,<sup>50</sup> by house origin and by each customer origin, and by each individual customer account; (C) with respect to an intermediary that clears swaps for a U.S. person, initial margin requirements and initial margin on deposit for each individual customer account of each U.S. person; and (D) daily variation margin, separately listing the mark-to-market amount collected from or paid to each U.S. clearing member. If a clearing member margins on a portfolio basis its own positions and the positions of its affiliates, and either the clearing member or any of its affiliates is a U.S. person, the exempt DCO would be required to separately list the mark-to-market amount collected from or paid to each such clearing member, on a combined basis. These reports would provide the Commission with information regarding the margin associated with U.S. persons clearing swaps through exempt DCOs in order to analyze the risks presented by such U.S. persons and to assess the extent to which U.S. business is being cleared by each exempt DCO.<sup>51</sup>

Proposed § 39.6(c)(2)(ii) would require an exempt DCO to compile a report as of the last day of each fiscal quarter, and submit the report to the Commission no later than 17 business days after the end of the fiscal quarter, containing a list of U.S. persons and FCMs<sup>52</sup> that are either clearing members or affiliates of any clearing member, with respect to the clearing of swaps, as of the last day of the fiscal quarter. This information would enable the Commission, in conducting risk surveillance of U.S. persons and swaps markets more broadly, to better understand and evaluate the nature and extent of the cleared swaps activity of U.S. persons. The Commission is no

<sup>46</sup> See FIA/SIFMA White Paper at 27–29, attached as Appendix A to FIA/SIFMA comment letter (Oct. 12, 2018) (discussing the fact that, in amending the “commodity contract” definition in the Bankruptcy Code in the Dodd-Frank Act, Congress retained the prong covering “any other contract, option, agreement, or transaction that is similar to a contract, option, agreement, or transaction referred to in [the definition of commodity contract],” as well as discussing related Dodd-Frank Act amendments to the CEA).

<sup>47</sup> By way of comparison, a registered FCM accepting U.S. customer funds for trading foreign futures or options on a registered foreign board of trade must provide its customers (which may include retail customers, *i.e.*, customers that are not eligible contract participants) with a disclosure statement addressing the risks of trading in foreign markets under § 30.6(a). 17 CFR 30.6(a).

<sup>48</sup> In order to promote effective and consistent global regulation of swaps, section 752 of the Dodd-Frank Act directs the Commission to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation of swaps, among other things. Section 752 of the Dodd-Frank Act, Public Law 111–203, 124 Stat. 1376 (2010), codified at 15 U.S.C. 8325.

<sup>49</sup> Regulation 39.19(b), 17 CFR 39.19(b), requires that a registered DCO submit reports electronically and in a format and manner specified by the Commission and establishes the relevant time zone for any stated time, unless otherwise specified by the Commission. The Commission has specified that U.S. Central time will apply with respect to the daily reports that must be filed by exempt DCOs pursuant to proposed § 39.6(c)(2)(i).

<sup>50</sup> The Commission is proposing to define “U.S. clearing member,” for purposes of proposed § 39.6, to mean a clearing member organized in the United States or whose parent company is organized in the United States, or an FCM.

<sup>51</sup> These requirements are similar to reporting requirements in § 39.19(c)(1)(i)(A) and (B) that apply to registered DCOs and similar to reporting requirements in proposed § 39.51(c)(2)(i) that would apply to registered DCOs subject to alternative compliance. See 17 CFR 39.19(c)(1)(i)(A) and (c)(1)(i)(B). See also Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, approved on July 11, 2019 (discussing similar reporting requirements for registered DCOs subject to alternative compliance).

<sup>52</sup> Such FCMs may or may not be U.S. persons. The Commission has a supervisory interest in receiving information regarding which of its registered FCMs are clearing members or affiliates of clearing members, with respect to the clearing of swaps on an exempt DCO.

longer proposing to require exempt DCOs to report the aggregate clearing volume of U.S. persons during the fiscal quarter, or the average open interest of U.S. persons during the fiscal quarter.

As previously proposed, § 39.6(c)(2)(vii) would require an exempt DCO to provide immediate notice to the Commission in the event of a default (as defined by the exempt DCO in its rules) by a U.S. person or FCM clearing swaps, including the name of the U.S. person or FCM, a list of the positions held by the U.S. person or FCM, and the amount of the U.S. person's or FCM's financial obligation. The Commission is supplementing this proposal to require immediate notice in the event of a default by any clearing member, including the amount of the clearing member's financial obligation. The Commission recognizes that the default of any clearing member may impact U.S. clearing members and U.S. persons clearing at the exempt DCO. If the defaulting clearing member is a U.S. clearing member, or clears for a U.S. person, the notice must also include the name of the defaulting clearing member and, as applicable, the name(s) of the U.S. person(s) for whom the clearing member clears and a list of the positions it held.

#### 4. Regulation 39.6(e)—Application Procedures

Proposed § 39.6(e) sets forth the application procedures for a clearing organization that seeks to be exempt from DCO registration. As previously proposed, § 39.6(e)(2) would require an applicant to submit a complete application, including all applicable information and documentation as detailed therein. In this supplemental proposal, the application procedures and associated materials remain mostly as previously proposed. The only changes the Commission is proposing in this release relate to § 39.6(e)(2)(vii), which would require that an applicant for exemption submit a copy of its rules that: Meet the open access requirements in § 39.6(b)(2) (proposed to be renumbered as § 39.6(b)(3)); meet the swap data reporting requirements in § 39.6(d); and provide written notice of protections available to U.S. persons (per newly proposed § 39.6(b)(2)). The Commission is proposing to additionally require a draft of the notice that meets the requirements of newly proposed § 39.6(b)(2), as applicable, as part of the application.

As previously proposed, § 39.6(e)(5) identifies those sections of an application for exemption from registration that would be made public. The Commission is proposing in this

release to add the draft rules proposed to be included in § 39.6(e)(2)(vii), as discussed above.

#### 5. Regulation 39.6(f)—Modification or Termination of Exemption Upon Commission Initiative

As previously proposed, § 39.6(f) would provide that the Commission may modify the terms and conditions of an order of exemption, either at the request of the exempt DCO or on the Commission's own initiative, based on changes to or omissions in material facts or circumstances pursuant to which the order of exemption was issued, or for any reason in the Commission's discretion. This is a further expression of the Commission's discretionary authority under section 5b(h) of the CEA to exempt a clearing organization from registration "conditionally or unconditionally," and it reflects the Commission's authority to act with flexibility in responding to changed circumstances affecting an exempt DCO. The Commission is now proposing to supplement this proposed provision to permit the Commission to terminate an exemption upon its own initiative, and also to set forth the process by which the Commission may issue such a modification or termination. Proposed § 39.6(f) would provide that the Commission may modify or terminate an exemption from DCO registration, in its discretion and upon its own initiative, if the Commission determines that any of the terms and conditions of its order of exemption, including compliance with § 39.6, are not met.

For example, the Commission could modify or terminate an exemption upon a determination that an exempt DCO has failed to observe the PFMI in any material respect. The Commission may receive information regarding the failure of the exempt DCO to comply with any of the terms and conditions of its order of exemption from a variety of sources, including, but not limited to, assessments conducted by a home country regulator or other national authority, or an international financial institution or international organization, or information otherwise received from a home country (or other) regulator.

The Commission could also modify or terminate an exemption upon its determination that the exempt DCO is no longer subject to "comparable, comprehensive supervision and regulation" by its home country regulator. As the Commission is statutorily required to determine that a non-U.S. clearing organization is subject to "comparable, comprehensive supervision and regulation" by a home country regulator to be eligible for an

exemption from DCO registration,<sup>53</sup> the Commission would be required to modify or terminate an exemption upon a subsequent determination that the home country regulator's supervision and regulation no longer meets that standard.

Further, the Commission could modify or terminate an exemption upon its determination that the exempt DCO poses substantial risk to the U.S. financial system. The reporting requirements for exempt DCOs would provide the Commission with information regarding the margin associated with U.S. persons clearing swaps through an exempt DCO in order for the Commission to assess the risk exposure of U.S. persons and the extent of the exempt DCO's U.S. clearing activity. To the extent that an exempt DCO's cleared swaps activity for U.S. persons reaches a level such that the exempt DCO would pose substantial risk to the U.S. financial system, the Commission may find that it does not qualify for an exemption from DCO registration.

Proposed §§ 39.6(f)(2), (f)(3), and (f)(4) would set forth the process for modification or termination of an exemption upon the Commission's initiative. Proposed § 39.6(f)(2) would require the Commission to first provide written notification to an exempt DCO that the Commission is considering whether to modify or terminate the DCO's exemption and the basis for that consideration.

Proposed § 39.6(f)(3) would permit an exempt DCO to respond to such a notification in writing no later than 30 business days following receipt of the Commission's notification, or at such later time as the Commission may permit in writing. The Commission believes that a minimum 30-business day timeframe would allow the Commission to take timely action to protect its regulatory interests while providing the exempt DCO with sufficient time to develop its response.

Proposed § 39.6(f)(4) would provide that, following receipt of a response from the exempt DCO, or after expiration of the time permitted for a response, the Commission may either: (i) Issue an order terminating the exemption as of a date specified in the order; (ii) issue an amended order of exemption that modifies the terms and conditions of the exemption; or (iii) provide written notification to the exempt DCO that the Commission has determined to neither modify nor terminate the exemption. The date for termination specified in a termination

<sup>53</sup> Section 5b(h) of the CEA, 7 U.S.C. 7a-1(h).



order would provide the exempt DCO with a reasonable amount of time to wind down its swap clearing services for U.S. persons, including the liquidation or transfer of the positions and related collateral of U.S. persons, as necessary.

Lastly, the Commission is proposing a technical change to proposed § 39.6(g), which relates to a termination of exemption upon request by an exempt DCO. Specifically, as previously proposed, § 39.6(g)(1)(iii) provides that an exempt DCO may petition the Commission to terminate its exemption if, in conjunction with the petition, the exempt DCO submits a completed Form DCO to become registered as a DCO pursuant to section 5b(a) of the CEA. To provide for the alternative compliance process that would be set forth in proposed § 39.3(a)(3),<sup>54</sup> the Commission is proposing in this release to instead refer to an application for registration in accordance with § 39.3(a)(2) or § 39.3(a)(3), as applicable.

#### IV. Proposed Amendments to Part 140

The Commission previously proposed amendments to § 140.94 to delegate authority to the Division of Clearing and Risk (DCR) for all functions reserved to the Commission in proposed § 39.6, subject to certain exceptions. Specifically, the Commission did not propose to delegate its authority to grant, modify, or terminate an exemption or prescribe conditions to an exemption order. Consistent with that proposal, the Commission is proposing in this release to supplement its delegation to DCR to include certain functions related to the modification or termination of an exemption order upon the Commission's initiative. These functions would include, but would not be limited to, sending an exempt DCO notice of an intention to modify or terminate its exemption order. However, the Commission alone would retain the authority to modify or terminate the exemption order. The Commission is proposing an additional amendment to § 140.94(c)(4) to reflect this change.

#### V. Request for Comments

In addition to the specific requests for comment noted elsewhere, the Commission generally requests comments on all aspects of the rules proposed in the 2018 Proposal and the supplemental rules proposed in this release. The Commission also requests comments on the following specific issues:

1. Due to uncertainty regarding the applicability of the Bankruptcy Code in the event of an insolvency of an FCM clearing for customers directly at, or through a foreign member of, the exempt DCO, the proposed regulations would permit U.S. customer positions to be cleared at an exempt DCO but only through a foreign intermediary that is not registered as an FCM.

a. Can the Bankruptcy Code be read to permit swaps customer funds to be deposited at an exempt DCO by an FCM directly, or through a foreign member of the exempt DCO, and still receive the same protections as swaps customer funds deposited at a registered DCO? Why or why not?

b. Does the Bankruptcy Code or other relevant laws distinguish swaps customer funds of U.S. persons from non-U.S. persons that are deposited at an exempt DCO by an FCM for purposes of distribution of such funds to the U.S. and non-U.S. persons in the event of the FCM's insolvency? If so, please explain which laws are relevant and how such laws address the distribution of customer funds of U.S. and non-U.S. persons.

c. Should the Commission permit FCMs to clear swaps for U.S. customers that are eligible contract participants at exempt DCOs despite uncertainty of bankruptcy protection in such arrangements? Why or why not?

d. Can any concerns regarding uncertainty with respect to U.S. customers whose transactions are cleared by an FCM directly or indirectly at an exempt DCO be sufficiently addressed by—

(1) Requiring, similar to the requirement in proposed § 39.6(b)(2), that an exempt DCO have rules that require an FCM seeking to clear swaps for a U.S. customer to provide written notice to, and obtain acknowledgement from, the U.S. customer prior to clearing that the exempt DCO is exempt from registration with the Commission, and that the protections of the Bankruptcy Code may not apply to the U.S. customer's funds? Why or why not?

(2) Limiting clearing of swap positions by U.S. customers at exempt DCOs through FCMs to only a specified subset(s) of eligible contract participants? Why or why not?

e. Can any concerns regarding potential uncertainty with respect to other U.S. customers (*i.e.*, customers who limit their activities to transactions cleared at registered DCOs) of an FCM that clears transactions for customers at an exempt DCO be sufficiently addressed through disclosure or other means? Why or why not? In this regard, please address the potential of (1) a

bankruptcy court in an FCM bankruptcy proceeding delaying the transfer of all swaps customer positions to another FCM to address potential legal challenges to the bankruptcy status of customer positions cleared at an exempt DCO, resulting in the need to close out customer positions, or (2) a shortfall in swaps customer funds affecting all swaps customers of the FCM due to the bankruptcy of an affiliated foreign clearing member of the FCM through which the FCM clears customer transactions at the exempt DCO?

f. Does the proposal strike the right balance between customer protection and providing greater access to swaps clearing? Are there additional measures the Commission should take to enhance customer protection?

2. Commenters also suggested a regime for swaps similar to that of futures, in which a distinct set of Commission regulations—part 30—governs “foreign futures” traded outside of the United States.<sup>55</sup> The Commission notes that the foreign futures regime is expressly contemplated by the CEA. Section 4(b)(2) of the CEA,<sup>56</sup> for example, authorizes the Commission to adopt rules and regulations requiring the “safeguarding of customers’ funds” by any person located inside the United States who engages in the offer or sale of a futures contract made on or subject to the rules of a board of trade, exchange, or market located outside the United States. The CEA does not include similar provisions for swaps, however. Similarly, the Bankruptcy Code establishes separate protections for foreign futures, traded on or subject to the rules of, a board of trade outside the United States, through a “foreign futures commission merchant,” but has no similar provisions for swaps.<sup>57</sup> Although these statutory distinctions do not necessarily preclude the Commission from constructing a “part 30-type” regime for swaps, the Commission is not proposing to do so at this time. However, the Commission is requesting additional comment on constructing a “part 30-type” regime for swaps.

3. As proposed, § 39.6(d) would require that if a clearing member clears through an exempt DCO a swap that has been reported to a registered swap data repository (SDR) pursuant to part 45 of the Commission's regulations, the exempt DCO must report to an SDR data regarding the two swaps resulting from the novation of the original swap that had been submitted to the exempt DCO

<sup>54</sup> Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, approved on July 11, 2019.

<sup>55</sup> FIA/SIFMA comment letter (Oct. 12, 2018).

<sup>56</sup> 7 U.S.C. 6(b)(2).

<sup>57</sup> 11 U.S.C. 761(4)(a), (11), and (12).

for clearing. In addition, an exempt DCO would be required to report the termination of the original swap accepted for clearing by the exempt DCO to the SDR to which the original swap was reported. Further, in order to avoid duplicative reporting for such transactions, an exempt DCO would be required to have rules that prohibit the part 45 reporting of the two new swaps by the counterparties to the original swap. The Commission notes that the intention would be to apply this requirement to U.S. customer trades cleared at an exempt DCO; however, the Commission requests comment as to whether this would pose challenges. Furthermore, should the Commission consider removing this requirement altogether?

4. Is the proposed test for “substantial risk to the U.S. financial system” the best measure of such risk? If not, please explain why, and if there is a better measure/metric that the Commission should use when implementing the exempt DCO regime, please provide a rationale and supporting data, if available.

5. What is the frequency with which the Commission should reassess an exempt DCO’s “risk to the U.S. financial system” for purposes of the test, and across what time period?

6. With respect to the written notice of protections available to U.S. persons required by proposed § 39.6(b)(2), the Commission invites comment as to the elements that should be required in any such disclosure, and how detailed such a disclosure should be in describing the relevant bankruptcy regimes.

7. The Commission requests that non-U.S. clearing organizations provide estimates of the percentage of initial margin deposited with the clearing organization that is attributable to clearing members that have a U.S. parent company.

8. The Commission requests that U.S. swaps market participants provide examples of swaps that they would like to clear at non-U.S. clearing organizations. Relatedly, to the extent that U.S. swaps market participants currently are engaging in these swaps on an uncleared basis, the Commission requests information about whether counterparties to these swaps are predominantly financial entities or commercial end-users.

9. The Commission requests information concerning legal, operational, or other impediments, if any, to (1) FCMs becoming members of exempt DCOs, and (2) exempt DCOs, and non-U.S. clearing organizations that may choose to become exempt DCOs, complying with cleared swaps customer

funds protection and segregation rules set forth in parts 1, 22, 39, and 190 of the Commission’s regulations.

10. The Commission requests estimates from swap dealers, FCMs, and their affiliates of the percentages of their swap business, measured in terms of initial margin, that they estimate is cleared at particular non-U.S. DCOs, either registered or exempt.

11. In the 2018 Proposal, the Commission proposed to define “good regulatory standing” to mean that either there has been no finding by the home country regulator of material non-observance of the PFMI or other relevant home country legal requirements, or there has been such a finding by the home country regulator, but it has been or is being resolved to the satisfaction of the home country regulator by means of corrective action taken by the exempt DCO.<sup>58</sup> Although the Commission proposed to limit this to instances of “material” non-observance of the PFMI or other relevant home country legal requirements, the Commission requests comment as to whether it should instead require all instances of non-observance.

12. Commenters suggested the Commission should clarify that a non-U.S. clearing organization clearing swaps does not trigger registration as a DCO solely because it permits participation (direct or indirect) by foreign branches of U.S. bank swap dealers (foreign branches).<sup>59</sup> The commenters argued that because such participation takes place outside the United States, it does not involve use of U.S. jurisdictional means by the non-U.S. clearing organization. The commenters noted that the Commission has recognized in other contexts that applying the Dodd-Frank Act’s registration requirements to parties transacting with foreign branches would result in competitive disparities that are not necessary to mitigate risk to the United States.<sup>60</sup> The commenters also noted that subjecting non-U.S. clearing

organizations clearing swaps to registration as DCOs when they permit participation by foreign branches discourages those non-U.S. clearing organizations from permitting such participation, and that, to access those non-U.S. clearing organizations, U.S. banks must incur the costs, including the additional regulatory burden, of “subsidiarizing” their local clearing operations.<sup>61</sup> To date, the Commission has not addressed directly the scope of the DCO registration requirement for non-U.S. clearing organizations clearing swaps in the specific context of foreign branches, and the Commission declines to do so at this time. However, the Commission requests additional comment on whether the Commission should address the scope of the registration requirement under section 2(i) with respect to foreign branches, as suggested by the commenters.

13. The Commission currently does not require non-U.S. customers clearing foreign futures or swaps at registered non-U.S. DCOs to clear through FCMs. In addition, the Commission is proposing in this release to permit U.S. customers to clear swaps through non-FCMs at exempt DCOs. In light of this, should the Commission consider permitting non-U.S. customers to clear futures and swaps through non-FCMs at U.S. registered DCOs? In other words, should the Commission give non-U.S. customers the option of choosing to clear futures and swaps through local intermediaries that are clearing members of U.S. registered DCOs, instead of requiring them to clear, directly or indirectly, through FCMs at U.S. registered DCOs?

14. Until now, it has been the Commission’s policy to allow U.S. customers’ swap positions to be cleared only through registered FCMs at registered DCOs. However, the Commission understands that an FCM may be reluctant to participate as a direct member of a registered non-U.S. DCO if the FCM’s affiliate is also a member of the DCO, due to duplicative requirements that would be borne by the two affiliates. The Commission requests comment as to alternatives to address concerns with this approach.

For example, where consistent with the rules of a registered DCO, an FCM could potentially participate as a “special” member whose obligations to the DCO could be guaranteed by its non-FCM affiliate acting as a “traditional” member of the DCO. All customer funds would flow directly from the FCM to the registered DCO, *i.e.*, they would *not* pass through the non-FCM affiliate.

<sup>58</sup> See 2018 Proposal, 83 FR at 39924–39925.

<sup>59</sup> See FIA/SIFMA White Paper at 36–38, attached as Appendix A to FIA/SIFMA comment letter (Oct. 12, 2018).

<sup>60</sup> See *id.* at 37 (citing the 2013 Cross-Border Guidance at 45,324 (“The Commission understands that commenters are concerned that foreign entities, in order to avoid swap dealer status, may decrease their swap dealing business with foreign branches of U.S. registered swap dealers and guaranteed affiliates that are swap dealers. Therefore, the Commission’s policy, based on its interpretation of Section 2(i) of the CEA, will be that swap dealing transactions with a foreign branch of a U.S. swap dealer or with guaranteed affiliates that are swap dealers should generally be excluded from the *de minimis* calculations of non-U.S. persons that are not guaranteed or conduit affiliates”).

<sup>61</sup> See *id.*

Similarly, in the event of the default of a customer of the FCM, the FCM would, nonetheless, be responsible in the first instance for making prompt payment in full of all obligations under contracts cleared through the FCM at the registered DCO. The guarantor affiliate's responsibility to perform on the guarantee would only be activated in the event that the FCM fails promptly to perform in full with respect to the positions it clears. In guaranteeing the FCM's obligations, the non-FCM affiliate would need a (subordinated) security interest in the collateral held at the registered DCO to enable it to protect its own interests if it is called upon to perform under that guarantee.<sup>62</sup> Such a security interest with respect to customer collateral generally, and, in the case of cleared swaps collateral specifically, would necessarily be subject to the limitation that the guarantor could access no more of the collateral than the registered DCO could use under section 4d of the CEA and the Commissions regulations thereunder (including, with respect to cleared swaps customer collateral, Part 22).

The Commission requests comment as to whether this approach is viable, and the extent to which there would need to be protections in place for the FCM, the non-FCM affiliate, FCM customers, and the registered DCO, and, if so, what protections would be appropriate.

In particular, the Commission further requests comment as to whether there would need to be modifications to § 22.2(d)(2), which provides that an FCM may not impose or permit the imposition of a lien on cleared swaps customer collateral, to accommodate this approach, and, if so, what modifications would be most appropriate (including providing appropriate protection for customer funds).

15. Considering the increased demand for swap clearing and the declining number of FCMs, are there other operational structures that the Commission should consider to better ensure availability of swap clearing services at both registered and exempt DCOs without jeopardizing U.S. customer protections? If so, please describe in detail.

<sup>62</sup> It would arguably be consistent with such a model for other responsibilities—e.g., payments under a mutualized guaranty fund, assessments, participation in end-of-day closing price determination exercises, and/or participation in default management activities—to be performed by the guarantor affiliate.

## VI. Related Matters

### A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires that agencies consider whether the regulations they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis on the impact.<sup>63</sup> The regulations proposed by the Commission will affect only clearing organizations. The Commission has previously established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its regulations on small entities in accordance with the RFA.<sup>64</sup> The Commission has previously determined that clearing organizations are not small entities for the purpose of the RFA.<sup>65</sup> Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed regulations will not have a significant economic impact on a substantial number of small entities.

### B. Paperwork Reduction Act

The Paperwork Reduction Act (PRA)<sup>66</sup> provides that Federal agencies, including the Commission, may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number from the Office of Management and Budget (OMB). This proposed rulemaking contains reporting requirements that are collections of information within the meaning of the PRA. The Commission is requesting a new OMB control number for the collection of information in proposed § 39.6. The responses to the collection of information would be necessary to obtain exemption from DCO registration.

#### 1. Application for Exemption from DCO Registration Under Proposed § 39.6

Based on its experience in addressing petitions for exemption, the Commission anticipates receiving one application for exemption per year, and one request for termination of an exemption every three years.<sup>67</sup> Burden hours and costs were estimated based on existing information collections for DCO registration and reporting, adjusted to reflect the significantly lower burden of the proposed regulations. The

<sup>63</sup> 5 U.S.C. 601 *et seq.*

<sup>64</sup> 47 FR 18618 (Apr. 30, 1982).

<sup>65</sup> See 66 FR 45604, 45609 (Aug. 29, 2001).

<sup>66</sup> 44 U.S.C. 3501 *et seq.*

<sup>67</sup> The Commission has determined that one termination every three years is a more appropriate estimate than one per year, which was used in the information burden estimate for the 2018 Proposal.

Commission has estimated the burden hours for this proposed collection of information as follows:

- Application for Exemption, Including All Exhibits, Supplements and Amendments

*Estimated number of respondents:* 1.  
*Estimated number of reports per respondent:* 1.  
*Average number of hours per report:* 40.

*Estimated gross annual reporting burden:* 40.

- Termination of Exemption

*Estimated number of respondents:* 1.  
*Estimated number of reports per respondent:* 0.33.  
*Average number of hours per report:* 2.

*Estimated gross annual reporting burden:* 0.66.

- Notice to Clearing Members of Termination of Exemption

*Estimated number of respondents:* 1.  
*Estimated number of reports per respondent:* 10.33.  
*Average number of hours per report:* 0.1.

*Estimated gross annual reporting burden:* 1.033.

#### 2. Reporting by Exempt DCOs

The number of respondents for the daily and quarterly reporting and annual certification requirements is conservatively estimated at a maximum of seven, based on the number of existing exempt DCOs (4) and one application for exemption each year. Reporting of specific events is expected to occur infrequently. The burden is estimated conservatively at four per year for event-specific reporting:

- Daily Reporting

*Estimated number of respondents:* 7.  
*Estimated number of reports per respondent:* 250.  
*Average number of hours per report:* 0.1.

*Estimated gross annual reporting burden:* 175.

- Quarterly Reporting

*Estimated number of respondents:* 7.  
*Estimated number of reports per respondent:* 4.  
*Average number of hours per report:* 1.

*Estimated gross annual reporting burden:* 28.

- Event-Specific Reporting

*Estimated number of respondents:* 4.  
*Estimated number of reports per respondent:* 1.

*Average number of hours per report:* 0.5.

*Estimated gross annual reporting burden:* 2.

- Annual Certification

*Estimated number of respondents:* 7.  
*Estimated number of reports per respondent:* 1.

*Average number of hours per report:* 1.5.

*Estimated gross annual reporting burden:* 10.5.

### 3. Third-Party Reporting by Clearing Members Clearing for Unaffiliated U.S. Persons Through Exempt DCOs

Proposed § 39.6(b)(2) would require an exempt DCO to have rules that require any clearing member seeking to clear for an unaffiliated U.S. person to provide written notice to, and obtain acknowledgement from, the U.S. person prior to clearing that the clearing member is not a registered FCM, the exempt DCO is exempt from registration with the Commission, and the protections of the Bankruptcy Code, as defined in § 190.01 of this chapter, do not apply to the U.S. person's funds. The notice must explicitly compare the protections available to the U.S. person under U.S. law and the exempt DCO's home country regulatory regime. The estimated burden for this requirement is based on the average number of clearing members at four existing exempt DCOs and three potential exempt DCOs (estimated at one applicant per year over the next three years), clearing for an average of 10 unaffiliated U.S. persons:

- Clearing Members Providing Written Notice to, and Obtaining Acknowledgement From, Unaffiliated U.S. Persons

*Estimated number of respondents:* 217.

*Estimated number of reports per respondent:* 10.

*Average number of hours per report:* 0.2.

*Estimated gross annual reporting burden:* 430.

### 4. Reporting by Exempt DCOs in Accordance With Part 45

Proposed § 39.6(d) would require an exempt DCO to report data regarding the two swaps resulting from the novation of an original swap to a registered SDR, if the original swap had been reported to a registered SDR pursuant to part 45 of the Commission's regulations. The Commission is proposing to revise the information collection for part 45 to add exempt DCOs as an additional category of reporting entity. The burden for

exempt DCOs reporting in accordance with part 45 is estimated to be approximately one-quarter of the burden for registered DCOs with respect to both non-recurring and recurring costs because exempt DCOs will not be required to report all swaps, only those that result from the novation of original swaps that have been reported to an SDR.<sup>68</sup> Consequently, the burden hours for the proposed collection of information in this rulemaking have been estimated as follows:

- Reporting in Accordance With Part 45

*Estimated number of respondents:* 7.  
*Estimated number of reports per respondent:* 1987.

*Average number of hours per report:* 0.1.

*Estimated gross annual reporting burden:* 1393.

The proposed exemption for foreign intermediaries from registration as an FCM in § 3.10(c)(7) will not impose any new recordkeeping or information collection requirements, or other collections of information that require approval of the OMB under the PRA.

#### C. Cost-Benefit Considerations

##### 1. Introduction

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.<sup>69</sup> Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors.

The baseline for the Commission's consideration of the costs and benefits of this proposed rulemaking are: (1) The current status, where the Commission has implemented a set of conditions and procedures for granting exemptions from DCO registration, and has proposed, but not yet codified, those conditions and procedures under Commission regulations;<sup>70</sup> (2) the core

principles applicable to registered DCOs set forth in the CEA;<sup>71</sup> (3) the general provisions applicable to registered DCOs under subparts A and B of Part 39; (4) Form DCO in Appendix A to Part 39; (5) Parts 1, 22, and 40 of the Commission's regulations; and (6) § 3.10.

The Commission notes that this consideration is based on its understanding that the swaps market functions internationally with (1) transactions that involve U.S. firms occurring across different international jurisdictions; (2) some entities organized outside of the United States that are prospective Commission registrants; and (3) some entities that typically operate both within and outside the United States and that follow substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the discussion of costs and benefits below refers to the effects of the proposed regulations on all relevant swaps activity, whether based on their actual occurrence in the United States or on their connection with activities in, or effect on, U.S. commerce pursuant to section 2(i) of the CEA.<sup>72</sup>

The Commission recognizes that the proposed rules may impose costs. The Commission has endeavored to assess the expected costs and benefits of the proposed rulemaking in quantitative terms, including PRA-related costs, where possible. In situations where the Commission is unable to quantify the costs and benefits, the Commission identifies and considers the costs and benefits of the applicable proposed rules in qualitative terms. The lack of data and information to estimate those costs is attributable in part to the nature of the proposed rules. Additionally, the initial and recurring compliance costs for any particular exempt DCO will depend on the size, existing infrastructure, level of clearing activity, practices, and cost structure of the DCO.

Finally, the costs and benefits of this proposal may be affected by the Commission's proposal to adopt a registration regime with alternative

Proposal were discussed within that release. Only the costs and benefits of the changes proposed in this release are discussed in this release.

<sup>71</sup> 7 U.S.C. 7a-1(c)(2)(A).

<sup>72</sup> Pursuant to section 2(i) of the CEA, activities outside of the United States are not subject to the swap provisions of the CEA, including any rules prescribed or regulations promulgated thereunder, unless those activities either have a direct and significant connection with activities in, or effect on, commerce of the United States; or contravene any rule or regulation established to prevent evasion of a CEA provision enacted under the Dodd-Frank Act, Public Law 111-203, 124 Stat. 1376. 7 U.S.C. 2(i).

<sup>68</sup> Details of the estimated burden related to non-recurring and recurring costs under part 45 are discussed in the part 45 adopting release. See Swap Data Recordkeeping and Reporting Requirements, 77 FR at 2171-2176.

<sup>69</sup> 7 U.S.C. 19(a).

<sup>70</sup> The Commission notes that the costs and benefits of the proposed changes in the 2018

compliance<sup>73</sup> under which an already registered non-U.S. DCOs would have the option of seeking an exemption from registration or applying for registration under registration procedures with alternative compliance. These clearing organizations would need to compare the costs and benefits of an exemption with the costs and benefits of registration with alternative compliance.

## 2. Proposed Amendments to Part 39

### a. Summary

Section 5b(h) of the CEA permits the Commission to exempt a non-U.S. clearing organization from DCO registration for the clearing of swaps to the extent that the Commission determines that such clearing organization is subject to comparable, comprehensive supervision by appropriate government authorities in the clearing organization's home country. Pursuant to this authority, the Commission has exempted four non-U.S. clearing organizations from DCO registration. An exempt DCO is currently permitted to clear only proprietary positions of U.S. persons and FCMs, and not customer positions. The proposed regulations, however, would permit an exempt DCO to clear U.S. customer positions under certain conditions, thereby providing more clearing options for swaps customers.

### b. Benefits and Costs

The proposed amendments to § 39.6 would allow U.S. customer positions to be cleared at an exempt DCO, provided that they are not cleared through a clearing member that is registered as an FCM. The Commission believes this would increase the number of non-U.S. clearing organizations available to clear swaps for U.S. customers and would afford clearing members and their customers more clearing options. Access to more clearing organizations may encourage more clearing of swaps, while reducing the concentration risk among registered and exempt DCOs. With this proposal and the proposal to adopt an alternative compliance regime, U.S. persons could have even more choices for interacting with non-U.S. clearing organizations.

A U.S. customer clearing at an exempt DCO under proposed § 39.6 would not be protected under the provisions of the Bankruptcy Code. However, this cost is potentially mitigated by two factors. First, the exempt DCO's home country may have a bankruptcy regime that would provide similar protections and

be applicable in that situation. Second, because proposed § 39.6(b)(2) would require an exempt DCO to have rules that require any clearing member seeking to clear for an unaffiliated U.S. person to provide written notice to, and obtain acknowledgement from, the U.S. person prior to clearing that the protections of the Bankruptcy Code would not apply to the U.S. person's funds, a U.S. person seeking to clear through an exempt DCO would know in advance that it is not protected by the Bankruptcy Code. The notice would be required to explicitly compare the protections available to the U.S. person under U.S. law and the exempt DCO's home country regulatory regime. This would allow the U.S. person to consider the pros and cons of that bankruptcy regime prior to making a decision to clear at a given exempt DCO.

The possibility of U.S. customer business at exempt DCOs may encourage non-U.S. clearing organizations that are not currently registered or exempt DCOs to apply to become an exempt DCO. Although there are costs involved with preparing an application for an exemption from DCO registration as well as ongoing compliance costs for exempt DCOs, such costs are significantly lower than the corresponding costs applicable to registered DCOs. Because proposed § 39.6 would allow an exempt DCO to clear for U.S. customers who are currently permitted to clear only through registered DCOs (provided that U.S. customers do not clear through a registered FCM), the Commission anticipates that some non-U.S. clearing organizations that are currently registered DCOs, or that would otherwise apply to register in the future, may choose to apply to become an exempt DCO, thus lowering their ongoing compliance costs. Some of these cost savings may be passed on to clearing members and customers.

The Commission notes that, if this proposal and the proposal to adopt an alternative compliance regime are adopted as proposed, eligible non-U.S. clearing organizations would have a choice between seeking an exemption from registration and registering under the alternative compliance regime. They would also retain the option of registering under the traditional registration procedures. Each clearing organization would need to compare the costs and benefits of an exemption with the costs and benefits of registration. Both alternative compliance and exemption from registration are significantly less costly than traditional registration. The Commission expects that alternative compliance would be

somewhat more costly than an exemption from registration. In the PRA analyses of the two proposals, the Commission estimated that it would take about 100 hours to register under the alternative procedures as compared to 40 hours to apply for an exemption. The daily, quarterly, and event-specific reporting requirements are estimated to impose the same hourly burden for both categories with the exception of swap data reporting under part 45. Registered DCOs subject to alternative compliance would be subject to the same part 45 reporting requirements as other registered DCOs, while exempt DCOs would only have to report data regarding the two swaps resulting from the novation of an original swap previously reported to an SDR. In the PRA section of this release, the Commission estimates that the part 45 reporting burden for an exempt DCO would be about one quarter as much as the burden on a registered DCO. Both exempt DCOs and registered DCOs subject to alternative compliance would primarily be subject to their home country regulatory regimes, but registered DCOs subject to alternative compliance would also be held to certain requirements set forth in the CEA and Commission regulations, including, for example, subpart A of part 39 and § 39.15. The extent to which these additional requirements would increase costs on registered DCOs subject to alternative compliance would depend on the extent to which these requirements would exceed the legal requirements of their home countries and the extent to which registered DCOs subject to alternative compliance would have to change their practices.

While the alternative compliance regime is more costly than an exemption, it would provide benefits that are not currently available to exempt DCOs or those that clear through an exempt DCO. For example, a DCO subject to alternative compliance would be permitted to clear for U.S. persons clearing through an FCM, and such U.S. persons would have the benefit of U.S. bankruptcy protection. Therefore, unlike exempt DCOs, DCOs subject to alternative compliance and their clearing members would not incur the costs associated with proposed § 39.6(b)(2) under which exempt DCOs would be required to have rules requiring their clearing members to provide written notice of the bankruptcy protections available to U.S. persons. An eligible clearing organization may choose to register under the alternative compliance regime over seeking an exemption if it determines that the

<sup>73</sup> Registration with Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, approved on July 11, 2019.

benefits of FCM customer clearing would justify the extra costs of alternative compliance relative to an exemption.

Registered DCOs may face a competitive disadvantage as a result of this proposal (as is the case with the proposal to adopt an alternative compliance regime). A registered DCO subject to full Commission regulation and oversight may have higher ongoing compliance costs than an exempt DCO. This competitive disadvantage is mitigated by the fact that exempt DCOs would, as a precondition of such exemption, be required to be subject to comparable, comprehensive supervision and regulation by a home country regulator that is likely to impose costs similar to those associated with Commission regulation. Such exempt DCOs, then, may have compliance costs in their home countries that registered DCOs might not.

FCMs may also face a competitive disadvantage as a result of this proposal, as they would not be permitted to clear customer trades at an exempt DCO. To the extent that their customers shift their clearing activity from registered DCOs to exempt DCOs, or otherwise reduce their clearing activity at registered DCOs as a result of this proposal, FCMs would lose business. As discussed above, however, the Commission believes there may be costs to customers if they were permitted to clear through an FCM at an exempt DCO, due to the uncertainty as to the bankruptcy protection customers would receive. The Commission believes that the exempt DCO framework would provide U.S. persons with additional options regarding the trading and clearing of swap transactions. The ability of U.S. persons to use foreign intermediaries to carry their accounts for clearing at exempt DCOs under proposed § 3.10(c)(7) would potentially expand the number of intermediaries that currently clear swaps for U.S. persons. The expansion of the exempt DCO framework to include foreign intermediaries clearing for customers has the potential for increasing the number of market intermediaries clearing for U.S. persons and reducing the concentration of U.S. customer funds in a small number of FCMs.

The proposal would also provide U.S. customers with access to swaps that are cleared in foreign jurisdictions that the U.S. customers otherwise would not be able to access. As discussed above, U.S. customers' access to foreign cleared swaps markets is restricted to foreign swaps cleared by registered DCOs.

The Commission does not anticipate that the proposal would impose costs on

non-FCM clearing members or customers. The proposal could increase the number of exempt DCOs<sup>74</sup> and permit some registered DCOs that wish to clear for U.S. customers to seek an exemption from registration, which may allow them to pass on cost savings to clearing members and customers. Therefore, the Commission believes that non-FCM clearing members and customers may face reduced costs as a result of this proposal. To the extent that exempt DCOs do not save costs relative to registered DCOs, or do not pass cost savings to their clearing members or customers, the Commission notes that clearing members and customers could simply continue clearing through traditionally registered DCOs, likely without any change in costs.

The Commission does not believe that the proposal would materially increase the risk to the U.S. financial system. Registered DCOs that pose substantial risk to the U.S. financial system would not be eligible for an exemption from registration.<sup>75</sup> Furthermore, a non-U.S. clearing organization cannot obtain an exemption from registration unless the Commission determines that it is subject to comparable, comprehensive supervision and regulation by its home country regulator, meaning that the non-U.S. clearing organization would be subject to regulation comparable to that imposed on registered DCOs. An MOU or similar arrangement must be in effect between the Commission and the exempt DCO's home country regulator, allowing the Commission to receive information from the home country regulator to help monitor the exempt DCO's continuing compliance with its legal obligations. The Commission also notes that foreign regulators have a strong incentive to ensure the safety and soundness of the clearing organizations that they regulate, and their oversight, combined with the DCO exemption regime, will enable the Commission to

<sup>74</sup> Any increase in the number of exempt DCOs would depend in part on the extent to which eligible clearing organizations choose to seek an exemption over registering under the alternative compliance regime (assuming both proposals are adopted).

<sup>75</sup> It may also be possible that the Commission's proposed test for "substantial risk to the U.S. financial system" may not be properly calibrated, allowing certain exempt DCOs to operate in U.S. markets when they may pose sufficient risk to the U.S. financial system to warrant greater oversight by the Commission. However, the Commission believes that even if these exempt DCOs are permitted to clear for U.S. customers, this risk will be mitigated by the Commission's determination that the exempt DCO is subject to comparable, comprehensive supervision and regulation by its home country regulator, as discussed above, and the Commission's access to certain daily and periodic reports regarding the exempt DCO.

more efficiently allocate its own resources to the oversight of traditionally registered DCOs.

Finally, the proposed regulations would promote and perhaps encourage international comity by showing deference to non-U.S. regulators in the oversight of non-U.S. clearing organizations that clear for U.S. customers. If regulators in other countries similarly defer to U.S. oversight of U.S. registered DCOs active in overseas markets, the reduced registration and compliance burdens on such DCOs would be an additional benefit of the proposed regulations.

### 3. Section 15(a) Factors

#### a. Protection of Market Participants and the Public

The proposed regulations would not materially reduce the protections available to market participants and the public because they would, among other things: (i) Require that an exempt DCO not pose substantial risk to the U.S. financial system; (ii) require that an exempt DCO's clearing members provide written notice to, and obtain acknowledgement from, their U.S. customers prior to clearing that the protections of the Bankruptcy Code do not apply to the U.S. customer's funds; and (iii) explicitly authorize the Commission to modify or terminate an order of exemption on its own initiative if it determines that there are changes to or omissions in material facts or circumstances pursuant to which the order of exemption was issued, or that any of the terms and conditions of the order of exemption have not been met. Collectively, these provisions, along with previously proposed regulations, would protect market participants and the public by ensuring that exempt DCOs would be subject to the internationally-recognized PFMI standards and do not pose substantial risk to the U.S. financial system. Although U.S. persons clearing through an exempt DCO would not have the protections of the Bankruptcy Code, such persons would be required to acknowledge this in advance, allowing them to conduct the necessary due diligence to determine whether it is worth giving up such protections in exchange for those that may be offered under the applicable foreign bankruptcy regime. Although the Commission acknowledges the possibility that some foreign regulatory regimes may ultimately prove to be less effective than that of the United States, the Commission believes that this risk is mitigated for the reasons discussed above.

#### b. Efficiency, Competitiveness, and Financial Integrity

The proposed regulations would promote operational efficiency by permitting exempt DCOs to clear swaps for U.S. customers without having to prepare and submit an application for DCO registration, which involves the submission of extensive documentation to the Commission. In addition, adopting the proposed regulations might prompt other regulators to adopt similar rules that would defer to the Commission in the regulation of U.S. registered DCOs operating outside the United States, which could increase competitiveness by reducing the regulatory burdens on such DCOs.

The proposed regulations may also promote competition among non-U.S. clearing organizations because they would hold exempt DCOs to the internationally-recognized standards set forth in the PFMI. This would allow such clearing organizations to compete with each other under comparable regulatory regimes. Furthermore, by allowing exempt DCOs to clear for U.S. customers, the proposed regulations would promote competition by increasing the number of DCOs available to clear for U.S. customers. As noted above, however, the proposed regulations may reduce competition among intermediaries that would otherwise clear for U.S. customers, as FCMs would be prohibited from clearing customer trades at an exempt DCO.

The proposed regulations would be expected to maintain the financial integrity of swap transactions cleared by exempt DCOs because such DCOs would be subject to supervision and regulation by their home country regulator within a legal framework that is comparable to that applicable to registered DCOs under the CEA and Commission regulations and that is comprehensive. In addition, the proposed regulations may contribute to the financial integrity of the broader financial system by spreading the potential risk of particular swaps among a greater number of registered and exempt DCOs, thus reducing concentration risk. However, the Commission acknowledges that foreign intermediaries clearing for customers at an exempt DCO may not be subject to the same level of effective supervision as an FCM.

#### c. Price Discovery

Price discovery is the process of determining the price level for an asset through the interaction of buyers and sellers and based on supply and

demand conditions. The Commission has not identified any impact that the proposed regulations would have on price discovery. This is because price discovery occurs before a transaction is submitted for clearing through the interaction of bids and offers on a trading system or platform, or in the over-the-counter market. The proposed rule would not impact requirements under the CEA or Commission regulations regarding price discovery.

#### d. Sound Risk Management Practices

The proposed regulations would continue to encourage sound risk management practices because exempt DCOs would be subject to the risk management standards set forth in the PFMI. In addition, a non-U.S. clearing organization that poses substantial risk to the U.S. financial system would not be eligible for an exemption from registration.

#### e. Other Public Interest Considerations

The Commission notes the public interest in access to clearing organizations outside of the United States in light of the international nature of many swap transactions. The proposed regulations might encourage international comity by deferring, under certain conditions, to the regulators of other countries in the oversight of home country clearing organizations. The Commission expects that such regulators will defer to the Commission in the supervision and regulation of registered DCOs domiciled in the United States, thereby reducing the regulatory and compliance burdens to which such DCOs are subject.

#### 4. Consideration of Alternatives

The Commission considered alternatives suggested by commenters on the 2018 Proposal for allowing U.S. customers to clear through exempt DCOs. One commenter suggested that the Commission amend the definition of “clearing organization” under part 190 of the Commission’s regulations to provide that it has the same meaning as that set forth in section 761(2) of the Bankruptcy Code, but “registered under the CEA” in that statute should be read to mean “registered *or exempt from registration* under the CEA.”<sup>76</sup> In the alternative, the commenter also suggested that the Commission assert by regulation that an exempt DCO counts as a class or type of registered DCO for purposes of bankruptcy law.<sup>77</sup> Other

commenters<sup>78</sup> proposed a regime for swaps similar to that for futures, including “a clearing structure in which a U.S. customer clears through a U.S. FCM that maintains the U.S. customer’s positions and margin in a customer omnibus account held by a non-U.S. clearing member that is not registered as an FCM.”<sup>79</sup>

As discussed above, the Commission, at this time, is not proposing these alternatives given uncertainty as to the extent to which U.S. customers would be protected under the Bankruptcy Code in the event of an FCM bankruptcy proceeding.

#### D. Antitrust Considerations

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the CEA, in issuing any order or adopting any Commission rule or regulation.<sup>80</sup>

The Commission believes that the public interest to be protected by the antitrust laws is the promotion of competition. The Commission requests comment on whether the proposed rulemaking implicates any other specific public interest to be protected by the antitrust laws. The Commission has considered the proposed rulemaking to determine whether it is anticompetitive. The Commission believes that the proposed rulemaking may promote greater competition in swap clearing because it would permit exempt DCOs to clear swaps for U.S. customers under certain circumstances, which would provide greater access to clearing and might encourage more non-U.S. clearing organizations to seek an exemption from registration to clear the same types of swaps for U.S. customers that are currently cleared by registered DCOs. The Commission is mindful of the potential competitive disadvantage for FCMs, however, as customers would not be permitted to clear through FCMs at exempt DCOs, but this is due to uncertainty of bankruptcy protection for customer funds held at an FCM. The Commission further notes that the proposal may increase the number of market intermediaries clearing for U.S. persons and reduce the concentration of U.S. customer funds in a small number of FCMs.

The Commission has not identified any less anticompetitive means of

<sup>78</sup> FIA/SIFMA comment letter (Oct. 12, 2018); ASX Clear (Futures) Pty comment letter (Oct. 11, 2018); and Japan Securities Clearing Corporation comment letter (Oct. 10, 2018).

<sup>79</sup> FIA/SIFMA comment letter at 4 (Oct. 12, 2018).

<sup>80</sup> 7 U.S.C. 19(b).

<sup>76</sup> International Swaps and Derivatives Association, Inc. comment letter at 3 (Oct. 12, 2018).

<sup>77</sup> *Id.* at 4.

achieving the purposes of the CEA. The Commission requests comment on whether there are less anticompetitive means of achieving the relevant purposes of the CEA that would otherwise be served by adopting the proposed rules.

**List of Subjects**

*17 CFR Part 3*

Definitions, Consumer protection, Foreign futures, Foreign options, Registration requirements.

*17 CFR Part 39*

Clearing, Customer protection, Derivatives clearing organization, Exemption, Procedures, Registration, Swaps.

*17 CFR Part 140*

Authority delegations (Government agencies), Organization and functions (Government agencies).

For the reasons stated in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR chapter I as follows:

**PART 3—REGISTRATION**

■ 1. The authority citation for part 3 continues to read as follows:

**Authority:** 5 U.S.C. 552, 552b; 7 U.S.C. 1a, 2, 6a, 6b, 6b–1, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6m, 6n, 6o, 6p, 6s, 8, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21, 23.

■ 2. Amend § 3.10 by reserving paragraph (c)(6) and adding paragraph (c)(7) to read as follows:

**§ 3.10 Registration of futures commission merchants, retail foreign exchange dealers, introducing brokers, commodity trading advisors, commodity pool operators, swap dealers, major swap participants and leverage transaction merchants.**

\* \* \* \* \*

(c) \* \* \*

(6) [Reserved].

(7)(i) A person located outside the United States, its territories or possessions is not required to register as a futures commission merchant if it accepts funds from a U.S. person to margin, guarantee, or secure swap transactions that are cleared by a derivatives clearing organization that is exempt from registration pursuant to section 5b(h) of the Act and § 39.6 of this chapter.

(ii) A person exempt from registering as a futures commission merchant in accordance with paragraph (c)(7)(i) of this section is not required to comply with those provisions of the Act and of the rules, regulations, or orders thereunder applicable solely to any registered futures commission merchant

or any person required to be so registered.

(iii) A person exempt from registering as a futures commission merchant in accordance with paragraph (c)(7)(i) of this section may not engage in other activities requiring registration as a futures commission merchant or voluntarily register as a futures commission merchant.

(iv) A person exempt from registering as a futures commission merchant in accordance with paragraph (c)(7)(i) of this section must be a clearing member of an exempt derivatives clearing organization and must directly clear the swap transactions of the U.S. person at an exempt derivatives clearing organization.

(v) A person exempt from registering as a futures commission merchant in accordance with paragraph (c)(7)(i) of this section may provide commodity trading advice to U.S. persons without registering as a commodity trading advisor, provided that, the commodity trading advice is provided solely with respect to swap transactions that are cleared by an exempt derivatives clearing organization.

\* \* \* \* \*

**PART 39—DERIVATIVES CLEARING ORGANIZATIONS**

■ 3. The authority citation for part 39 is revised to read as follows:

**Authority:** 7 U.S.C. 2, 7a–1, and 12a(5); 12 U.S.C. 5464; 15 U.S.C. 8325; Section 752 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, title VII, § 752, July 21, 2010, 124 Stat. 1749.

■ 4. Revise § 39.1 to read as follows:

**§ 39.1 Scope.**

The provisions of this subpart A apply to any derivatives clearing organization, as defined under section 1a(15) of the Act and § 1.3 of this chapter, that is registered or is required to register with the Commission as a derivatives clearing organization pursuant to section 5b(a) of the Act, or that is applying for an exemption from registration pursuant to section 5b(h) of the Act.

■ 5. In § 39.2, add the definitions of “Exempt derivatives clearing organization,” “Good regulatory standing,” “Home country,” “Home country regulator,” “Principles for Financial Market Infrastructures,” and “Substantial risk to the U.S. financial system” in alphabetical order to read as follows:

**§ 39.2 Definitions.**

\* \* \* \* \*

*Exempt derivatives clearing organization* means a derivatives

clearing organization that the Commission has exempted from registration under section 5b(a) of the Act, pursuant to section 5b(h) of the Act and § 39.6 of this chapter.

\* \* \* \* \*

*Good regulatory standing* means, with respect to a derivatives clearing organization that is organized outside of the United States, and is licensed, registered, or otherwise authorized to act as a clearing organization in its home country, that:

(1) In the case of an exempt derivatives clearing organization, either there has been no finding by the home country regulator of material non-observance of the Principles for Financial Market Infrastructures or other relevant home country legal requirements, or there has been a finding by the home country regulator of material non-observance of the Principles for Financial Market Infrastructures or other relevant home country legal requirements but any such finding has been or is being resolved to the satisfaction of the home country regulator by means of corrective action taken by the derivatives clearing organization; or

(2) In the case of a derivatives clearing organization registered through the process described in § 39.3(a)(3) of this part, either there has been no finding by the home country regulator of material non-observance of the relevant home country legal requirements, or there has been a finding by the home country regulator of material non-observance of the relevant home country legal requirements but any such finding has been or is being resolved to the satisfaction of the home country regulator by means of corrective action taken by the derivatives clearing organization.

\* \* \* \* \*

*Home country* means, with respect to a derivatives clearing organization that is organized outside of the United States, the jurisdiction in which the derivatives clearing organization is organized.

\* \* \* \* \*

*Home country regulator* means, with respect to a derivatives clearing organization that is organized outside of the United States, an appropriate government authority which licenses, regulates, supervises, or oversees the derivatives clearing organization’s clearing activities in the home country.

\* \* \* \* \*

*Principles for Financial Market Infrastructures* means the Principles for Financial Market Infrastructures jointly published by the Committee on



Payments and Market Infrastructures and the Technical Committee of the International Organization of Securities Commissions in April 2012.

\* \* \* \* \*

*Substantial risk to the U.S. financial system* means, with respect to a derivatives clearing organization organized outside of the United States, that (1) the derivatives clearing organization holds 20% or more of the required initial margin of U.S. clearing members for swaps across all registered and exempt derivatives clearing organizations; and (2) 20% or more of the initial margin requirements for swaps at that derivatives clearing organization is attributable to U.S. clearing members; *provided, however*, where one or both of these thresholds are close to 20%, the Commission may exercise discretion in determining whether the derivatives clearing organization poses substantial risk to the U.S. financial system. For purposes of this definition and §§ 39.6 and 39.51 of this chapter, *U.S. clearing member* means a clearing member organized in the United States, a clearing member whose parent company is organized in the United States, or a futures commission merchant.

\* \* \* \* \*

■ 6. Add § 39.6 to read as follows:

**§ 39.6 Exemption from derivatives clearing organization registration.**

(a) *Eligibility for exemption.* The Commission may exempt a derivatives clearing organization that is organized outside of the United States, from registration as a derivatives clearing organization for the clearing of swaps for U.S. persons, and thereby exempt such derivatives clearing organization from compliance with provisions of the Act and Commission regulations applicable to derivatives clearing organizations, if:

(1) The derivatives clearing organization is subject to comparable, comprehensive supervision and regulation by a home country regulator as demonstrated by the following:

(i) The derivatives clearing organization is organized in a jurisdiction in which a home country regulator applies to the derivatives clearing organization, on an ongoing basis, statutes, rules, regulations, policies, or a combination thereof that, taken together, are consistent with the Principles for Financial Market Infrastructures;

(ii) The derivatives clearing organization observes the Principles for Financial Market Infrastructures in all material respects; and

(iii) The derivatives clearing organization is in good regulatory standing in its home country;

(2) The derivatives clearing organization does not pose substantial risk to the U.S. financial system, as determined by the Commission; and

(3) A memorandum of understanding or similar arrangement satisfactory to the Commission is in effect between the Commission and the derivatives clearing organization's home country regulator, pursuant to which, among other things, the home country regulator agrees to provide to the Commission any information that the Commission deems necessary to evaluate the initial and continued eligibility of the derivatives clearing organization for exemption from registration or to review its compliance with any conditions of such exemption.

(b) *Conditions of exemption.* An exemption from registration as a derivatives clearing organization shall be subject to any conditions the Commission may prescribe including, but not limited to:

(1) *Clearing for U.S. persons.* The exempt derivatives clearing organization shall have rules providing that:

(i) An intermediary that clears swaps for a U.S. person may not be registered with the Commission as a futures commission merchant; and

(ii) An entity that is registered with the Commission as a futures commission merchant may be a clearing member of the exempt derivatives clearing organization, or otherwise maintain an account with an affiliated broker that is a clearing member, for the purpose of clearing swaps for itself and those persons identified in the definition of "proprietary account" set forth in § 1.3 of this chapter.

(2) *Notice of protections available to U.S. persons.* The exempt derivatives clearing organization shall have rules that require any clearing member seeking to clear for an unaffiliated U.S. person to provide written notice to, and obtain acknowledgement from, the U.S. person prior to clearing that the clearing member is not a registered futures commission merchant, the exempt derivatives clearing organization is exempt from registration with the Commission, and the protections of the Bankruptcy Code, as defined in § 190.01(c) of this chapter, do not apply to the U.S. person's funds. The notice must explicitly compare the protections available to the U.S. person under U.S. law and the exempt derivatives clearing organization's home country regulatory regime.

(3) *Open access.* The exempt derivatives clearing organization shall

have rules with respect to swaps to which one or more of the counterparties is a U.S. person that shall:

(i) Provide that all swaps with the same terms and conditions, as defined by product specifications established under the exempt derivatives clearing organization's rules, submitted to the exempt derivatives clearing organization for clearing are economically equivalent within the exempt derivatives clearing organization and may be offset with each other within the exempt derivatives clearing organization, to the extent offsetting is permitted by the exempt derivatives clearing organization's rules; and

(ii) Provide that there shall be non-discriminatory clearing of a swap executed bilaterally or on or subject to the rules of an unaffiliated electronic matching platform or trade execution facility.

(4) *Consent to jurisdiction; designation of agent for service of process.* The exempt derivatives clearing organization shall:

(i) Consent to jurisdiction in the United States;

(ii) Designate, authorize, and identify to the Commission, an agent in the United States who shall accept any notice or service of process, pleadings, or other documents, including any summons, complaint, order, subpoena, request for information, or any other written or electronic documentation or correspondence issued by or on behalf of the Commission or the United States Department of Justice to the exempt derivatives clearing organization, in connection with any actions or proceedings brought against, or investigations relating to, the exempt derivatives clearing organization or any U.S. person or futures commission merchant that is a clearing member, or that clears swaps through a clearing member, of the exempt derivatives clearing organization; and

(iii) Promptly inform the Commission of any change in its designated and authorized agent.

(5) *Compliance.* The exempt derivatives clearing organization shall comply, and shall demonstrate compliance as requested by the Commission, with any condition of its exemption.

(6) *Inspection of books and records.* The exempt derivatives clearing organization shall make all documents, books, records, reports, and other information related to its operation as an exempt derivatives clearing organization open to inspection and copying by any representative of the Commission; and in response to a request by any representative of the

Commission, the exempt derivatives clearing organization shall, promptly and in the form specified, make the requested books and records available and provide them directly to Commission representatives.

(7) *Observance of the Principles for Financial Market Infrastructures.* On an annual basis, within 60 days following the end of its fiscal year, the exempt derivatives clearing organization shall provide to the Commission a certification that it continues to observe the Principles for Financial Market Infrastructures in all material respects. To the extent the exempt derivatives clearing organization is unable to provide to the Commission an unconditional certification, it must identify the underlying material non-observance of the Principles for Financial Market Infrastructures and identify whether and how such non-observance has been or is being resolved by means of corrective action taken by the exempt derivatives clearing organization.

(8) *Representation of good regulatory standing.* On an annual basis, within 60 days following the end of its fiscal year, an exempt derivatives clearing organization shall request and the Commission must receive from a home country regulator a written representation that the exempt derivatives clearing organization is in good regulatory standing.

(9) *Other conditions.* The Commission may condition an exemption on any other facts and circumstances it deems relevant.

(c) *General reporting requirements.* (1) An exempt derivatives clearing organization shall provide to the Commission the information specified in this paragraph and any other information that the Commission deems necessary, including, but not limited to, information for the purpose of the Commission evaluating the continued eligibility of the exempt derivatives clearing organization for exemption from registration, reviewing compliance by the exempt derivatives clearing organization with any conditions of the exemption, or conducting oversight of U.S. persons and their affiliates, and the swaps that are cleared by such persons through the exempt derivatives clearing organization. Information provided to the Commission under this paragraph shall be submitted in accordance with § 39.19(b) of this chapter.

(2) Each exempt derivatives clearing organization shall provide to the Commission the following information:

(i) A report compiled as of the end of each trading day and submitted to the Commission by 10:00 a.m. U.S. Central

time on the following business day, containing with respect to swaps:

(A) Total initial margin requirements for all clearing members;

(B) Initial margin requirements and initial margin on deposit for each U.S. clearing member, by house origin and by each customer origin, and by each individual customer account;

(C) With respect to an intermediary that clears swaps for a U.S. person, initial margin requirements and initial margin on deposit for each individual customer account of each U.S. person; and

(D) Daily variation margin, separately listing the mark-to-market amount collected from or paid to each U.S. clearing member, by house origin and by each customer origin, and by each individual customer account; *provided, however,* if a clearing member margins on a portfolio basis its own positions and the positions of its affiliates, and either the clearing member or any of its affiliates is a U.S. person, the exempt derivatives clearing organization shall separately list the mark-to-market amount collected from or paid to each such clearing member, on a combined basis.

(ii) A report compiled as of the last day of each fiscal quarter of the exempt derivatives clearing organization and submitted to the Commission no later than 17 business days after the end of the exempt derivatives clearing organization's fiscal quarter, containing a list of U.S. persons and futures commission merchants that are either clearing members or affiliates of any clearing member, with respect to the clearing of swaps.

(iii) Prompt notice regarding any change in the home country regulatory regime that is material to the exempt derivatives clearing organization's continuing observance of the Principles for Financial Market Infrastructures or compliance with any of the requirements set forth in this section or in the order of exemption issued by the Commission;

(iv) As available to the exempt derivatives clearing organization, any assessment of the exempt derivatives clearing organization's or the home country regulator's observance of the Principles for Financial Market Infrastructures, or any portion thereof, by a home country regulator or other national authority, or an international financial institution or international organization;

(v) As available to the exempt derivatives clearing organization, any examination report, examination findings, or notification of the commencement of any enforcement or

disciplinary action by a home country regulator;

(vi) Immediate notice of any change with respect to the exempt derivatives clearing organization's licensure, registration, or other authorization to act as a derivatives clearing organization in its home country;

(vii) In the event of a default by a clearing member clearing swaps, with such event of default determined in accordance with the rules of the exempt derivatives clearing organization, immediate notice of the default including the amount of the clearing member's financial obligation; *provided, however,* if the defaulting clearing member is a U.S. clearing member, or clears for a U.S. person, the notice shall also include the name of the defaulting clearing member and, as applicable, the name(s) of the U.S. person(s) for whom the clearing member clears, and a list of the positions held by the defaulting clearing member and, as applicable, the positions held by the U.S. person(s) for whom the clearing member clears; and

(viii) Notice of action taken against a U.S. clearing member by an exempt derivatives clearing organization, no later than two business days after the exempt derivatives clearing organization takes such action against a U.S. person or futures commission merchant.

(d) *Swap data reporting requirements.* If a clearing member clears through an exempt derivatives clearing organization a swap that has been reported to a registered swap data repository pursuant to part 45 of this chapter, the exempt derivatives clearing organization shall report to a registered swap data repository data regarding the two swaps resulting from the novation of the original swap that had been submitted to the exempt derivatives clearing organization for clearing. The exempt derivatives clearing organization shall also report the termination of the original swap accepted for clearing by the exempt derivatives clearing organization, to the swap data repository to which the original swap was reported. In order to avoid duplicative reporting for such transactions, the exempt derivatives clearing organization shall have rules that prohibit the reporting, pursuant to part 45 of this chapter, of the two new swaps by the original counterparties to the original swap.

(e) *Application procedures.* (1) An entity seeking to be exempt from registration as a derivatives clearing organization shall file an application for exemption with the Secretary of the Commission in the format and manner specified by the Commission. The Commission will review the application

for exemption and may approve or deny the application or, if deemed appropriate, exempt the applicant from registration as a derivatives clearing organization subject to conditions in addition to those set forth in paragraph (b) of this section.

(2) *Application.* An applicant for exemption from registration as a derivatives clearing organization shall submit to the Commission the information and documentation described in this section. Such information and documentation shall be clearly labeled as outlined in this section. The Commission will not commence processing an application unless the applicant has filed a complete application. Upon its own initiative, an applicant may file with its completed application for exemption additional information that may be necessary or helpful to the Commission in processing the application. The application shall include:

(i) A cover letter containing the following information:

(A) Exact name of applicant as specified in its charter, and the name under which business will be conducted (including acronyms);

(B) Address of applicant's principal office;

(C) List of principal office(s) and address(es) where clearing activities are/will be conducted;

(D) A list of all regulatory licenses or registrations of the applicant (or exemptions from any licensing requirement) and the regulator granting such license or registration;

(E) Date of the applicant's fiscal year end;

(F) Contact information for the person or persons to whom the Commission should address questions and correspondence regarding the application; and

(G) A signature and date by a duly authorized representative of the applicant.

(ii) A description of the applicant's business plan for providing clearing services as an exempt derivatives clearing organization, including information as to the classes of swaps that will be cleared and whether the swaps are subject to a clearing requirement issued by the Commission or the applicant's home country regulator;

(iii) Documents that demonstrate that the applicant is organized in a jurisdiction in which its home country regulator applies to the applicant, on an ongoing basis, statutes, rules, regulations, policies, or a combination thereof that, taken together, are

consistent with the Principles for Financial Market Infrastructures;

(iv) A written representation from the applicant's home country regulator that the applicant is in good regulatory standing;

(v) Copies of the applicant's most recent disclosures that are necessary to observe the Principles for Financial Market Infrastructures, including the financial market infrastructure disclosure template set forth in Annex A to the Disclosure Framework and Assessment Methodology for the Principles for Financial Market Infrastructures, any other such disclosure framework issued under the authority of the International Organization of Securities Commissions that is required for observance of the Principles for Financial Market Infrastructures, and the URL to the specific page(s) on the applicant's website where such disclosures may be found;

(vi) A representation that the applicant will comply with each of the requirements and conditions of exemption set forth in paragraphs (b), (c), and (d) of this section, and the terms and conditions of its order of exemption as issued by the Commission;

(vii) A draft of the applicant's rules that meet the requirements of paragraphs (b)(1), (b)(2), (b)(3), and (d) of this section, and a draft of the notice that meets the requirements of paragraph (b)(2) of this section, as applicable; and

(viii) The applicant's consent to jurisdiction in the United States, and the name and address of the applicant's designated agent in the United States, pursuant to paragraph (b)(4) of this section.

(3) *Submission of supplemental information.* At any time during its review of the application for exemption from registration as a derivatives clearing organization, the Commission may request that the applicant submit supplemental information in order for the Commission to process the application, and the applicant shall file such supplemental information in the format and manner specified by the Commission.

(4) *Amendments to pending application.* An applicant for exemption from registration as a derivatives clearing organization shall promptly amend its application if it discovers a material omission or error, or if there is a material change in the information provided to the Commission in the application or other information provided in connection with the application.

(5) *Public information.* The following sections of an application for exemption from registration as a derivatives clearing organization will be public: The cover letter set forth in paragraph (e)(2)(i) of this section; the documentation required in paragraphs (e)(2)(iii) and (e)(2)(v) of this section; draft rules that meet the requirements of paragraphs (b)(1), (b)(2), (b)(3), and (d) of this section, as applicable; the draft notice that meets the requirements of paragraph (b)(2) of this section, as applicable; and any other part of the application not covered by a request for confidential treatment, subject to § 145.9 of this chapter.

(f) *Modification or termination of exemption upon Commission initiative.*

(1) The Commission may, in its discretion and upon its own initiative, terminate or modify the terms and conditions of an order of exemption from derivatives clearing organization registration if the Commission determines that there are changes to or omissions in material facts or circumstances pursuant to which the order of exemption was issued, or that any of the terms and conditions of its order of exemption have not been met, including, but not limited to, the requirement that:

(i) The exempt derivatives clearing organization observes the Principles for Financial Market Infrastructures in all material respects;

(ii) The exempt derivatives clearing organization is subject to comparable, comprehensive supervision and regulation by its home country regulator; or

(iii) The exempt derivatives clearing organization does not pose substantial risk to the U.S. financial system.

(2) The Commission shall provide written notification to an exempt derivatives clearing organization that it is considering whether to terminate or modify an exemption pursuant to this paragraph and the basis for that consideration.

(3) The exempt derivatives clearing organization may respond to the notification in writing no later than 30 business days following receipt of the notification, or at such later time as the Commission permits in writing.

(4) Following receipt of a response from the exempt derivatives clearing organization, or after expiration of the time permitted for a response, the Commission may:

(i) Issue an order of termination, effective as of a date to be specified therein. Such specified date shall be intended to provide the exempt derivatives clearing organization with a reasonable amount of time to wind

down its swap clearing services for U.S. persons;

(ii) Issue an amended order of exemption that modifies the terms and conditions of the exemption; or

(iii) Provide written notification to the exempt derivatives clearing organization that the exemption will remain in effect without modification to the terms and conditions of the exemption.

(g) *Termination of exemption upon request by an exempt derivatives clearing organization.* (1) An exempt derivatives clearing organization may petition the Commission to terminate its exemption if:

(i) Changed circumstances result in the exempt derivatives clearing organization no longer qualifying for an exemption;

(ii) The exempt derivatives clearing organization intends to cease clearing swaps for U.S. persons; or

(iii) In conjunction with the petition, the exempt derivatives clearing organization submits an application for registration in accordance with § 39.3(a)(2) or § 39.3(a)(3), as applicable, to become a registered derivatives clearing organization pursuant to section 5b(a) of the Act.

(2) The petition for termination of exemption shall include a detailed explanation of the facts and circumstances supporting the request and the exempt derivatives clearing organization's plans for, as may be applicable, the liquidation or transfer of the swaps positions and related collateral of U.S. persons.

(3) The Commission shall issue an order of termination within a reasonable time appropriate to the circumstances or, as applicable, in conjunction with the issuance of an order of registration.

(h) *Notice to clearing members of termination of exemption.* Following the Commission's issuance of an order of termination (unless issued in conjunction with the issuance of an order of registration), the exempt derivatives clearing organization shall provide immediate notice of such termination to its clearing members. Such notice shall include:

(1) A copy of the Commission's order of termination;

(2) A description of the procedures for orderly disposition of any open swaps positions that were cleared for U.S. persons; and

(3) An instruction to clearing members, requiring that they provide the exempt derivatives clearing organization's notice of such termination to all U.S. persons clearing swaps through such clearing members.

## PART 140—ORGANIZATION, FUNCTIONS, AND PROCEDURES OF THE COMMISSION

■ 7. The authority citation for part 140 continues to read as follows:

**Authority:** 7 U.S.C. 2(a)(12), 12a, 13(c), 13(d), 13(e), and 16(b).

■ 8. Amend § 140.94 by:

■ a. Revising the introductory text of paragraph (c);

■ b. Redesignating paragraphs (c)(4) through (c)(13) as paragraphs (c)(5) through (c)(14); and

■ c. Adding new paragraph (c)(4).

The revisions and additions read as follows:

### § 140.94 Delegation of authority to the Director of the Division of Swap Dealer and Intermediary Oversight and the Director of the Division of Clearing and Risk.

\* \* \* \* \*

(c) The Commission hereby delegates, until such time as the Commission orders otherwise, the following functions to the Director of the Division of Clearing and Risk and to such members of the Commission's staff acting under his or her direction as he or she may designate from time to time:

\* \* \* \* \*

(4) All functions reserved to the Commission in § 39.6 of this chapter, except for the authority to:

(i) Grant an exemption under § 39.6(a) of this chapter;

(ii) Prescribe conditions to an exemption under § 39.6(b) of this chapter;

(iii) Modify or terminate an exemption under § 39.6(f)(4) of this chapter; and

(iv) Terminate an exemption under § 39.6(g)(3) of this chapter.

\* \* \* \* \*

Issued in Washington, DC, on July 12, 2019, by the Commission.

**Robert Sidman,**

*Deputy Secretary of the Commission.*

**Note:** The following appendices will not appear in the Code of Federal Regulations.

### Appendices to Exemption From Derivatives Clearing Organization Registration—Commission Voting Summary, Chairman's Statement, and Commissioners' Statements

#### Appendix 1—Commission Voting Summary

On this matter, Chairman Giancarlo, and Commissioners Quintenz and Stump voted in the affirmative. Commissioners Behnam and Berkovitz voted in the negative.

#### Appendix 2—Statement of Chairman J. Christopher Giancarlo

The proposal would provide a non-U.S. DCO that does not pose a substantial risk to the United States, and that is subject to "comparable, comprehensive supervision and regulation" by appropriate regulators in the DCO's home jurisdiction, the option to be an exempt DCO. This proposal supplements regulations proposed by the Commission in August 2018 that would codify the policies and procedures that the Commission is currently following with respect to granting exemptions from registration as a DCO.<sup>1</sup> The proposal is grounded in section 5b(h) of the Commodity Exchange Act,<sup>2</sup> which provides that non-U.S. clearing organizations that are subject to "comparable, comprehensive supervision and regulation" by a home country regulator are eligible for an exemption from DCO registration.<sup>3</sup>

Unlike the current CFTC approach to exempt DCOs, the proposal would permit exempt DCOs to offer customer clearing to U.S. eligible contract participants—*i.e.*, non-retail customers—through foreign clearing members that are not registered as FCMs. To be eligible for this exemption, the DCO and the FCM would be required, among other things, to provide clear and succinct disclosure to U.S. eligible contract participants on the bankruptcy protections that would be afforded to them under relevant non-U.S. law. To facilitate this proposal, the Commission also is proposing to allow persons located outside of the United States to accept funds from U.S. persons to margin swaps cleared at an exempt DCO, without registering as FCMs.

This proposal is similar to the CFTC's longstanding approach to foreign futures clearing, which provides U.S. customers, including retail customers, with the ability to opt out of the bankruptcy protections offered under U.S. law to foreign futures funds. I believe it is wholly appropriate to permit U.S. eligible contract participants that are institutional, not retail, investors to exercise business judgment in this area. In other words, I believe it is appropriate to afford these institutional investors the opportunity to weigh the potential economic benefits of accessing products cleared at a non-U.S. CCP through a non-U.S. intermediary that would otherwise not be available to them, with the attendant potential risks relating to the use of a non-FCM intermediary. These are risks that institutional—and potentially retail—investors in those non-U.S. markets take every day when they choose to clear swaps

<sup>1</sup> Exemption From Derivatives Clearing Organization Registration, 83 FR 39923 (Aug. 13, 2018).

<sup>2</sup> 7 U.S.C. 7a–1(h).

<sup>3</sup> The Commission has construed "comparable, comprehensive supervision and regulation" to mean that the home country's supervisory and regulatory framework should be consistent with, and achieve the same outcome as, the statutory and regulatory requirements applicable to registered DCOs. Further, the Commission has deemed a supervisory and regulatory framework that conforms to the Principles for Financial Market Infrastructures to be comparable to, and as comprehensive as, the supervisory and regulatory requirements applicable to registered DCOs.

through those non-U.S. intermediaries at non-U.S. CCPs.

Some non-U.S. DCOs that are currently exempt from registration may elect to remain exempt or register under the full registration regime with alternative compliance, discussed earlier. In either case, they would be able to offer customer clearing, but in different ways. Exempt DCOs would be able to offer customer clearing to U.S. eligible contract participants through non-U.S. intermediaries operating in their markets, while fully registered DCOs subject to alternative compliance would be able to permit customer clearing through U.S. FCMs. In both cases, in terms of regulatory oversight of the DCO, the CFTC would defer to the primary regulator or regulators of the DCO.

I thank CFTC staff for their fine work that resulted in today's proposal. I look forward to reviewing comments from the public.

### Appendix 3—Statement of Commissioner Brian Quintenz

Today's supplemental proposal to permit exempt DCOs to clear swaps for U.S. customers will provide greater choice and flexibility to market participants. Currently, an exempt DCO is only authorized to clear the proprietary positions of its U.S. clearing members. Today's proposal will provide U.S. customers, like U.S. asset managers, insurance companies, and others, with increased access to foreign markets and an enhanced ability to hedge their risk.

I strongly support this proposal's inclusion of specific criteria that the Commission will use to determine whether a foreign DCO poses a "substantial risk to the U.S. financial system," and would therefore be ineligible for an exemption from registration. Today's rulemaking also appropriately streamlines exempt DCO reporting requirements to focus solely on the information necessary to evaluate "substantial risk" and to assess the extent to which the foreign DCO is clearing U.S. business.

I look forward to receiving comments on additional possibilities for U.S. customers to clear on exempt DCOs. In particular, I am interested to hear from commenters about whether U.S. futures commission merchants (FCMs) should be permitted to provide their U.S. customers with access to exempt DCOs, and, if so, how the protection of U.S. customer funds should be addressed. I also welcome comment about whether a foreign DCO, neither registered with the CFTC nor exempted from CFTC registration, should be permitted to clear for a foreign branch of a U.S. bank that is registered with the CFTC as a swap dealer. Finally, I look forward to hearing from market participants about whether a foreign clearing member of a foreign DCO should be permitted to sponsor a U.S. FCM's membership to the foreign DCO in order to facilitate access by U.S. customers.

### Appendix 4—Dissenting Statement of Commissioner Rostin Behnam

#### Introduction

I respectfully dissent from the Commodity Futures Trading Commission's (the "Commission" or "CFTC") supplemental

notice of proposed rulemaking addressing the granting of exemptions from registration as a derivatives clearing organization ("DCO") to non-U.S. clearing organizations and further permitting such "exempt DCOs" to clear swaps for U.S. customers through intermediaries that would be wholly outside the Commission's direct regulation and oversight (the "Supplemental Proposal"). While I supported the Commission's 2018 proposal to codify its current policies and procedures for granting exemptions from DCO registration<sup>1</sup> as a positive step towards increased cross-border cooperation and deference to our foreign regulatory counterparts, I cannot support it in its "supplemental" form. The Supplemental Proposal is not the product of internal consensus and its brief history and questionable timeline signal a lack of appropriate scrutiny and evaluation of the potential consequences of taking these first steps towards diverging from the customer protection model provided by the Commodity Exchange Act ("CEA" or "the Act") and U.S. Bankruptcy Code.<sup>2</sup>

I support the Commission's endeavor to explore ways to adapt and—if appropriate—seek to alter the current intermediary structure established under the CEA and Commission regulations to better accommodate both U.S. customer demand for increased access to clearing in foreign jurisdictions and evolving global swaps market structures. However, I cannot support the Commission's proposed use of its limited public interest exemptive authority to create a regulatory easement as a short cut to legal certainty in furtherance of such efforts and to the detriment of U.S. customers, market participants, and the financial system.

If the Commission believes it is appropriate at this time to provide U.S. customers with greater access to non-U.S. swap markets, then we can and should engage in a more careful analysis of options, assessment of alternatives, and evaluation of consequences. Policy decisions made in haste amid ongoing uncertainty undermine the regulatory process and our accountability. As I have said before, when evaluating our regulatory landscape and making critical determinations as to which parts to revisit, which to complete, and how we can guide legislation and develop regulations to address market evolution and developments—regardless of the underlying impetus, we must hold one another accountable, adhere to appropriate process, be wary of false progress, and engage in genuine dialog.<sup>3</sup> Today's Supplemental

<sup>1</sup> Exemption from Derivatives Clearing Organization Registration, 83 FR 39923 (proposed Aug. 13, 2018) (the "2018 Proposal").

<sup>2</sup> The Supplemental Proposal was drafted ad hoc in a rash attempt to launch a conception of how U.S. swaps customers may fare outside the protections offered through operation of the U.S. Bankruptcy Code. The critical financial, market, consumer protection, and systemic risk issues raised by the Supplemental Proposal should be considered in the context of a more fulsome and informed discussion.

<sup>3</sup> See, e.g., Rostin Behnam, Accountability & Moving Forward, Remarks of Commissioner Rostin Behnam at the FIA Boca 2018 International Futures Industry 43rd Annual Conference, Boca Raton, Florida (Mar. 15, 2018), <https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam4>.

Proposal in its timing, in its limitations, and in its uncertainty, is at best, false progress and, at worst, the false promise of benefits that will never be realized.

The substantial revisions to the Supplemental Proposal throughout these last several weeks with their various additions and carefully crafted excerpts do little to bolster the justifications and rationales put forth in advocacy of the proposed change in policy and attendant exemptive relief that would permit U.S. customer positions to be cleared at an exempt DCO through a foreign intermediary that is not registered as a futures commission merchant ("FCM"). Nowhere is this clearer than in the Request for Comments.<sup>4</sup>

The Supplemental Proposal utilizes its Request for Comments primarily to explore why this proposal represents the regulatory route that will cause the least amount of harm by soliciting the public for their best arguments as to the operation of the U.S. Bankruptcy Code (and relevant laws), and to solicit feedback on eligibility elements and several conditions of the exemption for DCOs. However, it also introduces and requests comment on alternatives to the Commission's longstanding policy (consistent with longstanding interpretation of the CEA) of allowing U.S. customers' swap positions to be cleared only through registered FCMs at registered DCOs. While this is an entirely appropriate issue to raise in the context of a proposed rulemaking (or other formal request for public comment such as an advance notice of proposed rulemaking, request for input, or concept release), the effectiveness of any comments received will be largely lost in this "supplement" since the line of questioning fails to accentuate—or itself propose—a rule from which any final Commission action could be taken as a logical outgrowth.<sup>5</sup> A line of questioning that seeks to introduce potentially new policy considerations for future consideration by a Commission in the midst of changing leadership is ill-fated, detracts commenters from the critical issues at hand, and undermines the integrity of the 2018 Proposal and the Supplemental Proposal.<sup>6</sup>

#### When You Are Boxed in by Uncertainty

Though I have many concerns with the Supplemental Proposal, I am most concerned with the Commission's contorted plan to permit DCOs that it would exempt from registration to clear swaps for U.S. customers through unregistered foreign intermediaries. This juggernaut of a proposal gained momentum from the ongoing uncertainty

<sup>4</sup> Supplemental Proposal at Section V.

<sup>5</sup> See, e.g., *CSX Transportation, Inc. v. Surface Transportation Board*, 584 F.3d 1076, 1079–81 (DC Cir. 2009) ("A final rule qualifies as a logical outgrowth 'if interested parties 'should have anticipated' that the change was possible, and thus reasonably should have filed their comments on the subject during the notice-and-comment period'").

<sup>6</sup> It seems particularly unfortunate in this instance where some extra time and staff attention may have permitted the Commission to deliberate and vote to issue an entirely separate proposal aimed at addressing timely and emerging concerns in the FCM community.

regarding the extent to which U.S. customers' funds would be protected under the U.S. Bankruptcy Code when clearing swaps at an unregistered DCO. While the Commission's decision to put a premium on legal certainty is laudable, it is not clear to me that the Commission ought to do so if it undermines key components of the CEA's customer protection regime aimed at protecting both U.S. customers and the stability of our markets and misaligns the Commission's already questionable use of its public interest exemptive authority with the purposes of the Act.<sup>7</sup> It appears that in attempting to deliver on the concept of permitting exempt DCOs to clear swaps for FCM customers—introduced just months ago by the Commission as a single question in the 2018 Proposal<sup>8</sup>—the Commission found itself boxed in by uncertainty. The only way out would be to remove any and all doubt that a U.S. customer who seeks to clear swaps on an exempt DCO will have to do so through a foreign intermediary not subject to CFTC regulation or oversight and outside the protections of the U.S. Bankruptcy Code.<sup>9</sup>

#### Ongoing Uncertainty

The Supplemental Proposal would permit U.S. customers to clear at an exempt DCO only through a foreign intermediary and not through an FCM due to uncertainty regarding the protection of U.S. customer funds in the event of an insolvency of the FCM. The Commission is continuing to consider and evaluate this issue, consider alternative approaches, and identify possible risks to customers that may result from that uncertainty. While this approach was selected as a means to provide the greatest clarity with regard to the Commission's current understanding of the U.S. Bankruptcy Code, given that it necessitates the Commission's exercise of exemptive authority to permit foreign intermediaries to accept U.S. customer funds to clear swaps without having to register as FCMs (or having to comply with Commission rules and regulations applicable solely to registered FCMs), it would seem, on its face, to be inconsistent with the customer protection regime established under the CEA and Commission regulations.<sup>10</sup> This should give the Commission ample reason to pause its consideration of moving forward on the Supplemental Proposal at this time. Inexplicably, it does not. And instead, the Commission is soliciting comments from the public on a number of issues involving the interpretation and applicability of the U.S. Bankruptcy Code (or other relevant laws) and the clearing of swaps customer funds deposited at an exempt DCO by an FCM

directly or through a foreign member of the exempt DCO.<sup>11</sup>

#### Misuse and Abuse of Authority

In order to permit foreign intermediaries to clear swaps for U.S. persons, and to ensure that only foreign intermediaries that are not FCMs will clear U.S. customer positions on exempt DCOs, the Commission is proposing to exercise its authority under section 4(c) of the CEA to exempt foreign intermediaries from the prohibition in section 4d(f) of the CEA against accepting customer funds to clear swaps at a registered or exempting DCO without registering as FCMs. Even assuming that the Commission's exemptive authority extends to the non-U.S. clearing organizations and intermediaries that are the subject of the Supplemental Proposal,<sup>12</sup> the Commission's proposed justifications for the use of such authority do not align with the very purpose of the authority to promote innovation and competition without sacrificing key components of the Commission's regulatory and oversight structure.

Section 4(c) of the CEA, commonly referred to as the public interest exemption, authorizes the Commission, in order to promote responsible innovation and fair competition, by rule, regulation, or order, to exempt, among other things, any person or class of persons offering, entering into, rendering advice, or rendering other services with respect to transactions from any of the provisions of the CEA other than certain enumerated provisions.<sup>13</sup> When enacting

<sup>11</sup> See Supplemental Proposal at V. I appreciate that asking these direct questions encourages interested parties and perhaps even bankruptcy scholars to provide their best interpretations and arguments. However, it is not clear to me that the U.S. Bankruptcy Court would be obliged to defer to such interpretations—even if accepted by the Commission. And that, unless the Commission aims to seek a legislative solution to alleviate the uncertainty presented by U.S. customer clearing on exempt DCOs—which it has not presented as a viable alternative in this Supplemental Proposal, I cannot appreciate the value of this exercise at this time when our immediate goal should be to codify policies and procedures for granting exemptions from DCO registration.

<sup>12</sup> Section 4(c) of the CEA, 7 U.S.C. 6(c), provides the Commission may exempt any agreement, contract, or transaction (including any persons offering, entering into, rendering advice or rendering other services with respect thereto) from the exchange trading requirements of section 4(a), or any other provision of the Act (subject to express limitations identified in section 4(c)(1)(A)) if such transaction—or person—is subject to section 4(a). Section 4(a) includes a parenthetical indicating that it does not apply to contracts “made on or subject to the rules of a board of trade, exchange, or market located outside the United States . . .” The Supplemental Proposal does address this potential limitation on its exemptive authority in its reading of section 4(c) (see Supplemental Proposal at Section II, n. 14). However, the CFTC's General Counsel confirmed that the Commission's use of section 4(c) exemptive authority is within the Commission's authority in this instance during the open public meeting at which the Supplemental Proposal was deliberated. See Press Release Number 7967–19, CFTC, CFTC Voted on Open Meeting Agenda Items (July 11, 2019), <https://www.cftc.gov/PressRoom/PressReleases/7967-19>.

<sup>13</sup> 7 U.S.C. 6(c)(1). Section 4(c)(2) of the CEA further provides that the Commission may not grant

section 4(c), Congress noted that the purpose of the provision is “to give the Commission a means of providing certainty and stability to existing and emerging markets so that financial innovation and market development can proceed in an effective and competitive manner . . . with due regard for the continued viability of the marketplace and considerations related to systemic risk in financial markets.”<sup>14</sup> Indeed, in exercising its exemptive authority under section 4(c) of the CEA, the Commission has long understood that it was Congress's intention and expectation that “the Commission will assess the impact of a proposed exemption on the maintenance of the integrity and soundness of markets and market participants.”<sup>15</sup> As well, Congress, in requiring the Commission to consider any material adverse effect on regulatory or self-regulatory responsibilities, indicated that the Commission is to consider such regulatory concerns as “market surveillance, financial integrity of participants, protection of customers, and trade practice enforcement.”<sup>16</sup>

The Commission's section 4(c) proposal, which would be codified in § 3.10(c)(7) of the Commission regulations, purports to be consistent with the exempt DCO framework being proposed in that it is based on deference to the regulation and supervision of foreign intermediary's home country regulator. To qualify for the exemption, the foreign intermediary: (1) Must accept funds from a U.S. person to margin, guarantee, or secure swap transactions that are cleared by an exempt DCO; (2) may not engage in other activities requiring registration as an FCM or voluntarily register as an FCM; and (3) must be a clearing member of an exempt DCO and must directly clear the swap transactions of the U.S. person at an exempt DCO. A foreign intermediary that is exempt from registering as an FCM pursuant to the foregoing requirements is not required to comply with those provisions of the Act and of the rules, regulations, or orders thereunder applicable solely to any registered FCM and may provide commodity trading advice to U.S. persons without registering as a commodity trading advisor (“CTA”), provided that the advice is provided solely with respect to swaps that are cleared by an exempt DCO.<sup>17</sup>

The Commission believes the proposed exemption for foreign intermediaries promotes responsible financial innovation and fair competition, and is consistent with

exemptive relief unless it determines that: (1) The exemption would be consistent with the public interest and the purposes of the CEA; (2) the transaction will be entered into solely between “appropriate persons” as that term is defined in section 4(c); and (3) the exemption will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory responsibilities under the CEA. 7 U.S.C. 6(c)(2).

<sup>14</sup> H.R. Rep. No. 102–978, 102d Cong. 2d Sess. 80 (1992).

<sup>15</sup> See Exemption for Certain Swap Agreements, 58 FR 5587, 5592 (Jan. 22, 1993), citing H.R. Rep. No. 102–978, 102d Cong. 2d Sess. 80 (1992).

<sup>16</sup> See Exemption for Certain Swap Agreements, 58 FR 5587, 5592 (Jan. 22, 1993), citing H.R. Rep. No. 102–978, 102d Cong. 2d Sess. 79 (1992).

<sup>17</sup> See Supplemental Proposal at Section II.

<sup>7</sup> See H.R. Rep. No. 102–978, 102d Cong. 2d Sess. 80 (1992).

<sup>8</sup> 2018 Proposal, 83 FR at 39930.

<sup>9</sup> Indeed, the Commission succinctly dismisses the consideration of proposed alternatives suggested by commenters on the 2018 Proposal “given the uncertainty as to extent to which U.S. customers would be protected under the Bankruptcy Code . . .” Supplemental Proposal at VI.C.4.

<sup>10</sup> See Supplemental Proposal at III.C.2.

the public interest and purposes of the CEA. In support of these beliefs, the Commission focuses on: (1) The provision allowing U.S. persons additional options for trading and clearing swap transactions and the concomitant expansion of available intermediaries, which has the potential to reduce the current concentration of U.S. customer funds in a small number of FCMs and (2) increased access for U.S. persons to swaps that are cleared in foreign jurisdictions, which may provide for greater hedging opportunities and increased liquidity in more standardized, cleared contracts.<sup>18</sup> However, these rationales ignore that this approach removes U.S. customers from the protections of the U.S. Bankruptcy Code and puts both FCMs and registered DCOs at a competitive disadvantage and with respect to clearing in non-U.S. swaps markets. While the Commission puts forth mitigating factors in response to the loss of U.S. Bankruptcy Code protections, as discussed below, its solution can only be said to promote “responsible” innovation if we assume that individual U.S. Customers need nothing more than notice of their lack of protections to engage responsibly in foreign financial markets to prevent harm to themselves and to the larger financial system. It is my belief that history has not demonstrated that this is the case. Regarding the competitive disadvantage to FCMs and registered DCOs, the Commission admits that this is a cost of its proposal,<sup>19</sup> but makes no arguments regarding fairness beyond briefly discussing the economics of being regulated as a clearing organization in any jurisdiction.

The Commission also concludes that the proposed exemption will be limited to appropriate persons, “as only U.S. persons that are eligible contract participants (“ECPs”) would be permitted to maintain accounts with a foreign intermediary for swaps cleared at an exempt DCO” and cites CEA section 2(e) which makes it unlawful for any person, other than an ECP, to enter into a swap unless the swap is entered on or subject to the rules of a designated contract market.<sup>20</sup> Of note, the Commission makes no reference to whether or how the foreign intermediary will comply with this limitation and the proposed conditions of exemption for DCOs do not require the DCO to have rules that would limit a foreign intermediary’s ability to solicit and accept U.S. customers that are not ECPs. Similarly, it is unclear as to whether the Exempt DCO or the foreign intermediary’s home regulator will ensure that the foreign intermediary does not solicit or provide trading advice to U.S. customers warranting CTA registration beyond the trading advice permitted by the exemption. It is difficult to even evaluate whether the Commission considered the adverse effect on its regulatory responsibilities, in terms of market surveillance, financial integrity of participants, protection of customers, and trade practice enforcement.

The Commission acknowledges that (1) some foreign regulatory regimes may prove to

be less effective than the United States and (2) that foreign intermediaries clearing for customers at an exempt DCO may not be subject to the same level of effective supervision as an FCM.<sup>21</sup> However, it does not elaborate on the obvious concerns that ought to be raised by these assertions. Rather, the Commission maintains that any risks to U.S. customers from clearing swaps traded on exempt DCOs through foreign intermediaries that are not registered as FCMs would be mitigated under the Supplemental Proposal’s requirements for exempt DCOs in two key ways.<sup>22</sup> First, the exempt DCOs must be in good regulatory standing in their home country jurisdictions, and subject to comparable, comprehensive supervision and regulation that includes a regulatory structure consistent with the PFIMs. Second, an exempt DCO must require a foreign intermediary to provide written notice to, and obtain acknowledgement from, a U.S. person in advance of engaging in any clearing on their behalf that: (1) The clearing member is not a registered FCM; (2) that the exempt DCO is not registered with the CFTC; and (3) that the protections of the U.S. Bankruptcy Code do not apply to the U.S. person’s funds. The notice must also explicitly compare the protections available to the U.S. person under U.S. law and the laws of the exempt DCO’s home country regulatory regime.

There is much to be said for the views of the Commission in this regard, but in the interest of brevity, this approach favors what amounts to wholesale deregulation in the interest of deference absent any analysis of the potential individual customer and systemic consequences. Congress did not intend for the Commission to use its section 4(c) exemptive authority to engage in “wide scale deregulation of markets falling within the ambit of the Act,”<sup>23</sup> so it seems even more egregious that it would attempt to reach beyond the Act to empower U.S. customers to act outside of the Commission’s jurisdiction as conduits of risk. Indeed, given the Commission’s own struggles with the application of the U.S. Bankruptcy Code, I am especially curious to hear from U.S. customers seeking to hedge risk or access non-U.S. swaps markets as to whether the Commission’s proposed “caveat emptor” notice model would satisfy the rigors of internal risk management.

### Conclusion

In issuing this dissent, I have only touched upon the many issues of concern raised by the Supplemental Proposal. With each reading, I find myself questioning how the 2018 Proposal morphed from a “Project Kiss” initiative<sup>24</sup> to codify the policies and procedures currently followed by the Commission with respect to granting exemptions from DCO registration—which we have historically used sparingly—into a quest to capture a concept of how U.S. swaps customers may fare outside the protections

offered through operation of the U.S. Bankruptcy Code and protections offered by the CEA and Commission regulations. I believe that the Commission has acted in haste, without due consideration of the risks to individuals and the financial system, and outside its authority. I remain hopeful that the public comment period will provide ample time and opportunity for thoughtful consideration and response to the critical questions posed directly and issues raised by the Supplemental Proposal.

Despite today’s dissent, and as I have said many times before,<sup>25</sup> I look forward to working with my colleagues on cross-border policies that will meet our core responsibilities of promoting safe, transparent and fair markets, while supporting global market access through responsible rule-makings that further harmonize our rules with international partners.

### Appendix 5—Statement of Commissioner Dawn D. Stump

#### Overview

In responding to the financial crisis, both the Group of 20 Nations (G–20) and the U.S. Congress recognized that the derivatives markets are global and in doing so provided for international coordination and a practical application of regulatory deference. I want to commend the Chairman for his leadership in reminding us of the global commitments made in 2009 and the subsequent efforts Congress made to encourage global regulatory harmonization. Specifically, the G–20 leaders stated the clear responsibility we have “to take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage.”<sup>1</sup> More directly related to the subjects before us today, Congress, in the Dodd-Frank Act, amended the Commodity Exchange Act to provide: “The Commission may exempt, conditionally or unconditionally, a derivatives clearing organization from registration . . . for the clearing of swaps if the Commission determines that the derivatives clearing organization is subject to comparable, comprehensive supervision and regulation by . . . the appropriate government authorities in the home country of the organization.”<sup>2</sup>

I believe deference to comparable regulatory regimes is essential. Historically, such deference has been the guiding principle of the CFTC’s approach to regulating cross-border derivatives. We cannot effectively supervise central

<sup>25</sup> See, e.g., Rostin Behnam, Sowing the Seeds of Success in 2020, Remarks of CFTC Commissioner Rostin Behnam at the ISDA 34th Annual General Meeting, Grand Hyatt Hong Kong, Hong Kong (Apr. 10, 2019), <https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam13>.

<sup>1</sup> Leaders’ Statement from the 2009 G–20 Summit in Pittsburgh, Pa. 7 (Sept. 24–25, 2009), [http://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh\\_summit\\_leaders\\_statement\\_250909.pdf](http://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf).

<sup>2</sup> 7 U.S.C. 7a–1(h) (2012).

<sup>21</sup> Supplemental Proposal at Section VI.C.3.a.

<sup>22</sup> Supplemental Proposal at Section II.

<sup>23</sup> H.R. Rep. No. 102–978, 102d Cong. 2d Sess. 80 (1992).

<sup>24</sup> See 2018 Proposal, 83 FR at 39923.

<sup>18</sup> *Id.*

<sup>19</sup> Supplemental Proposal at Section VI.C.2.b.

<sup>20</sup> *Id.*

counterparties (CCPs) in every corner of the world. We can, however, evaluate the regulatory requirements in a CCP's home country to determine if they are sufficiently commensurate to our own. We will never have the exact same rules around the globe. We should rather strive to minimize the frequency and impact of duplicative regulatory oversight while also demanding high comparable standards, just as Congress intended.

Had we previously established a more comprehensive structure for those comparably-regulated, foreign CCPs seeking to offer swaps clearing to U.S. customers, then CCPs wishing to seek an exemption would have been able to do so under a regime that Congress provided for in the Dodd-Frank Act. Alternatively, those that wanted to register as a DCO would have done so voluntarily in response to a business rationale demanded by their clearing members and customers. However, by not having previously established an exemption process, the CFTC left only one path for customer clearing on non-U.S. DCOs, which resulted in compelling several non-U.S. CCPs to become dually registered with both their home country regulator and the CFTC.

As a result, relationships with our global regulatory counterparts became strained, and there have been many unfortunate consequences such that now we must provide new ground rules. So today, we are advancing an overdue conversation on applying international regulatory deference through the establishment of a test to identify non-U.S. CCPs that pose substantial risk to the U.S. financial system. To be clear, neither of the proposals we are considering today would be available to DCOs that pose such risk. I fear that this point may be lost or confused by the fact that we are presenting these as two separate rulemakings. While I would have preferred a single rulemaking to alleviate any confusion, I want to make clear that we are simply proposing two regulatory options, each of which is only available to those DCOs that do NOT pose substantial risk to the U.S. financial system under the proposed test. I encourage commenters to provide input on the proposals as if they are a single package, particularly where the request for comments in one proposal may be relevant or more applicable to consideration of the other proposal.

These proposals are a step towards achieving the goals established in 2009—an effort I wholeheartedly support. However, I have concerns that these proposals may be a bit too rigid to pragmatically facilitate increased swaps clearing by U.S. customers, as we are committed to do by the original G-20 and Congressional directives. Under the Alternative Compliance proposal, non-U.S. DCOs can permit customer access only if a futures commission merchant (FCM) is directly facilitating the clearing while the other available option—provided for in the Exempt DCO proposal—completely disallows the FCM from being involved in customer clearing. While I recognize that the blunt nature of these bright line distinctions makes it easier to regulate, I worry that it may not be workable in practice. I support putting these proposals out for public comment in

hopes that those who participate in these markets and who are expected to apply the new swap clearing mandates will be able to lend their voices to the discussion. However, I anticipate that the elements left unaddressed in these proposals, which are detailed in the requests for comments, may require a re-proposal at some future date. Nonetheless, if that is to occur we will be well served to have that discussion with the benefit of public comments.

#### Exemption From DCO Registration

The CFTC implemented the clearing elements of the G-20 principles before other regulatory jurisdictions, and in that context determined that any non-U.S. CCP wishing to clear swap products for U.S. customers must become a fully registered DCO. Today, we can re-assess based on fellow international regulatory authorities having now implemented their own comparable reforms, thus aligning many of our regulatory principles, just as the G-20 envisioned. Notably, in authorizing the CFTC to implement these G-20 principles, Congress recognized that consistency, not duplication, is the goal and therefore provided authority in the Dodd-Frank Act to exempt, conditionally or unconditionally, a non-U.S. CCP from registration as a DCO if the CFTC determines that the entity is subject to comparable, comprehensive supervision and regulation by its home country authorities. Certainly, individual CCPs around the world should be able to seek registration with the CFTC to clear swaps for U.S. customers if they determine that is appropriate based on their individual commercial interests and the demands of their clearing members and end users; but, it is time to revisit the policy rationale of compelled DCO registration for comparably and comprehensively regulated non-U.S. CCPs.

Under this proposal, non-U.S. CCPs that do not pose substantial risk to the U.S. financial system will have another option for offering swap clearing services to U.S. customers in that they may request an exemption from registration, as provided by the Dodd-Frank Act. I appreciate that this may raise concerns by some, and I welcome public input on how best to address any such concerns. However, I would be remiss if I failed to point out that the G-20 leaders recognized in 2009 that we should not ignore the global nature of derivatives markets, a fact even more relevant today as U.S. persons increasingly need access to clearinghouses around the world. Contributing to this increased demand is the fact that during the past decade international regulatory bodies, including the CFTC and pursuant to the G-20 principles, have expanded the obligations for market participants to utilize clearing. It is not fair that we mandate and encourage the adoption of derivatives clearing and then limit access to, or severely hamper efficient operation of, such clearing services.

While I am therefore pleased to see this exemption process advancing, I maintain reservations about the lack of optionality for registered FCMs to engage in clearing services for their customers at an Exempt DCO. Once our agency has determined that an Exempt DCO is subject to regulation that

is comprehensive and comparable to our own, then the arrangement by which a U.S. person may access the Exempt DCO should be a business decision between the customer and their preferred clearing member, which may well be an FCM. I very much want to hear from commenters on how we might accomplish this going forward. We have extensive history in allowing such arrangements for U.S. futures clients of CFTC-registered FCMs to access non-U.S. DCOs. I am certain that the public input will assist us in determining how a clearing structure that works for futures customers might sensibly be extended to swaps customers.

I would remind commenters that only sophisticated market participants qualify as eligible contract participants able to enter into swaps (other than on a designated contract market). We need to assist these qualified U.S. market participants and their clearing members not only by providing access, but by pragmatically preserving their ability to enter into prudent business arrangements that they deem most appropriate for their operations and business needs. While prohibiting FCM participation on Exempt DCOs, as we are proposing today, is designed for simplicity, the realities of clearing arrangements and the bankruptcy treatment that applies to them are complex. I fear that ignoring that fact may render the Exempt DCO option with less appeal than I believe it is due and that Congress contemplated. I am confident that the tremendous institutional knowledge at this agency, coupled with public input, will enable us to design a workable solution, but it may not be the bright line test envisioned by this proposal.

#### Closing

At the beginning of this year I penned an opinion piece in the Financial Times<sup>3</sup> in which I attempted to appeal to our international regulatory partners to recommit to a coordinated approach, ensuring that our alliance remains strong rather than fractured. Regulatory conflicts are at odds with our shared mission and do a disservice to global market participants. I am committed to advancing a coordinated approach, and I believe the proposals we are putting forward today are a first step in that process. There is, however, more work to be done both in the way of the CFTC extending deference to other jurisdictions and vice versa. I hope our international regulatory partners will also take the opportunity to reset and recognize that our shared interest of advancing derivatives clearing is best achieved by respecting each jurisdiction's successful implementation of the principles agreed to ten years ago. Otherwise, it might unfortunately become challenging to advance the concept of deference under consideration today to the next stage of the process.

#### Appendix 6—Dissenting Statement of Commissioner Dan M. Berkovitz

I dissent from the proposal to exempt certain foreign clearinghouses from the

<sup>3</sup> Dawn DeBerry Stump, Opinion, We Must Rethink Our Clearinghouse Rules, Fin. Times (Jan. 24, 2019).



derivatives clearing organization (“DCO”) registration requirements. The proposal would jeopardize U.S. customers, create systemic risks to the U.S. financial system, promote the use of foreign intermediaries at the expense of U.S. firms, and exceed this agency’s limited exemptive authority.<sup>1</sup>

The Commodity Futures Trading Commission (“Commission”) previously has permitted the clearing of proprietary swap positions at a limited number of foreign clearinghouses that it has exempted from the DCO registration requirement.<sup>2</sup> The proposed rule before us today (“Exempt DCO Proposal” or “Proposal”) would permit, for the first time, exempt DCOs to clear positions of U.S. customers.<sup>3</sup> To accomplish this, the Proposal disregards key protections for U.S. customers and the U.S. financial system provided by the U.S. Bankruptcy Code, the CEA, and CFTC regulations.

The Exempt DCO Proposal would permit U.S. customers to clear swaps at exempt non-U.S. DCOs without the protections afforded to swap customers under the Bankruptcy Code or CFTC regulations. It would enable U.S. customers to trade at these exempt DCOs through non-registered foreign intermediaries who would not be covered by the U.S. Bankruptcy Code or subject to the CFTC’s customer protection requirements. Enabling U.S. customers to trade swaps and amass large positions in non-U.S. markets without these protections not only poses risks to those customers, but also presents systemic risks to the U.S. financial system.

The Exempt DCO Proposal also would prohibit U.S. FCMs that are registered with the CFTC from providing clearing services at exempt DCOs. The Exempt DCO Proposal thus requires that which the CEA prohibits (clearing by a non-registered intermediary), and prohibits that which the CEA requires (clearing by a registered FCM). The Proposal creates a Bizarro World<sup>4</sup> for U.S. swaps customers in which the CFTC does not regulate derivative clearing organizations, only unregistered foreign firms are allowed to serve U.S. customers, and U.S. customers get none of the protections provided by U.S. law.

The CFTC does not have the superpowers to fashion its own de-regulatory planet. It must stay within the orbit of the laws prescribed by the Congress. It cannot bypass any provision of the CEA that it considers an impediment to a global swaps market. Congress has not provided the CFTC’s with

unlimited exemptive authority. In particular, the CFTC’s limited exemptive authority under CEA section 4(c) does not extend to instruments that are not subject to the exchange-trading requirement of section 4(a), such as non-U.S. swaps traded in markets located outside the United States.<sup>5</sup> By seeking to exempt non-U.S. intermediaries who provide clearing services to U.S. swap customers in overseas markets from the registration requirement for FCMs,<sup>6</sup> the Proposal exceeds the Commission’s authority.

#### No Customer Protections

The Exempt DCO Proposal would eliminate the important protections afforded to U.S. swaps customers provided by Congress and the CFTC’s regulations.<sup>7</sup> Many of these protections result from the provisions in the Bankruptcy Code applicable to FCMs and the regulatory requirements imposed on the FCMs regarding the handling of customer funds. Section 4d(f) of the Act, which was added by the Dodd-Frank Act, provides that only registered FCMs may accept customer monies to margin cleared swaps. It also requires FCMs to segregate customer cleared swaps funds, and prohibits the comingling of customer and proprietary funds.<sup>8</sup> In addition, all FCMs must implement systems and procedures to address conflicts of interest, and they must each designate a chief compliance officer to fulfill specified duties and responsibilities.

In the event that a registered FCM becomes insolvent, swaps customers are protected if their funds reside in segregated accounts as required by the Act and Commission regulations,<sup>9</sup> are carried by an FCM, and are deposited with a registered DCO. Segregation helps to ensure that swaps customer funds are not comingled with an FCM’s proprietary funds, while registration helps ensure that they meet applicable definitions in the Bankruptcy Code to fall under its protections.

Customer protections under the Bankruptcy Code include safe harbors for certain derivatives contracts that allow non-defaulting counterparties in a bankruptcy proceeding to quickly terminate and net their swaps. The safe harbors override the Bankruptcy Code’s automatic stays that would otherwise foreclose any action to liquidate collateral and collect debts from a defaulting party.<sup>10</sup> Swap customer funds are

given priority treatment and not included in the bankruptcy estate that is subject to other creditors of the bankrupt firm. These protections facilitate the prompt transfer of customer positions away from an insolvent FCM, which can avoid a forced liquidation at potentially depressed valuations. In the event that an FCM becomes insolvent, the Bankruptcy Code also entitles the FCM’s customers to a pro rata distribution of customer assets ahead of any other creditors of the FCM.

The Exempt DCO Proposal would circumvent these fundamental swaps customer protections by permitting foreign intermediaries to accept U.S. customer funds to margin cleared swaps at exempt DCOs without registering as an FCM. It would free foreign intermediaries from all of the regulatory requirements that apply to U.S. FCMs, including requirements providing for the protection of customer funds, financial safeguards, and operational soundness. At the same time, it would prohibit CFTC-registered FCMs—the entities which are subject to these customer protection requirements—from acting as FCMs for U.S. customers at exempt DCOs. The Proposal thus legally ensures that U.S. customers will not receive the customer protections required by the CEA, CFTC regulations for swap transactions, and the Bankruptcy Code.

Absent these protections, U.S. swaps customers potentially face a range of financial and market risks. U.S. customers may find that foreign bankruptcy laws fail to provide priority treatment for derivatives and could include their funds in the general bankruptcy estate for all creditors of the insolvent firm. Uncertainty over the treatment of customer funds held at an exempt DCO or a foreign intermediary, as well as over the portability of open positions at the DCO could also lead counterparties to quickly terminate their swaps. The cascading effects on market prices, liquidity, the value of open positions, and perceived counterparty credit risk could quickly become a systemic event.

#### Systemic Risks

In the U.S., the segregation requirements for margin funds held at an FCM protect the funds of the customer in the event that the FCM becomes insolvent. If there are no similar segregation requirements, then the failure of the clearing intermediary could result in significant losses to the intermediary’s customers. These losses could impair one or more customers’ ability to maintain its trades with its other counterparties, not just those at the affected non-U.S. DCO. Such other counterparties may seek to terminate their trades with the affected U.S. persons to avoid potential losses that could arise in these circumstances. The losses of one or more U.S. entities due to the bankruptcy of another entity or intermediary in a non-U.S. jurisdiction without equivalent bankruptcy laws thus could rapidly escalate into a more widespread market event involving numerous other persons within the U.S.<sup>11</sup>

<sup>1</sup> See Commodity Exchange Act (“CEA”) section 4(c), 7 U.S.C. 6(c) (2018).

<sup>2</sup> *Id.* Section 5b(h), 7 U.S.C. 7a–1(h), which permits the Commission to exempt a DCO from registration if the Commission determines that it is subject to “comparable, comprehensive supervision and regulation” by its home country regulator. The Exempt DCO Proposal would add an additional requirement that the DCO not pose a “substantial risk to the U.S. financial system.” See Exempt DCO Proposal, section III.A. To date, the Commission has exempted four foreign clearinghouses from the requirement to register as DCOs for the clearing of proprietary swap positions.

<sup>3</sup> See Exempt DCO Proposal, section III.C.

<sup>4</sup> “In popular culture, ‘Bizarro World’ has come to mean a situation or setting which is weirdly inverted or opposite to expectations.” See *Bizarro World*, Wikipedia (July 10, 2019), [https://en.wikipedia.org/wiki/Bizarro\\_World](https://en.wikipedia.org/wiki/Bizarro_World).

<sup>5</sup> See Commodity Exchange Act section 4(c), 7 U.S.C. 6(c).

<sup>6</sup> The FCM registration requirement is at Commodity Exchange Act section 4d(f), 7 U.S.C. 6d(f).

<sup>7</sup> In lieu of the Act’s and Commission regulation’s extensive customer protection provisions, the Exempt DCO Proposal would require that each foreign intermediary provide its U.S. customers with notice that the intermediary is not an FCM, that the clearinghouse is not a registered DCO, and that the protections of the U.S. Bankruptcy Code do not apply. See Exempt DCO Proposal, § 39.6(b)(2).

<sup>8</sup> See Commodity Exchange Act section 4d(f)(1)–(2), 7 U.S.C. 6d(f)(1)–(2).

<sup>9</sup> *Id.* section 4d(f)(2), 7 U.S.C. 6d(f)(2); 17 CFR 22 (2019).

<sup>10</sup> See Stephen Adams, *Derivatives Safe Harbors in Bankruptcy and Dodd-Frank: A Structural Analysis* (Apr. 30, 2013), <http://nrs.harvard.edu/urn-3:HUL.InstRepos:10985175>.

<sup>11</sup> The Report of the President’s Working Group on Financial Markets on Hedge Funds, Leverage,

The Proposal contains no discussion or analysis of the potential systemic consequences if a foreign intermediary holding significant assets from large U.S. swaps customers were to fail. Similarly, it fails to examine the impact to the U.S. financial system if the overseas assets of large U.S. swaps customers were to become entangled—or potentially entangled—in foreign bankruptcy proceedings.

#### Exclusion of U.S. FCMs

The Exempt DCO Proposal would prohibit U.S. FCMs from providing clearing services to U.S. swaps customers at exempt DCOs.<sup>12</sup> By itself, this prohibition would not be problematic, as it is consistent with the Commission's interpretation of the CEA and longstanding policy. The Proposal veers off course by coupling this prohibition with permitting non-registered foreign intermediaries to provide those same services without any protections for U.S. customers.

In last year's initial proposal to establish a framework for exempt DCOs, the Commission proposed to prohibit FCMs from clearing customer swaps at exempt DCOs. At that time, the Commission explained:

Section 4d(f)(1) of the CEA makes it unlawful for any person to accept money, securities, or property (*i.e.*, funds) from a swaps customer to margin a swap cleared through a DCO unless the person is registered as an FCM. Any swaps customer funds held by a DCO are also subject to the segregation requirements of section 4df(2) of the CEA, and in order for a customer to receive

and the Long-Term Capital Management (1999), which followed the near collapse and industry bailout of the Long-Term Capital Management (LTCM) hedge fund, identifies the benefits to market stability of the provisions of the U.S. bankruptcy code and highlights the systemic issues that may arise when significant transactions of U.S. entities are subject to non-U.S. regulatory regimes that do not provide equivalent protections. LTCM was a large, U.S.-based hedge fund that at one point had gross notional amounts of over \$500 billion in futures, more than \$750 billion in swaps, and over \$150 billion in options and other derivatives in multiple jurisdictions around the world. The LTCM Report described how the application of bankruptcy laws in these other jurisdictions to LTCM would present "substantial uncertainty . . . for counterparties and other creditors of the Fund because bankruptcy proceedings may very well have been initiated both in the U.S. and abroad and involved resolution of complicated and novel international bankruptcy issues." Dept. of the Treasury, Bd. of Governors of the Federal Reserve System, Securities and Exchange Commission, Commodity Futures Trading Commission, *Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management*, Report of the President's Working Group on Financial Markets (Apr. 1999), at E-1. The LTCM Report cautioned, "While cross-border insolvencies have been characterized by growing cooperation, reliance on a case-by-case judicial approach can create unpredictability—particularly in emergency situations." *Id.* at E-3. Much of the discussion around LTCM occurred in the context of bilateral, OTC swaps rather than the cleared swaps that are the subject of this Proposal. However, LTCM's lessons on the protections offered by the Bankruptcy Code, and on the importance of legal certainty regarding how derivatives will be treated in an insolvency proceeding, remain current to this day.

<sup>12</sup> See Exempt DCO Proposal at § 39.6(b)(1)(i).

protection under this regime, particularly in an insolvency context, its funds must be carried by an FCM, and deposited with a registered DCO. Absent that chain of registration, the swaps customer's funds may not be treated as customer property under the U.S. Bankruptcy Code and the Commission's regulations. Because of this, it has been the Commission's policy to allow exempt DCOs to clear only proprietary positions of U.S. persons and FCMs.<sup>13</sup>

In its zeal to enable U.S. customers to access non-U.S. swap markets, the Commission seeks to sidestep these issues with the Bankruptcy Code by jettisoning the entire bankruptcy regime as it applies to U.S. swaps. It would accomplish this by permitting non-registered, non-U.S. intermediaries to clear swaps through exempt DCOs. But this approach leaves U.S. customers without any bankruptcy protection and competitively disadvantages U.S. FCMs with respect to clearing in non-U.S. swaps markets. In the cost/benefit considerations, the Commission acknowledges, "FCMs may . . . face a competitive disadvantage as a result of this proposal, as they would not be permitted to clear customer trades at an exempt DCO. To the extent that their customers shift their clearing activity at registered DCOs to exempt DCOs, or otherwise reduce their clearing activity at registered DCOs as a result of this proposal, FCMs would lose business."<sup>14</sup>

Not only would the Proposal place FCMs at a competitive disadvantage, the Proposal recognizes that this also would place registered DCOs at a competitive disadvantage. The Commission states in the cost/benefit considerations that it "anticipates that some non-U.S. clearing organizations that are currently registered DCOs, or that would otherwise apply to register in the future, may choose to apply to become exempt a DCO, thus lowering their ongoing compliance costs."<sup>15</sup>

A better approach would be to prohibit exempt DCOs from providing clearing services to U.S. customers—as the Commission proposed last year—and permit customer clearing only at registered DCOs, through registered FCMs. This would preserve the competitiveness of U.S. FCMs in the global swaps markets and maintain the bankruptcy and other protections for U.S. customers. Today's companion proposed rule, providing for registration with alternative compliance for DCOs that would be eligible for an exemption, would provide a second mechanism—in addition to full DCO registration—for non-U.S. DCOs to provide for clearing services to U.S. customers. The Commission does not explain why either the existing option for full registration, or the proposed alternative compliance mechanism, are insufficient to enable U.S. customers to access clearing services as non-U.S. DCOs.<sup>16</sup>

<sup>13</sup> Exemption from Derivatives Clearing Organization Registration, 83 FR 39,923, 39,926 (proposed Aug. 13, 2018).

<sup>14</sup> Exempt DCO Proposal, section VI.C.2.b.

<sup>15</sup> *Id.*

<sup>16</sup> To the extent that U.S. customers are not able to access clearing at non-U.S. registered DCOs due

The Commission asserts that by expanding the pool of available intermediaries and clearinghouses to include unregistered or exempt non-U.S. entities, the Proposal may "reduc[e] the concentration of U.S. customer funds in a small number of FCMs,"<sup>17</sup> and may also "reduc[e] the concentration risk among registered and exempt DCOs."<sup>18</sup> The exclusion of registered FCMs from non-U.S. swap markets, however, will in no way reduce the currently high levels of concentration amongst registered FCMs at registered DCOs serving the U.S. market. It is the high levels of concentration of registered FCMs at registered DCOs that pose potentially systemic risks to the U.S. financial system. The Commission should be working to enable greater FCM competition in U.S. swap markets, not precluding U.S. FCMs from competing in non-U.S. markets.

I strongly support efforts to increase competition and reduce concentration amongst registered, U.S. FCMs in the U.S. swaps markets. It is a topsy-turvy argument that this is best accomplished by prohibiting U.S. FCMs from participating in non-U.S. markets and enabling non-registered non-U.S. FCMs to take this business away from those U.S. FCMs.

#### Absence of Exemptive Authority

The Proposal relies on CEA Section 4(c) for authority to exempt non-U.S. intermediaries that provide customer clearing at exempt DCOs from the FCM registration requirement and the regulations applicable to registered FCMs.<sup>19</sup> Section 4(c), however, provides the Commission with limited exemptive authority, applicable to specified classes of instruments and markets. It does not provide the Commission with the ability to waive any provision of the CEA that it deems inconvenient.<sup>20</sup> The Commission's limited authority does not extend to the non-U.S. cleared swaps markets that are the subject of this rulemaking.

Section 4(c) provides that the Commission may exempt any agreement, contract, or transaction from the requirements of section 4(a) (which requires that contracts for future delivery be traded on a designated contract market) or any other provision of the Act if such agreement, contract, or transaction is, in the first instance, subject to section 4(a).<sup>21</sup> Notably, however, section 4(a) does not apply to contracts "made on or subject to the rules

to the absence of U.S.-registered FCM services at such DCOs, the Commission should work with such non-U.S. DCOs and FCMs to identify the impediments to the provision of such FCM services.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> The Proposal also relies on Section 4(c) to exempt these foreign intermediaries from the CTA registration requirements.

<sup>20</sup> The Conference Report for the Futures Trading Practices Act of 1992, which codified section 4(c), stated the conferees' expectation that "the Commission generally use this [4(c)] authority sparingly . . . ." The conferees further explained that "[t]he goal of providing the Commission with broad exemptive powers is not to prompt a wide-scale deregulation of markets falling within the ambit of the Act. See H.R. Conf. Rep. 102-978, 102d Cong. (2d Sess. 1992).

<sup>21</sup> Commodity Exchange Act section 4(c), 7 U.S.C. 6(c).

of a board of trade, exchange, or market located outside the United States . . .”<sup>22</sup> Swaps traded on a non-U.S. trading facility and cleared at a non-U.S. DCO appear to fall into the category of contracts “made on or subject to the rules of a board of trade, exchange, or market located outside the United States.” The Commission provides no justification or analysis for asserting that section 4(c) provides exemptive authority for

<sup>22</sup> *Id.* section 4(a), 7 U.S.C. 6(a) (emphasis added).

transactions in non-U.S. markets involving these contracts.

#### Conclusion

The Exempt DCO Proposal deprives U.S. customers of bankruptcy protection under U.S. law, creates systemic risks for the U.S. financial system, and promotes the use of foreign intermediaries at the expense of U.S. FCMs. It also exceeds the Commission’s exemptive authority under section 4(c) of the Act. If the Commission desires to facilitate

greater access by U.S. persons to foreign cleared swaps markets, it should do so within the framework of registered DCOs, registered FCMs, and the customer protections provided by the U.S. bankruptcy laws and CFTC regulations. It should not do so at the expense of protections for U.S. customers and the U.S. financial system. Accordingly, I dissent.

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