



June 3, 2011

**Via Electronic Mail:** [dcodcmsefGovernance@cftc.gov](mailto:dcodcmsefGovernance@cftc.gov)

David A. Stawick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581

Re: Notices of Proposed Rulemaking Related to Conflicts of Interest (RIN No. 3038-AD01)

Dear Mr. Stawick:

Citadel LLC<sup>1</sup> (“*Citadel*”) appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the “*Commission*”) on its complementary notices of proposed rulemaking related to “Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest”<sup>2</sup> and “Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest”<sup>3</sup> (together, the “*Proposed Rules*”), in each case, under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “*Dodd-Frank Act*”). Citadel supports the Commission’s proposals, and believes that the Proposed Rules represent an important step towards fair and open access to clearing, transparency and market integrity. We believe that the inclusion of certain clarifications to the Proposed Rules, as discussed below, would close potential gaps in their interpretation and implementation and ensure that the final rules secure their key objective of the elimination of conflicts of interest barriers to market reform and fair competition.

## **I. Recommendations Regarding Governance**

### **A. Boards of Directors and Committee Membership**

We emphatically support the Commission’s promotion of fair governance representation in designated clearing organizations (“*DCOs*”), designated contracts markets (“*DCMs*”) and

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<sup>1</sup> Established in 1990, Citadel is a leading global financial institution that provides asset management, investment banking, institutional sales & trading, and market making services. With over 1,200 employees globally, Citadel serves a diversified client base through its offices in the world’s major financial centers including Chicago, New York, London, Hong Kong, San Francisco and Boston.

<sup>2</sup> 75 Fed. Reg. 63732 (Oct. 18, 2010) (the “*Conflict of Interest NPRM*”).

<sup>3</sup> 76 Fed. Reg. 722 (January 6, 2011) (the “*Governance NPRM*”).

swap execution facilities (“SEFs”, and together with DCOs and DCMs, “Swap Market Entities”). In particular, we support the requirement that public directors be represented on each Swap Market Entity’s board of directors (“Board”) and relevant operating committees. Further, we believe that the Commission should make explicit that in order to further the concept of “fair representation,”<sup>4</sup> each Swap Market Entity must include customer representatives on its Board and any relevant operating committees or subcommittee thereof, not just on its risk management committee (“RMC”).<sup>5</sup> Unlike clearing members, who are not incentivized to promote increased clearing,<sup>6</sup> customers have a strong interest in progressive expansion of the cleared product set and clearing utilization, and in safe and sound governance mechanisms that will encourage clearing efficiency and fair pricing of both clearable products not subject to mandatory clearing as well as products that are required to be cleared.

In this vein, we respectfully disagree with the restriction in the Proposed Rule that would prevent employees or officers of a DCO from being members of the DCO’s RMC or similar governance bodies. We believe that the interests of employees and officers are also aligned with expanding the scope of clearing and access to DCOs and engaging in appropriate risk management that safeguards DCOs, members and the markets against loss. We also note that DCO employees, like customers, are not constrained by the conflicts of interest that pertain to clearing members.

## **B. Balanced Representation on Boards and Committees and Subcommittees**

We believe it is essential for the Commission in the final rules to make explicit that no stakeholder group may hold a controlling majority on Boards (or relevant operating committees or subcommittees) in order to limit the impact of conflicts of interest on decision-making and ensure governance is based on fair representation. Eliminating dominance by clearing members and ensuring that key decisions require a plurality of clearing members, public directors and customer representatives will help encourage utilization of objective, risk-based decision-making and lessen the risk that enumerated entities (“Enumerated Entities”)<sup>7</sup> will directly or indirectly hinder broader clearing access and expansion.

Relevant operating committees and subcommittees would include those that are responsible for decisions that regularly have a decisive impact on clearing, execution, transparency, competition and cost and liquidity of cleared swaps. We note that in its proposed Regulation MC, the Securities and Exchange Commission recognized this and clarified that its

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<sup>4</sup> Conflict of Interest NPRM at 63738.

<sup>5</sup> Proposed Rule 39.13(g)(3)(i) defines “customer” as any customer of a clearing member, including, without limitation, commodity customers, foreign futures or foreign options customers, and any customer entering into a cleared swap.

<sup>6</sup> The Commission noted Enumerated Entities’ several “economic incentives to minimize the number of swaps subject to mandatory clearing and trading”. Governance NPRM at 724; Conflicts of Interest NPRM at 63734.

<sup>7</sup> “Enumerated entities” are listed in Section 726(a) of the Dodd-Frank Act and include: (i) Bank holding companies with over \$50,000,000,000 in total consolidated assets; (ii) a nonbank financial company supervised by the Board of Governors of the Federal Reserve System; (iii) an affiliate of (i) or (ii); (iv) a swap dealer; (v) a major swap participant; or (vi) an associated person of (iv) or (v).



proposed numerical independent director requirements would apply to any Board committee authorized to act on behalf of the Board.<sup>8</sup> It is crucial that the Commission similarly clarify in its final rules that balanced representation applies not only to the Board itself, but also to any committee or subcommittee of the Board that has been delegated the power to make decisions on behalf of the Board.

We believe balanced representation is particularly important on RMCs, where dominance by Enumerated Entities could constrain access to and utilization of clearing facilities. The RMC is tasked with determining products eligible for clearing, setting standards and requirements for initial and continuing clearing membership eligibility and advising DCO Boards on risk model and default procedures,<sup>9</sup> all decisions with the potential to have an enormous impact on market structure. The RMC also has a decisive role in determining processing flows, legal documentation, and a wide range of operational aspects of clearing that significantly impact open access to clearing and the comparative efficiency and economics of cleared versus non-cleared transactions. Balanced governance over and customer involvement in all these decisions would increase the transparency and fairness of the decision-making process, helping mitigate potential conflicts of interest.

Finally, we ask the Commission to clarify expressly in the final rules that no DCO may have governance procedures that have the effect of permitting the balanced representation mandate to be circumvented, including any procedure that could allow Enumerated Entities to effectuate a delegation to a subcommittee that in turn is comprised of or controlled by Enumerated Entities.

### **C. Review of RMC Conflicts of Interest**

Citadel urges the Commission to make explicit that any dissenting RMC member may initiate a review process whereby the DCO Board would reexamine RMC decisions if the member could reasonably show that there was an underlying conflict of interest or that the RMC did not undertake an appropriate process to avoid a conflict of interest. If the Board review shows a conflict of interest, the Board should be able to overturn the RMC decision. Further, we support proposed Sections 37.1201(d) and 38.851(d), which would require a Swap Market Entity to report to the Commission any instance when its Board rejects a recommendation from or supersedes an action of the RMC, regulatory oversight committee or membership or participation committee, as applicable, or when a RMC overrules a subcommittee.<sup>10</sup>

### **D. Governance Transparency**

Citadel urges the Commission to make explicit that the requirement in proposed Section

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<sup>8</sup> Notice of Proposed Rulemaking on “Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges With Respect to Security-Based Swaps Under Regulation MC”, 75 Fed. Reg. 65882, 65911 (Oct. 26, 2010).

<sup>9</sup> Conflicts of Interest NPRM at 63750.

<sup>10</sup> Conflicts of Interest NPRM at 63741; Governance NPRM at 732.

39.25 that DCOs must have clear and transparent governance arrangements includes an obligation for DCOs to publish all their governance documents (including procedures for election or appointment of Board and committee members), the names of all Board and committee representatives, and the proceedings of all such governance bodies, except for competitively sensitive information as certified by an independent Board or committee member, or independent auditor. Expressly ensuring that such information is available will act as a deterrent to decision-making influenced by conflicts of interest, and will enable all market participants to better evaluate competing clearing offerings and remove any ambiguity as to the requirements under proposed Section 39.25.

## II. Recommendations Regarding Ownership

### A. DCOs

It is as crucial to ensure that clearing members do not have sole control of DCOs or an overriding profit sharing motivation to support one DCO at the expense of another. As such, in the context of the Conflicts of Interest NPRM, we prefer the Commission's proposed "First Alternative"<sup>11</sup> because we believe that its single-member limit and aggregate limit best addresses the control and profit sharing concerns expressed by the Commission.<sup>12</sup> Thus, we urge the Commission to either eliminate the "Second Alternative"<sup>13</sup> or revise it to include an aggregate limit. While we do not object to the inclusion of waiver procedures that could allow DCOs to not comply with either alternative, we believe that the Commission should make it clear that such waivers will be granted sparingly and only after the Commission conducts a thorough assessment of the potential impact of the related conflicts of interest on the DCO, the clearing regime and the financial markets.

### B. DCMs and SEFs

The enhanced system of clearing cannot be effective without the development of robust DCMs and SEFs. We urge the Commission to clarify that the same governance principles articulated above with respect to DCOs also apply to DCMs and SEFs, and to consider instituting DCM/SEF ownership limitations that would prevent a group of Enumerated Entities from owning a controlling share of a DCM or SEF. We are concerned that if the Commission does not make such a clarification, clearing members may be permitted to own or control a DCM or SEF, allowing such clearing members could drive liquidity to a certain platform, reduce competition or limit its competitors' access to a platform.<sup>14</sup>

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<sup>11</sup> *Id.* at 63743.

<sup>12</sup> *Id.* at 63742.

<sup>13</sup> *Id.* at 63744.

<sup>14</sup> The Proposed Rules would set a 20% limitation on the voting equity or voting power that any single member may own or control of a DCM or SEF, but includes no explicit limit on the aggregate voting equity or voting power that Enumerated Entities may own or control. Conflicts of Interest NPRM at 63745.



We appreciate the opportunity to provide comments on the Proposed Rules. Please feel free to call the undersigned at (312) 395-3100 with any questions regarding these comments.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "A. Cooper", written over the typed name.

Adam C. Cooper  
Senior Managing Director and Chief Legal Officer

cc: The Hon. Gary Gensler, Chairman  
The Hon. Michael Dunn, Commissioner  
The Hon. Bart Chilton, Commissioner  
The Hon. Jill E. Sommers, Commissioner  
The Hon. Scott D. O'Malia, Commissioner

The Hon. Mary Schapiro, SEC Chairman  
The Hon. Kathleen L. Casey, SEC Commissioner  
The Hon. Elisse B. Walter, SEC Commissioner  
The Hon. Luis A. Aguilar, SEC Commissioner  
The Hon. Troy A. Paredes, SEC Commissioner