CITADEL

September 29, 2017

Mr. Christopher J. Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Project KISS Recommendations

Dear Mr. Kirkpatrick:

Citadel LLC[1] ("Citadel") appreciates the opportunity to provide input to the Commodity Futures Trading Commission (the "Commission") as it considers ways to simplify and streamline the regulatory framework through the Project KISS initiative. We support efforts to streamline the regulatory framework while continuing to focus on the integrity, transparency, efficiency, and stability of our financial markets. Below, we provide specific recommendations that are designed to further strengthen the preeminent global position of the U.S. capital markets by reducing regulatory burdens on market participants and ensuring that these markets are fair, open, competitive, and transparent. Our recommendations address (a) registration, (b) reporting, (c) clearing, (d) execution, and (e) other market structure topics.

I. Registration

A. Simplifying Regulatory Reporting for Fund Managers

Fund managers that are dually registered with the Commission and the Securities and Exchange Commission (the "SEC") must regularly prepare and submit Forms CPO-PQR and CTA-PR to the Commission and Form PF to the SEC. The requirement to file these separate reports is duplicative given that they were originally intended to serve very similar purposes. Furthermore, numerous differences in how relevant information is required to be compiled and presented increases the burden on fund managers with little apparent commensurate benefit. We urge the Commission to work with the SEC to consolidate these reports into one form that can be used by both agencies. In addition, the agencies should streamline reporting by better leveraging data that firms already calculate as part of their day-to-day operations and by ensuring that the information requested is actually useful for oversight purposes. This will promote a more standardized approach to regulatory reporting while reducing complexity and burdens for market participants.

[1] Citadel is a global financial firm built around world-class talent, sound risk management, and innovative market-leading technology. For more than a quarter of a century, Citadel's hedge funds and capital markets platforms have delivered meaningful and measurable results to top-tier investors and clients around the world. Citadel operates in all major asset classes and financial markets, with offices in the world's leading financial centers, including Chicago, New York, San Francisco, Boston, London, Hong Kong, and Shanghai.

B. Appropriately Calibrating Capital Requirements for Swap Dealers

Swap dealer capital requirements are intended to promote market safety, stability, and integrity. However, they should be appropriately calibrated to the risks posed by a particular firm's dealing activities and should be flexible enough to permit a diverse array of swap dealers to serve the market. Improvements should be made to the Commission's proposal to:

1. Ensure a level playing field. The Commission proposal permits swap dealers to choose between a "bank-based" option and a "net liquid assets" option. However, there are higher minimum capital thresholds under the "net liquid assets" option for firms that wish to use an internal model. This creates an unlevel playing field for firms that cannot use the "bank-based" option.

2. Calibrate standardized market risk and credit risk charges for cleared swaps. We strongly support calculating standardized market risk charges for cleared instruments by reference to the initial margin requirements of the DCO, which are specifically designed to accurately measure the risks associated with a cleared swap portfolio. The Commission should clarify this will be the approach under both the "bank-based" option and the "net liquid assets" option, and that both self-clearing members and non-self clearing members will be treated equally under the rules.

3. Provide adequate time for implementation. All swap dealers should be given sufficient time to develop internal models and for those models to be approved by regulators. A swap dealer using an internal model will, in many cases, have a material competitive advantage from a capital perspective over a swap dealer using the standardized schedule.

II. Reporting

A. Improving the Swap Data Reporting Framework

We commend the Division of Market Oversight for recently publishing and soliciting comment on its "Roadmap to Achieve High Quality Swaps Data." We fully support Commission efforts to improve the quality and accuracy of swaps data while streamlining reporting requirements for market participants, and provided the following suggestions to the Division of Market Oversight:

1. Improve the Reporting of Package Transactions. In certain asset classes, a significant percentage of overall trading activity is transacted as part of a package. It is therefore critical that the Commission and market participants have accurate data regarding the types of packages that are traded, and the amount of trading activity in each type.

2. Streamlining the Reporting of Cleared Swaps. The Commission should reconsider whether it is necessary to report an intended-to-be-cleared "alpha" swap to a swap data repository ("SDR"). The current approach creates several duplicate records in an extremely short window of time, given that the Commission's straight-through-processing rules result in many "alpha" swaps being successfully cleared (and therefore cancelled) almost immediately following execution. Consideration should be given to whether the reporting

of "alpha" swaps to SDRs can be eliminated without impacting compliance with the separate real-time public reporting requirements.

In addition, DCOs are in the best position to maintain data on the post-clearing "beta" and "gamma" swaps. In our view, swap data reporting would be greatly simplified if DCOs were responsible for maintaining SDR data for cleared swaps, rather than redundantly reporting it to a third party SDR (and subsequently updating and reconciling records with such SDR).

3. Increasing the Utility of Publicly Disseminated Swap Data. The data fields that are publicly reported can be further streamlined. Unnecessary fields should be removed while certain select fields that would improve market transparency, such as identifying the relevant DCO for a cleared swap, should be included.

B. Appropriately Calibrating Block Trade Thresholds for Swaps

Pursuant to Commission Regulation §43.6(f), the current block trade thresholds for swaps (which were established in 2013) should be updated once an SDR has collected at least one year of reliable data for a particular asset class. Therefore, we believe that the Commission should, at a minimum, update the block trade thresholds for the credit and interest rate asset classes.

Market research demonstrates that the introduction of real-time public reporting in the swaps market has led to meaningful benefits for end investors, removing information asymmetries and facilitating more accurate assessments of execution quality.[2] By enabling investors to compare the prices they receive from liquidity providers with concurrent trading activity across the market, post-trade transparency enhances investor confidence and incentivizes price competition as investors are able to demand more accountability from their liquidity providers. The removal of previously existing information asymmetries also contributes to market resiliency by ensuring that changes in supply and demand are more efficiently reflected in current price levels.

It is therefore important that block trade thresholds are regularly updated using recent market data, since these transactions are eligible for a 15 minute delay from real-time public reporting requirements. Employing block trade thresholds that are based on market data from several years ago risks that too many, or not enough, transactions are eligible for the delay from real-time public reporting requirements.

C. Streamlining Recordkeeping Requirements for EFRPs

An Exchange for Related Position ("EFRP") involves executing a privately negotiated off-exchange future or option simultaneously with an equivalent quantity of the cash product, by-product or related product, or OTC derivative corresponding to the underlying asset of the future

[2] *See, e.g.*, Loon, Y. C., Zhong, Z. K., 2014. The impact of central clearing on counterparty risk, liquidity, and trading: Evidence from the credit default swap market. Journal of Financial Economics 112 (1), 91-115; Loon, Y. C., Zhong, Z. K., 2015. Does Dodd-Frank affect OTC transaction costs and liquidity? Evidence from real-time CDS trade reports, Journal of Financial Economics.

or option. EFRPs can be an effective way to transfer risk and hedge across products, and are overseen by the DCM that lists the relevant future or option.

However, DCMs frequently apply the recordkeeping requirements associated with EFRPs in an impractical and inflexible manner. For example, market participants executing an exchange for physical are required to provide third party proof of payment evidencing settlement and documentation representing the transfer of ownership of the commodity.[3] However, instead of accepting a SEC Rule 10b-10 confirmation or other records evidencing settlement that are readily accessible to a market participant, DCMs frequently request additional confirmation from a third-party clearinghouse. These additional recordkeeping requests are time-consuming and burdensome for market participants, and do not result in a more effective monitoring and surveillance regime for EFRPs. We recommend that the Commission work with DCMs to apply the recordkeeping requirements for EFRPs in a more practical manner.

III. Clearing

A. Continuing the Swap Market's Transition to Central Clearing

The Commission's implementation of mandatory clearing for certain interest rate and credit default swaps has led to a gradual and orderly market transition to a safer and more transparent regime. The scope of market participants subject to the clearing mandate was gradually phased-in over a nine-month period in 2013, and the list of covered instruments has also been gradually expanded over time.[4] This deliberate approach has enabled the market to transition to central clearing with minimal disruption, thereby maximizing the associated benefits of systemic risk mitigation, customer protection, and increased market transparency and competition. Central clearing uniquely mitigates systemic risk by replacing the interconnected web of bilateral counterparty credit exposures with a safer system where all market participants face a well-regulated clearinghouse. Customer protection is enhanced as the DCO safeguards customer collateral and protects market participants from the default of their trading counterparties. Central clearing is also the first step in other market innovations that can improve market transparency and efficiency, and increase competition. By eliminating bilateral counterparty credit risk and the need for bilateral trading documentation, central clearing creates the conditions necessary for market participants to access a wider range of trading counterparties, enhancing price discovery and liquidity.

Given the importance of the clearing mandate, and its positive impact on market liquidity,[5] we recommend that the Commission continue to regularly assess whether additional instruments

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[3] *See* CME Market Regulation Advisory Notice RA1707-5, Question 18 ((July 7, 2017), at http://www.cmegroup.com/notices/market-regulation/2017/07/RA1707-5.pdf.

[4] *See* 81 Fed. Reg. 71202, available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-23983a.pdf.

[5] *See* Loon, Y. C., Zhong, Z. K. Does Dodd-Frank affect OTC transaction costs and liquidity? Evidence from real-time CDS trade reports. Journal of Financial Economics, 119 (3), 645–672 (2016) at page 4, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2443654 ("the reduced counterparty risk and increased post-trade transparency associated with central clearing have beneficial effects on liquidity").

should be included. For example, certain additional CDS indices and FX non-deliverable forwards are now being cleared in material volumes[6] and may be appropriate for the clearing mandate.

In addition, we urge the Commission to refrain from modifying the scope of market participants subject to the clearing mandate. The current clearing mandate has been successfully implemented since late 2013, and substantively changing its coverage risks creating market disruption. Any additional exemptions proposed for proportionality reasons have to be carefully balanced against the potential impact on liquidity and risk in the cleared market. Overly broad exemptions can bifurcate liquidity between cleared and uncleared iterations of an instrument, reduce counterparty diversity within DCOs, and dis-incentivize DCOs, clearing members, and related service providers from investing in expanding their client clearing offerings.

B. Codifying Existing Straight-Through-Processing Standards for Cleared Swaps

The Commission's straight-through-processing requirements are a critical part of the regulatory framework for central clearing, successfully reducing market risk, credit risk, and operational risk by creating a robust execution-to-clearing workflow. These requirements include:

(i) pre-trade credit checks for cleared swaps executed on, or pursuant to the rules of, a SEF to ensure that both parties are able to successfully clear the transaction,

(ii) the submission by a SEF to the DCO of a transaction as soon as technologically practicable but in any event no later than 10 minutes following execution,

(iii) DCOs accepting or rejecting submitted transactions within 10 seconds, and

(iv) in the rare event that a transaction is rejected by the DCO, permitting the parties to submit a new trade in the event the rejection was due to an operational or clerical error, but otherwise declaring the trade void in order to prevent the reintroduction of bilateral counterparty credit risk.[7]

Given the importance of these standards, we urge the Commission to ensure that they are fully codified, as currently they are set forth in a combination of rules, guidance, and letters. Failure to codify these standards risks significant disruption to the market, as altering the current status quo could reintroduce bilateral counterparty credit risk and require market participants trading cleared swaps to negotiate complex and costly bilateral trading and credit support documentation. Any change to existing operational workflows would also be extremely costly and disruptive from a technological and operational perspective.

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[6] *See* "NDF Volumes – It's All About Clearing", Clarus Financial Technology (Dec. 21, 2016), available at: https://www.clarusft.com/ndf-volumes-its-all-about-clearing/. According to data from ICE, market participants have voluntarily cleared hundreds of billions of dollars of transactions in the CDX EM and iTraxx Senior Financials indices.

[7] *See* "Staff Guidance on Swaps Straight-Through Processing" (Sept. 26, 2013), available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/stpguidance.pdf; CFTC Letter No. 15-67 (Dec. 21, 2015), available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/15-67.pdf; and CFTC Letter No. 17-27 (May 30, 2017), available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/17-27.pdf.

In addition, we recommend the Commission actively verify that the required timeframes are being complied with by market participants. It has now been over a year since the Commission explicitly stated that cleared swaps executed on, or pursuant to the rules of, a SEF must be sent to the DCO within 10 minutes of execution.[8] Compliance with this requirement is critical to minimizing market and operational risk when executing a cleared swap, as it allows the trading counterparties to confirm as quickly as possible that the swap has successfully cleared. We also note that the same 10 minute standard will be effective for cleared swaps executed by voice on EU MTFs and OTFs starting in January 2018 (with an even tighter 10 second submission standard for electronic trades),[9] as the Commission's straight-through-processing requirements have served as a model for Europe when implementing MiFID II.

Finally, the Commission should coordinate with the SEC to adopt similar straight-through-processing requirements for security-based swaps. Currently, the execution-to-clearing workflow for single-name CDS is much slower and less robust than for index CDS, even though both types of swaps are cleared at the same clearinghouse and through the same clearing members. Due to the lack of SEC straight-through-processing requirements, it can still take more than a day for a single-name CDS transaction to be successfully cleared.

C. Appropriately Calibrating Prudential Requirements for Cleared Swaps

A key component of the G20 reforms to the OTC derivatives markets is transitioning trading activity in standardized swaps into central clearing. Therefore, it is important that prudential requirements are not implemented in a manner that is inconsistent with or undermines this regulatory objective. For example, we support revisions to the leverage ratio to recognize the exposure-reducing effect of client initial margin. We believe the current capital treatment of client initial margin may unnecessarily raise the cost of client clearing offerings. We recommend that the Commission coordinate with other policymakers and regulators to ensure that the overall regulatory framework is appropriately calibrated and does not inadvertently dis-incentivize the transition to central clearing.

D. Simplifying the Portfolio Margining Regime for Cleared Swaps and Cleared Security-based Swaps

We urge the Commission to work with the SEC to simplify and streamline the portfolio margining regime for index CDS and single-name CDS. The SEC currently requires each clearing member to establish its own margin methodology that is different from the margin methodology of the DCO. This undermines a core operational benefit of central clearing, which is that all market participants can rely on the same, fully vetted and approved margin methodology maintained by the DCO. In addition, it compromises investors' transparency into margin calculations and creates a barrier to entry for new clearing members seeking to provide clearing services to investors. As

[8] CFTC Letter No. 15-67 (Dec. 21, 2015), available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/15-67.pdf.

[9] *See* Commission Delegated Regulation (EU) 2017/582, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0582&from=EN.

a result, the current regime makes it more difficult and expensive to trade and clear index CDS and single-name CDS together.

E. Improving Porting Processes for Cleared Swaps

We recommend that the Commission engage with DCOs to develop more robust and automated porting processes. Currently, many of the operational workflows designed by DCOs are manual and time consuming. Improving the ability for customers to efficiently port cleared swaps between clearing members has several benefits, including (i) reducing systemic risk by enabling customers to protect against a clearing member default, (ii) enhancing portfolio management and facilitating compression, and (iii) increasing competition among clearing members. Development and use of these processes on a regular basis will also enhance stability in an actual clearing member default scenario, as customers will be able to more easily transfer portfolios to solvent clearing members.

F. CCP Resilience, Recovery, and Resolution

We support the Commission's continuing focus on CCP resilience, recovery, and resolution. As trading activity in standardized OTC derivatives continues to transition to central clearing, it is critical that there are robust standards around CCP governance, risk management, and default management. The recommendations put forward by the Commission's Market Risk Advisory Committee provide an example of Commission leadership on these important topics.[10] We recommend that the Commission continue to monitor progress with respect to the implementation of these recommendations.

IV. Execution

A. Enforcing Existing Impartial Access Standards on SEFs

The Commission has further clarified through rulemaking and guidance the statutory requirement that SEFs must provide market participants with impartial access.[11] This additional clarification has been instrumental in eliminating discriminatory access barriers that historically were used to limit competition from new liquidity providers and to restrict the ability of investors to access the best available prices. We note that EU regulators have issued similar guidelines for accessing MTFs and OTFs under MiFID II.[12]

We urge the Commission to actively monitor to ensure that SEFs are complying with these impartial access requirements. As part of this oversight, the Commission should assess whether

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[10] *See* CCP Risk Management Subcommittee Final Recommendations, available at: http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/mrac111716_ccpdrecommendations.pdf.

[11] *See* "Core Principles and Other Requirements for Swap Execution Facilities", 78 Fed. Reg. 33476 (June 4, 2013), available at: http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2013-12242a.pdf; and "Staff Guidance on Swap Execution Facilities Impartial Access" (Nov. 14, 2013), available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/dmostaffguidance111413.pdf.

[12] ESMA Q&A on MiFID II and MiFIR market structure topics (Sept. 12, 2017) at pages 30-32, available at: https://www.esma.europa.eu/sites/default/files/library/esma70-872942901-38_qas_markets_structures_issues.pdf.

the continued use of post-trade name give-up by SEFs that offer pre-trade anonymous trading protocols is inconsistent with the impartial access requirements. While post-trade name give-up makes sense for uncleared swaps since the two counterparties have an ongoing bilateral relationship, there is no justification for its continued use for cleared swaps. Instead, the practice serves only to dissuade buyside investors from joining SEFs that historically have been available only to dealers. In order to join one of these SEFs, a buyside investor must be prepared to (i) disclose to every other member of the SEF that it has joined the platform (as this will be disclosed once it enters into a trade), and (ii) tolerate the potential leakage of valuable trading information to every other member of the SEF (since it cannot control who the other counterparty will be when using pre-trade anonymous trading protocols). As a result, buyside market participants are discouraged from accessing these significant sources of liquidity on SEFs.[13]

Finally, the Commission should coordinate with the SEC to adopt similar impartial access requirements for security-based swaps. This will ensure that market participants are subject to the same standards when trading economically-correlated swaps together, such as index CDS and single-name CDS. Otherwise, divergent platform access requirements may negatively impact liquidity and price discovery in these correlated instruments.

B. Continuing the Transition of Package Transactions Onto SEFs

In certain asset classes, a significant percentage of overall trading activity is transacted as part of a package. For example, data has shown that over 50% of all USD interest rate swaps are entered into as a package.[14] Pursuant to Commission rules, once a swap is determined to be subject to the SEF trading obligation, all transactions in that swap must be executed on a SEF absent an exemption. This is the case even if a market participant chooses to execute the swap as part of a package with other instruments. However, the Commission sensibly adopted a phased approach for transitioning packages onto SEFs through no-action relief.[15] Under this phased approach, the most frequently traded types of packages successfully transitioned onto SEFs in 2014, including (i) interest rate curves, (ii) interest rate butterflies, (iii) interest rate and credit rolls, (iv) spread over Treasuries, and (v) CCP basis swaps.

However, the Commission has left the scope of the no-action relief for other package types unchanged since early 2015. This semi-permanent relief has reduced incentives for trading venues and market participants to develop solutions for trading a broader range of packages on SEFs. Transitioning as much trading activity onto regulated trading venues as possible in swaps that are already subject to the SEF trading obligation:

[13] *See also* MFA Position Paper: Why Eliminating Post-Trade Name Disclosure Will Improve the Swaps Market (March 31, 2015), available at: https://www.managedfunds.org/wp-content/uploads/2015/04/MFA-Position-Paper-on-Post-Trade-Name-Disclosure-Final.pdf.

[14] *See* "Spreadovers: US Treasury Spreads in the Swaps Data," Clarus Financial Technology (March 23, 2105), available at: https://www.clarusft.com/spreadovers-us-treasury-spreads-in-the-swaps-data/.

[15] CFTC Letter No. 16-76 (Nov. 1, 2016), available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/16-76.pdf.

- enhances market stability and integrity given the monitoring and surveillance capabilities of SEFs;
- reduces operational risk through the pre-trade credit check and straight-through-processing requirements that are applicable to SEF trades; and
- improves market liquidity and competition since SEFs are subject to impartial access requirements, thereby enabling market participants to have access to a greater number of liquidity providers.

We therefore recommend the Commission consider gradually scaling-back the no-action relief currently available to packages. For example, an intermediate step could be to require certain additional package types to be traded on SEF, but to continue to provide no-action relief from the separate required methods of execution requirement.

We also urge the Commission to engage with the CME to amend CME Rule 538 so as to allow invoice spread packages containing an interest rate swap and an interest rate future to trade on SEFs, bringing greater price transparency to market participants. Currently, CME Rule 538 prevents a swap that is traded on, or subject to the rules of, a DCM or SEF from serving as the related position component of an Exchange for Risk or Exchange of Option for Option transaction. There is no legal or operational justification for this limitation, and the conflict between CME Rule 538 and the SEF trading obligation must be resolved in order to facilitate the transition of invoice spread packages onto SEFs.

C. Enforcing DCM Prohibitions on Disruptive Trading Practices

We recommend that the Commission actively engage with DCMs to ensure that their monitoring and surveillance programs are effective in preventing disruptive trading practices in the futures markets, such as wash trading and spoofing. Recent enforcement cases suggest that this should remain an area of focus, as disruptive trading practices negatively impact market efficiency and price discovery for all investors.

In addition, we believe that requiring the use of self-trade prevention tools on DCMs that can be configured according to a specific market participant's trading activity will assist in reducing the incidence of disruptive trading practices. We also support increased transparency from DCMs regarding the occurrence of self-trades on their systems.

V. Miscellaneous

Improving the Commission's Commitments of Traders Reports

The Commission's weekly Commitments of Traders Report provides valuable transparency to commodity market participants. These reports detail total long and short open interest in major commodity contracts across the following categories of traders: (i) producer / merchant / processor / user, (ii) swap dealers, (iii) managed money, (iv) other reportables, and (v) non-reportable positions.

Recently, however, this transparency has been impaired by a material increase in the number of positions that are being reported under the "other reportables" and "non-reportable" categories. This trend warrants inquiry to ensure that market participants are accurately reporting and to determine why these two categories have increased in use. Depending on the conclusions reached, additional categories may be required in order to provide the intended level of transparency to market participants.

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We appreciate the opportunity to provide comments on the Commission's Project KISS. Please feel free to call the undersigned at (646) 403-8235 with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger
Managing Director, Government & Regulatory Policy