CITADEL

June 3, 2011

The Hon. Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

The Hon. Mary Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Dear Chairman Gensler and Chairman Schapiro,

Citadel LLC ("Citadel")[1] appreciates this opportunity to share our recommendations for a timeline for the implementation of the new rules proposed by the Commodity Futures Trading Commission ("CFTC") and Securities and Exchange Commission ("SEC") (together, the "Commissions") to achieve widespread clearing in the over-the-counter ("OTC") derivatives markets under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[2]

Citadel is a leading participant in the cleared and OTC derivatives markets, both as an investor and as a leading liquidity provider and market-maker. Further, Citadel is a longstanding proponent of central clearing as a cornerstone to open, fair, and transparent markets and is actively engaged with clearinghouses, clearing members, and peers as an advocate for central clearing for a broad range of OTC derivatives.

We appreciated the opportunity to participate in the staff roundtable on the implementation of Dodd-Frank that the Commissions organized jointly at the beginning of May.[3] We endorse the thirteen concepts[4] that CFTC staff laid out ahead of the Roundtable regarding the sequenced implementation of effective dates for final Dodd-Frank rules, and in this letter we recommend a path to put those concepts

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[1] Established in 1990, Citadel is a leading global financial institution that provides asset management, investment banking, institutional sales and 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.

[2] Further to the CFTC's request for "comment on the order in which it should consider the Dodd-Frank final rulemakings" in its *Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 76 Fed. Reg. 25274 (May 4, 2011).

[3] Joint CFTC-SEC Staff Roundtable on Implementation Phasing for Final Rules for Swaps and Security-Based Swaps Under Title VII of the Dodd-Frank Wall Street Reform And Consumer Protection Act, May 2-3, 2011 (the "**Roundtable**").

[4] CFTC, Request for Comment on *CFTC Staff Concepts and Questions Regarding Phased Implementation of Effective Dates for Final Dodd-Frank Rules* (April 29, 2011), at 1-3.

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into action. We believe that the key conclusions from the Roundtable were the following:

i. The financial industry seeks certainty with respect to implementation timelines;
ii. There is consensus that clearing is the logical first step in the implementation process; and
iii. A delay in clearing implementation is unwarranted and does not serve the broader public interest.

A. Recommended Approach

Consistent with the conclusions from the Roundtable, we firmly believe that moving forward with mandatory access to central clearing (*i.e.*, when clearinghouses would be "open for business", referred to as the "Mandatory Access Date")) by December 31, 2011[5] and progressively applying the clearing mandate on subsequent dates (referred to as "Mandatory Clearing Date(s)") during 2012 are attainable and appropriate goals that are also pivotal to the success of subsequent mandated reforms.

We fully support the implementation timeline proposed in the Managed Fund Association ("MFA")'s March 24, 2011 letter [6] (the "MFA Letter"), which included a December 31, 2011 Mandatory Access Date and a March 1, 2012 Mandatory Clearing Date for the initial product set.

We also offer in this letter, as an alternative, a phased-in approach ("Phased-In Approach"), as we understand there is active discussion of sequencing the mandatory clearing requirement by types or segments of market participants.[7] Our recommended Phased-In Approach would also include a December 31, 2011 Mandatory Access Date, followed by an initial Mandatory Clearing Date of April 30, 2012 for the largest and most active market participants, with subsequent Mandatory Clearing Dates to sequentially cover the entirety of the market by September 30, 2012.[8]

We recommend that the Commissions embody one of these central clearing implementation timelines in a formal rule and, as a first priority, adopt those rules that directly pertain to central clearing in order to launch the sequence.

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[5] Or 90 days after the date the relevant clearing rules are finalized (we understand that most DCOs are already working to comply with current proposed rules). *See* further discussion of the relevant rulemakings in Appendix A.

[6] Letter from Richard H. Baker of MFA to Chairmen Gensler and Schapiro, dated March 24, 2011, available at http://www.managedfunds.org/downloads/MFA%20Letter%20to%20Chairman%20Schapiro%203-24-11.pdf.

[7] *See* the CFTC's staff mention of "phasing transaction compliance by the type of financial entity" in CFTC, Request for Comment on *CFTC* Staff *Concepts and Questions Regarding Phased Implementation of Effective Dates for Final Dodd-Frank Rules* (April 29, 2011), point 6.

[8] Or, if the Mandatory Access Date is earlier or later than December 31, 2011, 120 and 270 days from that date for the start and completion of the phase-in, respectively.

While the overall timetable to achieve full compliance with the central clearing mandate will include a series of interim milestones for industry participants to tackle, we submit that the Commissions need only explicitly define the following items (each of which is explained in further detail below):

- Mandatory Access Date;
- Mandatory Clearing Dates; and
- Criteria for Buy-Side Segmentation.

The establishment of specific target dates for both access to clearing and then mandatory clearing will focus industry efforts, foster competition, and facilitate the Commissions' own efforts to prioritize and sequence promulgation of its final rules. Competitive forces will be unleashed as clearinghouses and clearing members strive to finalize their offerings and bring them to market. Meanwhile, under the Phased-In Approach, a sequential approach to mandating buy-side clearing based on objective, non-discriminatory, reasoned criteria, will allow the most active and best prepared participants to pave a more seamless path for other participants who may require longer transition times.

B. Finalize Clearing Rules First

Achieving robust, open and accessible clearing is the Commissions' first logical policy objective, since it will do the most towards mitigating systemic risk by reducing interconnectedness and counterparty credit exposure.

Central clearing is also the appropriate first step in the sequence of comprehensive reforms of the OTC derivatives markets required under Title VII of Dodd-Frank. Both the clearing process and the standardization that it entails are prerequisites to electronic trading and pre- and post-trade transparency regimes. Central clearing will also facilitate data collection and reporting efforts, providing the Commissions and other regulators with the information they need on market liquidity and pricing to effectively finalize further rules, as well as to conduct market supervision and monitoring. There is also no need to complete other reform phases, such as Swap Data Repositories ("SDRs"), as a prerequisite to launch clearing – substantial dealer-to-dealer clearing currently in the most traded products provides ample evidence of this. SDR work can proceed in parallel.

With over three years of foundational work in OTC derivatives clearing behind us, the industry is in a good position to complete the remaining milestones to prepare for widespread clearing by the end of 2011. It makes good policy sense to capitalize on this momentum. Simultaneously, this will allow time to resolve, and also contribute to the important ongoing dialogue concerning, more complex issues such as applicability of requirements to transact through swap execution facilities ("SEFs") and real-time public dissemination of transaction data.[9]

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[9] In specific response to Commissioner O'Malia's request for public comment on and invitation to offer alternatives to his proposed sequencing of the CFTC's consideration of final rules (CFTC, *Reopening and Extension of Comment Periods for*

C. Mandatory Access Date[10]

We propose that the Commissions set an indicative Mandatory Access Date of December 31, 2011. This is the date upon which clearinghouses will be "open for business" for *all* market participants, but importantly not the date that mandatory clearing must commence. On the Mandatory Access Date, clearinghouses and clearing members would be required to be in compliance with all the rules related to clearing and to offer open and impartial access to direct or indirect clearing to all eligible market participants.

The Mandatory Access Date should be the same for both interest rate swaps ("IRS") and credit default swaps ("CDS") and should apply to all products that are capable of being cleared at that point in time. This is because clearinghouses, and the industry as a whole, are at a stage of roughly equal preparedness for clearing these asset classes, and there is minimal conflict of resources in meeting this milestone simultaneously. Staggering the Mandatory Access Date for every product only delays the initial period in which market participants have an opportunity to "test" the system and gather information that could enhance the clearing process as a whole.

The proposed definition of the Mandatory Access Date is set forth more fully in Appendix A, and it is predicated upon conditions being met that eliminate structural and economic barriers to clearing and ensure the integrity of the cleared market. The Commissions' proposed rulemakings have already set out the requirements that would fulfill many of these conditions, and clearinghouses are making progress towards compliance.

D. Mandatory Clearing Dates[11]

We propose that, by adopting the Phased-in Approach, the Commissions further set Mandatory Clearing

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Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 25274 (May 4, 2011), Appendix 2, at 25276), we would therefore respectfully suggest the following amendments:

(a) Elevate the key Clearing rules referenced in Phase III and Phase IV to Phase I, or at the latest, Phase II (specifically, the rules listed in Phase III: (i) Designated Clearing Organization (DCO) Core Principles and (ii) Governance of DCOs; as well as in Phase IV: (iii) Rule 1.25, (iv) Segregation and Bankruptcy, and (v) Portfolio Margining); and

(b) Demote the Execution rules referenced in Phase III to Phase IV (specifically, the rules listed in Phase III: (i) Real-time Reporting, (ii) Swap Execution Facility (SEF) and Block Trade Rule, (iii) Designated Contract Market (DCM), (iv) Foreign Board of Trade (FBOT), (v) Part 40 Rule Certification, and (vi) Governance of SEFs and DCMs).

[10] The definition and characteristics of the Mandatory Access Date are the same under the Phased-In Approach and under the MFA Letter's approach.

[11] The MFA Letter proposes a March 1, 2012 Mandatory Clearing Date for the initial product set, in contrast to the Phased-In Approach's sequential Mandatory Clearing Dates per buy-side segment. However, both approaches include reasonable extensions for certain funds with long lead-time third-party approval requirements.

Dates for buy-side firms, based on their level of activity in the OTC derivatives markets, that are either 120, 210, and 270 days from the Mandatory Access Date, consistent with the framework outlined below.

We recommend an initial Mandatory Clearing Date that is 120 days after the Mandatory Access Date for all dealer-to-dealer transactions as well as for transactions between dealers and the largest and most active buy-side participants. This will provide the best prepared and most active market participants with 120 days to phase-in clearing and ramp up cleared volumes ahead of the Mandatory Clearing Date. We refer to the window between the Mandatory Access Date and the Mandatory Clearing Date as the voluntary clearing period ("Voluntary Clearing Period").

Further, we propose that the Commissions set subsequent Mandatory Clearing Dates for less active buy-side participants at 210 and 270 days after the Mandatory Access Date. The resulting longer Voluntary Clearing Periods for less active buy-side participants will allow them sufficient time to prepare for compliance, make operational changes, or obtain governance approvals.

Irrespective of size or activity level, buy-side firms will be welcome to begin clearing earlier than otherwise required by their respective Mandatory Clearing Date (*i.e.*, at any point during their respective Voluntary Clearing Period), and the purpose of the Mandatory Access Date is to enable such early access to clearing.

We offer two alternative methodologies for segmenting buy-side firms for the purposes of setting the Mandatory Clearing Dates, as outlined in the following section (*see* below and also Appendix B for details).

While we understand that the clearinghouses would be ready to start clearing both CDS and IRS simultaneously, the buy-side industry might prefer clearing in these asset classes to be implemented at different stages. The Commissions could therefore consider staggering the Mandatory Clearing Dates for CDS to fall 90 days after the respective Mandatory Clearing Dates for IRS, in order to divide the key compliance milestones into smaller incremental steps.[12]

E. Criteria for Buy-side Segmentation

For the purposes of applying the Mandatory Clearing Dates, we believe that the non-dealer community can be organized in an objective and non-discriminatory fashion into three segments based either on each firm's historical Turnover[13] and Open Exposure[14] in a given asset class for a given period, or on a going-

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[12] For example, the Mandatory Clearing Dates for Segment 1 would be March 31, 2012 for IRS and June 30, 2012 for CDS. Note, however, that the Mandatory Access Date would remain the same for both product sets, *i.e.* December 31, 2011. The relevant segmentation approaches set out in the text following would then be staggered accordingly. The MFA Letter embodies an analogous concept.

[13] Turnover means the total notional amount of swaps entered into.

forward measure based simply on Turnover measured from the Mandatory Access Date. Either measure is straightforward and is designed to capture the relative activity levels of firms in each product class. Segmenting firms on the basis of their activity level not only serves as a useful proxy for sophistication and readiness to clear, but will also achieve the principal goal of reducing risk.

The historical data for CDS is available from DTCC and the historical data for IRS could either be provided to the regulators by the leading dealers, or could be based on buy-side firms' own reporting directly to the Commissions. For going-forward measures, data could be captured either through the relevant SDR or through reporting by leading dealers, clearinghouses, and, if necessary, buy-side firms.

For the historical approach, the regulators could rank non-dealer participants (except for corporate end-users with respect to their exempt commercial hedging activities) in each asset class based on Turnover and Open Exposure over the 12-month period preceding the Mandatory Access Date. The most active participants would be placed into Segment 1 and would be subject to a Mandatory Clearing Date that is 120 days after the Mandatory Access Date. Other participants would be placed into Segments 2 and 3 based on their relative ranking under the same analysis, and the Mandatory Clearing Date applied to them would be 210 and 270 days respectively from the Mandatory Access Date.

For the going-forward approach, Turnover by each buy-side participant for the period 90 days from the Mandatory Access Date would be measured. All firms that exceeded a set threshold per asset class would be included in Segment 1. The Mandatory Clearing Date for Segment 1 would be 120 days after the Mandatory Access Date, allowing an additional 30 days for the identified firms to finalize preparations for all their relevant trades to be cleared. All firms that were not included in Segment 1 but that exceeded the set threshold over the measurement period 180 days from the Mandatory Access Date would comprise Segment 2. The Mandatory Clearing Date for Segment 2 would be 210 days after the Mandatory Access Date. The Mandatory Clearing Date for all other firms (*i.e.* Segment 3) would be 270 after the Mandatory Access Date.

We believe these alternative segmentation criteria are objective, risk-based, non-discriminatory, verifiable and transparent, and provide a framework for the CFTC to follow through with Concept 6 of the its *Staff Concepts and Questions Regarding Phased Implementation of Effective Dates for Final Dodd-Frank Rules*,[15] where staff potentially saw value in "phasing transaction compliance by the type of financial entity."[16]

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[14] Open Exposure means the total notional amount of swaps open, without netting or offsets, to which a relevant firm is a part (netting of offsetting positions with the same counterparty would be taken into account, as reflected, *e.g.*, in DTCC reporting, but not netting of offsetting positions with different counterparties).

[15] CFTC, Request for Comment on *CFTC* Staff *Concepts and Questions Regarding Phased Implementation of Effective Dates for Final Dodd-Frank Rules* (April 29, 2011).

[16] *Id.* at 2.

Potential methodologies for these segmentation options are set out in greater detail in Appendix B and we propose that the SEC apply the same sequencing as the CFTC for security-based swaps. For example, if certain of the most liquid single-name CDS contracts are included in the initial clearing mandate, the timeline would be the same as for the phase-in of the clearing mandate for the first set of mandated CDS index contracts.[17]

F. Resulting Timeline

We believe that if the Commissions take the steps above with respect to finalizing the clearing rules and promulgating a Mandatory Access Date and Mandatory Clearing Dates, the industry timeline outlined below would be achievable and enable a meaningful percentage of clearing eligible IRS and appropriate and liquid CDS to be cleared over the course of 2012.

Stage 1: Finalize Clearing Rules and Related Documentation – Summer 2011

The Commissions have now proposed the bulk of the rules relevant to establishing the clearing framework, with public comment periods set to close in June and July. We believe that if the Commissions prioritize the finalization of the rules essential for clearing by the end of August—including (i) clearinghouse risk management, (ii) clearing, processing and transfer of customer positions, and (iii) customer segregation—the market will have the requisite statutory foundation and certainty to make final preparations for clearing.

The industry has already made progress to standardize and streamline requisite documentation, including nearly finalizing the relevant clearing agreement addendum and optional bilateral execution agreement. These templates will shortly be sufficiently complete to support progress on timely widespread onboarding of clients by clearing members.

Stage 2: Industry Preparations to Begin Clearing – 2H 2011

Once the rules related to clearing are finalized, regulators and market participants can begin aggressively to focus on preparing for the launch of open and accessible central clearing. The three key focus areas will be:

- Clearinghouses to implement and become compliant with final rules;

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[17] We assume that once the entire market has complied with the mandate to clear the initial mandatorily cleared product set, subsequent products can be made subject to the mandate with notice to the entire market and without the need for a segment-based phase-in. The notice for a subsequent set of products to be subject to the mandate could be issued before the effectiveness of the mandate on the prior set. For example, if the initial mandated product set will become mandatory for the entire market on the date 270 days from the Mandatory Access Date, the notice period for the next mandated product set could begin on day 240, with effectiveness on day 330.

- Regulators, in close coordination with buy-side firms, dealers, and clearinghouses, to certify the set of products that will be subject to the initial clearing mandate; and
- Buy-side firms and dealers / clearing members to execute legal documentation required for onboarding, establish connectivity, and execute test trades

Stage 3: Clearinghouses Meet Mandatory Access Requirements and Launch Voluntary Clearing - 1Q-3Q 2012

By January 1, 2012, clearinghouses should be "open for business", meaning that open and impartial *access* to clearing should be mandatory. The ensuing three month period should allow for voluntary clearing of the eligible products, with firms incentivized to ramp up cleared volumes to confirm scale readiness for conversion to mandatory clearing. Less active buy-side firms would be afforded the flexibility to continue the Voluntary Clearing Period into the second or third quarter. Prior to the Mandatory Access Date, clearinghouses should have completed the required 90-day product certification process, and the Commissions should have designated the initial product sets slated for the clearing mandate.

Stage 4: Mandatory Clearing - 2Q-4Q 2012

After April 30, 2012, mandatory clearing of the first phase of eligible products should apply to 100% of trades for dealers and Segment 1 of buy-side firms. [18] The mandate would be expanded to cover additional market participants in subsequent quarters, so that indicatively by October 1, 2012, the clearing mandate would be fully in place for eligible products for all participants.

G. Conclusion

We have formulated the proposed timetable after extensive dialogue with all relevant stakeholders – including clearinghouses, clearing members, and a range of buy-side participants. We are confident that the intervals proposed are reasonable and achievable. Not only have the clearinghouse facilities for CDS and IRS already been through extensive dealer-to-dealer clearing, but the buy-side has also undertaken significant preparations. "Live" buy-side trades were executed in CDS already in December 2009 and in

[18] By this time the Commissions will need to have adopted final rules regarding the applicability of the end-user exception to mandatory clearing. *See* CFTC, Proposed Rule on *End-User Exception to Mandatory Clearing of Swaps*, RIN 3038–AD10, 75 Fed. Reg. 80747 (December 23, 2010); SEC, Proposed Rule on *End-User Exception to Mandatory Clearing of Security-Based Swaps*, Release No. 34–63556, File No. S7–43–10, RIN 3235–AK88, 75 Fed. Reg. 79992 (December 21, 2010).

IRS on various platforms in 2010. A number of buy-side firms, including Citadel, have negotiated clearing arrangements, tested margin methodologies, tested straight-through processing, and worked through a wide range of operational and reporting prerequisites to clearing in volume. Clearing members have been working for several years now on structuring offerings to clients, including smaller clients with limited operational capacity themselves, to support widespread clearing.

If the Commissions were to announce a date certain as the Mandatory Access Date and outline the subsequent mandate timeline now in a rule, the industry would have nearly a full year to prepare for the mandate in the first product set for the largest buy-side firms, and up to an additional six months for other buy-side participants. We are certain this is both achievable, and necessary, for the essential objectives of the Dodd-Frank Act to be met. We are confident, in fact, that the industry could fulfill a more aggressive schedule, and at any event are not aware of any basis for extension beyond this timeframe.

We very much appreciate the Commissions' work in establishing a clearing implementation timeline and achieving closure on this foundation phase of financial reform.

Yours sincerely,

Adam C. Cooper
Senior Managing Director and Chief Legal Officer

CC: Mr. David A. Stawick, CFTC Secretary
The Hon. Bart Chilton, CFTC Commissioner
The Hon. Michael Dunn, CFTC Commissioner
The Hon. Scott D. O'Malia, CFTC Commissioner
The Hon. Jill E. Sommers, CFTC Commissioner

Ms. Elizabeth M. Murphy, SEC Secretary
The Hon. Luis A. Aguilar, SEC Commissioner
The Hon. Kathleen L. Casey, SEC Commissioner
The Hon. Troy A. Paredes, SEC Commissioner
The Hon. Elisse B. Walter, SEC Commissioner

Appendix A

DEFINITION OF MANDATORY ACCESS DATE

As of the Mandatory Access Date[19], registered Derivatives Clearing Organization ("DCOs")/Clearing Agencies ("CAs") shall fulfill the following requirements: [20]

- Compliance with final rules pursuant to CFTC Notice of Proposed Rulemaking on *Risk Management Requirements for Derivatives Clearing Organizations*[21] and SEC Proposed Rule on *Clearing Agency Standards for Operation and Governance*;[22]

- Compliance with final rules pursuant to CFTC Notice of Proposed Rulemaking on *Requirements for Processing, Clearing and Transfer of Customer Positions*,[23] and any comparable SEC rules to be adopted;

- Compliance with final rules pursuant to CFTC Notices of Proposed Rulemaking on *Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest* [24] and *Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest*,[25] and

- Compliance with such other CFTC and SEC rules (regarding, *e.g.*, margin, segregation) necessary to ensure fair and open access and to provide sufficient certainty to allow market participants to finalize preparations to clear at scale.

Without limitation of the foregoing, the provision of facilities to all eligible market participants for direct or indirect clearing, and elimination of barriers to access to such clearing and integrity of the cleared market, must include:

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[19] Prior to such date, it is understood that registered DCOs/CAs shall have submitted their initial product sets for each relevant asset class for CFTC/SEC approval for clearing and certification of products subject to mandatory clearing, and the relevant comment periods and approvals shall have been completed.

[20] While not strictly necessary to launch the timeline, we believe that finalization of clearinghouse governance rules that mitigate conflicts of interest also by August 2011 will help clearinghouses prepare more competitively and rapidly to support the transition of markets to central clearing.

[21] RIN 3038–AC98, 76 Fed. Reg. 3698 (January 20, 2011).

[22] RIN 3235–AL13, 76 Fed. Reg. 14472 (March 16, 2011).

[23] RIN 3038–AC98, 76 Fed. Reg. 13101 (March 10, 2011).

[24] RIN No. 3038–AD01, 75 Fed. Reg. 63732 (Oct. 18, 2010).

[25] RIN 3038–AD01, 76 Fed. Reg. 722 (January 6, 2011).

1. Real-time disposition by DCOs/Clearing Agencies and their respective clearing members of trades, for acceptance or rejection for clearing regardless also of whether the trades are executed bilaterally or through a SEF/DCM;

2. Open, non-discriminatory access for clearing of trades executed by voice or other bilateral means, as well as trades executed on a SEF/DCM;

3. Anonymity between clearing members and such clearing members' customers' execution counterparties;

4. Elimination of structural barriers (such as for tripartite documentation) to access best execution;

5. Automatic compression (continuous or no less frequently than daily) of offsetting cleared positions held at the same DCO/CA;

6. Facilities to permit prompt pre-default full and partial portability, on customer instruction and without inappropriate cost or delay;

7. Non-discriminatory real-time clearing of correspondently cleared (or "4-way") transactions;

8. Availability to all clearing participants of tools to estimate margin;

9. Compliance with CFTC/SEC final rules for segregation of customer positions and margin; and

10. Facilities for qualifying participants to become direct clearing members on the basis of nondiscriminatory, objective, risk-based criteria.

Appendix B

METHODOLOGIES FOR SEGMENTING NON-DEALER MARKET PARTICIPANTS FOR CLEARING MANDATE

Framework:

Segment non-dealer participants subject to compliance with Dodd-Frank (allowing for exception for corporate end-users with respect to their exempt commercial hedging activities) in each asset class into three groups based on the criteria outlined below. Note that long-only funds wholly controlled by the relevant manager may be included in any segment, however long-only funds that manage third-party sub-accounts that require the specific approval of the client for clearing arrangements, and thus require additional time to obtain such approval, would be deferred to Segment 3. Criteria would be established for self-certification to qualify for such deferral.

The ranking is based on simple notional Turnover and/or Open Exposure definitions. It is acknowledged that these measures are not perfect indications of risk, but they provide objective, non-discriminatory, reasonable and readily ascertainable and comparable measures of levels of activity. To simplify the calculation, portfolio netting would not be taken into account, though netting of offsetting positions with the same counterparty would be taken into account.

The rationale for placing the more active firms in Segment 1 is that, by virtue of their activity level, these firms:

- Have been most actively engaged in monitoring regulatory developments and preparing for clearing;
- Typically have much greater operational infrastructure and resources than less active firm; and
- Typically have more extensive relationships with counterparties and facilities providers.

These factors all enable compliance with the mandate at an early date.

The Phased-in Approach thus allows the operational adaptations for clearing to be proven first by those best positioned to do so, paving the way for subsequent, more seamless incorporation of a greater number of less active participants. Finally, from the perspective of systemic risk mitigation, the most objective, risk-based approach to phasing is to require the participants with the largest activity and thus ability or likelihood to generate the largest risk exposures to clear first.

We anticipate that in the markets for both CDS and IRS, a relatively small number of the most active participants account for a significant percentage of overall activity, with a broad distribution of less active participants comprising the balance. Accordingly, we would expect Segment 1 in each asset class to represent 20-40 firms, with the next segment representing another 40-75 firms. If the segmentation

approaches were to yield group sizes significantly larger or smaller than anticipated, the Commissions should have flexibility to alter the percentage of buy-side activity targeted, in order to segment the groups in sizes that are both manageable and sufficient.

Data required for the ranking and segmentation would be compiled from reporting to the Commissions from SDRs, clearinghouses, dealers, and/or buy-side participants.[26]

In addition, the percentages and notional thresholds proposed in the segmentation methodologies below are based on our understanding of buy-side activity. The Commissions should have the flexibility to modify these figures to best achieve the intended outcome. Further, in the data gathering process, the Commissions should have similar flexibility to determine what specific product sets are appropriate for the purposes of ranking buy-side activity.

Although the two methodologies are intended as alternatives and are therefore constructed to be mutually exclusive, the Commissions could also consider collecting the data proposed in Methodology 1 to then set the appropriate notional thresholds in Methodology 2, in line with our suggestion that the Commissions should have the flexibility to tailor the thresholds as appropriate.

Segmentation for IRS

Methodology 1 involves a compilation of historical data preceding the Mandatory Access Date, whereas Methodology 2 ranks based on reporting for the period commencing as of the Mandatory Access Date.

Methodology 1 – Historical Turnover and Open Exposure

With respect to US dollar-denominated US LIBOR and EUR LIBOR interest rate swaps only:

- Compile data from the top 20 U.S. dealers[27] on Turnover with buy-side customers over a 12-month period extending back from the Mandatory Access Date, and the Open Exposure of each dealer to each customer as of the Mandatory Access Date.

- Aggregate all data for each buy-side firm. Stratify the ranked participants in segments, as follows:

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[26] Pursuant to the CFTC proposed rulemaking and under Section 729 of Dodd-Frank, the CFTC can require swap counterparties "to provide reports [concerning such swaps to] the Commission upon its request, in the form and manner specified by the Commission" (CFTC, *Proposed Rulemaking on Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps*, RIN 3038–AD48, 76 Fed. Reg. 22833 (April 25, 2011)).

[27] In the bilateral markets, a dealer bank is on one side of every trade. Publicly available statistics (*e.g.*, by the Office of the Comptroller of the Currency in the U.S.) indicate that nearly 100% of buy-side trades are conducted with the top 25 dealers. Accordingly, data from these 25 firms should provide a sufficiently accurate base to rank buy-side activity.

- Segment 1 to comprise the top group of buy-side participants representing 50% of the total non-dealer activity based on either metric;
- Segment 2 to comprise the firms needed to reach 75% of the total non-dealer activity based on either metric; and
- Segment 3 to comprise the remainder.

Methodology 2 – Going-Forward Turnover Only

- Measure the Turnover, in notional terms, of buy-side firms in US dollar denominated US LIBOR and EUR LIBOR interest rate swaps beginning on the Mandatory Access Date ("T").

- Segment firms on the following basis:

  - Segment 1 to comprise firms with $100 billion or more in Turnover between T and T+90;
  - Segment 2 to comprise firms with $50 billion or more in Turnover between T and T+180; and
  - Segment 3 to comprise all other firms, including long-only funds that qualify for a deferral to Segment 3.

In calculating the aggregate notional amount under either methodology, transactions that are unwinds or modifications would not be counted towards the total (provided, however, that a modification that increased the notional or extended the maturity would be counted).

Mandatory Clearing Dates

The Mandatory Clearing Dates for firms in a given segment would be as follows:

- Segment 1: T+120

- Segment 2: T+210

- Segment 3: T+270

Segmentation for CDS

Methodology 1 involves a compilation of historical data preceding the Mandatory Access Date, whereas Methodology 2 ranks based on reporting for the period commencing as of the Mandatory Access Date.

Methodology 1 – Historical Turnover and Open Exposure

With respect to CDS index and single name trades in U.S. reference entities only:

- Compile data from DTCC on the Turnover of buy-side participants over the 12-month period preceding the Mandatory Access Date, and the Open Exposure of each buy-side participant as of the Mandatory Access Date.

- Stratify the ranked participants in segments, as follows:

  - Segment 1 to comprise the top group of participants representing 50% based on either metric;
  - Segment 2 to comprise the firms needed to reach 75% of total non-dealer activity based on either metric; and
  - Segment 3 to comprise the remainder.

Methodology 2 – Going-Forward Turnover Only

- Measure the Turnover of buy-side firms in CDS beginning on the Mandatory Access Date ("T").

- Segment firms on the following basis:

  - Segment 1 to comprise firms with $10 billion or more in Turnover between T and T+90;
  - Segment 2 to comprise firms with $10 billion or more in Turnover between T and T+180; and
  - Segment 3 to comprise all other firms, including long-only funds that qualify for a deferral to Segment 3.

In calculating the aggregate notional amount under either methodology, transactions that are unwinds or modifications would not be counted towards the total (provided however, that a modification that increased the notional or extended the maturity would be counted).

Mandatory Clearing Dates

The Mandatory Clearing Dates for firms in a given segment would be as follows:

- Segment 1: T+120

- Segment 2: T+210

- Segment 3: T+270