November 22, 2019

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

RE: Exemption from Derivatives Clearing Organization Registration (RIN 3038-AE65)

To Whom It May Concern:

The Americans for Financial Reform Education Fund (AFR Ed Fund) appreciates the opportunity to comment on the above referenced Notice of Proposed Rulemaking (the "Proposal" or "NPRM") concerning the Commodity Futures Trading Commission's ("CFTC" or "Commission") application of Dodd-Frank Title VII rules to Derivatives Clearing Organizations ("DCOs") and Futures Commission Merchants ("FCMs"). Members of AFR Ed Fund include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.[1]

The AFR Ed Fund opposes the move by the Commission to exempt foreign DCOs and FCMs clearing swaps from U.S. persons from CFTC registration. We do not believe that the CFTC has statutory authority to grant this sweeping exemption, nor do we believe that the safeguards proposed in the rule are adequate.

In the Dodd-Frank Act, Congress mandated that derivatives deemed suitable for clearing by the CFTC must be cleared through a CFTC-registered DCO. Under Section 2(i) of the Commodity Exchange Act (CEA), these mandates extended to activities conducted outside of the United States that had a "direct and significant connection with activities in, or effect on, U.S. commerce". This mandate for clearing through a registered DCO was qualified by granting the Commission the ability to exempt a DCO from registration under certain circumstances. Under Section 5b(h) of the CEA, the following conditions must be satisfied if a DCO is to be granted exemption from registration:

> "The Commission may exempt, conditionally or unconditionally, a derivatives clearing organization from registration under this section for the clearing of swaps if the Commission determines that the derivatives clearing organization is subject to

[1] A list of coalition members is available at: http://ourfinancialsecurity.org/about/our-coalition/

> comparable, comprehensive supervision and regulation by the Securities and Exchange Commission or the appropriate government authorities in the home country of the organization."

In its 2018 rule on Exempt DCOs, the Commission stated that it intended to deem compliance with any foreign regulatory regime that conformed to the Principles for Financial Market Infrastructures (PFMIs) promulgated by the Financial Stability Board (FSB) as fulfilling the statutory requirements for exempting a DCO from registration under U.S. law.[2] This meant that foreign DCOs could be exempted from registration without any determination that they were subject to supervision and regulation that was in any way comparable to the specific U.S. laws or regulation under the Dodd-Frank Act or Part 39 of CFTC regulations governing clearing organizations. The only requirement was that they comply with the PFMIs, a set of broad principles issued by an international regulatory consortium with no standing under U.S. law.

In the 2018 rule, foreign DCOs were exempted from registration only for "house" derivatives cleared by U.S. persons or affiliates which were direct clearing members of the DCO. The Commission now proposes to expand the activities allowed under this exemption from registration to permit the DCO to clear derivatives from any U.S. person. The proposal would also exempt clearing members of the foreign DCO which accept funds from U.S. persons from registration as FCMs.

We believe that the Commission would significantly exceed its statutory exemptive authority in granting these exemptions, and indeed that it exceeded its statutory authority in the 2018 exemption as well. The Dodd-Frank Act clearly permits the Commission to exempt foreign DCOs from U.S. registration only when such DCOs are subject to "comparable, comprehensive supervision and regulation", as compared to DCOs registered under U.S. law. The Commission cannot substitute its judgement as to whether a foreign regime conforms to the PFMIs, a set of broad principles with no standing under U.S. law, for the statutory mandate to ensure that a DCO is subject to a regime comparable to U.S. regulation and supervision.

The combination of this broad exemption and the narrower 2018 exemption for clearing member swaps means that a large share of derivatives transactions conducted by U.S. persons will now be permitted to be transacted in DCOs that are not registered under U.S. law, through FCMs that are also not registered. This is in direct contravention to the Dodd-Frank Act which explicitly required the U.S. cleared derivatives market to be conducted through CFTC-registered clearinghouses.

The limitations proposed in this NPRM to protect against the possible negative effects of this step are highly inadequate to say the least. The Commission proposes to limit this exemption to DCOs which do not pose a "substantial risk to the U.S. financial system". To operationalize this concept, the Commission would only classify a DCO as a "substantial risk" to the U.S. financial

[2] Commodity Futures Trading Commission, Exemption From Derivatives Clearing Organization Registration, 83 Federal Register 39923 (August 13, 2018).

system if it 1) holds 20 percent or more of the required initial margin of U.S. clearing members for all swaps across the entire market, and 2) 20 percent or more of the total initial margin for swaps at that DCO are held by U.S. clearing members. This is a completely inadequate standard for determining the potential impact of a DCO failure or failures on the U.S. financial system. First, point in time holdings of initial margin may not reflect the margin share of a DCO under different or more stressed market conditions, as margin requirements change with market prices. In this sense initial margin holdings are simply not an adequate risk metric. Second, this rule could easily permit exempt DCOs to hold a total level of initial margin well in excess of 20 percent of the U.S. market, either aggregated across exempted DCOs or through DCOs that do not meet the second prong of the definition (having 20% of margin at the DCO held by U.S. clearing members). Finally, the use of a relative measure of 20 percent of total margin means that an exempted foreign DCO could hold very high absolute levels of U.S. customer margin, possibly $50 billion or more, while still being exempt from U.S. regulation.[3]

The "substantial risk" requirements of course also do not address the ways in which customer funds are endangered by clearing through exempt foreign entities, specifically the ways in which U.S. bankruptcy laws and related segregation requirements would not protect customers dealing with exempt foreign DCOs through unregistered FCMs. The Commission proposes to deal with this serious issue simply through a set of written notices and disclosures that would warn customers that they faced additional risks in dealing with an unregistered intermediary. We do not believe that these technical disclosures, which are likely to be disregarded by many customers, are a proper substitute for actual legal protections.

In sum, we do not believe that the exemption proposed in this NPRM is either legal under the statutory authority granted to the CFTC under Dodd-Frank, nor do we believe that it is a responsible decision given the CFTC's responsibility to protect the financial system and U.S. derivatives customers. We urge the Commission to withdraw the proposed exemption and continue to require foreign DCOs and intermediary FCMs to register under U.S. law when clearing swaps for U.S. persons.

Thank you for the opportunity to comment on the Proposal. If you have questions, please contact Marcus Stanley, AFR's Policy Director, at 202-466-3672 or marcus@ourfinancialsecurity.org

Sincerely,

Americans for Financial Reform Education Fund

[3] See International Swaps and Derivatives Association, "ISDA Margin Survey: Year-End 2018", ISDA Research Study (April, 2019).