

# **Diversifying Clearinghouse Ownership In Order to Safeguard Free and Open Access to the Derivatives Clearing Market<sup>1</sup>**

**by  
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Implementing the rigorous governance and ownership standards established in the Dodd-Frank Wall Street Reform and Consumer Protection Act<sup>3</sup> for derivatives clearing organizations (DCOs) will promote free and open access to clearing and reduce systemic risk within what is now the \$700 trillion notional value derivatives market.<sup>4</sup> Such standards are central to and advance the key regulatory tenants of Dodd-Frank: *i.e.*, to restore transparency, capital adequacy, and accountability to what was the unregulated over-the-counter (OTC) derivatives market by ensuring that swaps are cleared through financially sound DCOs. Also, these rules will promote competition by curtailing large swap dealers' (SDs) control over these markets to the disadvantage of swaps users.

This article focuses on the importance of swaps clearing to Dodd-Frank-mandated market reforms and the need for fair and open access to that clearing. Specifically, it shows that implementing objective governance standards for DCOs that include maximum capital requirements for DCO membership will enhance market stability and efficiency. To this end, the

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<sup>3</sup> Dodd-Frank Act Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter "Dodd-Frank"].

<sup>4</sup> Katy Burne, *Complex Financial Bets Rise Ahead of Overhaul*, WALL ST. JOURNAL (Nov. 16, 2011), available at <http://www.efinancialnews.com/story/2011-11-16/otc-derivatives-top-700-trillion>.

article focuses exclusively on clearing as it lies at the heart of Dodd Frank market reforms.<sup>5</sup>

Also, although the article discusses the SEC’s proposed rules on DCO governance and ownership, it primarily focuses on the CFTC’s rulemaking for DCOs since the CFTC has jurisdiction over 85% of the derivatives market.<sup>6</sup>

The article is divided into four parts. First, it shows that Congress intended the CFTC to adopt rigorous rules regarding DCO governance and ownership that eliminate the conflicts of interest that have allowed SDs to stifle competition for clearing services and to charge unnecessarily high transaction fees. Second, it explains how pre-Dodd-Frank market forces have limited access to clearing. Third, it shows that the CFTC’s final rule on participant eligibility<sup>7</sup>—particularly the rule establishing a \$50 million threshold for DCO membership—promises to both improve swap users’ access to clearing and ensure greater stability within the derivatives clearing market. Finally, the article argues that the CFTC should strengthen its proposed governance standards for DCOs in order to safeguard swap users’ access to clearing against the possibility that the CFTC’s participant eligibility requirements fail to increase DCO membership.<sup>8</sup>

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<sup>5</sup> See Dodd, Christopher & Blanche Lincoln, Letter to Representatives Barney Frank and Collin Peterson, respective chairs of the House Financial Services and Agriculture Committees (June 30, 2010) (stating that “Congress determined that clearing is at the heart of reform—bringing transactions and counterparties into a robust, conservative and transparent risk management framework”).

<sup>6</sup> Correspondence by Chris Young, Director of U.S. Public Policy, International Swaps and Derivatives Association (noting that although the CFTC and SEC have yet to finalize the definition of “swap” and “security-based swap,” the CFTC will likely have jurisdiction over “[w]ell over 80%” of the derivatives market and probably closer to 85% of the market).

<sup>7</sup> *Derivatives Clearing Organization General Provisions and Core Principles*, 76 Fed. Reg. 69334 (Nov. 8, 2011) [hereinafter “*Core Principles*”].

<sup>8</sup> See *Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest*, 75 Fed. Reg. 63732 (Oct. 18, 2010) [hereinafter “*Proposed Rules*”].

## I. Dodd-Frank Requires All Swaps Users To Have Free and Open Access to Clearing

Dodd-Frank’s almost universal mandatory clearing requirement<sup>9</sup> necessitates that swaps users have “fair and open access”<sup>10</sup> to DCOs as well as to swaps exchange facilities (SEFs) and designated contract markets (DCMs). SEFs and DCMs enable price discovery by posting the price and volume of exchange-traded swap transactions.<sup>11</sup> The public information generated by SEFs and DCMs ensures price transparency, which in turn promotes market liquidity by allowing swaps dealers to compete for business based on publically available data.<sup>12</sup> DCOs manage (and mitigate) systemic risk by guaranteeing the credit worthiness of cleared swap transactions and requiring dealers to set aside adequate collateral—*i.e.*, margin—in case of default.<sup>13</sup> In this respect, DCOs eliminate the interconnectedness between financial institutions

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<sup>9</sup> Dodd-Frank Act, § 723, *supra* note 3 (“It shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a derivatives clearing organization[.]”). *See also Id.* at § 763 (establishing parallel requirements for security-based swaps); S. REP. 111-176, at 32–35 (2010) (noting that draft provisions concerning other-the-counter derivatives were designed to minimize non-cleared, off-exchange trades).

<sup>10</sup> Dodd-Frank Act at § 725, *supra* note 3 (“The rules of a derivatives clearing organization . . . shall . . . provide for non-discriminatory clearing of a swap[.]”). *See* Kroszner, Randy, Transcript of *Public Roundtable on Governance and Conflicts of Interest in the Clearing and Listing of Swaps*, 33 (Aug. 20, 2010), available at [http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfs submission/dfs submission9\\_082010.pdf](http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfs submission/dfs submission9_082010.pdf) (“And the law is clear: Open access is the fundamental principle.”) [hereinafter “Roundtable Tr.”].

<sup>11</sup> *See* Proposed Rules at 63736, *supra* note 8.

<sup>12</sup> *See* S. REP. NO. 111-176, at 29–35 (2010) (stating that the clearing of exchange-traded swaps will “provide . . . derivatives users with more price transparency and liquidity, and regulators with more information about the risks in the system”); Bank of International Settlements, Committee on Payment and Settlement Systems, *Market Structure Developments in the Clearing Industry: Implications for Financial Stability* 57 (Nov. 2010), available at <http://www.bis.org/publ/cpss92.htm>.

<sup>13</sup> *See* Miller, Renner, *Conflicts of Interest in Derivatives Clearing*, Congressional Research Service 1 (March 22, 2011) (“Clearing is an institutional arrangement that helps protect against counterparty default. A DCO, or clearinghouse, clears and settles derivatives contracts between counterparties.”); Bank of International Settlements at 57, *supra* note 12 (“Central clearing generally reduces systemic risk and therefore carries social benefits. Principally, it reallocates

that contributed to the 2008 financial crisis that was precipitated by cascading counterparty risk emanating from the failure and bankruptcy of the likes of Bear Stearns, Lehman Brothers, and AIG.<sup>14</sup>

Given the importance of clearing to Dodd-Frank-mandated market reforms,<sup>15</sup> Congress directed financial regulators to establish rigorous regulations that would ensure market participants' eligibility to clear swap transactions,<sup>16</sup> reduce market concentration, and “mitigate conflicts of interest” in the operation of DCOs.<sup>17</sup> Congress was acutely aware of the over-concentration and conflicts of interests—the “problem[s]”—that arise when “95 percent of all of the clearinghouses in this country are owned by just five banks” who, in turn, limit competition for clearing services in order to boost their profits.<sup>18</sup> In order to eliminate this problem, Congress provided regulators with broad authority to adopt less restrictive participant eligibility criteria for DCOs<sup>19</sup> and “*strong* conflict of interest rules on control . . . of clearing and trading facilities”<sup>20</sup> so as to ensure that traders and investors could easily clear swap transactions.

Dodd-Frank includes specific provisions that prohibit DCOs from imposing arbitrary and

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credit risks to an entity . . . whose dedicated role it is to manage those risks in a robust and transparent manner.”).

<sup>14</sup> See Proposed Rules at 63732, *supra* note 8.

<sup>15</sup> See Dodd, Christopher & Blanche Lincoln, *supra* note 4.

<sup>16</sup> Dodd-Frank Act, § 725(c), *supra* note 3.

<sup>17</sup> *Id.* at § 726(c) (authorizing the CFTC to “consider any conflicts of interest arising from the amount of equity owned by a single investor . . . and the governance arrangements of any derivatives clearing organization that clears swaps”). See also 156 Cong. Rec. H5217 (2010), available at <http://www.gpo.gov/fdsys/pkg/CREC-2010-06-30/pdf/CREC-2010-06-30-pt1-PgH5212-3.pdf> (documenting a colloquy between Representative Stephen Lynch and Representative Barney Frank in which both Congressmen agreed that Sections 726 and 765 require the CFTC “to conduct rulemakings to eliminate the conflicts of interest arising from the control of clearing and trading facilities by entities such as swap dealers and major swap participants.”).

<sup>18</sup> 156 Cong Rec. H5217 (2010).

<sup>19</sup> See Dodd-Frank Act, § 725(c), *supra* note 3.

<sup>20</sup> *Id.* (emphasis mine).

excessive capital requirements on clearing members and that help ensure that DCO policies and procedures are not unduly influenced by the interests of SDs. Section 725 of Dodd Frank directs the CFTC to promulgate rules that require DCOs to establish “appropriate admission and continuing eligibility standards . . . for members of, and participants in . . . derivatives clearing organization[s]” so as to ensure “fair and open access” to clearing.<sup>21</sup> Additionally, Section 726 directs the CFTC to establish governance standards and limits on the ownership of voting equity that would mitigate the “conflicts of interest” that incentivize large SDs/banks to clear trades bilaterally rather than through clearinghouses.<sup>22</sup> Section 726 specifically directs the CFTC to limit the amount of equity a single investor may own in a DCO so that large SDs cannot use their influence as DCO stakeholders to hamper access to clearing.<sup>23</sup>

## **II. SD-Dominated Clearinghouses Have Placed Profits Over Prudent Risk-Management Strategies**

Large SDs have to date dominated the clearing industry and, as a consequence, have tended to oppose rules that establish meaningful ownership limitations and governance standards for DCOs.<sup>24</sup> As Senator Sherrod Brown observed in his comments on the CFTC’s proposed

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<sup>21</sup> Dodd-Frank Act, § 725(c), *supra* note 3.

<sup>22</sup> *Id.* at § 726. See also TRADEWEB, *Q&A With Hal Scott of Harvard Law: Clearinghouse Ownership and Risk* (Oct. 20, 2010) available at <http://www.tradeweb.com/Blog/Q-A-With-Hal-Scott-of-Harvard-Law--Clearinghouse-Ownership-and-Risk/>; See Bank of International Settlements at 67, *supra* note 12 (discussing “the incentives of users to resist the expansion of central clearing, as this might lead to migration towards the CCP of products previously cleared bilaterally and profitably for the CCP members themselves”).

<sup>23</sup> Dodd-Frank Act, § 726, *supra* note 3.

<sup>24</sup> See Kopecki, Dawn, *U.S. Derivatives Bill Bars Dealers From Owning Clearinghouses*, BLOOMBERG (Oct. 16, 2009) available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=agLyUI0aqYuk> (discussing the financial industry’s opposition to limits on the ownership of clearing facilities); Das, Satyajit, *Central Counter Party Tranquilliser Solutions*, NAKEDCAPITALISM.COM (Nov. 3, 2011), available at

conflicts of interest rules: “The financial services industry is arguing for a DCO membership regime that would favor the large dealer banks who currently dominate the over-the-counter derivatives market.”<sup>25</sup> When Dodd-Frank passed, 90 percent of swaps were traded through the world’s 10 largest banks that generated approximately \$60 billion in revenue a year from that trading.<sup>26</sup> As mentioned above, the five largest commercial banks—JPMorgan Chase, Bank of America, CitiGroup, Goldman Sachs, and HSHC—accounted for approximately 95 percent of the total banking industry’s notional amounts and 85 percent of the industry’s net credit exposure in the derivatives market.<sup>27</sup> These large banks—banks that “control the trading of derivatives and all key elements of the infrastructure of derivatives trading”<sup>28</sup>—have opposed reforms that aim to increase access to clearing and, subsequently, reduce the significant profits that large banks generate from bilateral trading.<sup>29</sup>

Today, the banking industry continues to dominate the clearing industry and to limit access to clearing in order to ensure that banks continue to profit from over-the-counter trading. An overwhelming number of clearing members of ICE Clear Europe, over which the CFTC has

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<http://www.nakedcapitalism.com/2011/11/satyajit-das-central-counter-party-tranquilliser-solutions.html> (“Predictably, large highly capitalised banks favour higher capital requirements, ensuring their dominant position.”).

<sup>25</sup> Letter by Senator Sherrod Brown to the CFTC (Nov. 17, 2010), *available at*

[http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26486&SearchText=.](http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26486&SearchText=)

<sup>26</sup> See Morgenson, Gretchen, *It’s Not Over Until It’s in the Rules*, N.Y. TIMES (Aug. 28, 2010), *available at*

[http://www.nytimes.com/2010/08/29/business/29gret.html?pagewanted=1&ref=derivatives.](http://www.nytimes.com/2010/08/29/business/29gret.html?pagewanted=1&ref=derivatives)

<sup>27</sup> Office of the Comptroller of the Currency, *OCC’s Quarterly Report on Bank Trading and Derivatives Activities, Second Quarter 2010* at 1 (2010).

<sup>28</sup> Robert E. Litan, *The Derivatives Dealers’ Club and Derivatives Markets Reform: A Guide for Policy Makers, Citizens and Other Interested Parties*, BROOKINGS, 3 (2010) *available at* [http://www.brookings.edu/~media/Files/rc/papers/2010/0407\\_derivatives\\_litan/0407\\_derivative\\_s\\_litan.pdf](http://www.brookings.edu/~media/Files/rc/papers/2010/0407_derivatives_litan/0407_derivative_s_litan.pdf).

<sup>29</sup> *Id.* See also Greenberger, Michael, Roundtable Tr. at 111, *supra* note 10 (“The transaction fees and the spreads still make an unregulated market very, very profitable, probably more profitable than the profits that would derive from clearing. So, if you have the swaps dealers in control of a clearing facility, they have that incentive.”).

jurisdiction,<sup>30</sup> are banks, bank holding companies, or affiliates thereof.<sup>31</sup> Such members include, but are not limited to: the five large U.S. commercial banks mentioned in the previous paragraph, Barclays Bank, BNP Paribas, Credit Suisse International, and Deutsche Bank.<sup>32</sup> These same large financial entities constitute the vast majority of the clearing members of ICE Trust, which is a U.S. affiliate of ICE Clear Europe.<sup>33</sup> Also, NYSE Euronext, which runs the New York Stock Exchange and New York Portfolio Clearing, is owned by several large banks including Goldman Sachs and Morgan Stanley.<sup>34</sup> Thus, the concentration within the derivatives clearing market remains high and continues to raise “concerns about anti-competitive pricing and conduct.”<sup>35</sup>

Large commercial banks have used their considerable influence as major stakeholders in DCOs<sup>36</sup> to keep smaller but highly credit worthy institutions out of the clearing market.<sup>37</sup> As the CFTC has observed, “enumerated entities have economic incentives to minimize the number of swap contracts subject to mandatory clearing” and have used their influence as DCO members to

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<sup>30</sup> Proposed Rules at 63733, *supra* note 8 (noting that “the Commission regulates certain entities based outside of the United States” including LCH.Clearnet Limited and ICE Clear Europe Limited, which are both based in the United Kingdom).

<sup>31</sup> See Ice Clear Europe, *Clearing Member List* (2011), available at [https://www.theice.com/publicdocs/clear\\_europe/ICE\\_Clear\\_Europe\\_Clearing\\_Member\\_List.pdf](https://www.theice.com/publicdocs/clear_europe/ICE_Clear_Europe_Clearing_Member_List.pdf) (listing the banks and bank holding companies (and their affiliates) as well as other major financial entities that constitute ICE Clear Europe’s members).

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> Spicer, Jonathan, *US Lawmakers Urged to Drop Clearinghouse Ownership Cap*, BLOOMBERG (Nov. 20, 2009) available at <http://blogs.reuters.com/financial-regulatory-forum/2009/11/20/us-lawmakers-urged-to-drop-clearinghouse-owner-cap/>.

<sup>35</sup> Brown, *supra* note 25.

<sup>36</sup> See Proposed Rules at 63734, *supra* note 8 (noting that because DCOs spread their losses across their members—members contribute substantial resources to a DCO default or guarantee fund that is used to cover outstanding losses that result from a member’s default—members exercise significant influence over how a DCO manages risk).

<sup>37</sup> See Kastner, Jason, Roundtable Tr., *supra* note 10 (stating that banks have been “really clever about keeping people out of the system”).

keep “swap contracts out of the mandatory clearing requirement.”<sup>38</sup> Also, Gary deWaal, general counsel at Newedge in New York, has argued that “[s]ome current capital requirements [for DCO membership] are exclusionary.”<sup>39</sup> Specifically, DCOs have imposed capital requirements for clearinghouse membership eligibility that far exceed the requirements needed for conservative risk management. For example, in 2010, the same year that Congress passed Dodd-Frank, ICE Trust required new members to contribute a minimum of \$1 billion of adjusted net capital to the general guaranty fund and required non-futures commercial merchants to have \$5 billion of tangible net worth in order to qualify for DCO membership.<sup>40</sup> Thus, SDs appear to have employed clearinghouse ownership as a tool to stifle competition within the derivatives clearing market and to force swaps users to pay the substantial fees bank charge for bilateral clearing.<sup>41</sup>

### **III. Restricting the Capital Requirement for DCO Members Will Facilitate Greater Access to Clearing and More Diverse Ownership of DCOs**

The CFTC’s final participant eligibility rule establishes requirements for DCO membership that promote swap traders and investors’ access to clearing.<sup>42</sup> The final rule

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<sup>38</sup> Proposed Rules at 63734, *supra* note 8 (commenting that “control of a DCO by the enumerated entities . . . constitutes the primary means for keeping swap contracts out of the mandatory clearing requirement”).

<sup>39</sup> Matt Cameron, *A Clash Over CCP Membership*, RISK MAGAZINE (Feb. 3, 2011), available at <http://www.risk.net/risk-magazine/feature/2015731/clash-ccp-membership>.

<sup>40</sup> Greenberger, Michael, Comment Letter to David Stawick, Secretary, Commodity Futures Trading Commission, *Re: ICE Trust U.S. LLC – Application for Registration as a Derivatives Clearing Organization Pursuant to Section 5b of the Commodity Exchange Act and Part 39 of the Regulations of the Commission 5* (Dec. 17, 2010), available at [http://www.michaelgreenberger.com/files/Greenberger\\_CFTC\\_ICE\\_Trust\\_Application\\_for\\_DC\\_O.pdf](http://www.michaelgreenberger.com/files/Greenberger_CFTC_ICE_Trust_Application_for_DC_O.pdf).

<sup>41</sup> Comments of Thomas Peterffy, Chairman and C.E.O., Interactive Brokers Group, Before The 2010 General Assembly Of The World Federation Of Exchanges 2, Oct. 11, 2010, available at <http://www.interactivebrokers.com/download/worldFederationOfExchanges.pdf> (blaming “short-sighted greed on the part of the brokers” for restricting access to clearing markets).

<sup>42</sup> *Core Principles* at 69436, *supra* note 7.



requires DCOs to adopt objective, publicly disclosed, and risk-based admission and continuing eligibility standards for DCO members.<sup>43</sup> This standards must represent the least restrictive means to achieve the DCO’s objectives.<sup>44</sup> To this end, the final rule prevents DCOs from setting a minimum capital requirement of more than \$50 million (*i.e.*, a \$50 million threshold) for any institution seeking clearing membership.<sup>45</sup> The final rule also requires DCOs to establish “capital requirements that are based on objective, transparent, and commonly accepted standards that appropriately match capital to risk.”<sup>46</sup>

The SEC has proposed similar participant eligibility and risk-management requirements to those found in the CFTC’s final rule.<sup>47</sup> The SEC’s proposed rule would require DCOs to “provide a person that maintains net capital equal to or greater than \$50 million with the ability to obtain membership at the clearing agency.”<sup>48</sup> It would also require DCOs to “establish, implement, maintain and enforce written policies and procedures” for risk management purposes.<sup>49</sup>

**a. Establishing a \$50 Million Threshold For DCO Membership Promises to Ensure Greater Stability and Competition Within the Derivatives Clearing Market**

The \$50 million threshold will allow the smaller financial entities that could not satisfy the excessive membership requirements imposed by large SDs to become DCO members and to

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<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Id.* See also Greenberger, Michael, Comment Letter to David Stawick, Secretary, Commodity Futures Trading Commission, *Re: Financial Resources Requirements for Derivatives Clearing Organizations* (Dec. 13, 2010), available at [http://michaelgreenberger.com/files/Greenberger\\_DCO\\_Financial\\_Resources.pdf](http://michaelgreenberger.com/files/Greenberger_DCO_Financial_Resources.pdf).

<sup>46</sup> *Core Principles* at 69437, *supra* note 7.

<sup>47</sup> *Clearing Agency Standards for Operation and Governance*, 76 Fed. Reg. 14472 (March 16, 2011). [hereafter “SEC Proposed Rule on DCO Operation and Governance”].

<sup>48</sup> *Id.* at 14538.

<sup>49</sup> *Id.*

compete to provide clearing services to individual traders and investors.<sup>50</sup> As CFTC Chairman Gary Gensler observed, the CFTC’s final capital requirement for DCO membership “promotes more inclusiveness . . . [and] improves competition that will benefit end-users of swaps, while protecting DCOs’ ability to manage risk.”<sup>51</sup> Similarly, the Department of Justice has long maintained that “strict” minimum requirements for DCO membership would “limit the possibility of anticompetitive conduct” by SDs in the derivatives clearing market.<sup>52</sup> Also, the Department of Justice has claimed that such strict requirements would create “competitive benefits” for market participants such as lower clearing transactions costs for swaps traders and improved market liquidity by helping to ensure that DCOs cooperate with SEFs and DCMs to facilitate exchange trading.<sup>53</sup>

The financial industry has argued that the increase in DCO membership facilitated by lowered capital requirements will increase risk in the derivatives clearing industry. Large SDs insist that current capital “requirements are set at prudent levels to ensure the safety of the clearing house” and dismiss claims that such requirements are “exclusionary” and not based on sound risk management principles.<sup>54</sup> For example, Christopher Edmonds, president of Ice Trust

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<sup>50</sup> *Core Principles* at 69355, *supra* note 7 (observing that lowered capital requirements will increase the number of firms clearing swaps). See Letter from CME Group to the Secretariat of the Basel Committee on Banking Supervision, *Consultative Document: Strengthening the resilience of the banking sector*, at 11 (April 16, 2010), available at <http://www.bis.org/publ/bcbs165/cmegroup.pdf> (illustrating that DCOs are profitable entities that rarely, if ever, experience default, and so will attract investment by small financial institutions who wish to clear swaps).

<sup>51</sup> Gensler, Gary, *Statement in Support* (Oct. 18, 2011), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/genslerstatement101811b>.

<sup>52</sup> See Department of Justice, Letter to the CFTC, 2 (Dec. 28, 2010).

<sup>53</sup> *Id.* (“Dealers might use their control over a DCO to resist the move to exchange trading by declining to clear contracts that are well-suited to central clearing but that the CFTC has not yet required to be centrally cleared.”).

<sup>54</sup> Cameron, *supra* note 39 (quoting an anonymous US dealer who asserted that “[t]he chatter about requirements being exclusionary and labeling current members a cabal is just rubbish.”)

in New York, asserted that “[c]apital requirements are part of the safety net in a default scenario, together with other factors such as margin and the default fund.”<sup>55</sup> Similarly, Bill Hill of Morgan Stanley insisted that unless you “have clearing members who have enough capital . . . to recapitalize the clearinghouse if a member defaults . . . [and] to keep the clearinghouse flat from an economic risk perspective . . . you actually increase risk in the clearinghouse because at a time when a member is defaulting, the clearinghouse won’t be able to absorb the losses.”<sup>56</sup> Thus, large SDs have consistently implied that they are uniquely qualified, by virtue of their vast financial resources, to insure against risk in the derivatives clearing market.

The systemic failure of the banking industry during the 2008 financial crisis undermines the argument that large SDs are best situated to guarantee stability within the derivatives clearing market. Large SDs proved incapable of stemming the financial crisis and relied on almost \$13 trillion of taxpayer bailouts and guarantees to remain in business.<sup>57</sup> The five major commercial U.S. banks that dominate the derivatives market were some of the first financial institutions to receive funds from the Troubled Asset Relief Program (TARP).<sup>58</sup> The crisis exposed the vulnerabilities of individual SDs—namely their collective inability to diversify risk by means other than relying on taxpayer subsidies<sup>59</sup>—to suggest that restricting DCO membership to large SDs jeopardizes, rather than improves market stability.

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<sup>55</sup> *Id.*

<sup>56</sup> See Hill, Roundtable Tr. at 18-19, *supra* note 10.

<sup>57</sup> PBS, *The True Cost of the Bank Bailout*, Sept. 3, 2010, available at <http://www.pbs.org/wnet/need-to-know/economy/the-true-cost-of-the-bank-bailout/3309/>.

<sup>58</sup> Renner at Summary, *supra* note 13.

<sup>59</sup> *Id.* at 2 (“Before 2007, such firms were generally viewed as too well diversified or too well managed to fail. In 2008, their vulnerability was shown to be greater than previously assumed, and the question of their long-term creditworthiness now depends in part on whether the government would again intervene to ensure that their contracts are honored during a future crisis.”).

In contrast to current market practices, the CFTC’s \$50 million cap for market participants satisfies Congress’s directive that DCOs have “sufficient financial resources” to meet their obligations.”<sup>60</sup> Expanding DCO ownership will decrease the magnitude of any membership default by distributing the costs of default across a greater number of members. It will also decrease “the high degree of market concentration” within the derivatives market as this concentration “still has the potential to result in the nullification of tens of billions of dollars worth of contracts.”<sup>61</sup> As Newedge’s Gary deWaal observed: “Membership needs to be opened up—clearing works when there is a large buffer of intermediaries dispersing the risk. If the risk is spread between too few entities, it is too close to bilateralism. You need to have different groups of clearing members, which lessens the correlation in the clearinghouse.”<sup>62</sup> In this respect, prudent risk management strategies require that DCO members have adequate capital resources and that members are sufficiently numerous so that risk is spread risk across an array of financial organizations.

Further, history demonstrates that broad-based risk management strategies that allow membership to a large number of financially stable institutions foster long-term stability for markets and market participants. For example, CME Group, which operates one of the largest clearinghouses in the world and has over 60 members,<sup>63</sup> has not defaulted on an obligation to a clearing member (or had a clearing member default on an obligation to CME) during its 110-plus year history.<sup>64</sup> The historical stability of diverse clearinghouses supports the CFTC’s conclusion that the \$50 million threshold “will not significantly increase risk or lead to admission of

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<sup>60</sup> Dodd-Frank Act, § 726(c), *supra* note 3.

<sup>61</sup> Renner at Summary, *supra* note 13.

<sup>62</sup> Cameron, *supra* note 39.

<sup>63</sup> See Official Website of CME Group, Clearing Firms, *available at* <http://www.cmegroup.com/tools-information/clearing-firms.html> (last visited on Feb. 1, 2012).

<sup>64</sup> Letter from CME Group at 11, *supra* note 50.

clearing members who are unable to meaningfully and responsibly participate in the clearing process.”<sup>65</sup> In fact, the final threshold for DCO membership will likely reduce risk for clearing members by including a diverse number of institutions that go beyond the “Too Big to Fail” banks that caused the 2008 financial crisis.

Moreover, the CFTC’s final rule on clearinghouse core principles, which includes the CFTC’s final participant eligibility rule, requires DCOs to establish minimum risk management standards to mitigate the risk posed by member default.<sup>66</sup> The CFTC requires DCOs to direct their members to post margin and authorizes DCOs to implement “other risk control mechanisms” that “limit . . . exposure to potential losses from defaults by clearing members.”<sup>67</sup> DCOs must collect margin that is commensurate with the particular risks associated with an individual clearing member’s portfolio or product and to reassess a member’s level of risk on a regular basis.<sup>68</sup> Additionally, a DCO must ensure that clearing members “have access to sufficient financial resources to meet obligations” to the DCO under “extreme but plausible market conditions.”<sup>69</sup> The regular and detailed review of DCO members’ risk exposure required by the CFTC’s final risk management rule further safeguards DCOs from the possibility of customer default even as DCOs experience a significant increase in membership.

Finally, lowering the capital threshold for DCO ownership best ensures that the profits that will result from Dodd-Frank’s mandatory clearing requirement will be distributed across a

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<sup>65</sup> *Core Principles* at 69355, *supra* note 7.

<sup>66</sup> *Id.* (noting that some commentators argued that the proposed capital requirements “should not increase risk to a DCO because a DCO can mitigate risk by, among other things, imposing position limits, stricter margin requirements, or stricter default deposit requirements on lesser capitalized clearing members”).

<sup>67</sup> *Id.* 69438. *See also* Bank of International Settlements, *supra* note 12 (acknowledging that “margins often constitute an important part of the CCP’s protection against default”).

<sup>68</sup> *Id.*

<sup>69</sup> *Id.* 69437.

wide-spectrum of participants within the derivatives clearing market. Dodd-Frank's clearing requirement will radically increase the volume of clearing trades and "result in trillions of dollars in derivatives transactions moving from the OTC dealer market into a clearing environment."<sup>70</sup> The CFTC's \$50 million threshold will prevent SDs from having exclusive access to substantial profits generated by mandatory clearing to increase the capital reserves of market participants as a whole.

**b. Increasing/ Circumventing Minimum Capital Requirements for DCO Membership**

The CFTC clearly intends DCOs to honor the \$50 million threshold for DCO membership; however, the limited exceptions to the \$50 million threshold, as well as the operational requirements included in the final participant eligibility rule, may be viewed as a loophole that will allow DCOs to impose higher capital requirements for clearing members.

As previously mentioned, the final rule authorizes DCOs to exceed the \$50 million threshold in order to "set forth capital requirements . . . that appropriately match capital to risk."<sup>71</sup> It also authorizes DCOs to use participant capital to ensure that clearing members meet the obligations to the DCO.<sup>72</sup> Additionally, the final rule directs DCOs to "require clearing members to have adequate operational capacity" to meet their obligations to the DCO. Such requirements include, but are not limited to the member's ability to: process expected volumes and values of cleared transactions within a specified time frame; fulfill collateral, payment, and delivery obligations to the DCO; and to participate in default management activities.<sup>73</sup>

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<sup>70</sup> Renner at 4, *supra* note 13.

<sup>71</sup> *Core Principles* at 69437, *supra* note 7.

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

The CFTC clearly intended for DCOs to establish member capital requirements that do not exceed the \$50 million threshold. The final rules require that a DCO *not* “enact[] some additional financial requirement that effectively renders the \$50 million threshold meaningless for some potential clearing members.”<sup>74</sup> The CFTC maintains that any such additional financial requirement would violate the final rule’s prerequisite that a DCO “not adopt restrictive clearing member standards if less restrictive requirements that achieve the same objective and that would not materially increase risk to the derivatives clearing organization or clearing members could be adopted.”<sup>75</sup> The final rule’s ban on needlessly restrictive requirements applies to a DCO’s operational capacity and member eligibility requirements.<sup>76</sup> Additionally, as previously noted, the final rule requires DCOs to base member capital requirements “on objective, transparent, and commonly accepted” risk management standards so that DCOs cannot impose arbitrary restrictions on their members.<sup>77</sup>

Despite the fact that the CFTC prohibits DCOs from imposing financial requirements that render the \$50 million threshold meaningless, the limited discretion that the final rules allow DCOs to exercise in relation to capital and operational requirements have been mistakenly and worrisomely read to allow DCOs to circumvent requirements that are designed to increase DCO membership. For example, CFTC Commissioner O’Malia observed in his *dissent* to the final rule: “[t]he final rulemaking recognizes that DCOs may increase capital requirements for legitimate, risk-reducing reasons,” but “provides little insight on how the Commission intends to differentiate between (i) a required risk-based increase in capital requirements and (ii) an

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<sup>74</sup> *Id.* at 69356.

<sup>75</sup> *Id.* at 69436.

<sup>76</sup> *Id.* at 69356.

<sup>77</sup> *Id.* at 69437.

illegitimate attempt to circumvent the \$50 million threshold to squash competition.”<sup>78</sup> Further, he dismissed the CFTC’s requirement that DCOs adopt less restrictive alternatives as too “vague” to provide “legal certainty or bright lines for DCOs and potential clearing members to follow.”<sup>79</sup> Again, these remarks are part of a dissent to passage of the final rule and should not be viewed as conclusively interpretive by the CFTC.

Unfortunately, however, the industry has demonstrated an intent to exploit any ambiguity in the rule. As a senior industry representative recently observed, “the debate is going to centre” on the exceptions to the \$50 million threshold since the “rule essentially gives DCOs . . . the ability to impose extra capital requirements, if they can prove it contributes to prudent risk management.” In this respect, the final rule may provide a loophole for DCOs by allowing them to “*appropriately* match capital to risk.”<sup>80</sup>

The minimal operational capacity requirements established by the final rule may provide DCOs with an additional opportunity to restrict clearing membership.<sup>81</sup> For example, CME has identified operational capacity as an “important hurdle” to DCO membership and insists that “[p]rospective clearing members must be able to provide evidence they have the requisite expertise to perform the duties required of a clearing member”<sup>82</sup> as these duties include having the capability to price and manage large derivatives portfolios. To this end, DCOs like CME

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<sup>78</sup> O’Malia, Scott, Statement of Dissent, Final Rulemaking On Derivatives Clearing Organizations (Oct. 18, 2011), *available at* <http://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement101811b>.

<sup>79</sup> *Id.* (explaining that in 2011 ICE Clear Credit reduced its minimum capital requirement for clearing members to \$100 million, but introduced a requirement that its members hold excess net capital equal to 5 percent of their segregated customer funds; the change prompted two FCMs to complain that ICE’s net capital requirements violated fair and open access requirements, concluding that the CFTC’s “final rulemaking gives very little guidance on the criteria that the Commission will apply in adjudicating a dispute”).

<sup>80</sup> *Core Principles* at 69437, *supra* note 7.

<sup>81</sup> Cameron, *supra* note 39.

<sup>82</sup> *Id.*



have suggested that members should operate an internal trading desk to ensure they provide DCOs with accurate pricing information,<sup>83</sup> a requirement that FCMs like Jefferies and Newedge have argued is totally unnecessary and constitutes “just another artificial barrier to keep the largest independent firms out.”<sup>84</sup>

Because of these contrivances, the kinds of further protections in proposed form by the CFTC are critically important.

#### **IV. Rigorous Governance Standards and Limitations on Ownership Interests For DCOs Will Help to Ensure Free and Open Access to Clearing**

The CFTC, as well as the SEC, has proposed rules to mitigate the conflicts of interest that Congress determined threaten to exclude swaps from Dodd-Frank’s mandatory clearing requirement.<sup>85</sup> Like the CFTC’s final rule on participant eligibility, the CFTC’s proposed conflicts of interest standards for DCOs, SEFs, and DCMs (“designated entities”) promote access to clearing and exchange trading by curbing SDs’ ability to restrict the membership of a designated entity.<sup>86</sup> The shared aims of the CFTC’s final rule on participant eligibility and the CFTC’s proposed conflicts of interest rule risk creating overlapping and perhaps even redundant regulation. Despite this fact, the CFTC should finalize rigorous governance standards for DCOs that eliminate conflicts of interests in derivatives clearing in order to safeguard the protections promised by the CFTC’s final \$50 million cap on capital requirements for DCO membership.<sup>87</sup>

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<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> See Proposed Rules at 63733, *supra* note 8. See also *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 (Oct. 26, 2010).

<sup>86</sup> See Proposed Rules at 63733, *supra* note 8.

<sup>87</sup> See Bank of International Settlements at 57, *supra* note 12 (discussing the fact that “in determining whether or not to have trades cleared . . . market participants may consider only the private benefits they obtain from doing so . . . [t]hey may not consider the positive effects central

Although this section focuses on the CFTC’s proposed governance rules for DCOs, the issues discussed below also pertain to the CFTC’s proposed rules on the governance of SEFs and DCMs and to the SEC’s proposed governance rules for designated entities. Many of the elements that make up the CFTC’s proposed governance standards for DCOs also make up the CFTC’s proposed governance rules for these trading entities in general. For example, the CFTC’s proposed rules require DCOs, SEFs, and DCMs all to establish risk management committees<sup>88</sup> and to have the same percentage of public directors (35 percent) on their Boards of Directors.<sup>89</sup> Similarly, many of same elements appear in both the CFTC and the SEC’s proposed conflicts rules (e.g. proposing the same individual and aggregate limits on the ownership of voting equity).<sup>90</sup> Consequently, despite its narrow focus, the following analysis raises many issues that are relevant to the conflicts of interest that threaten the clearing of both exchange-traded swaps and exchange-traded security-base swaps.

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clearing may have for third parties or the economy at large”); Jones, Huw, *Clearing house ownership not a risk issue – report*, REUTERS (Nov. 10, 2010 ) available at <http://www.forexpros.com/news/central-banks/clearing-house-ownership-not-a-risk-issue---report-173337> (“Clearing houses will play a key role in determining which derivatives and other products can be cleared and regulators say stakeholders like banks may be tempted to pursue their own financial interests to the detriment of risk management.”); Leising, Matthew, *Derivatives Clearinghouse-Ownership Limits Are Dropped From U.S. Bank Bill* (June 25 2010) available at <http://www.bloomberg.com/news/2010-06-25/derivatives-clearinghouse-ownership-limits-are-dropped-from-u-s-bank-bill.html> (“The limit was meant to reduce bank conflicts of interest over their control of clearinghouses and how they could block over-the-counter derivatives from being processed because they benefit from keeping the trades private.”).

<sup>88</sup> See Proposed Rules at 63733, *supra* note 8.

<sup>89</sup> *Id.* at 63738.

<sup>90</sup> See Securities and Exchange Commission, *Press Release: SEC Proposes Rules to Mitigate Conflicts of Interest Involving Security-Based Swaps* (Oct. 13, 2010), available at <http://www.sec.gov/news/press/2010/2010-190.htm>.

**a) The CFTC’s Proposed Governance Standards Aim to Ensure Fair and Open Access to Clearing**

The CFTC’s proposed conflicts of interest rule aims to “improve DCO governance”<sup>91</sup> by increasing the number of public directors—directors who have no material relationship with a clearinghouse or its members<sup>92</sup>—who compromise a DCO’s Board of Directors as well as its governing committees.<sup>93</sup> To this end, the proposed rule requires that a DCO’s Board of Directors comprise of no fewer than two public directors, at least 35 percent of public directors, and at least 10 percent of DCO customers or customer representatives.<sup>94</sup> The proposed rule also requires DCOs to establish nominating committees that must comprise of at least 51 percent of public directors<sup>95</sup> and at least one disciplinary panel that comprises of at least one public director who must also chair the committee.<sup>96</sup> Additionally, the CFTC’s proposed governance standards require a DCO to create a risk management committee that comprises at least 35 percent of public directors<sup>97</sup> and 10 percent of the DCO’s customers or customer representatives.<sup>98</sup>

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<sup>91</sup> See Proposed Rules at 63733, *supra* note 8.

<sup>92</sup> *Id.* at 63747 (proposing a bright-line definition of “public director” that expressly excludes the following persons: a DCO officer or employee; a director, officer, or employee of a DCO member; an officer of an entity that has a compensation committee (or equivalent body) upon which an officer from the DCO serves; a partner, officer, or employee of an entity that receives over \$100,000 in combined annual payments for legal, accounting, or consulting services from the DCO; or a committee director who accepts a contingent, conditioned, or revocable consulting, advisory, or other compensatory fee (other than deferred compensation) from the DCO, its affiliates, members, or affiliates of members. This proposed definition also excludes immediate family members of the aforementioned persons from qualifying as public directors.)

<sup>93</sup> *Id.* at 63751.

<sup>94</sup> *Id.* at 63738.

<sup>95</sup> *Id.* at 63752.

<sup>96</sup> *Id.*

<sup>97</sup> *Id.* at 63740.

<sup>98</sup> Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest, 76 Fed. Reg. 722, 736 (Jan. 6, 2011).

The CFTC's proposed conflicts of interests rule also includes limits on the ownership of voting equity that are designed to enhance the proposed governance rules by limiting the influence that larger shareholders may exert over a DCO's Board and its committees.<sup>99</sup> The proposed rule establishes two alternative limits on the ownership of voting equity and the exercise of voting power within a DCO. Under the first alternative, an individual member may not own or vote (directly or indirectly) an interest that exceeds more than 20 percent of any class of voting equity in the DCO.<sup>100</sup> In addition, enumerated entities,<sup>101</sup> regardless of whether they are DCO members, may not collectively own or vote (directly or indirectly) an interest that exceeds more than 40 percent of any class of voting equity in a DCO.<sup>102</sup> Under the second alternative, no DCO member or enumerated entity, regardless of whether the enumerated entity is a DCO member, may own or vote (directly or indirectly) an interest that exceeds 5 percent of the voting power of any class of voting equity in a DCO.<sup>103</sup>

**b) The CFTC Should Adopt Rigorous Governance Standards That Safeguard the Protections Offered by the CFTC's Final Rule on Participant Eligibility**

The CFTC's proposed conflicts of interest rule promises to curb SDs' ability to manipulate DCOs' policies and procedures and, subsequently, to restrict access to clearing. However, the CFTC's final conflicts of interests rule must expand the protections offered in the proposed rule standards if the rule is to safeguard fair and open access to clearing for swap traders.

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<sup>99</sup> Proposed Rules at 63738, *supra* note 8 (noting the importance of independent decision-makers for designated entities).

<sup>100</sup> *Id.* at 63750.

<sup>101</sup> *Id.* (defining "enumerated entities" as: 1) bank holding companies with over \$50 billion in total consolidated assets, 2) nonbank financial companies supervised by the Board of Governors of the Federal Reserve System, 3) an affiliate of 1) or 2), 4) a swap dealer, 5) a major swap participant, or 6) an associated person of 4) or 5).

<sup>102</sup> *Id.* at 63750-51.

<sup>103</sup> *Id.* at 63751.

**a. The CFTC Must Increase the Proposed Minimum Percentages for Public Directors to Ensure DCOs Remain Independent Of the Competitive and Commercial Concerns of DCO Members**

The CFTC’s final governance standards should increase the required percentage of public directors for a DCO’s Board of Directors from 35 to 50 percent and mandate that at least 35 percent of a DCO’s disciplinary panel comprise of public directors. Increasing the minimum percentage of public directors who serve on a DCO’s Board from 35 to 50 percent is consistent with the CFTC’s original proposed standard for the Boards of DCMs.<sup>104</sup> In its original proposal for DCMs, the CFTC argued that “the fifty percent minimum standard strikes a favorable balance between inside expertise and ‘outside’ impartiality” and ensures that all exchange stakeholders . . . enjoy adequate representation on the Board.<sup>105</sup> The CFTC also argued that requiring Boards to comprise of at least 50 percent “public” directors would align DCM governance with corporate practices.<sup>106</sup> These arguments are no less applicable to DCOs, which have “unprecedented influence over the manner in which a swap contract can be executed.”<sup>107</sup> Additionally, requiring DCO disciplinary panels to comprise of at least 35 percent of public directors is consistent with the standards proposed for risk management committees and would ensure the “independent perspective” of DCO disciplinary committees far more effectively than the single-public-director standard established in the proposed rules.<sup>108</sup>

Contrary to arguments made by the financial industry, increasing the number of public directors on DCO Boards and governing committees would not destabilize DCO governance. Goldman Sachs and Deutsche Bank have argued that persons who are not associated with the

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<sup>104</sup> See *Conflict of Interest in Self-Regulation and Self-Regulatory Organizations*, 71 Fed. Reg. 38740 (July 7, 2006).

<sup>105</sup> *Id.* at 38746.

<sup>106</sup> *Id.*

<sup>107</sup> Proposed Rules at 63734, *supra* note 8.

<sup>108</sup> *Id.* at 63737.

large financial institutions lack the “critical swap-market expertise” necessary to effectively manage a DCO.<sup>109</sup> DCO directors must have sufficient expertise in financial services, risk management, and clearing services; however, this expertise is not exclusive to persons who work for large SDs. The witness lists for hearings related to the Dodd-Frank Act, the Financial Crisis Inquiry Commission, and the many roundtables sponsored by the CFTC Dodd-Frank-related hearings reveal a vast number of academics, former regulators, and other former and current market participants who are qualified to serve as public directors on DCO Boards and committees.<sup>110</sup>

**b. The CFTC Must Impose Aggregate Limits on the Economic Interests Enumerated Entities May Hold in a DCO**

If finalized, the proposed 20 percent individual and 40 percent aggregate limitations on the ownership of DCO voting equity promises to reduce SDs’ influence over DCO decision-making. However, the final rule must apply the proposed limits on voting equity to the *economic interest* that enumerated entities may hold in a DCO if the final rule is to safeguard access to clearing.

The proposed 40 percent aggregate limitation on the ownership of DCO voting equity by enumerated entities will prevent SDs from holding a majority stake in a DCO’s voting interest and using that stake to restrict access to DCO clearing facilities. As the Justice Department observed in its comments on the proposed rule, the lack of “an aggregate ownership cap on major derivatives dealers” will “preserv[e] the opportunity for these powerful entities to achieve majority ownership” of clearinghouses and exchange facilities and “not sufficiently protect and

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<sup>109</sup> Renner at 8, *supra* note 13.

<sup>110</sup> *Id.*

promote the competition in the industry.”<sup>111</sup>

In contrast, the alternative 5 percent limit on voting equity ownership without an aggregate limit would do little to limit large banks’ overall influence over DCO decision-making if the CFTC’s \$50 million cap on capital requirements for DCO membership fails to diversify DCO ownership. The 5 percent limit on the ownership of voting equity would allow “a mere 11 dealers to dominate the clearinghouse, control a majority of its members, and dictate decisions of the organization” without having to own a significant stake in a DCO’s voting equity.<sup>112</sup> For example, ICE Trust LLC—a major over-the-counter CDS clearinghouse that has been criticized for preventing competitors from becoming DCO members—is controlled by a number of major banks including Goldman Sachs, Citigroup Inc., JPMorgan, Credit Suisse Group AG, and Bank of America Corp.<sup>113</sup> None of these large banks appear to own more than a 5 percent interest in ICE Trust; consequently, they could band together to use their combined 55 percent ownership stake to dictate ICE Trust’s policies and procedures.

Further, the final rule must apply the 20 percent individual and 40 percent aggregate limitations to the economic interests that enumerated entities may hold in a DCO. Although the financial industry has argued that “a shareholder would have direct influence over a DCO . . . only if the shareholder has the ability to exercise voting rights,” economic stakeholders can

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<sup>111</sup> See Department of Justice, Letter to the CFTC, 2 (Dec. 28, 2010).

<sup>112</sup> Lynch, Stephen, Letter to the CFTC (Oct. 18, 2010), *available at* <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26291&SearchText>.

<sup>113</sup> Greenberger, Michael, Comment Letter to David Stawick, Secretary, Commodity Futures Trading Commission, *Re: Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest 3* (Nov. 17, 2010), *available at* [http://michaelgreenberger.com/files/Greenberger\\_OwnershipCap\\_CommentLetter.pdf](http://michaelgreenberger.com/files/Greenberger_OwnershipCap_CommentLetter.pdf) [hereinafter “*Re: Requirements for Derivatives Clearing Organizations*”].

assert indirect influence over DCOs.<sup>114</sup> As Heather Slavkin of the AFL-CIO observed during the Roundtable on Governance and Conflict of Interest in the Clearing and Listing of Swaps, “I think most of us can imagine a situation where someone owns 5 percent of our company and asks us to do something. I don’t think it matters if that person gets to vote for the board of directors . . . that person has real influence regardless of whether it’s formal influence.”<sup>115</sup> Additionally, if the CFTC does not limit enumerated entities’ economic interest in DCOs, DCOs will likely create special entities that have no equity voting interests—*i.e.* limited partnerships—but exert influence over a DCO’s decision-making processes.<sup>116</sup> Thus, in order to reduce SDs’ influence over DCOs, the final rule must limit the amount of economic interest as well as voting equity that enumerated entities may hold.

## V. Conclusion

The CFTC’s final rule on participant eligibility and its proposed rule on conflicts of interests for DCOs promise to ensure fair and open access to clearing services. The \$50 million threshold established by the CFTC for DCO membership will increase the number of persons who qualify for DCO membership and so reduce concentration in the derivatives clearing market. The diversification of DCO ownership facilitated by the final rule will, in turn, improve competition for clearing services and increase stability within the derivatives markets by ensuring that risk is distributed across a broad and diverse base of financial entities. The CFTC should also adopt rigorous conflicts of interest rules—rules that include an aggregate limit on the amount of economic interest that an enumerated entity may hold in a DCO—in order to

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<sup>114</sup> Proposed Rules at 63742, *supra* note 8 (noting disagreement among commentators regarding whether “a shareholder would have direct influence over a DCO, DCM, or SEF Board of Directors only if the shareholder has the ability to exercise voting rights with respect to, *e.g.*, election, compensation, or removal of directors”).

<sup>115</sup> See Slavkin, Heather, Roundtable Tr. at 153, *supra* note 10.

<sup>116</sup> See *Re: Requirements for Derivatives Clearing Organizations* at 5, *supra* note 133.



safeguard open access to clearing facilities and reinforce the \$50 million threshold  
encouragement of diversification of DCO membership.