

August 5, 2012

**Via Electronic Submission:** <http://www.esma.europa.eu/consultation/59059/response>

European Securities and Markets Authority  
103 Rue de Grenelle  
75007 Paris France

Re: ESMA Consultation Paper on Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories

Dear Sir or Madam:

Citadel LLC<sup>1</sup> (“Citadel”) appreciates this opportunity to provide comments to the European Securities and Markets Authority (“ESMA”) in response to its Consultation Paper on “Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories” (the “Consultation Paper”).<sup>2</sup>

Citadel believes firmly that in order to realize the EMIR objectives of reducing systemic risk, improving transparency, promoting open access, and supporting competition in the OTC derivatives markets, it is critical that the regulatory technical standards (“RTS”) include a requirement for straight-through-processing (“STP”) that mandates that transactions in cleared OTC derivatives are accepted or rejected for clearing immediately following execution.

This STP standard should apply to all cleared OTC derivatives transactions, whether executed on or away from a trading platform, and regardless of whether the transaction is subject to the clearing obligation or cleared voluntarily. In addition, the STP standard must require that CCPs, clearing members, and swap dealers all have systems in place to support and provide STP, since each have a role in ensuring that transactions are accepted for clearing in real-time.

The alternative – allowing hours or days to elapse between the time that a trade is executed, submitted, and then accepted or rejected for clearing – undermines the objectives of EMIR and harms buy-side market participants.

### **Rationale for Including an STP Standard in the Final RTS**

Including an STP standard in the final RTS will reduce systemic risk and foster an open, level, competitive playing field in the OTC derivatives market for *all* market participants. An STP standard will (i) ensure that the optimal market structure evolves, (ii) improve the depth and liquidity of the OTC derivatives market, (iii) lead to efficient markets, and (iv) promote

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<sup>1</sup> Established in 1990, Citadel is a leading global financial institution that provides asset management and capital markets services. With over 1,100 employees globally, Citadel serves a diversified client base through its offices in the world’s major financial centers including Chicago, New York, London, Hong Kong, San Francisco and Boston.

<sup>2</sup> Available at: <http://www.esma.europa.eu/system/files/2012-379.pdf>.

competitive trading platforms. An STP standard is particularly important to buy-side participants because it ensures clients have the freedom to transact with the counterparty of their own choosing, safeguarding access to best execution. The benefits of STP are significant, as STP:

- Reduces systemic risk and interconnectedness – both core goals of EMIR – by eliminating any window of counterparty credit risk between execution and clearing. Any time period between the point of execution and the point of clearing acceptance creates bilateral counterparty exposure, uncertainty, and competitive distortions.
- Provides immediate certainty to counterparties that they will face the CCP, thus eliminating risk of bilateral counterparty credit risk exposure and the need to individually negotiate bilateral credit arrangements or execution agreements with each counterparty.<sup>3</sup>
- Encourages the development of trading platforms for OTC derivatives and eliminates critical operational and legal barriers to the evolution of central limit order book trading.
- Promotes competition in the provision of clearing services by decoupling execution and clearing and ensuring that clearing members compete on a standalone basis based on the robustness, quality, and pricing of their clearing services.
- Increases market depth and liquidity by removing barriers to entry for alternative liquidity providers and enabling smaller swap dealers to compete on more equal terms with the current limited universe of large swap dealers.
- Facilitates new entrants to the market on the buy-side as well as the sell-side.
- Allows the emergence of an all-to-all-market.
- Narrows bid-ask spreads through increased competition, the entry of alternative liquidity providers, the development of an all-to-all market, and the emergence of electronic and/or anonymous execution.
- Improves access to best execution by ensuring the ability of clients to transact freely with any execution counterparty in the market coupled with narrower bid-ask spreads.

The experience of other established cleared derivatives markets shows that the forms of robust trading transparency, such as limit order books, that are a key objective of EMIR, will evolve naturally once an efficient clearing foundation that includes STP is built.

If, however, ESMA does not now, at this foundational stage, require STP, buy-side participants will be forced to enter into arrangements, such as trilateral execution agreements or other credit intermediation structures underneath clearing, that not only represent a waste of resource and effort, but will become difficult to remove. These structures would represent a

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<sup>3</sup> We see the lack of a need for such documentation as one of the most significant systemic benefits of clearing, as it allows participants to transact with any competitive, eligible counterparty without the need for extensive execution documentation or credit or guarantee arrangements, thus eliminating barriers to entry for new eligible participants in the market.

significant barrier to buy-side access to clearing, fragment buy-side liquidity, and force buy-side participants to trade with only the largest incumbent swap dealers. This would inhibit competition and block access to competitive pricing. Such arrangements, which mirror today's bilateral ISDA agreements, would fundamentally undermine the natural evolution of anonymous limit order book trading, or any form of trading that provides competitive pre-execution transparency, as they lock in the requirement that the buy-side trade only on a non-anonymous, disclosed basis with the largest swaps dealers. For these reasons, STP will not be able to evolve absent an explicit legal requirement in the final RTS from ESMA.

### **CFTC Final Rule and Industry Preparedness**

We note that Commodity Futures Trading Commission's final rules on *Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management*<sup>4</sup> will require STP for OTC derivatives clearing by October 1, 2012, and will bar arrangements, like trilateral execution agreements, that would interpose credit intermediation underneath clearing. As a result, significant preparations have been made in the industry which we submit should be leveraged to benefit European OTC derivatives market participants. Further, major CCPs and clearing members already have systems in place in other cleared derivatives market, including the futures, listed equity options, and energy swaps market, that provide and support STP, which they are similarly adapting to support STP for OTC derivatives clearing.

### **Legal Justification and Proposed Language for an STP Standard**

Citadel endorses the letter from the Managed Funds Association to ESMA regarding STP,<sup>5</sup> including its analysis of the benefits of STP, legal justification for including STP in the final RTS, and proposed language for such an RTS for STP. STP is the norm in other established cleared derivatives markets. We strongly urge ESMA to require that this be the sound footing on which clearing of OTC derivatives is built.

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We appreciate the opportunity to provide comments in response to the Consultation Paper. Please call the undersigned at +1-312-395-3100 with any questions regarding these comments.

Respectfully,

/s/ Adam C. Cooper  
Senior Managing Director and Chief Legal Officer

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<sup>4</sup> 77 Fed. Reg. 21278 (Apr. 9, 2012) available at <http://www.cftc.gov/LawRegulation/DoddFrankAct/Dodd-FrankFinalRules/ssLINK/2012-7477a>

<sup>5</sup> "MFA Supplementary Letter to the MFA Comment Letter in Response to ESMA Consultation Paper on Draft Technical Standards for the Regulation on OTC Derivatives, CCPs and Trade Repositories regarding Straight-Through-Processing" dated August 5, 2012