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Diversifying Clearinghouse Ownership In Order To Safeguard Free And Open Access To The Derivatives Clearing Market

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SYMPOSIUM

THE REGULATION OF OVER-THE-COUNTER DERIVATIVES

DIVERSIFYING CLEARINGHOUSE OWNERSHIP IN ORDER TO SAFEGUARD FREE AND OPEN ACCESS TO THE DERIVATIVES CLEARING MARKET

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INTRODUCTION

Implementing the rigorous governance and ownership standards established in the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] ("Dodd-Frank Act") for derivatives clearing organizations ("DCOs") will promote free and open access to clearing, and reduce systemic risk within what is now the $700 trillion worldwide notional value derivatives market.[2] These statutory 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 previously 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 the world's large swap dealers' ("SDs") continued control over these markets to the disadvantage of swaps users and smaller dealers wishing to compete on a level playing field.

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, efficiency, and competitiveness. To this end, the article focuses on clearing—as opposed to the related designated contract markets ("DCMs") or swaps execution facilities ("SEFs")—as clearing lies at the

1. Dodd-Frank Act Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

2. Katy Burne, *Complex Financial Bets Rise Ahead of Overhaul*, WALL ST. J., Nov. 16, 2011, at C4, *available at* http://online.wsj.com/article/SB10001424052970204190504577040372556074142.html.

heart of these Dodd-Frank market reforms.[3] Also, although the article discusses the Securities and Exchange Commission's ("SEC") proposed rules on DCO governance and ownership in passing, it focuses on the Commodity Futures Trading Commission's ("CFTC") rulemaking for DCOs since the CFTC has jurisdiction over 88% of the swaps market.[4]

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 has allowed SDs to stifle competition for clearing services and to charge unnecessarily high transaction fees to users of swaps. Second, it explains how pre-Dodd-Frank market forces have limited access to clearing services. Third, it demonstrates that the CFTC's final rule on participant eligibility[5]—particularly the $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 suggests 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.[6]

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3. *See* Letter from Sen. Christopher Dodd, Chairman, Senate Comm. on Banking, Hous., and Urban Affairs, and Sen. Blanche Lincoln, Chairman, Senate Comm. on Agric., Nutrition and Forestry, to Rep. Barney Frank, Chairman, Fin. Servs. Comm., and Rep. Colin Peterson, Chairman, Comm. on Agric. (June 30, 2010), *available at* http://www.federalreserve.gov/SECRS/2011/August/20110826/R-1415/R-1415_082411_87659_389488835477_1.pdf ("Congress determined that clearing is at the heart of reform bringing transactions and counterparties into a robust, conservative and transparent risk management framework.").

4. Correspondence by Chris Young, Dir. of U.S. Public Policy, Int'l Swaps and Derivatives Ass'n (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 close to 85% of the market) (on file with author).

5. *See* Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69,334 (Nov. 8, 2011) [hereinafter Core Principles].

6. *See* Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 Fed. Reg. 63,732 (proposed 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[7] for standardized swaps necessitates that swaps users have "fair and open access"[8] to DCOs as well as to SEFs and DCMs. SEFs and DCMs enable price discovery by posting the price and volume of exchange-traded swap transactions.[9] 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 publicly available data.[10] DCOs manage (and mitigate) systemic risk by guaranteeing the credit worthiness of swap counterparties, and requiring counterparties to set aside adequate collateral—i.e., margin—to prevent default.[11] In this respect, DCOs eliminate the interconnectedness

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7. *See* Dodd-Frank Act, Pub. L. No. 111-203, § 723, 124 Stat. 1376, 1675–76 (2010) ("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.* § 763, 124 Stat. at 1762 (establishing parallel requirements for security-based swaps); S. REP. NO. 111-176, at 32–35 (2010), *available at* http://www.gpo.gov/fdsys/pkg/CRPT-111srpt176/pdf/CRPT-111srpt176.pdf (noting that draft provisions concerning OTC derivatives were designed to minimize non-cleared, off-exchange trades).

8. Dodd-Frank Act § 725(c), 124 Stat. at 1688. *See id.* § 723(a), 124 Stat. at 1676 ("The rules of a derivatives clearing organization . . . shall . . . provide for non-discriminatory clearing of a swap . . . ."); CFTC & SEC, PUBLIC ROUNDTABLE ON GOVERNANCE AND CONFLICTS OF INTEREST IN THE CLEARING AND LISTING OF SWAPS 33 (Aug. 20, 2010) [hereinafter ROUNDTABLE TRANSCRIPT], *available at* http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission9_082010.pdf ("[T]he law is clear: Open access is the fundamental principle.") (statement of Randy Kroszner).

9. *See* Proposed Rules, 75 Fed. Reg. at 63,736.

10. *See* S. REP. NO. 111-176, at 29–35 (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"); *see also* BANK FOR INT'L SETTLEMENTS, COMM. 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.pdf.

11. *See* RENA S. MILLER, CONG. RESEARCH SERV., R41715, CONFLICTS OF INTEREST IN DERIVATIVES CLEARING 1 (2011) ("Clearing is an institutional arrangement that helps protect against counterparty default. A DCO, or clearinghouse, clears and settles derivatives contracts between counterparties."); BANK FOR INT'L SETTLEMENTS, *supra* note 10, at 57 ("Central clearing generally reduces systemic risk and therefore

between financial institutions that contributed to the 2008 financial crisis that was precipitated by cascading counterparty risk emanating from the bankruptcy or need to rescue the likes of Bear Stearns, Lehman Brothers, and AIG.[12]

Given the importance of clearing to Dodd-Frank-mandated market reforms,[13] Congress directed financial regulators to establish rigorous regulations that would ensure well-capitalized market participants' eligibility for clearing membership,[14] thereby reducing market concentration, and "mitigat[ing] conflicts of interest" in the operation of DCOs.[15] Congress was acutely aware of the over-concentration and conflicts of interest—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.[16] To eliminate this problem, Congress provided regulators with broad authority to adopt less restrictive participant membership criteria for DCOs[17] and "*strong* conflict of interest rules on control . . . of clearing and trading facilities."[18]

Dodd-Frank includes specific provisions that prohibit DCOs from imposing arbitrary and excessive capital requirements on clearing members and that help ensure that DCO policies and procedures are not

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carries social benefits. Principally, it reallocates credit risks to an entity . . . whose dedicated role it is to manage those risks in a robust and transparent manner.").

12. *See* Proposed Rules, 75 Fed. Reg. at 63,736.

13. *See* Letter from Senators Christopher Dodd and Blanche Lincoln, *supra* note 3.

14. Dodd-Frank Act, Pub. L. No. 111-203, § 725(c), 124 Stat. 1376, 1687 (2010).

15. *Id.* § 726(b), 124 Stat. at 1695. *S*ee *id.* § 726(c) ("[T]he Commodity Futures Trading Commission shall "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 . . . ."); 156 CONG. REC. H5217 (daily ed. June 30, 2010), *available at* http://www.gpo.gov/fdsys/pkg/CREC-2010-06-30/pdf/CREC-2010-06-30.pdf (recording a colloquy between Representative Stephen Lynch and Representative Barney Frank in which both Congressmen agreed that sections 726 and 765 require the CFTC and the SEC "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").

16. 156 CONG. REC. H5217 (daily ed. June 30, 2010).

17. *See* Dodd-Frank Act § 725(c), 124 Stat. at 1687.

18. 156 CONG REC. H5217 (daily ed. June 30, 2010) (statement of Rep. Lynch) (emphasis added).

unduly influenced by the interests of large 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 services.[19] Additionally, section 726 of the statute directs the CFTC to establish governance standards and limits on the ownership of voting equity that would mitigate the "conflicts of interest" that encourage large SDs/banks to clear trades bilaterally rather than—as Dodd-Frank mandates—through clearinghouses.[20] Section 726 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 membership.[21]

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 reasonable ownership limitations and governance standards for DCOs.[22] As Senator Sherrod Brown observed in his comments on the CFTC's proposed conflicts of interest rules, "[t]he financial services industry is arguing for a DCO membership regime that would favor the large dealer

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19. Dodd-Frank Act § 725(c), 124 Stat. at 1688.

20. *Id.* § 726(c), 124 Stat. at 1695; *see also* BANK FOR INT'L SETTLEMENTS, *supra* note 10, at 67 ("[T]he incentives of users to resist the expansion of central clearing . . . might lead to migration towards the CCP of products previously cleared bilaterally and profitably for the CCP members themselves."); DerivAlert, *Q&A With Hal Scott of Harvard Law: Clearinghouse Ownership and Risk*, TRADEWEB (Oct. 20, 2010), http://www.tradeweb.com/Blog/Q-A-With-Hal-Scott-of-Harvard-Law--Clearinghouse-Ownership-and-Risk/.

21. *See* Dodd-Frank Act § 726, 124 Stat. at 1695.

22. *See* Satyajit Das, *Central Counter Party Tranquilliser Solutions*, NAKED CAPITALISM (Nov. 3, 2011), 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."); Dawn Kopecki, *U.S. Derivatives Bill Bars Dealers From Owning Clearinghouses*, BLOOMBERG (Oct. 16, 2009), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=agLyUl0aqYuk (discussing the financial industry's opposition to limits on the ownership of clearing facilities).

banks who currently dominate the OTC derivatives market."[23] When Dodd-Frank passed, 90% of swaps were traded through the world's ten largest banks; swaps trading generated approximately $60 billion in revenue a year for these banks.[24] As mentioned above, the five largest commercial banks—JPMorgan Chase, Bank of America, Citigroup, Goldman Sachs, and HSBC—accounted for approximately 96% of the total banking industry's notional amounts and 85% of the industry's net credit exposure in the derivatives market.[25] These large banks—banks that "control the trading of derivatives and all key elements of the infrastructure of derivatives trading"[26]—have resisted reforms that aim to increase access to clearing and, subsequently, reduce the significant profits that large banks generate from bilateral trading.[27]

Because Dodd-Frank's clearing mandates will not apply to any swap executed before the statute's regulations are implemented well into 2013, the big SDs continue to dominate swaps clearing and to limit access to clearing in order to ensure that banks can still extract extraordinary profits from OTC trading. For example, an overwhelming number of clearing members of ICE Clear Europe are large banks, large bank holding companies, or affiliates thereof.[28] Such members include,

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23. Comment Letter from Sen. Sherrod Brown to David A. Stawick, Sec'y, Commodity Futures Trading Comm'n, and Elizabeth M. Murphy, Sec'y, Sec. Exch. Comm'n (Nov. 17, 2010), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26486&SearchText=.

24. *See* Gretchen Morgenson, *It's Not Over Until It's in the Rules*, N.Y. TIMES, Aug. 29, 2010, at BU1, *available at* http://www.nytimes.com/2010/08/29/business/29gret.html?pagewanted=1&ref=derivatives.

25. *See* OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC'S QUARTERLY REPORT ON BANK TRADING AND DERIVATIVES ACTIVITIES: SECOND QUARTER 2010 (2010).

26. ROBERT E. LITAN, BROOKINGS INSTITUTION, THE DERIVATIVES DEALERS' CLUB AND DERIVATIVES MARKETS REFORM: A GUIDE FOR POLICY MAKERS, CITIZENS AND OTHER INTERESTED PARTIES 3 (2010), *available at* http://www.brookings.edu/~/media/Files/rc/papers/2010/0407_derivatives_litan/0407_derivatives_litan.pdf.

27. *See id.*; *see also* ROUNDTABLE TRANSCRIPT, *supra* note 8, at 111 ("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.").

28. *See ICE Clear Europe Clearing Members,* ICE (Dec. 13, 2012), *available at* https://www.theice.com/publicdocs/clear_europe/ICE_Clear_Europe_Clearing_Membe

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.[29] 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.[30] Also, NYSE Euronext, which runs the New York Stock Exchange and New York Portfolio Clearing, is partnered with several large banks including Goldman Sachs and Morgan Stanley.[31] Thus, the concentration within the derivatives clearing market remains high, and continues to raise "concerns about anti-competitive pricing and conduct."[32]

Large banks have used their considerable influence as major stakeholders in DCOs[33] to keep smaller but highly credit-worthy institutions out of the clearing market.[34] 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 keep "swap contracts out of the mandatory clearing requirement."[35] Also, Gary deWaal, general counsel at Newedge in New York, has argued that "[s]ome current capital

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r_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).

29. *See id.*

30. Proposed Rules, 75 Fed. Reg. 63,732, 63,735 (proposed Oct. 18, 2010).

31. *See* Jonathan Spicer, *US Lawmakers Urged to Drop Clearinghouse Ownership Cap*, REUTERS (Nov. 20, 2009, 2:08 PM), http://www.reuters.com/article/2009/11/20/us-financial-clearing-limit-idUSTRE5AJ3ZM20091120.

32. Letter from Sen. Sherrod Brown, *supra* note 23; *see* Suzanne Miller, *Derivatives Risks Still Loom Large*, THE DEAL MAGAZINE (Dec. 9, 2011, 12:00 PM), http://www.thedeal.com/magazine/ID/043305/features/derivatives-risks-still-loom-large.php (reporting that "large clearing groups pose significant concentration risks in the leading Western markets" and that "[c]oncentration risks loom as exchanges and clearinghouses continue to consolidate").

33. *See* Proposed Rules, 75 Fed. Reg. at 63,734 (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).

34. *See* ROUNDTABLE TRANSCRIPT, *supra* note 8, at 26 (stating that banks have been "really clever about keeping people out of the system").

35. Proposed Rules, 75 Fed. Reg. at 63,734.

requirements [for DCO membership] are exclusionary."[36] 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.[37] Thus, SDs appear to have employed clearinghouse ownership as a tool to stifle competition within the derivatives clearing market and, subsequently, to force swaps users to pay the substantial fees banks charge for bilateral clearing, and to use execution facilities controlled by these same SDs.[38]

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.[39] The final rule requires DCOs to adopt objective, publicly disclosed, and risk-based admission and continuing eligibility standards for DCO membership.[40] These standards must also

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

37. Comment Letter from Michael Greenberger, Professor, Univ. of Md. Sch. of Law, to David A. Stawick, Sec'y, Commodity Futures Trading Comm'n, 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_DCO.pdf.

38. Thomas Peterffy, Chairman and CEO, Interactive Brokers Grp., Comments Before the 2010 General Assembly of the World Federation of Exchanges, at 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).

39. Core Principles, 76 Fed. Reg. 69,334, 69,436 (Nov. 8, 2011).

40. *Id.*

represent the least restrictive means to achieve the DCO's objectives.[41] Significantly, 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.[42] Also, the final rule requires DCOs to establish "capital requirements that are based on objective, transparent, and commonly accepted standards that appropriately match capital to risk."[43]

The SEC has proposed similar participant eligibility and risk-management requirements to those found in the CFTC's final rule.[44] 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."[45] It would also require DCOs to "establish, implement, maintain and enforce written policies and procedures" for risk management purposes.[46]

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 smaller but strong, financial entities that could not satisfy the excessive membership requirements imposed by large SDs to become DCO members and compete to provide clearing services to individual traders and investors.[47] As CFTC

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41. *Id.*
42. *Id.* at 69,437. *See* Comment Letter from Professor, Univ. of Md. Sch. of Law, to David A. Stawick, Sec'y, Commodity Futures Trading Comm'n, Re: Financial Resources Requirements for Derivatives Clearing Organizations (Dec. 13, 2010), *available at* http://michaelgreenberger.com/files/Greenberger_DCO_Financial_Resources.pdf.
43. Core Principles, 76 Fed. Reg. at 69,437.
44. Clearing Agency Standards for Operation and Governance, Exchange Act Release No. 64,017, 76 Fed. Reg. 14,472 (proposed Mar. 16, 2011).
45. *Id.* at 14,538.
46. *Id.*
47. Core Principles, 76 Fed. Reg. at 69,355–56 (observing that lowered capital requirements will increase the number of firms clearing swaps). *See* Letter from CME Grp. to the Secretariat of the Basel Comm. on Banking Supervision, Re: Consultative Document: Strengthening the Resilience of the Banking Sector, at 11 (Apr. 16, 2010) [hereinafter Letter from CME Group], *available at* http://www.bis.org/publ/bcbs165/

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."[48] 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.[49] The Department of Justice has also claimed that such strict requirements would create "competitive benefits" for market participants, such as lower costs of clearing transactions for swaps traders and improved market liquidity by helping to ensure that DCOs cooperate with SEFs and DCMs to facilitate exchange trading.[50]

The financial industry has argued that the increase in DCO membership, facilitated by lowered capital requirements, will increase risk in derivatives clearing. Large SDs insist that current capital "requirements are [now] set at prudent levels to ensure the safety of the clearing house[s]" and dismiss claims that such requirements are "exclusionary" or based on unsound risk management principles.[51] For example, Christopher Edmonds, president of ICE Trust 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."[52] Similarly, Bill Hill, of Morgan Stanley, insisted that unless DCOs "have clearing members who have enough capital . . . to recapitalize the clearinghouse if a member defaults . . . [and] to keep the

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cmegroup.pdf (reporting that in 2009 CME processed and cleared approximately 2.6 billion contracts with an estimated notional value of $813 trillion).

48. Gary Gensler, Chairman, Commodity Futures Trading Comm'n, Statements of Support by Chairman Gary Gensler: Position Limits (Oct. 18, 2011), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/genslerstatement101811b.

49. Comment Letter from the Dep't of Justice to the Commodity Futures Trading Comm'n, at 2 (Dec. 28, 2010), *available at* http://www.justice.gov/atr/public/comments/265618.htm.

50. *Id.* at 3 ("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.").

51. Cameron, *supra* note 36 (quoting an anonymous US dealer who asserted that "[t]he chatter about requirements being exclusionary and labelling current members a cabal is just rubbish").

52. *Id.*

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."[53] Thus, large SDs have consistently argued 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 by inference 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.[54] Further, 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).[55] The crisis exposed the vulnerabilities of individual SDs—namely their collective inability to diversify risk by means other than relying on taxpayer subsidies[56]—and suggests that restricting DCO membership to large SDs jeopardizes, rather than improves market stability.

In contrast to current swaps clearing membership practices, the CFTC's $50 million cap for market participants satisfies Congress's directive that DCOs have "sufficient financial resources . . . to meet their obligations."[57] 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

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53. ROUNDTABLE TRANSCRIPT, *supra* note 8, at 18–19.

54. *The True Cost of the Bank Bailout*, PBS (Sept. 3, 2010, 8:25 AM), *available at* http://www.pbs.org/wnet/need-to-know/economy/the-true-cost-of-the-bank-bailout/3309/.

55. MILLER, *supra* note 11, at Summary.

56. *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.").

57. Dodd-Frank Act, Pub. L. No. 111-203, § 725(c), 124 Stat. 1376, 1688 (2010).

of billions of dollars worth of contracts."[58] As Newedge's Gary deWaal observed: "[m]embership 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."[59] 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 across a diverse array of financial organizations.

Further, history demonstrates that broad-based risk management strategies that offer membership to a large number of financially stable institutions foster long-term stability for markets and market participants. For example, the CME Group, which operates one of the largest clearinghouses in the world and has over sixty members,[60] 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.[61] 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 clearing members who are unable to meaningfully and responsibly participate in the clearing process."[62] 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.[63] The CFTC requires DCOs to direct

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58. MILLER, *supra* note 11, at Summary.

59. Cameron, *supra* note 36.

60. *See Clearing Firms*, CME GROUP, http://www.cmegroup.com/tools-information/clearing-firms.html (last visited Feb. 1, 2012).

61. Letter from CME Group, *supra* note 47, at 11.

62. Core Principles, 76 Fed. Reg. 69,334, 69,355 (Nov. 8, 2011).

63. *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").

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."[64] DCOs must collect margin that is commensurate with the particular risks associated with an individual clearing member's portfolio or product and reassess a member's level of risk on a regular basis.[65] 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."[66] 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 wide-spectrum of participants within the derivatives clearing market. Dodd-Frank's clearing requirement will radically increase the volume of clearing swap trades and "result in trillions of dollars in derivatives transactions moving from the OTC dealer market into a clearing environment."[67] The CFTC's $50 million threshold will prevent SDs from having exclusive access to substantial profits generated by mandatory clearing that will 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

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64. *Id.* at 69,418. *See also* BANK FOR INT'L SETTLEMENTS, *supra* note 10, at 66 ("[M]argins often constitute an important part of the CCP's protection against default . . . .").

65. Core Principles, 76 Fed. Reg. at 69,417–18.

66. *Id.* at 69,437.

67. MILLER, *supra* note 11, at 4; *see also* Kopecki, *supra* note 22 (quoting Congressman Barney Frank as saying that Dodd-Frank will "driv[e] a lot of business to the exchanges").

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."[68] It also authorizes DCOs to use participant capital to ensure that clearing members meet their obligations to the DCO.[69] Additionally, the final rule directs DCOs to "require clearing members to have adequate operational capacity" to meet their obligations to the DCO.[70] 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 participate in default management activities.[71]

The CFTC clearly does not intend for DCOs to establish member capital requirements that exceed the $50 million threshold. The final rule requires that a DCO *not* "enact[] some additional financial requirement that effectively renders the $50 million threshold meaningless for some potential clearing members."[72] 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."[73] The final rule's ban on needlessly restrictive requirements applies to a DCO's operational capacity and member eligibility requirements.[74] 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.[75]

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68. Core Principles, 76 Fed. Reg. at 69,437.
69. *Id.*
70. *Id.*
71. *Id.*
72. *Id.* at 69,356.
73. *Id.* at 69,436.
74. *Id.* at 69,355–56.
75. *Id.* at 69,437.

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 rule allows 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 illegitimate attempt to circumvent the $50 million threshold to squash competition."[76] 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."[77] 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 may try 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."[78] In this respect, the final rule may provide a loophole for DCOs by allowing them to "*appropriately* match capital to risk."[79]

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76. Scott D. O'Malia, Comm'r, Commodity Futures Trading Comm'n, Statement of Dissent, Final Rulemaking On Derivatives Clearing Organizations (Oct. 18, 2011), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement101811b.

77. *Id.* 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% of their segregated customer funds. *Id.* The change prompted two FCMs to complain that ICE's net capital requirements violated fair and open access requirements, and led O'Malia to conclude that the CFTC's "final rulemaking gives very little guidance on the criteria that the Commission will apply in adjudicating a dispute . . . ." *Id.*

78. Cameron, *supra* note 36.

79. Core Principles, 76 Fed. Reg. at 69,437.

The minimal operational capacity requirements established by the final rule may provide DCOs with an additional opportunity to restrict clearing membership.[80] 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,"[81] including the capability to price and manage large derivatives portfolios. To this end, DCOs like CME have suggested that members should operate an internal trading desk to ensure that they provide DCOs with accurate pricing information,[82] 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."[83]

The kinds of further protections proposed by the CFTC are critically important because of these contrivances.

IV. RIGOROUS GOVERNANCE STANDARDS AND LIMITATIONS ON OWNERSHIP INTERESTS FOR DCOS WILL HELP TO ENSURE FREE AND OPEN ACCESS TO CLEARING

The CFTC and the SEC have proposed rules to mitigate the conflicts of interest that Congress determined threaten to exclude financial institutions from various swaps clearing memberships.[84] 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 in a designated entity.[85] The shared aims of the CFTC's final rule on participant eligibility and the

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80. Cameron, *supra* note 36.

81. *Id.*

82. *Id.*

83. *Id.*

84. *See* Proposed Rules, 75 Fed. Reg. 63,732, 63,733 (proposed Oct. 18, 2010). *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, Exchange Act Release No. 63,107, 75 Fed. Reg. 65,882 (proposed Oct. 26, 2010).

85. *See* Proposed Rules, 75 Fed. Reg. at 63,733.

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 interest in derivatives clearing[86] in order to safeguard the protections promised by the CFTC's final $50 million cap on capital requirements for DCO membership.

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 regarding the governance of SEFs and DCMs, and to the SEC's proposed governance rules for designated entities. Many of the elements that comprise the CFTC's proposed governance standards for DCOs also comprise the CFTC's proposed governance rules for designated entities generally. For example, the CFTC's proposed rules require DCOs, SEFs, and DCMs to establish nominating committees and disciplinary panels[87] and have the same percentage of public directors (35%)—directors who have no material relationship with a clearinghouse or its members[88]—on their Boards of Directors.[89]

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86. *See* Huw Jones, *Clearing House Ownership Not a Risk Issue – Report*, INVESTING.COM (Nov. 10, 2010, 12:13 PM), 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."); BANK FOR INT'L SETTLEMENTS, *supra* note 10, at 57 ("[I]n determining whether or not to have trades cleared . . . market participants may consider only the private benefits they obtain from doing so. They may not consider the positive effects central clearing may have for third parties or the economy at large."); Matthew Leising, *Derivatives Clearinghouse-Ownership Limits Are Dropped from U.S. Bank Bill,* BLOOMBERG (June 25, 2010, 1:44 PM), 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.").

87. *See* Proposed Rules, 75 Fed. Reg. at 63,733.

88. *Id*. at 63,747 (proposing a bright-line definition of "public director"). The proposed definition 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,

Similarly, many of the same elements appear in the CFTC and the SEC's proposed conflicts rules (e.g., proposing the same individual and aggregate limits on ownership of voting equity).[90] 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-based swaps.

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 the governance of certain DCOs"[91] by increasing the number of public directors who comprise a DCO's Board, as well as its governing committees.[92] Accordingly, the proposed rule requires that a DCO's Board of Directors be comprised of at least 35% public directors,[93] no fewer than two public directors, and at least 10% DCO customers or customer representatives.[94] The proposed rule also requires DCOs to establish nominating committees that must be comprised of at least 51% public directors[95] and at least one disciplinary panel that comprises at least one public director, who also must chair the committee.[96] Additionally, the CFTC's proposed governance standards require a DCO to create a risk management committee that is comprised of at

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advisory, or other compensatory fee (other than deferred compensation) from the DCO, its affiliates, members, or affiliates of members. *Id.* This proposed definition also excludes immediate family members of the aforementioned persons from qualifying as public directors. *Id.*

89. *Id.* at 63,738.

90. *See* Press Release, Sec. and Exch. Comm'n, 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.

91. Proposed Rules, 75 Fed. Reg. at 63,733.

92. *Id.* at 63,751–52.

93. *Id.* at 63,738.

94. 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, 729 (proposed Jan. 6, 2011).

95. Proposed Rules, 75 Fed. Reg. at 63,752.

96. *Id.*

least 35% public directors and 10% DCO's customers or customer representatives.[97]

Further, the CFTC's proposed conflicts of interest rule includes limits on the ownership of voting equity that are designed to enhance the proposed governance rules by limiting the influence that large shareholders may exert over a DCO's Board and its committees.[98] 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 20% of any class of voting equity in the DCO.[99] In addition, enumerated entities,[100] regardless of whether they are DCO members, may not collectively own or vote (directly or indirectly) an interest that exceeds 40% of any class of voting equity in a DCO.[101] Under the second alternative, no DCO member or enumerated entity, regardless of whether that member or entity is a DCO member, may own or vote (directly or indirectly) an interest that exceeds 5% of the voting power of any class of voting equity in a DCO.[102]

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 interest rule must expand the protections offered in the proposed rule if the rule is to ensure fair and open access to clearing.

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97. *Id.* at 63,740.

98. *See id.* at 63,738 (noting the importance of independent decision-makers for designated entities).

99. *Id.* at 63,733.

100. *Id.* at 63,750 (defining "enumerated entities" as: (1) bank holding companies with at least $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)).

101. *Id.* at 63,733.

102. *Id.*

1. 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% and mandate that at least 35% 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% is consistent with the CFTC's original proposed standard for the Boards of DCMs.[103] 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 other exchange stakeholders are adequately represented."[104] The CFTC also argued that requiring Boards to comprise of at least 50% "public" directors would align DCM governance with other corporate practices.[105] These arguments are no less applicable to DCOs, which have "unprecedented influence over the manner in which a swap contract can be executed."[106] Additionally, requiring DCO disciplinary panels to comprise of at least 35% 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.[107]

Contrary to arguments made by the financial services 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 a large financial institutions lack the "critical swap-market expertise" necessary to effectively manage a DCO.[108] DCO directors must have sufficient expertise in financial services, risk management,

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103. *See* Conflicts of Interest in Self-Regulation and Self-Regulatory Organizations, 71 Fed. Reg. 38,740, 38,744 (proposed July 7, 2006).

104. *Id.* at 38,746.

105. *Id.*

106. Proposed Rules, 75 Fed. Reg. 63,732, 63,734 (proposed Oct. 18, 2010).

107. *Id.* at 63,737.

108. MILLER, *supra* note 11, at 8.

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,[109] the Financial Crisis Inquiry Commission,[110] and the many roundtables sponsored by the CFTC Dodd-Frank-related hearings[111] reveal a vast number of academics, former regulators, and other former and current market participants who are qualified to serve as public directors[112] on DCO Boards and committees.[113]

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

As shown below, when finalized, only the proposed 20% individual and 40% aggregate limitations on the ownership of DCO voting equity promise to reduce SDs' influence over DCO decision-making. However, the final rule must also 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% aggregate limitation on the ownership of DCO voting equity by enumerated entities would 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 Department of Justice observed in its comments on the proposed rule, the lack of "an aggregate ownership cap on major derivatives dealers" would "preserv[e] the opportunity for these powerful entities to achieve majority ownership"

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109. *See Regulatory Restructuring and Reform of the Financial System*: *Hearing Before the H. Fin. Serv. Comm.*, 110th Cong. III (2008), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-110hhrg46591/pdf/CHRG-110hhrg46591.pdf; *see also Hearing to Review the Role of Credit Derivatives in the U.S. Economy*: *Hearing Before the H. Ag. Comm.* 110th Cong. III (2008), *available at* http://agriculture.house.gov/sites/republicans.agriculture.house.gov/files/testimony/110/110-49.pdf.

110. Media Advisory, Financial Crisis Inquiry Commission, Financial Crisis Inquiry Commission Announces Full Witness List for First Public Hearing, (Jan. 10, 2010), *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-news/2010-0110-WitnessList.pdf.

111. *See* ROUNDTABLE TRANSCRIPT, *supra* note 8, at 2–5.

112. For the requirements of a Public Director, see Core Principles and Other Requirements for Designated Contract Markets, 77 Fed. Reg. 36612, 36720–21 (June 19, 2012).

113. *See* MILLER, *supra* note 11, at 8.

of clearinghouses and exchange facilities and would "not sufficiently protect and promote the competition in the industry."[114]

In contrast, the alternative 5% 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% limit on the ownership of voting equity would allow "a mere eleven 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 DOC's voting equity.[115] 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.[116] None of these large banks appear to own more than a 5% interest in ICE Trust; consequently, they could band together using their combined 55% ownership stake to dictate ICE Trust's policies and procedures.

Furthermore, the final rule must apply the 20% individual and 40% aggregate limits 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 also assert indirect influence over DCOs.[117] As

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114. Comment Letter from the Dep't of Justice to the Commodity Futures Trading Comm'n, *supra* note 49, at 2.

115. Comment Letter from Rep. Stephen F. Lynch to Gary Gensler, Chairman, Commodity Futures Trading Comm'n (Oct. 18, 2010), *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26291&SearchText.

116. Comment Letter from Michael Greenberger, Professor, Univ. of Md. Sch. of Law, to David Stawick, Sec'y, Commodity Futures Trading Comm'n, Re: Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, at 3 (Nov. 17, 2010) [hereinafter Comment Letter, Re: Requirements for Derivatives Clearing Organizations], *available at* http://michaelgreenberger.com/files/Greenberger_OwnershipCap_CommentLetter.pdf.

117. Proposed Rules, 75 Fed. Reg. 63,732, 63,742 n.77 (proposed Oct. 18, 2010) (noting disagreement among commentators regarding whether "a shareholder would have direct influence over a DCO, DCM, or SEF Board of Directors only if the

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 five 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 . . . ."[118] Additionally, if the CFTC does not limit enumerated entities' economic interests 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.[119] 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.

CONCLUSION

The CFTC's final rule on participant eligibility and its proposed rule on conflicts of interest 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 safeguard open access to clearing facilities and reinforce the $50 million threshold, as it would encourage DCO membership diversification.

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shareholder has the ability to exercise voting rights with respect to, e.g., election, compensation, or removal of directors").

118. ROUNDTABLE TRANSCRIPT, *supra* note 8, at 153.

119. *See* Comment Letter, Re: Requirements for Derivatives Clearing Organizations, *supra* note 116, at 5.