Deutsche Bank

November 8, 2010

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington DC 20581

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Rule Proposals to Mitigate Potential Conflicts of Interest in the Ownership and Governance Structures of Clearing Houses and Trade Execution Platforms (CFTC RIN 3038-AD01, SEC File No. S7-27-10)

Dear Ms. Murphy and Mr. Stawick:

Deutsche Bank AG ("DBAG" and, together with its affiliates, "Deutsche Bank") appreciates the opportunity to provide the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC" and, together with the CFTC, the "Commissions") with our views and suggestions regarding the CFTC's and SEC's rule proposals to mitigate potential conflicts of interest in the ownership and governance structures of clearing houses and trade execution platforms with respect to swaps and security-based swaps (collectively, "swaps").

Sections 726 and 765 (the "Conflicts Provisions") of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") require the Commissions to adopt rules to address conflicts of interest for the purposes of mitigating systemic risk and promoting competition to the extent that the Commissions determine, after a review, that such rules are necessary or appropriate to further such purposes. The Dodd-Frank Act permits, but does not require, the Commissions to do this by imposing numerical limits on the control of, or the voting rights with respect to, any derivatives clearing organization ("DCO"), designated contract market ("DCM"), swap execution facility ("SEF"), clearing agency that clears security-based swaps ("SBSCA"), security-based swap execution facility ("SB SEF") or national securities exchange that posts or makes

available for trading security-based swaps ("SBS Exchanges"), by certain enumerated entities.

Deutsche Bank supports the stated goals of the Conflicts Provisions – to mitigate systemic risk and promote competition – but is deeply concerned that the rules proposed by the Commissions will have the opposite effects.

Ownership and Voting Limitations on DCOs and SBSCAs

The Proposed Rules. The CFTC and SEC rule proposals each provide two alternative rules. The CFTC's "Option 1" would prohibit (a) any individual member (and its related persons) of a DCO from (i) beneficially owning in excess of 20% of any class of voting equity or (ii) directly or indirectly voting an interest exceeding 20%, and (b) enumerated entities (and their related persons), whether or not members of the DCO, from (i) collectively owning on a beneficial basis in excess of 40% of any class of voting equity or (ii) directly or indirectly voting an interest exceeding 40% of voting power of any class of equity interest. The SEC's Option 1 would impose similar 20% individual and 40% aggregate limitations, except that the 40% aggregate limitation proposed by the SEC would apply only to SBSCA participants (and their related persons).

Both the CFTC's and SEC's "Option 2" would impose an extremely low individual ownership and voting limitation of 5% with no aggregate limitation. The CFTC's limitation would be applicable to any individual member of a DCO and any enumerated entity (and their related persons). The SEC's limitation would apply only to SBSCA participants (and their related persons).

The proposals overstate certain conflicts. In proposing clearinghouse ownership limitations, the Commissions focused on a potential conflict of interest that, if clearinghouses are controlled by the few financial institutions that currently are the largest over-the-counter swap dealers, they will resist mandatory clearing and execution of swaps on trade execution platforms to preserve revenues from bilateral swaps. However, such concerns are unfounded. Clearing itself does not adversely affect the profitability of bilateral swaps.[1] In fact, swaps subject to clearing result in more favorable regulatory capital requirements,[2] and

[1] *See* CFTC Release, text accompanying note 22.

[2] Dealers receive improved risk-weighted asset treatment for cleared transactions, which makes cleared trades less expensive than un-cleared trades. Clearing on a qualified clearinghouse results in an exposure value of zero for counterparty credit risk as compared to typically much higher capital charges for such risk on un-cleared trades (even for trades facing highly rated counterparties, such as banks).

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clearing can therefore improve profitability. In addition, not all swaps that are subject to mandatory clearing must be executed on a DCM, SBS Exchange, SEF or SB SEF. Execution on a DCM, SBS Exchange, SEF or SB SEF is not applicable if no such trading system makes the swap "available for trading." To the extent there is any conflict of interest in this regard, it would arise in connection with decisions to be made by DCMs, SBS Exchanges, SEFs and SB SEFs, not clearinghouses. Moreover, the stated goals of the Conflicts Provisions are to mitigate systemic risk and increase competition, not increase pre-trade price transparency.

The proposals would increase systemic risk. These aggregate and low individual ownership and voting control limitations would increase systemic risk due to the misalignment of interest caused by such limitations. In typical corporations, shareholders bear the risk of loss ahead of creditors and have voting control commensurate with such risk. In contrast, in a clearinghouse, risk of loss is borne primarily by the members of the clearinghouse who must absorb the potential default of other clearing members through their contributions to the clearinghouse guaranty fund and by assuming the risks of the positions of defaulting members. In addition, they must fund any further assessments required by the clearinghouse to replenish the depleted clearinghouse guaranty fund. In the clearinghouse structure, the shareholders do not bear any loss until the clearinghouse guaranty fund has been completely exhausted (and the clearing members have suffered losses in the amount of their guaranty fund contributions, if not more).

This peculiar aspect of the clearinghouse structure removes the typical alignment of interest between those who make the decisions and those who bear the risks of loss arising from those decisions. Such a misalignment of interest presents a moral hazard and could lead to perverse incentives to increase clearing revenues by offering to clear swaps that are unsuitable for clearing with the associated risks being borne by clearing members. Further, if members are limited in their ability to own equity in the clearinghouse and to exert the rights associated with such ownership, they will be less likely to put their capital at risk. Without the capital support of their members, clearinghouses will be unable to

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Also, the clearing process incorporates a compression mechanism whereby the positions of the clearing member at the clearinghouse (and, consequently, the counterparty exposure to the clearinghouse) are netted, rather than remaining at a gross position level, as would be the case in a non-cleared scenario. The capital benefits related to compression would apply for all of a clearinghouse's clearing members (regardless of their capital regime) and irrespective of whether a clearinghouse was "qualified" or not.

withstand the default of an individual member, placing the entire system at greater risk. Rather than reducing systemic risk, the limitations on ownership and voting control by clearing members exacerbate the problem.

The proposals would reduce competition. These limitations will also reduce competition among clearinghouses. New equity for a clearinghouse is most likely to come from those who will benefit from its services—the swap dealers and other financial institutions that are most likely to be its members. A 40% cap on aggregate ownership by enumerated entities (as proposed by the CFTC) will require a 60% outside investment by investors who likely are not involved in the swaps industry in a significant way. These owners will be drawn exclusively by the prospect of profits and are likely to seek to maximize return on investment by placing greater costs and risks on users of clearinghouses. This will impede the creation of new clearinghouses and will consolidate the market position of existing clearinghouses. A 40% cap on the aggregate ownership by clearinghouse members (as proposed by the SEC) has the advantage of not categorically disqualifying investors by virtue of their status. However, it raises the same issue in that the most likely investors in a clearinghouse are the members of that clearinghouse.

A 5% cap on any individual enumerated entity or, in the case of the SEC proposal, clearinghouse member, will present a serious obstacle to the growth of new clearinghouses. This limitation would require a minimum of 20 enumerated entities to come together to form a clearinghouse. Such a number approximates (and may exceed) the number of entities that would have the financial wherewithal and expertise to form a new clearinghouse. Rather than promote competition, this requirement entrenches existing clearinghouses.

Deutsche Bank's Alternative proposal. Because the Commissions' proposals would create the misalignments of interest and moral hazard discussed above, Deutsche Bank believes that the Commissions should adopt ownership and voting rules that do not impose any aggregate limit on clearinghouse members or enumerated entities. In addition, Deutsche Bank believes that individual limits should be set at no less than 20%. Combined with the independence requirements on the board of directors proposed by the Commissions (except with respect to the risk management committee, which we discuss below), such limitations will more appropriately address conflicts of interest, mitigate systemic risk and promote competition among clearinghouses.

Governance Provisions for DCOs and SBSCAs

The Proposed Rules. Under the CFTC proposal, a DCO's board of directors (and any executive committee thereof) must be composed of 35% public

directors[3] with no less than 2 public directors. The nominating committee must have at least a 51% majority of public directors and the chairman (whose role is to identify individuals qualified to serve on the board of directors and administer a process for their nomination) must be a public director. The DCO must have a risk management committee composed of 35% public directors with sufficient expertise in clearing services and 10% customers of clearing members. The DCO's disciplinary panel would consist of at least 1 person who would not be disqualified as a public director. The appellate body for the disciplinary panel would have at least 1 public director.

The SEC proposal would vary depending on which alternative for ownership and voting limitations applies. If the 20% individual/40% aggregate limits apply, then the applicable governance provisions would be quite similar to those imposed under the CFTC proposal. The board of directors (and committees thereof, including any risk management committee, but other than the nominating committee) would be composed of 35% independent directors.[4] The nominating committee must have at least a majority of independent directors. The disciplinary panel would consist of at least 1 independent director. The appellate body for the disciplinary panel would have at least 1 independent director. If the 5% individual limitation applies, then stricter governance rules would apply. The key differences are that the board of directors (and committees thereof, including any risk management committee, but other than the nominating committee) would be composed of a majority of (rather than 35%) independent directors and the nominating committee would be composed of 100% (rather than a majority of) independent directors.

The independence requirements for the risk management committee are excessive and inappropriate. Robust risk management of a clearinghouse is central to systemic risk mitigation. The function of the risk management committee is to (i) determine standards and requirements for initial and continuing clearing membership eligibility; (ii) approve or deny (or review approvals or denials of) clearing membership applications; and (iii) determine the products it believes are eligible for clearing. As discussed above, because clearing members' capital is at risk, Deutsche Bank believes it is appropriate that they have the decisive input into risk management decisions. For example, given

[3] The CFTC proposal uses the term "public director" while the SEC proposal uses the term "independent director." These terms, though different in scope and detail, both broadly seek to exclude individuals with material relationships with the clearinghouse or its members.

[4] Unlike the CFTC proposal, the SEC proposal does not contain any expertise requirement for board members.

that trades of defaulting members will be transferred to non-defaulting members, clearing members should be involved at a minimum in vetting and approving membership decisions. Therefore, Deutsche Bank believes that limiting the potential participation of clearing members on the risk management committee to 55% (in the case of the CFTC proposal) or to as little as 49% (under Option 2 of the SEC proposal) inappropriately separates decision-making from those who have the most to lose by those decisions.

Deutsche Bank is also concerned that there is no minimum number of directors that must be clearing members. With the nominating committee composed of 51% public directors (in the case of the CFTC proposal) and as high as 100% independent directors (under Option 2 of the SEC proposal), there is no assurance that clearing members will be nominated or selected to serve on the risk management committee in appropriate numbers.

Further, as the SEC acknowledges in its release, directors who are related to the participants in a clearinghouse are likely to have greater risk management expertise and experience than directors who are not so related. While Deutsche Bank recognizes that the involvement of fully qualified non-participant-related directors with sufficient risk management expertise is valuable, Deutsche Bank is concerned that sufficient numbers of such directors will not readily be available.

Alternative proposal. Deutsche Bank believes that independent directors on clearinghouse boards will help ensure that a variety of viewpoints are heard and that conflicts of interest can be addressed at early stages. The boards of directors play an important role in supervising the work of the risk management committees. First, directors and other committee members serve on committees at the pleasure of the board of directors. Second, while committees make recommendations for consideration by the board, the decisions are made by the board. However, because of the critical role played by the risk management committee, Deutsche Bank believes that the Commissions should adopt rules that require the risk management committee of a clearinghouse to include a number of members of the clearinghouse that fully reflects the alignment of their interests with that of the clearinghouse.

Ownership and Voting Limitations on SEFs and SB SEFs

The Proposed Rules. The CFTC proposal would prohibit any individual member (and its related persons) of an SEF from (i) beneficially owning in excess of 20% of any class of voting equity or (ii) directly or indirectly voting an interest exceeding 20% of a SEF. Likewise, the SEC proposal would prohibit any individual member (and its related persons) of an SB SEF from (i) beneficially

owning in excess of 20% of any class of voting equity or (ii) directly or indirectly voting an interest exceeding 20%.

The proposals would reduce competition. The proposed individual ownership limitations would reduce competition by discouraging the formation of new SEFs and SB SEFs. As the CFTC acknowledges in the proposing release, members[5] will be the most likely source of funding for new SEFs. The 20% limit would discourage members and their affiliates from investing in new SEFs and SB SEFs. Further, a 20% ownership interest may not provide members with sufficient economic incentives to contribute their technological resources and expertise to SEFs or SB SEFs. Fewer new SEFs and SB SEFs means less competition and an entrenchment of existing trading platforms. The results of reduced competition – chilling innovation, reducing quality of service and concentration of operational and legal risk – could adversely affect the U.S. financial system.

The issue of open access can be directly and adequately addressed through governance requirements. The Commissions have expressed concerns that members might use their significant ownership and voting rights to cause SEFs and SB SEFs to limit access to these facilities. We believe this issue would be more appropriately addressed by requiring trading platforms to establish membership committees mandated to prevent inappropriate restrictions or burdens on access and by imposing on SEFs and SB SEFs fair access requirements the purported breach of which can be appealed to the Commissions. This governance arrangement and explicit requirement have the advantage of specifically and directly resolving the access issue. By contrast, a blanket ownership limitation (which may or may not have an indirect impact on access) is a blunt solution because it also stifles competition and innovation.

Increased Ownership Creates Incentives to Increase Swaps Made Available to Trade. The Commissions are also concerned that members might use their significant voting and ownership interests to cause SEFs and SB SEFs to limit the types of swaps made available for trading, especially if there is a strong economic incentive for the members to bilaterally trade these swaps in the OTC market. We disagree. Deutsche Bank believes that members of SEFs and SB SEFs that are willing to contribute significant capital and expertise to new SEFs and SB SEFs will seek to trade as many swaps on those platforms as is profitable for those platforms to trade. By permitting individual members to hold voting

[5] In the context of an SEF or SB SEF, we believe that the term "member" refers to entities that have the right to trade, and are actively engaged in trading, on the SEF or SB SEF.

equity interests in excess of 20%, their economic interests will be better aligned with those of the SEF or SB SEF—members will seek to trade as many swaps as possible on their own trading platform.

If an individual ownership limitation were adopted at all (which we do not advocate), we believe it should be set at the 50% level. In other words, individual members should be permitted to own up to 50% of any class of voting equity in a SEF or SB SEF. Also, if an ownership limitation were adopted at all, it should apply to members only, and not to enumerated entities.

Dual-Registered Entities and Compliance Issues

As the SEC discusses in its proposing release, an entity that registers with the SEC as an SBSCA is likely to also register with the CFTC as a DCO. Although generally similar, there are significant differences between the SEC and CFTC proposals. These differences would create situations where a dual-registered entity qualifies under one set of rules but violates another set of rules. For example, aspects of the CFTC's ownership alternatives for DCOs limit voting interests held by "enumerated entities" and their related persons, whereas the SEC's ownership alternatives for SBSCAs do not.

In addition, the second ownership alternatives for SBSCAs and DCOs differ in the requirements relating to the board of directors and some of their committees. Specifically, under the CFTC's second alternative, a DCO's board of directors must be composed of 35%, but no less than 2 public directors. By contrast, under the SEC's second alternative, an SBSCA's board of directors must be composed of a majority of independent directors. Because of definitional differences, there is a possibility that someone who qualifies as a public director may not qualify as an independent director (or vice versa). Moreover, a DCO with a board consisting of 35% public directors that wishes to register as an SBSCA must significantly reshuffle its board. The costs and delay associated with these governance changes would present a "regulatory" barrier to entry for a DCO seeking to enter the security-based swaps market by registering as an SBSCA. The same of course is true for an SBSCA wishing to register as a DCO. Deutsche Bank urges the Commissions to continue to work together to ensure uniformity in their final rules on conflicts of interest.

Conclusion

In conclusion, Deutsche Bank is concerned that the ownership and voting limitations relating to clearinghouses and trading platforms as proposed by the Commissions would have the unintended effects of increasing, rather than decreasing, systemic risk and stymieing, rather than promoting, competition

among these institutions. In particular, Deutsche Bank is concerned that the proposed governance provisions relating to the risk management committees of clearinghouses would inappropriately separate the decision-makers on risk decisions from those in the best position to make such decisions. Similarly, the individual ownership and voting limitation relating to SEFs and SB SEFs will remove members' economic incentives to contribute significant capital and expertise to these facilities.

To most effectively address conflicts of interest with respect to clearinghouses, the Commissions should (a) adopt ownership and voting rules that do not impose any aggregate limit on clearinghouse members or enumerated entities and impose individual limits of no less than 20% and (b) establish risk management committees with a minimum number of clearing members that fully reflects the alignment of the interests of clearing members and the clearing house. To address conflicts of interests with respect to SEFs and SB SEFs, the Commissions should rely on fair access appeal rights and governance provisions, such as robust membership committees, which will provide direct and adequate solutions to issues of open access. If, however, the Commissions determine that an individual ownership limitation relating to SEFs and SB SEFs were necessary, it should be applied to members only and should be set at no less than the 50% level.

Finally, Deutsche Bank urges the Commissions to work together to harmonize rules relating to conflicts of interest to mitigate compliance issues for dual registered entities.

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We thank the Commissions for the opportunity to comment on the topics discussed above and for the Commissions' consideration of Deutsche Bank's views. We would be happy to provide the Commissions any additional information on any of the subjects discussed in this letter.

Please feel free to call either of the undersigned with any question or request for additional information that you may have.

Sincerely,

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