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VIA E-MAIL: dcodcmsefGovernance@cftc.gov

David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: “Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest,” 75 *Fed. Reg.* 63732 (October 18, 2010).

Dear Mr. Stawick:

Natural Gas Exchange Inc. (“NGX”) appreciates the opportunity to comment on the Commodity Futures Trading Commission’s (“Commission”) notice in the *Federal Register* entitled, “Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest,” 75 *Fed. Reg.* 63732 (October 18, 2010) (“Notice”). The Notice proposes rules implementing Section 726 of the Dodd-Frank Wall Street Reform and Consumer Protection Act¹ and are designed to mitigate potential conflicts of interest in the operation of a derivatives clearing organization (DCO), designated contract market (DCM), or a swap execution facility (SEF). The proposed rules relate to both structural governance requirements and limits on the ownership of voting equity and the exercise of voting power.

NGX

NGX operates a trading and clearing system for energy products that provides electronic trading, central counterparty clearing and data services to the North American natural gas, electricity and oil markets. On December 12, 2008, NGX was registered by the Commission as a DCO.²

¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No. 111–203, 124 Stat. 1376 (2010) (“Dodd-Frank Act”).

² NGX also operates as an exempt commercial market (“ECM”). NGX notified the Commission on November 5, 2002, of its operation as an ECM and has requested an extension to operate as an ECM for a period of one year following the effective date of the Dodd-Frank Act.

NGX is a wholly-owned subsidiary of TMX Group Inc. (“TMX Group”), which has its head office in Toronto, Ontario, and operates cash and derivative markets for multiple asset classes including equities, fixed income and energy products through the Toronto Stock Exchange, the TSX Venture Exchange and the Montreal Exchange (“MX”), amongst other subsidiaries. TMX Group also operates the Canadian Derivatives Clearing Corporation through MX.

TMX Group is a publicly traded Canadian company. Its shares have been listed for trading on the Toronto Stock Exchange since November 2002. TMX Group is a reporting issuer in every province and territory of Canada. TMX Group is not listed on any U.S. exchange.

Conflicts of Interest

The Commission proposes a number of governance requirements and limits on ownership of voting equity and the exercise of voting power in order to “mitigate on a prophylactic basis the conflicts of interest” that it has identified.³ The Commission identifies the risks that a DCO “may confront when determining (i) whether a swap contract is capable of being cleared, (ii) the minimum criteria that an entity must meet in order to become a swap clearing member, and (iii) whether a particular entity satisfies such criteria.”⁴ The Commission continues by explaining that the interests of the members of a DCO that are banks, swap dealers or major swap dealers may be at odds with the offer by a DCO of swap contracts for clearing or the admission of certain members. The Commission explains that the purpose of its rules is to “ensure . . . that the private, competitive interests of certain DCO members do not capture DCO risk assessments.”⁵

The Commission’s reasoning relies upon the structural relationships of clearing members to the DCO which follows the typical DCO model of mutualizing credit risk among clearing intermediaries. NGX follows a very different model. All participants on the NGX trading platform must become clearing participants. Accordingly, there is no intermediation and no differentiation between clearing members and non-members. More fundamentally, NGX does not mutualize default risk among clearing participants. All of the risk arising from the default of a clearing participant is borne by NGX. These characteristics do not give rise to the types of structural conflicts which form the philosophical and factual predicate for the proposed rules.

The Commission’s proposal also fails to take into account that some DCOs, like NGX, are themselves non-U.S. entities or are subsidiaries of non-U.S. companies. Futures trading is increasingly global and as a result international regulators are striving to harmonize the rules governing swaps trading and clearing; it is likely that these trends of globalization and harmonization will continue. NGX believes that the Commission

³ 75 *Fed. Reg.* at 63737.

⁴ 75 *Fed. Reg.* 63733.

⁵ *Id.* at 63736.

should take these trends into account by recognizing that a DCO may be owned by a foreign parent corporation which would be bound by the rules governing listed companies promulgated by the home jurisdiction of a non-U.S. parent.

With these general observations in mind, we offer the following specific comments.

Governance

NGX believes that the types of conflicts of interest identified by the Commission with respect to DCOs are best addressed through governance requirements alone. Restrictions on DCO ownership do not address the conflicts identified by the Commission, particularly, as discussed above, in the case of a non-intermediated, non-mutualized clearing house, such as NGX. Accordingly, NGX respectfully suggests that the Commission refrain from imposing such ownership restrictions on DCOs and the parent companies of such registered entities.

Board of Directors Independence

The proposed rules place requirements on the structure of the Board of Directors of DCOs that are intended to bring an independent perspective to their operation. The proposed rules would require the board of a DCO to be comprised of thirty-five percent, and no less than two, "Public Directors,"⁶ which the Commission contemplates as persons without industry ties or other relationships that may pose a conflict of interest.⁷ The Commission further proposes that the members of the Board of Directors, including public directors shall have sufficient expertise in financial services, risk management and clearing services.

NGX believes that the public director requirement presents a balance between independence and experience. The operation of a clearing house is a highly specialized activity, requiring a high level of expertise. NGX agrees with the Commission's assessment that the Boards of Directors of registered entities would benefit from the inclusion of public directors and is not opposed to the Commission's proposal of 35% public directors. NGX believes, however, that including a higher percentage of public directors for DCOs might adversely tip the balance between independence and the necessary expertise.

The Commission has also proposed that members of the Board of Directors of a registered entity have "sufficient expertise in financial series, risk management, and

⁶ The proposed rules define the term "Public Director" to mean "a member of the Board of Directors (each, a "director") of a registered derivatives clearing organization (as defined in Section 1a(15) of the Act), a board of trade designated as a contract market pursuant to Section 5 of the Act, or a registered swap execution facility (as defined in Section 1a(50) of the Act), as applicable, who has been found, by the Board of Directors of the registered entity, on the record, to have no material relationship with such registered entity. The Board of Directors must make such finding upon the nomination or appointment of the director and as often as necessary in light of all circumstances relevant to such director, but in no case less than annually."

⁷ 75 FR 63738.

clearing services.” Few individuals are truly and equally expert in all of these areas. A well-balanced Board of Directors will include individuals from diverse backgrounds with diverse experiences and skills. NGX recommends that the Commission clarify that the expertise requirement is intended to ensure such a diversity on the Board, that each of the Board’s members need not be expert in each of the areas identified, and that some may have expertise in other areas that are also important to the over-all well-functioning of the enterprise, such as information technology, communications and human relations.

Risk Management Committee

The issue of the optimal balance between expertise and independence leads to a different conclusion in the context of the composition of the required risk management committee, however. A DCO would be required under the proposed rules to have a risk management committee in order to address the risks associated with ensuring the performance of the derivatives contracts that it clears. Under the Commission’s proposal, however, public directors would be required to make up thirty-five percent of the risk management committee. Furthermore, customers of clearing members would be required to make up ten percent of the members of the risk management committee.⁸

NGX recognizes that a risk management committee serves an important function, and strongly supports the requirement that a DCO’s governance structure include such a committee. However, the risk committee should be composed of those members with the greatest expertise, which often will not be the independent members of the Board. NGX is especially concerned by the proposed prohibition on employees of a DCO serving as voting members on a risk management committee.⁹ Where the DCO does not mutualize risk, the entire default risk rests with the DCO. With so much at stake for the DCO, it is crucial that the DCO be able to bring the full expertise of its employees and officers to bear in making the decisions on how to respond to a default scenario. Accordingly, it is TMX’s view that DCO employees should not be prevented from serving as voting members of the risk management committee.

The separate requirement that ten percent of the risk management committee be composed of customers of clearing members raises significant issues for a non-intermediated clearing house. The proposed rule does not account for DCOs, such as NGX, whose members clear for themselves rather than for outside customers. Accordingly, in the case of NGX and other similarly situated DCOs, there is no separate class of customers available to fulfill this requirement. More fundamentally, there is an issue with respect to the potential conflict of interest created when a clearing participant has access to the market positions of fellow market participants. There is no way to shield a clearing participant from this conflict other than preventing that clearing participant from also transacting in the NGX market. We believe that this inherent conflict is more serious than the conflicts identified by the Commission as the reason behind these proposed requirements.

⁸ Proposed Rule § 39.13(g)3(i).

⁹ Proposed Rule § 39.13(g)3(C)(ii).

Disciplinary Panels

The Commission proposes requiring DCOs to have disciplinary panels that will be responsible for conducting hearings, rendering decisions and imposing sanctions related to disciplinary matters.¹⁰ The rules call for the panel to include at least one “Public Participant,”¹¹ who must chair the committee. NGX supports this proposal.

Books and Records

The proposed rules prohibit an entity from operating a DCO unless the entity agrees to subject its officers, directors, employees and agents to Commission authority and also subjects its books and records to inspection and copying by the Commission. While NGX supports the authority of the Commission to obtain books and records of the parent where such records relate to the operation of its DCO, in circumstances where the parent is a non-U.S. corporation the Commission should in the first instance seek such records under the applicable international information-sharing agreements.

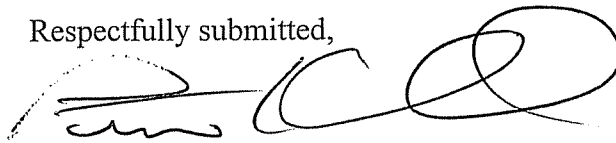
NGX objects to treating the officers, directors, employees and agents of a parent company as serving an affiliate or subsidiary in the same capacity. This proposal violates well-established legal principles that separately organized legal entities have separate legal identities.

Conclusion

NGX recognizes the importance of the mitigation of conflicts of interest and supports the Commission’s proposals to ensure that DCOs are free from conflicts. However, we believe that certain revisions to the Commission’s proposed rules are necessary. These include permitting employees to hold a voting position on the Risk Management Committee, in providing that customers need not serve on such a committee where the DCO is non-intermediated and recognizing the applicability of standards in non-U.S. jurisdictions, in particular where parent companies of DCOs are publicly listed on non-U.S. exchanges.

NGX appreciates the opportunity to comment on the Commission’s Notice of Proposed Rulemaking. Please feel free to contact me at (403) 974-1705 or Peter.Krenkel@ngx.com with any questions.

Respectfully submitted,



Peter Krenkel, President

¹⁰ Proposed rule § 40.9(c)3.

¹¹ The proposed rules define a “Public Participant” as an entity that meets the materiality tests contained in the definition of “Public Director.”

