

March 7, 2011



Filed Electronically

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

Re: "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 (January 6, 2011); RIN 3038-AD01.

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, "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 (January 6, 2011) (the "January Notice"). The Notice proposes rules implementing Sections 726 and 725(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act¹ and is designed to mitigate potential conflicts of interest in the operation of a derivatives clearing organization (DCO) and other registered entities. The proposed rules supplement or amend an earlier Notice of Proposed Rulemaking, 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) (the "October Notice"), relating to both structural governance requirements and limits on the ownership of voting equity and the exercise of voting power.

NGX

NGX is a trading system for energy products in the North American market. Since March 1, 2004, NGX has been a wholly owned subsidiary of TMX Group Inc.² NGX also provides clearing services through which it acts as central counterparty

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

² TMX Group operates cash and derivative markets for multiple asset classes including equities, fixed income and energy products. TMX Group is a corporation incorporated under the Business Corporations Act (Ontario) and has its head office in Toronto, Ontario. 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.

("CCP") for transactions entered into on the NGX electronic marketplace, certain transactions executed in the OTC market and transactions entered into on a third party trading platform. On December 12, 2008, NGX was registered by the Commission as a Derivatives Clearing Organization ("DCO").³

The Proposed Additional Reporting Requirements

The January Notice proposes to require, in addition to the earlier proposed rules, that a DCO report to the Commission when its Board of Directors rejects a recommendation from or supersedes an action of its risk management committee ("RMC"); that each DCO implement a regulatory program to identify potential conflicts of interest; prescribe limits on the use or disclosures of non-public information by, among others, members of any committee; and make public information on governance arrangements including "summaries of significant decisions." In the case of DCOs, such significant decisions relate to open access, membership, and the finding of products acceptable (or not acceptable) for clearing.

The requirement to make public a summary of membership-related actions, particularly denial of an application for membership, may have unintended, adverse consequences for the applicant. An application for membership will be judged by a number of publicly disclosed admission criteria. These will likely include the applicant's financial resources, whether it or its principals have any statutory disqualifications, and whether the applicant meets other fitness and minimum technical requirements. Publicly disclosing that an applicant has been denied membership has the potential to expose an unsuccessful applicant to unwanted public scrutiny. Accordingly, public disclosure of a denial of an application for admission, rather than operating as a protection from abuse due to a conflict of interest, has the potential to punish an unsuccessful applicant. Accordingly, NGX respectfully suggests that at a minimum, the Commission provide in the final rules that an unsuccessful applicant for membership have the right to instruct the DCO not to make public the fact of the denial of its application.

Customer Representation on the RMC or Board of Directors

The January Notice re-proposes the October proposal that the DCO's governing body have ten percent customer representation. The Commission has re-proposed the requirement in the alternative, that each DCO have ten per cent customer representation on its Board of Directors in lieu of having ten per cent customer representation on the RMC or vice versa. The Commission will decide on the final requirement after consideration of the comments.⁴

The Commission has re-proposed the ten percent customer representation requirement in light of the split between commenters on the October proposal. Some

³ 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.

⁴ January Notice at 729.

commenters advocated that customers be on the Board of Directors “particularly in the developing swap markets where, at this time, investors have access to only a handful of swap entities for clearing and trading.”⁵ Other commenters took the opposite position, suggesting that “buy-side participants, like customers of clearing members, need meaningful representation on the committees that make the critical determinations on the core functions of the organization that impact all of its participants.”⁶ Despite these apparent contradictory views, both start from a common assumption, as does the Commission’s proposal itself, that the clearing structure is necessarily intermediated--that is, that in all cases a customer can only access the clearing house through a clearing member.

As NGX explained in its comment submitted in connection with the October Notice, NGX follows a very different model. NGX is a non-intermediated clearing house. There are no customers and all clearing participants clear only for their own accounts. Moreover, NGX does not mutualize risk among clearing participants. Rather NGX itself bears completely the risk of non-performance by any of the clearing participants.

The Commission’s proposed rules relating to DCOs fail to take into consideration the fact that a DCO may operate under a non-intermediated model, as does NGX. A non-intermediated clearing house will not be able to fulfill the proposed requirement that customers be represented on either the Board of Directors or the RMC. There simply are no customers in a non-intermediated clearing house structure to fulfill this requirement.

Nor can clearing participants fulfill this function. There is a fundamental issue with respect to the potential conflict of interest created when a clearing participant has access to the market positions of his fellow market participants. Because all clearing participants are active participants in the market, it is doubtful that any could participate in any decision of the clearing house without a conflict of interest. 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. Thus, it is difficult to envision how an NGX clearing participant could participate on either the RMC or the Board of Directors.⁷ We believe that this inherent conflict is more serious than the conflicts identified by the Commission as the reason behind these proposed requirements.

Conclusion

NGX recognizes the importance of the mitigation of conflicts of interest and supports the Commission’s efforts to ensure that DCOs are free from conflicts. NGX

⁵ *Id.*

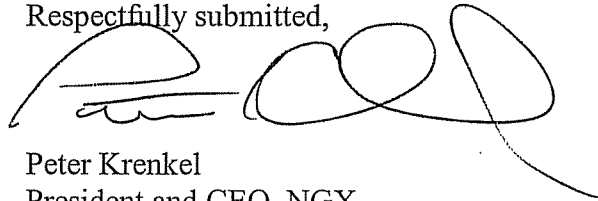
⁶ *Id.*

⁷As proposed in the October Notice, Proposed Rule § 39.13(g)(3)(C)(ii) would prohibit an employee of a DCO serving as a voting member on a risk management committee. As NGX commented previously in response to the October Notice, it agrees that an RMC serves an important function, and strongly supports the requirement that a DCO governance structure include such a committee. However, where the DCO does not mutualize risk and the entire default risk rests with the DCO, the DCO should 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, DCO employees should be able to service as voting members of the RMC.

respectfully requests that the Commission in the final rules provide an opportunity for a DCO to seek an individual waiver where, because it is a non-intermediated clearing house, it is not possible to comply with the requirements as proposed.

Please feel free to contact Cheryl Graden at (416) 947-4359, or our outside counsel, Paul M. Architzel of Wilmer Cutler Pickering Hale and Dorr LLP, at (202) 663-6240, with any questions about these comments.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Peter Krenkel', with a long, sweeping horizontal stroke extending to the right.

Peter Krenkel
President and CEO, NGX