

September 13, 2019

Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Via CFTC Comments Portal: <https://comments.cftc.gov>

Re: Derivatives Clearing Organization General Provisions and Core Principles
RIN 3038-AE66

Dear Mr. Kirkpatrick:

Nodal Clear, LLC (“Nodal Clear”) appreciates the opportunity to submit these comments on the Commodity Futures Trading Commission’s (“CFTC or the “Commission”) proposed rules to amend certain requirements applicable to derivatives clearing organizations (“DCOs”).¹ As background, Nodal Clear is a registered DCO and the clearinghouse for Nodal Exchange, LLC (“Nodal Exchange”) a CFTC designated contract market (“DCM”). Nodal Clear is a wholly owned subsidiary of Nodal Exchange and both are wholly owned by the European Energy Exchange. Nodal Clear is a “Subpart C” DCO, having elected to comply with the requirements applicable to DCOs that have been designated systemically important (“SIDCOs”) by the Financial Stability Oversight Council. Nodal Clear respectfully submits the following comments regarding the Proposal.

A. Overview

The Proposal notes that the Commission is considering these changes while mindful of the overall goals of Project KISS, which calls for simplifying and clarifying existing Commission regulations, as well as codifying existing relief and guidance, in an effort to “...make them simpler, less burdensome, and less costly...” Nodal Clear believes that many of the changes suggested in the Proposal are helpful in clarifying or simplifying many regulations applicable to DCOs, however, Nodal Clear also believes that some changes are unduly prescriptive and will unnecessarily add to the regulatory burden and cost of operating a DCO. Nodal Clear believes that the principles-based approach the Commission has embraced since

¹ Derivatives Clearing Organization General Provisions and Core Principles, 84 Fed. Reg. 22,226 (May 16, 2019)(hereinafter, the “Proposal”).

inception has been effective. The Commission finds its best success when it works with DCOs and values the DCO's discretion and flexibility to appropriately address important issues and increase the integrity and stability of the market.

With appreciation for the Project KISS purpose and the Commission's successful tradition of taking a principles-based approach, Nodal Clear respectfully requests the Commission thoughtfully consider the following comments on certain aspects of the Proposal.

B. Proposed Regulation 39.10(d) – Enterprise Risk Officer

The Commission is proposing Regulation 39.10(d), which would require a DCO to identify as its enterprise risk officer an appropriate individual who exercises the full responsibility and authority to manage the DCO's enterprise risk management function under the enterprise risk management program requirement in the Proposal. The Commission requests comment as to whether a DCO's Chief Risk Officer ("CRO") should be permitted to also serve as its enterprise risk officer.² Nodal Clear believes that a DCO should have complete discretion to identify the appropriate person to serve as the enterprise risk officer, including whether that person may also be the DCO's CRO. At Nodal Clear, for example, the CRO is responsible for implementing the risk management policies, procedures and controls of the clearing house and for making recommendations regarding risk management functions to the Risk Management Committee of Nodal Clear's Board of Directors. Accordingly, Nodal's CRO may already be appropriately positioned to undertake the additional responsibilities of the enterprise risk officer provided for in the Proposal, including reporting to the Board of Directors should that become a requirement of the position. Additionally, pursuant to the "enterprise-wide" intent articulated in the Proposal, the legally separate but affiliated entities within a corporate structure that includes a DCO are best situated to make the appropriate determination of where the enterprise risk program should reside, and the identity of the enterprise risk officer, within that corporate group to satisfy the obligations under proposed Regulation 39.10(d)(1)-(3).³ Consistent with the overall goals of Project KISS, which call for making Commission regulations simpler and less burdensome, Nodal Clear believes that just as the Commission proposes to allow for a variety of corporate structures that include DCOs to have the discretion to address the most efficient manner of operating an enterprise risk program within its unique corporate structure, the Commission should also allow DCOs the flexibility to identify the best individual who can exercise the full responsibility and authority to manage that risk management program, even if that person is also the Chief Risk Officer.

C. Proposed Regulation 39.13(g)(3) – Independent Validation

The Commission is proposing to amend Regulation 39.13(g)(3), which requires that a DCO's systems for generating initial margin requirements, including its theoretical models, be reviewed and validated by a qualified and independent party on a regular basis, to specify that

² Proposal at 22,232.

³ Proposal at 22,232, FN 22, stating that the Commission will allow a DCO to satisfy its obligations under the proposed rule if it is part of a corporate group with its own enterprise risk management program in place which complies with the requirements of the rule and that includes the DCO within its scope.

“on a regular basis” means “annually” and to permit employees of an affiliate of the DCO to conduct the validations. Nodal Clear believes that specifying that a “regular basis” should be an annual requirement for validating a DCO’s systems for generation of initial margin requirements, *even for theoretical models*, is unnecessary because theoretical models generally do not change from year to year. Even with the accommodation to allow affiliates of the DCO to conduct these validations, it would still present an undue burden on certain DCOs due to the significant cost and time that would be involved in obtaining an independent validation. After considering Nodal’s concern, if the Commission decides to adopt this amendment, Nodal Clear requests that the Commission exclude theoretical models from the annual validation requirement to the extent that they have not materially changed since the prior independent validation.

D. Proposed Regulations 39.16(b) and 39.16(c) – Default Rules and Procedures

The Commission is proposing to amend Regulation 39.16(b) to add a requirement that the DCO include its clearing members in a test of the DCO’s default management plan on at least an annual basis. The Commission justifies this addition by stating it believes that the plan cannot be tested effectively without clearing member participation. Nodal Clear believes that, while this requirement to include clearing members could be appropriate for those DCOs that utilize an auction process in the event of clearing member defaults, it is not necessary for a DCO like Nodal Clear, which does not rely exclusively upon clearing member auctions. For example, Nodal Clear would expect to either use a trading participant auction or to liquidate the portfolio of a defaulting clearing member via brokers who facilitate block trades with other Nodal Exchange participants. Neither path involves clearing members in the same way as an auction-type process under which all DCO clearing members bid on a defaulting member’s contracts. Therefore, Nodal Clear believes that including clearing members in an annual testing requirement would, in this example, not be necessary for an effective default management test and could complicate or increase the time and cost of an annual test. Nodal Clear believes that DCOs should have the discretion to manage their default management plan as they deem appropriate based on their own markets. If the Commission deems it appropriate to take a prescriptive approach, Nodal Clear requests that the Commission limit the application of the proposed rule for clearing member participation in default management testing to those DCOs that may primarily rely on a clearing member auction process in their default management plans, rather than apply it on a one size fits all basis to all DCOs.

The Commission also is proposing amendments to Regulation 39.16(c) that would require: 1) a DCO to have a default committee that would be convened in the event of a default involving “substantial or complex positions” to help identify market issues with any action the DCO is considering and requiring the default committee to include clearing members and other participants to help the DCO to efficiently manage the house or customer positions of the defaulting member (Regulation 39.16(c)(1), and (2)) that a DCO’s default procedures provide for immediate public notice on a DCO’s website of a declaration of default (Regulation 39.16(c)(2)(ii)).

Nodal Clear believes that requiring the creation of a default committee that includes clearing members, or other participants, is not likely to assist in the efficient management of the

house or customer positions of the defaulting member, but instead add unnecessary complexity to what is, at Nodal, an efficient process. In the event of a default, it is critical for a DCO to quickly and efficiently liquidate the portfolio of the defaulting member in order to reduce the portfolio's exposure to market risk (i.e., the risk that the price of the underlying positions change during the liquidation process). Any delay created in convening a default committee could increase market risk and the cost to liquidate the portfolio of the defaulting clearing member. Additionally, a default committee with clearing members could also create the potential for conflicts for any clearing member or participant selected, as well as interject an element of self-interest or potential gaming within the decision-making of the default procedure and response. Nodal Clear believes that it has the specific expertise to best understand, define, and address "substantial and complex positions" in a default. While Nodal Clear appreciates the Commission's concern that a clearing member or participant perspective may assist in the default process, Nodal Clear already has the ability to obtain this input via its Risk Advisory Committee, which includes representatives from each Nodal Clear Clearing Member, and is in regular dialog with its participants. As such, Nodal Clear would request that the requirement to create a default committee be either left to the discretion of each DCO, or written such that it would only be required if a DCO does not have a system or mechanism in place, like Nodal Clear, to obtain clearing member or participant input on how the DCO would manage the default liquidation process.

Regarding the Commission proposal requiring an immediate public notice on the DCO's website of a default, Nodal Clear is concerned that the timing of the default announcement could potentially impact the market and the DCO's ability to manage the default. While Nodal Clear generally supports providing notice to the market of a clearing member's default, there may be circumstances where immediate public notice may not be appropriate and could potentially facilitate gaming of the default process by market participants. For example, during a broker assisted liquidation, if market participants are aware that a clearing member is in default, they may make less competitive bids and offers thereby increasing the market risk of the portfolio and liquidation costs. If the Commission adopts the rule, Nodal Clear recommends that DCOs be given discretion and flexibility with regard to the appropriate timing of the public notice of a clearing member default. In that regard, the rule text could be modified to state that the default procedures provide for public notice, and only immediate public notice if the DCO in its discretion or in cooperation with the Commission deems it to be appropriate in order to effectively manage a clearing member default.

E. Proposed Regulation 39.19 - Reporting

In addition to clarifying certain existing reporting requirements, the Commission is proposing to adopt a number of additional reporting requirements for DCOs in Commission Regulation 39.19. As a general comment, Nodal Clear respectfully requests that the Commission provide a more fulsome explanation of the benefits of the proposed event specific reporting requirements⁴ and consider the benefit of being notified within the short timeframes proposed for

⁴ A decrease in liquidity resources in proposed § 39.19(c)(4)(ii); a legal name change in proposed § 39.19(c)(4)(xi); any change in any liquidity funding arrangement in proposed § 39.19(c)(4)(xiii); a change in settlement bank

each event. For example, please consider whether the Commission derives a benefit from being notified of a change in a DCO's fiscal year immediately versus within thirty business days. Nodal Clear also believes that some of the proposed Regulation 39.19 reporting requirements seem antithetical to the Project KISS initiative in that they appear to duplicate existing requirements. For example, existing Regulation 1.20(g)(4) provides that a DCO must "obtain a written acknowledgment from each depository prior to or contemporaneously with the opening of a futures customer funds account" and the depository must provide that "executed written acknowledgment no later than three business days after the opening of the account or the execution of a new written acknowledgment for an existing account, as applicable." In summary, the Commission is notified whenever a DCO establishes a new depository account for holding customer funds. In light of this existing requirement, it appears duplicative to also require a DCO to provide notice of a change in depositories for customer funds under Proposed 39.19(c)(4)(xvi).

Nodal Clear respectfully submits the following comments on proposed Regulations 39.19(c)(4)(xxi), (xxiv) and (xxvi).

1. Commission Regulation 39.19(c)(4)(xxi) – Change in Independent Accounting Firm

The Commission is proposing new Commission Regulation 39.19(c)(4)(xxi), which would require a DCO to report to the Commission no later than one business day after any change in the DCO's independent public accounting firm. The report would be required to include the date of such change, the name and contact information of the new firm, and the reason for the change. While Nodal Clear does not object to reporting this information to the Commission, we believe that reporting this type of information should not be considered by the Commission to be time sensitive to accomplish the ultimate goal of ensuring the DCO's compliance with the CEA and regulations. Nodal Clear appreciates that the Commission views this as pertinent information that should be reported to the Commission in a timely fashion, but without further explanation from the Commission why this particular information is time sensitive, requiring it within one business day would be an undue burden to the DCO. Nodal Clear requests that if this regulation is adopted, reporting a change in independent accounting firm within 15 business days would be more reasonable and consistent with the requirements of other financial regulators. For example, under FDIC regulations, an insured depository institution is required to provide notice to the FDIC within 15 days of a change in independent public accountant.⁵

arrangements in proposed § 39.19(c)(4)(xiv); a change in a DCO's arrangements with its depositories that hold customer funds in proposed § 39.19(c)(4)(xvi); a change in the DCO's fiscal year end in proposed § 39.19(c)(4)(xx); a change in the DCO's accounting firm in proposed § 39.19(c)(4)(xxi); major decisions of the DCO's board in proposed § 39.19(c)(4)(xxii); issues with a DCO's margin model in proposed § 39.19(c)(4)(xxiv) or settlement bank in proposed § 39.19(c)(4)(xv); and new futures or option products accepted for clearing by the DCO in proposed § 39.19(c)(4)(xxvi).

⁵ See 12 CFR § 363.4(d).

2. Commission Regulation 39.19(c)(4)(xxiv) – Margin Model Issues

The Commission is proposing new Commission Regulation 39.19(c)(4)(xxiv), which would require a DCO to report to the Commission no later than one business day after any issue occurs with a DCO’s margin model, including margin models for cross-margined portfolios, that affects the DCO’s ability to calculate or collect initial margin or variation margin.⁶ Nodal Clear believes that the regulation as proposed is prescriptive, overbroad, and vague to the extent it requires the reporting of *any issue*, no matter how immaterial, even when no actual positions are affected. The Commission has always operated from a principles-based regulatory standpoint that provides appropriate discretion to the DCO. While certain issues may rise to a significant level that the DCO should report them to the Commission, Nodal Clear believes that the DCO is in the best position to determine what is a material or significant issue. If the Commission adopts this regulation, Nodal Clear requests that it be revised to require such reporting only if the margin model issue *materially* affects the DCO’s ability to calculate or collect initial margin or variation margin and an actual position is affected. As revised, the regulation would read: “. . . after any issue occurs with a DCO’s margin model, including margin models for cross-margined portfolios, that materially affect an actual position in the DCO’s calculation of initial margin or variation margin.”

3. Commission Regulation 39.19(c)(4)(xxvi) – New Product Accepted for Clearing

The Commission is proposing to add Regulation 39.19(c)(4)(xxvi), which would require a DCO to provide notice to the Commission no later than 30 calendar days prior to accepting a new product for clearing. The Commission notes that it has not defined “product” for purposes of Regulation 40.2 (Listing products for trading by certification) and Regulation 40.3 (Voluntary submission of new products for Commission review and approval), and requests comment on whether defining this term would be helpful in clarifying what products must be reported.⁷ Nodal Clear would agree that defining the term “product” would help clarify when a DCO should notify the Commission of it accepting a “new product” for clearing. However, this type of proposal should be handled via the Commission’s standard rule proposal process, with the Commission proposing a definition of “product” for the industry, including DCMs and DCOs, to consider and comment on. As this definition would have broad impact on many aspects of the industry for DCMs and DCOs, it would be inappropriate for the Commission to proceed with this rule change without first proposing and receiving comment on a new rule definition of “product.” Therefore, Nodal Clear requests that this regulatory change not be considered or adopted until such time as the Commission takes the necessary steps to propose the other appropriate regulatory changes.

Though Nodal Clear believes it is premature to propose or make this regulatory change at this time, we will provide comment on the change as it is proposed. As with many of the other new requirements proposed, Nodal Clear believes that the regulation is not necessary because DCOs, certainly Nodal Clear, regularly notify the Commission of new products that the DCO

⁶ Proposed Regulation 39.19(c)(4)(xxiv)(emphasis added).

⁷ See Proposal at 22,243.

believes present unique risks or risks that the DCO does not typically manage. The Commission, operating in a principles-based regulatory environment, has traditionally relied on and allowed a DCO to utilize its experience and discretion for these types of determinations. However, if the Commission deems it appropriate to take a prescriptive approach and adopt the proposed regulation, Nodal Clear believes that a “new product” should mean a derivative contract that presents a unique or novel risk that is not currently being cleared in the marketplace by any DCO, and not just at the particular DCO. An example of that would be bitcoin futures when they were first proposed to be cleared, since no DCO at that time cleared such a product.

If the Commission were to require a DCO notice filing prior to clearing a new product, such as every new contract that a DCO clears including new expiries of existing contracts, it is not clear what benefit the Commission would derive from such frequency and volume of DCO reporting. Additionally, it would impose a significant burden on DCOs to provide the 30-day advance notice and filing for each contract. For example, Nodal Clear clears approximately 1,800 different contracts offered by Nodal Exchange, requiring a DCO make a notice filing for every new contract would require significant resources at the DCO to produce the notices and for the Commission to review such notices, with no apparent benefit over the current process. Such a requirement would be unnecessary and inconsistent with the objectives of Project KISS to make the Commission’s rules simpler and less burdensome.

Nodal Clear also wishes to point out that, while the Proposal’s stated rationale for the proposed rule is that Commission Regulation 40.2 applies to self-certification by DCMs and swap execution facilities for listing of new products, but does not apply to DCOs, the Proposal would impose more onerous requirements on DCOs intending to clear a new product. In this regard, while proposed Regulation 39.19(c)(4)(xxvi) would require a DCO to provide notice no later than 30 calendar days prior to accepting a new product for clearing, Regulation 40.2 only requires that a submission be made one (1) business day preceding the product’s listing on a DCM or swap execution facility. In addition, proposed Regulation 39.19(c)(4)(xxvi) would require a DCO to provide an explanation of any substantive opposing views received from outreach to clearing members and/or the general public and how the DCO addressed such views or objections. No such requirement exists in Commission Regulation 40.2 for DCMs. If the rationale for Regulation 39.19(c)(4)(xxvi) is that Regulation 40.2 does not apply to DCOs, then the requirements for Regulation 39.19(c)(4)(xxvi) should be substantially the same as in Regulation 40.2. It would be inconsistent with the goals of Project KISS, pursuant to which the Proposal was issued, to require more burdensome requirements for DCOs in Regulation 39.19(c)(4)(xxvi) as proposed.

F. Regulation 39.26 – Composition of Governing Boards

The Commission is proposing to add Regulation 39.26, which would implement Core Principle Q. Core Principle Q requires a DCO to ensure that the composition of its governing board or committee includes market participants. In its discussion regarding proposed Regulation 39.26, the Commission clarifies the requirements of Core Principle Q by interpreting “governing board or committee” to mean the governing body with ultimate decision-making

authority, whether a board or a committee. Nodal Clear agrees that a DCO needs to be responsive to its clearing members and its customers.

Nodal Clear appreciates the Commission’s efforts to clarify the requirements of Core Principle Q and the proposed implementing Regulation 39.26. However, Nodal Clear believes DCOs would benefit from further clarification. Nodal Clear currently has market participant representation on the board of the parent company who provide significant and meaningful input. Accordingly, Nodal Clear would request the Commission further interpret “governing board or committee” to include the board of the DCO’s parent company to the extent it has relevant decision-making authority over the DCO. As a general matter, Nodal Clear actively engages its clearing members and participants on a regular basis.

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Nodal Clear appreciates the opportunity to comment on the Proposal.

Respectfully submitted,

/s/ Cody Alvarez

Cody Alvarez
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