

October 11, 2022

Via Electronic Submission

Christopher J. Kirkpatrick
Secretary of the Commission
Commodities Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 201581

Re: Governance Requirements for Derivatives Clearing Organizations

Dear Mr. Kirkpatrick,

ForecastEx LLC (“ForecastEx”) appreciates the opportunity to comment on the Commodity Futures Trading Commission’s (“CFTC” or the “Commission”) proposed rulemaking on governance requirements for Derivatives Clearing Organizations (“DCOs”). ForecastEx is an applicant for DCO registration as well as Designated Contract Market (“DCM”) registration. While not currently registered as a DCO or DCM, ForecastEx anticipates that it will be registered by the time any final rules would go into effect.

ForecastEx is generally supportive of the Commission’s attempts to increase transparency and participant input into DCO governance procedures. However, ForecastEx believes that the Commission could improve the final rule by taking into consideration some of the different DCO models that have arisen recently.

In particular, there are two developing trends. First, DCOs and Derivatives Contract Markets (“DCMs”) are vertically integrated and imbedded into FCMs. For example, FTX as well as CME, if they successfully register as an FCM, would fall into this category. Second, there are DCOs that primarily or exclusively list fully-collateralized products. Currently, FTX falls into this category. Both of these trends have implications for the CFTC’s rule, which appears to be primarily designed for the traditional DCO model. The CFTC should adapt its final rules to explicitly consider these DCO models.

General Comments

For DCOs and FCMs that are imbedded within each other, this will cause some FCM members of the DCO to be affiliates. Having affiliates on the Risk Management Committee (“RMC”) or Risk Working Group (“RWG”) could potentially introduce conflicts of interest and would be counterproductive. The affiliate should not be expected to have differing views from the DCO. Further, if the DCO has placed informational barriers between itself and its affiliated FCM, placing affiliates on the RMC and RWG would risk permeating those barriers. The Commission should specify that affiliates of the DCO may not serve as members of the RMC.

For a fully-collateralized market, the Commission's proposed rules provide minimal risk management benefit. The risks that the RMC and RWG would be expected to advise on are generally not present in a fully-collateralized market. The areas mentioned by the Commission that could materially affect the risk profile of the DCO are changes to margin models, default procedures, participation requirements, risk monitoring practices, and the clearing of new products. These areas do not present financial risks for a fully-collateralized DCO. As the Commission has noted "fully collateralized positions do not expose DCOs to many of the risks that traditionally margined products do, as full collateralization prevents a DCO from being exposed to credit risk stemming from the inability of a clearing member or customer of a clearing member to meet a margin call or a call for additional capital." (85 FR 4800, 4803-4804) The lack of credit risk minimizes the importance for margin models, default procedures, and participation requirements, and risk management procedures. Additionally, as long as a DCO is only listing fully-collateralized products, they do not pose financial risks to the DCO either.

ForecastEx is also concerned that the cost of maintaining a RMC and RWG would be high for smaller DCOs. As currently constructed, the proposed rule would require a minimum of 8 members between the RMC and RWG which would exceed the number of ForecastEx's permanent staff. In addition, given that the RMC is intended to be involved heavily in the DCO's decision-making process, the administrative costs of could also be fairly high. These costs will disproportionately impact smaller DCOs given the high fixed costs that while easily absorbed by a large DCO, could represent a significant portion of a small DCO's budget.

Given the reduced risk profile and limited number of risks applicable to a fully-collateralized DCO, the Commission's proposal would provide a negligible risk management benefit while imposing significant costs. As a result, the Commission should amend its proposed rules by exempting DCOs which only clear fully-collateralized products. The CFTC has previously exempted fully collateralized positions and DCOs which only clear fully collateralized products from some portions of Part 39 (See CFTC Regulation 39.11(c)(1), 39.11(e)(1)(ii), 39.11(a)(5)(i), 39.13(h)(3), and 39.16(e)) so making a similar change here would be consistent with current regulations. At the very least, if in light of the foregoing, the CFTC believes that there are any material risks for fully collateralized DCOs that should be subject to RMC consultation, the Commission should provide more detail as to what types of issues would require RMC consultation and accordingly limit the required use of an RMC for a fully-collateralized DCO.

Responses to CFTC Questions

In addition to the general comments above, please see the below responses to specific issues for which the CFTC requested comment.

Impact of New Products on DCO's Risk Profile

The Commission requested comment on whether a DCO's proposal to clear a new product should be categorically treated as a matter that could material affect the DCO's risk profile. A DCO's proposal to clear a fully-collateralized product does not materially affect the DCO's risk profile as by definition, the DCO will have sufficient funds on hand to cover all obligations that

arise from clearing that product. The CFTC should exempt fully-collateralized products from new products that require risk management committee (“RMC”) consultation.

RMC membership rotation

The Commission requested comment on whether RMC membership should be rotated on a regular basis. We do not believe that there should be a codified rotation requirement as different rotation schedules may be more appropriate for different DCOs. For example, it may be less beneficial to rotate membership if a DCO is small and has most of its activity coming from a couple of clearing members. In those cases, because those clearing members represent an outsized portion of the DCO’s activity, it may be more beneficial from a risk management perspective to ensure that the larger clearing members are represented on the RMC for longer periods of time. In these cases, less frequent rotations would be useful.

Risk Working Group (“RWG”) Requirement

Because of the large time commitment and limited pool of potential members, the CFTC proposes requiring DCOs to create one or more RWGs in addition to the RMC. For a small DCO, staffing a RMC and a RWG would be a substantial burden. To reduce the compliance burden on smaller DCOs, we would recommend that the Commission give DCOs who are not systemically important DCOs the option to choose between maintaining either a RMC or a RWG, but not both. This way, smaller DCOs could assess whether the RMC or the RWG would best support the safety and efficiency of the DCO and the stability of the broader financial system without overly taxing the DCO with overly burdensome requirements.

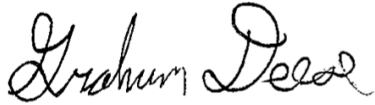
Role of RMC members as independent experts

The Commission requested comment on the requirement that RMC members act as independent experts. The Commission should adopt this requirement. Core Principle O requires that DCOs consider the views and interests of clearing members and customers of clearing members when making decisions. The views of clearing members and customers of clearing members will only be represented on a RMC or a RWG if the individuals appointed to these committees are acting on behalf of, and in the interest of those respective clearing members and customers of clearing members. If the RMC members are fully independent of their employers, Core Principle O would not be furthered by the Commission’s proposal.

Furthermore, it seems unlikely that a RMC member who is employed by a clearing member or a customer of a clearing member, could ever truly act in a manner independent from their employers interest. Those individuals allegiances will ultimately rest with their employers. Rulemaking based on an artificial concept of independence does not appear to us as a productive construct. A better approach would to recognize the tie the RCM members will have with their employers and to design a regulation with this connection in mind.

ForecastEx appreciates the opportunity to comment on the CFTC proposal, and is available to provide further input as the Commission may request. If the Commission has any questions or comments regarding this letter, please feel free to contact me through email at gdeese@4castex.com.

Respectfully,

A handwritten signature in cursive script that reads "Graham Deese".

Graham Deese
Chief Regulatory Officer
ForecastEx LLC