

February 13, 2023

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: Comment on Notice of Proposed Rulemaking Regarding Reporting and Information Requirements for Derivatives Clearing Organizations
RIN 3038-AF12

Dear Mr. Kirkpatrick:

Nodal Clear, LLC (“Nodal Clear” or “Nodal”) appreciates the opportunity to respond to the Commodity Futures Trading Commission’s (“CFTC” or “Commission”) Notice of Proposed Rulemaking regarding reporting and information requirements for Derivatives Clearing Organizations (“DCOs”) (referred to herein as the “NOPR”).¹ As background, Nodal Clear is a registered DCO and the clearinghouse for Nodal Exchange, LLC (“Nodal Exchange”) and Coinbase Derivatives,² which are both CFTC designated contract markets (“DCMs”). Nodal Clear is a wholly owned subsidiary of Nodal Exchange, itself ultimately wholly owned by the European Energy Exchange AG (“EEX”). 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 NOPR.³

I. General Comments

Nodal Clear generally supports the Commission’s efforts in the NOPR to enhance its reporting and information regulations. Nodal Clear appreciates the opportunity to review and comment on

¹ Reporting and Information Requirements for Derivatives Clearing Organizations, 87 Fed. Reg. 77698 (Dec. 15, 2022).

² Coinbase Derivatives is a registered DCM under LMX Labs LLC, formerly doing business as FairX.

³ Nodal Clear also participates in The Global Association of Central Counterparties (“CCP12”) and supports the comment letter submitted by CCP12 regarding the NOPR.

the proposed regulations to share its perspective as a DCO. As further described below, Nodal Clear has concerns regarding certain elements of the NOPR. Nodal Clear is chiefly concerned with the proposed increased scope of Regulation 39.18(g) (notice of exceptional events) as the removal of the “materiality” threshold for reporting would remove DCO expertise in determining whether an event warrants reporting and would cause a significant increase in filing of immaterial and unexceptional events. Instead of expanding the regulatory burden (for both the Commission and DCOs), Nodal Clear believes that the publication of guidance by the Division of Clearing and Risk (“DCR”) could be a more effective and efficient method of ensuring consistent reporting of exceptional events. Nodal Clear also has comments and questions regarding the proposed daily reports, which are described below.

II. 39.18 – System Safeguards – Notification of Exceptional Events

The proposed amendments to Regulation 39.18 would broaden the scope of what is a reportable exceptional event to the detriment of DCOs and the Commission. Nodal Clear understands from the NOPR that the Commission is seeking to prevent the non-reporting of malfunctions, incidents, or threats that it finds material. Meeting the CFTC’s expectation, that it may confidently rely on the knowledge and expertise of a DCO in the determination of what is a material reportable exceptional event, is highly valued at Nodal Clear. However, Nodal Clear believes that the proposed revisions would cause a significant increase in the number of events that are reported, at significant cost to DCOs responsible for reporting such events and burden for the Commission staff responsible for reviewing the influx of insignificant and unnecessary filings. In a principles-based regulatory structure, DCOs should be permitted to continue to utilize their expertise to evaluate whether an event is reportable under the current regulations while referring to DCR guidance to appropriately calibrate such reporting. Nodal Clear believes this approach would be the optimal way to ensure that DCOs report the events that the Commission wants to be made aware of, while minimizing the reporting of extraneous events by DCOs.

A. 39.18(g) – Removal of “Materiality Threshold”

The Commission states that it is proposing to remove the materiality threshold in Regulation 39.18(g) to require the reporting of “any threat, and not just ‘targeted’ ones”⁴ in an effort to “ensure that the [DCR] receives notice of the full spectrum of cyberattacks and cyberthreats”⁵ and to promote consistent reporting across DCOs.⁶ However, the removal of the materiality threshold would remove a valuable filter used by DCOs to determine whether an event should be reported and would expand the scope of reportable events. Also, without the materiality threshold, the number of reportable events is likely to increase dramatically as inconsequential security threats that are routinely thwarted by a DCO’s standard security measures would be reportable. For

⁴ 87 Fed. Reg. at 76701.

⁵ *Id.*

⁶ *See id.*

example, DCO firewalls routinely repel brute force attacks and identify network scans. While these threats could represent a “significant likelihood of impairment,”⁷ they are typically repelled by a DCO’s standard security measures with limited impact on a DCO or its users. Under the current regulations, DCOs are allowed to employ their procedures and knowledge of their systems to evaluate whether an event is reportable, thereby reducing the number of trivial events reviewed by the Commission. The proposed rule amendment removes this discretion and will result in an exponential increase in filings.

To wit, Nodal Clear is concerned that the Commission may be significantly underestimating the impact that proposed amendments to Regulation 39.18(g) will have on DCO reporting frequency and costs. Specifically, in the cost benefit analysis of the NOPR, the Commission states that it expects the proposed rule to require an additional four reports per year.⁸ However, our preliminary analysis indicates that the number of reportable events (and associated costs) would increase dramatically. Also, such reporting may tax the Commission’s limited resources for no useful purpose as Commission staff would have to review likely voluminous inconsequential reports. Unfortunately, the “noise” created by the increased reporting may also increase the likelihood that material events are overlooked.

In short, Nodal believes the proposed Regulation 39.18(g) reporting rules will increase costs for DCOs, while making it more difficult for the Commission to meet its stated objectives, consume limited resources, and potentially lead to material events being overlooked.

Instead of removing the materiality threshold, Nodal Clear would suggest that the Commission could achieve its goal of ensuring that it consistently receives notice of material impairing events by helping DCOs appropriately calibrate their respective materiality thresholds. Commission staff has a long history of issuing guidance or staff memoranda to inform or direct registrants like DCOs and DCMs to revise and improve reporting practices, clarify expectations, and align practices across regulated entities.⁹ Such guidance is an effective tool for promoting consistent reporting across DCOs. By outlining examples of the types of events that are material and require reporting, DCR can help DCOs calibrate their internal filters to determine which events may be material, and thus, reportable. This guidance could also evolve over time to meet changing conditions of what the Commission might deem material and could be informed by feedback from the DCOs and through findings from DCO exams to allow other DCOs to prevent similar missteps. The issuance of guidance by DCR would also be consistent with the practices of the Commission’s Division of Market Oversight (“DMO”), which provides guidance to DCMs, swap execution facilities, and swap data repositories regarding the reporting of system disruption notifications. Such guidance provides non-exclusive examples of significant system disruptions and includes a template for

⁷*Id.* at 76716. Proposed Regulation 39.18(g)(1).

⁸ *Id.* at 76711.

⁹ For example, DCR has provided informal guidance to DCOs that clarifies reporting obligations and best practices such as DCR memorandum dated November 3, 2014, regarding DCO annual compliance reports.

reporting such events.¹⁰ Nodal believes that similar guidance issued by DCR would be a more effective and efficient way to promote consistent reporting across DCOs than to remove the materiality threshold.

In sum, DCOs utilize the materiality threshold filter to determine what is reportable. Without this important filter, DCOs will have to report – and the Commission will have to review – significantly more reports that are consistently immaterial, thereby misusing resources at both the DCO and the Commission. Instead of removing this important filter, Nodal Clear suggests the Commission staff steer DCOs to the Commission’s understanding of “materiality” through guidance.

B. 39.18(a) & 39.18(g)(1) – “Hardware of Software Malfunction,” and “Operator Error”

The Commission has proposed to define the term “hardware or software malfunction” as “any circumstance where an automated system or a manually initiated process fails to function as designed or intended, or the output of the software produces an inaccurate result.”¹¹ It has also proposed to amend Regulation 39.18(g)(1) to include events stemming from operator error.¹² Nodal Clear believes that these proposed amendments are too broad and could result in an excessive number of innocuous filings of little value to the Commission.

In conjunction with the proposed removal of the materiality threshold, these proposed amendments appear to create an overbroad requirement to report “any circumstance . . . where . . . a manually initiated process fails to function as designed or intended”¹³ This broad standard – including “any circumstance” could encompass relatively minor matters, such as keystroke errors, that can be readily addressed. In order to limit the number of innocuous “exceptional event notices,” Nodal Clear believes DCOs should continue to be permitted to determine whether an event is a material impairment or creates a significant likelihood of a material impairment.

III. 39.19(c)(1) – Daily Reporting Requirements

The Commission is seeking to amend the daily reporting obligations as stated in Regulation 39.19(c)(1) to require additional information to be reported daily.

A. Daily Reporting of Margin Model Back Testing

The Commission is proposing to require DCOs to include in their daily reports the results of their margin model back testing.¹⁴ Such testing is required to be performed daily, and Nodal Clear already provides this back testing information to the Commission on a voluntary basis. Nodal Clear

¹⁰ DMO’s guidance and reporting template is provided to DCMs via a hyperlink maintained on the CFTC Portal webpage for DCMs reporting events under Commission Regulation 38.1051.

¹¹ 87 Fed. Reg. at 76701.

¹² *Id.*

¹³ *Id.* (emphasis added).

¹⁴ 87 Fed. Reg. at 76704.

supports establishing a rule that provides for the reporting of back testing information. However, Nodal Clear believes it is difficult to establish the data fields for a new daily report via the rulemaking process as proposed data fields raise questions that could be more effectively addressed via collaboration between DCOs and DCR.¹⁵ Accordingly, Nodal believes the Commission should meet its Back Test Reporting objectives by replicating the process used to establish the Reporting Guidebook¹⁶ where, as noted in the NOPR,¹⁷ DCR consulted with DCOs to develop and revise reporting fields and technical specifications.

B. Reporting Completeness

In an effort to assist the Commission in knowing when daily DCO reporting is complete, the Commission is proposing to require that DCOs include information in their daily reports to indicate that the information reported is complete.¹⁸ The Commission proposes that DCOs demonstrate the completeness of information by either submitting a manifest file that contains a list of files sent by the DCO, or by including the file number and count information embedded within each submitted report, “where each FIXML file would indicate its position in the sequence of files submitted that day, *i.e.*, file 1 of 10.”¹⁹ The Commission also requests comment on which of the proposed responses is preferable.

Nodal Clear prefers submitting a manifest file. This is an effective way to accomplish the Commission’s goal of identifying the completion of reporting without confusion or multiple reports. If the proposed file number and count were embedded within each report, the additional notification would be required if a report were ever added, replaced, or taken away. Also, in the event reports were generated out of sequence on a given day (due to technical issue or some delay that only affects a subset of reports), further notice would also be required. Nodal Clear finds that

¹⁵ For example, Nodal Clear has a few questions on how the data should be reported for the daily Breach Details and Breach Summary fields:

1. The requirements for reporting the Variation Margin used to calculate the Breach Amount state “Variation margin should include the net sum of all cash flows between the DCO and clearing members by origin.” 87 Fed. Reg. at 76731. For the customer origin, does this mean that the Initial Margin and Variation Margin figures should be reported on an omnibus-basis with Initial Margin calculated gross across all clients that the Clearing Member clears on behalf of and Variation Margin should be calculated net across all clients (with gains for one client netted against losses for another client)?
2. Will the breach summary section of the report reflect back tests that are based on the latest risk parameters used by the DCO to evaluate margin model performance as opposed to a summary of the breach details in the same report across the testing period?
3. What should be the back test range over which results are reported? Should all CCPs report back test results over the same range (*e.g.*, 250 trading days)?

¹⁶ Commodity Futures Trading Commission Guidebook for Part 39 Daily Reports, Version 1.0.1, Dec. 10, 2021 (Reporting Guidebook).

¹⁷ 87 Fed. Reg. at 76702.

¹⁸ *Id.* at 76703.

¹⁹ *Id.*

if manifest files were submitted, extra notifications would not be needed because the manifest file would be generated last, so the sum of the reports would exist in that one file. Therefore, Nodal Clear's preference would be to submit a manifest file to demonstrate completeness of the information reported.

C. Settlement Prices for All Instruments

The Commission is considering whether it should require DCOs to provide the current settlement prices and related information published by DCMs for futures and options contracts with no open interest.²⁰ The Commission currently receives daily position information that includes settlement prices for a range of contracts with open interest, and it believes that requiring DCOs to provide this proposed information would “enhance the Commission’s ability to perform futures and options risk surveillance by using complete settlement price data.”²¹ The Commission is requesting comment by the DCOs.

Nodal Clear believes that requiring DCOs to report settlement prices for contracts with no open interest would duplicate information already published by the DCMs pursuant to Part 16 of the Commission’s regulations. Additionally, it is not practical to add settlement prices for contracts with no open interest to existing DCO daily position reports as such reports are of course structured to reflect contracts where a clearing member has a position.

* * * * *

Nodal Clear appreciates the opportunity to comment on the NOPR.

Respectfully submitted,

/s/ Cody Alvarez

Cody Alvarez
Chief Compliance Officer &
Corporate Counsel

²⁰ *Id.*

²¹ *Id.*