



September 26, 2023

Mr. Clark Hutchinson, Director, Division of Clearing and Risk  
Mr. Vincent McGonagle, Director, Division of Market Oversight  
Ms. Amanda Olear, Director, Market Participants Division  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st, NW  
Washington, DC 20581

Re: Request for Comment on the Impact of Affiliations on Certain  
CFTC-Regulated Entities

Dear Division Directors,

NFA welcomes the opportunity to submit comments in response to CFTC staff's questions regarding the *Impact of Affiliations on Certain CFTC-Regulated Entities*. NFA is an independent self-regulatory organization (SRO) and does not operate a market. Moreover, we do not have any affiliated entities. Therefore, we do not face any of the potential inherent conflicts described in staff's request for comment.

At the outset, we commend Commission staff for taking this opportunity to review, in part, the SRO structure and consider whether enhancements are necessary to ensure its ongoing effectiveness. NFA recognizes that change and innovation in the derivatives markets help keep them strong and competitive. We also believe that the Commission should periodically review the industry's regulatory oversight structure and consider, if appropriate, enhancements in light of material changes in the way markets function.

In the comment request, Commission staff highlights three separate affiliate relationships—derivatives clearing organizations (DCOs) and affiliated futures commission merchants (FCMs); designated self-regulatory organizations (DSROs) and FCMs; and designated contract markets/swap execution facilities (SEFs) and affiliated intermediaries (e.g., FCMs, IBs, CTAs and CPOs). NFA believes that the comment request raises important questions about the current regulatory oversight framework, which relies heavily on SROs and a Joint Audit Program by which SROs can delegate certain monitoring and examination functions to a DSRO.<sup>1</sup> Given NFA's unique industry

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<sup>1</sup> As the CFTC's staff comment request notes, CFTC Regulation 1.52 permits two or more SROs to file a plan with the Commission to delegate primary, but not exclusive, oversight responsibility to a DSRO for an FCM that is a member of those.



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role, we are most familiar with the issues associated with SRO and the DSRO framework and will limit our comments to those areas. The other topics, however, also raise important questions, and NFA encourages the Commission to consider carefully the comments of market participants impacted by or involved in those types of affiliated relationships.

The comment request highlights certain affiliations—particularly those relating to DCMs and their affiliated FCMs—that may impact a DCM's SRO obligations and the DSRO framework. As explained below, NFA believes that DCM/SROs have appropriately addressed these conflicts and other issues associated with having FCM investors and affiliated FCMs. Moreover, we firmly believe that DCMs recognize the importance of integrity and public trust in the industry's self-regulatory framework and will continue to act reasonably in the future to address any material conflicts arising from having FCM investors or affiliates.

#### *The CFTC's Prior Review of Self-Regulation*

At the outset, NFA observes that the types of relationships between DCMs and FCMs identified in staff's comment request are not new. In the early 2000s, the Commission conducted a review of self-regulation in the futures industry to determine whether, and how, SROs can fulfill their statutorily mandated responsibilities. At that time, the Commission noted that increasing competition, changing ownership structures and evolving business models were dramatically transforming the U.S. futures industry. The Commission stated that exchanges and FCMs may compete directly (e.g., FCMs internalize order flow or exchanges disintermediate FCMs) or indirectly when FCMs establish or invest in new exchanges offering substitutable contracts.<sup>2</sup> The Commission noted that "the FCM-owners of new exchanges may both compete against, and be subject to the regulation of, the established SROs of which they are members".<sup>3</sup>

During this prior review, the Commission's review of self-regulation identified three key principles. First, self-regulation is the most effective regulatory model available to the futures industry, and this model must be updated and enhanced, as appropriate and necessary, to keep pace with the changing marketplace. Second, market structures, driven by global competition and changing ownership structures, pose a heightened risk that SROs may fail to fairly and vigorously carry out their regulatory responsibilities. The Commission importantly stated that conflicts, whether

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<sup>2</sup> The Commission cited Cantor Financial Futures Exchange, BrokerTec Futures Exchange and U.S. Futures Exchange as examples.

<sup>3</sup> See 71 Fed. Reg. 38740 (July 7, 2006), FNs. 8 and 9.





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actual or perceived, must be addressed proactively in the first instance by the SROs themselves. Third, the market environment [in the early 2000s] mandates enhanced and transparent governance as an essential business practice for maintaining market integrity and the public trust.<sup>4</sup>

Issues Raised by CFTC Staff's Current Comment Request

NFA strongly believes that self-regulation subject to appropriate government oversight maximizes regulatory effectiveness while minimizing regulatory burdens. Moreover, the three key principles identified during the Commission's review of self-regulation more than fifteen years ago have stood the test of time and the industry's evolving business models. In the early 2000s, FCMs established or invested in new exchanges and at least one FCM had an affiliate that operated as a contract market. Today, there are four registered FCMs and two pending FCMs that have DCM affiliates.<sup>5</sup>

With respect to these relationships, NFA strongly believes that enhanced and transparent governance practices are critical to managing and mitigating or eliminating perceived and actual conflicts of interest. To that end, we believe that affiliated registered entities in most instances should have separate Board of Directors, key management personnel, appropriate information sharing barriers and policies that manage and mitigate or eliminate conflicts of interest.

Pursuant to the Commodity Exchange Act and Commission Regulations, DCMs have an obligation to implement rules and monitor their FCM members to ensure their financial integrity and protection of customer funds. Staff's comment request notes that a DCM monitors its FCM members' compliance with its minimum financial requirements by receiving FCM financial information and surveilling its FCM members' obligations created by their customers' positions. A DCM also has SRO obligations to, in part, conduct periodic examinations of its FCM members to monitor for compliance with its minimum financial requirements.

As Commission staff is aware, not all DCMs conduct periodic examinations of their FCM members. CFTC Regulation 1.52(d) allows DCMs to delegate the SRO functions described in CFTC Regulation 1.52(b) and (c) (e.g., on-site examinations) to a DSRO. The delegator DCM remains responsible, however, as an SRO for its FCM members' compliance. To effectuate CFTC Regulation 1.52's DSRO framework, DCM/SROs and NFA have entered into a Joint Audit Committee

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<sup>4</sup> See 71 Fed. Reg. 38740, 38741 (July 7, 2006).

<sup>5</sup> Another DCM had an affiliated FCM that withdrew from NFA membership in June 2022.



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Agreement. Today, only one DCM, CME Group Inc., acts as a DSRO and conducts examinations of its clearing member FCMs. NFA conducts examinations of any FCM that is not a clearing member of CME Group, Inc.

Commission staff's comment release raises two important issues relating to a DCM/SRO's obligation to conduct examinations when it has an affiliated FCM. First, the release specifically inquires whether a DCM should be prohibited from acting as the DSRO for an affiliated FCM. Unquestionably, when a DSRO shares a common ownership interest with an affiliated FCM, the DSRO has a perceived material conflict of interest—it may be more lenient examining its affiliated FCM and, if it has unaffiliated FCM members, stricter overseeing them.

Over the years, DCM/SROs have recognized this significant conflict of interest and have acted rationally and proactively to eliminate it. Since the early 2000s, no DCM with an affiliated FCM has sought to act as a DSRO and conduct its own examination activities for its affiliated FCM. Recently, each DCM with a registered or pending affiliated FCM has voluntarily requested that NFA act as the DSRO for its affiliated FCM. As noted above, as the industry's independent SRO, NFA is uniquely situated to assume the DSRO responsibilities for these affiliated FCMs. Although DCM/SROs have repeatedly addressed this conflict appropriately, NFA believes that this conflict is sufficiently material that it cannot be managed and mitigated within an affiliate structure. Even though DCM/SROs have voluntarily and appropriately addressed this conflict in the past, there is no assurance that a future DCM with an affiliated FCM will do so. Therefore, NFA recommends that the Commission consider amending Regulation 1.52 to specifically address this issue (e.g., by adopting a prohibition) to eliminate the possibility that a DCM would attempt to be the DSRO for its affiliated FCM in the future.

The second important issue has not arisen in the past and, therefore, is not one that DCM/SROs have previously addressed. Specifically, this issue is whether a DCM with an active affiliated FCM should be the DSRO for its non-affiliated FCM members. NFA believes that this type of DSRO oversight relationship may raise conflicts and competitive issues that may be heightened by the DSRO's access to its non-affiliate FCMs' confidential information and a perception that actions taken in overseeing its non-affiliated FCM members benefit its affiliated FCM.

As previously noted, SROs and DSROs have not previously faced this second issue—a DCM with an active affiliated FCM that may desire to serve as the DSRO for its non-affiliated FCM members—and may not in the future. Although it is not





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entirely clear at this time that a DSRO affiliated FCM will become active in the future,<sup>6</sup> NFA believes that the Commission should begin discussions, before this occurs, with the industry's SROs and DSROs to proactively address this issue and develop a framework that maintains and fosters the public's and market participants' trust in self-regulation.<sup>7</sup>

As noted above, the SRO framework has proven to be an efficient and, more importantly, an effective regulatory framework in the derivatives industry. The affiliated relationships identified in staff's release raise important questions regarding SROs and the DSRO framework. NFA commends the Commission for previously working with the SROs, DSROs and industry participants to mitigate conflicts of interests. Further, we firmly believe that the industry's SROs and DSROs can work with the industry and the CFTC to address future issues to ensure the ongoing effectiveness of the self-regulatory framework.

Respectfully submitted,

A handwritten signature in blue ink that reads "Carol A. Wooding". The signature is written in a cursive, flowing style.

Carol A. Wooding  
Senior Vice President  
General Counsel and Secretary

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<sup>6</sup> NFA recognizes that CME Group, Inc. has an affiliate, F&O Financial LLC, with a pending FCM registration application.

<sup>7</sup> Many of the same issues that arise when a DSRO has an affiliated FCM is responsible for regulatory oversight of other FCMs arise in the DCM context. As the CFTC staff notes in its request, a DCM has other self-regulatory obligations under the CEA and Commission regulations to enforce certain DCM rules, including those related to financial integrity, and bring disciplinary actions for any violations with respect to its member FCMs. These rules help protect the integrity of the markets in general and well as the specific DCM, and NFA understands the DCM's interest in carrying out this oversight function. Any framework developed to address the potential conflict issues involving a DSRO with an affiliated entity acting as DSRO for other FCMs should also address the potential conflicts that arise in the DCM context.