

September 26, 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 Derivatives Clearing Organizations Recovery and Orderly Wind-Down Plans; Information for Resolution Planning; RIN 3038-AF16

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 recovery and orderly wind-down plans and information for resolution planning for Derivatives Clearing Organizations (“DCOs”) (the “NOPR”).¹ As background, Nodal Clear is a registered DCO and the clearing house for Nodal Exchange, LLC (“Nodal Exchange”) and Coinbase Derivatives Exchange,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.

General Comments

Nodal Clear generally supports the Commission’s ongoing efforts to enhance the resilience of DCOs and strengthen the financial system in furtherance of the clearing mandate espoused by the G20 in 2009. The CFTC has confidently relied on the knowledge and expertise of DCOs through

¹ Derivatives Clearing Organizations Recovery and Orderly Wind-Down Plans; Information for Resolution Planning, 88 FR 48968 (July 28, 2023).

² Coinbase Derivatives Exchange is a registered DCM under LMX Labs LLC.

its principles-based regulatory regime because such an approach allows the DCOs to best address issues raised by the ever-changing financial markets while providing opportunities for innovation. The proposed amendments set forth in the NOPR would expand the regulatory burden and, in some cases, are unnecessary as existing regulations address many of the NOPR objectives.

The current regulations and CFTC Letter No. 16-61 allow and encourage DCOs to develop and maintain practical Recovery and Wind Down Plans (“RWPs”) that mitigate risks that could affect the broader market, while allowing DCOs to continue to focus on effective risk management and the prevention of events that might trigger RWP deployment. Any regulation regarding recovery and orderly wind-down should recognize that the risk management practices at DCOs are designed to provide for the continuity of critical operations and services and support the stability of the broader financial system, and that these practices mitigate the risk that extreme but plausible events would trigger recovery. These risk management practices are part of the reason why no DCO has ever initiated recovery or wind-down. The current regulations and CFTC Letter No. 16-61 already achieve the Commission’s goal of maintaining resilient DCOs and strengthening the financial system, but the proposed Regulations would shift the principal focus and resources of DCOs away from risk management planning and toward planning to recover from risk management failures.

A. Proposed Regulation § 39.19(c)(4)(xxiv), Annual Submissions of RWPs

The Commission is proposing Regulation 39.19(c)(4)(xxiv), which would require a DCO to maintain a recovery and orderly wind-down plan, submit the current plan(s) at least annually, and, upon revising its recovery plan or orderly wind-down plan, submit the current plan(s) and supporting information with a description of any changes and the reason(s) for such changes.

Nodal supports proposed rules requiring DCOs to submit RWPs to the Commission at least on an annual basis if there have been material changes made to the plan(s). Minor changes, such as if a DCO revises the layout of an RWP or corrects minor typos, should not require submission to the CFTC. The CFTC has long relied on the discretion of the DCOs to assess the materiality of policy changes and the need for notification, and this instance should be afforded the same standard. Nodal also supports providing the Commission with any supporting information with its RWP submission to the extent such information is actually part of the plan itself - such as appendices or annexes.

B. Proposed Regulation § 39.39(b)(2), Notice of Initiation of the Recovery Plan and of Pending Orderly Wind-Down

The Commission is proposing Regulation 39.39(b)(2), which would require each systemically important DCO and subpart C DCO to have procedures for informing the Commission and clearing members, as soon as practicable, when the recovery plan is initiated or orderly wind-down is pending.

Nodal supports proposed Regulation 39.39(b)(2) to the extent the Commission allows DCOs to exercise discretion, as provided in proposed Regulation 39.39(c)(3), in determining what triggers an RWP. The ability to set appropriate RWP triggers should ensure that DCOs are not required to provide notice of immaterial events.

C. Proposed Regulation § 39.39(c)(2), Recovery Scenarios and Analysis

The Commission is proposing Regulation 39.39(c)(2), which would require DCOs to identify scenarios that may prevent the DCO from meeting its obligations or providing its critical services as a going concern, with a specific analysis of each possible scenario. The plan should also address the default and non-default risks with specific scenarios delineated by the Commission. The NOPR lists eleven scenarios that SIDCOs or Subpart C DCOs must consider in their recovery plans, some of which the Commission acknowledges may not apply to DCOs based on their particular activities.³ Nodal appreciates the Commission's description of scenarios that it should consider, but it believes that such scenarios should be described as examples instead of requirements as not all scenarios apply to each DCO. The DCOs are best positioned to determine which of the eleven scenarios would be applicable to their activities, and should be allowed to use their discretion to determine if any further scenarios should be considered. Additionally, such flexibility will permit the regulation to evolve with the industry/technology.

In creating RWPs and recovery scenarios, DCOs must be able to account for their business-as-usual risk management practices. In many cases, these risk management practices may significantly mitigate the likelihood that recovery will be triggered. This rings especially true regarding events that include non-default losses. In these instances, DCOs should not be required to consider prescribed scenarios that its current risk management practices would prevent. Recovery scenarios should consist of extreme but plausible scenarios that could ultimately threaten the viability of a DCO's critical operations and services, based on its unique risk profile and current risk management practices. Requiring that a DCO focus on identifying and describing all the various aspects of a prescribed scenario in a DCO's recovery plan could result in a plan that is not as readily usable in an actual recovery event, as the RWP is less likely to recognize the myriad of circumstances that could arise in a recovery event. With RWPs that focus on operations, and not narrative, the regulatory burden would be reduced while the effectiveness would be enhanced. Reducing the additional narrative of the documentation allows DCOs to focus on the day-to-day risk management practices that will help prevent DCOs from ever initiating recovery or orderly wind-down procedures.

In addition, certain provisions of the NOPR, such as the requirements to analyze the market conditions and potential financial and operational impact on the DCO and external parties for each scenario (provisions (D) and (E)) appear to require DCOs to provide a speculative analysis. Nodal

³ 88 FR at 48978 (stating that a DCO may determine that a scenario is not possible in light of its activities).

believes such analysis would be of limited value and would likely not even be applicable in an actual recovery event, as each event leading up to a recovery scenario will be unique and involve varied and dynamic external factors. DCOs should be allowed the discretion to define types of loss events and how they might be combined with other simultaneous events to make sure that relevant scenarios are considered. Nodal would suggest that the DCO be allowed to provide an easy-to-read table or a matrix that details this process, rather than provide potentially lengthy narrative, which is what the proposed rule seems to require. The speculative analysis and mandatory consideration of certain scenarios the proposed rule would require could potentially distract from the main objective of recovery planning. The focus of RWPs should be in an analysis that focuses on plausible scenarios for each individual DCO, which the specific DCO is in the best position to determine and evaluate for itself while following appropriate principles-based regulatory requirements.

As the Commission acknowledges, no DCO has ever initiated recovery,⁴ which also means that no DCO has ever wound-down due to a failure of recovery. Nodal believes that this perfect track record is in large part due to the current robust risk management practices of DCOs and the Commission's oversight of such risk management practices. Nodal understands the importance of contingency planning and that RWPs could be important tools if extreme but plausible events happen. But we also believe that focusing on creating and maintaining effective risk management practices that prevent the need for recovery or orderly wind-down provides greater protection to the financial system, even in extreme but plausible conditions. For example, DCOs that are not SIDCOs have long sought United States Federal Reserve deposit account access in order to eliminate the risk of depository bank failure (an enumerated recovery plan scenario in proposed Regulation 39.39(c)(2)(ii)) and while the Commission has recognized and advocated for Federal Reserve deposit access⁵ such access has not been established. Nodal believes that attending to the management of existing risks is of greater value to the financial system than planning to recover from risk management failures.

Since recovery has never happened for any DCO before, and the events that would lead to a recovery or orderly wind-down are generally extreme and highly unlikely scenarios, the proposed rules would require DCOs to provide – and in some instances to divine – worst-case and extremely improbable scenarios in their RWPs. The NOPR as written does not fully consider the work that DCOs have spent over the years to develop viable RWPs. It would also require DCOs to consider potentially limitless scenarios and would take up DCO resources that should otherwise be prioritized for creating effective risk management practices to avoid the need for recovery and orderly wind-down.

⁴ *Id.* at 48995.

⁵ <https://www.risk.net/regulation/7945026/behnam-urges-wider-ccp-access-to-fed-deposit-accounts>.

D. Proposed Regulation § 39.39(c)(4), Recovery Tools

The Commission is proposing Regulation 39.39(c)(4), which would require a DCO to have a recovery plan that includes an assessment of the likelihood that the tools will work well and result in recovery and an assessment of the impact on non-defaulting clearing members and their customers with respect to transactions cleared on the DCO, linked financial market infrastructures, and the financial system more broadly.

Nodal, as a DCO, takes care to design recovery tools in an RWP that are viable and that are likely to result in a successful recovery as it would be useless to include a tool that would not lead to a successful recovery. However, the NOPR appears to suggest that DCOs will include tools that are not expected to work and would require DCOs to speculate with regard to the risks of these tools to clearing members, customers of clearing members, and to the larger financial system. It would not be useful for DCOs to include tools in their RWPs (or for the Commission to review such plans) that are not expected to be successful. Therefore, the requirement for such an assessment should not be included in the regulations.

Further, the proposed Regulation regarding assessment of the impact to clearing members' customers and linked financial market infrastructures, and the financial system more broadly would require DCOs to provide highly speculative assessments that would provide little predictive value. Not all tools would necessarily impact these parties directly, so DCOs would need to speculate regarding the possible indirect effects, which is unlikely to provide significant value to DCOs in the creation of recovery plans or to the Commission. Such speculative assessments would quickly become stale as economic factors change, and therefore would likely not provide value for the DCO or the CFTC, so they should not be required in the regulations. Also, clearing member risk exposure is capped at many DCOs so an evaluation of clearing member risk pursuant to proposed rule 39.39(c)(5)(x) would not provide additional information to the extent such risk exposure exceeded the DCOs established caps. More broadly, Commission Regulation 39.24(a)(1)(iv) already requires DCOs to have governance arrangements that “[e]xplicitly support the stability of the broader financial system and other relevant public interest consideration of clearing members, customers of clearing members, and other relevant stakeholders.” Therefore, Nodal believes that the current regulations satisfy the goals of the proposed sections.

E. Proposed Regulation § 39.39(c)(5), Orderly Wind Down Scenarios and Tools

The Commission is proposing Regulation 39.39(c)(5), which would require a DCO to have an orderly wind-down plan that includes scenarios that may prevent it from meeting its obligations or providing critical operations and services as a going concern; assessments of the likelihood that tools, individually and taken together, would result in orderly wind-down; and an assessment of the risks from the use of each such tool to non-defaulting clearing members and those clearing

members' customers with respect to transactions cleared on the DCO, linked financial market infrastructures, and the financial system more broadly.

Similar to proposed rule 39.39(c)(4), proposed rule 39.39(c)(5) suggests that DCOs will include tools that are not expected to work and would require DCOs to speculate with regard to the risks of these tools to clearing members, customers of clearing members, and to the larger financial system. As noted above, it would not be useful for DCOs to include tools in orderly wind-down plans (or for the Commission to review such plans) wherein the tools listed are not expected to be successful. Therefore, the requirement for such an assessment should not be included in the regulations.

Further, the proposed Regulation regarding assessment of the impact to clearing members' customers and linked financial market infrastructures, and the financial system more broadly would require DCOs to provide highly speculative assessments that would provide little predictive value. Again, not all tools would necessarily impact these parties directly, so DCOs would need to speculate with regard to the possible indirect effects, which is unlikely to provide significant value to DCOs in the creation of orderly wind-down plans or to the Commission. As these assessments would be mere speculation, they could quickly become stale, and therefore would likely not provide value for the DCO or the CFTC, so they should not be required in the regulations. Also, clearing member risk exposure is capped at many DCOs so an evaluation of clearing member risk pursuant to proposed rule 39.39(c)(5)(x) would not provide additional information to the extent such risk exposure exceeded the DCOs established caps. More broadly, Commission Regulation 39.24(a)(1)(iv) already requires DCOs to have governance arrangements that "[e]xplicitly support the stability of the broader financial system and other relevant public interest consideration of clearing members, customers of clearing members, and other relevant stakeholders." Therefore, Nodal believes that the current regulations satisfy the goals of the proposed sections.

F. Proposed Regulation § 39.39(c)(6), Agreements to be Maintained During Recovery and Orderly Wind-Down

The Commission is proposing Regulation 39.39(c)(6), which would require a DCO to determine which of its contracts, arrangements, agreements, and licenses associated with providing critical operations and services would be subject to alteration or termination if the recovery plan or orderly wind-down plan were implemented. Further, a DCO would be required to describe the actions it has taken to ensure that its critical operations and services will continue during recovery and orderly wind-down despite such alteration or termination.

Nodal generally supports the idea that DCOs must be able to identify agreements related to providing critical services and operations that could be impacted from recovery and orderly wind-down. However, the proposed requirement that DCOs would need to take proactive steps to ensure that their critical operations and services would continue in recovery and orderly wind-down

relative to the services provided under these agreements is likely to present challenges. For example, DCOs may be limited in the steps they may take to employ contingency arrangements with these contracts and even where possible, such actions may be overly burdensome, costly, and provide limited benefits. Also, even if a DCO takes actions to support the continuity of services under these agreements, DCOs will not be able to ensure that their critical operations and services will continue. It would be more appropriate if the language of the provision instead read “. . . actions that the derivatives clearing organization has taken *that are reasonably expected to succeed, if at all possible*, in maintaining critical operations”

G. Proposed Regulation § 39.39(c)(7), Governance

The Commission is proposing Regulation 39.39(c)(7), which would require a DCO to have its RWP annually reviewed and formally approved by its board of directors, describe the processes that DCOs will use to guide its discretionary decision making regarding its RWP, and describe its process for identifying and managing the diversity of stakeholder views and conflicts of interests between the DCO and stakeholders.

The goals of this proposed section such as ensuring that DCOs have sufficient resources, capabilities, and legal authority to implement the tools and procedures for recovery and orderly wind-down activities are sufficiently met under existing Regulation 39.24, which provides DCOs the ability to design governance arrangements for their RWPs tailored to their unique organizational structures. Decision making discretion is key to successfully implement an RWP, as it allows DCOs to swiftly adopt appropriate decisions consistent with their obligations under § 39.24 that notably require a DCO to “place a high priority on the safety and efficiency of the derivatives clearing organization” and “[e]xplicitly support the stability of the broader financial system and other relevant public interest consideration of clearing members, customers of clearing members, and other relevant stakeholders.” Through a principles and outcome-based CFTC framework, DCOs currently exercise discretion where necessary under their governance arrangements which are appropriately defined under 39.24; therefore, the goals of 39.39(c)(7) are already met and it should not be included in a final rule.

Similarly, Nodal is concerned that the requirement in the proposal to consider stakeholder views may reduce the effectiveness and certainty of managing a recovery or wind-down event. Considering stakeholder views in RWPs is already addressed under current CFTC regulations. In particular, as referenced above, a DCO’s governance arrangements with respect to its RWPs should be consistent with the obligation under 39.24 that a DCO’s governance arrangements “[e]xplicitly support the stability of the broader financial system and other relevant public interest considerations of clearing members, customers of clearing members, and other relevant stakeholders.” As this continues to be at the core of a DCO’s governance arrangements, which includes recovery and orderly wind-down planning, the requirements under proposed

39.39(c)(7)(iv) could conflict with this to the extent stakeholder views do not align with the obligations under 39.24.

Additionally, from a practical perspective, while Nodal agrees that stakeholder views could be considered in establishing tools that directly impact stakeholders, to the extent that this requirement may be understood as contemplating a process for stakeholder negotiations during the implementation of RWPs, it could be counterproductive and even detrimental to a DCO's recovery or orderly wind-down. It is likely that it would inadvertently slow down or stall the process in the absence of consensus where stakeholders have diverging views. Also, different stakeholders could be driven by different interests, especially in extreme market conditions, which could negatively impact the incentives which many recovery tools depend on and alter the successfulness of the RWP implementation. Furthermore, it is unclear how such a requirement would function in practice where a DCO already has well-established rules-based provisions for using certain tools under its RWP, which have already been subject to review through the CFTC rule filing process.

Nodal notes that 39.39(c)(7)(i), the prescribed requirement for annual reviews of the RWPs by the board of directors, seems unnecessary. Each DCO should be allowed to exercise its discretion to determine the most appropriate governance arrangements for the approval of the RWP. Each DCO, given its specific activities and structure, is best positioned to determine what regular interval its board of directors should review and approve the RWP, or when material changes are introduced to the RWP, or to the DCO's products, service offerings, or any other significant aspect of the DCO's functioning.

Based on all of the comments above, Nodal recommends that the Commission does not adopt proposed § 39.39(c)(7).

H. Proposed Regulation § 39.39(c)(8), Testing

The Commission is proposing Regulation 39.39(c)(8), which would require a DCO to include testing procedures in its RWPs. These tests would need to include the DCO's ability to implement tools that its RWP relies on. DCOs would be required to detail the types of testing performed, to whom the test results are reported, and procedures for updating the RWPs in light of findings from the tests. The proposed Regulation would also require DCOs to conduct such tests with the participation of clearing members, where the RWP depends on their participation, and must consider including external stakeholders. In addition, DCOs would be required to conduct testing following any material change of the plans, but will need to test at least annually, and plans will need to be promptly updated based on the findings from tests.

Tools for orderly wind-down scenarios cannot be easily tested in many circumstances, and it is unclear if such testing is possible, for tools including transfer or sale to another DCO, full tear-up, and bankruptcy proceedings. While there are some specific tools that DCOs should mechanically

test (e.g., implementing partial tear-up), other tools may be simple ad hoc guaranty fund and margin calls which DCOs do on a business-as-usual basis. Nodal believes that the regulations should consider that many of these tools that would be utilized in recovery or orderly wind-down may be part of a DCO's business-as-usual operations and preparations. Therefore, DCOs should be allowed, in their learned discretion, to identify what tests from RWP scenarios should be tested separately from their existing core operations.

The proposed Regulation states that Subpart C DCOs must include clearing members in RWP testing, but it is unclear how many clearing members would be required to participate, and the ambiguity around the provision suggests that all clearing members are to participate in tests. Therefore, if adopted, Nodal would like to request clarification regarding the requirement for testing to include clearing members. With this proposed rule, the regulations should also consider the large burden that coordination of tests with any clearing members would be, especially if several tests per year would be de facto required, as is further detailed below.

If the CFTC mandates testing for recovery and orderly wind-down scenarios and tools, it would be consistent to follow the same requirements as stated in proposed Regulation 39.13(c)(8) for non-SIDCOs and non-Subpart C DCOs. As stated, the purpose of testing recovery and orderly wind-down plans for all entities should only be to assess the "reliable operability of the tools that potentially would be implemented in a [recovery or] wind-down" and should not require DCOs "to conduct crisis management drills as part of the testing requirement."⁶ While this still does not consider that some tools are utilized in business-as-usual times, or that orderly wind-down plans may be impossible to test, the CFTC states that non-SIDCOs and non-Subpart C DCOs would not be required to include clearing member participation because of "the wide range of possible types of clearing members."⁷ As SIDCOs and Subpart C DCOs also can have a wide range of possible types of clearing members, they should also be able to determine if clearing member participation is necessary or practical.

Further, any regulations surrounding testing RWPs should consider how onerous it is to coordinate with external parties for regular annual tests, let alone for further testing if material changes are made based on the results of previous testing. Such regulations should also consider whether clearing members will be willing to commit time and resources to such testing.

With proposed Regulation 39.39(c)(8), there is concern that the testing requirements as written in the NOPR would create an unending loop of updating and testing for DCOs, creating inefficiencies in DCO operations without sufficient benefits. The NOPR would require that RWPs be "promptly updated in light of the findings resulting from such testing" and for further testing "following any material change to the recovery plan or orderly wind-down plan."⁸ If any changes made to an RWP as a result of testing are determined to be "material," then the RWP will likely need to be tested

⁶ 88 FR at 48991.

⁷ *Id.*

⁸ *Id.* at 49007-08.

again, and again if any findings in the subsequent test lead to a “material change.” This testing loop could potentially continue, as tests can always show areas for improvement, which could cause a strain on DCO resources. A DCO’s focus and efforts should be on creating and maintaining effective risk management practices that prevent the need for recovery or orderly wind-down. Also, if clearing members are required to participate in these tests, the willingness and availability of clearing members to participate in several tests – let alone one – could be a challenge if the DCO needs to test multiple times each year based on the findings of its own testing. As written, the proposed rules would also require the DCO to submit to the CFTC each time the RWP is updated (whether or not the update is material)⁹ because the DCO is required to update the plan in light of the findings from testing. In addition to the burden on the DCOs, this could potentially cause confusion among CFTC staff who may be receiving multiple versions of the plan during a given year and need to determine which plan is the current plan.

In conclusion, the principles-based approach set forth in the current regulations and guidelines have served the Commission and DCOs very well over the years, and the regulations should reflect this. Therefore, Nodal believes that DCOs should be able determine how and when testing of RWPs will happen, what tools or scenarios will be tested, whether the testing should include clearing members or other external parties, when updates to the RWPs are necessary, and when further testing should happen based on the results of testing.

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Nodal Clear appreciates the opportunity to comment on the NOPR. If you have any questions regarding these comments, please do not hesitate to contact the undersigned.

Respectfully submitted,

/s/ Cody Alvarez

Cody Alvarez
Chief Compliance Officer &
Corporate Counsel

⁹ See Proposed 39.19(c)(4)(xxiv) “. . . A derivatives clearing organization shall, upon revising its recovery plan or orderly wind-down plan, but in any event no less frequently than annually, submit the current plan(s) and supporting information to the Commission, along with a description of *any* changes and the reason(s) for such changes.” (emphasis added).