



Via electronic submission to CFTC comments portal

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U.S. Commodity Futures Trading Commission
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Washington, DC 20581

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

Coinbase Global, Inc. (“Coinbase”)¹ appreciates the opportunity to respond to the U.S. Commodity Futures Trading Commission (“CFTC” or the “Commission”) staff’s request for comment on the impact of affiliations on certain CFTC-regulated entities (the “Request for Comment”).² Coinbase operates Coinbase Derivatives Exchange (“CDE”), a CFTC-registered designated contract market (“DCM”), that offers intermediated access to trading contracts like Nano Bitcoin Futures and Nano Ethereum Futures. Our subsidiary, Coinbase Financial Markets, Inc. (“CFM”) is registered as a futures commission merchant (“FCM”) with the National Futures Association (“NFA”). Coinbase supports the Commission staff’s efforts to seek public comment in order to better inform their understanding of potential issues that may arise among affiliated registrants, as well as possible mitigating measures.

I. Executive Summary

The Request for Comment asks whether affiliation of registrants and other entities raises unique risks, including conflicts of interest such that the CFTC should adopt new or additional rules. In considering this question, it is prudent to recognize that our financial system has never fully eliminated conflicts of interest. Doing so is not only impossible but would also represent a significant departure from the CFTC’s longstanding approach of principles-based regulation.

Conflicts of interest are inherent in any commercial enterprise where transacting counterparties have competing incentives and profit motives; they arise whether participants are

¹ Coinbase was founded in 2012 as a consumer platform making it easy to purchase, sell, and transact in crypto assets. Our business was founded on the premise that crypto—and the open, global network upon which it is built—creates unprecedented opportunities to accelerate innovation across the global financial services sector and beyond. Coinbase was among the first regulated crypto exchanges in the United States and today our global operations are regulated under a number of regimes, including federal futures and investment advisory rules, as well as state money transmission, lending, and virtual currency regulations like New York’s BitLicense.

² *Request for Comment on the Impact of Affiliations of Certain CFTC-Regulated Entities*, CFTC (June 27, 2023) <https://www.cftc.gov/media/8826/rfcimpactaffiliations062823/download>.

affiliated or unaffiliated. This is well understood by market participants and is addressed in the existing regulatory principles set forth in the Commodity Exchange Act (“CEA”) by Congress.

The CEA and CFTC regulations currently impose certain obligations on CFTC registrants, such as DCMs, FCMs, swap execution facilities (“SEFs”), and derivatives clearing organizations (“DCOs”),³ that address many of the potential issues raised in the Request for Comment. For example, existing laws and regulations prohibit DCMs from engaging in anticompetitive behavior and require them to maintain impartial access to their market, enforce their rulebooks consistently across participants, maintain adequate staffing, safeguard confidential information and manage conflicts of interest. FCM disclosure obligations, duties to customers, and risk management obligations set out in CFTC regulations and NFA rules also seek to achieve the same outcomes.

While affiliated relationships may present an additional dimension of conflicts of interest, they are not new to the CFTC or regulated markets. Affiliated entity relationships, whether they are between a DCM and a DCO, or a SEF and an introducing broker, have been present in the futures and derivatives markets for decades. The CFTC’s principles-based regulatory regime is designed to address potential conflicts of interest in affiliate arrangements and is supported by a robust practice of registrant audits, exams, rule enforcement reviews and other forms of supervision, by both the CFTC and NFA. These practices have enabled the CFTC to meet its regulatory mandate and continue fulfilling its oversight authority in the face of an evolving market structure, including where market structures start to diverge from historical practices.

Coinbase encourages the CFTC staff to carefully consider existing provisions that address potential conflicts of interest and to revise those provisions only to the extent that the CFTC staff, or the Commission identifies a “gap” in the regulatory framework with respect to affiliated regulated entities. This could include, for example, a clear definition of what the CFTC believes constitutes a “conflict of interest,” which is not defined in CFTC regulation, for conflicts of interest due to both affiliated and unaffiliated entities.

We commend CFTC staff for embarking upon this review by seeking feedback from the public and market participants. If, as a result, the Commission should consider future initiatives, such as a rulemaking, it is critical that this exercise continues to involve public feedback. Nor should it yield overly prescriptive regulations that deviate from the CFTC’s historical practice of adopting regulation that can apply to a wide variety of registrants without undue regulatory costs or burdens. Commission staff should be mindful of the broad general impact that making sweeping alterations to the current rules and practices could have on registrants, market structure, and customers.

In our comments below, Coinbase aims to show how existing regulations and practices apply to the various risks raised by the Request for Comment in response to CFTC staff’s questions. Many of our comments reflect views shared as part of our on going engagement with

³ The Request for Comment recognizes that DCOs are also subject to statutory risk management requirements, including, for example, financial resources (Core Principle B), participant and product eligibility (Core Principle C), risk management (Core Principle D), settlement procedures (Core Principle E), treatment of funds (Core Principle F), rule enforcement (Core Principle H), conflicts of interest (Core Principle P), and legal risk (Core Principle R).

CFTC staff and Commissioners, as well as with NFA, in connection with operating both a DCM and FCM. Coinbase has found the process of working with the CFTC and CFTC staff to be productive, and Coinbase appreciates the opportunity to continue our dialogue on these important policy issues.

II. Existing DCM Regulatory Framework

DCMs are subject to certain specific requirements related to conflicts of interest, and Coinbase believes that these requirements are effective to address the questions raised by the Request for Comment. Core Principle 16, called “Conflicts of Interest,”⁴ requires an exchange to “minimize conflicts of interest in the decision-making process” of the exchange and “establish a process for resolving conflicts of interest.” CFTC Guidance to Core Principle 16 further elaborates on what is acceptable and appropriate for a DCM to comply with these requirements, including the establishment of an independent committee of the board, the “Regulatory oversight committee” (the “ROC”) to oversee the DCM’s regulatory program and “to monitor the contract market’s regulatory program for sufficiency, effectiveness, and independence.”

Other Core Principles direct the DCM to operate an open, competitive market, subject to effective rules and oversight by the DCM, including, for example:

- Core Principle 2 requires a DCM to ensure effective compliance of *any person* with its rules including open access requirements and rules prohibiting abuse trading practices.
- Core Principle 9 requires a DCM to “provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade.”
- Core Principle 19 prohibits a DCM from “(a) adopt[ing] any rule or taking any action that results in any unreasonable restraint of trade; or (b) Impos[ing] any material anticompetitive burden on trading on the contract market.”

These Core Principles interact with the remainder of the existing DCM regulatory framework to shape how a DCM operates its business and fulfills all of its regulatory obligations as a self-regulatory organization (“SRO”). Read together, these Core Principles require that a DCM treat all participants equally, regardless of affiliation, which is confirmed by CFTC staff through regular examination and the rule enforcement review process. From onboarding to surveillance, examination to trade processing, and even in default, an FCM’s affiliation with the DCM on which trading occurs should not provide any “benefits” that advantage it, disadvantage other entities, or impede the DCM’s ability to fulfill its regulatory obligations.

This existing framework also requires DCMs to address the concerns articulated by CFTC staff in the Request for Comment as follows:

⁴ 17 C.F.R. § 38.850.

Impartial Access, Competitive Effects and Execution. The Request for Comment asks whether the affiliation between a DCM and an FCM participant raises impartial access concerns⁵ or potential competitive implications⁶ and whether any specific measures should be required to be adopted by a DCM to ensure that all participants and their respective customers and clients receive impartial access. It also asks whether existing regulatory requirements effectively address the potential for a DCM to favor an affiliated FCM and/or its customers in trade execution.⁷

Coinbase believes that DCMs should not be required to adopt specific additional measures to ensure compliance with Core Principle 2 (Impartial Access), Core Principle 9 (Execution of Transactions), or Core Principle 19 (Antitrust Considerations). As noted above, these principles, read in connection with Core Principle 16 (Conflicts of Interest) already require equal treatment of similarly situated participants (whether affiliated with the DCM or not). Coinbase also believes that these existing regulatory requirements effectively address any concerns about a DCM favoring an affiliated FCM and/or its customers in trade execution. Favoring an affiliate (or any participant, affiliated or unaffiliated) in execution would also violate prohibitions on abusive and manipulative trading practices.⁸

From a market structure perspective, Coinbase believes that having multiple participants, including multiple FCMs, provides better liquidity, more competitive pricing, and a better customer experience and welcomes all eligible participants to access and trade on CDE. Coinbase does not believe, for example, that a single-intermediary model is the best model for the markets CDE provides. If the CFTC staff is concerned about “closed” systems with only affiliated DCMs and intermediaries, Coinbase would encourage further analysis of the market structure conditions of that type of market as opposed to the open, competitive derivatives markets that have historically served customers.

Fulfillment of Regulatory Functions. The Request for Comment seeks feedback on whether a DCM can appropriately fulfill its obligations as an SRO in respect of an affiliated FCM. The Request for Comment also asks about governance structures, or other steps, that would effectively mitigate the potential conflicts of interest that may arise from a DCM acting as an SRO with respect to an affiliated FCM.

Coinbase believes that, properly implemented, the Core Principles already provide a framework that allows a DCM to appropriately and impartially fulfill its regulatory obligations in respect of an affiliated FCM and do not require supplementation or revision. For example, Appendix B to Part 38 provides guidance related to the important role of the DCM’s ROC. The ROC already is responsible for, and carries out, many of the specific items that CFTC staff address in the Request for Comment. The ROC is a board committee that shall, among other things, “oversee all facets” of the DCM’s regulatory program, “including trade practice and market surveillance; audits, examinations, and other regulatory responsibilities with respect to member firms (including ensuring compliance with financial integrity, financial reporting, sales practice, recordkeeping, and other requirements); and the conduct of investigations.” Further,

⁵ Request for Comment Question 24.

⁶ Request for Comment Question 26.

⁷ Request for Comment Question 29.

⁸ See 17 C.F.R. § 38.152.

the ROC is required to issue a report each year assessing the DCM's self-regulatory program and, in addition, recommend changes to the DCM's Board "that would ensure fair, vigorous, and effective regulation." Importantly, composition of the ROC is limited to public directors⁹ precisely to manage conflicts and protect against bias. In accordance with the CDE Rulebook and Appendix B to Part 38 of the CFTC's regulations, the public directors have no "material relationship" with the DCM which is defined as one that "reasonably could affect the independent judgment or decision-making of the public directors."

Finally, in response to this question, CFTC staff should carefully consider how any affiliation-focused new rules might prevent a DCM from carrying out a comprehensive risk management and market surveillance function, which would frustrate the DCM's ability to maintain the integrity of its venue.

Market Integrity. The Request for Comment asks questions about a DCM's ability to meet Core Principle 4, namely its capacity and responsibility to "prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures" where an affiliated FCM's customers trade on its markets, both in business as usual and in times of stress.

Core Principle 4 does not distinguish between affiliated entity activity and unaffiliated entity activity and a DCM would be in violation of this Principle (and potentially others) if it were to provide disparate treatment for an affiliate in this context. Further, as mentioned above, the ROC is charged with overseeing the DCM's regulatory program, including those aspects designed to protect market integrity, and in this role serves as an independent check on the DCM's surveillance, compliance and enforcement activities.

Because the Core Principles prohibit a DCM from favoring any participant or its customers in execution or otherwise (see above), we do not believe that the failure of an affiliated FCM should impact a DCM's compliance with Core Principle 4 to a different degree than the failure of an unaffiliated FCM. We see no reason why the liquidation of an affiliated FCM's customer positions by a trustee would have a different impact on market integrity than the liquidation of an unaffiliated participant's customer positions. Where the failure of an FCM is caused by a customer default that requires the affiliated FCM to liquidate positions in the market, it is also not clear to us that this should lead to different adverse consequences than liquidations conducted by a non-affiliated FCM where a DCM remains compliant with its applicable Core Principles. In other words, Coinbase believes that the Commission's rules, in their current form, sufficiently address this risk.

Mitigants. CFTC staff also seek feedback on whether DCMs should be required to adopt specific measures to address certain conflicts of interest, including information barriers, limitations on resource sharing, conduct restrictions or additional disclosures.¹⁰

⁹ See 17 C.F.R. Appendix B to Part 38, Core Principle 16 § (b)(3)(i) ("A board of directors of any contract market shall establish a Regulatory Oversight Committee ("ROC") as a standing committee, consisting of only public directors as defined in section (2), to assist it in minimizing actual and potential conflicts of interest.").

¹⁰ Questions 21 and 28 ask about whether DCMs should be required to adopt information barriers between DCM and FCM personnel to "ensure that staff of an affiliated FCM are prevented from accessing or utilizing confidential information in possession of DSRO staff." Similarly, Question 27 asks what limits, if any, should be placed on

Coinbase agrees that information barriers, disclosures, and controls with respect to shared resources between a DCM and affiliated FCM are powerful tools that can be used to mitigate or even prevent certain conflicts of interest from arising. In fact, CDE has implemented all of these as part of its overall compliance with the Core Principles.

As CFTC staff is aware from rule enforcement reviews and detailed discussions with CDE, CDE has conflicts management policies and procedures in place that separate CDE and CFM personnel. These policies establish proper information barriers as well as physical barriers and provide procedures for escalating compliance concerns.¹¹ CDE participants and their customers are also made aware of the affiliation between CDE and CFM via CDE Rule 307, which discloses the affiliation between the entities. CDE Rule 307 expressly prohibits CDE from giving CFM preferential pricing or any other advantage with respect to CDE's trade matching engine and from granting CFM access to CDE's material nonpublic information.¹²

These mitigants flow from existing requirements in DCM Core Principles, including limitations on how information obtained by the DCM can be used, requirements to have sufficient staff and effective compliance and regulatory oversight programs, and requirements to impartially enforce rules.¹³ As noted above, these requirements already ensure that a DCM is required to treat FCMs equally, regardless of affiliation. Coinbase does not believe it is appropriate to mandate any additional requirements, at this time. These issues are best addressed on a platform-by-platform basis, depending on the unique facts and circumstances as part of a holistic compliance program.

Affiliated Spot Market. The Request for Comment asks whether concerns are raised if a DCM is affiliated with a spot market and, if so, what mitigants would be effective. Before addressing the question, we would like to note that affiliation between a spot market and a DCM that trades correlated contracts¹⁴ can be advantageous towards achieving certain of the

DCMs sharing personnel with, among others, affiliated FCMs to avoid or mitigate any negative impact on the DCM's "surveillance, investigatory or disciplinary obligations with respect to the affiliated intermediary." Question 32 asks whether there are additional disclosures that should be required in cases of an affiliate relationship between a DCM and an FCM. Finally, Question 33 asks if there are specific requirements, policies and/or procedures, if instituted, which would effectively ensure that affiliated intermediaries interact on an "arms-length" basis with DCMs such that affiliated intermediaries would be treated in a manner equivalent to non-affiliated intermediaries (e.g., incentives available to affiliates are equivalently available to non-affiliates; information available to the affiliate is equivalently available to nonaffiliates).

¹¹ Though not addressed directly by the RFC, we note for completeness that CFM has likewise adopted policies and procedures that include measures such as information barriers and physical barriers.

¹² CDE Rule 307 provides: "RULE 307. Affiliated Participant" (a) The Exchange permits Coinbase Financial Markets, Inc. ("CFM"), a CFTC-registered Futures Commission Merchant and an affiliate of the Exchange, to be a Participant, or customer of a Participant, for the purpose of trading Exchange products. (b) CFM shall neither receive preferential pricing from the Exchange nor shall it have an inherent advantage over any other Participant with respect to the Exchange's trade matching engine or procedures. (c) CFM shall not have access to the Exchange's material nonpublic information, and the Exchange shall ensure CFM's access to information is limited to public information available to all Participants. (d) CFM shall be subject to the same access criteria and must abide by the same Rules as all other Participants."

¹³ 17 C.F.R. §§ 38.7, 38.155, 38.151(c).

¹⁴ As a general matter, a spot market and a DCM may offer wholly unrelated products – there are limited single stock futures trading in the US and, to date, only two digital asset commodities (BTC and ETH) underlie futures contracts

Commission's regulatory objectives. DCM Core Principles require that spot markets underlying a futures contract are not readily susceptible to manipulation. While DCMs are generally unable to surveil spot markets directly due to privacy law concerns that may limit a spot market's ability to share certain information with third parties or commercial considerations, among others, affiliation between a spot market and a DCM reduces some of these concerns and, as a result, facilitates more open sharing of information between the two in order to serve the goals of cross-market surveillance and market integrity.

We appreciate that the CFTC staff will always be in search of unique risks or potential conflicts of interest between affiliate relationships. To the extent they may be present, however, the DCM Core Principles provide a robust framework for addressing conflicts of interest and ensuring market integrity that is adaptable to a variety of circumstances and relationships. We do not believe that the Commission should adopt additional requirements at this time and should instead continue to examine DCMs affiliated with spot markets for compliance with DCM Core Principles.

Affiliated Trader. The Request for Comment asks whether concerns are raised if a DCM is affiliated with a market maker or other trader that executes trades on the DCM and, if so, what mitigants would be effective. Coinbase appreciates the CFTC staff's concern that the presence of affiliated market makers or other traders may present conflicts of interest. Further, we posit that the degree to which these relationships pose a conflict of interest varies depending on whether the trader is trading on behalf of others, as is the case with an affiliated Commodity Pool Operator, or whether the trader is solely trading for its own profit.

As a general matter, many of the same rules that mitigate conflicts of interest between a DCM and an affiliated FCM also apply to and mitigate the risks arising from relationships between DCMs and affiliated traders. These include the requirement for traders to be treated equally, regardless of affiliation, requirements to provide impartial access and efficient execution as well as the independent oversight provided by the ROC in respect of the DCM's regulatory program. As noted above, the effectiveness of the CFTC's regulatory regime stems from the ability to apply the Core Principles flexibly to market participants' unique circumstances in order to mitigate the specific risks arising from those circumstances. In the case of an affiliated trader, a DCM may consider implementing mitigants differently depending on the type of activity at issue.

CFTC Oversight. Finally, it is worth recognizing that DCMs are subject to CFTC oversight, most often in the form of audits, examinations, and rule enforcement reviews. For example, the CFTC's oversight could certainly discover deficiencies in a DCM's equal treatment of its participants by reviewing a DCM's compliance with requirements to conduct various audits and ongoing surveillance of its participants regardless of affiliation. CFTC Regulation 38.553 requires DCMs to "enforce its audit trail and recordkeeping requirements through at least annual reviews of all members and persons and firms subject to" the DCMs recordkeeping rules

that trade on DCMs. Where the contracts trading on the markets are unrelated, we can think of very few, if any, concerns raised by affiliation between these two types of entities that would not apply to affiliate relationships more generally.

[emphasis added]. CFTC Regulation 38.553 also requires and empowers DCMs to “levy meaningful sanctions when deficiencies are found.” Further, an affiliate FCM is subject to the same DCM recordkeeping and audit trail requirements as an unaffiliated FCM, and failure to comply with the DCM’s requirements would be identified and addressed in the same way, irrespective of affiliation.

III. Existing FCM Regulatory Framework

Like DCMs, FCMs are already subject to comprehensive regulation by the CFTC and NFA that address the questions posed by CFTC staff in the Request for Comment. At a high-level, these regulations ensure that FCMs manage all risks arising from the conduct of their business, including risks posed by affiliates,¹⁵ that they “deal fairly with customers and other market participants”¹⁶ and disclose any “material incentives and any material conflicts of interest regarding the decision of a customer as to the trade execution and/or clearing of the derivatives transaction.” These rules reflect the CFTC’s principles-based approach to regulation and require FCMs to adapt the implementation of such rules to the specific facts and circumstances of their business. In short, as with the DCM Core Principles, existing FCM regulations are robust yet flexible enough to adapt to any new risks posed by affiliation between an FCM and a DCM.

Below we discuss how such rules address specific questions posted by CFTC staff:

Customer Impact and Mitigants. The Request for Comment asks whether an FCM might favor its affiliate’s DCM’s product listings in advising or otherwise serving customers, clients or participants and, if so, whether there are ways to mitigate this possibility.¹⁷

An FCM may favor its affiliate DCM’s product listings for many reasons, including those that are beneficial to customers. For example, an affiliated DCM may offer products that are more suitable for or attractive to that FCM’s customer base. Analyzing an FCM’s motivations in offering products traded on an affiliated exchange would likely be a challenging subjective exercise for the CFTC or NFA to conduct, and it is unnecessary, particularly in light of existing mitigants in NFA rules and CFTC regulations set out below.

As a starting point, NFA Compliance Rule 2-4 “requires all Members and Associates to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business. This includes a requirement to deal fairly with customers and other market participants at all times.” NFA has issued a number of Interpretive Notices in furtherance of NFA Compliance Rule 2-4, addressing, for example, FCM transaction cost disclosures, sweep account disclosures, misuse of trade secrets and proprietary information, and commissions, fees, and other charges. The breadth of topics addressed by these Interpretive Notices illustrates how NFA Compliance Rule 2-4 shapes an FCM’s interactions with customers to ensure fair treatment. FCMs must conduct themselves in accordance with these standards

¹⁵ 17 C.F.R. § 1.11.

¹⁶ NFA Compliance Rule 2-4.

¹⁷ Request for Comment Question 30.

when advising or otherwise serving customers with respect to products listed on an affiliated DCM.

CFTC regulations and NFA rules related to disclosures and customer communications also ensure that customers are made aware of any material conflicts of interest that an FCM may have, including those that arise from relationships with affiliates. As noted above, CFTC Reg 1.71(e) provides that “[e]ach futures commission merchant and introducing broker must adopt and implement written policies and procedures that mandate the disclosure to its customers of any material incentives and any material conflicts of interest regarding the decision of a customer as to the trade execution and/or clearing of the derivatives transaction.”¹⁸ Plus, CFTC Reg 1.55 requires FCMs to disclose certain information to customers, including information about its affiliates and risks to the FCM created by the FCM’s affiliates and their activities. CFTC Reg 1.55 also requires, for example, mandatory risk disclosure statements about the risk of loss in trading futures and a signed statement from the FCM’s customer that they received and understood the disclosure statement. Finally, NFA Compliance Rule 2-29 prohibits FCMs from employing marketing materials or public communications that may mislead or deceive the public or the FCM’s customers.

These requirements, coupled with a customer’s ability to choose their preferred FCM based on information provided in disclosures, effectively mitigate any negative consequences that may result from an FCM offering its affiliates products. To ensure that they are effective, CFM believes that disclosure should be accurate, informative, and digestible. But CFM does not believe that the current disclosure regime is deficient with respect to the disclosure of affiliate relationships or that it should be modified in any respect.¹⁹

¹⁸ 17 C.F.R. § 1.71(e).

¹⁹ Request for Comment Question 32.

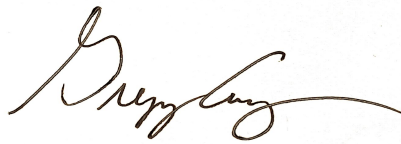
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Coinbase appreciates the Commission staff's willingness to provide opportunities for consultation from market participants. If there are any questions regarding these comments, please contact the undersigned.

Sincerely,



Faryar Shirzad
Chief Policy Officer



Gregory Compa
Senior Director, Head of Institutional Compliance

cc: The Hon. Rostin Behnam, Chair
The Hon. Christy Goldsmith Romero, Commissioner
The Hon. Kristin N. Johnson, Commissioner
The Hon. Summer K. Mersinger, Commissioner
The Hon. Caroline D. Pham, Commissioner