



BETTER MARKETS

By Electronic Submission

November 6, 2023

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Provisions Common to Registered Entities (RIN 3038-AF28)

Dear Mr. Kirkpatrick:

Better Markets¹ appreciates the opportunity to comment on the proposed rule (“Proposed Rule”) issued by the Commodity Futures Trading Commission (“CFTC” or “Commission”), which is proposing to amend the Commission’s regulations under the Commodity Exchange Act (“CEA”) that govern how registered entities submit self-certifications, and requests for approval, of their rules, rule amendments, and new products for trading and clearing, as well as the Commission’s review and processing of such submissions.²

CFTC Regulation Part 40 is a set of provisions that pertain to registered entities, encompassing entities such as designated contract markets (DCMs), derivatives clearing organizations (DCOs), swap execution facilities (SEFs), and swap data repositories (SDRs). These provisions establish the necessary requirements and procedures for registered entities to adhere to when they submit their rules and products to the Commission before implementing new rules, introducing products for trading, or accepting products for clearing.³

The most recent amendments to Part 40 date back to 2011, primarily in response to changes in the Commodity Exchange Act brought about by the Dodd-Frank Wall Street Reform and Consumer Protection Act.⁴ The proposed amendments currently under consideration by the

¹ Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans’ jobs, savings, retirements, and more.

² Provisions Common to Registered Entities; 88 Fed. Reg. 61,432 (September 6, 2023).

³ 88 Fed. Reg. 61432.

⁴ Public Law 111–203, title VII, sec. 734(a), July 21, 2010, 124 Stat. 1718 (2010).

Commission are a result of the practical experience gained through the application of Part 40 over the years.⁵

Better Markets supports these proposed amendments, emphasizing the critical role of complete information in the Commission's oversight of new products. It is imperative for the Commission to thoroughly understand whether an exchange is complying with its core principles, assess the product's legal compliance, and evaluate any heightened risks the product may pose to customers and financial stability. As outlined in the Proposed Rule, these amendments acknowledge a recurring issue faced by Commission staff – the absence of sufficient information in product submissions to fulfill the Commission's regulatory obligations.⁶ The proposal addresses this by requiring a comprehensive explanation of a new product's terms and conditions, providing valuable context for what constitutes completeness, thus enabling the Commission to fulfill its oversight responsibilities, including assessing the product's lawfulness and risk.⁷

However, while Better Markets endorses the proposed amendments, we believe the amendments still fall short of adequately accommodating the ever-evolving landscape of derivatives products. With the surge of cryptocurrency and the introduction of new contracts related to lithium and rare metals, which are gaining increased interest due to the growing investment in electric vehicles⁸, the proposed rule doesn't adequately address the discrepancy in the way the Commission reviews self-certified products in CFTC Regulation 40.2 as compared to the way it reviews self-certification of rules in CFTC Regulation 40.6.

For instance, Better Markets believes the Commission should consider providing a ten-business-day review period for self-certified products, aligning it with the existing ten-business-day review period for self-certified rules.⁹ Another example is to expand the stay provision in Regulation 40.2 similar to the stay provision in Regulation 40.6.¹⁰ Under this provision, the Commission should be able to postpone the certification of a product when that product introduces novel or complex issues necessitating extended analysis.

As derivative products become increasingly complex and innovative, a single business day may not offer sufficient time for Commission staff to conduct a comprehensive review of these new products, especially when dealing with novel or intricate products requiring in-depth analysis. Furthermore, as more products become complex, the Commission needs to have a regulatory tool

⁵ *Id.*

⁶ See Proposed Rule at 61,435.

⁷ *Id.*

⁸ See Proposed Rule at 61,459.

⁹ 17 CFR 40.6(a)(3).

¹⁰ 17 CFR 40.6(c).

to postpone a product listing until Commission staff have sufficient time to go through the proper analysis.

While the proposed amendments to CFTC Regulation Part 40 are a step in the right direction, they may need further adjustments to effectively address the fast-paced changes in the derivatives marketplace, ensuring that regulatory oversight keeps pace with innovation and evolving financial products.

BACKGROUND

The derivatives market is a dynamic and ever-evolving sector that plays a vital role in the global financial system. It is a crucial hub for managing risk, discovering fair prices for commodities and financial assets, and facilitating investment strategies. Market participants, including hedgers, speculators, and investors, rely on derivatives to protect themselves against price fluctuations, access global markets, and optimize their portfolios. As such, the market's capacity to adapt and introduce innovative financial products and trading strategies is central to its relevance and functionality.

Innovation within the derivatives market takes various forms, including new contract types, trading platforms, and risk management tools. These innovations often respond to market demands, technological advancements, and evolving economic conditions. For example, the introduction of new commodity futures contracts may address emerging markets for renewable energy sources, carbon emissions, or even cryptocurrencies. Similarly, the development of novel trading algorithms and strategies can enhance market efficiency and liquidity.

While innovation in the derivatives market brings numerous benefits, it also brings a concomitant need for effective regulatory oversight. This is where CFTC Regulation Part 40 plays a critical role. Part 40 represents a regulatory framework that acts as a gatekeeper for the introduction of new financial products and rules into the derivatives market. Its significance lies in the fact that it ensures that innovation takes place within the boundaries of market integrity, transparency, and the protection of market participants.

Part 40 of the CFTC's regulations serve as the primary conduit through which novel financial products and rules enter the derivatives market. The regulatory framework is designed to perform a multifaceted examination, evaluation, and approval process that scrutinizes these innovations from various angles. This examination is carried out with a focus on safeguarding the market's stability, ensuring customer protection, and preserving the overall financial integrity of the derivatives market. CFTC Regulation Part 40 is instrumental in striking a balance between fostering innovation and maintaining a secure, transparent, and well-regulated derivatives market. It provides a framework for the Commission to engage with market participants, assess innovations, and make informed decisions that contribute to the overall health and competitiveness of the derivatives market.

COMMENTS

I. The Proposed Rule is a positive step in the right direction as it requires DCMs or SEFs that self-certify a product to submit a concise explanation and analysis of the product, including its compliance with applicable provisions of the CEA, core principles, and the Commission's regulations.

The proposed amendments mark a positive development in the regulatory framework governing derivatives markets. These amendments notably require registered entities to furnish a comprehensive explanation of new products, whether self-certified or submitted to the Commission for approval. This explanation must be exhaustive in nature, covering the product's terms and conditions and, critically, its adherence to the applicable provisions of the CEA, including the core principles and the Commission's regulations.

This requirement for a complete explanation is a significant and much-needed enhancement. It addresses a historical challenge that Commission staff has faced in their interactions with registered entities. In the practical experiences of the staff, it has been observed that registered entities have, at times, omitted critical information pertaining to the underlying commodity when introducing a new product. This omission has posed challenges for the Commission in fulfilling its analysis of compliance, a fundamental requirement under both the CEA and Part 40 regulations.

The proposed amendments bridge this information gap by calling for the inclusion of additional details about the product's underlying commodity. These additional details encompass crucial characteristics such as the grade, quality, and deliverable supply of the commodity. By explicitly requiring this information, the amendments serve to bolster the transparency and completeness of the information provided to the Commission. It is important to underline that the introduction of these new data points is not a mere formality but an essential component of the regulatory process.

The proposed amendments not only seek to address this information shortfall but also provide clear guidance on how this level of detail should be presented. Specifically, the guidance offered in Appendix C to Part 38 is cited as a valuable reference point for achieving compliance with this newly proposed standard. This reference not only ensures uniformity in information provision but also streamlines the process for registered entities, making it easier for them to meet the new requirements effectively.

Better Markets expresses its support for these proposed amendments. The transparency and completeness they introduce enhance regulatory oversight in the derivatives market. By mandating comprehensive information about new products, including their underlying commodities, these amendments bolster market integrity, protect the interests of market participants, and ensure that the Commission can effectively and thoroughly evaluate compliance. As derivative markets

continue to evolve and innovate, these amendments are an important step toward maintaining a well-regulated and resilient market.

II. The Proposed Rule represents a necessary enhancement to CFTC Regulation Part 40; however, the proposed amendments still do not fully address the complex nature of reviewing novel derivative products.

Although Better Markets supports the proposed amendments, there remain possible gaps in CFTC’s staff review of complex, novel derivative products. The rise of digital currencies and the introduction of new contracts linked to resources such as lithium and rare metals, fueled by the increasing focus on electric vehicles, present review challenges that the proposed rule does not completely address. A significant area of concern revolves around the unequal handling of self-certified products under CFTC Regulation 40.2 in comparison to self-certification of rules in CFTC Regulation 40.6. Specifically, CFTC Regulation 40.2 allows for the listing of self-certified products within just one business day of the Commission receiving the submission, whereas CFTC Regulation 40.6 prescribes a ten-business-day waiting period for implementing new rules or rule amendments following the Commission's receipt of the submission.

One potential solution to bridge this gap is for the Commission to consider implementing a consistent ten-business-day review period for both self-certified products and rules, aligning the process to ensure a more equitable evaluation of complex and innovative derivatives. Moreover, it's important to acknowledge the significance of the stay provision within Regulation 40.6, which grants the Commission the ability to postpone the certification of a rule or rule amendment when the introduction of the rule involves novel or complex issues requiring in-depth analysis. This provision becomes particularly relevant as derivative products become more intricate and innovative. It is worth noting, however, that Regulation 40.2 lacks a similar provision.

Given the increasingly intricate nature of novel products, a single business day may prove inadequate for Commission staff to conduct a thorough review, especially when dealing with intricate, in-depth analysis. To address this, providing staff with sufficient time for rigorous evaluations is critical. CFTC staff must be afforded the necessary time to ensure a comprehensive examination of the product's compliance with regulatory standards.

Interestingly, in its most recent rulemaking for security-based swap execution facilities (“SBSEF”), the Securities Exchange Commission (“SEC”) mirrored the CFTC’s approach to review self-certified products in an effort to harmonize with the CFTC’s regulation. Nevertheless, the SEC decided to take the regulatory approach of CFTC Regulation 40.6 in regard to reviewing self-certified products.¹¹ The final rule states:

“While a ten-day review period differs from the CFTC’s one-day review period, one business day would not provide the SEC staff sufficient time to review a new product filing for error or incompleteness, let alone review a new product

¹¹ Securities and Exchange Commission, Security-Based Swap Execution and Registration and Regulation of Security-Based Swap Execution Facilities, Release No. 34-98845, available at <https://www.sec.gov/files/rules/final/2023/34-98845.pdf>.

for compliance with the SEA or Regulation SE. Further, if a product does warrant a stay, the Commission would also need sufficient time to go through the administrative steps of formally issuing the stay. The proposed ten-business-day review period for self-certified products also accords with the CFTC's ten-business-day review period for self-certified rules, which the Commission is replicating in Rule 807(a)(3). Further, while a shorter review period may allow SBS to trade on an SBSEF more quickly, failing to provide the Commission with a meaningful period for review of a new product would hamper the Commission's ability to protect market participants and maintain fair, orderly, and efficient SBS markets. A **ten-day review period** would still **permit market participants** to trade SBS on regulated platforms **within a "reasonable period"** and would provide the Commission the time it needs to review submissions."¹²

The SEC's rationale for the ten-day review period includes the need for ample time to thoroughly evaluate new product filings. This includes checking for errors, assessing compliance with the Securities Exchange Act (SEA) or Regulation SE, and addressing the administrative steps required for stays, where necessary. This extended timeframe is significant for protecting market participants and maintaining the integrity of security-based swap markets, emphasizing the importance of providing a meaningful review period.

It is worth noting that the CFTC had mentioned a ten-day review period for new products, rules, and rule amendments in 2011.¹³ In its 2011 proposed rulemaking, the CFTC stated:

"The Commission has determined that the costs associated with the self-certification and submission for Commission review of new products, new rules, and rule amendments will not negatively affect the efficiency, competitiveness, and financial integrity of the futures and swaps markets, particularly because of the time limits that Congress has imposed on Commission review. The Commission will have 10 days to review new products, new rules, and rule amendments, and only 90 days if it stays a rule to issue a rule approval or disapproval."¹⁴

It appears that the underlying belief was that such a timeframe would not negatively impact the efficiency, competitiveness, or financial integrity of futures and swaps markets. Given this historical context, we respectfully suggest that the CFTC provide a similar 10-day buffer for Regulation 40.2. This adjustment would provide the CFTC with the requisite time for a thorough evaluation, while still allowing market participants to engage with new products within a reasonable timeframe.

Moreover, Better Markets believes it would be prudent for the Commission to consider expanding its stay provision in Regulation 40.2(c). Specifically, it could reflect the provisions

¹² *Id.*

¹³ Provisions Common to Registered Entities; 75 Fed. Reg. 67,282 (September 6, 2023).

¹⁴ *Id.*

found in Section 40.6(c) of the CFTC rules, which would allow for the stay of self-certified products on the grounds that the product presents novel or complex issues that require additional time to analyze or is accompanied by an inadequate explanation. With the rapid emergence of novel and complex financial products, it's crucial for the Commission to have the flexibility to ensure thorough and comprehensive reviews. This added buffer can prove invaluable in maintaining market stability and safeguarding market participants.

Harmonizing CFTC rules with those of the SEC would not only promote consistency in regulatory practices but also demonstrate a commitment to adapting to the evolving financial landscape.¹⁵ Given the intricacies of modern financial products, this step could enhance the effectiveness of regulatory oversight and contribute to the overall integrity and fairness of the markets.

Better Markets believes that aligning review periods for certified products and rule changes, coupled with enhancing the stay provision for certified products, can enable the CFTC to enhance regulatory oversight, protect market participants, and maintain the integrity of the derivatives market. This is especially important in an environment where SEFs and DCMs consistently introduce intricate, innovative products and complex rule changes.

CONCLUSION

We hope these comments are helpful.

Sincerely,



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¹⁵ See Securities and Exchange Commission, Security-Based Swap Execution and Registration and Regulation of Security-Based Swap Execution Facilities, Release No. 34-98845, available at <https://www.sec.gov/files/rules/final/2023/34-98845.pdf>.