coinbase DERIVATIVES

November 6, 2023

VIA ON-LINE SUBMISSION

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

Re: **Amendments to Provisions Common to Registered Entities (RIN 3038–AF 28); 88 FR 61432 (Sept. 6, 2023).**

Dear Mr. Kirkpatrick:

LMX Labs, LLC, d/b/a/ Coinbase Derivatives (the "**Exchange**") welcomes the opportunity to provide our comments to the Commodity Futures Trading Commission ("**CFTC**" or "**Commission**") on the Commission's notice of proposed rulemaking to amend its Part 40 Regulations ("**NOPR**") referenced above. The NOPR proposes amendments to the CFTC Part 40 Regulations, which set out the procedures that registered entities such as the Exchange must follow when submitting new products, rules, or rule amendments to the Commission, and the procedures and review standards the Commission follows for reviewing such submissions.

The Exchange has been a designated contract market ("**DCM**") under the Commodity Exchange Act ("**CEA**") since 2020. It is a subsidiary of Coinbase Global, Inc. and an affiliate of Coinbase Inc., one of the United States' leading spot market exchanges for crypto assets – an affiliation through which we have gained specialized knowledge of spot crypto markets. The Exchange is a relatively new DCM with a commitment to a strong compliance culture and long-term success and has experience listing products via certification after conducting the due diligence and analysis required to assure that our listing of a contract will comply with the CEA and CFTC regulations. The Exchange currently lists cash-settled futures contracts on Bitcoin and Ether, the Bloomberg US Large Cap Index, and West Texas Intermediate Crude Oil. The Exchange offers futures contracts whose sizes vary to attract both institutional and retail market participants. The Exchange actively considers and evaluates potential new derivatives products it could list for trading in compliance with the CEA and Commission regulations.

The Exchange supports the Commission's goal to clarify and streamline the Part 40 Regulations and agrees with many of the proposed revisions set out in the NOPR as they apply to a DCM. The Exchange strongly objects, however, to certain proposed substantive changes to Regulations 40.2 and 40.3 both as unnecessary and as contrary to the clear text of CEA section 5c(c) governing registered entities and the Commission with respect to new product filings, and

the longstanding policies the statutory text embodies. We offer our comments from the perspective of how the proposed changes will impact the Exchange as a DCM.[1]

I. Background: Relevant Statutory Provisions and Their Historical Predicate

As a matter of federal policy of nearly 25 years standing, futures exchanges have a clear choice for how to list new contracts for trading, under terms intended to provide certainty and clarity on the timing and standards of review. These procedures have worked well. Our central concerns with the proposed changes identified below are that they conflate the two alternatives and will introduce procedural uncertainty and confusion, most notably to the product certification process by suggesting the Commission could reject or stay a certified product filing deemed "incomplete" when it has no statutory authority to do so.

CEA section 5c(c) sets out two clear, very different alternatives for a DCM to list a new product for trading. First, as provided in section 5c(c)(1), a DCM may elect to list a new contract for trading by providing the Commission with a certification that the new contract "complies with the Act (including regulations under this Act)." The statutory provision does not require a DCM to file anything else but the certification before listing the product for trading; it rests instead on the premise that the DCM will have spent the time, effort, and diligence necessary to assure itself that its listing of the product complies with the CEA and CFTC regulations before submitting the certification.

Nothing in section 5c(c) authorizes the Commission to reject a DCM's certified product submission or stay the DCM's listing of the product. This stands in sharp contrast to the explicit authority that section 5c(c)(3) grants to the Commission to stay a DCM's certified rule filing under the circumstances prescribed. If the Commission later determines that the DCM's listing of a certified contract does not comply with the CEA or CFTC regulations, it has other statutory authority to address its concerns. While these authorities may be severe and include the ability to bring an enforcement action for a false certification, DCMs are aware of these authorities, and they incentivize the DCM to conduct proper diligence prior to submitting a product certification.

Second, as an alternative to listing a product via certification, CEA section 5c(c)(4) provides a DCM the choice, when it decides appropriate, to submit a new product to the Commission for the Commission's review and approval. As provided in CEA section 5c(c)(4)(C), the Commission must take final action within 90 days after the DCM submits the request unless the DCM agrees to extend the time. As provided in CEA section 5c(c)(5)(B), the Commission "shall" approve the product filing unless it finds that the contract would violate the CEA or CFTC regulations. Thus, the standard for the Commission to approve a contract is the same as the standard a DCM must determine it meets before certifying a new contract under the first alternative.

[1] That said, we believe our comments are also generally relevant for other registered entities, including derivatives clearing organizations with respect to submitting new products for clearing and for swap execution facilities with respect to listing new products for trading.

Fundamentally, to list a new product a DCM must comply with the CEA and Commission regulations and the statute allows a DCM to choose how to demonstrate that compliance. In many cases, a DCM may feel confident and comfortable with its analysis and seek to move quickly to market once it has completed the product development work for a particular contract by choosing to certify the contract, willing to face Commission action ex post if its certification is false. In others, the DCM may prefer to seek ex ante approval, choosing a slower process for greater regulatory certainty. As noted below, in practice DCMs will engage with Commission staff prior to submitting a filing under either route. Regardless of the route taken, DCMs require certainty about the timing and process for bringing the product to market.

The provisions described above have been part of the CEA since late 2000, added with the Commodity Futures Modernization Act ("**CFMA**"), and their origins can be traced back even earlier to Commission rulemaking. In 1999, the Commission adopted rules pursuant to its exemptive authority to allow an established exchange to list a new product by submitting to the Commission, no later than the business day before trading in the product commences, a copy of the contract's terms and conditions and a certification that they do not violate and are not inconsistent with the CEA or the rules thereunder.[2] The Commission later included a restated version of this rule as part of a broader set of rules adopted in December 2000, which also contained rules prescribing "fast track" procedures for an exchange to submit a new product voluntarily to the Commission for review and approval.[3] The CFMA was enacted very shortly thereafter, and largely codified the Commission's alternative approaches for a DCM to list a new product.[4]

The Commission adopted the product certification rule in 1999 in response to concerns that futures exchanges needed the ability to list contracts without delay to maintain their competitiveness. The Commission recognized that "it can, and should, place greater reliance on the exchanges' roles as self-regulatory organizations, particularly in connection with their decisions to list new products for trading."[5] It further understood that in allowing a product to

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[2] *Revised Procedures for Listing New Contracts*, 64 FR 66373 (Nov. 26, 1999). Before that, in 1997, the Commission had adopted rules to establish special "fast track" procedures for an exchange to obtain designation as a "contract market" to list a new product to expedite the time-consuming process that existed at the time. *Revised Procedures for Commission Review and Approval of Applications for Contract Market Designation and Exchange Rules Relating to Contract Terms and Conditions*, 62 FR 10434 (Mar. 7, 1997). Under the CEA as then in effect, an exchange had to seek approval as a "contract market" for each contract it wanted to list for trading.

[3] *A New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries, and Clearing Organizations; Rules Relating to Intermediaries of Commodity Interest Transactions; A New Regulatory Framework for Clearing Organizations; Exemption for Bilateral Transactions*, 65 FR 77962.

[4] The Commission then promptly withdrew those final rules in light of the CFMA's amendments. *A New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries, and Clearing Organizations; Rules Relating to Intermediaries of Commodity Interest Transactions; A New Regulatory Framework for Clearing Organizations; Exemption for Bilateral Transactions*, 65 FR 82272 (Dec. 28, 2000) (Final Rules; partial withdrawal).

[5] 64 FR at 66374.

be listed via certification it would "place greater reliance on its existing oversight authorities" including "to alter or supplement exchange rules or to take emergency action, as appropriate."[6]

The Commission adopted the original Part 40 Regulations in 2001 to implement the new statutory provisions added by the CFMA in 2000, which included the original version of Regulation 40.2 covering a registered entity's certified product filings and Regulation 40.3 covering a DCM's voluntary submission of a new rule for Commission review and approval.[7]

Congress amended section 5c(c) in 2010 when it enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**DFA**"). Among other changes, DFA Section 745 revised the certification procedures for rule and rule change filings, to provide the Commission a 10-business day review period for such filings and to set out explicit authority for the Commission to stay a certified rule filing by a DCM. Notably, Section 745 did ***not*** substantively revise the ***product*** certification provisions in section 5c(c), nor did it add any explicit terms authorizing the Commission to stay a DCM's listing of a certified product.

The DCM's regulatory obligations when designing a contract do not change based on the process chosen by the DCM to list it. As mentioned above, the DCM must ensure that the contract complies with the CEA and Commission regulations, most importantly perhaps that any contract it lists for trading is not readily susceptible to manipulation, as required under CEA section 5(d)(3) ("**DCM Core Principle 3**"). Certainly, a DCM must evaluate whether a new product implicates other statutory core principles, but we highlight DCM Core Principle 3 because the NOPR's changes focus primarily on a DCM's obligations under that statutory provision. A DCM must carefully evaluate the relevant underlying spot market and take various factors into consideration when designing a new contract to ensure that the contract and the DCM's listing of the contract comply with DCM Core Principle 3. The Commission provides detailed guidance a DCM may consider in this regard in Appendix C to the Part 38 Regulations. As a matter of best practice, the Exchange will generally follow that guidance where appropriate in its product development efforts.

It is worth noting that the Commission made significant amendments to the Part 40 Regulations in 2011 following the DFA amendments to CEA section 5c(c). These revisions added provisions prescribing the information and analysis that a DCM must provide to accompany a certified product filing under Regulation 40.2 (or a certified rule filing under Regulation 40.6).[8] In response to objections raised during the 2011 comment process that the information and documentation requirements the Commission had proposed for a product filing were unduly burdensome, the Commission pared back the proposed requirements in the final rule to require a DCM to provide a "concise explanation and analysis" of the product along with its compliance

[6] Id. at 66373.

[7] *A New Regulatory Framework for Trading Facilities, Intermediaries and Clearing Organizations,* 66 FR 42256 (Aug. 10, 2001).

[8] *Provisions Common to Registered Entities*, 76 FR 44776 (July 27, 2011).

with applicable law.[9] That is the standard in place today under Regulation 40.2. The Commission stated that since the 2000 amendments it "has long recognized 'the need to balance the flexibility' that the Act . . . gives 'a DCM in being able to [quickly] self-certify new products .* *.* . against the obligations of both the DCM and the Commission to assure themselves that the certification is accurate—*i.e.,* that the product or rule does indeed comply with applicable * * * core principles.'"[10]

The changes proposed in the current NOPR are not in response to any statutory amendments, nor have staff articulated any significant market failure or rationale that necessitates changes beyond those incorporated as a result of the 2011 DFA amendments. While we acknowledge and strongly encourage the Commission's right to revisit existing rules to ensure they keep pace with evolving markets even absent a statutory change, in our view, the Commission struck the appropriate balance in the 2011 Part 40 rulemaking and that balance remains appropriate today. The Commission's regulations allow the Commission to "assure [itself] that the certification is accurate"[11] even when DCMs certify contracts referencing assets that are less familiar to the Commission.

II. Comments on Proposed Revisions to Regulation 40.2

a. Overarching Comments

Generally, we believe the Commission reached the appropriate balance when it adopted the current text of Regulation 40.2(a)(3) in 2011, and the rule does not need to be changed. Regulation 40.2 implements the product certification process that section 5c(c) establishes. As explained above, this procedure serves as an alternative to submitting new products to the Commission for review and approval. Its inclusion in the CEA since 2000 without substantive change evidences clear, longstanding Congressional intent to enable DCMs to move quickly to list a new product upon making the requisite certification, to support their competitiveness in the highly competitive global derivatives markets.

Under current Regulation 40.2(a)(3), a DCM must include in its certified product submission a "concise explanation and analysis of the product and its compliance with applicable provisions of the Act, including core principles, and the Commission's regulations thereunder." The NOPR proposes to expand this standard to require a DCM to provide a "concise explanation and analysis ***that is complete with respect to the product's terms and conditions, the underlying commodity,*** and the product's compliance with applicable provisions of the Act, including core principles, and the Commission's regulations thereunder."

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[9] 76 FR 44779.

[10] 76 FR 44779, quoting 75 FR 57282 (Nov. 2, 2010).

[11] *Id*.

We believe the proposed completeness standard lacks clarity and would significantly alter the existing process for certification under Regulation 40.2. The proposed revision is unnecessarily burdensome in what it would require a DCM to provide to evidence compliance with the CEA and Commission regulations. It is thus contrary to the policies embodied in CEA section 5c(c) that, prior to certification, the burden of evaluating a contract for compliance is with the DCM (not the Commission). If adopted, the standard could significantly expand a DCM's regulatory costs for preparing certified product filings.

Equally troubling, the proposed change if adopted will create procedural confusion by incorrectly implying that the Commission has discretion to reject or stay a submission if it determines the submitting entity did not satisfy the prescriptive requirement.[12] The statute does not provide a clear path for the Commission to reject or stay a certified product filing. To the contrary, the fact that Congress amended section 5c(c) in 2010 to expressly authorize the Commission to stay a certified ***rule*** filing on the grounds that the submitting entity has provided insufficient explanation but not to stay a certified ***product*** filing is clear proof Congress does not intend for the Commission to reject or stay a certified product filing for incompleteness. As explained above, the statute imposes no requirement on a DCM beyond that it must certify that the contract "complies with this Act (including regulations under this Act)."

We understand and generally accept the Commission's position that it is appropriate to impose some standard on a registered entity to explain the basis for its compliance with the CEA and CFTC Regulations in the filing. But the Commission must balance that interest against the federal policies reflected in CEA section 5(c), namely, that a DCM should have the flexibility to launch new products quickly upon submitting the requisite certification and should be relied upon to fulfill their regulatory obligations to take the time, effort, and care to design the contracts they list for trading to ensure compliance with DCM Core Principle 3 and other applicable core principles and the Commission's related regulations.

The Commission reached the appropriate balance when it adopted the current text of Regulation 40.2(a)(3) in 2011, and the rule does not need to be changed. A DCM must explain concisely how it meets the statutory standard that is the predicate for it to list a new product via self-certification. As required by statute, the Commission should continue to rely upon a DCM's judgment as to the level of information and analysis to include in a product certification to explain and analyze concisely the new product, including an explanation of the terms and conditions of the contract or the spot market for the underlying commodity where the DCM considers appropriate.

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[12] We understand the Commission is not proposing to add a provision to Regulation 40.2 that would allow it or Commission staff to stay a DCM's implementation of a new product listing on the basis that the certification is accompanied by an inadequate explanation, which we take as the Commission's acknowledgement of this limitation on its authority. We also recognize that the current standard the Commission added to the rule in 2011 also raises the implication that a DCM could face procedural consequences if its certified filing does not meet that standard, but replacing the standard that a registered entity should provide a concise explanation and analysis with a more prescriptive standard will in our view only heighten the procedural confusion.

This is not to say that the Commission should have no recourse to obtain additional information from DCMs to determine whether a new product complies with the CEA. Indeed, the statute gives the Commission other authority to take steps after a certification has been filed. This reflects a policy choice made by Congress. Accordingly, we recommend that the Commission not incorporate the proposed new standard into Regulation 40.2(a)(3).

We have more specific comments to offer, as well, set out in the following sections.

b. The Existing Product Certification Process Overall Works Well

The NOPR provides only modest justification for expanding the information and analysis requirements, stating that CFTC staff "has observed a trend that new product certifications tend not to include sufficient information on the underlying commodity to enable the Commission to complete its analysis, particularly for contracts on new commodities (*e.g.,* rare earth metals) for which staff may have less prior experience."[13] Notably, the NOPR does not cite any concerns that DCMs are abusing the certification procedure by certifying non-compliant products.[14] To the contrary, in 2018 Commission staff commented that the process has worked well in the case of DCMs. Specifically, it stated:

> To date, the existing self-certification process for new contracts has worked well. Typically, exchanges reach out to Commission staff in advance of launching a new contract. In the case of the CME and CFE bitcoin futures contracts, Commission staff and exchange staff had extensive discussions over a course of months leading up to the product launch to ensure that staff understood the bases for the self-certifications that the contracts and the settlement processes were not readily susceptible to manipulation. This type of lengthy engagement is not unusual for products that may implicate complex issues.[15]

The Exchange expects to continue to follow the common practice of engaging informally with CFTC staff if we believe a potential new product has unique features we should explain before we submit a filing via certification, just as we will be appropriately guided by the standards in Appendix C to the Part 38 Regulations. We believe that this conduct is properly incentivized by existing regulations and Commission authorities, as discussed in more detail in II.d, below. If, nonetheless, other DCMs are less transparent or diligent than the Commission would like, that is not a reason to impose more burdensome filing requirements as a general matter on all DCMs

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[13] 88 FR 61435.

[14] Although the CFTC has recently disapproved certain self-certified filings for event contracts that the Commission determined implicated CEA section 5c(c)(5), those are unique contracts and circumstances, limited in number, and do not justify imposing more burdensome filing requirements.

[15] CFTC Advisory 18-14, *Advisory with respect to Virtual Currency Derivative Product Listings* (May 21, 2018), at p. 7.

or all registered entities. And if the real issue the Commission is trying to address is that some DCMs may not be conducting appropriate analysis and due diligence to reasonably and truthfully certify that their filings comply with the CEA and Commission regulations, that is a very different problem that the Commission has separate authority it can and should use to address.

c. The Proposal Would Impose Significant Unnecessary Costs and Conflate the Certification and Review Procedures

We expect that imposing expanded information and analysis requirements on registered entities for certified product filings will impose significant, unnecessary regulatory costs on DCMs. It can be time consuming and costly to prepare lengthy, detailed filings against an expanded subjective checklist of what constitutes a "complete" filing, even more so if a DCM must address the items in the guidance provided in Appendix C to Part 38 as the NOPR suggests. The proposal, if adopted, will leave little daylight between what a DCM would submit in a certified filing compared to a new product filed voluntarily for CFTC review and approval under CFTC Regulation 40.3. This runs counter to the fundamental structure of section 5c(c), which as explained above prescribes very different procedural choices for a DCM to make, each with different hurdles and consequences.

The NOPR explains that to meet the proposed "completeness" standard, a DCM (or a swap execution facility) "should be guided by portions of appendix C to part 38 that apply to the contract listed."[16] Although Appendix C provides useful guidance, DCMs are not required to apply that guidance under CFTC Regulations 38.200 and 38.201, which implement DCM Core Principle 3. DCMs may feel compelled, though, to apply the detailed guidance in Appendix C as their benchmark for completeness in the face of these statements in the NOPR, even when portions of the guidance may be inapplicable to the product at hand. At a minimum, the proposed "completeness" standard combined with those statements will likely introduce uncertainty as to what level of detail is required.

As highlighted above, this is a separate matter from a DCM's regulatory obligation when designing a new contract for trading to conduct appropriate due diligence and evaluation for each new contract it plans to list to assure itself that it meets its obligations under DCM Core Principle 3 and other applicable core principles. Those obligations are the same, whether a DCM submits a new product via certification under Regulation 40.2 or for Commission review and approval under Regulation 40.3.

d. The Commission Should Rely on Its Existing Authority

Instead of increasing the regulatory burden for a DCM to avail itself of the product certification procedure established by the CEA, the CFTC should rely on its oversight authority over DCMs as registered entities. If the Commission believes that a new product filing contains insufficient explanation and analysis for CFTC staff to evaluate it against applicable regulatory standards, the

[16] 88 FR 61436.

Commission has the authority to require the registered entity to provide additional information to demonstrate its compliance. This is reflected in Regulation 40.2(b) and, in the case of a DCM, in Regulation 38.5.[17] We appreciate that this is an after the fact action, but that is the deliberate structure of section 5c(c) for a DCM's (or another registered entity's) certification of new contracts.

If cases arise where a DCMfiles a new product via certification that does not comply with one or more provisions of the CEA or the Commission's regulations, the Commission has the authority to take enforcement action against the DCM for filing a false certification, as provided in Regulation 40.2(c). That is a significant action not to be taken lightly, but it is available to the Commission in egregious circumstances. Apart from enforcement action, the Commission also has authority under CEA section 8a(7) (also cited in Regulation 40.2(c)), to alter or amend a contract's terms and conditions.

III. Comments on Proposed Revisions to Regulations 40.3

CFTC Regulation 40.3 sets out the filing and review procedures that apply when a DCM decides to submit a new product for Commission review and approval. The Exchange understands it is far more common for a DCM to file products via the certification procedure under Regulation 40.2, but we also believe there may from time to time be circumstances when a DCM will prefer to seek Commission approval of a new product to ratify the DCM's determination that the product's terms and conditions comply with relevant CEA provisions and CFTC Regulations.

The Exchange disagrees with the NOPR's proposed change to Regulation 40.3(c) regarding the 45-day review period. Currently, unless the Commission exercises its authority to extend the review period, a new product is deemed approved by the Commission 45 days after the Commission receives the filing, so long as two conditions are met: (i) the submission contains the elements required under paragraph (a) of Regulation 40.3, and (ii) "the submitting entity does not amend or supplement the terms and conditions of the product or supplement the request for approval, except as requested by the Commission or for correction of typographical errors, renumbering or other non-substantive revisions, during that period." If the submitting entity substantively amends the terms and conditions during the rule review period of its own volition, but not at the Commission's request, the Commission treats that as a new submission that restarts the 45-day clock.

In the NOPR, the Commission proposes to delete the "except as requested by the Commission" qualifier. If adopted, that would mean that when a DCM amends or supplements its original filing at the Commission's request, the subsequent filing will also be treated as a new submission that restarts the 45-day review period.

[17] Indeed, in CFTC Advisory 18-14, Commission staff notes favorably notes in its defense of the certification process that "if Commission staff is unable to confirm that the contract being self-certified complies with the CEA and regulations, but the exchange lists (or intends to list) the contract, staff may notify the exchange of its concerns in writing." CFTC Advisory 18-14, *supra* note 7, at p. 7.

The Commission should not extend its review period through this indirect "reset" mechanism triggered by requesting a DCM to amend or supplement its original filing, under circumstances when it has also determined that the DCM's original filing satisfies the requirements of Regulation 40.3(a). Presumably, Commission staff will have carefully reviewed and analyzed the original complete submission before asking the DCM to take such action and there is no compelling reason why it should need a new 45-day window to complete its review of a submission with which it should already be familiar. If the new product raises novel or complex issues, the Commission has clear authority under the rule to extend the review period up to an additional 45 days, operating within the statutory mandate to take final action within 90 days, and to extend the review period further if the DCM agrees. Building in an arbitrary extension mechanism that could ensnare a DCM in a chain of potentially endless restarts of the clock flies in the face of the timing certainty that CEA section 5c(c)(4) is designed to provide to DCMs.

The justification offered in the NOPR that the proposed change is "necessary to better ensure the Commission has sufficient time to review substantive changes to requests for product approval"[18] does not warrant this dramatic change to Regulation 40.3.

For these reasons, the Exchange recommends that the Commission retain the "except as requested by the Commission" qualifier in Regulation 40.3(c).

[18] 88 FR 61437.

IV. Conclusion

The Exchange appreciates the opportunity to provide our comments to the Commission on the NOPR. For the reasons explained above, the Exchange urges the Commission not to revise Regulation 40.2(a)(3) as proposed. The proposed change would impose unnecessary, prescriptive requirements on a DCM to provide a "concise explanation and analysis" yet one that must also be "complete" in addressing specific enumerated items. The proposed revision is contrary to the spirit and intent of CEA section 5c(c) and, if adopted, could significantly expand a DCM's regulatory costs for preparing certified product filings and cause other adverse consequences including, but not limited to, unnecessarily limiting and delaying the availability of a process for listing of derivatives contracts quickly after expending the time, effort and diligence to develop the product in the highly competitive global derivatives market. The Exchange also recommends that the Commission reject the NOPR's proposal to delete the phrase "except as requested by the Commission '' from Regulation 40.3(c), as explained above.

We are happy to discuss any questions that the Commissioners or Commission staff may have on our comments. Please feel free to contact the undersigned by email at Faryar.Shirzad@Coinbase.com or Boris.Ilyevsky@Coinbase.com.

Sincerely,

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Faryar Shirzad, Chief Policy Officer

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Boris Ilyevsky, Chief Executive Officer, LMX Labs d/b/a Coinbase Derivatives Exchange

cc: Chairman Rostin Behnam
Commissioner Kristin Johnson
Commissioner Summer Mersinger
Commissioner Caroline Pham
Commissioner Christy Goldsmith Romero
Vincent McGonagle, Director, Division of Market Oversight
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