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January 17, 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 Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations; RIN 3038-AF24

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 investment of customer funds by futures commission merchants ("FCMs") and 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

As a DCO, Nodal Clear recognizes the protection of customer funds as a core responsibility. Therefore, Nodal supports the Commission's ongoing efforts to review and enhance rules regarding the investment and protection of customer funds including: (i) providing guidance

[1] Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations, 88 FR 81236 (November 21, 2023).
[2] Coinbase Derivatives Exchange is a registered DCM under LMX Labs LLC.

surrounding the requirements for investing customer funds, (ii) permitting certain qualified exchange-traded funds ("ETFs") and specific foreign sovereign debt as investable assets, (iii) incorporating further guidance in the investment of money market funds, and (iv) adding acknowledgment letter templates for additional investments.

As the Commission is seeking to strengthen DCO safeguards for the investment of customer funds via rules designed to minimize credit risk, market risk, and liquidity risk, it should be noted that the most effective and efficient way to minimize these risks would be to permit all DCOs to deposit customer funds at the Federal Reserve Banks. The Commission itself acknowledged in a recent proposed rulemaking, "central banks are often the safest place to deposit customer funds…".[3] Accordingly, the Commission should continue to advocate for Federal Reserve deposit access for all DCOs holding customer funds, so those funds are held in the safest place.

A. Proposed Regulation § 1.25(b)(3)(ii) Issuer-Based Concentration Limits

The Commission is proposing amendments to Regulation 1.25(b)(3)(ii), which would revise the concentration limit for investment in government money market mutual funds ("Government MMFs") so that, of the total assets held in segregation by an FCM or DCO, interest in any single family of funds may not exceed 25% and interest in any individual fund may not exceed 5%. In proposing these limits, the Commission states its concern that Government MMFs are susceptible to cyber-attacks and operational incidents that may adversely impact their normal operating capabilities, including delaying or otherwise preventing them from processing redemption requests in a timely manner.[4]

Nodal supports concentration limits that are designed to mitigate the impact of cyber-attacks and other operational incidents. However, whether an FCM or DCO is investing in one fund or multiple funds at one issuer/fund family, it is generally subject to the same cybersecurity and operational risks at that issuer/fund family. Therefore, the relevant limit that would apply to minimize these risks is the 25% fund family limit, which is consistent with the Commission's other 25% issuer-based concentration limits for US agency obligations[5] and counterparty concentration limits for reverse repos[6] as investments, for example, as such investments have similar risk profiles. Therefore, the proposed 5% concentration limit adds relatively little incremental value in minimizing the impacts from cyber-attacks and other operational incidents.

By contrast, the costs associated with the 5% fund limit proposal are significant. While the proposed issuer-based concentration limits for investment in Government MMFs provide for both

[3] Protection of Clearing Member Funds Held by Derivatives Clearing Organizations 89 FR 286 (Jan 3, 2024) at 289 and 290.
[4] 88 FR at 81256.
[5] 17 CFR 1.25(b)(3)(ii)(A).
[6] 17 CFR 1.25(b)(3)(v).

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a fund family limit of 25% and a fund limit of 5%, the practical limit for certain FCMs and DCOs would be 5%. For example, Nodal is aware that many fund families have only one Government MMF per fund type (e.g., treasury securities only, treasury with repo, treasury with agency, etc.).[7] When considered with an FCM's or DCO's particular risk appetite that may restrict an FCM's or DCO's investment of customer funds to only one fund type (e.g., treasury securities), FCMs and DCOs may be limited to investing in only one fund per fund family. This scenario would result in an effective limit of 5% per fund family instead of the CFTC proposed 25%. Such an outcome would require an FCM or DCO to identify and open accounts with many fund families,[8] which would create a significant operational burden for FCMs and DCOs tasked with maintaining these accounts.

Nodal proposes that the 5% per fund limit be eliminated. Instead, the issuer-based limit for the investment of customer funds in Government MMFs should be 25% interest in any single family of funds. This flat limit of 25% would address the Commission's concerns about cyber-attacks and operational issues by ensuring the diversity of fund families for Government MMFs without imposing excessive per fund limits that are inconsistent with existing investment limits.

B. Proposed Regulation § 1.25(a) Removal of Certain Permitted Investments

The Commission is requesting comment on whether it should revise Regulation 1.25 by removing bank Certificates of Deposit ("CDs") from the list of permitted investments. In the NOPR the Commission states that it is not aware of any FCMs or DCOs that currently invest in bank CDs under 1.25(a) and asks whether any FCMs or DCOs invest in bank CDs and would be materially adversely impacted if bank CDs were removed as a permitted investment.[9]

Nodal supports the Commission's efforts to regularly review and determine whether a permitted investment type continues to be appropriate for the investment of customer funds by an FCM or DCO, but such determination should be risk-based and not based on whether an investment is currently used as economic conditions can quickly evolve and make an unused investment type suddenly desirable and useful. Accordingly, Nodal supports the removal of bank CDs as permitted investments based on a risk-based determination that bank CDs replace but do not materially mitigate counterparty risk (i.e., settlement bank failure versus issuing bank failure) while

[7] Money Market Fund Index, Dreyfus (as of Jan. 3, 2024), https://www.dreyfus.com/products/mm.html#overview (displaying Dreyfus's MMF options that includes only one Government MMF fund per fund type and investor class when filtered to "Government/Treasury"); Fund Finder, State Street Global Advisors (as of Jan. 3, 2024), https://www.ssga.com/us/en/institutional/cash/fund-finder (listing out available Government MMF funds that only have one Government MMF fund per fund type when filtering by "Strategy" to "Treasury" and "US Government" and by "Share Class" to "Institutional"); Products: Mutual Funds, Federated Hermes (as of Jan. 3, 2024), https://www.federatedhermes.com/us/products.do (listing only one Government MMF option per fund type when the "Category" is filtered to "Government/Treasury").

[8] Nodal estimates that it may need to utilize more than 10 fund families if the proposed concentration limits are adopted.

[9] *Id.* at 81254-55.

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increasing liquidity risk (as compared to keeping funds at a settlement bank) during the term of the bank CD for any amount that is not insured by the Federal Deposit Insurance Corporation.

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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