

May 13, 2024

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: Requirements for Designated Contract Markets and Swap Execution Facilities Regarding Governance and the Mitigation of Conflicts of Interest (RIN Number 3038–AF29)

Dear Mr. Kirkpatrick:

Nodal Exchange, LLC (“Nodal Exchange” or “Nodal”) appreciates the opportunity to submit comments to the Commodity Futures Trading Commission’s (“CFTC” or “Commission”) notice of proposed rulemaking, *Requirements for Designated Contract Markets and Swap Execution Facilities Regarding Governance and the Mitigation of Conflicts of Interest*, 89 Fed. Reg. 19646 (March 19, 2024) (“NOPR” or the “Proposed Rule”).¹

As background, Nodal Exchange is a designated contract market (“DCM”) and is part of the EEX Group of companies owned by the European Energy Exchange AG (“EEX”). Nodal Exchange is at the forefront of innovation in the electric power and locational (nodal), natural gas, and environmental futures contract markets. Nodal’s growth and success since becoming a DCM has been possible due to the flexibility and discretion afforded under the CFTC’s principles-based regulatory system for DCMs. Nodal Exchange’s Rules incorporate both applicable DCM Core Principles as well as guidance on, and acceptable practices in, compliance with the DCM Core Principles (“Guidance and Acceptable Practices”) for implementing governance fitness standards and conflicts of interests rules for the exchange. Members of the Nodal Exchange Board of Directors, its standing committees, and any disciplinary or appeals committees must adhere to the Nodal Exchange Rules on conflicts of interests.

Although the NOPR addresses proposed changes to DCM and swap execution facility (“SEF”) regulations, Nodal Exchange’s comments herein will focus only on proposed changes to DCM-specific regulations in Part 38 to the CFTC’s regulations (“Part 38”).²

¹ On April 22, 2024, the CFTC extended the comment period for the Proposed Rule to May 13, 2024.

² 17 CFR Part 38.

I. General Comments

If adopted, the Proposed Rule would create additional structural governance and conflicts of interest requirements for a DCM that will be more prescriptive than the existing regulations. Importantly, the preamble to the Proposed Rule states the CFTC's objective to further implement governance and fitness requirements and conflicts of interest standards that may impact "market regulation functions," a newly defined term introduced under conflicts of interest core principle regulations which, among other things, is prescriptively linked to new DCM duties, roles, and responsibilities, such as those for a DCM's Chief Regulatory Officer ("CRO").³

Nodal Exchange appreciates the CFTC's efforts to harmonize rules and adopt regulations to mitigate conflicts of interest between a DCM's market regulation functions and business functions. While we can generally support codifying into the regulations certain limited parts of the Guidance and Acceptable Practices and provisions from the Proposed Rule that are already uniformly followed by DCMs as a standard industry practice, we would note that in certain instances changing Guidance and Acceptable Practices into regulation will lead to a more prescriptive regulatory structure that will dampen the very innovation the CFTC has long supported in the industry. When the CFTC considered its longstanding DCM core principles-based approach in 2012 after the Dodd-Frank Wall Street Reform and Consumer Protection Act,⁴ it explained that:

In determining whether to codify a compliance practice in the form of a rule or guidance/acceptable practice, the Commission was guided by whether the practice consisted of a commonly-accepted industry practice. Where there is a standard industry practice that the Commission has determined to be an acceptable compliance practice, the Commission believes that the promulgation of clear-cut regulations will provide greater legal certainty and transparency to DCMs in determining their compliance obligations, and to market participants in determining their obligations as DCM members, and will facilitate the enforcement of such provisions. Several of the rules adopted in this notice of final rulemaking largely codify practices that are commonly accepted in the industry and are currently being undertaken by most, if not all, DCMs.⁵

Nodal Exchange has serious concerns that the Proposed Rule's wholesale codification of select Guidance and Acceptable Practices and new regulatory definitions/requirements into Part 38 does *not* reflect "standard industry practice," particularly for small or new DCMs, and therefore would be inconsistent with principles-based regulation. Instead, if adopted, the Proposed Rule would represent a notable, significant, and untenable shift to a prescriptive regulatory regime that

³ Proposed Rule at 19647 ("[M]arket regulation functions' ... include ... responsibilities related to trade practice surveillance, market surveillance, real-time market monitoring, audit trail data and recordkeeping enforcement, investigations of possible DCM or SEF rule violations, and disciplinary actions."). The NOPR also proposes enhanced notification requirements with respect to changes in the ownership or corporate or organizational structure of a DCM or SEF.

⁴ Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

⁵ *Core Principles and Other Requirements for Designated Contract Markets*, 77 FR 36612, 36614 (June 19, 2012).

disproportionately and negatively impacts small or new DCMs relative to their established competitors.

Adopting the Proposed Rule would be at odds with the DCM core principle framework. The core principle framework provides the necessary flexibility for DCMs, particularly smaller and more innovative ones, to appropriately manage compliance with the Commodity Exchange Act (“CEA” or “Act”) and the CFTC’s regulations consistent with each DCM’s specific, and perhaps even unique, business and markets. If adopted, the changes from the Proposed Rule would represent such a sudden and significant shift to prescriptive oversight that it would impact new and smaller DCMs’ continued growth and abilities to compete in an already highly regulated industry.

Changes proposed in the NOPR are wide-ranging and detailed—however, they appear to fall into three general categories. First, the NOPR proposes entirely new requirements—for example, the establishment of specific roles and duties of an CRO—that are not based on existing CEA or CFTC regulatory language. Second, there are proposed changes that would codify in Part 38 modified versions of Guidance and Acceptable Practices and/or mirror certain language, often with modifications, from other Parts of the CFTC’s regulations that DCMs must follow. Finally, some proposed language mirrors, often also with modifications, regulatory provisions that DCMs are currently exempt from under CFTC regulation 38.2, thereby creating new obligations for DCMs.

In instances where the Proposed Rule aims to adopt entirely new requirements not based on the CEA or existing CFTC regulations, some of these new provisions, even if generally followed by the majority of DCMs, would remove flexibility that is crucial to the principles-based framework under which DCMs operate. For example, the proposed specific duties for a CRO would, if adopted, remove flexibility from new or smaller DCMs to appropriately staff and affordably manage resources, as currently allowed under Part 38.

In instances where modified versions of existing language from Guidance and Acceptable Practices would be adopted, some of the proposed requirements appear to be unnecessary relative to the status quo. For example, the Proposed Rule would expand minimum fitness standards to a DCM’s “officers” in prescriptive regulations without explaining the regulatory need to do so or how it would differ from existing DCM practices. Current DCM Core Principle 15 (Governance Fitness Standards) Guidance and Acceptable Practices already provide that minimum governance fitness standards should apply to “persons ... who exercise disciplinary authority” which would appear to cover those employees the NOPR is attempting to capture.

In instances where the Proposed Rule would adopt language from regulations that DCMs are exempt from following, some of the proposed requirements transpose prescriptive language that is not tailored for DCMs. Existing practices for DCMs appropriately comport with the principles-based regulatory framework that has been implemented by the CFTC for decades.

With that in mind, the CFTC should reconsider whether the Proposed Rule is consistent with the DCM core principle framework, which has been in place since the CFTC implemented the

Commodity Futures Modernization Act of 2000.⁶ For many years the CFTC has provided discretion under the existing regulatory framework for DCMs to grow and innovate. DCMs have used that discretion (and flexibility) to become successful as businesses and to adopt Guidance and Acceptable Practices in ways most appropriate for their specific markets. That oversight has pushed regulated businesses to improve, without resorting to prescriptive requirements. Flexibility has also allowed the derivatives industry to grow, innovate, and increase competition to the benefit of the markets. Additionally, DCMs appropriately rely on the core principle framework today because it promotes and enhances an open dialogue with the CFTC and its staff on how to manage compliance in new or smaller DCMs, which have fewer resources and personnel.

Nodal urges the Commission not to codify as regulation certain and specific methods of regulatory compliance it and other DCMs may already follow under the Guidance and Acceptable Practices. The core principles regime has been vital for new and innovative DCMs (such as Nodal) to create new products that are important to the industry. The Proposed Rule appears to shift that core principles-based regime to a prescriptive one. Such a shift would restrict DCMs to only one manner of compliance, leaving no room for discretion to allow for business and compliance efficiencies or to innovate consistent with regulations under DCM Core Principle 1 which provides DCMs with “reasonable discretion in establishing the manner in which the board of trade complies with the core principles....”⁷

We note that smaller DCMs must temporarily accept certain conflicts in roles and responsibilities, with procedures to check that they do not become violations, so they can grow from a small staff to a more robust staff. If the minimum amount of staff to even start a DCM were to change from a small number with dual-hatted responsibilities to tenfold that number so a person can only do certain tasks, then current small DCMs could face difficult financial decisions while they attempt to create new and innovative products and allow sufficient time for those products to be accepted and traded by market participants. For example, Nodal Exchange may not have grown to host the world’s most diverse suite of exchange-traded environmental and clean energy futures and options contracts for a wide range of mandatory programs, without the necessary flexibility to launch new products and determine if there is sufficient industry demand to thrive on the exchange. More prescriptive requirements would force smaller and newer DCMs to consider the added cost required before determining if it can accept the financial and business risk of each new and innovative product. The Proposed Rule, if adopted, would create a barrier for smaller DCMs to grow and new DCMs may not be created, harming innovation and competition in the industry.

The CFTC should re-evaluate proposed changes it may currently view as merely codifying into regulation existing DCM practices with select additional requirements. While the CFTC may believe such codification is necessary to protect the industry, doing so could inadvertently eliminate the discretion the industry relies on to innovate and thrive—such codification may forever change the industry by reducing both innovation and competition. Nodal implores the

⁶ Appendix E of Pub. L. No. 106-554, 114 Stat. 2763 (Dec. 21, 2000); *A New Regulatory Framework for Trading Facilities, Intermediaries and Clearing Organizations*, 66 FR 42256 (Aug. 10, 2001).

⁷ 17 C.F.R. § 38.100.

CFTC to reconsider the proposed new regulatory requirements, and instead refocus on fostering the principles-based approach it has followed since 2001.

Below, Nodal Exchange provides comments addressing specific proposed regulations in more detail. However, we note that the Proposed Rule incorporates so many additional regulatory requirements into Part 38 that it is difficult to fully assess, even with the briefly extended comment period, the nuances of and the long term impacts its adoption might have on Nodal Exchange or the industry.

II. Nodal Exchange's Specific Comments

As stated above, if adopted, the Proposed Rule should aim to incorporate only limited language into Part 38 reflecting existing DCM practices consistent with the core principle framework that DCMs have operated under for decades. To the extent that language from Guidance and Acceptable Practices is being codified, such codification should remain flexible and as close to existing language as possible to reduce unintended prescriptive consequences.

A. New Governance Fitness Standards

Continuing to allow DCMs to address conflicts in governance structures through Part 38 Guidance and Acceptable Practices better aligns with a core principles-based framework. The flexible framework also allows new or smaller DCMs to continue to grow and innovate in an economical manner. By contrast, the Proposed Rule's prescriptive codification approach is inconsistent with a core-principle-based framework and as a result may stifle innovation.

1. Verification Procedures

For example, Proposed Regulation 38.801 would require each DCM to establish appropriate procedures for the collection and verification of information supporting compliance with appropriate fitness standards. The verification practices the CFTC proposes to adopt are generally prescriptive and remove the DCM's current discretion under the core principles framework. The proposed requirements include specific frequency of review, requires procedures for notifying individuals that no longer meet fitness standards, and documentation of findings, among other things.⁸ Consistent with the CFTC's core principles-based regulatory approach, the Guidance and Acceptable Practices already allow DCMs to select appropriate collection and verification standards to assess compliance with Core Principle 15. At DCMs like Nodal Exchange, verification is conducted by its Compliance Department per procedures in its Compliance Manual. The CFTC should reconsider adopting a one-size-fits-all approach when codifying new regulations that are more prescriptive than the status quo. The more prescriptive the requirement the more time and resources must be devoted to meeting it, which can be exponentially more troublesome for smaller DCMs looking to expand and innovate while

⁸ Proposed Regulation 38.801(d)(1)(i)–(iv) would address these practices by requiring: (i) fitness information be verified at least annually, (ii) the DCM to have procedures providing for immediate notice to the DCM if an individual no longer meets the minimum fitness standards to serve in their role, (iii) the initial verification of information supporting an individual's compliance with relevant fitness standard be completed prior to the individual serving in the capacity with fitness standards, and (iv) the DCM to document their findings with respect to the verification of fitness information. Proposed Rule at 19659.

balancing their costs. Here too, Nodal would recommend continuing to utilize the more flexible language in Core Principle 15 Guidance and Acceptable Practices.

2. Officers

Also, any new requirements for “officers” should only be addressed or clarified in the Guidance and Acceptable Practices and not codified as regulation. Under Proposed Regulation 38.801, new categories of persons would be subject to minimum fitness requirements, including “officers.” The NOPR states that “[t]hese are individuals who were not historically subject to DCM fitness requirements under DCM Core Principle 15, or ... DCM fitness requirements under Commission regulation § 1.63(c).”⁹ Although the CFTC explains that such minimum standards are appropriate because these individuals have “governing, decision-making, and disciplinary responsibilities within a ... DCM,” current DCM Core Principle 15 Guidance and Acceptable Practices already provide that minimum governance fitness standards should apply to “persons ... who exercise disciplinary authority” at the DCM, which would appear to cover employees the NOPR aims to include with the “officer” requirements.¹⁰ Instead of codifying new regulations, the CFTC should consider clarifying the Guidance and Acceptable Practices to explicitly refer to officers. Doing so would be consistent with the DCM core principle framework.

3. Sufficiently Good Repute

In response to the NOPR’s specific request for comment, it is unnecessary for the CFTC to codify as regulation an additional minimum fitness requirement that applicable individuals must be in “sufficiently good repute.”¹¹ The NOPR states that “[t]he purpose of a ‘sufficiently good repute’ standard would be to identify individuals with a well-established history of honesty, integrity, and fairness in their personal, public, and professional matters.”¹² The proposal would include that DCMs may flexibly establish criteria for demonstrating “good repute.” Even so, the existing minimum fitness standards already overlap with criteria that DCMs likely would use to assess whether an individual is in “sufficiently good repute”. For example, at Nodal Exchange, the governance fitness standards applied to Board members or any committee includes disqualifying any individual who has committed a disciplinary offense or is subject to a disqualification from any registration with the CFTC. If the CFTC required DCMs to adopt the “sufficiently good repute” standard as proposed here, that requirement would reflect another example of unnecessary and prescriptive new rules for DCMs. Adopting the new proposed language is unnecessary, and potentially prescriptive, as it would not ultimately change the status quo for most DCMs. The status quo is consistent with a principles-based regulatory approach, therefore the proposed language is unnecessary.

DCMs would be required to expend time and resources to amend Exchange Rules, policies and/or procedures to explicitly refer to the standard—an additional burden that, when considered holistically with other new regulations the NOPR proposes to codify, would disproportionately

⁹ Proposed Rule at 19657

¹⁰ 17 C.F.R. Part 38, Appx. B (Core Principle 15 of section 5(d) of the Act: Governance Fitness Standards).

¹¹ See Proposed Rule at 19659-60.

¹² *Id.* at 19659.

affect smaller DCMs. For these reasons, Nodal Exchange recommends that the CFTC does not incorporate the “sufficiently good repute” minimum fitness requirement in Part 38 regulations.

However, if the CFTC insists on adopting the proposed requirement, then Nodal recommends including a clarification *only* in the Guidance and Acceptable Practices. As the CFTC noted in the proposed language, DCMs may flexibly establish criteria to comply with the “sufficiently good repute” requirement. Limiting clarifications to the Guidance and Acceptable Practices, as opposed to a regulatory requirement, would be consistent with DCM Core Principle 1 which provides DCMs with “reasonable discretion in establishing the manner in which the board of trade complies with the core principles....”¹³

B. Conflicts of Interest and Non-Disclosure of Material Non-Public Information

The Proposed Rule, if adopted, would codify the following regulatory provisions in Part 38: (i) new definitions related to identifying, managing, and resolving conflicts of interest for decision-making, such as “market regulation functions,” (ii) substantive requirements for the same, and (iii) appropriate limitations on the use and disclosure of MNPI. Here too, changes proposed would excessively impact smaller DCMs with little added benefit to the overall industry’s compliance regime.

Conflicts required to be addressed would include, but not be limited to, any of those between and among a DCM’s “market regulation functions”; its commercial interests; and the several interests of its management, members, customers and market participants and other third-party constituencies. The changes would also include adding requirements for existing governance roles for a DCM’s Board of Directors, Regulatory Oversight Committee, and a DCM’s Public Directors. The Proposed Rule would also add an entirely new set of requirements for DCM CROs and a requirement to establish a Nominating Committee. Both of these new sets of requirements are not based on any existing language in the CFTC’s regulations or Guidance and Acceptable Practices. Consistent with our comments above, Nodal Exchange generally recommends that the CFTC continue to follow the core-principles framework by making little to no changes to existing core principle regulations.

1. New Market Regulation Functions Definition

Proposed Regulation 38.851(b) would introduce a new definition under Core Principle 16 (Conflicts of Interest) called “market regulation functions.” Adopting that new term will impose undue burdens on small DCMs that operate with limited resources and personnel. The term, if adopted, would be defined only by reference to a subset of existing DCM core principles. The Proposed Rule’s preamble also notes that CFTC may select other core principles that may serve as market regulation functions in the future.¹⁴

First, the proposed definition of “market regulation functions” is unnecessary, particularly with respect to its interaction with existing conflicts of interests requirements, because all core

¹³ 17 C.F.R. § 38.100.

¹⁴ Proposed Rule at 19655.

principles should be considered by a DCM establishing conflicts of interest rules and controls under the existing core principles.¹⁵ The CEA and CFTC’s DCM core principle regime provides that DCMs “shall establish and enforce rules--(a) [t]o minimize conflicts of interest in the decision-making process of the contract market; and (b) [t]o establish a process for resolving conflicts of interest described in subparagraph (A)...”¹⁶ The Proposed Rule does not intend to change this requirement but codifies as regulation additional, numerous, and specific conflicts of interest requirements for DCMs that rely on the “market regulation functions” definition. With respect to DCM core principles, the CFTC has explicitly stated that “each of the 23 core principles and the final implementing regulations, guidance and acceptable practices, apply to all ‘contracts’ listed on a DCM...”¹⁷ Additionally, pursuant to the CEA’s statutory mandate, codification of any DCM requirement as regulation signals that the CFTC believes it is reasonably necessary to serve the public interest through a system of *effective self-regulation of trading facilities*.¹⁸ Therefore, all DCM requirements (including DCM core principles) necessarily inform a DCM’s decision-making process as a self-regulated trading facility. The CFTC need not adopt the definition because the term is at odds with the DCM’s existing core principles framework. The definition would not change a DCM’s general obligation to “minimize” and establish processes to resolve conflicts of interest as it pertains to the decision-making process of the contract market.

Second, many small DCMs rely on the core principle framework to maximize operational efficiency. The framework’s flexibility allows DCMs to assign personnel multiple DCM-related functions and roles. Personnel may be responsible for day-to-day operations that include a mixture of DCM core principle functions, some of which are covered by the proposed “market regulation functions” definition, and some which are not. For example, a department within a DCM could manage both customer support as well as have tier 1 market surveillance functions. By selecting a subset of DCM core principle functions to be treated differently than others, the Proposed Rule restricts the ability of small DCMs to allocate personnel efficiently and

¹⁵ Proposed Regulation 38.851(b)(9) defines ‘market regulation functions’ as the DCM functions required by DCM Core Principle 2 (Compliance with Rules), DCM Core Principle 4 (Monitoring of Trading), DCM Core Principle 5 (Position Limits or Accountability), DCM Core Principle 10 (Trade Information), DCM Core Principle 12 (Protection of Markets and Market Participants), DCM Core Principle 13 (Disciplinary Procedures), DCM Core Principle 18 (Recordkeeping) and the Commission’s regulations thereunder. The preamble to the Proposed Rule states that market regulation functions “include responsibilities related to trade practice surveillance, market surveillance, real-time market monitoring, audit trail data and recordkeeping enforcement, investigations of possible SEF or DCM rule violations, and disciplinary actions. Commission staff conducts oversight of these market regulation functions in a number of ways, including rule enforcement reviews.”

¹⁶ 7 U.S.C. 7(d)(16) (DCM Core Principles: Conflicts of Interest); 17 C.F.R. 38.350 (mirroring the statutory core principle).

¹⁷ *Core Principles and Other Requirements for Designated Contract Markets*, 77 Fed. Reg. 36612, 36613 (June 19, 2012).

¹⁸ Proposed Rule at 19648 n.18 (“CEA section 8a(5), 7 U.S.C. 12a(5), authorizes the Commission to make and promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of the CEA. The CEA contains a finding that the transactions subject to the CEA are affected with a “national public interest by providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities,” and among the CEA’s purposes are to serve the aforementioned public interests through a system of ‘effective self-regulation of trading facilities.’ See CEA section 3.”).

effectively. For example, some smaller DCMs may not require extensive surveillance staff due to the volume of market trading it must surveil, however, the skills and experience necessary to provide competent surveillance need to be increased over time and by multiple personnel to allow for appropriate coverage (i.e. vacation and sick time needs). Allowing certain personnel to operate within multiple departments increases efficiency, expands knowledge through experience, and allows more affordable options without diminishing compliance. The definition could lead to DCMs being *required* to establish separate departments or hire additional staff that, in practice, only increases operational/administrative costs while chilling the ability of small DCMs to remain competitive compared to their more established peers.¹⁹ As used in the Proposed Rule, the definition would disproportionately affect smaller DCMs with little added benefit to the overall industry's compliance regime.

2. Proposed Structural Governance Requirements

a) *CRO*

If adopted, the Proposed Rule would mandate specific obligations for a CRO under Proposed Regulation 38.856 and pursuant to Core Principle 16 (Conflicts of Interest). Currently, Core Principle 16 Guidance and Acceptable Practices do not provide that DCMs have a CRO nor does it specify a CRO's specific obligations. Codifying as regulation specifics for the CRO's role, responsibilities, and duties is a prescriptive change that will ultimately increase costs for smaller DCMs in demonstrating compliance.

The NOPR states that “DCM CROs generally are responsible for administering a DCM’s market regulation functions.”²⁰ Proposed Regulation 38.856 includes granular detail of the requirements of the CRO position, such as (a) having “appropriate” background and skills; (b) to whom the CRO must report; (c) appointment/removal procedures; (d) consultation and compensation; and (e) specified duties.²¹ Pursuant to Proposed Regulation 38.856(e), CRO duties “must include, but are not limited to, the following: (1) [s]upervising the designated contract market’s market regulation functions; (2) [e]stablishing and administering policies and procedures related to the designated contract market’s market regulation functions; (3) [s]upervising the effectiveness and sufficiency of any regulatory services provided to the designated contract market by a regulatory service provider in accordance with § 38.154; (4) [r]eviewing any proposed rule or programmatic changes that may have a significant regulatory impact on the designated contract market’s market regulation functions and advising the regulatory oversight committee on such matters; and (5) [i]n consultation with the designated contract market’s regulatory oversight committee,

¹⁹ We note that certain of the proposed regulations appear to closely mirror the Guidance and Acceptable Practices for conflicts of interest and structural governance to the extent that DCMs would have to make little to no changes to their current practices. For example, the terms “material information,” “non-public information,” “commodity interest,” “related commodity interest,” and “linked exchange” largely mirror definitions as they are in CFTC Regulation 1.59(a), which DCMs are already required to follow. Nodal Exchange supports the CFTC’s adoption of these definitions to the extent they are applicable to new requirements the CFTC chooses to adopt in Part 38. However, other proposed definitions (like the “market regulation functions” definition) could lead to unintended consequences.

²⁰ Proposed Rule at 19674.

²¹ *See id.* at 19674-75.

identifying, minimizing, managing, and resolving conflicts of interest involving the designated contract market's market regulation functions.”

Nodal appreciates the CFTC's goal to “codify current DCM practices regarding the CRO position,” however, the manner in which the Proposed Rule accomplishes this is at odds with that objective.²² By codifying CRO duties and responsibilities smaller and new DCMs will, in practice, no longer be able to exercise discretion or flexibility necessary to comply with the core principles in ways that are appropriately tailored to their specific business, markets, more limited resources and personnel. The granular detail proposed could leave little room for smaller or new DCMs to appropriately manage and staff the duties laid out for the role. For example, DCMs may want to bifurcate the duties listed above between more than one individual in compliance. DCM could also need to combine such duties with a legal role when the responsibilities of the CRO may not warrant the hiring of a full-time employee at smaller DCMs. Also, as mentioned above, the requirement that a CRO supervise DCM staff responsible for “market regulation functions” is at odds with the existing framework which allows personnel to accomplish multiple DCM core principle-related functions. Without appropriate flexibility to staff and manage resources, small or new DCMs could be posed with unnecessary barriers to competing with established DCMs and are ultimately restricted from utilizing the discretion regulatorily allowed under the core-principles regime.

b) *Nominating Committee*

Proposed Regulation 38.855, if adopted, would require that DCMs establish a nominating committee to identify a diverse pool of individuals qualified to serve on the board of directors and administer a process for doing so pursuant to Core Principle 17 (Composition of Governing Boards of Contract Markets). The Proposed Regulation “incorporates and expands upon, the diversity of membership requirements found” in CFTC Regulation 1.64 (composition of various self-regulatory organization governing boards and major disciplinary committees). DCMs are currently not subject to CFTC Regulation 1.64. Nodal Exchange has already adopted rules consistent with Proposed Regulation 38.855, and believes it is common industry practice for other DCMs to have a nominating committee. Even so, Nodal Exchange recommends incorporating nominating committees into the Guidance and Acceptable Practices for Core Principle 17, rather than prescriptive regulations. Doing so would better align with the existing core principle framework which provides guidance but not a direct obligation on governance roles and committees that DCMs can establish to evidence appropriate compliance.

c) *Other Structural Governance Changes*

In addition to the CRO position and the nominating committee, the Proposed Rule also considers adopting new prescriptive requirements for existing governance positions. Such requirements represent a significant shift from the existing core principle-based framework. These additional requirements include, but are not limited to, the following roles:

- *The Board of Directors (“Board”) in Proposed Regulation 38.854.* In addition to codifying applicable Guidance and Acceptable Practices, Proposed Regulation 38.854

²² Proposed Rule at 19674.

would codify specific roles and responsibilities of Board members, require removal where a Board member’s conduct is likely to be “prejudicial to sound and prudent management”, and require notification of changes in Board composition.

- *The Regulatory Oversight Committee (“ROC”) in Proposed Regulation 38.857.* In addition to codifying applicable Guidance and Acceptable Practices, Proposed Regulation 38.857 would codify requirements that the ROC must be involved in the appointment, removal, and compensation of the CRO, that the ROC must meet quarterly, and ROC meeting minutes must include specific items.
- *A new definition of “Public Director” in Proposed Regulation 38.851(b)(13).* Proposed Regulation 38.851(b)(13) would adopt a definition of Public Director that has additional conditions relative to the existing description in applicable Guidance and Acceptable Practices. For example, the definition would include expanded bases of disqualification from the role.
- *Disciplinary Panel requirements in Proposed Regulation 38.858.* Proposed Regulation 38.858 would codify additional disciplinary panel requirements differing from the Guidance and Acceptable Practices. The requirements would involve changes to panel composition and disqualification for conflicts of interest.

As mentioned above, any new requirements that are inconsistent with the DCM core principle framework should not be adopted by the CFTC. The additional requirements for governance positions mentioned above remove the flexibility that new and smaller DCMs may utilize to comply with the core principles as most appropriate for their specific businesses and markets. For example, requiring that a ROC meet quarterly creates an additional burden for smaller DCMs that do not have the complexity and/or breadth of issues from a compliance standpoint requiring such frequent attention by the ROC as more established DCMs. Instead, DCMs should have the discretion to determine if and when it should meet more than once a year with its ROC, if necessary. Reduced flexibility directly impacts a smaller DCM’s ability to compete with a larger competitor that may have significantly more resources to compensate ROC members for their time and to address more prescriptive regulatory structures. This is contrary to the innovation and diversity the CFTC has promoted over the last twenty years under its principle-based approach to regulation.

3. Proposed Changes to Conflicts of Interest Requirements

a) *Expanded Scope of Conflicts of Interest Considerations*

The CFTC should focus on clarifying existing Guidance and Acceptable Practices, and not codify as regulation, new conflicts of interest requirements for DCMs. Additionally, it is not clear how a DCM could be confident that it is fully complying with some of the new regulatory requirements as proposed. For example, Proposed Regulation 38.851(a) requires that a DCM “must establish a process for identifying, minimizing, and resolving *actual or potential* conflicts of interest that may arise, *including, but not limited to*, conflicts between and among any of the designated contract market’s market regulation functions; its commercial interests; and the several interests of its management, members, owners, customers and market participants, other

industry participants, and other constituencies.”²³ The use of “actual or potential conflicts” and “including, but not limited to” in Proposed Regulation 38.851(a) (*i.e.*, language that is not currently included elsewhere in Part 38) adds ambiguity as to how DCMs can demonstrate they are in full compliance with the proposed regulation. Existing Guidance and Acceptable Practices only advise DCMs to consider decision-making processes as they relate to self-regulatory responsibilities, without the qualifying language described above.

Here, it is not clear what types of conflicts other than those involving “market regulation functions,” are intended to be captured.²⁴ It is also not clear what adding the terms “actual or potential” to modify “conflicts of interests” changes in practice. At a minimum, the Commission should not adopt the “actual or potential” or the “including, but not limited to” language in proposed regulation 38.851(a), because of the ambiguity of these phrases and the resulting compliance challenges they would create. More broadly, the CFTC should reconsider whether adopting “modernized” versions of existing Part 38 Guidance and Acceptable Practices achieves the NOPR’s objectives to minimize risks posed to markets by conflicts of interest rules. Instead, the changed language may inadvertently create confusion and cause DCMs to needlessly expend more resources on deciphering and attempting to comply with these obligations.

4. Limitations on the Use and Disclosure of MNPI

If adopted, Proposed Regulation 38.853 would include new requirements in Part 38 related to the use and disclosure of material non-public information. The proposed requirements are modeled off Guidance and Acceptable Practices for Core Principle 16 (Conflicts of Interest) and CFTC Regulation 1.59. Currently, Core Principle 16 Guidance and Acceptable Practices explain that DCMs should “provide for appropriate limitations on the use or disclosure of material non-public information gained through the performance of official duties by board members, committee members and contract market employees or gained through an ownership interest in the contract market.”²⁵ DCMs must also comply with CFTC Regulation 1.59(d), which prohibits SRO employees, governing board members, committee members, or consultants from (i) trading in a commodity interest on the basis of MNPI obtained in connection with such person’s DCM duties or (ii) disclosing MNPI obtained in connection with such person’s DCM duties.²⁶

Nodal Exchange supports the CFTC clarifying that only owners with a 10 percent or more interest in the DCM would be subject to the MNPI trading prohibition and incorporating exemptions to the prohibition as appropriate. However, consistent with our above-mentioned comments, those changes should be adopted to Core Principle 16 Guidance and Acceptable Practices.

²³ Proposed Rule at 19716 (emphasis added).

²⁴ As previously noted, the CFTC should not adopt the proposed “market regulation functions” definition.

²⁵ Core Principle 16 Guidance and Acceptable Practices.

²⁶ As stated in the NOPR, “[p]ursuant to Commission regulation § 38.2, DCMs are exempt from § 1.59(b) and (c), but must comply with § 1.59(a) and (d). . . .” Proposed Rule at 19660 n.151.

The remainder of the requirements in Proposed Regulation 38.853 should not be adopted because it is unclear what MNPI standards are applicable to DCMs. The Proposed Regulation expands the scope of applicable commodity interests in Proposed Regulation 38.853 relative to Regulation 1.59(d) but fails to exempt DCMs from complying with Regulation 1.59(d). Consequently, if adopted, the expanded scope under Proposed Regulation 38.853 creates multiple standards that DCMs would have to navigate—one under Part 38 and another under Regulation 1.59(d) (applicable more broadly to SROs).

5. Cost Considerations

Although the Proposed Rule’s preamble identifies costs and benefits associated with its adoption, it primarily focuses on potential benefits without adequately addressing the increased and significant financial burden that new and smaller DCMs may face in implementing its requirements. Smaller DCMs will need to operationally and functionally reorganize their existing businesses to ensure that they comply with the proposed requirements. Most notably, if the “market regulation functions” definition (*i.e.*, a subset of existing DCM core principles) is adopted and linked to newly codified specific roles, responsibilities, and supervisory authority (for instance, as they relate to the CRO), a smaller DCM may have to hire multiple new personnel, form entirely new departments and reporting lines, spin off responsibilities from existing personnel, or some combination of all of the above. Doing so could be cost prohibitive for smaller DCMs to continue to innovate, launch new products needed in the industry (*i.e.* power and environmental products that will allow the industry to adapt to serious climate changes anticipated), and operation efficiently while expanding to increase its financial success. Further, these costs could prevent new DCMs from registering which would naturally reduce competition and innovation necessary to address many of the industry’s greatest challenges.

The preamble also does not sufficiently consider the unique challenges and circumstances faced by new and small DCMs that play a vital role in fostering competition and innovation in the derivatives markets. For example, had the core principle framework not been introduced under the Commodity Futures Modernization Act, the industry may not have the breadth and diversity of environmental products it has today. No new DCM would have been able or willing to expend the significant up-front costs to satisfy a very prescriptive regulatory structure and requirement for extensive staff while launching new environmental products that require more time to mature, allow demand to increase for long term viability, and to ultimately thrive for the betterment of the industry and marketplace as a whole. Instead, the businesses would have likely decided to not take the risk to innovate, or innovate considerably less, because it would have been cost prohibitive.

Imposing disproportionate regulatory costs on new and small DCMs stifles their growth and limits market diversity. The CFTC must conduct a thorough assessment of the potential economic impact on all DCMs. A more comprehensive appreciation of the potential costs, particularly as they relate to smaller DCMs, is necessary to ensure that the core principles regulatory framework continues to promote market innovation and competition.

III. Conclusion

Nodal Exchange is deeply concerned that the additional requirements from the Proposed Rule represent an abrupt shift from a core principle based regulatory regime to a prescriptive regulatory regime. Nodal would consider such a change to be highly detrimental to the industry, by reducing competition within the industry, by increasing the cost of operating a DCM which would dampen and/or stifle necessary derivative product innovation, and other long-term impacts that may not be foreseen. We believe these changes, if adopted, will be disproportionately felt by new or smaller DCMs. An unintended consequence of shifting to more prescriptive rules in an already highly regulated industry is that it will be very difficult for smaller DCMs to manage, run, grow, and operate a successful business enterprise.

Nodal Exchange therefore requests that the CFTC reconsider many of the changes of this NOPR with a strong and thoughtful focus on avoiding the prescriptive requirements. The CFTC should avoid making changes to the principles-based regulatory structure that has allowed certain DCMs to be created and grow, and smaller DCMs to continue to innovate and compete. We ask the CFTC to issue only those proposed regulations that are targeted and consistent with the principles-based regime, maintain the current parameters of the Guidance and Acceptable Practices or add to them as appropriate, instead of adding to the regulations, and remain consistent with the existing DCM core principle regulatory framework that has allowed the industry to innovate, increase competition, and thrive for the benefit of the markets.

Nodal Exchange appreciates the opportunity to comment on the NOPR for Requirements for Designated Contract Markets and Swap Execution Facilities Regarding Governance and the Mitigation of Conflicts of Interest. If you have any questions regarding these comments, please do not hesitate to contact the undersigned.

Respectfully submitted,

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