Re: Comment on Proposed Rule 89 FR 1946
By: Industry CCO - Concerned Compliance Officer
Date: May 13, 2024

I commend the Commission Staff who worked on the proposed rule on Requirements for Designated Contract Markets and Swap Execution Facilities Regarding Governance and the Mitigation of Conflicts of Interest Impacting Market Regulation Functions (the "Proposal"). No doubt, a tremendous amount of effort was included in this Proposal. I also appreciate the opportunity to submit a public comment as part of the critical component of good government of public engagement in rulemaking. This is especially important for rules that have a strong and direct impact on our industry such as this one.

I have organized my comments below based on the sections of the Proposal; note, however, that the comments expressed below apply to all instances reasonably relevant and are not repeated at every possible instance. I also thank the Commission and Commission Staff in advance for their consideration of this comment below.

Market Regulation Functions

The definition of the term "Market Regulation Functions" in the Proposal is inconsistent.

As used in the introduction of the Proposal, the term "market regulation function" includes "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."

However, in the context of the proposed rules, the definition of the term "market regulation functions" is broadened to include compliance with various listed Core Principles, generally, and is not limited to the responsibilities outlined in the proposed preamble. Proposed § 37.1201(b)(9) defines "market regulation functions" as the SEF functions required by SEF Core Principle 2 (Compliance with Rules), SEF Core Principle 4 (Monitoring of Trading and Trade Processing), SEF Core Principle 6 (Position Limits or Accountability), SEF Core Principle 10 (Recordkeeping) and the Commission's regulations thereunder. Proposed § 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 Commission should clarify a consistent definition of the term "market regulation functions" in the Proposal so that the industry can appropriately comment on the proposed rules relating to governance of such "market regulation functions". See response to requested questions for comment on this section below.

Response to the specific questions the Commission requested comment on regarding the proposed definition of "market regulation functions."

1. Has the Commission appropriately defined "market regulation functions" for purposes of this rule proposal? Are there additional functions that should be included in the proposed definition?

No. The Proposal does not provide a uniform definition of the term "market regulation functions" throughout, as described above. See also immediately below.

2. In this rule proposal, and for purposes of the conflicts of interest that it is intended to address, has the Commission appropriately distinguished "market regulation functions" from the broader self-regulatory functions of a SEF or DCM?

No. The Commission should clarify further the difference between the self-regulatory functions of a SEF or DCM with regards to the Part 37 and Part 38 regulatory requirements and the specific Core Principles the Proposal uses to refer to "market regulation functions." SEFs and DCMs must comply with all relevant Commission Regulations as CFTC Registrants. *See*, 17 CFR 37.1 ("The provisions of this part shall apply to every swap execution facility that is registered or is applying to become registered as a swap execution facility under section 5h of the Commodity Exchange Act[.]"); ("the Act"); 17 CFR 38.1("The provisions of this part 38 shall apply to every board of trade that has been designated or is applying to become designated as a contract market under Sections 5 and 6 of the Act."). This includes all Core Principles. *See,* 17 CFR 37.100(a) ("In general. To be registered, and maintain registration, as a swap execution facility, the swap execution facility shall comply with—(1) The core principles described in section 5h of the Act[.]"; 17 CFR 38.100(a) ("In general. To be designated, and maintain a designation, as a contract market, a board of trade shall comply with: (1) Any core principle described in section 5(d) of the Act[.]").

Cherry-picking particular Core Principles as being relevant to "market regulation functions" while not others, as the Proposal does, is confusing. Why, for example, are System Safeguards (37 CFR 37.1400 and 38.1050) not considered to be a market regulation function when the reliability, security, and capacity of the market depend on

its system safeguards? The same question can be asked for SEF Core Principles 3 (Swaps Not Readily Subject to Manipulation), 8 (Emergency Authority), and many others. And the same question can be asked for DCM Core Principles 3 (Contract Not Readily Subject to Manipulation), 6 (Emergency Authority), and many others as well.

The Commission should further clarify what the term "market regulation functions" is intended to describe beyond a seemingly arbitrary list of Core Principles.

Conflicts of Interest Between Market Regulation Functions and Commercial Interests

The Proposal raises a concern that the "SEFs' and DCMs' obligations to perform market regulation functions may conflict with their commercial interests." Examples of these potential conflicts and commercial interests include (1) "the use of staff and resources that might otherwise be dedicated to commercial functions, such as seeking new market participants or promoting new products;" (2) the "commercial interest to earn fees from market participants, and to avoid deterring participants from trading on their platforms" which may impact "enforcement actions or the imposition of fines, that may deter the use of the platform by certain market participants, and therefore run counter to commercial interests of the platform;" and (3) "Commercial pressure, such as competition among SEFs and among DCMs, may strain market regulation obligations."

These concerns are misplaced; already addressed in the Regulations and Guidance; and should be removed from the Proposal.

The foundational responsibility for any CFTC Registrant is to lead the business in a manner that comports with its regulatory obligations. This is the most important function of the Compliance Department of a Registrant; without this function, there would be no need for a compliance department or a Chief Compliance Officer. As is obvious, the Chief Compliance Officer and Compliance Department of any CFTC Registrant must balance the competing interests of advancing the commercial interests and maintaining regulatory compliance. This is their entire function.

Just as a closed market is most protected from market manipulation; a handicapped business, i.e., one that cannot navigate its commercial interests without proscribed overly burdensome regulatory limitations on commercial interests, would be most protected from conflicts of interest. But just as a closed market does not reflect the robust market structure that the CFTC currently regulates, neither will proscribed handicapping limitations on commercial development. Not only will this handicap registrants, it will significantly cool the interest of potential applicants or currently

unregulated entities from coming under the protective shelter that CFTC Regulation provides.

Markets are constantly moving and developing; providing a reasonable framework for effective regulatory protection, *as is the case currently without the Proposal*, without being overly proscriptive will help the currently regulated entities, encourage the unregulated entities towards regulation, and benefit market participants.

Moreover, the oversight of the commercial considerations and regulatory requirements that the Compliance Department oversees is already codified in existing regulations and acceptable practices. For example, the specific duties of the SEF's Chief Compliance Officer specifically include, in 17 CFR 37.1501(c),

> Taking reasonable steps, in consultation with the board of directors or the senior officer of the swap execution facility, to resolve any material conflicts of interest that may arise, including, but not limited to:
>
> (i) Conflicts between business considerations and compliance requirements;
>
> (ii) Conflicts between business considerations and the requirement that the swap execution facility provide fair, open, and impartial access as set forth in § 37.202; and;
>
> (iii) Conflicts between a swap execution facility's management and members of the board of directors;

This requirement is (a) workable and (b) effective, and should remain as is.

Proposed Governance Fitness Requirements

I agree that it is essential that the individuals responsible for governing a SEF or DCM, such as officers and members of the board of directors, committees, disciplinary panels, and dispute resolution panels, are ethically and morally fit to serve in their roles. However, I disagree that proscriptive codified regulations are required to effectuate this goal.

Questions for Comment

The Commission requests comment on all aspects of the proposed fitness standards for SEFs and DCMs. The Commission further requests comment on the questions set forth below.

1. Should SEFs and DCMs be required to establish additional fitness standards for officers or members of the board of directors whose background, although not automatically disqualifying under proposed §§ 37.207 or 38.801, raises concerns about the individual's ability to effectively govern, manage, or influence the operations or decision-making of a SEF or DCM? If so, is "sufficiently good repute" an appropriate fitness standard for officers and members of the board of directors (or anyone performing similar functions) of a SEF or DCM?

No. The Commission should allow registrants the discretion to implement the existing guidance. Moreover, "sufficiently good repute" is a term so subjective as to render its utility meaningless and harmful for lack of clarity.

2. The Commission quoted above a "sufficiently good repute" standard, for purposes of a potential requirement that SEFs and DCMs require members of their boards of directors and officers be of good repute. Please explain whether you agree with that standard. Does such standard provide sufficient flexibility to SEFs and DCMs? Should such standard be more detailed and list specific criteria or factors evidencing good repute? Would "sufficiently good repute," already be encompassed in CEA section 8a(3)(M), "other good cause?"

I disagree. "Sufficiently good repute" is a term so subjective as to render its utility meaningless and harmful for lack of clarity. The creation of a long list of additional factors would be more proscriptive and less practical for registrants, especially those that do not have the traditional standard business operations as more established registrants.

3. Is a 10 percent or more ownership interest the appropriate threshold to trigger minimum fitness requirements for owners? Is the ability to control or direct the management or policies of the DCM the appropriate qualifier to trigger minimum fitness standards for 10 percent or more owners of a SEF or DCM?

No. the threshold should be raised to at least 25 percent to reflect the nature of the industry.

4. Should owners of 10 percent or more be subject to the disqualifying disciplinary offenses in proposed §§ 37.207(c) and 38.801(c)?

5. Proposed §§ 37.207(b) and 38.801(b) apply to "members of the designated contract market with voting privileges" and "members of the swap execution facility with voting privileges," respectively. Is this an appropriate category of persons to subject to the proposed minimum fitness standard requirements? Does this category remain relevant to current SEF and DCM governance and business structures, or is it no longer applicable?

This category is not relevant to all registrants. Many operate based on their board and advisors, others operate based on shareholder interests where voting privileges are negligible.

Proposed Substantive Requirements for Identifying, Managing and Resolving Actual and Potential Conflicts of Interest

Questions for Comment

1. Should the Commission enumerate certain other relationships or circumstances that may give rise to an actual or potential conflict of interest? If so, which relationships or circumstances?

No.

2. Does the proposed definition of "family relationship" cover the appropriate types of relationships? Should any relationships be added or removed from the proposed definition?

No.

Proposed Structural Governance Requirements for Identifying, Managing and Resolving Actual and Potential Conflicts of Interest

Composition and Related Requirements for Board of Directors—Proposed §§ 37.1204 and 38.854

Questions for Comment

1. Have there been any industry changes since the adoption of the DCM Core Principle 16 Acceptable Practices that the Commission should consider in adopting board composition requirements for SEFs and DCMs?

2. Is the 35 percent public director requirement sufficient to introduce an independent perspective on a SEF's or DCM's board of directors?

Yes.

3. Should the Commission increase the required percentage of public directors to 51 percent?

No. this would stymie the registrants ability to operate.

4. Is there a number less than 51 percent but greater than 35 percent that would be more appropriate?

No; 35 percent is adequate.

5. Should the Commission prohibit public director compensation from including any equity ownership?

No.

6. Should the Commission prescribe a specific numerical limit on the amount of equity ownership paid to a public director, and, if so, what is the appropriate limit?

No.

7. What are examples of compensation that would be more than nominal or directly dependent on the business performance of a SEF or DCM?

Public Director Definition—Proposed §§ 37.1201(b)(12) and 38.851(b)(12)

Questions for Comment

1. Are there other circumstances that the Commission should include as bright-line disqualifiers? Are there circumstances that the Commission should remove from such tests?

2. Should the Commission increase or decrease the $100,000 in aggregate payment threshold?

Increase for inflation.

3. Is the one-year look back period sufficient, in order to protect market regulation functions from directors that are conflicted due to industry ties?

Yes.

4. Should the Commission continue to permit public directors to serve on the board of directors of a SEF's or DCM's affiliate? Why or why not?
Yes. This provides helpful context for the operations of affiliated entities and their regulatory compliance obligations.

Nominating Committee and Diverse Representation—Proposed §§ 37.1205 and 38.855

The imposition of a nominating committee by regulatory requirement completely undercuts the ability of a registrant to effectively manage its business as a SEF or DCM, for several reasons. First, not all registrants have the ability or resources to maintain a nominating committee separate from its existing board members and advisors (which makes this requirement completely redundant). Second, the board of each registrant operates based on its operating agreement or charter, and is commercial in nature; a regulatory requirement of a strictly commercial aspect of the registrants business is wildly misplaced. It also runs afoul of the conflicts of interest the rest of this Proposal goes to great lengths to minimize: the conflict between the regulations and the commercial interest of a registrant. This proposal should be eliminated completely.

Regulatory Oversight Committee—Proposed §§ 37.1206 and 38.857

Questions for Comment

1. Are there any additional duties that should be included within the scope of the ROC's duties under proposed §§ 37.1206 and 38.857? Are there any additional requirements the Commission should consider prescribing for the ROC annual report?

No.

2. Should business executives and employees working outside of the SEF's or DCM's market regulation functions be permitted to attend even portions of ROC meetings that relate to their business? Or should ROC meetings be strictly limited to ROC members and employees who perform work related to the SEF's or DCM's market regulation functions?

The ROC should have the discretion to invite whichever employees may be helpful for the context of the meetings, in consultation with the CRO if helpful.

Disciplinary Panel Composition—Proposed §§ 37.1207 and 38.858

Questions for Comment

1. Are there any situations in which it would be appropriate for a disciplinary panel to be comprised of only one individual? If so, please describe.

Matters below a certain dollar threshold of violation or where the potential disciplinary actions are limited.

2. Should the Commission exempt requiring a public participant on a disciplinary panel in cases solely involving decorum or attire?
Yes.

DCM Chief Regulatory Officer—Proposed § 38.856

As a general matter, in describing at length the CRO's reporting lines to the Regulatory Oversight Committee and Board, proposed § 38.856 does not provide any guidance as to when the CRO can act unilaterally, as she must be able to in order to effectively administer her responsibilities. The Commission should clarify that the CRO has reasonable discretion when fulfilling her role as CRO, and not that she be handcuffed by

approval requests to the ROC or Board in order to manage the regulatory function of the registrant.

The Proposal seeks to establish "clear and transparent standards for the CRO duties, and may prevent the board of directors or senior officer from unreasonably limiting the CRO's role. For example, a board of directors or senior officer would be prohibited from taking over the market regulation functions in order to prioritize commercial interests." While admirable, there is a lurking danger here in that this may prohibit a member of the board or senior officer from (a) assisting the CRO in performing her duties as needed on a day to day basis or (b) acting as a backup to the CRO or in the CRO's line of backups when the CRO is unavailable.

Having a senior officer be able to act as a backup for the CRO may provide more reasonable assurances that regulatory functions will remain in compliance due to the seniority of oversight as opposed to, if the senior manager could not act in CRO capacity, even as a backup (which is implied by the Proposal), relying on a junior compliance officer to handle the CRO roles. This is especially the case for registrants with various levels of staff across various departments. It is not contemplated, and indeed not the intent of the Proposal, to require an additional detailed chain of backups for the CRO and regulatory function in order to prevent any scent of potential conflict between a regulatory officer and the commercial function of the registrant. (As mentioned above, the balance of the commercial interests and regulatory requirements is understood and accepted by every registrant by choosing to maintain CFTC registration; prescriptive limitations should not be required for this.)

With regards to the Proposal's view of the "CRO's role as being narrower than that of a CCO", I note that this is not a practical distinction. As registrants are required to comply with all of the relevant regulations (Part 37 for SEFs and Part 38 for DCMs), the oversight of one Core Principle as a regulatory function and the oversight of a different Core Principle as a non-regulatory function cannot be materially distinguished. [This relates to the point above that the term "market regulation functions" should be revised as it suffers from the same lack of clarity.]

Presumably, there is a reason the Proposal contemplates the addition of a CRO for DCMs CRO and not a CCO; but the reasoning behind this choice is absent from the Proposal and has led to much confusion with the Proposal as currently drafted.

Response to Questions for Comment

1. Is the Commission correct that all DCMs have CROs or an individual performing CRO functions?

Yes, there is generally an individual performing the CRO functions for a DCM. Note, however, that depending on the size of the DCM and the nature of any related entities, the individual performing CRO functions for the DCM may also be performing similar or other executive functions for the DCM or another affiliated entity. For example, one company may have a SEF and a DCM, and have the same individual performing the CRO functions for both.

The Commission should consider adding an explicit clause that a person may occupy the CRO position for multiple registrants, and can occupy multiple executive positions. Because the CRO functions are similar, although not identical, across regulated entities, this practice provides a reasonable and effective method for managing CRO functions.

2. Are there any additional duties that should be included under proposed § 38.856(e)? Are there any that should be removed?

§ 38.856(e)(3) should be clarified to accommodate service providers that provide both "market regulation functions" (although, as noted earlier, this comment recommends that the definition of that term be revised for clarity) and services that may impact regulatory services in which case supervisory authority may be shared by the CRO with the head of engineering or other relevant function. For example, a cloud provider such as Amazon Web Services may impact regulatory functions as well as general commercial functions, and sole supervisory authority of the CRO may not be most effective for all of the services that a cloud provider provides to a registrant.

As noted above, in describing at length the CRO's reporting lines to the Regulatory Oversight Committee and Board, proposed § 38.856(e) does not provide any guidance as to when the CRO can act unilaterally, as she must be able to in order to effectively administer her responsibilities. The Commission should clarify that the CRO has reasonable discretion when fulfilling her role as CRO, and not that she be handcuffed by approval requests to the ROC or Board in order to manage the regulatory function of the registrant.

Conforming Changes

Commission Regulations §§ 37.2, 38.2, and Part 1

Transfer of Equity Interest—Commission Regulations §§ 37.5(c) and 38.5(c)

These proposed regulations contain items of concern for the industry. Proposed regulations 37.5(c)(6) and 38.5(c)(6) provide that the Commission may suspend or revoke the registrants designation pursuant to sections 5e and 6(b) of the Act. However, there is no description of the due process, evidentiary standards, appeal standards, or any of the like that should accompany such a decision by the Commission. By comparison, the Commission requires registrants to maintain robust disciplinary proceedings for market participants similar to those expected in courts of law. The absence of any process for registrants themselves is a glaring omission in the Proposal, and provides the Commission unfettered discretion without any due process protections.

The minimum requirement for the Commission to determine that there has been a "failure to comply" is not reasonably defined; there is nothing in the Proposal that provides registrants any guidance as to whether a junior staff member leaving would implicate this rule, or whether there would have to be a finding of material noncompliance; in fact there is no guidance at all – and seems to subtly expand the Commission's authority, particularly if this authority is delegated to the Division of Market Oversight or another Division. The decision to revoke registrations should happen only at the Commission level, and only with a fair and transparent method of due process.

Moreover, the placement of this proposed regulation is odd: the authority to revoke designation is listed for failure to comply with the requirement to report a change in ownership or organizational structure; but not for failure to comply with any other regulatory requirement such as maintaining reliable systems, preventing fraud, and providing clear and transparent information to market participants.

This clause should be removed from the Proposal; or at the very least, moved elsewhere and expanded upon in great detail.

Effective and Compliance Dates

The Commission should provide additional time for implementation as the Proposal includes many items that are not already part of the acceptable practices.

Related Matters

Question for Comment

As noted above regarding the regulatory baseline, the Commission's understanding is that all of the DCMs that are currently designated by the Commission rely on the acceptable practices to comply with Core Principle 16, and therefore the actual costs and benefits of the codification of those acceptable practices with respect to DCMs may not be as significant. Is this understanding correct in all cases or are there situations where DCMs using other means to satisfy the core principles? If so, what are these means?

As a general matter, DCMs rely on the acceptable practices to comply with Core Principle 16. However, the actual costs and benefits of the codification of the acceptable practices may still be significant.