COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 37 and 38

RIN 3038–AF29

Requirements for Designated Contract Markets and Swap Execution Facilities Regarding Governance and the Mitigation of Conflicts of Interest Impacting Market Regulation Functions

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (''Commission'' or ''CFTC'') is proposing new rules and amendments to its existing regulations for designated contract markets (''DCMs'') and swap execution facilities (''SEFs'') that would establish governance and fitness requirements with respect to market regulation functions, as well as related conflict of interest standards. The proposed new rules and amendments include minimum fitness standards, requirements for identifying, managing, and resolving conflicts of interest, and structural governance requirements to ensure that SEF and DCM governing bodies adequately incorporate an independent perspective. The proposal also address requirements relating to the following: composition requirements for board of directors and disciplinary panels; limitations on the use and disclosure by employees and certain others of material non-public information; requirements relating to Chief Regulatory Officers, Chief Compliance Officers, and Regulatory Oversight Committees; and notification of certain changes in the ownership or corporate or organizational structure of a SEF or DCM.

DATES: Comments must be received on or before April 22, 2024.

ADDRESSES: You may submit comments, identified by ''Requirements for Designated Contract Markets and Swap Execution Facilities Regarding Governance and the Mitigation of Conflicts of Interest'' and RIN 3038–AF29, by any of the following methods:

- *CFTC Comments Portal: https://comments.cftc.gov.* Select the ''Submit Comments'' link for this rulemaking and follow the instructions on the Public Comment Form.
- *Mail:* Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.
- *Hand Delivery/Courier:* Follow the same instructions as for Mail, above.

Please submit your comments using only one of these methods. Submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *https://comments.cftc.gov.* You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act (''FOIA''), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the Commission's regulations.[1]

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse, or remove any or all of your submission from *https://www.comments.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under FOIA.

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SUPPLEMENTARY INFORMATION:

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[1] 17 CFR 145.9.

I. Introduction

The Commission proposes to establish governance fitness regulations related to market regulation functions,[2] and related conflict of interest requirements, for swap execution facilities (''SEFs'') and designated contract markets (''DCMs''). Although SEFs and DCMs have similar obligations with respect to market regulation functions, they are subject to different obligations with respect to governance fitness standards and mitigating conflicts of interest. SEFs and DCMs are required to minimize and resolve conflicts of interest pursuant to identical statutory core principles.[3] However, SEF and DCM regulatory requirements addressing governance fitness standards currently differ. With respect to governance fitness standards, DCMs are subject to specific statutory core principles addressing governance,[4] while SEFs do not have parallel core principle requirements. Additionally, SEFs and DCMs currently have different regulatory obligations with respect to governance fitness standards.[5] Further, while both SEFs and DCMs are subject to equity transfer requirements,[6] the applicable regulatory provisions currently have different notification thresholds and obligations.

In this proposal, the Commission is drawing on staff experience in conducting its routine oversight of SEF and DCM ''market regulation functions,'' which 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,[7] SEF regulatory consultations and registration application reviews, DCM designation application reviews, and regular engagement with SEFs and DCMs.[8]

Through its oversight, Commission staff has identified areas where it preliminarily believes that SEF and DCM regulations should be enacted, in lieu of existing guidance and acceptable practices, to further support the statutory objective of ensuring that conflicts of interest are appropriately mitigated. The Commission is proposing enhanced substantive requirements for identifying, managing, and resolving conflicts of interest related to a SEF's or DCM's market regulation functions, and structural governance requirements to ensure that SEF and DCM governing bodies adequately incorporate an independent perspective. The Commission is also proposing additional amendments to address governance standards as they relate to the performance of the market regulation function. The Commission is further proposing enhanced notification requirements with respect to changes in the ownership or corporate or organizational structure of a SEF or DCM.

More specifically, the Commission proposes: (1) new rules to implement DCM Core Principle 15 (Governance Fitness Standards) that are consistent with the existing guidance on compliance with DCM Core Principle 15; [9] (2) new rules to implement DCM Core Principle 16 (Conflicts of Interest) that are consistent with the existing guidance on, and acceptable practices in, compliance with DCM Core Principle 16; [10] (3) new rules to implement SEF Core Principle 2 (Compliance With Rules) that are consistent with the DCM Core Principle 15 Guidance; [11] (4) new rules to implement SEF Core Principle 12 (Conflicts of Interest) that are consistent with the DCM Core Principle 16 Guidance and Acceptable Practices; (5) new rules under part 37 of the Commission's regulations for SEFs and part 38 of the Commission's regulations for DCMs that are consistent with existing conflicts of interest and governance requirements under Commission regulations §§ 1.59 and 1.63; [12] (6) new rules for DCM Chief Regulatory Officers (''CROs''); (7) amendments to certain requirements relating to SEF Chief Compliance Officers (''CCOs''); and (8) new rules for SEFs and DCMs relating to the establishment and operation of a Regulatory Oversight Committee (''ROC''). The Commission also is proposing to remove the guidance on

[2] As discussed further below, the Commission is proposing to define ''market regulation functions'' to include the SEF functions required by SEF Core Principles 2 (Compliance with Rules), 4 (Monitoring of Trading and Trade Processing), and 6 (Position Limits or Accountability), the DCM functions required by DCM Core Principles 2 (Compliance with Rules), 4 (Prevention of Market Disruption), 5 (Position Limitations or Accountability), 10 (Trade Information), 12 (Protection of Markets and Market Participants), and 13 (Disciplinary Procedures), and regulations thereunder. These responsibilities include, but are not limited to, the responsibilities of SEFs and DCMs to conduct trade practice surveillance, market surveillance, real-time market monitoring, audit trail enforcement, investigations of possible SEF or DCM rule violations, and disciplinary actions. *See* proposed §§ 37.1201(b)(9) and 38.851(b)(9).

[3] *See* SEF Core Principle 12, Commodity Exchange Act (''CEA'') section 5h(f), 7 U.S.C. 7b–3(f), and DCM Core Principle 16, CEA section 5(d), 7 U.S.C. 7(d).

[4] *See* DCM Core Principles 15 and 17, CEA section 5(d)(15), 7 U.S.C. 7(d)(15), and CEA section 5(d)(17), 7 U.S.C. 7(d)(17), respectively.

[5] As discussed below, SEFs, but not DCMs, are required to comply with requirements under part 1 of the Commission's regulations addressing the sharing of nonpublic information, service on the board or committees by persons with disciplinary histories, board composition, and voting by board or committee members where there may be a conflict of interest.

[6] Commission regulation § 37.5(c) (SEFs) and Commission regulation § 38.5(c) (DCMs).

[7] *See* Rule Enforcement Reviews of Designated Contract Markets, *https://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/dcmruleenf.html*.

[8] As explained below, this proposal is not addressing SEF and DCM obligations relating to core principles that specifically address the financial integrity of transactions under SEF Core Principle 7 and DCM Core Principle 11.

[9] Part 38, Appendix B, Core Principle 15 Guidance.

[10] Part 38, Appendix B, Core Principle 16 Acceptable Practices.

[11] As discussed further below, SEF Core Principle 2 requires SEFs to establish rules governing the operations of the facility. To effectuate this requirement, the Commission preliminarily believes it is necessary to establish governance fitness standards for the individuals responsible for directing the operations of the SEF. *See* Section III(a) herein.

[12] The Commission is also proposing conforming amendments to remove SEFs and DCMs from the scope of these part 1 requirements. *See* Section V(a) herein.

compliance with DCM Core Principle 15, as well as the guidance on, and acceptable practices in, compliance with DCM Core Principle 16.

The Commission also proposes amendments to existing rules in part 37 and part 38 of its regulations regarding the notification of a transfer of equity interest in a SEF or DCM. The proposal would harmonize and enhance the rules for SEFs and DCMs, and would also harmonize these SEF and DCM rules with the corollary rules for derivatives clearing organizations (''DCOs'') under part 39 of the Commission's regulations.[13] The proposal would further confirm the Commission's authority to obtain information concerning continued regulatory compliance in the event of changes in the ownership or corporate or organizational structure of a SEF or DCM.

Finally, the Commission is proposing certain technical and conforming changes to SEF and DCM rules relating to disciplinary panels, staffing, and investigations.[14]

In developing the rules proposed in this NPRM, the Commission has consulted with the Securities and Exchange Commission (''SEC''), pursuant to section 712(a)(1) of the Dodd-Frank Act.[15]

II. Background

a. Statutory Requirements for SEFs and DCMs

Section 5h [16] of the CEA sets forth requirements for SEFs. CEA section 5h(f)(1)(A) provides that in order to be registered, and to maintain registration, with the Commission, a SEF must comply with (1) 15 core principles, and (2) any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5) of the CEA.[17] Unless otherwise determined by the Commission by rule or regulation, a SEF has reasonable discretion to establish the manner in which it complies with a particular core principle. As of January 2024, there were 21 registered SEFs.

Similarly, Section 5 of the CEA sets forth requirements for DCMs. CEA section 5(d)(1)(A) requires that to be designated, and to maintain designation, by the Commission, a DCM must comply with (1) 23 core principles, and (2) any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5) of the CEA.[18] Unless otherwise determined by the Commission by rule or regulation, a DCM has reasonable discretion to establish the manner in which it complies with a particular core principle.[19] As of January 2024, there were 17 registered DCMs.

Both SEFs and DCMs are subject to a respective core principle addressing conflicts of interest. Pursuant to SEF Core Principle 12 and DCM Core Principle 16, both SEFs and DCMs must establish and enforce rules to minimize conflicts of interest in their decision-making processes, and must establish a process for resolving such conflicts.[20]

SEFs are also subject to a Chief Compliance Officer core principle. SEF Core Principle 15 requires SEFs to designate an individual to serve as a CCO, sets forth CCO duties,[21] including a duty to resolve conflicts of interest,[22] and requires CCOs to prepare and submit an annual report to the Commission describing the SEF's compliance with the CEA and the SEF's policies and procedures, including the SEF's code of ethics and conflicts of interest policies.[23] There is no equivalent statutory core principle for DCMs.[24]

DCMs are additionally subject to three core principles addressing governance.[25] DCM Core Principle 15 requires a DCM to establish and enforce appropriate fitness standards for members of its board of directors, disciplinary committee members, members of the DCM, persons with direct access to the DCM, and any party affiliated with of any of the foregoing persons. DCM Core Principle 17 establishes that a DCM's governance arrangements ''shall be designed to permit consideration of the views of market participants.'' [26] DCM Core Principle 22 requires publicly-traded DCMs to endeavor to recruit individuals to serve on the board of directors and other decision-making bodies of the DCM from among, and to have the composition of these bodies reflect, a broad and culturally diverse pool of qualified candidates.[27] While there are no SEF core principles directly addressing governance, the Commission believes a SEF cannot effectively manage its SEF Core Principle 2 obligations without effective governance.

b. Proposed and Final Rules Addressing SEF and DCM Governance and Conflicts of Interest

Since 2001, the Commission has proposed and adopted guidance and acceptable practices addressing conflicts

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[13] *See, e.g.,* part 39 of the Commission's regulations, adopted pursuant to Derivatives Clearing Organization General Provisions and Core Principles, 76 FR 39333 (Nov. 8, 2011).

[14] *See* Section V(e)–(g) herein.

[15] 15 U.S.C. 8302 (Providing that before commencing any rulemaking or issuing an order regarding swaps, swap dealers, major swap participants, swap data repositories, derivative clearing organizations with regard to swaps, persons associated with a swap dealer or major swap participant, eligible contract participants, or swap execution facilities pursuant to the applicable subtitle, the CFTC must consult and coordinate to the extent possible with the SEC and the prudential regulators for the purposes of assuring regulatory consistency and comparability, to the extent possible).

[16] 7 U.S.C. 7b–3.

[17] 7 U.S.C. 7b–3(f).

[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.

[19] CEA section 5(d)(1)(B), 7 U.S.C. 7(d)(1)(B).

[20] CEA sections 5(d)(16), 5h(f)(12). DCM Core Principle 16 and SEF Core Principle 12 are substantively identical in the statute.

[21] The duties include to report directly to the board or senior officer of the SEF; review compliance with the core principles; resolve conflicts of interest in consultation with the board, a body performing a function similar to that of a board, or the senior officer of the facility; be responsible for establishing and administering the SEF's self-regulatory policies and procedures; ensure compliance with the CEA and rules and regulations issued thereunder; and establish a procedure for remedying noncompliance issues found during compliance office reviews, look backs, internal or external audit findings, self-reported errors, or validated complaints. *See* CEA section 5h(f)(15)(B), 7 U.S.C. 7b–3(f)(15)(B).

[22] The CCO must fulfill this duty in consultation with the board of directors, a body performing a function similar to that of a board, or the senior officer of the SEF. CEA section 5h(f)(15)(B)(iii), 7 U.S.C. 7b–3(f)(15)(B)(iii).

[23] CEA section 5h(f)(15)(D), 7 U.S.C. 7b–3(f)(15)(D).

[24] The Core Principle 16 Acceptable Practices specify that DCMs should have a Regulatory Oversight Committee that, among other things, supervises the DCM's chief regulatory officer, who will report directly to the Regulatory Oversight Committee. *See* section V(f)(3) herein for a discussion of the difference between a chief regulatory officer and a chief compliance officer.

[25] Related governance requirements for SEFs exist in part 1 of the Commission's regulations. Commission regulation § 1.69(b) requires SEFs to adopt rules requiring any member of the board of directors, disciplinary committee or oversight panel to abstain from deliberating and voting on any matter involving a conflict of interest. Commission regulation § 1.69 applies to ''self-regulatory organizations'' (''SRO''), as defined in Commission regulation § 1.3, which includes SEFs and DCMs. However, pursuant to Commission regulation § 38.2, DCMs are exempt from the requirements of Commission regulation § 1.69.

[26] Commission regulation § 38.900, DCM Core Principle 17, Composition of Governing Boards of Contract Markets.

[27] This proposal is not addressing the requirements identified in DCM Core Principles 17 and 22.

of interest and governance standards for SEFs and DCMs.

1. 2001 Regulatory Framework

On August 10, 2001, the Commission adopted a regulatory framework (''2001 Regulatory Framework'') implementing the Commodity Futures Modernization Act of 2000 (''CFMA''), effective October 9, 2001.[28] The CFMA required the Commission to implement a framework of flexible core principles in lieu of detailed regulatory prescriptions. Section 110 of the CFMA, codified in section 5(d)(1) of the CEA, stated that a DCM shall have reasonable discretion in establishing the manner in which it complies with the core principles.

The CFMA contained core principles, that among other things, related to governance fitness standards and conflicts of interest. DCM Core Principle 14 (Governance Fitness Standards) [29] provided that boards of trade shall establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract market, and any other persons with direct access to the facility (including any parties affiliated with any of the persons described in this paragraph).[30] DCM Core Principle 15 (Conflicts of Interest) [31] provided that boards of trade shall establish and enforce rules to minimize conflicts of interest in the decision-making process of the contract market and shall establish a process for resolving such conflicts of interest.[32]

The 2001 Regulatory Framework implemented guidance for DCM Core Principles 14 (Governance Fitness Standards) and 15 (Conflicts of Interest). Guidance provides contextual information regarding the core principles, including important concerns which the Commission believes should be taken into account in complying with specific core principles.[33] The guidance for a core principle is illustrative only of the types of matters a DCM may address, and is not intended to be used as a mandatory checklist.[34]

The guidance for DCM Core Principle 14 states that minimum fitness standards for ''persons who have member voting privileges, governing obligations or responsibilities, or who exercise disciplinary authority,'' and ''natural persons who directly or indirectly have greater than a ten percent ownership interest in a designated contract'' should include those bases for refusal to register a person under section 8a(2) of the CEA.[35] Additionally, the guidance states that persons who have governing obligations or responsibilities, or who exercise disciplinary authority, should not have a significant history of serious disciplinary offenses, such as those that would be disqualifying under Commission regulation § 1.63.[36] The guidance further states that fitness standards should include providing the Commission with fitness information for such persons, whether registration information, certification to the fitness of such persons, an affidavit of such persons' fitness by the contract market's counsel or other information substantiating the fitness of such persons.[37] Finally, the guidance provides that if a contract market provides certification of the fitness of such a person, the Commission believes that such certification should be based on verified information that the person is fit to be in his or her position.[38]

The guidance for DCM Core Principle 15 (Conflicts of Interest) provides that the means to address conflicts of interest in a DCM should include methods to ascertain the presence of conflicts of interest and to make decisions in the event of such a conflict.[39] The guidance also states that a DCM should provide 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.

In the 2001 Regulatory Framework, the Commission adopted Commission regulation § 38.2, which exempted ''agreements, contracts, or transactions'' traded on a DCM, as well as the ''contract market'' itself, and the ''contract market's operator'' from all Commission regulations for such activity, except for the requirements of part 38 and §§thnsp;1.3, 1.12(e), 1.31, 1.38, 1.52, 1.59(d), 1.63(c), 1.67, 33.10, part 9, parts 15 through 21, part 40, and part 190.[40] The Commission did so in the context of the CFMA, which provided DCMs with a framework of flexible core principles in lieu of detailed regulatory prescriptions.[41]

2. 2007 Final Release, Conflicts of Interest Acceptable Practices for DCMs

On February 14, 2007, the Commission adopted ''acceptable practices'' [42] as a way for DCMs to demonstrate compliance with the conflicts of interest core principle (''2007 Final Release'').[43] Acceptable practices are more detailed examples of how DCMs may satisfy particular requirements of the core principles.[44] Similar to guidance, acceptable practices are for illustrative purposes only and do not establish a mandatory or exclusive means of compliance with a core principle. Acceptable practices, however, are intended to assist DCMs by outlining specific practices for core principle compliance. As the Commission has stated, acceptable practices provide examples of how DCMs may satisfy particular requirements of the core principles; they do not, however, establish mandatory

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

[29] In 2001, DCM Core Principle 14 addressed governance fitness standards. In the Dodd-Frank Act, the DCM conflicts of interest core principle was renumbered to be Core Principle 15. *See* Dodd-Frank Act, section 735(b); 7 U.S.C. 7(d)(15).

[30] *See* CFMA section 110, codified at CEA section 5(d)(14).

[31] In 2001, DCM Core Principle 15 addressed conflicts of interest. In the Dodd-Frank Act, the DCM conflicts of interest core principle was renumbered to be Core Principle 16. *See* Dodd-Frank Act, section 735(b); 7 U.S.C. 7(d)(16).

[32] *See* CFMA section 110, codified at CEA section 5(d)(15).

[33] The 2001 Regulatory Framework described the guidance contained therein as ''application guidance,'' but the concept is substantively similar to the ''guidance'' in part 38, Appendix B, sec. 1. *See* 2001 Regulatory Framework, 66 FR 42256 at 42278.

[34] Part 38, Appendix B, sec 1.

[35] *See* 2001 Regulatory Framework, 66 FR 42256 at 42283.

[36] *Id.* The DCM Core Principle 14 Guidance states that members with trading privileges but having no or only minimal equity in the DCM and non-member market participants who are not intermediated ''and do not have these privileges, obligations, or responsibilities or disciplinary authority'' could satisfy minimum fitness standards by meeting the standards that they must meet to qualify as a ''market participant.''

[37] 2001 Regulatory Framework, 66 FR 42256 at 42283.

[38] *Id.*

[39] *Id.* In 2001, DCM Core Principle 15 addressed conflicts of interest. In the Dodd-Frank Act, the DCM conflicts of interest core principle was renumbered to be Core Principle 16. *See* Dodd-Frank Act, section 735(b); 7 U.S.C. 7(d)(16).

[40] *See* 2001 Regulatory Framework, 66 FR 42256 at 42277. *See also id.* at 42257.

[41] *See* Section II(b)(6) herein for a description of a revised version of Commission regulation 38.2.

[42] *See* Section II(b)(1) herein for a description of acceptable practices, and how acceptable practices compare to guidance.

[43] Conflicts of Interest in Self-Regulation and Self-Regulatory Organizations, 72 FR 6936 (Feb, 14, 2007) (''2007 Final Release'').

[44] *See* 2001 Regulatory Framework, 66 FR 42256 at 42279; Part 38, Appendix B, sec 2. Acceptable practices were adopted in the 2001 Regulatory Framework for core principles other than those relating to governance fitness standards and conflicts of interest. For example, acceptable practices were adopted for DCM Core Principles 2, 3, 4, 5, 6, 9, 10, 13, and 17. *See* 2001 Regulatory Framework, 66 FR 42256 at 42279–83.

means of compliance.[45] Acceptable practices apply only to compliance with specific aspects of a core principle, and do not protect the DCM with respect to charges of violations of other sections of the CEA or other aspects of the core principle.[46]

The DCM Core Principle 16 acceptable practices have several key provisions. First, the acceptable practices provided that DCM boards of directors, and any executive committees or similarly empowered bodies, be comprised of at least 35 percent ''public directors.'' Second, the acceptable practices also established a definition of who would constitute a ''public director'' for purposes of the acceptable practices. Third, the acceptable practices provided that a DCM establish a ROC comprised exclusively of public directors, which would have among its duties to supervise the contract market's CRO, who will report directly to the ROC.[47] The Commission explained that properly functioning ROCs should be robust oversight bodies capable of firmly representing the interests of vigorous, impartial, and effective self-regulation. ROCs should also represent the interests and needs of regulatory officers and staff; the resource needs of regulatory functions; and the independence of regulatory decisions. In this manner, ROCs will insulate DCM self-regulatory functions, decisions, and personnel from improper influence, both internal and external.[48]

The Commission also underscored the importance of a DCM's ROC being composed of 100 percent public directors, particularly given the industry shift toward demutualization.[49] The Commission stated that it strongly believed that new structural conflicts of interest within self-regulation require an appropriate response within DCMs. The Commission further stated that it believed that ROCs, consisting exclusively of public directors, are a vital element of any such response. The Commission observed that ROCs make no direct commercial decisions, and therefore, have no need for industry directors as members. The public directors serving on ROCs are a buffer between self-regulation and those who could bring improper influence to bear upon it.[50]

Fourth, the acceptable practices specified that DCM disciplinary panels should not be dominated by any group or class of DCM members or participants, and provided that at least one person who would qualify as a public director be included on the panel.

The Commission provided existing DCMs with a phase-in period of the lesser of two years or two regularly scheduled elections of the board of directors to demonstrate full compliance with the conflicts of interest core principle for DCMs.[51] Then, on March 26, 2007, the Commission proposed certain amendments to the ''public director'' definition.[52] With the ''public director'' definition in flux, the Commission stayed the phase-in period for existing DCMs to demonstrate full compliance with the conflicts of interest core principle.[53]

3. 2009 Final Release, Definition of Public Director

On April 27, 2009, the Commission adopted final amendments to the acceptable practices for complying with the conflicts of interest core principle for DCMs (''2009 Final Release).[54] The amendments established a final definition of who constitutes a ''public director'' for purposes of the acceptable practices and the stay for demonstrating full compliance with the conflicts of interest core principle was lifted.[55] In adopting the amendments, the Commission stated that ''self-regulation must be vigorous, effective, and impartial.'' [56]

The most important component of the ''public director'' definition is an overarching materiality test, which provides that a public director must have no material relationship with the DCM. Certain circumstances are specified under which a director would be deemed to have a material relationship. A director would be deemed to have a material relationship by virtue of: (1) being an officer or employee of the DCM, or an officer or employee of an affiliate of the DCM; (2) being a member, or an officer or director of a member, of the DCM; or (3) receiving more than $100,000 in annual payments from the DCM or an affiliate of the DCM for legal, accounting, or consulting services. The director would also have a material relationship if a family member had any of the aforementioned relationships. Whether a director or family member had any such relationship would be subject to a one-year look-back period.

4. 2010 Conflicts of Interest Rule Proposal

On October 18, 2010, the Commission issued a rule proposal (the ''Mitigation of Conflicts of Interest NPRM''), which proposed prophylactic measures aimed to mitigate conflicts of interest in the operation of a SEF or DCM.[57] After identifying certain potential conflicts of interest, the Commission made rule proposals for SEFs and DCMs concerning (1) governance, and (2) ownership of voting equity and the exercise of voting rights. With respect to governance, the Commission proposed, as rules, enhanced versions of the acceptable practices that had previously been adopted for the DCM core principle on conflicts of interest.[58] Specifically, the Commission proposed to require that each SEF or DCM have:

- a board of directors with at least 35 percent, but no less than two, public directors;
- a nominating committee with at least 51 percent public directors, and with a public director as chair;
- one or more disciplinary panels, with a public participant as chair;
- a ROC with all public directors; and
- a membership or participation committee, with 35 percent public directors.

The Commission also proposed, as rules, certain limitations with respect to the ownership of voting equity in the SEF or DCM and the exercise of voting rights. These proposals limited SEF participants or DCM members (and related persons) to: (1) beneficially

[45] Core Principles and Other Requirements for Designated Contract Markets, 77 FR 36612 at 36614 n.13 (June 19, 2012); 7 U.S.C. 7(d)(1) (amended 2010).

[46] *Id.*

[47] *Id.* at 6951 n.80.

[48] *Id.* at 6950–51.

[49] By 2007, the futures industry had been shifting away from mutually owned exchanges, starting in 2000 with the rule amendment approvals for CME and NYMEX to move from not-for-profit corporations to for-profit corporations. *See* Commission Release #4407–00 (June 16, 2000) *https://www.cftc.gov/sites/default/files/opa/press00/opa4407-00.htm* and Commission Release #4427–00 (July 28, 2000) *https://www.cftc.gov/sites/default/files/opa/press00/opa4427-00.htm,* respectively. The Commission also approved a demutualization plan for the Chicago Board of Trade (CBOT) on April 18, 2005. *See* Certified Rule Submissions, *https://www.cftc.gov/IndustryOversight/IndustryFilings/deaapprovalofrulestable.html.*

[50] *See* 2007 Final Release, 72 FR 6936 at 6951.

[51] *See id.*

[52] Conflicts of Interest in Self-Regulation and Self-Regulatory Organizations, 72 FR 14051 (March 26, 2007).

[53] *Id.* at 65659.

[54] Conflicts of Interest in Self-Regulation and Self-Regulatory Organizations, 74 FR 18982 (Apr. 27, 2009) (''2009 Final Release'').

[55] *Id.* at 18983.

[56] *Id.* at 18984.

[57] Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 FR 63732 (Oct. 18, 2010).

[58] *Id.* at 63733. *See also* 2009 Final Release, 74 FR 18982 (which defined ''public director''); 2007 Final Release, 72 FR 6936 (Feb. 14, 2007) (which adopted final acceptable practices for the DCM core principle on conflicts of interest); 71 FR 38740 (July 7, 2006) (which proposed acceptable practices for such DCM core principle).

owning no more than 20 percent of any class of voting equity in the SEF or DCM; and (2) exercising (whether directly or indirectly) no more than 20 percent of the voting power of any class of equity interest in the SEF or DCM.

The Commission never adopted the proposed rules as final rules.[59]

5. 2011 Governance and Conflicts of Interest NPRM

On January 6, 2011, the Commission issued a post-Dodd-Frank Act rule proposal (the ''2011 Governance and Conflicts of Interest NPRM'') to establish the manner in which DCMs, SEFs and DCOs must comply with their respective core principle obligations with regard to conflicts of interest.[60] The rule proposal aimed to mitigate conflicts of interest through requirements regarding reporting, transparency in decision-making, and limitations on the use or disclosure of non-public information, among other things.[61] The 2011 Governance and Conflicts of Interest NPRM also proposed rules to establish the manner in which DCMs and DCOs must comply with their respective core principle obligations with regard to governance fitness standards [62] and the composition of governing bodies,[63] and proposed rules to establish the manner in which publicly traded DCMs must comply with their core principle obligation with regard to the diversity of their board of directors.[64] The Commission never adopted the 2011 Governance and Conflicts of Interest NPRM as final rules.[65]

6. 2012 Part 38 Final Rule

The Dodd-Frank Act overhauled or reversed key aspects of the regulatory framework under the CFMA, but retained the core principles framework. Importantly, however, the Dodd-Frank Act specifically empowered the Commission to determine by rule or regulation, the manner in which a DCM may comply with core principles. Section 735 of the Dodd-Frank Act amended section 5 of the CEA to include the proviso that ''*[u]nless otherwise determined by the Commission by rule or regulation . . .*'' boards of trade shall have reasonable discretion in establishing the manner in which they comply with the core principles.[66] On June 19, 2012, the Commission adopted a rulemaking to implement the Dodd-Frank Act's amendments to section 5 of the CEA pertaining to the designation and operation of contract markets (the ''2012 Part 38 Final Rule'').[67] Similar to the Commission's approach in this rule proposal, the Commission's implementation of the new provisions under the Dodd-Frank Act substituted rules in lieu of guidance and acceptable practices for several of the DCM core principles.[68]

In the 2012 Part 38 Final Rule, the Commission adopted rules establishing the manner in which a DCM must comply with several of the DCM core principles. The Commission also adopted revised guidance and acceptable practices for certain of the DCM core principles. The Commission chose to maintain the existing guidance [69] on compliance with the DCM core principle on governance fitness standards, and to maintain the existing guidance on,[70] and acceptable practices in, compliance with the DCM conflicts of interest core principle.[71] This included the acceptable practice that the DCM's ROC supervise the DCM's CRO, who reports directly to the ROC. While the Commission did not adopt rules to establish this as an affirmative requirement for all DCMs, the Commission stated in the adopting release that current industry practice is for DCMs to designate an individual as chief regulatory officer, and it will be difficult for a DCM to meet the compliance staff and resources requirements of § 38.155 without a chief regulatory officer or similar individual to supervise its regulatory program, including any services rendered to the DCM by a regulatory service provider.[72] In the 2012 Part 38 Final Rule, the Commission contemplated that rules implementing the DCM conflicts of interest core principle might be adopted in the future.[73]

In the 2012 Part 38 Final Rule, the Commission also adopted equity transfer notification requirements for DCMs. Pursuant to § 38.5(c), DCMs must notify the Commission when they enter into a transaction involving the transfer of 10 percent or more of the equity interest in the DCM.[74] DCMs must notify the Commission of such a transfer at the earliest possible time, but in no event later than the open of business 10 business days following the date upon which the DCM enters into a firm obligation to transfer the equity interest.[75] In particular, the Commission explained that while DCMs may take up to 10 business days to submit a notification, the DCM must provide Commission staff with sufficient time, prior to consummating the equity interest transfer, to review and consider the implications of the change in ownership, including whether the change in ownership will adversely impact the operations of the DCM or the DCM's ability to comply with the core principles and the Commission's regulations thereunder.[76]

In addition to Commission regulation § 38.5(c)'s equity interest transfer requirements, the Commission adopted regulations requiring DCMs to submit certain information to the Commission.

[59] The proposal was withdrawn on the Fall 2020 Unified Agenda and Regulatory Plan. The withdrawal entry is available at: *https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202010&RIN=3038-AD37*.

[60] Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest, 76 FR 722 (January 6, 2011).

[61] *Id.*

[62] *See* section 5(d)(15) of the CEA, 7 U.S.C. 7(d)(15) (DCM core principle on governance fitness standards), as redesignated by section 735 of the Dodd-Frank Act.

[63] *See* section 5(d)(17) of the CEA, 7 U.S.C. 7(d)(17) (DCM core principle on composition of governing boards), as added by section 735 of the Dodd-Frank Act.

[64] *See* section 5(d)(22) of the CEA, 7 U.S.C. 7(d)(22) (DCM core principle on diversity of board of directors), as added by section 735 of the Dodd-Frank Act.

[65] The proposal was withdrawn on the Fall 2019 Unified Agenda and Regulatory Plan. The withdrawal entry that appeared in the Fall 2019 Agenda is available at: *https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201910&RIN=3038-AD36*.

[66] *See* CEA section 5(d)(1)(B) (emphasis added).

[67] Core Principles and Other Requirements for Designated Contract Markets, 77 FR 36612 (June 19, 2012) (the ''2012 Part 38 Final Rule'').

[68] In 2007, DCM Core Principle 15 addressed conflicts of interest. In the Dodd-Frank Act, the DCM conflicts of interest core principle was renumbered to be Core Principle 16. *See* Dodd-Frank Act, section 735(b); 7 U.S.C. 7(d)(16).

[69] *See* section II(b)(1) herein for a description of the guidance adopted in 2001 relating to governance fitness standards.

[70] *See* section II(b)(1) herein for a description of the guidance adopted in 2001 relating to conflicts of interest.

[71] 2012 Part 38 Final Rule, 77 FR 36612 at 36655–56. The Commission added Commission regulation § 38.851 to permit DCMs to continue to rely on the conflicts of interest guidance in Appendix B to part 38. See section II(b)(2)–(3) herein for a description of acceptable practices adopted in 2007 and 2009 relating to conflicts of interest.

[72] 2012 Part 38 Final Rule, 77 FR 36612 at 36628.

[73] The Commission explained that until such time as it may adopt the substantive rules implementing Core Principle 16, the Commission was maintaining the current guidance and acceptable practices under part 38 applicable to Conflicts of Interest (formerly Core Principle 15). Accordingly, the existing Guidance and Acceptable Practices from Appendix B of part 38 applicable to Core Principle 16 were codified in the revised Appendix B adopted in the final rulemaking. The Commission noted that at such time as it may adopt the final rules implementing Core Principle 16, Appendix B would be amended accordingly. 2012 Part 38 Final Rule, 77 FR 36612 at 36656.

[74] *See* Commission regulation § 38.5(c).

[75] *See id.*

[76] 2012 Part 38 Final Rule, 77 FR 36612 at 36619.

Pursuant to Commission regulation § 38.5(a), upon request, a DCM must file with the Commission information related to its business as a DCM, including information relating to data entry and trade details, in the form and manner and within the time specified by the Commission in its request.[77]

The Commission notes that in the 2012 Part 38 Final Rule, pursuant to § 38.5(d), the Commission delegated ''the authority set forth in paragraph (b) of this section'' (demonstration of compliance) to the Director of the Division of Market Oversight.[78] This differs from the corresponding regulation for SEFs.[79] Existing Commission regulation § 37.5(d) provides that the Commission delegates ''the authority set forth in this section'' to the Director of the Division of Market Oversight, which is a broader delegation compared to the Part 38 regulation. In particular, the delegation provision in § 37.5(d) includes the authority to request information pursuant to both regulations §§ 37.5(a) (requests for information) and (b) (demonstration of compliance).[80] The delegation provision in § 38.5(d) does not apply to § 38.5(a) (requests for information).

Finally, in the 2012 Part 38 Final Rule, the Commission adopted a revised version of § 38.2 that specified ''the Commission regulations from which DCMs will be exempt'' as opposed to listing the regulations that DCMs were obligated to comply with.[81] The Commission made this change to add clarity and to eliminate the need for the Commission to continually update § 38.2 when new regulations with which DCMs must comply are codified.[82] The Commission exempted DCMs from certain provisions within part 1 of the Commission's regulations that address conflicts of interest and governance for self-regulatory organizations (''SROs''). In particular, the Commission exempted DCMs from all or part of the following provisions:

- Commission regulation § 1.59, which addresses limitations on the use and disclosure of non-public information;[83]
- Commission regulation § 1.63, which restricts persons with certain disciplinary histories from serving on governing boards or committees;[84]
- Commission regulation § 1.64, which addresses composition of governing boards and disciplinary committees;[85] and
- Commission regulation § 1.69, which addresses voting by conflicted members of governing boards and committees.[86]

In exempting DCMs from the provisions listed above, the Commission noted that Commission regulation § 38.2 will likely be amended if and when the referenced rules are eliminated from the regulations or modified.[87]

7. 2013 Part 37 Final Rule

On June 4, 2013, the Commission adopted a final rulemaking (the ''Part 37 Final Rule'') which established regulatory obligations that SEFs—a new category of regulated entity introduced under the Dodd-Frank Act.[88] In the Part 37 Final Rule, the Commission adopted rules establishing the manner in which a SEF must comply with several of the SEF core principles, and also adopted guidance and acceptable practices for certain of the SEF core principles. In the Part 37 Final Rule, the Commission did not adopt the guidance on, and acceptable practices in, compliance with the conflicts of interest core principle that the Commission had adopted to date for DCMs. In the adopting release, the Commission explained that, as noted in the notice of proposed rulemaking for the Part 37 Final Rule, the substantive regulations implementing SEF Core Principle 12 (Conflicts of Interest) were proposed in a separate release, the Mitigation of Conflicts of Interest NPRM. The Commission noted that until such time as it may adopt the substantive rules implementing Core Principle 12, SEFs have reasonable discretion to comply with this core principle as stated in § 37.100.[89]

As discussed above, the Commission never adopted the Mitigation of Conflicts of Interest NPRM as final rules.

Pursuant to Commission regulation § 37.2, adopted in the Part 37 Final Rule, SEFs are subject, in their entirety, to Commission regulations §§ 1.59, 1.63, 1.64 and 1.69 which, as discussed above, address conflicts of interest and governance for self-regulatory organizations. Therefore, SEFs are currently subject to a different set of conflicts of interest and governance requirements than DCMs.

In the Part 37 Final Rule, the Commission adopted rules to implement the Chief Compliance Officer core principle for SEFs that, among other things, addressed the CCO's duties and the annual compliance report requirement, provided that the CCO's duties include supervising the SEF's self-regulatory program with respect to, among other regulatory responsibilities, trade practice surveillance, market surveillance, real-time market monitoring, compliance with audit trail requirements, enforcement and disciplinary proceedings, audits, and examinations.[90] In addition, the rules provided that the CCO's duties included supervising the effectiveness and sufficiency of any regulatory services provided to the SEF by a permitted

[77] *See* Commission regulation § 38.5(a).

[78] *See* Commission regulation § 38.5(d).

[79] *See* Section II(b)(7) for a description of the rulemaking implementing regulatory obligations of SEFs in which the current version of Commission regulation 37.5 was adopted.

[80] *See* Commission regulation § 37.5(d).

[81] *See* 2012 Part 38 Final Rule, 77 FR 36612 at 36615. See Section II(b)(1) herein for a description of the previous version of Commission regulation § 38.2.

[82] *Id.*

[83] Commission regulation § 38.2 exempts DCMs from Commission regulation § 1.59(b) (requiring self-regulatory organizations to, by rule, prohibit employees from trading in certain contracts traded on or cleared by the self-regulatory organization or related to those traded on or cleared by the self-regulatory organization, and from trading on or disclosing material non-public information), and Commission regulation § 1.59(c) (requiring self-regulatory organizations to, by rule, prohibit governing board members, committee members, and consultants from disclosing material non-public information gained as a result of official duties). DCMs remain subject to Commission regulations §§ 1.59(a) (definitions) and 1.59(d) (prohibiting self-regulatory organization employees, governing board members, committee members, and consultants from trading on or disclosing material non-public information).

[84] Commission regulation § 38.2 exempts DCMs from all paragraphs of Commission regulation § 1.63 except for Commission regulation § 1.63(c), which states that no person may serve on a disciplinary committee, arbitration panel, oversight panel or governing board of a self-regulatory organization if such person is subject to any of the conditions listed in Commission regulation § 1.63(b)(1) through (6), which lists certain disqualifying offenses, suspensions, settlements, revocations, bars, and denials.

[85] Commission regulation § 38.2 exempts DCMs from the entirety of Commission regulation § 1.64.

[86] Commission regulation § 38.2 exempts DCMs from the entirely of Commission regulation § 1.69.

[87] *See* 2012 Part 38 Final Rule, 77 FR 36612 at 36615.

[88] *See* Core Principles and Other Requirements for Swap Execution Facilities, 78 FR 33476 (June 4, 2013) (the ''Part 37 Final Rule'').

[89] *Id.* at 33538.

[90] *See* Part 37 Final Rule, 78 FR 33476, which adds CCO duties beyond those contained in SEF Core Principle 15, including (1) providing examples of the types of conflicts of interest that a CCO must resolve, including conflicts between business considerations and compliance requirements, and (2) supervising the SEF's self-regulatory program with respect to trade practice surveillance, market surveillance, real-time market monitoring, compliance with audit trail requirements, enforcement and disciplinary proceedings, audits, examinations, and other regulatory responsibilities with respect to members and market participants (including ensuring compliance with, if applicable, financial integrity, financial reporting, sales practice, recordkeeping, and other requirements), and (3) supervising the effectiveness and sufficiency of any regulatory services provided by a regulatory service provider pursuant to Commission regulation § 37.204.

regulatory service provider.[91] With respect to the annual compliance report, the rules provided that the CCO must, prior to submission to the Commission, provide the report for review to the SEF's board of directors or, in the absence of a board of directors, to the senior officer of the SEF.[92] Members of the board of directors or the SEF's senior officer (as applicable) must not require the CCO to make any changes to the report.[93]

The Part 37 Final Rule adopted equity transfer notification requirements for SEFs, but they differ in three areas from those applicable to DCMs pursuant to the 2012 Part 38 Final Rule. First, under Commission regulation § 37.5(c), SEFs must notify the Commission when they enter into a transaction involving the transfer of 50 percent or more of the equity interest in the SEF.[94] This is a higher percentage than the 10 percent or more percentage that applies with respect to DCM equity interest transfers, and is therefore effectively a lower notification standard. Second, Commission regulation § 37.5(c) specifically authorizes the Commission, upon receipt of notification from a SEF of an equity interest transfer, to request supporting documentation regarding the transaction; this authority also is delegated to the Director of the Division of Market Oversight or such other employee(s) as the Director may designate from time to time. Finally, upon an equity interest transfer, SEFs are affirmatively required to certify to the Commission, no later than two business days after the transfer takes place, that the SEF meets all of the requirements of section 5h of the CEA (which includes the statutory SEF core principles) and the Commission's regulations thereunder.[95] There is currently no analogous certification requirement that applies to a DCM under Commission regulation § 38.5(c).[96]

8. 2021 Part 37 Amendments—CCO Duties and Annual Compliance Report

On May 12, 2021, the Commission adopted final rules amending SEF requirements related to audit trail data, financial resources, and CCO obligations, including the rules addressing the CCO's obligation to submit an annual report to the Commission (''Part 37 Updates'').[97] The Commission stated that the purpose of the CCO amendments was to streamline requirements for the CCO position, allow SEF management to exercise greater discretion in CCO oversight, and simplify the preparation and submission of the required annual compliance report.[98] Among other changes, the Commission clarified that a CCO did not need to include in the annual compliance report a review of all the Commission regulations applicable to a SEF or an identification of the written policies and procedures designed to ensure compliance with the CEA and Commission regulations. The amendments clarified that the CCO was required to include in the annual report a description and self-assessment of the effectiveness of the written policies and procedures of the SEF to ''reasonably ensure'' compliance with the CEA and applicable Commission regulations. Additionally, the amendments clarified that CCOs are required to discuss only ''material'' noncompliance matters in the annual report, instead of all ''noncompliance issues.''

In the Part 37 Updates, the Commission also modified SEF CCO requirements in several other ways, including by: (1) consolidating certain CCO duties; [99] (2) eliminating ROC-related components of part 37; [100] (3) allowing the CCO to consult with the board of directors or senior officer of the SEF in developing the SEF's policies and procedures; (4) allowing a CCO to meet with the senior officer of the SEF on an annual basis, in lieu of an annual meeting with the board of directors; and (5) allowing a CCO to provide self-regulatory program information to the SEF's senior officer, in addition to the board of directors. The modifications identified as (3), (4) and (5) in the preceding sentence enhance the role of the SEF's senior officer, providing for an oversight role over the CCO equivalent to that of the board of directors. The Commission considered this change to be consistent with SEF Core Principle 15, which requires a CCO to report to the SEF's board of directors or senior officer.[101]

In addition, the Commission amended the rules addressing the removal of a CCO. The rules previously had restricted CCO removal authority to a majority of the board of directors, or in the absence of a board, to a senior officer. In the Part 37 Updates, the Commission amended the requirement to establish that either the board or senior officer of the SEF may remove the CCO. The Commission stated that in many instances, the senior officer may be better positioned than the board of directors to provide day-to-day oversight of the SEF and the CCO, as well as to determine whether to remove a CCO.[102]

The Part 37 Updates also amended the duties of the CCO to allow a CCO to identify noncompliance issues through ''any means'' and clarified that the procedures that the CCO takes to address noncompliance issues must be ''reasonably designed'' to handle,

[91] *Id.* at 33594. Commission regulation § 37.204(a) permits a SEF to utilize another registered entity, a registered futures association, and, in the case of SEFs, the Financial Industry Regulatory Authority, for the provision of services to assist in complying with the CEA and Commission regulations. Commission regulation § 37.204(b) provides that a SEF that chooses to use a regulatory service provider shall retain sufficient staff to supervise the regulatory services, that SEF compliance staff shall hold regular meetings with the regulatory service provider to discuss matters of regulatory concern, and that the SEF must conduct periodic reviews of the services provided. Further, Commission regulation § 37.204(b) requires that the SEF carefully document such periodic reviews and provide them to the Commission upon request. Commission regulation § 37.204(c) states that a SEF that chooses to use a regulatory service provider shall retain exclusive authority in all substantive decisions made by the regulatory service provider, and that the SEF must document any instances where its actions differ from those recommended by the regulatory service provider.

[92] *See* Commission regulation § 37.1501(e)(1).

[93] *Id.*

[94] *See* Commission regulation § 37.5(c).

[95] *See* Commission regulation § 37.5(c)(4).

[96] In 2018, as part of a notice of proposed rulemaking relating to SEFs and the trade execution requirement, the Commission proposed to amend Commission regulation § 37.5 to (i) require notification in the event of any transaction that results in the transfer of direct or indirect ownership of 50 percent or more of the equity interest in the SEF; and (ii) delete the part 40 filing requirement. *See* Swap Execution Facilities and the Trade Execution Requirement, 83 FR 61946, 71–72 (Nov. 30, 2018). The Commission withdrew this proposal in 2021. *See* 86 FR 9304 (Feb. 12, 2021).

[97] Swap Execution Facilities, 86 FR 9224 (Feb. 11, 2021) (the ''Part 37 Updates'').

[98] *Id.* at 9225.

[99] The Commission explained that the rules would allow a CCO to identify non-compliance matters through ''any means'' in addition to the means previously provided in the rule, which were by compliance office review, look-back, internal or external audit finding, self-reported error, or validated complaint. *Id.* at 9235 n.171. The Commission modified the duty for a CCO to establish procedures for the remediation of noncompliance issues to clarify that a CCO must establish procedures reasonably designed to handle, respond, remediate, retest, and resolve noncompliance issues, based on an acknowledgement that a CCO may not be able to design procedures that detect all possible noncompliance issues and noted that a CCO may utilize a variety of resources to identify noncompliance issues beyond a limited set of means. *Id.* at 9235.

[100] The ROC-related components of part 37 included a mandatory quarterly meeting of the CCO with the ROC, and the requirement that a CCO provide self-regulatory program information to the ROC. *Id.* at 9233–34. In determining to eliminate the ROC-related components of the regulation, the Commission stated that Core Principle 15 does not require a SEF to establish a ROC and the Commission has not finalized a rule that establishes requirements for a ROC. *See id.* at 9234. Pursuant to proposed § 37.1206 in this proposed rulemaking, the Commission now seeks to establish explicit requirements for a SEF ROC.

[101] *See* Commission regulation § 37.1500(b)(1).

[102] Part 37 Updates, 86 FR 9224 at 9234.

respond to, remediate, retest, and resolve those issues.[103] Such changes provide the CCO with additional flexibility in identifying and addressing noncompliance, and recognize that a CCO may not be able to design procedures that detect all possible noncompliance issues and may utilize a variety of resources to identify noncompliance issues.[104]

In addition, the Commission amended the CCO's duty to resolve conflicts of interest, requiring the CCO to take ''reasonable steps'' to resolve ''material'' conflicts of interest that may arise.[105] In adding the concepts of reasonableness and materiality, the Commission stated that the current requirement was overly broad and impractical because a CCO cannot be reasonably expected to successfully resolve every potential conflict of interest that may arise.[106]

c. Industry Changes and Impact on Regulatory Developments

By 2007, when the Commission adopted the acceptable practices relating to conflicts of interest and governance standards,[107] the futures industry had begun shifting from mutually-owned exchanges into for-profit institutions.[108] For example, in 2000, the Commission approved rules relating to plans by CME,[109] NYMEX,[110] and CBOT [111] to convert from non-profit corporations owned by their members to for-profit corporations.[112] Given that demutualization was relatively new and evolving, the Commission provided flexibility regarding governance structures and conflicts of interest provisions.[113] In contrast to many of the other SEF and DCM core principles, to date the Commission has not adopted rules to prescribe the manner in which compliance with the conflicts of interest core principle for SEFs or DCMs, or the governance fitness standards core principle for DCMs, must be demonstrated. While the guidance on compliance with the relevant DCM core principles sets forth important considerations that the Commission believes should be taken into account by DCMs in complying with those core principles, and the acceptable practices [114] for the DCM conflicts of interest core principle additionally set forth examples of how DCMs may satisfy particular requirements under that core principle, neither the guidance nor the acceptable practices establish mandatory compliance obligations for DCMs. With respect to the conflicts of interest core principle for SEFs, the Commission to date has not adopted guidance or acceptable practices for compliance with the core principle.

While the statutory core principles are intended to be broad and flexible, the Commission is mindful that, in certain circumstances, flexibility in the manner of compliance may create confusion. Practically speaking, while this flexibility exists, Commission staff has found that all DCMs have chosen to adopt the acceptable practices to demonstrate compliance with DCM Core Principle 16.

The Commission preliminarily believes that establishing affirmative, harmonized requirements for governance fitness standards and the mitigation of conflicts of interest are necessary to promote the integrity of SEFs and DCMs as self-regulatory organizations and to ensure the effective and impartial fulfillment of those functions. In particular, the Commission has recently observed an increase in the number of SEFs and DCMs that are part of corporate families that also have other Commission registrants and other market participants. In conducting SEF regulatory consultations that were completed in 2021, Commission staff identified several SEFs that were in the same corporate family as intermediaries that also traded on the SEF. Similarly, in 2021, Commission staff conducted an informal inquiry into which DCMs were in corporate families with intermediaries who traded on the DCM, and identified three such DCMs.

Where multiple Commission registrants or other market participants exist in the same corporate family, the risk of conflicts of interest may increase. For example, when a SEF or DCM is in the same corporate family as an intermediary, like an introducing broker (''IB'') or a futures commission merchant (''FCM''), that trades on or brings trades to the SEF or DCM for execution, the SEF's or DCM's market regulation obligations [115] may conflict with interests of the intermediary, such as in circumstances where there are questions about the intermediary's compliance with a SEF or DCM rule.[116] The emergence of these affiliations could also affect certain key components of a SEF's or DCM's framework for addressing conflicts of interest that may impact market regulation functions. With respect to determining whether an individual satisfies the public director standard, as outlined in the DCM Core Principal 16 Acceptable Practices, certain relationships that the individual may have with an affiliate of the DCM would need to be evaluated. Furthermore, officers and members of the board of director may need to evaluate whether certain relationships with an affiliate of

[103] *See id.* at 9235.

[104] *See id.*

[105] *See id.*

[106] *See id.*

[107] *See* Section II(b)(2).

[108] In 2007, DCM Core Principle 15 addressed conflicts of interest. In the Dodd-Frank Act, the DCM conflicts of interest core principle was renumbered to be Core Principle 16. *See* Dodd-Frank Act, section 735(b); 7 U.S.C. 7(d)(16).

[109] *See* Commission Release #4407–00, *https://www.cftc.gov/sites/default/files/opa/press00/opa4407-00.htm.*

[110] *See* Commission Release #4427–00, *https://www.cftc.gov/sites/default/files/opa/press00/opa4427-00.htm.*

[111] *See* Commission Release #4434–00, *https://www.cftc.gov/sites/default/files/opa/press00/opa4434-00.htm.*

[112] The process continued through 2020, when MGEX went through demutualization. *https://www.cftc.gov/sites/default/files/filings/documents/2020/orgdcmmgexordertransfer201124.pdf*; *https://www.mgex.com/documents/MIAX_MGEX_SeatVote_PressRelease_000.pdf.*

[113] On July 7, 2006, the Commission proposed the acceptable practices that it finalized in the 2007 Final Release. Conflicts of Interest in Self-Regulation and Self-Regulatory Organizations, 71 FR 38739 (July 7, 2006). In that proposal, the Commission acknowledged that the U.S. futures industry was being transformed by, among other things, the demutualization of member-owned exchanges and their conversion to publicly traded stock corporations. *Id.* at 38740–38741. The Commission noted that the acceptable practices would, among other things, ensure that industry expertise, experience, and knowledge continue to play a vital role in self-regulatory organization governance and administration and thus, preserve the ''self'' in self-regulation. *Id.* at 38741–38742. In the 2007 Final Release, the Commission reiterated that the acceptable practices were being adopted in response to, among other things, demutualization. The Commission observed that it did identify industry changes that it believed create new structural conflicts of interest within self-regulation, increase the risk of customer harm, could lead to an abuse of self-regulatory authority, and threaten the integrity of, and public confidence in, self-regulation in the U.S. futures industry. The Commission further noted that increased competition, demutualization and other new ownership structures, for-profit business models, and other factors are highly relevant to the impartiality, vigor, and effectiveness with which DCMs exercise their self-regulatory responsibilities. 2007 Final Release, 72 FR 6936 at 6944.

[114] Through its acceptable practices, the Commission provides exchanges with specific practices that DCMs may adopt to demonstrate a safe harbor for compliance with selected requirements aspects of a core principle, but such acceptable practices were not intended as the exclusive means of compliance. *See* CEA section 5c(a)(1), 7 U.S.C. 7a–2(a)(1).

[115] For example, Commission regulation § 38.152 requires DCMs that allow intermediation to prohibit customer-related abuses such as trading ahead of customer orders, trading against customer orders, accommodation trading, and improper cross trading. Commission regulation § 37.203 imposes a similar requirement on SEFs.

[116] In contrast to situations in which a DCM and DCO are in the same corporate family—which the Commission has observed over the past two decades—a SEF or DCM being in the same corporate family as an intermediary registrant raises unique issues. Rena S. Miller, Congressional Research Service, Conflicts of Interest in Derivatives Clearing (2011), *https://crsreports.congress.gov/product/pdf/R/R41715/4.*

the DCM or SEF would give rise to an actual or potential conflict of interest that could impact decision-making. Accordingly, the Commission is herein proposing conflict of interest rules that focus on the identification, management and resolution of conflicts of interest related to a SEF's or DCM's *market regulation functions,* as preliminarily defined by the Commission below, as well as related governance standards that the Commission believes support the mitigation of such conflicts of interest. The set of rules proposed herein draw on many years of Commission staff's experience conducting its routine oversight of SEFs and DCMs, and reflect the Commission's identification of specific, harmonized measures that it preliminarily believes will help to ensure that SEFs and DCMs fulfill their market regulation functions in an effective and impartial manner.

Separately, on June 28, 2023, Commission staff issued a Request for Comment on the Impact of Affiliations Between Certain CFTC-Regulated Entities (''RFC'').[117] The RFC sought public comment in order to better inform Commission staff's understanding of a broad range of potential issues that may arise if a DCM, DCO or SEF is affiliated with an intermediary, such as an FCM or IB, or other market participant such as a trading entity.[118] The Commission also notes that on December 18, 2023, its Divisions of Clearing and Risk, Market Oversight, and Market Participants issued a staff advisory on affiliations between a DCM, DCO or a SEF and an intermediary, such as an FCM, or other market participant, such as a trading entity. The advisory reminds DCOs, DCMs, and SEFs that have an affiliated intermediary or trading entity, as well as the affiliated intermediary or trading entities themselves, of their obligations to ensure compliance with existing statutory and regulatory requirements with this affiliate relationship in mind.[119]

[117] Request for Comment on the Impact of Affiliations of Certain CFTC-Regulated Entities, CFTC Release 8734–23, June 28, 2023. *https://www.cftc.gov/PressRoom/PressReleases/8734-23.*

[118] The Commission received a number of comments raising concerns about the impact of affiliation, and anticipates proposing regulations that will address issues identified as a result of the RFC, including additional concerns raised by commenters about the conflicts of interest, specifically relating to market regulation functions, posed by affiliations. This rulemaking does not reflect the comments submitted in response to the Commission staff's RFC. Those comments will not be made part of the administrative record before the Commission in connection with this proposal.

[119] Staff Advisory on Affiliations Among CFTC-Regulated Entities, CFTC Release 8839–23, Dec. 18, 2023. *https://www.cftc.gov/PressRoom/PressReleases/8839-23.* In addition to the increased focus on affiliate relationships, another market structure development relates to the participation of intermediaries on SEF and DCM markets. With limited exceptions, derivatives trading today is conducted through regulated intermediaries who perform many important functions, such as providing customers with access to exchanges and clearinghouses, processing transactions, ensuring compliance with federal regulations, and guaranteeing performance of the derivatives contract to the clearinghouse. Recently, the Commission has observed a trend in which registered entities pursue a ''non-intermediated'' model, or direct trading and clearing of margined products to retail customers.

d. Conflicts of Interest Relating to Market Regulation Functions

1. Market Regulation Functions

This rule proposal addresses certain conflicts of interest that may impact a SEF's or DCM's market regulation functions. For purposes of this rule proposal, the Commission is proposing to define as ''market regulation functions'' the 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.[120] The Commission believes that effective performance of these market regulation functions require SEFs and DCMs, consistent with their core principle obligations, to establish a process for identifying, minimizing, and resolving actual and potential conflicts of interest that may arise between and among any of the SEF's or DCM's market regulation functions and its commercial interests; or the several interests of its management, members, owners, customers and market participants, other industry participants, and other constituencies.

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.

[120] *See* proposed §§ 38.851(b)(9) and 37.1201(b)(9).

The Commission's proposed definition of ''market regulation functions'' does not include certain other SEF or DCM obligations. For example, the proposed definition does not include DCM Core Principle 11 (Financial Integrity of Transactions), the related financial surveillance requirements for DCMs under Commission regulation § 1.52, or a SEF's obligations under Core Principle 7 (Financial Integrity of Transactions).

As noted above, the Commission staff's RFC sought public comment on a range of potential issues that may arise if a DCM, DCO or SEF is affiliated with an intermediary, such as an FCM or IB, or other market participant such as a trading entity. While the scope of the proposed term ''market regulation functions'' in this rulemaking is limited to SEF and DCM functions under specific core principles, the Commission notes that public comment in response to the RFC may inform future Commission action. The Commission may further address SEF or DCM conflicts of interest obligations that may impact broader self-regulation functions of SEFs and DCMs, including their obligations under SEF Core Principle 7 and DCM Core Principle 11. The Commission notes that any future action impacting broader self-regulatory functions may consider whether those self-regulatory functions should be subject to requirements that are similar or different to the requirements being proposed in this rulemaking. As discussed further below, the main objective of this rulemaking is to establish requirements to mitigate certain conflicts of interest that may impact those SEF and DCM functions most closely tied to the SEF's or DCM's market regulation function.

2. Questions for Comment

The Commission seeks comment on the questions set forth below 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?

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?

3. Conflicts of Interest Between Market Regulation Functions and Commercial Interests

SEFs' and DCMs' obligations to perform market regulation functions may conflict with their commercial interests. For example, performing market regulation functions requires the use of staff and resources that might otherwise be dedicated to commercial functions, such as seeking new market participants or promoting new products.[121] In addition, SEFs and DCMs have a commercial interest to earn fees from market participants, and to avoid deterring participants from trading on their platforms. Fulfillment by a SEF or DCM of its market regulation functions may result in the SEF or DCM taking actions, such as 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. Commercial pressure, such as competition among SEFs and among DCMs, may strain market regulation obligations.[122]

III. Proposed Governance Fitness Requirements

a. Overview

The Commission is proposing rules that would require SEFs and DCMs to establish minimum fitness standards for certain categories of individuals who are responsible for exchange governance, management, and disciplinary functions, or who have potential influence over those functions. These proposed requirements are intended to help ensure that SEFs and DCMs effectively fulfill their critical role as self-regulatory organizations by excluding individuals with a history of certain disciplinary or criminal offenses from serving in roles with influence over the governance and operations of the exchange. The integrity of these functions is critically important to their respective operations, markets, and market regulation functions. Accordingly, 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. Similarly, the Commission believes it is important that minimum fitness standards be applicable to an individual who owns 10 percent or more of a SEF or DCM and has the ability to control or direct the SEF's or DCM's management or policies.

The Commission also believes establishing the same minimum fitness requirements for both SEFs and DCMs is necessary given that their officers and members of the board of directors, committees, disciplinary panels, and dispute resolution panels have identical responsibilities for governing and administering operations, including the operations of the market regulation functions. Straightforward and consistent minimum fitness requirements are reasonably necessary to promote the hiring and designation of officers and members of the board of directors, committees, disciplinary panels, and dispute resolution panels that have the appropriate character and integrity to perform their duties.

b. Minimum Fitness Standards—Proposed §§ 37.207 and 38.801

1. Existing Regulatory Framework

DCM Core Principle 15 requires a DCM to establish and enforce appropriate fitness standards for members of the board of directors, members of any disciplinary committee, members of the DCM, other persons with direct access to the DCM, and ''any party affiliated'' with any of the foregoing persons. The DCM Core Principle 15 Guidance states that minimum fitness standards for ''persons who have member voting privileges, governing obligations or responsibilities, or who exercise disciplinary authority,'' and ''natural persons who directly or indirectly have greater than a ten percent ownership interest in a designated contract'' should include those bases for refusal to register a person under section 8a(2) of the CEA.[123] Additionally, the DCM Core Principle 15 Guidance states that persons who have governing obligations or responsibilities, or who exercise disciplinary authority, should not have a significant history of serious disciplinary offenses, such as those that would be disqualifying under Commission regulation § 1.63 [124] The DCM Core Principle 15 Guidance also states that DCMs should have standards for the collection and verification of information supporting compliance with the DCM's fitness standards. Pursuant to Commission regulation § 38.2, DCMs are exempt from some of the provisions of Commission regulation § 1.63. They are not exempt, however, from Commission regulation § 1.63(c), which prohibits persons that are subject to any of the disciplinary offenses set forth in Commission regulation § 1.63(b) from serving on a disciplinary committee, arbitration panel, oversight panel or governing board of a self-regulatory organization.

SEFs are not subject to a specific core principle requirement to establish fitness standards. However, as authorized by the CEA,[125] SEFs must comply with all requirements in Commission regulation § 1.63, which sets forth requirements and procedures to prevent persons with certain disciplinary histories from serving in certain governing or oversight capacities at a self-regulatory organization.

2. Proposed Rules

The Commission is proposing identical fitness requirements for SEFs and DCMs. The Commission believes the proposed rules are reasonably necessary to effectuate a DCM's

[121] *See* Commission regulations §§ 38.155 (DCM) and 37.203(c) (SEF).

[122] Proposed Acceptable Practices for compliance with section 5(d)(15) of the Commodity Exchange Act, 71 FR 38740, 38741 n.10 (July 7, 2006) (citing five separate domestic and international studies reaching the same conclusion); *See also* Kristin N. Johnson, Governing Financial Markets: Regulating Conflicts, 88 Wash. L.Rev. 185, 221 (2013) (''While clearinghouses and exchanges are private businesses, these institutions provide a critical, public, infrastructure resource within financial markets. The self-regulatory approach adopted in financial markets presumes that clearinghouses and exchanges will provide a public service and engage in market oversight. The owners of exchanges and clearinghouses may, however, prioritize profit-maximizing strategies that de-emphasize or conflict with regulatory goals.'')

[123] Appendix B to Part 38, Guidance on, and Acceptable Practices in, Compliance with Core Principles; Core Principle 15, Governance Fitness Standards. This Guidance was promulgated under the 2001 Regulatory Framework in direct response to the recognition that with the de-mutualization of DCMs, the governance role of ''members'' is exercised by the DCM's owner or owners. The Commission has previously noted that the 10 percent ownership threshold is consistent with the same 10 percent threshold for fitness standards that Congress itself adopted for exempt commercial markets in section 2(h)(5)(A)(iii) of the CEA, prior to the Dodd Frank amendments. *See* 2001 Regulatory Framework, 66 FR 42255, 42262 n.40. Exempt commercial markets were eliminated as a category in the CEA pursuant to Title VII of the Dodd Frank Act, which also introduced SEFs as a new category of CFTC-regulated exchange. Public Law 106–554, 114 Stat. 2763 (Dec. 21, 2000); *See also* Repeal of the Exempt Commercial Market and Exempt Board of Trade Exemptions, 80 FR 59575 (Oct. 2, 2015).

[124] *Id.* The DCM Core Principle 15 Guidance states that members with trading privileges but having no or only minimal equity in the DCM and non-member market participants who are not intermediated ''and do not have these privileges, obligations, or responsibilities or disciplinary authority'' could satisfy minimum fitness standards by meeting the standards that they must meet to qualify as a ''market participant.''

[125] Commission Regulation § 1.63 was adopted pursuant to the following statutory authority: 7 U.S.C. 2, 2a, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 7, 7a, 8, 9, 12, 12a, 12c, 13a, 13a–l, 16,19, 21, 23, and 24, Service on Self-Regulatory Organization Governing Boards or Committees by Persons with Disciplinary Histories, 55 FR 7884, 7890 (March 6, 1990, Final Rule).

obligations to establish and enforce appropriate fitness standards under DCM Core Principle 15, and to effectuate a SEF's obligations to establish and enforce rules governing the operation of the SEF under SEF Core Principle 2.[126] A SEF's ability to effectively operate as both a market and SRO, and to perform its market regulation functions, is largely dependent upon the individuals who govern or control the SEF's operations, including officers, and members of the board of directors, disciplinary committees, dispute resolution panels, members and controlling owners. Given this relationship, the Commission believes that it is reasonably necessary to extend the same governance fitness standards to SEFs as to DCMs.[127]

i. Categories of Persons Subject to Minimum Fitness Standards

In proposed §§ 37.207(a) and 38.801(a), the Commission is requiring that SEFs and DCMs establish and enforce appropriate fitness standards for officers; for members of its board of directors, committees, disciplinary panels, and dispute resolution panels (or anyone performing functions similar to the foregoing); for members of the SEF or DCM; for any other person with direct access to the SEF or DCM; and for any person who owns 10 percent or more of a SEF or DCM and who, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the management or policies of the SEF or DCM, and any party affiliated with any of those persons.

Specifically, the Commission notes that proposed §§ 37.207(a) and 38.801(a) would extend minimum fitness requirements to certain individuals, including officers and owners of 10 percent or more of a SEF or DCM, and SEF and DCM members with voting privileges, who were not historically subject to DCM fitness requirements under DCM Core Principle 15, or SEF and DCM fitness requirements under Commission regulation § 1.63(c). However, as discussed below, the Commission believes applying consistent minimum fitness standards to classes of individuals enumerated in proposed §§ 37.207(a) and 38.801(a) is reasonably necessary given that these individuals have: (1) obligations with respect to a SEF's or DCM's governance or disciplinary process; or (2) the ability to exercise control over a SEF or DCM.

First, officers of a SEF or DCM would be subject to the minimum fitness requirements in proposed §§ 37.207(a) and 38.801(a).[128] The Commission believes this is reasonably necessary because officers—like members of the board of directors, committee members, or members of disciplinary or dispute resolution panels, and members with voting privileges [129]—also have governing, decision-making, and disciplinary responsibilities within a SEF or DCM, and therefore must be able to demonstrate standards of integrity and rectitude in order to effectively perform their duties.

Second, members with voting privileges would also be subject to the minimum fitness requirements in proposed §§ 37.207(a) and 38.801(a).[130] Although DCM Core Principle 15 applies to a broad class of individuals associated with a DCM, including members with voting privileges, there is no parallel application for SEFs. The Commission acknowledges that SEF and DCM members with voting privileges may not have the same governing duties as officers and members of its board of directors, committees, disciplinary panels, or dispute resolution panels. Nevertheless, they may have the ability to influence or control, either directly through their voting privileges or through other indirect means, the operations or decision-making of the SEF or DCM. Accordingly, the Commission believes it is reasonably necessary to establish and enforce certain minimum standards of fitness for such individuals.

Third, certain owners of 10 percent or more of a SEF or DCM would also be subject to the minimum fitness requirements in proposed §§ 37.207(a) and 38.801(a).[131] Although the guidance to DCM Core Principle 15 lists a broad class of individuals, including natural persons who directly or indirectly have greater than a 10 percent ownership interest in a DCM, there is no parallel application for a SEF. While individuals who own 10 percent or more of a SEF or DCM may not be involved in the daily operations of a SEF or DCM, their sizeable ownership interest may, either directly or indirectly, enable them to exert influence or control over various aspects of decision-making, including decisions that may impact market regulation functions.[132] As an example, a person with a 10 percent ownership interest in the SEF or DCM may have competing business interests that are improperly prioritized, particularly if that person has influence in selecting officers or members of the board of directors. Similarly, a person with 10 percent ownership may have influence or control over the SEF's or DCM's contracts with third party service providers, or, even the ability to wield his or her influence in determining whether to investigate potential rule violations. Therefore, the Commission believes it is reasonably necessary to require that persons owning 10 percent or more of the SEF or DCM, and who, either directly or indirectly, through agreement or otherwise, in any other manner, control or direct the management or policies of the SEF or DCM [133] be subject to certain minimum fitness requirements, as described below.

ii. Minimum Fitness Standards

Proposed §§ 37.207(b) and 38.801(b) would set forth minimum standards of fitness SEFs and DCMs must establish and enforce for officers and members of its board of directors,[134] committees,

[126] CEA section 5h(f)(2); 7 U.S.C. 7b–3(f)(2).

[127] The Commission is proposing to exercise its authority under CEA section 8a(5) to establish the SEFs fitness standards; DCMs are already subject to a similar requirement to set appropriate fitness standards. CEA section 5(d); 7 U.S.C. 7(d)(15).

[128] Officers are also subject to the 8a(2) and 8a(3) minimum fitness requirements in proposed §§ 37.207(b) and 38.801(b), and the disqualifying offenses in proposed §§ 37.207(c) and 38.801(c).

[129] In addition to the three categories of individuals highlighted in this section, members of its board of directors, committees, disciplinary panels, and dispute resolution panels, all members of the SEF or DCM, and any other person with direct access to the SEF, are subject to the requirement to have appropriate fitness requirements in §§ 37.207(a) and 38.801(a).

[130] Members with voting privileges are also subject to the 8a(2) and 8a(3) minimum fitness requirements in proposed §§ 37.207(b) and 38.801(b).

[131] Owners of 10 percent or more of a SEF or DCM, who also may control or direct the management or policies of a SEF or DCM, are also subject to the 8a(2) and 8a(3) minimum fitness requirements in proposed §§ 37.207(b) and 38.801(b).

[132] As noted below concerning the proposed changes to Commission regulations § 37.5(c), if one entity holds a 10 percent equity share in a SEF it may have a significant voice in the operation and/or decision-making of the SEF.

[133] The language of the proposed fitness standards for owners of 10 percent or more of a SEF or DCM intentionally generally mirrors the language from the Appendices to Part 37 and 38, Form SEF and Form DCM, Exhibit A. Exhibit A to Form SEF and Form DCM require disclosure of owners of 10 percent or more of the applicant's stock as part of the application for registration or designation. A similar 10 percent or more ownership threshold is found in other Commission regulations, *e.g.,* the definition of Principal in Commission regulation § 3.1 and section 8a(2)(H) of the CEA, which effectively prevent individuals subject to the grounds for refusal to register in CEA section 8a(2) or section 8a(3) from owning 10 percent of voting stock in an intermediary subject to registration requirements. The 10 percent ownership interest threshold is similarly found in the reporting requirements for ''insiders'' in section 16 of the Securities Exchange Act of 1934. *See also* 17 CFR 240.16a–2.

[134] For purposes of the rules proposed herein, the Commission is proposing to define ''board of

Continued

disciplinary panels, and dispute resolution panels (or anyone performing functions similar to the foregoing), for members with voting privileges,[135] and any person who owns 10 percent or more of the SEF or DCM and who, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the management or policies of the DCM,[136] to include the bases for refusal to register a person under sections 8a(2) and 8a(3) of the CEA.[137] DCM Core Principle 15 Guidance includes the bases for refusal to register under CEA section 8a(2), but it does not include the bases for refusal to register a person under section 8a(3). However, as described below, the Commission believes inclusion of the section 8a(3) disqualifications for individuals with governance or disciplinary responsibilities at the SEF or DCM, or the ability to control or direct the management or policies of the SEF or DCM, is reasonably necessary for SEFs and DCMs to fulfill their responsibilities as SROs without influence from individuals with backgrounds incompatible with such responsibility.

Sections 8a(2) and 8a(3) of the CEA provide a consistent, minimum industry framework to promote high ethical standards among officers, directors and other individuals with controlling influence over intermediaries or other registrants in the futures and swaps industry.[138] In proposing to extend the sections 8a(2) and 8a(3) minimum fitness standards to individuals subject to the fitness requirements in proposed §§ 37.207(a) and 38.801(a), the Commission is extending the same consistent, minimum industry framework [139] to promote high ethical standards among individuals with similar control or influence over the important self-regulatory functions at SEFs and DCMs. These standards are reasonably necessary to promote consistent high ethical industry standards for a SEF or DCM to serve as an effective SRO.

Proposed §§ 37.207(c) and 38.801(c) would require SEFs and DCMs to establish and enforce additional minimum fitness standards for certain individuals—officers and for members of its board of directors, committees, disciplinary panels, and dispute resolution panels (or anyone performing functions similar to the foregoing). These additional fitness requirements include ineligibility based on six types of disciplinary offenses that generally track the disciplinary offenses listed in §§ 1.63(b)(1)–(6), with certain modifications. In effect, the proposed rules would apply the fitness requirements of Commission regulation § 1.63 consistently to both SEFs and DCMs, subject to certain enhancements as further described below.

The six disciplinary offenses in proposed §§ 37.207(c)(1)–(6) and 38.801(c)(1)–(6) are substantially similar to the existing ineligibility requirements in § 1.63(b).

- Proposed §§ 37.207(c)(1) and 38.801(c)(1), require that an individual would be ineligible if they were found, in a final, non-appealable [140] order by a court of competent jurisdiction, an administrative law judge, the Commission, a self-regulatory organization,[141] or the SEC, to have committed any of four offenses described in proposed §§ 37.207(c)(1)(i)–(iv) and 38.801(c)(1)(i)–(iv) within the previous three years.[142] This requirement is substantially the same as the ineligibility requirement found in § 1.63(b)(1), except for the addition of findings by the SEC.
- Proposed §§ 37.207(c)(1)(i)–(iv) and 38.801(c)(1)(i)–(iv), include, in substance, the same four disciplinary offenses listed in § 1.63(a)(6)(i)–(iv).
- Proposed §§ 37.207(c)(2)–(6) and 38.801(c)(2)–(6) mirror, in substance, the disciplinary offenses found in § 1.63(b)(6)(2)–(6), with minor enhancements to expressly include both SEFs and DCMs when referencing suspensions from trading on a contract market.

Proposed §§ 37.207(c) and 38.801(c) also enhance the existing minimum fitness requirements in several ways, compared to the requirements in Commission regulation § 1.63. The language in proposed §§ 37.207(c) and 38.801(c) does not use the limiters ''significant history'' or ''serious disciplinary offenses'' in setting forth disqualifying offenses. These terms appear in DCM Core Principle 15 Guidance [143] and the Commission proposes to clarify which disciplinary offenses are included by specifying which offenses would automatically be

directors'' as a group of people serving as the governing body of a SEF or DCM, or—for SEFs or DCMs whose organizational structure does not include a board of directors—a body performing a function similar to a board of directors. *See* proposed §§ 37.1201(b)(2) and 38.851(b)(2).

[135] Consistent with current Core Principle 15 Guidance, members with voting privileges have the same minimum fitness standards as other individuals with the ability to directly affect the operations or governance of the Exchange, whereas members without voting privileges are subject only to the requirement that the DCM or SEF set appropriate fitness standards for them, as set out in proposed regulations §§ 37.207(a) and 38.801(a). In light of industry changes, the Commission is requesting comment on whether ''members with voting privileges'' remains a relevant category that should be subject to this distinction.

[136] These categories of individuals are similar to those subject to the 8a(2) standards in the DCM Core Principle 15 Guidance.

[137] Section 8a(2) and 8a(3) bases include, for example, revocation of registration, convictions or guilty pleas for violations of the CEA, the Securities Act of 1933, the Securities Exchange Act of 1934, misdemeanors involving embezzlement, theft, or fraud, past failure to supervise, willful misrepresentations or omissions, and ''other good cause.''

[138] CEA sections 8a(2) and (3), 7 U.S.C. 12a(2) and (3); Principals, including officers, managing members, directors and owners of 10 percent or more voting stock of FCMs, IBs, and other registrants, may already be disqualified from registration pursuant to CEA sections 8a(2) and 8a(3), which in turn may result in the revocation of the registration of the FCM, IB or other registrant. (CEA section 8a(2)(H), 7 U.S.C. 12a(2)(H), defining ''Principal,'' to include any officer, director, or beneficial owner of at least 10 percent of the voting shares of the corporation, and any other person that the Commission by rule, regulation, or order determines has the power, directly or indirectly, through agreement or otherwise, to exercise a controlling influence over the activities of such person which are subject to regulation by the Commission. Both sections 8a(2) and 8a(3) provide for the revocation of registration of an FCM, IB, or other registrant where a principal of the registrant is subject to a statutory disqualification found in CEA sections 8a(2) or 8a(3).) As stated in the interpretative statement to CEA section 8a(3)(M), in Appendix A to part 3, which provides the Commission with the authority to refuse registration of any person for other good cause, any inability to deal fairly with the public and consistent with the just and equitable principles of trade may render an applicant or registrant unfit for registration, given the high ethical standards which must prevail in the industry.

[139] Individuals serving as officers, board members, disciplinary committee members, members with voting privileges, and owners with 10 percent or more of a DCM or SEF and with the ability to control or direct the management or policies of the SEF or DCM should not be subject to lower fitness standards than the fitness standards applied to principals of intermediaries facilitating trading on SEF or DCM. Otherwise, an individual could be disqualified from serving as the principal of an FCM or IB, due to the factors set out under CEA 8a(2) or 8a(3), but be allowed to serve in a role exercising influence or control over the self-regulatory functions of a SEF or DCM; the SEF or DCM is the front-line regulator of the trading activity facilitated by FCMs and IBs on a SEF or DCM.

[140] The final, non-appealable order language comes from the definition of ''final decision'' found in Commission regulation § 1.63(a)(5).

[141] With the exception of the addition of the SEC, these are the same categories as in the definition of ''final decision'' found in Commission regulation § 1.63(a)(5).

[142] Pursuant to Commission regulation § 1.63(b)(1), an individual is ineligible to serve on disciplinary committees, arbitration panels, oversight panels or governing board if, within the past three years, that individual was found to have committed a ''disciplinary offense.''

[143] DCM Core Principle 15 Guidance provides that, among other things, persons who have governing obligations or responsibilities, or who exercise disciplinary authority, should not have a significant history of serious disciplinary offenses, such as those that would be disqualifying under Commission regulation § 1.63.

disqualifying. As described above, the list of disciplinary offenses in proposed §§ 37.207(c) and 38.801(c) includes, in substance, the same offenses identified in Commission regulation § 1.63,[144] and expands the disqualifying offenses to include agreements not to apply for, or to be disqualified from applying for, registration in any capacity with the SEC, or any self-regulatory organization, including the Financial Industry Regulatory Authority (''FINRA'').[145]

iii. Verification and Documentation of Minimum Fitness Standards

Proposed §§ 37.207(d) and 38.801(d) would require each SEF and DCM to establish appropriate procedures for the collection and verification of information supporting compliance with appropriate fitness standards. The Commission believes that, to be effective, such procedures must be written, must be in a location where people who would use them can find them, and must be preserved and ready for the Commission to review.[146] The Commission anticipates staff will review the procedures and fitness determinations as part of its routine oversight.

In conducting its oversight of SEFs and DCMs, Commission staff has learned that some SEFs and DCMs accepted fitness representations from the individual subject to the fitness standard without any practice of independent verification. Independent verification of fitness information is particularly important because certain individuals could be disincentivized from self-reporting fitness information that could disqualify them from service.[147] The Commission believes SEFs and DCMs should verify fitness information provided by individuals by collecting information from third parties, for example, via the National Futures Association's (''NFA'') Background Affiliation Status Information Center (''BASIC'') system or background checks.

Commission staff also discovered during the course of its oversight that some SEFs and DCMs did not have a practice to verify an individual's compliance with applicable fitness standards prior to the individual starting to serve in the capacity requiring the fitness standard. Additionally, some SEFs and DCMs lacked practices for regular verification of fitness standards, allowing fitness information to become stale. Without these practices for verifying and documenting fitness information, the Commission believes there is an increased risk that individuals will serve in a capacity for which they are not fit. Proposed §§ 37.207(d)(1)(i)–(iv) and 38.801(d)(1)(i)–(iv) would address these practices by requiring: (i) fitness information be verified at least annually, (ii) the SEF or DCM have procedures providing for immediate notice to the SEF or 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 SEF and DCM to document their findings with respect to the verification of fitness information.

The Commission further proposes to clarify the applicability of the governance fitness requirements to SEFs and DCMs by locating them, respectively, within parts 37 and 38 of the Commission's regulations, rather than within part 1 of the Commission's regulations. The Commission also proposes to make conforming amendments to Commission regulations §§ 37.2 and 38.2 to exempt SEFs and DCMs from Commission regulation § 1.63 in its entirety.

iv. Additional Considerations for Minimum Fitness Requirements

The Commission is considering whether additional fitness requirements would enhance the performance and accountability of the individuals who are charged with governing a SEF or DCM or its operations, or have the ability to influence such functions. Therefore, the Commission is seeking comment on whether SEFs and DCMs should consider additional eligibility criteria to prevent individuals from serving as an officer or member of the board of directors if their background, although not automatically disqualifying under proposed §§ 38.801(c) or 37.207(c), raises concerns about the individual's ability to effectively govern, manage, or influence the operations or decision-making of a SEF or DCM. For example, the Commission notes that at least three SEFs have already implemented a ''good repute'' requirement for members of their board of directors,[148] and the same requirement exists for members of the management body of regulated markets in the European Union.[149] The 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. The Commission's potential standard could be as follows:

> Minimum standards of fitness for the SEF's and DCM's officers and for members of its board of directors must include the requirement that each such individuals be of *sufficiently good repute;* provided, however, that SEFs and DCMs have flexibility to establish the criteria for how individuals demonstrate good repute, as appropriate for their respective markets.

The Commission also seeks comment on whether SEFs and DCMs should also consider, in defining ''good repute,'' the type of information that is subject to disclosure in the Uniform Application for Securities Regulation (''Form U4'') for consideration by FINRA for registration.[150] Other examples for consideration include instances where the license of a licensed professional (such as a certified public accountant or attorney) has been involuntarily suspended or revoked, or where an individual is suspended by an order of

[144] The disciplinary offenses generally include a decision by a court or a self-regulatory organization (or a settlement) of: violations of the substantive rules of a self-regulatory organization, felonies, convictions involving fraud or deceit, violations of the CEA or Commission regulations, or a suspension or denial by a self-regulatory organization to serve on a board or disciplinary panel.

[145] Commission regulation § 1.63(b)(6) provides as disqualifying anyone who is currently subject to a denial, suspension or disqualification from serving on the disciplinary committee, arbitration panel or governing board of any self-regulatory organization as that term is defined in section 3(a)(26) of the Securities Exchange Act of 1934.

[146] The Commission believes that in the absence of a cohesive set of SEF or DCM conflicts of interest policies and procedures, individuals with potential conflicts of interest may have difficulty ascertaining the policies and procedures that apply to a given situation. The Commission believes that similar concerns would be raised where there is not a cohesive set of procedures related to the verification fitness information.

[147] Both the NFA and FINRA conduct background checks to confirm information provided in the Form U4 is accurate, and FINRA Rule 3110(e) requires SEC-registered member firms to verify the information provided in a Form U4 using ''reasonably available public records, or a third-party provider.''

[148] *See* CBOE SEF Rulebook, Rule 202; Bloomberg SEF Rulebook, Rule 201; ICAP Global Derivatives SEF Rulebook, Annex 1, Governance Policy. Additionally, at least five DCMs and one SEF require their members or market participants to be of ''good repute,'' ''good moral character,'' or ''good reputation.''

[149] Article 45(2)(a) to (c) of the Markets in Financial Instruments Directive 2014/65/EU (''MiFID II'') (requiring members of the management body of market operators to be of ''sufficiently good repute''); Article 4(36) defines ''management body'' to include the individuals ''empowered to set the entity's strategy, objectives, and overall direction, and which oversee and monitor management decision-making . . .'').

[150] The Form U4 includes information such as criminal charges, pending regulatory cases, license suspensions or revocations, and decisions by foreign courts.

a foreign regulator or court in foreign jurisdiction.

3. 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?*

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?*''

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?

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?*

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

a. General Requirements for Conflicts of Interest and Definitions—Proposed §§ 37.1201 and 38.851

1. Existing Regulatory Framework and Definitions

As described above, SEFs and DCMs must establish and enforce rules to minimize conflicts of interest in their decision-making processes and establish a process for resolving such conflicts, pursuant to SEF Core Principle 12 and DCM Core Principle 16. SEFs and DCMs have different standards for addressing conflicts of interest. The DCM Core Principle 16 Acceptable Practices provide specific practices that DCMs may adopt to demonstrate compliance with aspects of DCM Core Principle 16. The Commission has not adopted guidance on, or acceptable practices in, compliance with the conflicts of interest requirements under SEF Core Principle 12. Commission regulation § 1.59, however, addresses the management of conflicts of interest for SEFs in connection with protecting material non-public information from misuse and disclosure.[151]

There are several terms defined in the DCM Core Principle 16 Acceptable Practices and Commission regulation § 1.59(a) which the Commission believes are relevant to identifying and resolving conflicts of interest that may impact a SEF's or DCM's market regulation functions, and which the Commission is proposing to adopt in these proposed new conflict of interest rules with certain minor modifications as discussed below. The DCM Core Principle 16 Acceptable Practices defines a ''public director'' as an individual with no material relationship to the DCM and describes the term ''immediate family'' to include spouse, parents, children, and siblings. The terms ''material information,'' ''non-public information,'' ''commodity interest,'' ''related commodity interest,'' and ''linked exchange'' are defined in Commission regulation § 1.59. ''Material information'' is defined in § 1.59(a)(5) to mean information which, if such information were publicly known, would be considered important by a reasonable person in deciding whether to trade a particular commodity interest on a contract market or a swap execution facility, or to clear a swap contract through a derivatives clearing organization.[152] ''Non-public information'' is defined in § 1.59(a)(6), as information which has not been disseminated in a manner which makes it generally available to the trading public. Commission regulations §§ 1.59(a)(8) and (9) define ''commodity interest,'' to include all futures, swaps, and options traded on or subject to the rules of a SEF or DCM[153] and ''related commodity interest'' to include any commodity interest which is traded on or subject to the rules of a SEF, DCM, linked exchange, or other board of trade, exchange, or market, or cleared by a DCO, other than the self-regulatory organization[154] by which a person is employed, and which is subject to a self-regulatory organization's intermarket spread margins or other special margin treatment.

2. Proposed Rules

Proposed §§ 37.1201(a) and 38.851(a) would set forth the foundational requirement that SEFs and DCMs, respectively, must establish a process for identifying, minimizing, and resolving actual and potential conflicts of interest that may arise, including, but not limited to, conflicts between and among any of the SEF's or DCM'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. These proposed rules would largely codify existing language from the DCM Core Principle 16 Acceptable Practices.[155]

Proposed §§ 37.1201(b) and 38.851(b) would establish definitions. As discussed above, many of the terms are already defined in existing Commission regulations, and in the acceptable

[151] Commission regulation § 1.59 addresses the management of conflicts of interest for self-regulatory organizations, including SEFs and DCMs, in connection with protecting material, non-public information from use and disclosure. Pursuant to Commission regulation § 38.2, DCMs are exempt from § 1.59(b) and (c), but must comply with § 1.59(a) and (d); SEFs must comply with all subparts of § 1.59.

[152] The definition of material information in Commission regulation § 1.59(a)(5) also provides that as used in that section, ''material information'' includes, but is not limited to, information relating to present or anticipated cash positions, commodity interests, trading strategies, the financial condition of members of self-regulatory organizations or members of linked exchanges or their customers, or the regulatory actions or proposed regulatory actions of a self-regulatory organization or a linked exchange.

[153] The definition of commodity interest also includes futures or swaps cleared by a Designated Clearing Organization. Commission regulation § 1.59(a)(8).

[154] Commission regulation § 1.3 defines this term as a contract market (as defined in § 1.3(h)), a swap execution facility (as defined in § 1.3(rrrr)), or a registered futures association under section 17 of the CEA.

[155] Part 38, Appendix B, Core Principle 16.

practices for compliance with the DCM conflicts of interest core principle, and would be duplicated with minor modifications. The Commission believes that specifically defining these terms in parts 37 and 38 of its regulations would provide greater clarity to SEFs and DCMs, and to the public, regarding regulatory requirements applicable to these entities. Additional reasons for proposing these defined terms are discussed below.

First, the terms ''material information,'' ''non-public information,'' ''commodity interest,'' ''related commodity interest,'' and ''linked exchange'' would be defined in proposed §§ 37.1202(b) and 38.851(b) as they are in § 1.59(a), but modified specifically to reference SEFs and DCMs, respectively. Additionally, as addressed below, proposed §§ 37.1202(b) and 38.851(b) would define ''public director'' and ''family relationship.'' [156] ''Family relationship'' would replace the term ''immediate family'' that is currently used in the DCM Core Principle 16 Acceptable Practices.[157] As discussed above,[158] proposed §§ 37.1201 and 38.851 focus on conflicts of interests involving a subset of a SEF or DCM's self-regulatory functions—those that are generally related to the SEF's or DCM's obligations to ensure market integrity and proper and orderly conduct in its markets, and to deter abusive trading practices. Those functions include trade practice surveillance, market surveillance, real-time market monitoring, audit trail and recordkeeping enforcement, investigations of possible rule violations, and disciplinary actions. As discussed above, the Commission is proposing to define ''market regulation functions'' in §§ 37.1201(b)(9) and 38.851(b)(9) to describe the self-regulatory functions addressed in this rule proposal.

Finally, the Commission is proposing a new definition for the term ''affiliate.'' The Commission recognizes that this term is defined elsewhere in the Commission regulations. However, the definition of ''affiliate'' elsewhere in Commission regulations does not apply to SEFs or DCMs.[159] For the limited purpose of this rule proposal, the Commission proposes defining ''affiliate'' in proposed §§ 37.1201(b)(1) and 38.851(b)(1), to mean a person that directly or indirectly controls, or is controlled by, or is under common control with, the SEF or DCM (as applicable). The definition of affiliate in proposed §§ 37.1201(b)(1) and 38.851(b)(1) would establish that, for purposes of this rule proposal, ''affiliate'' broadly includes direct or indirect common ownership or control.

b. Conflicts of Interest in Decision-Making—Proposed §§ 37.1202 and 38.852

1. Background

Officers, members of the board of directors, committees, and disciplinary panels, are the key decision-makers at a SEF or DCM that can directly affect the day-to-day execution of market regulation functions. Therefore, the Commission believes individuals fulfilling these roles must have the ability to make informed and impartial decisions. If any of these decision-makers have an actual or potential conflict of interest, it can impair the decision-making process of the SEF or DCM. Accordingly, the Commission is proposing to codify and harmonize for SEFs and DCMs, in proposed §§ 37.1202 and 38.852, respectively, certain elements of Commission regulation § 1.69 that require a self-regulatory organization to address the avoidance of conflicts of interest in the execution of its self-regulatory functions. As noted above, SEFs are currently subject to the requirements of Commission regulation § 1.69; however, DCMs are exempt from these requirements pursuant to Commission regulation § 38.2. Nonetheless, Commission staff has found that as a matter of practice, most DCMs have adopted rules that voluntarily implement these requirements.

2. Existing Regulatory Framework

Commission regulation § 1.69 generally requires self-regulatory organizations to have rules requiring any member of the board of directors, disciplinary committee, or oversight panel, to abstain from deliberating and voting on certain matters that may raise conflicts of interest. Commission regulation § 1.69(a) includes a list of definitions relevant to the section, including the definition of ''named party in interest,'' which means a person or entity that is identified by name as a subject of any matter being considered by a governing board, disciplinary committee, or oversight panel. Commission regulation § 1.69(b)(1)(i)(A)–(E) enumerates a list of relationships. If a member of the board of directors, disciplinary committee, or oversight panel, has such a relationship with a named party in interest, then this would require the member to abstain from deliberating and voting on that matter. Prior to the consideration of any matter involving a named party in interest, Commission regulation § 1.69(b)(1)(ii) requires members of a governing board, disciplinary committee or oversight panel to disclose their relationships with the named party in interest. Commission regulation § 1.69(b)(1)(iii) requires self-regulatory organizations to establish procedures for determining whether any members of governing boards, disciplinary committees or oversight panels are subject to a conflicts restriction in any matter involving a named party in interest, and specifies certain requirements for making such determinations.

Commission regulation § 1.69(b)(2) requires members of governing boards, disciplinary committees or oversight panels to abstain from deliberating and voting in any significant action if the member knowingly has a direct and substantial financial interest in the result of the vote. Additional requirements for disclosure of interest and the procedures for making a conflicts determination are addressed in Commission regulations §§ 1.69(b)(2)(ii) and (iii), respectively. Commission regulation § 1.69(b)(3) permits members of governing boards, disciplinary committees or oversight panels, who otherwise would be required to abstain from deliberations and voting on a matter because of a conflict under Commission regulation § 1.69(b)(2), to deliberate but not vote on the matter under certain circumstances.[160] Finally, Commission regulation § 1.69(b)(4) requires self-regulatory organizations to document certain conflicts determination requirements.

3. Proposed Rules

The Commission proposes to include certain elements of Commission regulation § 1.69 in proposed §§ 37.1202 and 38.852, and to make a conforming amendment to Commission regulation

[156] *See* Section V(b)(3) (addressing the term public director) and Section IV(b)(3) (addressing the term family relationship).

[157] Section IV(c)(3) herein provides details regarding the proposed definitions for public director and family relationship.

[158] *See* Section II(d) herein.

[159] For example, § 162.2(a) defines ''affiliate'' specifically in relation to futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator, introducing broker, major swap participant, or swap dealer.

[160] Commission regulation § 1.64(b)(3)(ii) lists the following factors for the deliberating body to consider in determining whether to allow such member to participate in deliberations: (1) if the member's participation is necessary to achieve a quorum; and (2) whether the member has unique or special expertise, knowledge or experience in the matter under consideration.

§ 37.2 to exempt SEFs from Commission regulation § 1.69. While the intent behind Commission regulation § 1.69 remains relevant, the Commission believes that certain modifications and enhancements are necessary to reflect the current state of the futures and swaps markets. For example, Commission regulation § 1.69(b)(1)(i)(C) describes a relationship with a named party in interest through a ''broker association'' as defined in § 156.1. While this relationship may have been significant at the time Commission regulation § 1.69 was adopted, the Commission does not believe it is necessary to include it in proposed §§ 37.1202 and 38.852 given the decline of open outcry trading. Furthermore, the scope of proposed §§ 37.1202 and 38.852 would require a relationship with an individual as part of a broker association, as well as other professional associations, to be disclosed regardless of whether it is an enumerated relationship. The scope of proposed §§ 37.1202 and 38.852 expressly covers officers, as well as members of boards of directors, committees, and disciplinary panels,[161] to accurately reflect the individuals and governing bodies that are involved in the decision-making processes of a SEF or DCM and that may therefore be subject to the same conflicts of interest.

The Commission notes that Commission regulation § 1.69(a)(2) currently includes ''family relationship'' as one of the enumerated relationships, which is defined as a person's spouse, parent, stepparent, child, stepchild, sibling, stepbrother, stepsister, or in-law. The Commission proposes redefining ''family relationship,'' as the person's spouse, parents, children, and siblings, in each case, whether by blood, marriage, or adoption, or any person residing in the home of the person, as set forth in proposed §§ 37.1201(b)(7) and 38.851(b)(7). This proposed definition focuses on the closeness of the relationship that the committee member has with the subject of the matter being considered. The proposed definition also reflects a more modern description of the relationships intended to be covered. The Commission emphasizes that the relationships listed in this proposed definition are not exhaustive; rather, each relationship should be viewed in light of the particular circumstances surrounding the relationship and the closeness of the relationship.

Proposed §§ 37.1202(a) and 38.852(a) require SEFs and DCMs, respectively, to establish policies and procedures requiring any officer or member of its board of directors, committees, or disciplinary panels to disclose any actual or potential conflicts of interest that may be present prior to considering any matter. The proposed language is a modernized version of the requirement in Commission regulation § 1.69(b). Although not exhaustive, proposed §§ 37.1202(a)(1) and 38.852(a)(1) enumerate certain conflicts in which the member or officer: (1) is the subject of any matter being considered; (2) is an employer, employee, or colleague [162] of the subject of any matter being considered; (3) has a family relationship with the subject of any matter being considered; or (4) has any ongoing business relationship with or a financial interest in the subject of any matter being considered.[163] The Commission is proposing §§ 37.1202(a)(2) and 38.852(a)(2) to extend the conflicts of interest enumerated in proposed §§ 37.1202(a)(1) and 38.852(a)(1) to also apply to relationships that an officer or member of its board of directors, committees, or disciplinary panels has with an affiliate of the subject of any matter being considered.

As discussed above, the evolution of market structures has increased the interconnectedness between SEFs, DCMs, and their affiliates. This relationship between a SEF or DCM and its affiliates—and by extension, the officers, members of the board of directors, committees, or disciplinary panels—could create, in the Commission's view, an actual or potential conflict of interest. Accordingly, the Commission believes proposed §§ 37.1202(a)(2) and 38.852(a)(2) is necessary to mitigate conflicts of interest in a SEF's or DCM's decision-making.

Proposed §§ 37.1202(b) and 38.852(b) largely track existing requirements in Commission regulation § 1.69(b)(4) and require the board of directors, committee, or disciplinary panel to document its processes for complying with the requirements of the proposed rules, and such documentation must include: (1) the names of all members and officers who attended the relevant meeting in person or who otherwise were present by electronic means; and (2) the names of any members and officers who voluntarily recused themselves or were required to abstain from deliberations or voting on a matter and the reason for the recusal or abstention. To ensure the intent of proposed §§ 37.1202 and 38.852 is captured, the Commission continues to require voluntary recusals to be documented, in addition to the instances in which a determination was made to require the abstention of an officer or member of a board of directors, committee, or disciplinary panel.

In a limited number of circumstances, Commission regulation § 1.69(b)(3) permits members of governing boards, disciplinary committee, or oversight panel, who otherwise would be required to abstain from deliberations and voting on a matter because of a conflict under Commission regulation § 1.69(b)(2), to deliberate but not vote on the matter. The Commission is not proposing to adopt this exemption. If a board of directors, committee or panel believes that it has insufficient expertise to consider a matter, the Commission encourages the committee to seek information from an expert or consultant that is not subject to a conflicts restriction. The Commission believes it is imperative for boards of directors, committees, and disciplinary panels to have access to unbiased, conflict-free information to assist in decision-making.

4. Questions for Comment

The Commission requests comment on all aspects of the proposed conflicts of interest in decision-making rules. The Commission further requests comment on the questions set forth below.

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?

2. Does the proposed definition of ''family relationship'' cover the appropriate types of relationships?

[161] Commission regulation § 1.69(a) defines ''disciplinary committee(s),'' ''governing board(s),'' and ''oversight panel(s).''

[162] The Commission proposes replacing the current term ''fellow employee'' with ''colleague'' to include individuals with whom the officer or director may have a collegial relationship, but may not be employed by the same employer. As an example, two individuals who worked in the same office, where the first is a full-time employee of the organization, and the other works alongside the first but is employed by an outside contractor, would be considered colleagues for purposes of proposed §§ 37.1202 and 38.852.

[163] The Commission believes that this relationship, along with the overarching requirement in proposed §§ 37.1202(a) and 38.852(a) requiring an officer or member of its board of directors, committees, or disciplinary panels to disclose any actual or potential conflicts of interest that may be present prior to considering any matter, are sufficient for addressing conflicts of interest involving financial interest. Accordingly, the Commission is not proposing to include in proposed §§ 37.1202 or 38.852 a parallel to existing Commission regulation § 1.69(b)(2)'s requirements concerning financial interests in significant actions.

Should any relationships be added or removed from the proposed definition?

c. Limitations on the Use and Disclosure of Material Non-public Information—Proposed §§ 37.1203 and 38.853

1. Background

Preventing the misuse and disclosure of material non-public information at SEFs and DCMs further the objectives of promoting self-regulation of exchanges and maintaining public confidence in SEF and DCM markets. The CEA includes prohibitions on the misuse and disclosure of material non-public information. It is unlawful for any person who is an employee, member of the governing board, or member of any committee of a board of trade, to willfully and knowingly (1) trade for such person's own account, or for or on behalf of any other account, in contracts for future delivery or option thereon on the basis of any material non-public information obtained through special access related to the performance of such person's official duties as an employee or member; or (2) to disclose for any purpose inconsistent with the performance of such person's official duties as an employee or member, any material non-public information obtained through special access related to the performance of such duties.[164] Furthermore, a potential conflict of interest arises when employees or insiders with access to material non-public information leverage their insider access to advance their personal interests, or the interests of others, to the detriment of the decision-making process of the contract market. The Commission believes reducing the potential for such misuse of material nonpublic information helps to mitigate conflicts of interest. Accordingly, the Commission is proposing new rules to implement elements of the conflicts of interest core principles for SEFs and DCMs, within parts 37 and 38, respectively, that are consistent with existing requirements under current Commission regulation § 1.59, which establishes limitations on the use and disclosure of material non-public information. The proposed rules would establish prohibitions on the use or disclosure of material non-public information by: (1) employees of the SEF or DCM; and (2) members of the board of directors, committee members, consultants and those with an ownership interest of 10 percent or more in the SEF or DCM.

Moreover, the Commission is proposing to harmonize and streamline SEF and DCM requirements related to the safeguarding of material non-public information by proposing rules under §§ 37.1203 and 38.853, and to make conforming amendments to Commission regulation § 37.2 to exempt SEFs from Commission regulation § 1.59. As discussed in more detail below, the proposal would establish consistent rules for SEFs and DCMs related to the use and disclosure of material non-public information.

2. Existing Regulatory Framework

Commission regulation § 1.59 generally requires self-regulatory organizations to adopt rules prohibiting employees, governing board members, committee members or consultants from trading commodity interests on the basis of material non-public information obtained in the course of their official duties. Under Commission regulation § 1.59, employees of self-regulatory organizations are subject to stricter trading prohibitions than governing board members, committee members or consultants. Specifically, employees are prohibited from trading in any commodity interest traded on or cleared by the employing SEF, DCM or DCO, or from trading in any related commodity interest. Additionally, employees having access to material non-public information concerning a commodity interest are prohibited from trading in any such commodity interest that is traded on or cleared by any SEF, DCM or DCO, or any linked exchange.[165]

Members of the board of directors, committee members, and consultants of a self-regulatory organization, on the other hand, are prohibited from using material non-public information for any purpose other than the performance of their official duties. The possession of material non-public information, therefore, does not absolutely bar these individuals from trading commodity interests. Rather, under Commission regulation § 1.59(d), members of the board of directors, committee members, or consultants of a self-regulatory organization are directly prohibited from trading for their own account, or for or on behalf of any other account, based on this material non-public information.

The direct prohibitions under Commission regulation § 1.59(d) were adopted in 1993 to effectuate section 214 of the Futures Trading Practices Act (''FTPA'') of 1992, which, among other things, makes it a felony for employees and governing members of self-regulatory organizations to disclose or trade on inside information and for tippees of such insiders to trade on inside information so disclosed.[166] Historically, the Commission has adopted a more lenient standard for governing board members and committee members.[167] A more lenient standard helps to ensure that a trading prohibition does not impair the ability or diminish willingness of knowledgeable industry members who also are active traders from serving on a self-regulatory organization's board of directors or its major policy or disciplinary committees.

While § 1.59(b) prohibits trading in commodity interests or related commodity interests by employees, the rule also provides that exemptions may be granted. Under current § 1.59(b)(2)(ii)(b), a self-regulatory organization may adopt rules setting forth circumstances under which exemptions may be granted, as long as those exemptions are consistent with the CEA, the purposes of § 1.59, just and equitable principles of trade, and the public interest. Exemptions also may be granted, under rules adopted by a self-regulatory organization, in situations where an employee participates in a pooled investment vehicle without direct or indirect control of such vehicle.[168]

The prohibitions and requirements under § 1.59 apply differently to SEFs and DCMs. As a result of the core principles framework promulgated under the Commodity Futures Modernization Act of 2000, DCMs were relieved from many rule-based requirements in favor of core principles. Consequently, DCMs were exempted from § 1.59(b) and (c). However, employees, governing board members, committee members, and consultants at DCMs are not exempted from

[164] CEA section 9(e), 7 U.S.C. 13(e).

[165] Commission regulation § 1.59(a)(7) defines linked exchange to include any exchange or board of trade outside of the United States that lists products traded on the SEF or DCM, or that has an agreement with a SEF or DCM to permit positions in one commodity interest to be liquidated on the other market, or any clearing organizations that clears the products in any of the foregoing markets.

[166] Final Rule, Prohibition on Insider Trading, 58 FR 54966 (Oct. 25, 1993).

[167] When Commission regulation § 1.59 was first proposed, it proposed to apply the same standard to employees and governing board members and committee members. Activities of Self-Regulatory Organization Employees and Governing Members Who Possess Material, Nonpublic Information, 50 FR 24533 (June 11, 1985). In response to public comment, however, the Commission initially finalized § 1.59 without addressing what obligations applied to members of the governing board of committee members. Instead, the Commission adopted the more lenient standard in a separate rulemaking. Activities of Self-Regulatory Organization Employees Who Possess Material, Non-Public Information, 51 FR 44866 (Dec. 12, 1986).

[168] Commission regulation § 1.59(b)(ii)(b).

§ 1.59(d).[169] In addition to the Commission's statutory authority on insider trading,[170] the DCM Core Principle 16 Guidance states that DCMs should provide for appropriate limitations on the use or disclosure of material non-public information gained through performance of official duties by members of the board of directors, committee members, and DCM employees or gained by those through an ownership interest in the DCM.[171]

In contrast, Commission regulation § 1.59 applies in its entirety to SEFs. Unlike for DCMs, the Commission did not adopt any guidance or acceptable practices addressing how a SEF may demonstrate compliance with SEF Core Principle 12 related to appropriate limitations on the use and disclosure of material non-public information.

3. Proposed Rules

The Commission is proposing harmonized rules for SEFs and DCMs related to the use and disclosure of material non-public information from § 1.59.[172] Proposed §§ 37.1203(a) and 38.853(a) require SEFs and DCMs to establish and enforce policies and procedures on safeguarding the use and disclosure of material non-public information. These policies and procedures must, at a minimum, prohibit a SEF or DCM employee, member of the board of directors, committee member, consultant, or owner with a 10 percent or more interest in the SEF or DCM, from trading commodity interests or related commodity interests based on, or disclosing, any non-public information obtained through the performance of their official duties. As discussed in more detail below, the scope of individuals subject to trading limitations under this proposed rule is consistent with those individuals subject to the trading limitations under both existing § 1.59 and existing Core Principle 16 Guidance. The proposal codifies existing Core Principle 16 Guidance which considers appropriate limitations on those with an ownership interest in the exchange. The proposal clarifies that the limitation would apply to those with an ownership interest of 10 percent or more in the SEF or DCM.

Proposed §§ 37.1203(b) and 38.853(b) require SEFs and DCMs, respectively, to prohibit employees from certain types of trading [173] or disclosing for any purpose inconsistent with the performance of the person's official duties as an employee any material non-public information obtained as a result of such person's employment. The Commission believes that such a stringent restriction is necessary for employees, who, by virtue of their official position, have access to material non-public information. However, the Commission also recognizes that there may be limited circumstances under which employees should be exempted from the trading restrictions, so long as the subject trading is not pursuant to material non-public information. Accordingly, the Commission is proposing rules requiring SEFs and DCMs to oversee exemptions from the trading prohibition granted to employees.[174] Proposed §§ 37.1203(c) and 38.853(c) would allow SEFs and DCMs, respectively, to grant exemptions that are (1) approved by the SEF or DCM ROC; (2) granted only in limited circumstances in which the employee requesting the exemption can demonstrate that the trading is not being conducted on the basis of material non-public information gained through the performance of their official duties; and (3) individually documented by the SEF or DCM in accordance with requirements in existing Commission regulations §§ 37.1000 and 37.1001 or §§ 38.950 and 38.951, respectively.

In its routine oversight, Commission staff has observed certain deficiencies in the manner in which DCMs evaluated, granted, and documented exemptions from their trading prohibitions. As a result, the Commission is proposing §§ 37.1203(d) and 38.853(d) to require SEFs and DCMs, respectively, to establish and enforce policies and procedures to diligently monitor the trading activity conducted under any exemptions granted to ensure compliance with any applicable conditions of the exemptions and the SEF's or DCM's policies and procedures on the use and disclosure of material non-public information. The Commission believes that SEFs and DCMs have an obligation to monitor and ensure compliance with any applicable conditions of the exemptions that may be granted by the exchange. Moreover, SEFs and DCMs must ensure that any granted exemptions are in accordance with the exchange's policies and procedures governing employees' use and disclosure of material non-public information, as well as the CEA and Commission regulations. The Commission believes that SEFs and DCMs should already have existing programs to monitor, detect, and deter abuses that may arise from trading conducted pursuant to an exemption from the employee trading prohibition. Accordingly, a SEF or DCM should utilize its existing surveillance program to monitor trading by employees or other insiders who are granted trading exemptions pursuant to proposed §§ 37.1203(c) and 38.853(c). Such surveillance should focus on the commodity interests or related commodity interests to which the non-public information relates and the time period during which misuse of such information reasonably could be expected to occur.

The Commission continues to believe it is an important policy objective to ensure that the trading prohibition does not impair the ability or diminish the willingness of knowledgeable members of the industry who also are active traders from serving on a SEF's or DCM's board of directors or its major policy or disciplinary committees. The Commission, therefore, is maintaining its historical policy of allowing SEFs and DCMs flexibility, within limits, to establish rules that may restrict governing board members, committee members, employees, and consultants from trading in commodity interests for their own account, or for or on behalf

[169] Under the provisions of Commission regulation § 1.59(d), no employee, governing board member, committee member, or consultant shall trade for such person's own account, or for or on behalf of any other account, in any commodity interest, on the basis of any material, non-public information obtained through special access related to the performance of such person's official duties as an employee, governing board member, committee member, or consultant. Furthermore, such persons must not disclose for any purpose inconsistent with the performance of their official duties as an employee, governing board member, committee member, or consultant any material, non-public information obtained through special access related to the performance of such duties. In addition, no person shall trade for their own account, or for or on behalf of any other account, in any commodity interest, on the basis of any material, non-public information that such person knows was obtained in violation of paragraph (d)(1) of § 1.59 from an employee, governing board member, committee member, or consultant.

[170] CEA section 9(e).

[171] Part 38, Appendix B, Core Principle 16.

[172] This rule proposal would not amend Commission regulation § 1.59, which will remain unchanged and continue to be applicable to registered futures associations.

[173] Proposed §§ 37.1203(b)(1) and 38.853(b)(1) restrict trading directly or indirectly, in the following: (1) Any commodity interest traded on the employing designated contract market; (2) Any related commodity interest; (3) A commodity interest traded on designated contract markets or swap execution facilities or cleared by derivatives clearing organizations other than the employing designated contract market if the employee has access to material non-public information concerning such commodity interest; or (4) A commodity interest traded on or cleared by a linked exchange if the employee has access to material non-public information concerning such commodity interest.

[174] The exemptions, applicable only to SEF or DCM employees trading on the SEF or DCM, or trading in the same or related commodity interests, would be administered on a case-by-case basis, at the level of granularity appropriate for the situation, considering all relevant factors. The exemptions would be reviewed by Commission staff as part of its routine oversight of SEFs and DCMs.

of any other account, based on this material non-public information. Accordingly, proposed §§ 37.1203(e) and 38.853(e) require SEFs and DCMs, respectively, to establish and enforce policies and procedures that, at a minimum, prohibit members of the board of directors, committee members, employees, consultants, and those with an ownership interest of 10 percent or more from: (1) trading in any commodity interest or related commodity interest on the basis of any material non-public information obtained through the performance of such person's official duties; (2) trading in any commodity interest or related commodity interest on the basis of any material non-public information that such person knows was obtained in violation of this section; or (3) disclosing for any purpose inconsistent with the performance of the person's official duties any material non-public information obtained as a result of their official duties.

The Commission is expanding the scope of the direct prohibition on trading based on material non-public information under proposed §§ 37.1203(e) and 38.853(e) as compared to existing Commission regulation § 1.59 in three ways. First, the Commission is proposing to apply the prohibitions already applicable to employees in § 1.59(b), regarding trading in ''related commodity interests,'' to governing board members, committee members, and consultants who are in possession of material non-public information.[175] Consistent with the definition of ''related commodity interests,'' in § 1.59(a)(9), the Commission believes that the direct prohibitions on trading while in the possession of material non-public information should include related commodity interests whose price movements correlate with the price movements of a commodity interest traded on or subject to the rules of a SEF or DCM to such a degree that intermarket spread margins or special margin treatment is recognized or established by the employer SEF or DCM.[176] Second, the Commission is proposing to codify existing DCM Core Principle 16 Guidance related to those with an ownership interest in §§ 37.1203(e)(3) and 38.853(e)(3). While this expands the scope of individuals subject to trading limitations as compared to existing Commission regulation § 1.59, it is codifying existing Core Principle 16 Guidance, with one clarification. Specifically, with regards to owners, the Commission is clarifying that the direct prohibition under §§ 37.1203(e) and 38.853(e) would only apply to those with an ownership interest of 10 percent or more in the SEF or DCM.[177] Third, while the proposed rules continue to maintain a restriction on the disclosure of material non-public information, the proposal would address differences in the existing language between §§ 1.59(b)(1)(D)(ii) and 1.59(d)(ii) regarding the restrictions on the disclosure of material non-public information. The Commission is proposing the same restriction on disclosure for both employees under §§ 37.1203(b)(2) and 38.853(b)(3) and members of the board of directors, committee members, consultants, and those with an ownership interest of 10 percent or more under §§ 37.1203(e)(3) and 38.853(e)(3), to make clear that these ''insiders'' would be subject to the same restriction from disclosing material non-public information obtained as a result of their official duties at a SEF or DCM.

As mentioned in Section IV.b, the Commission is proposing to include substantial sections of existing definitions from Commission regulation § 1.59 in proposed parts 37 and 38. For example, the proposal includes, for purposes of §§ 37.1203 and 38.853, the same historical definitions of (1) ''commodity interest,'' (2) ''linked exchange,'' (3) ''material information,'' (4) ''non-public information,'' and (5) ''pooled investment vehicle.'' The Commission is proposing non-substantive changes to the (1) ''commodity interest'' and (2) ''related commodity interest'' definitions. The proposal would update the definition of a commodity interest by removing the phrase ''of a board of trade which has been designated as a'' and keep the reference to ''designated contract market.'' For the ''related commodity interest'' definition, the proposal replaces the reference to ''self-regulatory organization'' with a reference to either a SEF or DCM in the regulatory text in parts 37 and 38. The Commission believes that it is appropriate for a SEF or DCM to have the ability to grant an exemption from the trading prohibition where an employee is participating in pooled investment vehicles where the employee has no direct or indirect control with respect to transactions executed for or on behalf of such vehicles.[178]

4. Questions for Comment

The Commission requests comment on all aspects of the proposed rules regarding the use and disclosure of material non-public information. The Commission further requests comment on the questions set forth below.

1. Has the Commission proposed an appropriate definition for ''material''? If not, why not? What would be a better alternative?

2. Has the Commission proposed an appropriate definition for ''non-public information''? If not, why not? What would be a better alternative?

3. Has the Commission proposed appropriate limitations on the use and disclosure of material non-public information for SEF and DCM board of directors, committee members, employees, consultants, and those with an ownership interest of 10 percent or more? If not, why not? What would be a better alternative?

4. With regards to owners, has the Commission proposed an appropriate limitation in applying the restrictions under §§ 37.1203(e) and 38.853(e) to those with an ownership interest of 10 percent or more in the SEF or DCM? Should the restriction be applied to all those with an ownership interest in the SEF or DCM? If not, why not? What would be a better alternative?

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

In general, the proposed structural governance requirements are intended to mitigate conflicts of interest at a SEF or DCM by introducing a perspective independent of competitive, commercial, or industry considerations to the deliberations of governing bodies (*i.e.,* the board of directors and committees). The Commission believes that such independent perspective would be more likely to encompass regulatory considerations, and accord such considerations proper weight. The Commission believes that such independent perspective also would more likely contemplate the manner in which a decision might affect all constituencies, as opposed to

[175] Proposed §§ 37.1203(e)(1) and 38.853(e)(1).

[176] *See* proposed §§ 37.1201(b)(15) and 38.851(b)(15) (defining ''related commodity interests'').

[177] Owners of 10 percent or more of a company are considered ''insiders'' pursuant to section 16 of the Securities Exchange Act of 1934. *See* section IV(C) herein.

[178] In particular, that it would be appropriate to grant an employee an exemption to trade in a pooled investment vehicle organized and operated as a commodity pool within the meaning of § 4.10(d) of the Commission regulations, and whose units of participation have been registered under the Securities Act of 1933, or a trading vehicle for which Commission regulation § 4.5 makes available relief from registration as a commodity pool operation.

concentrating on the manner in which a decision affects the interests of one or a limited number of constituencies.[179] The Commission further believes that independent decision-makers are necessary to protect a SEF's or DCM's market regulation functions from its commercial interests and that of its constituencies.

Accordingly, the Commission is proposing to require a SEF's or DCM's board of directors, and any executive committee, to include at least 35 percent public directors. The Commission also proposes establishing two committees to further enhance the structural governance of SEFs and DCMs. First, the proposed rules would require a nominating committee that is comprised of at least 51 percent public directors to enhance the transparency of the board of directors. Second, the proposed rules would require a ROC comprised solely of public directors to protect the integrity of the market regulation function of SEFs and DCMs. The Commission is also proposing a new DCM CRO requirement, and updating the existing SEF CCO requirement, to clearly establish these roles as central to the SEF's or DCM's management of conflicts of interest that may impact market regulation functions.

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

1. Background

As the ultimate decision-maker of an exchange, governing boards are an essential component in an exchange's ability to identify, manage, and resolve conflicts of interest.[180] In particular, the board of directors, along with senior management, set the ''tone at the top'' for a SEF's or DCM's governance and compliance culture.[181] In its routine oversight, Commission staff has observed that board composition standards have become a key piece of SEFs' and DCMs' structural governance, and when coupled with clear, comprehensive policies and procedures to address conflicts of interest, have helped to minimize conflicts of interests faced by members of the board of directors. For example, the presence of public directors, both on the board of directors and the ROC, has created an avenue for DCMs, SEFs, their officers and employees to escalate, and eventually seek resolution of, conflicts of interest.

2. Existing Regulatory Framework

Currently, the board of director composition component of the DCM Core Principle 16 Acceptable Practices provides that a DCM's board of directors or executive committees include at least 35 percent public directors.[182] In adopting this acceptable practice, the Commission stated that the 35 percent figure struck an appropriate balance between (1) the need to minimize conflicts of interest in DCM decision-making processes and (2) the need for expertise and efficiency in such processes.[183]

As compared to DCMs, SEFs are currently subject to substantially different board composition standards. Specifically, SEFs are subject to Commission regulation § 1.64(b)(1), which establish a 20 percent ''non-member'' requirement.[184] This requirement was adopted in 1993 for SROs when exchanges were member-owned. At the time, the Commission sought to ensure that an SRO governing board fairly represented the diversity of membership interest at such SRO[185] and would not have an exclusively member perspective.[186] While this was a laudable goal at the time, Commission regulation § 1.64(b)(1) requirements are no longer relevant for SEFs and DCMs given that exchanges are no longer member-owned. The Commission's goal through this proposal is to ensure that SEFs and DCMs have sufficient independent perspective in their decision-making, taking into account that SEFs and DCMs are now for-profit entities that also are charged with market regulation functions. Applying Commission regulation § 1.64(b)(1) has created an unintentional consequence of allowing SEFs to compose their boards of directors with ''insiders.'' SEFs with no independent voice on the board, either through inclusion of public directors or other non-affiliated directors, have been able to meet the requirements of Commission regulation § 1.64(b)(1). For example, if an executive was seconded to the SEF from an affiliate (therefore, not a ''salaried employee''), and only spent a fraction of their time performing services for the SEF (therefore, not ''primarily performing services'' for the SEF), the executive could arguably be deemed to satisfy the ''non-member'' requirement of Commission regulation § 1.64(b)(1). Under the current DCM Core Principle 16 Acceptable Practices, however, the executive would not likely be considered a public director and therefore, to meet the acceptable practices, could not be included as a director that satisfies the board composition standards.

The Commission continues to believe that the practice of including in the board of directors at least 35 percent public directors, as reflected in the DCM Core Principle 16 Acceptable Practices, is appropriate for DCMs, and that it is also is appropriate for SEFs. In reaching this conclusion, the Commission has considered the board composition requirements applicable to publicly-traded companies, which require that a majority of the board of directors must be ''independent'' directors.[187] However, the goal of this higher threshold, which is to protect shareholders of publicly-traded companies through boards of directors that are sufficiently independent from

[179] *See* 2007 Final Release, 72 FR 6936 at 6947 (stating that the public interest will be furthered if the boards and executive committees of all DCMs are at least 35% public. Such boards and committees will gain an independent perspective that is best provided by directors with no current industry ties or other relationships which may pose a conflict of interest. These public directors, representing over one-third of their boards, will approach their responsibilities without the conflicting demands faced by industry insiders. They will be free to consider both the needs of the DCM and of its regulatory mission, and may best appreciate the manner in which vigorous, impartial, and effective self-regulation will serve the interests of the DCM and the public at large. Furthermore, boards of directors that are at least 35% public will help to promote widespread confidence in the integrity of U.S. futures markets and self-regulation).

[180] *See* 2007 Final Release, 72 FR 6936.

[181] Donald C. Langevoort, Cultures of Compliance, 54 a.m. CRIM. L. REV. 933, 946–947 (2017); Group of Thirty, Banking Conduct and Culture, A Call for Sustained and Comprehensive Reform, Washington, DC, July 2015; The Role of the Board of Directors and Senior Management in Enterprise Risk Management, by Bruce C. Branson, Chapter 4, Enterprise Risk Management: Today's Leading Research and Best Practices for Tomorrow's Executives, 2nd Edition, edited by John R. S. Fraser, Rob Quail, Betty Simkins, Copyright 2021 John Wiley & Sons; *See also* comments from former SEC Chair Mary Jo White, to the Stanford University Rock Center for Corporate Governance, June 23, 2014, *https://www.sec.gov/news/speech/2014-spch062314mjw* (accessed June 24, 2023) (''It is up to directors, along with senior management under the purview of the board, to set the all-important ''tone at the top'' [regarding compliance with federal securities laws] for the entire company.'').

[182] Part 38, Appendix B, Core Principle 16 Acceptable Practices (b)(1).

[183] 2007 Final Release, 72 FR 6936 at 6946–6947.

[184] Commission regulation § 1.64(b)(1) requires that twenty percent of the board of directors must be persons who are (1) knowledgeable of futures trading or financial regulation or otherwise capable of contributing to governing board deliberations; and (2) not members of the SEF, not currently salaried employees of the SEF, not primarily performing services for the SEF, and not officers, principals or employees of a member firm.

[185] Final Rule and Rule Amendments Concerning Composition of Various Self-Regulatory Organization Governing Boards and Major Disciplinary Committees, 58 FR 37644 at 37646 (July 13, 1993).

[186] *Id.* at 37647.

[187] NYSE American Company Guide Rule 802; Nasdaq Rule 5605(b).

management, is not entirely the same as the Commission's concern at hand.

The Commission's primary goal with respect to Core Principle 16 is to ensure that the commercial interests of SEFs and DCMs and of its constituencies do not compromise market regulation functions. Accordingly, the Commission recognizes the need to have individuals on the board of directors with sufficient background and expertise to support the SEF's or DCM's market functions. The Commission, however, also is cognizant of the importance of having individuals with sufficient independent perspectives on the board of directors to ensure that the SEF or DCM can properly manage conflicts in its decision-making. Indeed, publicly-traded companies are moving towards requiring that a majority of the board of directors must be independent directors. However, the Commission believes that imposing a majority threshold in all circumstances may deny SEFs and DCMs the flexibility necessary to ensure that the board of directors includes individuals with adequate market expertise. The Commission is currently unaware of any circumstances that would support requiring public directors to constitute a majority of the board of directors of every SEF or DCM. Therefore, the Commission is proposing a bright-line threshold that would balance the need to ensure proper representation of impartial views with the need for market expertise. In doing so, the Commission recognizes that SEF and DCM boards of directors may vary in size. However, based on the Commission's observation of existing SEFs and DCMs, the Commission believes that a minimum threshold of 35 percent public directors would lead to at least two public directors on most SEF and DCM boards of directors. At the same time, the proposal would allow SEFs and DCMs the discretion to establish a higher threshold.

The Commission requests comment on all aspects of the proposed 35 percent public director board composition requirements, including comments on the specific questions listed below in this section.

3. Proposed Rules

The Commission proposes to enhance the existing board composition standards for both SEFs and DCMs by: (1) codifying in proposed § 38.854(a)(1) the practice under the DCM Core Principle 16 Acceptable Practices that DCM boards of directors be composed of at least 35 percent ''public directors;'' [188] (2) extending this requirement to SEF boards of directors under proposed § 37.1204(a)(1); [189] and (3) adopting additional requirements to increase transparency and accountability of the board of directors. The Commission believes that in addressing these board of director composition requirements in proposed § 37.1204, it is necessary to amend Commission regulation § 37.2 to exempt SEFs from Commission regulation § 1.64, including the board of directors composition requirements under Commission regulation § 1.64(b)(1).

In addition to proposing board of director composition requirements, the Commission proposes the substantive requirements set forth below, which aim to enhance transparency and the accountability of the SEF and DCM board of directors regarding the manner in which such board of directors causes the SEF or DCM to discharge all statutory, regulatory, or self-regulatory responsibilities under the CEA, including the market regulation functions.

- A SEF or DCM must establish and enforce policies and procedures outlining the roles and responsibilities of the board of directors, including the manner in which the board of directors oversees compliance with all statutory, regulatory, and self-regulatory responsibilities under the CEA and the regulations promulgated thereunder.[190]
- A SEF or DCM must have procedures to remove a member from the board of directors, where the conduct of such member is likely to be prejudicial to the sound and prudent management of the SEF or DCM.[191]
- A SEF or DCM must notify the Commission within five business days of any changes to the membership of the board of directors or its committees.[192]

Given the complex nature of the SEF and DCM marketplace, their role as self-regulators over their markets, and the overall impact of such exchanges on the integrity, resilience, and vibrancy of U.S. derivatives and financial markets, the Commission proposes in §§ 37.1204(b) and 38.854(b) to require that each member of a SEF or DCM board of directors have relevant expertise to fulfill the roles and responsibilities of their position. The Commission believes that experience in financial services, risk management, and financial regulation are examples of relevant expertise.

The Commission proposes §§ 37.1204(c) and 38.854(c) to prohibit linking the compensation of public directors and other non-executive members of the board of directors to the business performance of the SEF or DCM, or any affiliate of the SEF or DCM. The Commission believes prohibiting compensation in this manner would help enable non-executive directors to remain independent and focused on making objective decisions for the SEF or DCM. The Commission further believes it is necessary to capture all compensation—from either the SEF or the DCM or an affiliate—that a public director or non-executive member of the board could receive. Whether a specific compensation arrangement is ''directly dependent on the business performance'' of the SEF or DCM, or its affiliates, as contemplated under proposed §§ 37.1204(c) and 38.854(c), would depend on specific facts and circumstances. The Commission understands that it may be industry practice to include some form of nominal equity in a compensation package. The Commission does not consider nominal equity ownership interest, in and of itself, to be compensation that is ''directly dependent on the business performance'' of the SEF or DCM or its affiliates. However, the Commission considers any equity ownership interest in a SEF or DCM or its affiliates that is more than nominal to be compensation that is ''directly dependent on the business performance'' of the SEF or DCM or its affiliates. In addition, the Commission believes that providing bonuses based on specific sales or customer acquisition targets would constitute compensation that is ''directly dependent on the business performance'' of the SEF or DCM or its affiliates. Finally, any equity ownership included as a component of public director compensation that reasonably could be viewed as being substantial enough to potentially compromise the impartiality of a public director would not be considered nominal.

Proposed §§ 37.1204(d) and 38.854(d) require SEFs' and DCMs' board of directors to conduct an annual self-assessment to review their performance. The Commission believes that such self-assessments will encourage boards of directors to reflect on their performance and will enhance their accountability to the Commission regarding the manner in which such board of directors causes the SEF or DCM to discharge all statutory, regulatory, and self-regulatory responsibilities under the CEA, including market regulation functions. For example, Commission staff may request to see the results of the self-

[188] Proposed § 38.854(a)(1).

[189] Proposed § 37.1204(a)(1).

[190] Proposed §§ 37.1204(a)(2) and 38.854(a)(2).

[191] Proposed §§ 37.1204(e) and 38.854(e).

[192] Proposed §§ 37.1204(f) and 38.854(f).

assessment during a rule enforcement review of the SEF or DCM. The Commission notes that many SEF and DCM boards of directors already conduct self-assessments, and that this proposal provides significant discretion to SEFs and DCMs to determine how best to implement such an assessment. The Commission believes that SEFs and DCMs should consider including the following in the self-assessment: (1) observations relating to the flow of information provided to the board of directors; (2) the effects of any changes to the board composition, succession planning and human capital management; (3) potential improvement to the SEF's or DCM's governance structure; and (4) any other information or analysis that would improve the board's ability to perform its duties and responsibilities.

4. Questions for Comment

The Commission requests comment on all aspects of the proposed board composition requirements. The Commission further requests comment on the questions set forth below.

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?

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

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

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

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?

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

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

1. Background

Public directors can be a valuable governance tool for organizations, including SEFs and DCMs. As ''outsiders,'' public directors are in a unique position to bring an unbiased perspective. Their objectivity and independence may enhance the accountability of the board of directors and lend credibility to the organization, its leaders, and its governance arrangements. Since public directors do not have a material relationship with the SEF or DCM, the Commission believes they are well-suited to balance the commercial interests of the SEF or DCM and its regulatory obligations, including its market regulation functions.

2. Existing Regulatory Framework

The current ''public director'' definition found in the DCM Core Principle 16 Acceptable Practices provides for the DCM's board of directors to determine, on the record, that the director has no ''material relationship'' with the DCM (the ''overarching materiality test'').[193] A ''material relationship'' is ''one that reasonably could affect the independent judgment or decision-making of the director.'' Additionally, the public director definition contains a list of per se material relationships (the ''bright-line disqualifiers'') that disqualify service as a public director if: (1) such director is an officer or an employee of the DCM or an officer or an employee of its affiliate; (2) such director is a member of the DCM; (3) such director, or a firm in which the director is an officer, director, or partner, receives more than $100,000 in aggregate annual payments [194] for legal, accounting, or consulting services from the DCM, or an affiliate of the DCM.[195] Such list is neither exclusive nor exhaustive; even if the bright-line disqualifiers are not triggered, each public director nominee must satisfy the overarching materiality test. Additionally, the bright-line disqualifiers apply to a member of the director's ''immediate family,'' which includes spouse, parents, children and siblings.[196] Both the overarching materiality test and the bright-line disqualifiers are subject to a one-year look-back period.[197] The public director definition in the DCM Core Principle 16 Acceptable Practices provides that a DCM's public directors may also serve as directors of the DCM's affiliate, so long as they satisfy the requirements of the public director definition.[198] Finally, a DCM is obligated to disclose to the Commission which members of its board of directors are public directors, and the basis for those determinations.[199]

3. Proposed Rules

The Commission proposes to adopt in §§ 37.1201(b)(12) and 38.851(b)(12) a public director definition, similar to the definition in the DCM Core Principle 16 Acceptable Practices, for SEFs and DCMs, respectively. The Commission believes that SEFs and DCMs must have a board of directors that includes sufficient representation of independent perspective through public directors. The Commission believes that, in determining whether an individual qualifies as a public director, it must be considered whether there are any specific interests that would affect the individual's decision-making. In the Commission's experience, through its routine oversight of SEFs and DCMs, a ''material relationship'' that is based on certain personal or professional interests or financial incentives, could affect an individual's decision-making.

While Commission regulation § 1.64 seeks to address the conflict of interest that was prevalent when SROs were member-owned—*i.e.,* that governing boards would have an exclusively member perspective [200]—this is no longer the predominant concern for existing SEFs and DCMs. In a demutualized exchange environment, the conflicts between commercial interests and market regulation functions are exacerbated. The Commission believes that the higher standard created by the proposed public director definition is reasonably necessary to ensure an independent perspective in a demutualized exchange environment. Commission staff has identified, through its oversight of SEFs, that some SEFs have voluntarily adopted board composition requirements that reflect the DCM Core Principle 16 Acceptable Practices public director definition.

The Commission proposes to codify the existing DCM Core Principle 16 Acceptable Practices public director definition for both SEFs and DCMs, with some modifications. First, the proposed definition would amend the bright-line disqualifier that applies to a director receiving more than $100,000

[193] Part 38, Appendix B, Core Principle 16 Acceptable Practices (b)(2)(i).

[194] However, compensation for services as a director of the DCM or as a director of an affiliate of the DCM does not count toward the $100,000 payment limit, nor does deferred compensation for services prior to becoming a director, so long as such compensation is in no way contingent, conditioned, or revocable.

[195] Part 38, Appendix B, Core Principle 16 Acceptable Practices (b)(2)(ii).

[196] Part 38, Appendix B, Core Principle 16 Acceptable Practices (b)(2)(ii)(D).

[197] Part 38, Appendix B, Core Principle 16 Acceptable Practices (b)(2)(iii).

[198] Part 38, Appendix B, Core Principle 16 Acceptable Practices (b)(2)(iv).

[199] Part 38, Appendix B, Core Principle 16 Acceptable Practices (b)(2)(v).

[200] 58 FR 37644 at 37647.

in aggregate annual payments to remove the reference ''for legal, accounting, or consulting services'' from the SEF or DCM, or an affiliate of the SEF or DCM. The bright-line disqualifier would now limit receiving any payments in excess of $100,000 for any purpose. The proposed rule also would amend this bright-line disqualifier to apply to situations where a director is an employee of a firm receiving such payments.

Second, the proposed rule expands the bright-line disqualifier that applies to a situation where a director is a member of the SEF or DCM or a director, an officer of a member, to also apply where: (1) such director is an employee of a member of the SEF or DCM; and (2) extends the disqualification to apply to the prospective director's relationships, as a director, officer or employee, with an affiliate of a member of the SEF or DCM. Third, the Commission proposes expanding the scope of the bright-line disqualifiers to account for relationships that the director may have with an affiliate of the SEF or DCM or an affiliate of a member of the SEF or DCM.

Fourth, the Commission proposes to establish a new bright-line disqualifier that would prohibit an individual who, directly or indirectly, owns more than 10 percent of the SEF or DCM or an affiliate of the swap execution facility, or is an officer or employee of an entity that directly or indirectly owns more than 10 percent of the swap execution facility, from serving as a public director.

Fifth, the proposed public director definition replaces the term ''immediate family'' and expands the bright-line disqualifiers to apply to any person with whom the director has a ''family relationship,'' as set forth in proposed §§ 37.1201(b)(7) and 38.851(b)(7). Finally, the proposed definition includes a new requirement to clarify that the public director determination must be made ''upon the nomination or appointment of the director and at least on an annual basis thereafter.'' Consistent with the proposed fitness requirements in proposed §§ 37.1201(b)(12) and 38.851(b)(12), the Commission believes all determinations with respect to the public director status of members of the board of directors should be completed upon their nomination to the board of directors—*i.e.,* prior to their appointment. Further, Commission staff's oversight has revealed that not all DCMs were diligently reviewing their public director determinations for existing directors on an annual basis.

The Commission believes that the above-mentioned amendments to the public director definition are necessary to capture the full scope of the relationships that could affect a prospective director's ability to bring an independent perspective to the decision-making of a SEF or DCM. Eliminating ''legal, accounting, or consulting service'' from the bright-line disqualifier that applies to payments in excess of $100,000 is necessary, as the provision of other services could also be ''material'' for purposes of establishing whether an individual qualifies as a public director. The Commission also proposes to expand the bright-line disqualifiers to certain relationships in which the director is an employee of: (1) a member of a SEF or DCM or its affiliate; and (2) an entity that receives more than $100,000 in aggregate annual payments from the SEF or DCM or its affiliate. In these situations, the Commission believes the ties between the outside entity and the SEF or DCM are close enough to impact the actual or perceived ability of the prospective director to bring an independent perspective. Furthermore, the Commission notes that such employees would likely be restricted from serving as public directors under the overarching materiality test. Similarly, the Commission is also expanding the bright-line disqualifier to include certain relationships with affiliates. The Commission has found, as detailed above, as market structures have evolved, growing interconnectedness between SEFs, DCMs, and their affiliates. This relationship between a SEF or DCM and its affiliates—and by extension, their employees and officers—creates, in the Commission's view, a ''material relationship.'' Finally, although the 10 percent ownership bright-line disqualifier would be new, the Commission believes that an individual with an ownership interest greater than 10 percent would not currently qualify as a public director under the overarching materiality test. A 10 percent ownership of a SEF or DCM is significant enough to call into question, whether in actuality or perception, a public director's ability to act in an impartial manner to ensure business concerns do not impact market regulation functions.

4. Questions for Comment

The Commission requests comment on all aspects of the proposed public director definition. The Commission further requests comment on the questions set forth below.

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?

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?

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?

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

1. Background

As described herein,[201] the structural governance requirements applicable to boards of directors of SEFs and DCMs aim to mitigate conflicts of interest through the representation of independent perspectives. Public director composition requirements alone may not be sufficient to ensure the representation of such independent perspective. Commission staff's routine oversight has found that many SEFs and DCMs do not currently have formal policies or procedures for identifying potential members of the board of directors, and instead rely entirely on the personal networks of members of their boards of directors or executives. The Commission believes that an independent perspective on the SEF or DCM board of directors is necessary to mitigate conflicts of interest. Lack of policies or procedures for identifying potential members of the board of directors may result in delays in the appointment process.

2. Existing Regulatory Framework

DCM Core Principle 17 requires the governance arrangements of a board of directors of a DCM to permit consideration of the views of market participants. Similarly, pursuant to Commission regulation § 1.64(b)(3), members of self-regulatory organization governing boards, including SEF governing boards, must include a diversity of membership interests. However, neither DCMs nor SEFs are currently obligated by Commission regulations to have a nominating committee to identify or manage the process for nominating potential members of the board of directors.

To help protect the integrity of the process by which a SEF or DCM selects members of its board of directors, the Commission proposes requiring each

[201] *See* Section V(a) herein; Proposed §§ 37.1204 and 38.854.

SEF or DCM to have a nominating committee. The role of the nominating committee would be to: (1) identify a diverse pool of individuals qualified to serve on the board of directors, consistent with Commission regulations; and (2) administer a process for the nomination of individuals to the board of directors.

3. Proposed Rules

Proposed §§ 37.1205 and 38.855 would require a nominating committee to identify a pool of candidates who are qualified and represent diverse interests, including the interests of the participants and members of the SEF or DCM. Thus, proposed §§ 37.1205 and 38.855 incorporate, and expand upon, the diversity of membership requirements found in Commission regulation § 1.64, and, with respect to DCMs, are consistent with DCM Core Principle 17, and reasonably necessary to advance DCM Core Principle 16. Accordingly, the Commission proposes conforming amendments to Commission regulation § 37.2 to exempt SEFs from Commission regulation § 1.64.

Proposed §§ 37.1205 and 38.855 would require that public directors comprise at least 51 percent of the nominating committee, that a public director chair the nominating committee, and that the nominating committee report directly to the board of directors. The Commission proposes that the nominating committee be at least 51 percent public directors to limit the influence of non-public directors that are already involved in the governance and management of a SEF or DCM, and to help ensure a broader pool of candidates for consideration, in turn promoting diversity and independent perspectives in the governing bodies of SEFs and DCMs. The nominating committee takes the first steps in identifying the pool of future members of the board of directors, and a broad pool of candidates is critical to maintaining independent perspectives on the board of directors. Therefore, the Commission is proposing that public directors should represent a majority of members of the nominating committee.

Proposed §§ 37.1205 and 38.855 also would require the nominating committee to administer a process for nominating individuals to the board of directors. This process must be adopted prior to registration as a SEF or designation as a DCM. Similarly, boards of directors must be appointed prior to registration or designation. However, as set out in proposed §§ 37.1205(b) and 38.855(b) the initial members of the board of directors serving upon registration or designation would not be required to be appointed by the nominating committee.

4. Questions for Comment

The Commission requests comment on all aspects of the proposed nominating committee requirements.

d. Regulatory Oversight Committee—Proposed §§ 37.1206 and 38.857

1. Background

SEFs and DCMs are faced with commercial pressures to remain competitive in an industry where business models, trading practices, and products are rapidly evolving. As business enterprises, SEFs and DCMs are also tasked with maximizing shareholder value, generating profits, and satisfying the diverse needs of their constituencies. SEFs and DCMs, therefore, may face conflicts between their commercial interests and their market regulation obligations.

Other competing demands may unduly influence a SEF's or DCM's market regulation functions, such as the interests of their ownership, management, market participants, membership, customers, and other constituencies. Externally, SEFs and DCMs may find themselves conflicted with affiliated entities—including affiliated entities that are directly or indirectly trading on or subject to the rules of the SEF or DCM, affiliated entities that are in possession of data acquired by or generated from the SEF or DCM, and affiliated entities to whom SEF or DCM employees owe duties based on participating in the functions of both the affiliated entities and the SEF or DCM. The Commission published the ROC component of the DCM Core Principle 16 Acceptable Practices in 2007 to minimize these conflicts by helping to insulate core regulatory functions from improper influences and pressures.[202] In the Commission's experience, ROCs can serve one of the most critical elements of a DCM's governance structure for mitigating conflicts of interests.

2. Existing Regulatory Framework

In proposing requirements for SEF and DCM ROCs, the Commission is largely codifying language found in the ROC component of the DCM Core Principle 16 Acceptable Practices.[203] Currently, to demonstrate compliance under the acceptable practices, a DCM must establish a ROC, consisting of only public directors, to assist it in minimizing actual and potential conflicts of interest.[204] A ROC is a standing committee of the board of directors.[205] The purpose of the ROC is to oversee the DCM's regulatory program on behalf of the board of directors, which in turn delegates sufficient authority, dedicates sufficient resources, and allows sufficient time for the ROC to fulfill its mandate.[206] The Acceptable Practices for DCM Core Principle 16 describe a ROC that is responsible for the following: (1) monitoring the DCM's regulatory program for sufficiency, effectiveness, and independence; (2) overseeing all facets of the program;[207] (3) reviewing the size and allocation of the regulatory budget and resources; and the number, hiring and termination, and compensation of regulatory personnel; (4) supervising the DCM's CRO, who will report directly to the ROC; (5) preparing an annual report assessing the DCM's self-regulatory program for the board of directors and the Commission; (6) recommending changes that would ensure fair, vigorous, and effective regulation; and (7) reviewing regulatory proposals and advising the board of directors as to whether and how such changes may impact regulation.[208] In performing these functions, the ROC plays a critical role in insulating the CRO and the DCM's self-regulatory function from undue influence that may exert pressure over the CRO to put a DCM's commercial interests ahead of its market regulation functions. The ROC's is specifically tasked with oversight of a SEF's or DCM's market regulation functions. Conversely, while the interests of the ROC and a DCM's CRO or a SEF's CCO are aligned, only the ROC carries with it the authority granted by the board of directors. Accordingly, the ROC, along with the board of directors and CCO or CRO, are all integral components of a SEF's or DCM's conflicts of interest framework.

Given that SEFs and DCMs face similar pressures that may conflict with their market regulation functions—such as trade practice surveillance, market surveillance, real-time market monitoring, audit trail enforcement, investigations of possible rule violations, and disciplinary actions—the

[202] 2007 Final Release, 72 FR 6936 at 6940.

[203] Part 38, Appendix B, Core Principle 16 Acceptable Practices.

[204] Part 38, Appendix B, Core Principle 16 Acceptable Practices (b)(3)(i).

[205] *Id.*

[206] *Id.*

[207] This includes including trade practice and market surveillance; audits, examinations, and other regulatory responsibilities with respect to member firms (including ensuring compliance with financial integrity, financial reporting, sales practice, recordkeeping, and other requirements); and the conduct of investigations.

[208] Part 38, Appendix B, Core Principle 16 Acceptable Practices (b)(3)(ii).

Commission believes that SEFs and DCMs would benefit from the protections that are offered by a ROC.

3. Proposed Rules

i. Codifying DCM Core Principle 16 ROC Acceptable Practices

Accordingly, the Commission proposes to require in § 38.857(a) that DCMs must have a ROC composed of only public directors. Commission staff has found, through its general oversight of DCMs, that existing DCM ROCs are effective in providing structural governance protections that help DCMs to minimize conflicts of interest. For example, in their role as members of the ROC, these public directors are not tasked with making decisions on commercial matters or other interests of the SEF or DCM that may conflict with market regulation functions. Accordingly, Commission staff has found that ROC members have provided DCM CROs a ''safe space'' to raise concerns and have advocated, when appropriate, for the CRO and the market regulation functions.

Second, the Commission proposes in § 37.1206(a) to include a ROC requirement for SEFs, which, like DCMs, also perform market regulation functions. Through its experience with SEF registrations, routine communications with SEFs, and regulatory consultations, Commission staff has found that some SEFs established ROCs that included non-public directors and SEF executives (or executives of SEF affiliates). As a result, a committee intended to insulate the market regulation function from commercial interests had its own potential conflicts of interest. Accordingly, the Commission proposes to include in § 37.1206(a), just as it is proposing to include in § 38.857(a), a requirement that SEFs have a ROC composed only of public directors.

Under proposed §§ 37.1206(d) and 38.857(d), both SEF and DCM ROCs would generally have identical oversight duties over market regulation functions, including: (1) monitoring the SEF's or DCM's market regulation functions for sufficiency, effectiveness, and independence; (2) overseeing all facets of the market regulation functions; [209] (3) approving the size and allocation of the regulatory budget and resources; and the number, hiring and termination, and compensation of staff required pursuant to §§ 37.203(c) and 38.155(a); (4) recommending changes that would promote fair, vigorous, and effective self-regulation; and (5) reviewing all regulatory proposals prior to implementation and advising the board of directors as to whether and how such proposals may impact market regulation functions.[210]

The Commission recognizes that SEFs are also subject to a statutory core principle requirement (SEF Core Principle 15) to designate a CCO to monitor the SEF's adherence to statutory, regulatory, and self-regulatory requirements and to resolve conflicts of interest that may impede such adherence.[211] Additionally, the CCO must report to the SEF board of directors (or similar governing body) or the senior SEF officer.[212] To account for the standing CCO requirements and to integrate the addition of a ROC, the Commission envisions the CCO continuing their duties to supervise the SEF's self-regulatory program,[213] as well as making recommendations in consultation with the ROC (in the event a conflict of interest involving the CCO exists).[214] As further discussed below,[215] the Commission believes involving the ROC in such matters will help to ensure that the CCO remains insulated from undue pressures and that conflicts of interest are appropriately managed.

To ensure that the ROC can fulfill its mandate, proposed §§ 37.1206(c) and 38.857(c) require that the board of directors delegate sufficient authority, dedicate sufficient resources, and allow sufficient time for the ROC to perform its functions. The Commission has previously stated that the ROC should have the authority, discretion and necessary resources to conduct its own inquiries; consult directly with regulatory staff; interview employees, officers, members, and others; review relevant documents; retain independent legal counsel, auditors, and other professional services; and otherwise exercise its independent analysis and judgment to fulfill its regulatory obligations.'' [216]

ii. Additional Proposed Requirements To Enhance SEF and DCM ROCs

In addition to codifying the existing DCM ROC acceptable practices for both SEFs and DCMs, the Commission proposes enhancing the ROC requirements with best practices Commission staff has identified through the course of its routine oversight. Commission staff has found that DCMs have substantial differences in their implementation of ROC administrative and procedural standards. For example, some DCMs have limited individuals other than ROC members or DCM staff performing market regulation functions from attending the ROC meetings, while others have allowed DCM executives and non-ROC members of the board of directors to attend. The Commission believes the former practice is preferable as the latter practice invites to ROC meetings the very conflicts of interest that the establishment of a ROC is intended to address. Accordingly, as discussed below, the Commission is proposing certain requirements related to ROC procedures, meetings, and documentation to help ensure that the manner in which SEFs and DCMs structure and administer their ROCs does not give rise to conflicts of interest.

In the DCM Core Principle 15 Release, the Commission stressed that ROCs conduct oversight and review, and are not intended to assume managerial responsibilities or to perform direct compliance work.[217] Accordingly, the Commission is not proposing to adopt the existing component of the Acceptable Practices for DCM Core Principle 16 addressing the ROC's supervision of the DCM CRO. As further discussed in proposed § 38.856,[218] proposed § 38.856(b)(1) would require the CRO to report to the board or senior officer of the DCM.[219] Similar to other employees and executives at SEFs and DCMs, the Commission expects that CCOs and CROs, respectively, would report up to a senior officer for

[209] The Commission is proposing a more simplified version of the ROC's current duties to oversee all facets of the regulatory program, including trade practice and market surveillance; audits, examinations, and other regulatory responsibilities with respect to member firms (including ensuring compliance with financial integrity, financial reporting, sales practice, recordkeeping, and other requirements); and the conduct of investigations.

[210] This includes, for example, proposed rules, and business initiatives, etc.

[211] *See* CEA section 5h(f)(15); 7 U.S.C. 7b–3(f)(15).

[212] *See* CEA section 5h(f)(15)(B)(i); 7 U.S.C. 7b–3(f)(15)(B)(i).

[213] See Commission regulation § 37.1501(c)(7), which requires the CCO to supervise the SEF's self-regulatory program with respect to trade practice surveillance, market surveillance, real-time market monitoring, compliance with audit trail requirements, enforcement and disciplinary proceedings, audits, examinations, and other regulatory responsibilities with respect to members and market participants (including ensuring compliance with, if applicable, financial integrity, financial reporting, sales practice, recordkeeping, and other requirements). Part 37 Final Rule, 78 FR 33476.

[214] Proposed § 37.1501(c).

[215] *See* Section V(h)(3) herein.

[216] See DCM Core Principle 15 Release, 71 FR 38740 at 38744–45, as it relates to the DCM acceptable practices in Appendix B to part 38.

[217] *See* 2007 Final Release, 72 FR 6936 at 6950.

[218] *See* Section V(f) herein.

[219] The Commission is using the term ''report to'' in proposed § 38.856(b) instead of the concept of supervision used in the DCM CP 16 Acceptable Practices because a board of directors, as an entity, cannot ''supervise'' a person.

managerial and administrative matters. The Commission believes this approach allows the ROC to focus its resources on its core responsibilities related to overseeing a SEF's or DCM's market regulation functions. Finally, the ROC will be involved in matters related to the appointment, removal and compensation of the SEF CCO or DCM CRO, under proposed §§ 37.1501(a)(4) and (5) and 38.856(c) and (d), respectively.

Based on Commission staff's routine oversight of SEFs and DCMs, the Commission's experience is that the ROC has served a crucial role in the management of conflicts of interest. As a board-of-directors-level committee of public directors, the Commission believes the ROC is well-positioned to manage conflicts that may impact market regulation functions. The conflicts of interest with which the Commission envisions the ROC's involvement are not merely potential or hypothetical. The Commission's oversight of SEFs and DCMs has identified instances involving actual conflicts of interest impacting market regulation functions which were adequately managed and addressed only when the SEF or DCM had a strong governance structure and sound conflicts of interest policies and procedures. Accordingly, the Commission is including in the duties in proposed §§ 37.1206(d) and 38.857(d) that the ROC, a standing committee of the board of directors, is charged with consulting with the SEF CCO or DCM CRO with identifying, minimizing and resolving any actual or potential conflicts of interest involving market regulation functions.

Proposed §§ 37.1206(e) and 38.857(e) require the ROC to periodically report to the board of directors. The Commission expects that this reporting would occur, for example, in regularly scheduled board of director meetings.

The Commission is also proposing several requirements related to procedures and documentation for ROC meetings. The Commission believes these requirements reflect best practices that certain DCMs already implement. Proposed §§ 37.1206(f) and 38.857(f) address ROC meetings and communications. Both SEF and DCM ROCs would be required to meet quarterly. These meetings may include CROs or CCOs and will allow the ROC to share information, discuss matters of mutual concern, and speak freely about potentially sensitive issues that may relate to the SEF's or DCM's management. To facilitate this open line of communication, the proposed rules prohibit, except for the limited circumstances referenced below, any individuals with actual or potential conflicts of interest from attending ROC meetings.

The Commission recognizes, however, that there may be limited circumstances in which it would be appropriate for individuals outside of the ROC–including business executives or employees whose interest may conflict in certain respects with the ROC's market regulation functions—to attend portions of ROC meetings. In particular, if a business executive or non-market-employee had a legitimate need [220] to attend a portion of a ROC meeting, the Commission's preliminary view is that it would not be inappropriate for the ROC to elect to allow these individuals to attend such portion of the meeting. However, the Commission preliminarily believes these individuals should not attend any portion of the ROC meeting outside of the discussion of their business. These individuals should not be present, in any capacity, during discussions of the SEF's or DCM's market regulation functions, such as surveillance, investigation, or enforcement work.

To account for these circumstances, the Commission proposes in §§ 37.1206(f)(1)(iii) and 38.857(f)(1)(iii) that the following information must be included in ROC meeting minutes: (a) list of the attendees; (b) their titles; (c) whether they were present for the entirety of the meeting or a portion thereof (and if so, what portion); and (d) a summary of all meeting discussions. Finally, proposed §§ 37.1206(f)(2) and 38.857(f)(2) would require the ROC to maintain documentation of the committee's findings, recommendations, deliberations, or other communications related to the performance of its duties. If SEFs and DCMs make their ROC meeting minutes available for distribution, including to the board of directors or another committee, the Commission believes any information relating to the SEF's or DCM's market regulation functions, including surveillance, investigations, and pending enforcement actions should be redacted to avoid any undue influence on these market regulation functions.

Finally, the Commission proposes to codify for both SEFs and DCMs, and to enhance, the existing annual report component of the ROC duties under the Acceptable Practices for DCM Core Principle 16.[221] These acceptable practices contemplate that the ROC, as part of its duties, will prepare an annual report assessing the DCM's self-regulatory program for the board of directors and for the Commission, which sets forth the regulatory program's expenses, describes its staffing and structure, catalogues disciplinary actions taken during the year, and reviews the performance of disciplinary committees and panels. In addition to codifying and enhancing this as an annual report requirement, in proposed §§ 37.1206(g)(1) and 38.857(g)(1), the Commission proposes requiring ROC annual reports to contain a list of any actual or potential conflicts of interest that were reported to the ROC, including a description of how such conflicts of interest were managed and resolved and an assessment of the impact of any conflicts of interest on the SEF's or DCM's ability to perform its market regulation functions, as well as requiring disclosure of details relating to all actions taken by the board of directors pursuant to recommendations of the ROC.

The Commission also proposes in §§ 37.1206(g)(2) and 38.857(g)(2) new SEF and DCM rules addressing filing requirements for the ROC annual report. The procedural requirements would mirror the SEF annual compliance report requirements [222] including specifying a filing deadline no later than 90 days after the end of the SEF's or DCM's fiscal year, establishing a process for report amendments and extension requests, recordkeeping requirements, and providing to the Division of Market Oversight delegated authority to grant or deny extensions. Finally, proposed §§ 37.1206(g)(3) and 38.857(g)(3) would establish a recordkeeping requirement for the SEF or DCM to maintain all records demonstrating compliance with the duties of the ROC and the preparation and submission of the annual report.

4. Questions for Comment

The Commission requests comment on all aspects of the proposed ROC requirements. The Commission further requests comment on the questions set forth below.

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[220] For example, to present new product launches or discuss personnel or policy changes unrelated to market regulation functions.

[221] The Commission recognizes that SEF CCOs also prepare an annual report; however, the ROC annual report will provide a critically important, independent perspective to assess the market regulation function, including the CCO. Additionally, the ROC annual report expressly requires disclosures of actual or potential conflicts of interest reported to the ROC and details of any instances of the board of directors rejecting the recommendations of the ROC, regardless of whether the same information would qualify as ''material non-compliance matters,'' subject to disclosure pursuant to § 37.1501(d)(4).

[222] *See* Commission regulation § 37.1501(d).

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?

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?

e. Disciplinary Panel Composition—Proposed §§ 37.1207 and 38.858

1. Background

As part of its market regulation function, each SEF and DCM must have a disciplinary program to discipline, suspend, or expel members or market participants that violate the SEF's or DCM's rules.[223] Disciplinary panels administer this program by conducting hearings, rendering decisions, and imposing sanctions with respect to disciplinary matters. The Commission believes that fair disciplinary procedures require SEF and DCM disciplinary panels to be: (1) independent of outside influences, (2) impartial, and (3) representative of a diversity of perspectives and experiences. Accordingly, the Commission is proposing rules implementing elements of the conflicts of interest obligations under DCM Core Principle 16 and SEF Core Principle 12 in order to promote and support these panel attributes.

2. Existing Regulatory Framework

Currently, the DCM Core Principle 16 Acceptable Practices provide that DCMs establish disciplinary panel composition rules that preclude any group or class of industry participants from dominating or exercising disproportionate influence on such panels.[224] Furthermore, the DCM Core Principle 16 Acceptable Practices provide for all disciplinary panels (and appellate bodies) to include at least one person who would qualify as a public director, except in cases limited to decorum, attire, or the timely submission of accurate records required for clearing or verifying each day's transactions.[225]

Commission regulation § 1.64(c), which applies to SEFs, requires each major disciplinary committee [226] or hearing panel to include: (1) at least one member who is not a member of the SEF; and (2) sufficient different membership interests so as to ensure fairness and to prevent special treatment or preference for any person in the conduct of a committee's or the panel's responsibility.

3. Proposed Rules

The Commission is proposing to adopt rules in proposed §§ 37.1207 and 38.858, respectively, that would codify, with certain enhancements, the DCM Core Principle 16 Acceptable Practices with respect to disciplinary panel composition. While the Commission believes that both the DCM Core Principle 16 Acceptable Practices and Commission regulation § 1.64(c) seek to promote fairness in the disciplinary process by introducing a diversity of interests to serve on disciplinary panels, the Commission believes that the DCM Core Principle 16 Acceptable Practices establish more appropriate practices for achieving fairness in today's SEF and DCM environments. For example, providing for a public participant on the disciplinary panel to be the chair introduces an independent perspective in a steering role that the Commission believes will enhance the overall fairness of the disciplinary process. The Commission believes that if SEFs are subject to rules that codify the DCM Core Principle 16 Acceptable Practices with respect to disciplinary panel composition, it would not be necessary for SEFs also to be subject to the requirements of Commission regulation § 1.64(c). As noted above in Section V(c)(3) herein, the Commission is also proposing to amend Commission regulation § 37.2 to exempt SEFs from Commission regulation § 1.64 in its entirety.

Proposed § 38.858(a)(1) would require that DCMs adopt rules to preclude any group or class of participants from dominating or exercising disproportionate influence on a disciplinary panel, and proposed § 37.1207(a)(1) would establish an analogous requirement for SEFs. Accordingly, the proposed rules would be consistent with the disciplinary panel component of the DCM Core Principle 16 Acceptable Practices. The Commission believes the proposed rules are reasonably necessary to promote impartial disciplinary panels, which are critical decision-makers in fulfilling a SEF's or DCM's market regulation functions.

The Commission is also proposing additional requirements to enhance the existing regulatory framework. First, the proposal would clarify in proposed §§ 37.1207(a) and (b) and 38.858(a) and (b) that SEFs' and DCMs' disciplinary panels and appellate panels must consist of two or more persons. The Commission believes a disciplinary panel must have more than one person in order to preclude any group or class of participants from dominating or exercising disproportionate influence, as currently contemplated under the DCM Core Principle 16 Acceptable Practices, and proposed in these rules. Second, proposed §§ 37.1207 and 38.858 would prohibit any member of a disciplinary panel from participating in deliberations or voting on any matter in which the member has an actual or potential conflict of interest, consistent with the general conflicts of interest provisions proposed in §§ 37.1202 and 38.852. Third, proposed §§ 37.1207(b) and 38.858(b) would extend the public participant requirement to any SEF and DCM committee to which disciplinary panel decisions may be appealed. Fourth, the Commission proposes technical amendments to Commission regulations §§ 37.206(b) and 38.702 to remove the references that disciplinary panels must meet the composition requirements of part 40,[227] and replace these references with references to the composition requirements of proposed regulations §§ 37.1207 and 38.858, respectively. The Commission also proposes changing the reference to ''compliance'' staff to ''market regulation'' staff. This is intended for clarity and is consistent with proposed changes to §§ 38.155(a) and 37.203(c).

4. Questions for Comment

The Commission requests comment on all aspects of the proposed disciplinary panel composition requirements. The Commission further requests comment on the questions set forth below.

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.

[223] CEA section 5(d)(13); 7 U.S.C. 7(d)(13); CEA section 5h(f)(2)(B); 7 U.S.C. 7b–3(f)(2)(B).

[224] Part 38, Appendix B, Core Principle 16 Acceptable Practices (b)(4).

[225] *Id.*

[226] Commission regulation § 1.64(a)(2) defines a ''Major disciplinary committee'' as a committee of persons who are authorized by a self-regulatory organization to conduct disciplinary hearings, to settle disciplinary charges, to impose disciplinary sanctions or to hear appeals thereof in cases involving any violation of the rules of the self-regulatory organization subject to certain exceptions.

[227] There are currently no composition requirements in part 40 of the Commission's regulations.

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

f. DCM Chief Regulatory Officer—Proposed § 38.856

1. Background

The Commission is proposing to codify current DCM practices regarding the CRO position. The DCM Core Principle 16 Acceptable Practices do not provide that DCMs have a CRO. However, Commission staff has found through its oversight activities that all DCMs either have a CRO, or an individual performing the same functions as a CRO. DCM CROs generally are responsible for administering a DCM's market regulation functions.

2. Existing Regulatory Framework

Although not expressly a component of the DCM Core Principle Acceptable Practices, the framework created under the DCM Core Principle 16 Acceptable Practices clearly envisioned the establishment of a CRO position. Specifically, supervising the ''the contract market's chief regulatory officer, who will report directly to the ROC'' is one of the ROCs enumerated duties.[228] In adopting the DCM Core Principle 16 Acceptable Practices, the Commission emphasized that the relationship between the ROC and the CRO is a key element of the insulation and oversight provided by the ROC structure, and that, along with the board of directors, it is intended to protect regulatory functions and personnel, including the CRO, from improper influence in the daily conduct of regulatory activities and broader programmatic regulatory decisions.[229]

While the Commission did not explicitly require DCMs to appoint CROs as part of the DCM Final Rules, the Commission noted that current industry practice is for DCMs to designate an individual as chief regulatory officer, and it will be difficult for a DCM to meet the staffing and resource requirements of § 38.155 without a chief regulatory officer or similar individual to supervise its regulatory program, including any services rendered to the DCM by a regulatory service provider.[230]

3. Proposed Rules

Proposed § 38.856(a)(1) requires each DCM to establish the position of CRO and designate an individual to serve in that capacity and to administer the DCM's market regulation functions. The proposed rule further requires that (1) the position of CRO must carry with it the authority and resources necessary to fulfill the duties set forth for CROs; and (2) the CRO must have supervisory authority over all staff performing the DCM's market regulation functions. The Commission believes that the above-described requirements of the proposed rule would ensure that a CRO has authority over any staff and resources while they are acting in furtherance of the DCM's market regulation functions. Of course, any such employees are subject to the DCM's conflicts of interest policies and procedures that DCMs must establish and enforce pursuant to DCM Core Principle 16 and corresponding proposed regulations §§ 38.851 and 38.852.

Proposed § 38.856(a)(2) requires that the individual designated to serve as CRO must have the background and skills appropriate for fulfilling the duties of the position. The Commission notes that a DCM should identify the needs of its particular market regulation functions, and ensure that the CRO has the requisite surveillance and investigatory experience necessary to perform the CRO's role. In addition, proposed § 38.856(a)(2) would provide that no individual disqualified from registration pursuant to sections 8a(2) or 8a(3) of the CEA may serve as a CRO.

Proposed § 38.856(b) sets forth reporting line requirements for the CRO, providing that the CRO must report directly to the DCM's board of directors or to a senior officer. This is a change from the existing supervisory structure contemplated under the DCM Core Principle 16 Acceptable Practices, which provide for the ROC to supervise the CRO.[231] Commission staff has found, through its RERs and general DCM oversight activities, that most CROs, like other exchange executives, report to a senior officer for purposes of performance evaluations and approval of administrative requests. The ROC may not be the appropriate body for a CRO to report to, as the ROC might meet only on a quarterly basis. The DCM's senior officer represents the highest level of authority at the exchange, other than the board of directors or its committees. Consequently, the Commission believes that it would be appropriate for the CRO to report to the senior officer.

However, proposed § 38.856(b) should be interpreted in conjunction with proposed § 38.856(f), discussed below, which specifies, among other things, that a CRO must disclose actual or potential conflicts of interest to the ROC, and that a qualified person temporarily serve in place of the CRO for any matter in respect of which the CRO has such a conflict. A DCM's ROC would therefore be involved in minimizing any actual or potential conflicts of interest of the CRO, which would include conflicts of interest between the duties of the CRO and the DCM's commercial interests. As the Commission previously stated, the CRO–ROC relationship permits regulatory functions and personnel, including the CRO, to continue operating in an efficient manner while simultaneously protecting them from any improper influence which could otherwise be brought to bear upon them.[232] The DCM is responsible for establishing the reporting lines for the CRO to ensure that conflicts of interest are routed to the appropriate decision-makers.

Finally, the Commission notes generally that a CRO reporting structure in which the CRO has a direct line to the board of directors or the senior officer allows the CRO to more easily gain approval for any new policies related to the DCM's market regulation functions that the CRO needed to implement, to the extent that they required approval of a senior officer or the board of directors. Since DCM rule changes often need to be approved by the board of directors, having the CRO report to the board of directors or to the senior officer (who likely regularly communicates with the board) would allow the CRO to more easily explain the need for rule changes, and to answer questions from the board of directors or the senior officer about such changes.

Proposed § 38.856(c) provides the following CRO appointment and removal procedures: (1) the appointment or removal of a DCM's CRO must occur only with the approval of the DCM's ROC; (2) the DCM must notify the Commission within two business days of the appointment of any new CRO, whether interim or permanent; and (3) the DCM must notify the Commission within two business days of removal of the CRO. These procedures help ensure that the CRO is

[228] Part 38, Appendix B, Core Principle 16 Acceptable Practices (b)(3)(ii)(D).

[229] 2007 Final Release, 72 FR 6936 at 6951 n.80.

[230] The Commission understands that some DCMs use a slightly different title for their CRO position. For example, they may use the term Chief Compliance Officer, as opposed to Chief Regulatory Officer, but such position is the functional equivalent to the CRO role proposed herein.

[231] Part 38, Appendix B, Core Principle 16 Acceptable Practices (b)(3)(ii)(D). Additionally, the Commission is using the term ''report to'' in proposed § 38.856(b) instead of the concept of supervision used in the DCM CP 16 Acceptable Practices because a board of directors, as an entity, cannot ''supervise'' a person.

[232] 2007 Final Release, 72 FR 6936 at 6951 n.80.

properly insulated from undue influence, including commercial interests. For example, the requirement of ROC approval means that a senior officer of the DCM may not take unilateral action to replace the CRO if there is any dispute over the CRO's decisions or role in any market regulation function. In addition, the procedures requiring notification to the Commission ensure appropriate staff within the Commission are aware of who is fulfilling this key role and can initiate communications with the CRO as necessary. Moreover, the Commission will be aware if there is any lag in the appointment of a replacement CRO, and can take appropriate oversight action in such a scenario, as well.

Proposed § 38.856(d) provides that the board of directors or the senior officer of the DCM, in consultation with the DCM's ROC, must approve the compensation of the CRO. Involving the ROC in approving the compensation of the CRO further ensures that the CRO's role is insulated from improper influence or direction from the DCM's commercial interests. The Commission notes that while some portion of compensation may be in the form of equity, DCMs should avoid tying a CRO's salary to business performance in order to avoid potential conflicts of interest. The Commission believes the ROC is well-situated to determine whether specific compensation structures could raise potential conflicts of interest.

Proposed § 38.856(e) details the duties of the CRO, which include: (1) supervising the DCM's market regulation functions; (2) establishing and administering policies and procedures related to the DCM's market regulation functions; (3) supervising the effectiveness and sufficiency of any regulatory services provided to the DCM by a regulatory service provider in accordance with § 38.154; (4) reviewing any proposed rule or programmatic changes that may have a significant regulatory impact on the DCM's market regulation functions, and advising the ROC on such matters; and (5) in consultation with the DCM's ROC, identifying, minimizing, managing, and resolving conflicts of interest involving the DCM's market regulation functions.

The Commission views a CRO's role as being narrower than that of a CCO. As contemplated in these proposed rules, both CCOs and CROs would be required to have supervisory authority over certain staff,[233] and supervise the quality of regulatory services received, as applicable.[234] CCOs have additional responsibilities deriving from the statutory chief compliance officer core principle for SEFs, for which there is no DCM analogue. For example, CCOs are responsible for overall compliance of the SEF with section 5h of the CEA and related Commission rules,[235] for establishing and administering written policies to prevent violation of the CEA and Commission rules,[236] and for establishing procedures to address noncompliance issues identified through any means, such as look-back, internal or external audit findings, self-reported errors, or validated complaints.[237] The Commission understands that in some instances, CROs may take on these additional responsibilities, such as supervising the DCM's financial surveillance program under Core Principle 11 and associated Commission regulations.

Finally, and as discussed above, proposed § 38.856(f) provides that each DCM must establish procedures for the CRO's disclosure of actual or potential conflicts of interest to the ROC and designation of a qualified person to serve in the place of the CRO for any matter in respect of which the CRO has such a conflict, and documentation of such disclosure and designation.

4. Questions for Comment

The Commission requests comment on all aspects of the proposed CRO regulatory requirements. The Commission further requests comment on the questions set forth below.

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

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

g. Staffing and Investigations—Proposed Changes to §§ 38.155, 38.158, and 37.203

1. Background

The Commission is proposing amendments to existing SEF and DCM rules relating to staffing and investigations. As discussed below, Commission staff has found there is a lack of clarity that has led to inconsistent approaches with respect to compliance with SEF and DCM market regulation staff and resource requirements. The Commission proposes enhancing SEF staffing requirements to require annual monitoring of staff size and workload to ensure SEFs have sufficient staff and resources dedicated to performing market regulation functions.[238] This would align SEF staffing obligations with existing DCM staffing obligations. Finally, for the purpose of clarity, staff is proposing certain non-substantive amendments.

2. Existing Regulatory Framework

Commission regulation § 38.155(a) provides that each DCM must establish and maintain sufficient compliance department resources and staff to ensure that it can conduct effective audit trail reviews, trade practice surveillance, market surveillance, and real-time market monitoring. A DCM's compliance staff also must be sufficient to address unusual market or trading events as they arise, and to conduct and complete investigations in a timely manner. Commission regulation § 38.155(b) provides that a DCM must monitor the size and workload of its compliance staff annually, and ensure that its compliance resources and staff are at appropriate levels. In determining the appropriate level of compliance resources and staff, the DCM should consider trading volume increases, the number of new products or contracts to be listed for trading, any new responsibilities to be assigned to compliance staff, the results of any internal review demonstrating that work is not completed in an effective or timely manner, and any other factors suggesting the need for increased resources and staff.

Existing Commission regulation § 37.203(c), similar to existing Commission regulation § 38.155(a), provides that a SEF must have sufficient compliance staff and resources to ensure it can conduct effective audit trail reviews, trade practice surveillance, market surveillance, and real-time market monitoring. However, part 37 of the Commission's regulations does not include for SEFs a regulation parallel to Commission regulation § 38.155(b)'s requirement for DCMs to annually

[233] Proposed § 37.1501(a)(1)(ii) requires the SEF CCO to have supervisory authority over all staff acting at the CCO's direction. Proposed § 38.856(a)(1)(iii) requires the DCM CRO to have supervisory authority over all staff performing the DCM's market regulation functions. Similarly, proposed § 38.856(e)(1) specifies that the DCM CRO must supervise the DCM's market regulation functions.

[234] Proposed §§ 37.1501(b)(8) and 38.856(e)(3).

[235] CEA section 5h(f)(15)(B)(v); 7 U.S.C. 7b–3(f)(15)(B)(v).

[236] CEA section 5h(f)(15)(B)(iv); 7 U.S.C. 7b–3(f)(15)(B)(iv).

[237] CEA section 5h(f)(15)(B)(vi); 7 U.S.C. 7b–3(f)(15)(B)(vi).

[238] As discussed below, the Commission also is proposing a technical amendment to existing § 38.155(a) to replace the list of duties a DCM must have sufficient staff to perform with the term ''market regulation functions.''

monitor the sufficiency of staff and resources.

Existing regulations §§ 38.158 and 37.203(f) relate to SEF and DCM obligations, respectively, regarding investigations and investigation reports. These provisions generally address investigation timeliness, substance of investigation reports, and how frequently warning letters may be issued.

3. Proposed Rules

The Commission is proposing amendments to existing §§ 38.155(a) and 37.203(c). First, the Commission proposes to replace references to ''compliance staff'' with ''staff.'' Second, proposed §§ 38.155(a) and 37.203(c) would amend the first sentence of the existing regulations to provide that SEFs and DCMs must establish and maintain sufficient staff and resources to ''effectively perform market regulation functions'' rather than listing the individual functions.[239] The Commission does not view these as substantive changes. References to staff rather than compliance staff are intended for clarity. Compliance staff could be viewed as a broad term that encompasses individuals who have obligations for compliance with all of the CEA and Commission regulations. To avoid confusion and a lack of clarity about which staff might fall within the scope of this broad term, the Commission proposes simply to replace references to ''compliance staff'' with ''staff.'' As noted, Commission regulations §§ 38.155(a) and 37.203(c) solely are focused on staff dedicated to performing market regulation functions.

The Commission also proposes to amend § 37.203 to add a new paragraph (d). The proposed provision would require SEFs to annually monitor the size and workload of its staff, and ensure its resources and staff effectively perform market regulation functions at appropriate levels. In determining the appropriate level of resources and staff, the proposed rule lists factors SEFs should consider. These factors include trading volume increases, the number of new products or contracts to be listed for trading, any new responsibilities to be assigned to staff, any responsibilities that staff have at affiliated entities, the results of any internal review demonstrating that work is not completed in an effective or timely manner, any conflicts of interest that prevent staff from working on certain matters and any other factors suggesting the need for increased resources and staff. In addition, paragraph (d) would include a reference to paragraph (c) to clarify that it applies to staff responsible for conducting market regulation functions.

Proposed § 37.203(d) is virtually identical to existing § 38.155(b) for DCMs. Given that SEFs and DCMs have the same obligation to perform market regulation functions, the Commission believes it is equally important for SEFs to annually review their staffing and resources to ensure they are appropriate and sufficient to adequately perform market regulation functions. Accordingly, consistent with the language in proposed § 37.203(d), the Commission is proposing to add to the list of factors that a DCM should consider in determining the appropriate level of resources and staff: (1) any responsibilities that staff have at affiliated entities; and (2) any conflicts of interest that prevent staff from working on certain matters. The Commission believes that the addition of these factors is necessary to account for potential constraints on resources and staff.

Additionally, the Commission proposes the following non-substantive changes to existing Commission regulation §§ 38.155 and 38.158. Proposed § 38.155 would rename the regulation ''Sufficient staff and resources.'' Proposed § 38.155(b) would add an internal reference to paragraph (a). This change is intended to clarify that the annual staff and resource monitoring requirement pertains to staff performing market regulation functions required under § 38.155(a). Proposed § 38.158(a) would replace the reference to ''compliance staff'' with ''staff responsible for conducting market regulation functions.'' Proposed § 38.158(b) would delete the reference to ''compliance staff investigation'' being required to be completed in a timely manner, and instead provide, more simply, that ''[e]ach investigation must be completed in a timely manner.'' Finally, proposed §§ 38.158(c) and (d) would delete the modifier ''compliance'' when referencing to staff.

Finally, the Commission proposes the following non-substantive changes to existing Commission regulation § 37.203. Proposed § 37.203(c) would rename the paragraph ''Sufficient staff and resources.'' The addition of proposed § 37.203(d) would result in renumbering the remaining provisions of § 37.203. Proposed § 37.203(g)(1), which would replace existing Commission regulation § 37.203(f)(1), adds a reference to ''market regulation functions,'' consistent with the new proposed defined term. Similarly, to avoid lack of clarity, the Commission proposes to delete the modifier ''compliance'' when referencing staff in existing § 37.203(f)(2)–(4).

4. Questions for Comment

The Commission requests comment on all aspects of the proposed changes to §§ 38.155, 38.158 and 37.203.

h. SEF Chief Compliance Officer—Proposed Changes to § 37.1501

1. Background

The Commission is proposing amendments to § 37.1501 for several reasons. First, the Commission proposes certain amendments to the existing SEF CCO requirements to ensure that, to the extent applicable, these requirements are consistent with the proposed DCM CRO requirements. Second, the Commission is proposing additional SEF CCO requirements to harmonize the language with other aspects of this rule proposal, namely proposed amendments that pertain to the board of directors and conflicts of interest procedures. Third, the Commission is proposing amendments that will more closely align § 37.1501 with the language of SEF Core Principle 15, which is codified in § 37.1500.[240]

2. Existing Regulatory Framework

The statutory framework for SEFs requires each SEF to designate an individual to serve as a CCO.[241] The CCO must report to the SEF's board of directors or senior officer,[242] and is responsible for certain enumerated duties, including compliance with the CEA and Commission regulations and resolving conflicts of interest.[243] The CCO is also responsible for designing the procedures to establish the handling, management response, remediation, retesting, and closing of

[239] *See* Sections I and II(d)(1) herein for a description of the definition of ''market regulation functions'' in proposed §§ 38.851(b)(9) and 37.1201(b)(9).

[240] *See* Commission regulation § 37.1500(b)(1).

[241] CEA section 5h(f)(15)(A); 7 U.S.C. 7b–3(f)(15)(A).

[242] CEA section 5h(f)(15)(B)(i); 7 U.S.C. 7b–3(f)(15)(B)(i).

[243] CEA section 5h(f)(15)(B) (ii)–(vi); 7 U.S.C. 7b–3(f)(15)(B)(ii)–(vi) establishes the following CCO duties: (1) reviewing compliance with the core principles; (2) in consultation with the board, a body performing a function similar to that of a board, or the senior officer of the SEF, resolving any conflicts of interest that may arise; (3) being responsible for establishing and administering the policies and procedures required to be established pursuant to this section; (4) ensuring compliance with the CEA and the rules and regulations issued under the CEA, including rules prescribed by the Commission pursuant to section 5h of the CEA; and (5) establishing procedures for the remediation of noncompliance issues found during compliance office reviews, look backs, internal or external audit findings, self-reported errors, or through validated complaints.

noncompliance issues.[244] Finally, the CCO is required to prepare an annual report describing the SEF's compliance with the CEA and the policies and procedures of the SEF.[245] These statutory requirements also are codified in Commission regulation § 37.1500.

Commission regulation § 37.1501 further implements the statutory CCO requirements. First, Commission regulation § 37.1501(a) establishes definitions for the terms ''board of directors'' and ''senior officer.'' Second, Commission regulation § 37.1501(b)(1) addresses the authority of the CCO, stating that the position shall: (1) carry with it the authority and resources to fulfill the CCO's duties; and (2) have supervisory authority over all staff acting at the discretion of the CCO. Third, Commission regulation § 37.1501(b)(2) establishes qualifications for the CCO, including a requirement that the CCO must: (1) have the appropriate background and skills; and (2) must not be disqualified from registration under CEA 8a(2) or 8a(3). Fourth, Commission regulation § 37.1501(b)(3) outlines the appointment and removal procedures for the CCO, which state that: (1) only the SEF's board of directors or senior officer may appoint or remove the CCO; and (2) the SEF shall notify the Commission within two business days of a CCO's appointment or removal. Fifth, Commission regulation § 37.1501(b)(4) requires the SEF's board of directors or senior officer to approve the CCO's compensation. Sixth, Commission regulation § 37.1501(b)(5) requires the CCO to meet with the SEF's board of directors or senior officer at least annually. Seventh, Commission regulation § 37.1501(b)(6) requires the CCO to provide any information regarding the self-regulatory program of the SEF as requested by the board of directors or the senior officer.

Commission regulation § 37.1501(c) further outlines the duties of the CCO, expanding on those already required under SEF Core Principle 15. For example, Commission regulation § 37.1501(c)(2) details that the CCO must take reasonable steps, in consultation with the board of directors or the senior officer of the SEF, to resolve any material conflicts of interest that may arise, including, but not limited to: (1) conflicts between business considerations and compliance requirements; (2) conflicts between business considerations and the requirement that the SEF provide fair, open, and impartial access as set forth in § 37.202; and; (3) conflicts between a SEF's management and members of the board of directors. In connection with establishing and administering the requisite procedures under Core Principle 15, Commission regulation § 37.1501(c)(6) specifies that the CCO must establish and administer a compliance manual designed to promote compliance with the applicable laws, rules, and regulations and a written code of ethics for the SEF designed to prevent ethical violations and to promote honesty and ethical conduct by SEF personnel. Finally, Commission regulation §§ 37.1501(c)(7) and (c)(8) detail the requirement that the CCO supervise the SEF's self-regulatory program as well as the effectiveness and sufficiency of any regulatory service provider, respectively.

Commission regulation § 37.1501(d) addresses the statutory requirement under SEF Core Principle 15 requiring a CCO to prepare an annual compliance report. Commission regulation § 37.1501(d) details that the report must contain, at a minimum: (1) a description and self-assessment of the effectiveness of the written policies and procedures of the SEF; (2) any material changes made to compliance policies and procedures during the coverage period for the report and any areas of improvement or recommended changes to the compliance program; (3) a description of the financial, managerial, and operational resources set aside for compliance with the CEA and applicable Commission regulations; (4) any material non-compliance matters identified and an explanation of the corresponding action taken to resolve such non-compliance matters; and (5) a certification by the CCO that, to the best of his or her knowledge and reasonable belief, and under penalty of law, the annual compliance report is accurate and complete in all material respects.[246]

Commission regulation § 37.1501(e) addresses the submission of the annual compliance report, stating that: (1) the CCO must provide the annual compliance report for review to the board of directors or senior officer, who shall not require the CCO to make any changes to the report; (2) the annual compliance report must be submitted electronically to the Commission no later than 90 calendar days after the end of the SEF's fiscal year; (3) promptly upon discovery of any material error or omission made in a previously filed annual compliance report, the CCO must file an amendment with the Commission; and (4) the SEF may request an extension of time to file its annual compliance report from the Commission. Commission regulation § 37.1501(f) requires the SEF to maintain all records demonstrating compliance with the duties of the CCO and the preparation and submission of annual compliance reports consistent with Commission regulations §§ 37.1000 and 37.1001.

Finally, Commission regulation § 37.1501(g) delegates to the Director of the Division of Market Oversight the authority to grant or deny a request for an extension of time for a SEF to file its annual compliance report under Commission regulation § 37.1501(e).

3. Proposed Rules

The Commission is proposing to move the terms ''board of directors'' and ''senior officer'' from existing regulation § 37.1501(a) to proposed § 37.1201(b). The meaning of each term would remain unchanged, with one exception. Specifically, the Commission seeks to clarify the existing definition of ''board of directors'' by including the introductory language ''a group of people'' serving as the governing body of the SEF. The Commission notes that deleting the definitions from Commission regulation § 37.1501(a) will result in renumbering the remaining provisions of Commission regulation § 37.1501.

The Commission is not proposing any changes to existing Commission regulation § 37.1501(b)(1) or (b)(2).[247] However, the Commission is proposing a new § 37.1501(a)(3) that would require the CCO to report directly to the board or to the senior officer of the SEF. This would be a new provision in § 37.1501, but it is consistent with the language of SEF Core Principle 15, which is codified in § 37.1500.[248] Additionally, the language is consistent with the proposed supervisory requirements for a DCM CRO set forth in proposed § 38.856(b)(1).

Proposed § 37.1501(a)(4)(i) would amend the language in existing Commission regulation § 37.1501(b)(3)(i) to provide that the board of directors or senior officer may appoint or remove the CCO with the approval of the SEF's regulatory oversight committee. This addition is intended to help insulate the position of CCO from improper or undue influence. Proposed § 37.1501(a)(4)(ii) would retain the two-business day notification

[244] CEA section 5h(f)(15)(C); 7 U.S.C. 7b–3(f)(15)(C).

[245] CEA section 5h(f)(15)(D); 7 U.S.C. 7b–3(f)(15)(D).

[246] Commission regulation § 37.1501(d)(1)–(5).

[247] These provisions would be renumbered under the proposal as Commission regulation § 37.1501(a)(1) and (a)(2), respectively.

[248] *See* Commission regulation § 37.1500(b)(1).

requirement to the Commission of the removal of a CCO under Commission regulation § 37.1501(b)(3)(ii).

Proposed § 37.1501(a)(5) would amend the existing requirement in Commission regulation § 37.1501(b)(4) that the board of directors or the senior officer of the SEF shall approve the compensation of the CCO, to now require this approval to occur in consultation with the SEF's ROC. The Commission believes this proposed requirement would help ensure that the CCO position will remain free of improper influence.

The duties of the CCO under proposed § 37.1501(b) are substantively similar to existing Commission regulation § 37.1501(c), with two exceptions. First, proposed § 37.1501(b)(2) provides that the CCO must take reasonable steps in consultation with the SEF's board of directors ''or a committee thereof'' to manage and resolve material conflicts of interest. Regarding the CCO's duties to ''manage and resolve'' material conflicts of interest, the Commission notes there are multiple ways a conflict of interest could be managed and resolved. One example would be simply replacing a conflicted individual with an independent and qualified back-up. Another method to manage and resolve a conflict would be not to pursue a business priority where there is no other way in which to resolve the conflict. The added reference to ''committee'' accounts for the ROC's role in resolving conflicts of interest, which is provided in proposed § 37.1206(d)(4).

Second, proposed § 37.1501(b)(2)(i) specifies that conflicts of interest between business considerations and compliance requirements includes, with respect to compliance requirements, the SEF's ''market regulation functions.'' [249] The Commission believes that this proposed added language will help to clarify for SEFs and CCOs the obligation of CCOs to resolve conflicts of interest that relate to SEF Core Principle 2, SEF Core Principle 4, SEF Core Principle 6, Core Principle 10 and the applicable Commission regulations thereunder. Existing Commission regulation § 37.1501(c)(7) provides that the CCO must supervise the SEF's ''self-regulatory program,'' which includes trade practice surveillance; market surveillance; real time market monitoring; compliance with audit trail requirements; enforcement and disciplinary proceedings; audits, examinations, and other regulatory responsibilities (including taking reasonable steps to ensure compliance with, if applicable, financial integrity, financial reporting, sales practice, recordkeeping, and other requirements). Proposed § 37.1501(b)(7) would amend this provision to state that the CCO is responsible for supervising the SEF's self-regulatory program, including the market regulation functions set forth in § 37.1201(b)(9). Proposed § 37.1201(b)(9) defines ''market regulation functions'' to mean SEF functions required by SEF Core Principle 2, SEF Core Principle 4, SEF Core Principle 6, SEF Core Principle 10 and the applicable Commission regulations thereunder. The Commission is proposing this amendment for clarity and ease of reference.[250] The Commission views the proposed change as being consistent with the CCO's duties as described in existing Commission regulation § 37.1501(c)(7).[251]

Proposed § 37.1501(c) is an entirely new regulation that addresses conflicts of interest involving the CCO. The proposed rule requires the SEF to establish procedures for the disclosure of actual or potential conflicts of interest to the ROC. In addition, the SEF must designate a qualified person to serve in the place of the CCO for any matter for which the CCO has such a conflict, and maintain documentation of such disclosure and designation. As noted above, proposed § 37.1206(d)(4) requires the ROC to consult with the CCO in managing and resolving any actual or potential conflicts of interest involving the SEF's market regulation functions. The CCO's disclosure of actual or potential conflicts of interest to the ROC will facilitate the ROC's assistance in managing and resolving conflicts of interest involving the SEF's market regulation functions. The requirement that the SEF have procedures to designate a qualified person to serve in the place of the CCO for any matter in which the CCO is conflicted will help ensure there is a person with sufficient independence, expertise and authority to address such matters. The Commission believes that a qualified substitute for the CCO must, at a minimum, meet the qualification provisions set forth in existing Commission regulation § 37.1501(b)(2), but that a qualified substitute also should be free from conflicts of interest relating to the matter under consideration.

Proposed § 37.1501(d)(5) amends the existing annual compliance report requirement under Commission regulation § 37.1501(d) to require the annual report to include any actual or potential conflicts of interests that were identified to the CCO during the coverage period for the report, including a description of how such conflicts of interest were managed or resolved, and an assessment of the impact of any conflicts of interest on the swap execution facility's ability to perform its market regulation functions. The Commission proposes this requirement to help ensure it has sufficient notice of conflicts of interest, how they were resolved and whether they were resolved effectively.

4. Questions for Comment

The Commission requests comment on all aspects of the proposed changes to the SEF CCO regulatory requirements. The Commission further requests comment on the question set forth below.

1. Has the Commission struck the appropriate balance between the responsibilities of the CCO and the ROC with respect to identifying, managing and resolving conflicts of interest? Are there ways in which this balance should be modified?

2. Proposed § 37.1501(a)(5) provides that the board of directors or the senior officer of the SEF, in consultation with the ROC, shall approve the compensation of the CCO. Proposed § 38.856(d) provides the same requirement for the DCM's CRO. Should the Commission expand on this requirement, to also prohibit CCO and CRO compensation from being directly dependent on the SEF's or DCM's business performance?

VI. Conforming Changes

a. Commission Regulations §§ 37.2, 38.2, and Part 1

The Commission proposes adopting certain existing requirements from part 1, in particular those from Commission regulations §§ 1.59, 1.63, 1.64 and 1.69, into new regulations for SEFs and DCMs in parts 37 and 38, respectively. Accordingly, and as discussed in more detail above, the Commission is proposing to amend Commission

[249] Proposed § 37.1501(b)(2)(ii) includes a technical edit to add the words ''implementation of'' prior to the clause ''of the requirement that the swap execution facility provide fair, open, and impartial access as set forth in § 37.202.''

[250] The CCO's market regulation function duties are referenced in various contexts throughout the proposed rules including proposed §§ 37.1201, 37.1206(a), (d) and (f)).

[251] For avoidance of doubt, the term ''self-regulatory program,'' as used in proposed § 37.1501(b)(7), continues to include the full scope of areas described in existing Commission regulation § 37.1501(c)(7): trade practice surveillance, market surveillance, real time market monitoring, compliance with audit trail requirements, enforcement and disciplinary proceedings, audits, examinations, and other regulatory responsibilities (including financial integrity, financial reporting, sales practice, recordkeeping, and other requirements).

regulations §§ 37.2 and 38.2 to clarify the specific part 1 regulations that will no longer be applicable to SEFs and DCMs. Commission regulations §§ 1.59, 1.63, 1.64 and 1.69 would then apply only to registered futures associations. As part of the proposed amendments to 38.2 in this release, the Commission is proposing a ministerial amendment to eliminate from 38.2 any references to sections that are either ''reserved'' or have been removed.[252] Specifically, the Commission is proposing a ministerial amendment by eliminating references to (i) sections 1.44, 1.53, and 1.62, all of which have been reserved by the Commission, and (ii) part 8, which has been removed and reserved. Finally, consistent with the exemption language now included in proposed regulation § 37.2, the Commission is renaming this ''Exempt Provision.''

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

1. Background

The Commission proposes to amend regulations §§ 37.5(c) and 38.5(c) to: (1) ensure the Commission receives timely and sufficient information in the event of certain changes in the ownership or corporate or organizational structure of a SEF or DCM; (2) clarify what information is required to be provided and the relevant deadlines; and (3) conform to similar existing and proposed requirements applicable to DCOs. SEFs and DCMs can enter into transactions that result in a change in ownership or corporate or organizational structure. In those situations, Commission staff conducts due diligence to determine whether the change will impact adversely the operations of the SEF or DCM or its ability to comply with the CEA and Commission regulations. Similarly, Commission staff also considers whether any term or condition contained in a transaction agreement is inconsistent with the self-regulatory responsibilities of the SEF or DCM or with the CEA or Commission regulations. Commission staff's ability to undertake a timely and effective due diligence review of the impact, if any, of such transactions is essential.

While SEFs and DCMs are registered entities subject to Commission oversight, many of these entities are part of larger corporate families. SEF and DCM affiliates, including parent entities that own or control the SEF or DCM, are not necessarily registered with the Commission or otherwise subject to Commission regulations. Understanding how these larger corporate families are structured and how they operate may be critical to Commission staff understanding how a change in ownership or corporate or organizational structure could impact a SEF's or DCM's ability to comply with the CEA and Commission regulations. For example, how finances and resources are connected or shared between a parent, affiliates, and the SEF or DCM are critical facts that can impact the SEF's or DCM's core principle compliance. Similarly, how much control the parent company or an affiliate can legally exert over a SEF or DCM may impact the exchange's compliance culture, including governance policies.

Additionally, budgetary concerns might cause reductions in compliance staff, or a change in surveillance vendors. Changes in affiliate framework might also necessitate enhanced conflicts of interest procedures. In light of the corporate changes that can occur with respect to SEFs and DCMs, and the considerable impact such changes may have on the SEF's or DCM's business, products, rules, and overall compliance with the CEA and Commission regulations, the Commission is proposing rules that will clarify and enhance the Commission's authority to request information and documents in the event of certain changes in a SEF's or DCM's ownership or corporate or organizational structure.

2. Existing Regulatory Framework

Commission regulations §§ 37.5(c)(1) and 38.5(c)(1) require SEFs and DCMs, respectively, to notify the Commission in the event of an equity interest transfer. However, the notification requirement differs in two respects. First, the threshold that obligates a DCM to notify the Commission is when the DCM enters into a transaction involving the transfer of 10 percent or more of the equity interest in the DCM. In comparison, a SEF is required to notify the Commission when it enters into a transaction involving the transfer of 50 percent or more of the equity interest in the SEF. Second, Commission regulation § 37.5(c)(1) provides that the Commission may, ''upon receiving such notification, request supporting documentation of the transaction.'' Commission regulation § 38.5(c)(1) does not contain a similar explicit authority for the Commission to request such documentation for DCMs.

Commission regulations §§ 37.5(c)(2) and 38.5(c)(2) set forth the timing of the equity interest transfer notification to the Commission. These regulations are substantively similar and require notification at the earliest possible time, but in no event later than the open of business 10 business days following the date upon which the SEF or DCM enters into a firm obligation to transfer the equity interest.

Commission regulations §§ 37.5(c)(3) and 38.5(c)(3) govern rule filing obligations that may be prompted by the equity interest transfer. Specifically, if any aspect of the transfer necessitates the filing of a rule as defined part 40 of the Commission's regulations, then the SEF or DCM is required to comply with the rule filing requirements and procedures under section 5c(c) of the CEA and applicable Commission regulations.

Commission regulation § 37.5(c)(4) provides a certification requirement where a SEF is required to notify the Commission no later than two days after the equity transfer takes place that the SEF meets all of the requirements of section 5h of the CEA and the Commission regulations adopted thereunder. DCMs do not have an analogous certification requirement.

Finally, Commission regulations §§ 37.5(d) and 38.5(d) make certain delegations of authority to the Director of the Division of Market Oversight. Commission regulation § 37.5(d) provides that the Commission delegates the authority ''set forth in this section'' to the Director of the Division of Market Oversight. Therefore, the delegation of authority applies to information requests related to the business of the SEF in regulation § 37.5(a), demonstrations of compliance with the core principles and Commission regulations in § 37.5(b), and equity interest transfers in § 37.5(c). In contrast, the delegation of authority under Commission regulation § 38.5(d) provides that the Commission delegates the authority ''set forth in paragraph (b) of this section'' to the Director of the Division of Market Oversight. The scope of the delegation of authority provisions under § 38.5(d) is therefore limited to DCM demonstrations of compliance with the core principles and Commission regulations in § 38.5(b) and does not extend to requests for information related to the business of the DCM in § 38.5(a) and equity interest transfers in § 38.5(c).

3. Proposed Rules

The Commission proposes to amend regulation § 37.5(c)(1) to require SEFs to file with the Commission notification of transactions involving the transfer of at least 10 percent of the equity interest in

[252] Final Rule that deleted part 8—Final Rule, Adaptation of Regulations to Incorporate Swaps, 77 FR 66288 (November 2, 2012).

the SEF.[253] The proposed change to revise the reporting threshold from 50 percent to 10 percent would conform the SEF requirement with existing regulation § 38.5(c)(1) for DCMs and Commission regulation § 39.19(c)(4)(ix) for DCOs. As the Commission previously stated for DCMs, a 10 percent threshold is appropriate because a change in ownership of such magnitude may have an impact on the operations of the DCM.[254] The Commission believes the same is true for SEFs. The Commission also believes that such impact may be present even if the transfer of equity interest does not result in a change in control. For example, if one entity holds a 10 percent equity share in a SEF it may have a more significant voice in the operation and/or decision-making of the SEF than five entities each with a minority two percent equity interest.

Given the potential impact that a change in ownership could have on the operations of a DCM, the Commission believes it is appropriate to require a DCM to certify after such change that it will continue to comply with all obligations under the CEA and Commission regulations. The Commission believes that conforming § 38.5(c) to the SEF certification requirement will better allow the Commission to fulfill its oversight obligations, without undue burdens on DCMs.

The Commission also is proposing to amend regulations §§ 37.5(c)(1) and 38.5(c)(1) to expand the types of changes of ownership or corporate or organizational structure that would trigger a notification obligation to the Commission. The proposed amendments would require SEFs and DCMs to report any anticipated change in the ownership or corporate or organizational structure of the SEF or DCM, or its respective parent(s) that would: (1) result in at least a 10 percent change of ownership of the SEF or DCM, or a change to the entity or person holding a controlling interest in the SEF or DCM, whether through an increase in direct ownership or voting interest in the SEF or DCM, or in a direct or indirect corporate parent entity of the SEF or DCM; (2) create a new subsidiary or eliminate a current subsidiary of the SEF or DCM; or (3) result in the transfer of all or substantially all of the assets of the SEF or DCM to another legal entity. The proposed language generally tracks the current requirement for DCOs in Commission regulation § 39.19(c)(4)(ix)(A), as amended by the Commission's Final Rule on Reporting and Information Requirements for Derivatives Clearing Organizations.[255]

This final rule amended Commission regulation § 39.19(c)(4)(ix)(A)(1) to require a DCO to notify the Commission of changes that result in at least a 10 percent change of ownership of the derivatives clearing organization or a change to the entity or person holding a controlling interest in the derivatives clearing organization, whether through an increase in direct ownership or voting interest in the derivatives clearing organization or in a direct or indirect corporate parent entity of the derivatives clearing organization.[256]

In proposing this amendment, the Commission explained that it was proposing to amend the provision to require a DCO to report any change to the entity or person that holds a controlling interest, either directly or indirectly, in the DCO. The Commission noted that, because the current rule was tied to changes in ownership of the DCO by percentage share of ownership, DCOs are not currently required to report all instances in which there is a change in control of the DCO. It is possible that a change in ownership of less than 10 percent could result in a change in control of the DCO. For example, if an entity increases its stake in the DCO from 45 percent ownership to 51 percent, it is possible that control of the DCO would change without any required reporting. In addition, in some instances, a DCO is owned by a parent company, and a change in ownership or control of the parent was not required to be reported under the current rule despite the fact that it could change corporate control of the DCO. The Commission noted that the proposed changes to the rule would ensure that the Commission has accurate knowledge of the individuals or entities that control a DCO and its activities.[257]

The Commission believes the same rationale is applicable to SEFs and DCMs. It is possible that an increase in equity interest in an exchange from 45 percent to 51 percent, would change control of the exchange without required reporting under the current SEF and DCM regulations. Similarly, a change in ownership or control of a SEF's or DCM's parent is not required to be reported under the current regulations even though it could change corporate control of the SEF or DCM. The proposed changes would help to ensure that the Commission has accurate knowledge of the individuals or entities that control a SEF or DCM and its activities.[258]

The Commission is proposing to amend Commission regulations §§ 37.5(c)(2) and 38.5(c)(2) to clarify what information must be submitted to the Commission as part of a notification pursuant to Commission regulations §§ 37.5(c)(1) and 38.5(c)(1), as proposed to be amended. Existing Commission regulation § 37.5(c)(1) provides that upon receiving notification of an equity interest transfer from a SEF, the Commission may request the SEF to provide ''supporting documentation of the transaction.'' Although Commission regulation § 38.5(c)(1) currently includes a notification requirement for DCMs regarding equity interest transfers, it does not grant the Commission the specific authority to request supporting documentation upon the receipt of such a notification. Accordingly, the Commission proposes to harmonize and enhance the requirements between SEFs and DCMs by amending Commission regulations §§ 37.5(c)(2) and 38.5(c)(2) to state that, as part of a notification pursuant to Commission regulations §§ 37.5(c)(1) or 38.5(c)(1), as proposed to be amended, a SEF or DCM must provide ''required information'' including: a chart outlining the new ownership or corporate or organizational structure, a brief description of the purpose or the impact of the change, and any relevant agreement effecting the change and corporate documents such as articles of incorporation and bylaws.[259] Pursuant to proposed regulations §§ 37.5(c)(2)(i) and 38.5(c)(2)(i), the Commission may,

[253] In 2011, the Commission proposed a 10 percent equity interest transfer threshold for SEFs. Core Principles and Other Requirements for Swap Execution Facilities, 76 FR 1214 (Jan. 7, 2011). The final rule increased the threshold to 50 percent. Part 37 Final Rule, 78 FR 33476 (June 4, 2013).

[254] Core Principles and Other Requirements for Designated Contract Markets; Proposed Rule, 75 FR 80572 at 80576 n.32 (Dec. 22, 2010).

[255] Reporting and Information Requirements for Derivatives Clearing Organizations, 88 FR 53664 (Aug. 8, 2023).

[256] Reporting and Information Requirements for Derivatives Clearing Organizations, 87 FR 76698, 76716–17 (Dec. 15, 2022). *See id.* at 76716–17.

[257] *See id.* at 76704.

[258] The Commission's Division of Market Oversight generally addressed concepts of ownership in another rulemaking. *See, e.g.,* Ownership and Control Reports, Forms 102/102S, 40/40S, and 71; Final Rule, 78 FR 69178, 69261 (Parent—for purposes of Form 40, a person is a parent of a reporting trader if it has a direct or indirect controlling interest in the reporting trader; and a person has a controlling interest if such person has the ability to control the reporting trader through the ownership of voting equity, by contract, or otherwise.)

[259] The Commission notes that regulation § 39.19(c)(4)(ix)(B) currently requires a DCO to provide the Commission with the following: A chart outlining the new ownership or corporate or organizational structure; a brief description of the purpose and impact of the change; and any relevant agreements effecting the change and corporate documents such as articles of incorporation and bylaws.

after receiving such information, request additional supporting documentation related to the change in ownership or corporate or organizational structure, such as amended Form DCM or Form SEF exhibits, to demonstrate that the SEF or DCM will, following the change, continue to meet all the requirements in section 5 or 5h of the CEA (as applicable) and applicable Commission regulations.

The Commission believes that clarifying and enhancing its authority to request this information will encourage SEFs and DCMs to remain mindful of their self-regulatory and market regulation responsibilities when negotiating the terms of significant equity interest transfers or other changes in ownership or corporate or organizational structure. The Commission believes that it also will enhance Commission staff's ability to undertake a timely and effective due diligence review of the impact, if any, of such changes. In particular, parts 37 and 38 of the Commission's regulations require the filing of certain exhibits when a SEF or DCM applies for designation or registration. These include, among others, Exhibit A (the name of any person who owns ten percent (10%) or more of the Applicant's stock or who, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the management or policies of the Applicant); Exhibit B (a list of the present owners, directors, governors or persons performing similar functions, including a description of any disqualifications or disciplinary actions related such persons under sections 8b and 8c of the Act); Exhibit E (a description of the personnel qualifications for each category of professional employees), Exhibit F (an analysis of staffing requirements necessary to carry out key operations), Exhibit H (a brief description of any material legal proceedings to which the SEF or DCM or any of its affiliates is a party), Exhibit M (the rulebook), Exhibit N (applicant agreements, including with third party service providers and member or user agreements), and Exhibit O (the compliance manual). In the event of a transfer of equity interest or similar ownership or corporate or organizational change to a SEF or DCM, the proposed amendments would strengthen Commission staff's authority to seek updated copies of such exhibits and other documents to confirm that the SEF or DCM will continue to be able to meet its regulatory obligations.

Pursuant to proposed regulations §§ 37.5(c)(2)(i) and 38.5(c)(2)(i), Commission staff would have clear authority to request amended Form SEF or DCM exhibits, such as Exhibit A. Exhibit A requires the full name and address of each such person. One potential scenario is that such updated exhibit reflects a non-U.S. 10 percent owner. Such information may cause Commission staff to undertake further inquiry as to whether the SEF or DCM, with such new non-U.S. owner, can demonstrate it has the ability to continue satisfying all of the requirements of section 5 of the CEA and applicable Commission regulations. Additionally, an amended Exhibit B of the Form SEF or Form DCM may reflect that an officer or director is disqualified or had disciplinary action taken against them under the Act.[260] The Commission also notes pursuant to proposed §§ 37.207(a) and 38.801(a), SEFs and DCMs must establish and enforce appropriate fitness standards for, among others, their officers, directors and any person who owns 10 percent or more of the SEF or DCM and who, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the management or policies of the SEF or DCM, and any party affiliated with any of those persons. Information obtained through proposed regulations §§ 37.5(c)(2) and 38.5(c)(2) will inform the Commission as to whether the SEF or DCM remains compliant with such minimum fitness standards.

Next, proposed §§ 37.5(c)(3) and 38.5(c)(3) will require a notification pursuant to Commission regulations §§ 37.5(c)(1) or 38.5(c)(1), as proposed to be amended, to be submitted no later than three months prior to the anticipated change, provided that the SEF or DCM may report the anticipated change later than three months prior to the anticipated change if it does not know and reasonably could not have known of the anticipated change three months prior to the anticipated change. In such event, the SEF or DCM shall immediately report such change to the Commission as soon as it knows of such change. The Commission believes the proposed timing requirement strikes the appropriate balance between allowing Commission staff sufficient time to review the impact of the change and assess compliance with applicable statutory and regulatory requirements, while also preserving flexibility to the SEF or DCM if the anticipated change occurs more quickly than within three months.

In addition to the new reporting requirements, the proposal includes a new certification requirement for DCMs. Existing Commission regulation § 37.5(c)(4) requires the SEF, upon a transfer of equity interest, to file a certification that it meets all of the requirements of section 5h of the CEA and the Commission regulations adopted thereunder. The certification must be filed no later than two business days following the date on which the subject equity interest was acquired. DCMs currently do not have an analogous certification requirement.[261] Therefore, the Commission is proposing to amend Commission regulation § 38.5(c) by adding a certification requirement in regulation § 38.5(c)(5). The certification will require a DCM, upon a change in ownership or corporate organizational structure described in Commission regulation § 38.5(c)(1), to file with the Commission a certification that the DCM meets all of the requirements of section 5 of the CEA and applicable Commission regulations. The certification must be filed no later than two business days following the date on which the change in ownership or corporate or organizational structure takes effect. This should be interpreted to mean two business days after the change contemplated by the effectuating agreements actually occurred.

The Commission believes that there is no substantive difference necessitating disparate treatment between SEFs and DCMs regarding the certification. Given their roles as self-regulatory organizations, in the event of a subject change in ownership or corporate or organizational structure, the Commission believes it is imperative for the SEF or DCM to certify its compliance with the CEA and Commission regulations. The certification will help ensure that any such changes do not result in non-compliance. Toward that end, proposed §§ 37.5(c)(6) and 38.5(c)(6) provide that a change in the ownership or corporate or organizational structure of a SEF or DCM that results in the failure of the SEF or DCM to comply with any

[260] Exhibit B requires: a description of: (1) Any order of the Commission with respect to such person pursuant to section 5e of the CEA; (2) Any conviction or injunction against such person within the past ten (10) years; (3) Any disciplinary action with respect to such person within the last five (5) years; (4) Any disqualification under sections 8b and 8d of the CEA; (5) Any disciplinary action under section 8c of the CEA; and (6) Any violation pursuant to section 9 of the CEA.

[261] In the final rule implementing part 38 of the Commission's regulations, the Commission stated that the documentation that the Commission may request under Commission regulation § 38.5 may include a certification that the DCM continues to meet all of the requirements of section 5(d) of the CEA and Commission regulations adopted thereunder. *See* Part 38 Final Rule, 77 FR 36612 at 36619.

provision of the Act, or any regulation or order of the Commission thereunder, shall be cause for the suspension of the registration or designation of the SEF or DCM, or the revocation of registration or designation as a SEF or DCM, in accordance with sections 5e and 6(b) of the CEA. The proposed rule further provides that the Commission may make and enter an order directing that the SEF or DCM cease and desist from such violation, in accordance with sections 6b and 6(b) of the CEA.[262] Section 6(b) of the CEA authorizes the Commission to suspend or revoke registration or designation of a SEF or DCM if the exchange has violated the CEA or Commission orders or regulations. Section 6(b) includes a number of procedural safeguards, including that it requires notice to the SEF or DCM, a hearing on the record, and appeal rights to the court of appeals for the circuit in which the SEF or DCM has its principal place of business. It is imperative that SEFs and DCMs, regardless of ownership or control changes, continue to comply with the CEA and all Commission regulations to promote market integrity and protect market participants.

Finally, the Commission proposes to amend existing regulation § 38.5(d) by extending the delegation of authority provisions to the Director of the Division of Market Oversight to include information requests related to the business of the DCM in § 38.5(a) and equity interest transfers in § 38.5(c). This amendment would conform § 38.5(d) to the existing delegated authority the Division of Market Oversight has with respect to SEFs under § 37.5(d). Changes in ownership or control of a DCM can occur relatively quickly. Therefore, the Commission believes it is important for effective oversight to provide the Director of the Division of Market Oversight with the authority in such circumstances, to immediately request information and documents to confirm continued compliance by a DCM with the CEA and relevant Commission regulations.

4. Questions for Comment

1. Proposed regulation § 37.5(c)(1) revises the notification threshold for SEFs from 50 percent to 10 percent to align with the DCM requirement in § 38.5(c)(1). Is there any reason why the threshold should be different for SEFs?

2. Do the proposed rules provide sufficient notice and clarity to SEFs and DCMs regarding what documents and information may be requested by the Commission?

3. Are the timing provisions for the required notification (proposed regulations §§ 37.5(c)(3) and 38.5(c)(3)) and certification (proposed regulations §§ 37.5(c)(5) and 38.5(c)(5)) sufficiently clear? Do such timing provisions allow sufficient time for SEFs and DCMs to provide the required notification and certification?

VII. Effective and Compliance Dates

The Commission is proposing that the effective date for the proposed rules be sixty days after publication of final regulations in the **Federal Register**. The Commission believes that the proposed effective date would be appropriate given that DCMs have implemented many of the proposed rules' requirements that are being adopted from the DCM Core Principle 16 Acceptable Practices. Additionally, many SEFs have voluntarily adopted elements of these standards to demonstrate compliance with SEF Core Principle 12. The Commission also proposes a compliance date of one-year after the effective date of the final regulations. The Commission believes this will provide current SEFs and DCMs, as well as prospective SEF and DCM applicants, with sufficient time to comply with the final regulations.

Question for Comment

The Commission requests comment on whether the proposed effective date is appropriate and, if not, the Commission further requests comment on possible alternative effective dates and the basis for any such alternative dates.

VIII. Related Matters

a. Cost-Benefit Considerations

1. Introduction

As described above, the Commission proposes to establish governance standards and conflicts of interest rules related to market regulation functions, for SEFs and DCMs. Although SEFs and DCMs have similar obligations with respect to market regulation functions, they are subject to different obligations with respect to governance fitness standards and mitigating conflicts of interest. SEFs and DCMs are required to minimize and resolve conflicts of interest pursuant to identical statutory core principles.[263] However, with respect to governance fitness standards, DCMs are subject to specific statutory core principles addressing governance,[264] while SEFs do not have parallel core principle requirements. Additionally, SEFs and DCMs currently have different regulatory obligations with respect to governance fitness standards.[265] Further, while both SEFs and DCMs are subject to equity transfer requirements,[266] the applicable regulatory provisions currently have different notification thresholds and obligations.

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.[267] Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors (collectively referred to herein as ''Section 15(a) Factors'') below.

The goal of the proposed rulemaking is to provide SEFs and DCMs with a clear regulatory framework for implementing governance standards to promote the integrity of its self-regulatory functions and for identifying, managing, and resolving conflicts of interest related to their market regulation functions. Specifically, the proposed rulemaking harmonizes and enhances the existing SEF and DCM regulations by proposing: (1) new rules to implement DCM Core Principle 15 (Governance Fitness Standards) that are consistent with the existing guidance on compliance with DCM Core Principle 15 (Governance Fitness Standards); (2) new rules to implement DCM Core Principle 16 (Conflicts of Interest) that are consistent with the DCM Core Principle 16 Guidance and Acceptable Practices; (3) new rules to implement SEF Core Principle 2 (Compliance With Rules)

[262] 7 U.S.C 7b; 7 U.S.C. 13a; 7 U.S.C 8(b).

[263] *See* SEF Core Principle 12, Commodity Exchange Act (''CEA'') section 5h(f)(12), 7 U.S.C. 7b–3(f)(12), and DCM Core Principle 16, CEA section 5(d)(16), 7 U.S.C. 7(d)(16).

[264] *See* DCM Core Principles 15 and 17, CEA section 5(d)(15), 7 U.S.C. 7(d)(15), and CEA section 5(d)(17), 7 U.S.C. 7(d)(17), respectively.

[265] As discussed below, SEFs, but not DCMs, are required to comply with requirements under part 1 of the Commission's regulations addressing the sharing of nonpublic information, service on the board or committees by persons with disciplinary histories, board composition, and voting by board or committee members persons where there may be a conflict of interest.

[266] Commission regulation § 37.5(c) (SEFs) and Commission regulation § 38.5(c) (DCMs).

[267] 7 U.S.C. 19(a).

that are consistent with the DCM Core Principle 15 Guidance; (4) new rules to implement SEF Core Principle 12 (Conflicts of Interest) that are consistent with the DCM Core Principle 16 Guidance and Acceptable Practices; (5) new rules under part 37 of the Commission's regulations for SEFs and part 38 of the Commission's regulations for DCMs that are consistent with existing conflicts of interest and governance requirements under Commission regulations §§ 1.59 and 1.63; (6) new rules for DCM Chief Regulatory Officers (''CROs''); (7) amendments to certain requirements relating to SEF Chief Compliance Officers (''CCOs''); and (8) new rules for SEFs and DCMs relating to the establishment and operation of a Regulatory Oversight Committee (''ROC'').

The Commission recognizes that the proposed changes in this release could result in benefits, but also could impose costs. Any initial and recurring compliance costs for any SEF or DCM will depend on the size, existing infrastructure, practices, and cost structure of the entity. The Commission has endeavored to provide qualitative analysis of costs based on its experience overseeing SEFs and DCMs. The Commission generally requests comment on all aspects of its cost-benefit considerations, including the identification and assessment of any costs and benefits not discussed herein; data and any other information to assist or otherwise inform the Commission's ability to quantify or qualitatively describe the costs and benefits of the proposed amendments; and substantiating data, statistics, and any other information to support positions posited by commenters with respect to the Commission's discussion. The Commission welcomes comment on such costs and benefits.

2. Baseline

The baseline for the Commission's consideration of the costs and benefits of this proposed rulemaking is the existing statutory and regulatory framework regarding conflicts of interests and governance standards for SEFs and DCMs. The existing governance requirements and conflicts of interest standards for SEFs are set forth in SEF Core Principles 2, 12 and 15,[268] and certain regulations in part 1 of the Commission's regulations that apply to SROs, including SEFs. SEFs must comply with SEF Core Principle 2, requiring SEFs to establish and enforce rules governing the operation of the SEF.[269] Commission regulation § 1.59 provides limits on the use and disclosure of SEF material, non-public information. Commission regulation § 1.63 restricts persons with certain disciplinary histories from serving on disciplinary committees, arbitration panels, oversight panels or the governing board of a SEF. Commission regulation § 1.64 sets forth requirements for the composition of SEF governing boards and major disciplinary committees. Commission regulation § 1.69 requires a SEF to have rules to prevent members of the board of directors, disciplinary committees, or oversight panels, to abstain from deliberating and voting on certain matters that may raise conflicts of interest.

The existing requirements for DCMs to minimize and resolve conflicts of interests are outlined in DCM Core Principle 16.[270] DCMs must also comply with DCM Core Principle 15, which sets forth governance fitness standards for members of the board of directors or disciplinary committees, members of the contract market, any other person with direct access to the facility, and any person affiliated with those enumerated individuals. Additionally, DCM Core Principle 17 requires a DCM's governance arrangements be designed to consider the views of market participants and DCM and Core Principle 22 requires DCMs that are publicly traded to endeavor to have boards of directors and other decision-making bodies composed of diverse individuals. DCMs are also subject to existing regulatory requirements in Commission regulation § 1.63(c), that disqualifies individuals with certain disciplinary histories from serving on DCM governing boards, arbitration or oversight panels, or disciplinary committees. disciplinary committees, arbitration panels, oversight panels or the governing board of a DCM. Although DCMs are exempt from Commission regulation § 1.59(b) and (c), Commission regulation § 1.59(d) directly prohibits members of the board of directors, committee members, or consultants of a self-regulatory organization from trading for their own account, or for or on behalf of any other account, based on this material non-public information.

Both SEFs and DCMs are subject to equity interest transfer requirements set forth in Commission regulations §§ 37.5(c) and 38.5(c), respectively.

The Commission notes that this cost-benefit consideration is based on its understanding that the derivatives market regulated by the Commission functions internationally with: (1) transactions that involve U.S. entities occurring across different international jurisdictions; (2) some entities organized outside of the United States that are registered with the Commission; and (3) some entities that typically operate both within and outside the United States and that follow substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the discussion of costs and benefits below refers to the effects of the proposed rules on all relevant derivatives activity, whether based on their actual occurrence in the United States or on their connection with, or effect on, U.S. commerce.[271]

3. Proposed Rules

i. Minimum Fitness Standards—Proposed §§ 37.207 and 38.801

SEFs must comply with SEF CP 2, which requires SEFs to establish and enforce rules governing the operation of its facility.[272] Currently, SEFs must also comply with all requirements in Commission regulation § 1.63, which restricts persons with certain disciplinary histories from serving on disciplinary committees, arbitration panels, oversight panels or the governing board of a SEF, because SEFs qualify as SROs and are not otherwise exempt. While DCMs are also SROs, they are exempt from Commission regulations §§ 1.63(a), (b), and (d)–(f), pursuant to Commission regulation § 38.2. DCMs are not, however, exempt from Commission regulation 1.63(c), which provides that persons are disqualified from serving on disciplinary committees, arbitration panels, oversight panels or the governing board of a DCM if they are subject to any of the disciplinary offenses found in § 1.63(b). DCMs must also comply with DCM Core Principle 15, requiring DCMs to establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract market, and any other person with direct access to the facility (including

[268] *See* CEA section 5h(f)(2), 7 U.S.C. 7b–3(f)(2), CEA section 5h(f)(12), 7 U.S.C. 7b–3(f)(12) and CEA section 5h(f)(15), 7 U.S.C. 7b–3(f)(15).

[269] CEA section 5h(f)(2), 7 U.S.C. 7b–3(f)(2).

[270] The Commission, however, notes that—as a practical matter—all of the DCMs that are currently designated by the Commission rely on the acceptable practices to comply with Core Principle 16, in lieu of any other means for compliance. As such, the actual costs and benefits of the codification of those acceptable practices with respect to DCMs, as realized in the market, may not be as significant.

[271] *See, e.g.,* 7 U.S.C. 2(i).

[272] CEA section 5h(f)(2); 7 U.S.C. 7b–3(f)(2).

any party affiliated with any person described in this paragraph).[273]

Proposed §§ 37.207(a) and 38.801(a) would require SEFs and DCMs to establish and enforce appropriate fitness requirements for officers, members of its board directors, committees, disciplinary panels, dispute resolution panels, any other persons with direct access to the SEF or DCM, any person who owns 10 percent or more of the SEF or DCM and who, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the management or policies of the SEF or DCM, and for any party affiliated with any of the foregoing. In subparts (b), and (c) of proposed §§ 37.207 and 38.801, the Commission has identified certain minimum fitness standards that SEFs and DCMs would be required to establish and enforce. First, under subpart (b), SEFs and DCMs would be required to include the basis for refusal to register a person under sections 8(a)(2) and 8a(3) of the CEA as minimum fitness standards for members of its board of directors, committees, disciplinary panels, dispute resolution panels, for members with voting privileges, and any person who owns 10 percent or more of the SEF or DCM and who, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the management or policies of the SEF or DCM. Second, under subpart (c), SEF and DCM minimum fitness standards would be required to include six offenses the Commission has identified as disqualifying for key decision-makers, including members of its board of directors, committees, disciplinary panels, and dispute resolution panels.

Commission regulation § 1.63(d) requires each SRO to provide the Commission with a certified list of persons removed from a disciplinary committee, arbitration panel, or oversight panel, in the previous year. In addition to the above standards, proposed §§ 37.207(d) and 38.801(d) would require that SEFs and DCMs to establish new procedures for the initial and annual collection, verification, and preservation of information supporting compliance with appropriate fitness standards.

A. Benefits

The Commission believes that requiring appropriate, minimum fitness standards for individuals with the ability to exercise influence or control over the operations of SEFs and DCMs, including their market regulation functions, will improve the integrity and effectiveness of SEFs and DCMs in their role as SROs. By establishing automatic disqualifiers, including disqualifications described in CEA sections 8a(2) and 8a(3), or a history of disciplinary offenses described in Commission regulation § 1.63, SEFs and DCMs may benefit by attracting individuals with demonstrated ethical conduct and sound decision-making to those influential roles. Proposed §§ 37.207 and 38.801 are likely to reduce the likelihood and the extent of harm caused by individuals with a history of disciplinary offenses to the operations of SEFs and DCMs, including their market regulation functions. In addition, clear minimum standards for individuals with the ability to influence or control the governance of SEFs and DCMs will provide market participants using exchange services, as well as exchange shareholders, with greater confidence in key SEF and DCM decision-makers. Ongoing verification of the fitness of these decision-makers may also provide greater accountability and trust in the management and operations of SEFs and DCMs. Such requirements may also increase the trust of market participants using exchange services.

Establishing automatic disqualifiers and establishing independent fitness verification procedures for SEFs and DCMs are likely to aid in identifying trustworthy individuals to serve in roles with the ability to control or influence the governance of the exchange or its market regulation functions. It is important that the individuals able to influence or control a SEF's and DCM's governance, management, and disciplinary standards have a record of integrity and rectitude. Such record provides confidence that those individuals will be able to effectuate a SEF's or DCM's obligations to establish and enforce its rules, and a DCM's obligation to establish and enforce appropriate minimum fitness requirements.[274]

Finally, as discussed above, SEFs currently must comply with all requirements in Commission regulation § 1.63. To the extent SEFs are already compliant with this regulation, the benefits of proposed § 37.207 may be less significant. Similarly, DCMs currently must comply with Commission regulation § 1.63(c) and DCM Core Principle 15. To the extent that DCMs are already compliant with § 1.63(c) and DCM Core Principle 15, the benefits of proposed § 38.801 may be less significant. Finally, to the extent that SEFs or DCMs have already implemented rules consistent with all aspects of the DCM Core Principle 15 Guidance, the benefits of proposed § 37.207 and § 38.801 may be less significant.[275]

B. Costs

The Commission believes that SEFs and DCMs would incur additional costs from proposed §§ 37.207 and 38.801 through the additional hours SEF and DCM employees might need to spend analyzing the compliance of their existing rules and procedures with these proposed requirements, and implementing new or amended rules and procedures, as necessary. Specifically, SEFs and DCMs may incur costs in the form of administrative time related to drafting new policies to comply with the proposed fitness standards and verification procedures. Costs associated with complying with proposed §§ 37.207 and 38.801 may further vary based on the size of the SEF or DCM, available resources, and existing practices and policies. Accordingly, those costs would be impracticable to reasonably quantify. The Commission believes that the policies and procedures required for implementing minimum fitness standards would likely not change significantly from year to year, so after the initial creation of the policies and procedures, the time required to maintain those policies and procedures would be negligible.

When implementing proposed §§ 37.207 and 38.801, to the extent that the current officers or membership of their board of directors, or committees do not meet the proposed minimum fitness requirements, SEFs and DCMs may need to make changes to their officers, members of their board of directors, or committees. This might lead to additional costs related to any time and efforts SEFs and DCMs may need to take to find suitable candidates.

The Commission notes that, regarding DCMs, the above costs may be mitigated to the extent that a DCM is already complying with DCM Core Principle 15 and Commission regulation § 1.63(c). Additionally, to the extent a DCM has already implemented practices

[273] CEA section 5(d)(15); 7 U.S.C. 7(d)(15).

[274] The minimum fitness requirements facilitate a SEF's and DCM's ability to establish and enforce their rules, in accordance with SEF Core Principle 2 (Compliance with Rules), CEA section 5h(f)(2); 7 U.S.C. 7b–3(f)(2), DCM Core Principle 2 (Compliance with Rules), CEA section 5(d)(2); 7 U.S.C. 7(d)(2), and DCM Core Principle 15, respectively.

[275] As described *supra,* Section III(a)(Proposed Governance Fitness Standards—Proposed §§ 37.207 and 38.801), the proposed minimum fitness standards are consistent with the existing DCM Core Principle 15 Guidance, subject to certain enhancements described therein.

consistent with DCM Core Principle 15 Guidance, some of the costs may have been already realized. The DCM Core Principle 15 Guidance states that minimum fitness standards for persons who have member voting privileges, governing obligations or responsibilities, or who exercise disciplinary authority, should include those bases for refusal to register a person under section 8a(2) of the CEA.[276] Additionally, the DCM Core Principle 15 Guidance states that persons who have governing obligations or responsibilities, or who exercise disciplinary authority, should not have a significant history of serious disciplinary offenses, such as those that would be disqualifying under Commission regulation § 1.63.[277] As a practical matter, many DCMs may have already adopted practices consistent with the Core Principle 15 Guidance. As such, the actual costs of the proposed rules amendments may be less significant.

The costs to implement the proposed §§ 37.207 and 38.801 minimum fitness requirements for SEFs may be mitigated to the extent that they already have a framework in place to comply with existing Commission regulation § 1.63, which sets forth requirements and procedures to prevent persons with certain disciplinary histories from serving in certain governing or oversight capacities as an SRO.

Proposed §§ 37.207 and 38.801 require each SEF and DCM to establish appropriate procedures for the collection and verification of information supporting compliance with appropriate fitness standards. Ongoing implementation of the proposed rules would also impose costs associated with the time required to collect and verify a candidate's fitness in a timely manner, to document the findings with respect to the fitness standards, to make the findings available to the Commission as a part of staff's oversight activities, and to re-verify fitness eligibility on an annual basis. Similar to above, a SEF's or DCM's costs may be less significant if it is already following the DCM Core Principle 15 Guidance, which states that DCMs should have standards for the collection and verification of information supporting compliance with the DCM's fitness standards.

The Commission requests comments on the potential costs of proposed §§ 37.207 and 38.801, including any costs that would be imposed on SEFs, DCMs, other market participants, or the financial system more broadly.

C. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of proposed §§ 37.207 and 38.801 with regard to the specific considerations identified in Section 15(a) of the CEA. The Commission believes that proposed §§ 37.207 and 38.801 may protect market participants and the public, as well as the financial integrity of the markets, by ensuring the integrity of individuals influencing the decisions made by SEFs and DCMs. By having fit and reputable decision-makers, the Commission believes SEFs and DCMs are likely able to increase industry and public trust in their organizations and markets. Minimum fitness standards also may increase the confidence in the decisions made by officers and members of its board of directors, committees, disciplinary panels, dispute resolution panels, and certain owners. The Commission believes that trust and confidence in SEF and DCM leadership fosters market participation, which could in turn enhance liquidity, price discovery, and the financial integrity of markets. The Commission has considered the other Section 15(a) Factors and believes that they are not implicated by the proposed amendments to §§ 37.207 and 38.801.

ii. General Requirements for Addressing Conflicts of Interest and Definitions—Proposed §§ 37.1201 and 38.851

Currently, both SEFs and DCMs have an obligation under SEF Core Principle 12 and DCM Core Principle 16 to minimize and resolve conflicts of interest in their decision-making. Additionally, DCM Core Principle 16 Acceptable Practices set forth practices for complying with Core Principle 16. By contrast, there are no acceptable practices or guidance for SEF Core Principle 12.

Proposed §§ 37.1201(a) and 38.851(a) require SEFs and DCMs to establish processes for identifying, minimizing, and resolving actual and potential conflicts of interest that may arise. Proposed §§ 37.1201(b) and 38.851(b) revise existing definitions[278] and define two new terms. First, the term ''market regulation function,'' under § 38.851(b)(9) means DCM functions required by DCM Core Principle 2, DCM Core Principle 4, DCM Core Principle 5, DCM Core Principle 10, DCM Core Principle 12, DCM Core Principle 13, DCM Core Principle 17 and the applicable Commission regulations thereunder. ''Market regulation function'' under § 37.1201(b)(9) means SEF functions required by SEF Core Principle 2, SEF Core Principle 4, SEF Core Principle 6, SEF Core Principle 10 and the applicable Commission regulations thereunder. Second, the proposed rules define the term ''affiliate,'' which refers to a person that directly, or indirectly, controls, or is controlled by, or is under common control with, the SEF or DCM.

A. Benefits

The Commission believes that SEF and DCM conflict of interest processes, as required by proposed §§ 37.1201(a) and 38.851(a), are likely to provide the framework necessary for SEFs and DCMs to minimize conflicts of interest and comply with their core principle requirements. The specific conflicts of interest this proposal addresses relate to market regulation functions, *i.e.,* SEF and DCM functions that promote market integrity and orderly conduct in the markets.[279]

The Commission believes that the new definitions for ''market regulation functions'' and ''affiliate'' in proposed §§ 37.1201(b) and 38.851(b) will provide benefits, including operational efficiency. SEFs and DCMs will spend less time and resources in determining how to comply with regulatory requirements. Moreover, the definitions will provide additional regulatory certainty and risk reduction; delineate

[276] *See* Appendix B to part 38, Guidance to Core Principle 15 of section 5(d) of the Act, Governance Fitness Standards.

[277] *Id.*

[278] The DCM Core Principle 16 Acceptable Practices defines a ''public director'' as an individual with no material relationship to the DCM and describes the term ''immediate family'' to include spouse, parents, children, and siblings. The terms ''material information,'' ''non-public information,'' ''commodity interest,'' ''related commodity interest,'' and ''linked exchange'' are defined in Commission regulation § 1.59. ''Material information'' is defined in § 1.59(a)(5) to mean information which, if such information were publicly known, would be considered important by a reasonable person in deciding whether to trade a particular commodity interest on a contract market or a swap execution facility, or to clear a swap contract through a derivatives clearing organization. ''Non-public information'' is defined in § 1.59(a)(6), as information which has not been disseminated in a manner which makes it generally available to the trading public. Commission regulations § 1.59(a)(8) and (9) define ''commodity interest,'' to include all futures, swaps, and options traded on or subject to the rules of a SEF or DCM and ''related commodity interest'' to include any commodity interest which is traded on or subject to the rules of a SEF, DCM, linked exchange, or other board of trade, exchange, or market, or cleared by a DCO, other than the self-regulatory organization by which a person is employed, and which is subject to a self-regulatory organization's intermarket spread margins or other special margin treatment. Commission regulations § 1.59(a)(5), (a)(6), (a)(8), and (a)(9).

[279] *E.g.,* 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.

the responsibilities addressed by SEF and DCM regulations, including which functions are considered self-regulatory versus market regulation; and clarify which relationships are affiliate relationships. Reducing ambiguities regarding the meaning of these terms should promote regulatory compliance.

B. Costs

SEFs and DCMs may incur additional costs from proposed §§ 37.1201(a) and 38.851(a) in terms of employee hours spent analyzing whether existing rules and procedures comply with the proposed requirements, and drafting and implementing new or amended rules and procedures, as necessary. Costs associated with complying with proposed §§ 37.1201 and 38.851 may further vary based on the size of the SEF or DCM, available resources, and existing practices, rules, and procedures. Accordingly, those costs would be impracticable to reasonably quantify. Further, rules and procedures required for implementing the proposed conflict of interest requirements would likely not change significantly from year to year, so after the initial creation of such rules and procedures, the time required to maintain those rules and procedures would be negligible.

The Commission does not believe that there any independent costs related to the amended and new definitions in proposed §§ 37.1201(b) and 38.851(b). Costs that might be associated with the proposed definitions will likely arise in connection with implementing the conflict of interest requirements under proposed §§ 37.1201(a) and 38.851(a).

The Commission requests comments on the potential costs of proposed §§ 37.1201 and 38.851, including any costs that would be imposed on SEFs, DCMs, other market participants, or the financial system more broadly.

C. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of proposed §§ 37.1201 and 38.851 with regard to the specific considerations identified in Section 15(a) of the CEA. The Commission believes that proposed §§ 37.1201 and 38.851 may have a beneficial effect on the protection of market participants and the public, as well as on the financial integrity of the markets by ensuring that SEFs and DCMs have an adequate framework for addressing potential conflicts of interest. Procedures for identifying conflicts of interest also may reduce the risk of decision-makers being influenced by concerns that are not in the best interest of the SEF's or DCM's market regulation functions. Rules and processes to identify and manage conflicts of interest also aid in ensuring that decision-makers are accountable to SEFs and DCMs, and therefore, proposed §§ 37.1201 and 38.851 may lead to increased trust in SEF and DCM markets by market participants and the public. The Commission has considered the other Section 15(a) Factors and believes they are not implicated by proposed §§ 37.1201 and 38.851.

iii. Conflicts of Interest in Decision-Making—Proposed §§ 37.1202 and 38.852

As described above, SEFs are subject to the requirements of SEF Core Principle 12, requiring SEFs to establish and enforce rules and processes to identify and resolve conflicts of interest.[280] Currently, SEFs are also required to comply with Commission regulation § 1.69, which requires SROs to have rules requiring any member of its board of directors, disciplinary committees, or oversight panels to disclose conflicts of interest and abstain from deliberating and voting in actions with certain personal or financial conflicts of interest. DCMs, however, are exempt from these requirements pursuant to Commission regulation § 38.2.

The Commission is proposing to make a conforming amendment to Commission regulation § 37.2 to exempt SEFs from Commission regulation § 1.69. However, the Commission is also proposing §§ 37.1202 and 38.852, which incorporate certain elements of existing Commission regulation § 1.69, for both SEFs and DCMs, along with certain modifications and enhancements. Notably, the Commission proposes to redefine the term ''family relationship'' to enhance and modernize the conflict of interest disclosure requirements.

For example, under § 1.69, if a member of the board of directors, disciplinary committee, or oversight panel, has a relationship with a named party in interest [281] that falls within the enumerated relationships in § 1.69(b)(1)(i)(A)–(E), the member is required to abstain from deliberating and voting on that matter. One of the enumerated relationships is a ''family relationship,'' which is currently defined as a person's spouse, parent, stepparent, child, stepchild, sibling, stepbrother, stepsister, or in-law.[282]

In proposed §§ 37.1201(b)(7) and 38.851(b)(7), the Commission redefines ''family relationship,'' as the person's spouse, parents, children, and siblings, in each case, whether by blood, marriage, or adoption, or any person residing in the home of the person. This proposed definition focuses on the closeness of the relationship that the officer, or member of the board of directors, committee, or disciplinary panel has with the subject of the matter being considered. The proposed definition also reflects a more modern description of the relationships intended to be covered.

More broadly, proposed §§ 37.1202(a) and 38.852(a) require SEFs and DCMs to establish policies and procedures requiring any officer or member of their board of directors, committees, or disciplinary panels to disclose any actual or potential conflicts of interest that may be present prior to considering any matter. Proposed §§ 37.1202(a)(1) and 38.852(a)(1) provide a list of enumerated relationships that are deemed to be conflicts of interest, and proposed §§ 37.1202(a)(2) and 38.852(a)(2) would extend the applicability of these enumerated relationships that an officer or member of their board of directors, committees, or disciplinary panels has with an affiliate of the subject of any matter being considered. Similar to existing § 1.69(b)(4), proposed §§ 37.1202(b) and 38.852(b) require documentation of conflict of interest determinations. Specifically, under the proposed rules, SEFs and DCMs must require members of their board of directors, committees, and disciplinary panels to document in meeting minutes, or otherwise document in a comparable manner, compliance with the applicable requirements.

A. Benefits

Requiring SEF and DCM officers, and members of their board of directors, committees, or disciplinary panels to disclose conflicts of interests before considering a matter, under proposed §§ 37.1202 and 38.852, is essential to implementing the goals of this proposed rulemaking. Given the governing authority bestowed upon key decision-makers, it is crucial that their decision-making is guided by the best interests of the SEF or DCM, and is not influenced by personal or financial gain. In requiring these key decisions-makers to be transparent about relationships that may raise conflicts of interest, SEFs and DCMs are better able to hold these individuals accountable. Additionally, the Commission believes that proposed §§ 37.1202(a) and 38.852(a) are beneficial because requirements to disclose conflicts of interests promote transparency in the decision-making

[280] *Supra* Section II(a).

[281] As defined in Commission regulation § 1.69(a).

[282] Commission regulation § 1.69(a)(2).

process relating to SEF and DCM market regulation functions, further promoting confidence in their markets.

The Commission believes that the proposed §§ 37.1202(b) and 38.852(b) documentation requirements have several additional benefits. First, documentation requirements identifying conflicts of interest and recusals promotes transparency, ensures that conflicts of interests have been managed, and provides useful precedent for how the SEF or DCM can manage similar types of conflicts of interest in the future. Second, requiring conflicts of interest to be documented, rather than simply disclosed, is likely to promote more accountability among members of the board of directors, committees, and disciplinary panels. Third, this documentation is important evidence demonstrating compliance efforts, which can aid the SEF, DCM, and the Commission, in conducting oversight.

SEFs currently are subject to Commission regulation § 1.69. Therefore, to the extent SEFs already are compliant with Commission regulation § 1.69, the benefits of proposed § 37.1202 may be less significant. Similarly, if DCMs, as a matter of industry practice, already have procedures in place consistent with Commission regulation § 1.69 requirements, the benefits of proposed § 38.852 may be less significant.

B. Costs

The Commission believes that SEFs will not incur significant costs implementing proposed § 37.1202 as the requirements of the proposed rule are similar to the existing Commission regulation§ 1.69 requirements. SEFs may incur some administrative costs of analyzing their existing rules and procedures to determine whether they comply with proposed § 37.1202, as the proposed rule, as discussed above, contains some enhancements, such as the new definition of ''family relationship,'' that do not exist in Commission regulation § 1.69.

DCMs may incur costs implementing proposed § 38.852, including the administrative costs of analyzing their existing rules and procedures to determine whether they comply with the proposed requirements, and drafting and implementing new or amended rules and procedures, as necessary. Additionally, proposed § 38.852 requires disclosures to be made by DCM officers or members of the board of directors when any actual or potential conflict of interest may be present, and requires these officers or members of the board of directors to abstain from deliberations and voting on issues where the individual is conflicted. Costs will arise not only from administrative time in handling the disclosure, but also in the required documentation to ensure compliance with the intent of the proposed rules. Furthermore, there may be additional costs incurred when conflicted individuals abstain from deliberations and the DCM officers, and members of the board of directors, committees, and disciplinary panels potentially need to seek additional information from independent, non-conflicted experts and consultants. Finally, the Commission believes that DCMs will incur costs related to collecting and storing documents evidencing conflicts of interest determinations. The Commission notes that some of these costs may be less significant to the extent that DCMs have voluntarily adopted the requirements of Commission regulation § 1.69.

Costs associated with complying with the proposed §§ 37.1202 and 38.852 may further vary based on the size of the SEF or DCM, available resources, and existing practices and policies. Further, conflict of interest policies required for implementing proposed §§ 37.1202 and 38.852, would likely not significantly change from year to year, so after the initial creation of the policies, the time required to maintain and amend rules and procedures would be negligible.

The Commission requests comments on the potential costs of proposed §§ 37.1202 and 38.852, including any costs that would be imposed on SEFs, DCMs, other market participants, or the financial system more broadly.

C. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of proposed §§ 37.1202 and 38.852 in light of the specific considerations identified in Section 15(a) of the CEA. The Commission believes that proposed §§ 37.1202 and 38.852 may have a beneficial effect on protection of market participants and the public, as well as on the financial integrity of the markets, by taking steps to help ensure the impartiality of key SEF and DCM decision-makers, particularly those persons responsible for the exchange's market regulation functions. Identifying and documenting actual and potential conflicts of interest before reviewing a matter may reduce the risk of decision-makers being influenced by personal interests rather than acting in best interest of the SEF or DCM, and, ultimately, market participants and the public. Such a requirement also is likely to hold decision-makers accountable to SEFs and DCMs and may foster market participant and public trust in the SEFs and DCMs, which is also essential to maintaining the integrity of markets. The Commission has considered the other Section 15(a) factors and believes that they are not implicated by proposed §§ 37.1202 and 38.852.

iv. Limitations on the Use and Disclosure of Material Non-Public Information—Proposed §§ 37.1203 and 38.853

Currently, Commission regulation § 1.59 generally requires SROs to adopt rules prohibiting employees, governing board members, committee members or consultants from trading commodity interests on the basis of material non-public information. DCMs are exempt from Commission regulation § 1.59(b) and (c), but the entirety of § 1.59 applies to SEFs. As previously described in detail,[283] both SEFs and DCMs must comply with the requirements of Commission regulation § 1.59(d), which prohibits members of the board of directors, committee members, or consultants of the SRO from trading for their own account, or for or on behalf of any other account, based on material non-public information.

In addition to the Commission's statutory authority on insider trading,[284] DCMs are subject to Core Principle 16, which requires DCMs to establish and enforce rules to minimize conflicts of interest. DCM Core Principle 16 Guidance provides that DCMs should provide appropriate limitations on the use or disclosure of material non-public information gained through performance of official duties by members of the board of directors, committee members, and DCM employees, or gained by those through an ownership interest in the DCM.[285]

Proposed §§ 37.1203 and 38.853 would require SEFs and DCMs to establish and enforce policies and procedures for their employees, members of the board of directors, committee members, and consultants to prohibit the disclosure of material non-public information and to prohibit trading if the individual has access to material non-public information. Additionally, proposed §§ 37.1203 and 38.853 would provide conditions under which exemptions to employee trading prohibitions could be granted.

Proposed §§ 37.1203(c) and 38.853(c) state that SEFs and DCMs may grant trading exemptions to employees pursuant to its policies and procedures,

[283] *Supra* Section IV(c).

[284] *See* CEA section 9(e), 7 U.S.C. 13(e).

[285] *See* Appendix B to part 38, Core Principle 16 Guidance.

on a case-by-case basis, only if certain requirements are met, including: (1) the ROC approves the trading exemption; (2) the employee can demonstrate that the trading is not being conducted on the basis of material non-public information gained through the performance of their official duties; and (3) the SEF or DCM documents the employee's exemption in accordance with requirements in existing Commission regulations §§ 37.1000 and 37.1001, or 38.950 and 38.951, as applicable. Additionally, proposed §§ 37.1203(d) and 38.853(d) would require SEFs and DCMs to diligently monitor trading activity conducted pursuant to such exemptions.

A. Benefits

The Commission believes proposed §§ 37.1203(a) and 38.853(a), requiring SEFs and DCMs to establish policies and procedures to safeguard the use and disclosure of material non-public information, will result in several benefits. Generally, the Commission believes that these proposed rules are likely to result in benefits by reducing the instances of conflicts of interest where persons responsible for exchange governance or market regulation functions take advantage of their roles for personal financial benefit. Establishing consistent and clearly defined standards is likely to reduce instances of the misuse and disclosure of material non-public information by employees, members of the board of directors, committee members, and consultants at SEFs and DCMs and promote public confidence in the markets. In addition, preventing SEF and DCM employees or insiders with access to material non-public information from leveraging their access to benefit themselves, or others, commercially or otherwise, promotes fair and transparent markets, which will benefit all the market participants.

There also will be benefits from the requirements in proposed §§ 37.1203(b) and 38.853(b), which prohibit employees from certain types of trading or disclosing for any purpose inconsistent with the performance of the person's official duties as an employee any material non-public information obtained as a result of such person's employment. Additionally, the parameters outlined in proposed §§ 37.1203(c) and 38.853(c) for granting exemptions to the employee trading prohibition, along with the new requirement to monitor such exemptions under proposed §§ 37.1203(d) and 38.853(d), are likely to deter misuse of the employee trading exemptions. Additionally, these proposed rules may also promote confidence in the market regulation functions of SEFs and DCMs because they are: (1) requiring SEFs and DCMs to limit the issuance of exemptions to specific, case-by-case instances; and (2) protecting the markets from trading by employees with unfair, informational advantages.

As noted above, Commission regulation § 1.59 currently requires SEFs to adopt rules prohibiting employees, governing board members, committee members or consultants from trading commodity interests on the basis of material non-public information. Both SEFs and DCMs must comply with the requirements of Commission regulation § 1.59(d), which prohibits members of the board of directors, committee members, or consultants of an SRO from trading for their own account, or for or on behalf of any other account, based on material non-public information. DCM Core Principle 16 Guidance states that DCMs should provide for appropriate limitations on the use or disclosure of material non-public information. To the extent that SEFs and DCMs have policies and procedures consistent with Commission regulation § 1.59, DCM Core Principle 16 Guidance, or have existing programs to monitor trading conducted pursuant to an exemption from the employee trading prohibition, the discussed benefits may be less significant.

The Commission believes that enhancing SEFs' and DCMs' obligations regarding their oversight of the exemptions they grant is an appropriate balance between limiting the misuse of exemptions and ensuring that the employee trading prohibition is not overly broad. One of the benefits of the proposed requirements related to the permitted trading exemptions is that providing such exemptions, as appropriate, will not impair the ability or diminish willingness of potential employees to accept employment opportunities with a SEF or DCM. Similarly, the proposed regulatory limitations on the use and disclosure of material non-public information as well as the new requirements on administering the exemptions will result in a more efficient process where there is transparency of the trading conducted by SEF or DCM employees.

The proposed rules' expansion of the trading prohibition to ''related commodity interests'' at the product level, as well as the expansion of the trading prohibition on direct owners on the person/entity level, are also likely to have benefits. The Commission believes that expanding these limitations are likely to prevent and reduce the instances of conflicts of interest even as to those contracts that are interconnected due to having price movements correlate with the price movements of a commodity interest traded on, or subject to the rules of a SEF or a DCM to such a degree that intermarket spread margins or special margin treatment is recognized or established by the SEF or DCM.

The Commission also believes that proposed §§ 37.1203(e) and 38.853(e) prohibiting certain trading by members of the board of directors, committee members and consultants in possession of material non-public information and barring the release of material non-public information will have benefits by promoting confidence in SEF and DCM market regulation functions and the integrity of the marketplace. The Commission also believes that preventing decision-makers from trading on or disclosing material non-public information, is beneficial in that is further prevents such decision-makers from exploiting unfair informational advantages. In turn, that helps create integrity and fairness in the markets. Finally, by restricting the disclosure of material non-public information, SEF and DCM decision-makers are less likely to share information that might put other market participants at a disadvantage.

Regarding proposed non-substantive changes to certain terms such as ''commodity interest'' and ''related commodity interest,'' as fully discussed above,[286] the Commission believes these changes enhance ease of reference for SEF and DCM staff.

B. Costs

Proposed §§ 37.1203 and 38.853 would require that SEFs and DCMs implement policies and procedures to safeguard against the misuse of material non-public information. SEFs and DCMs would incur additional costs from this proposal through the additional hours SEF or DCM employees might need to spend analyzing the compliance of their rules and procedures with these requirements, and drafting and implementing new or amended rules and procedures, when necessary. Costs associated with complying with the proposed §§ 37.1203 and 38.853 may further vary based on the size of the SEF or DCM, available resources the SEF or DCM may have, and existing practices and policies the SEF or DCM may have in place.

While the Commission believes that most SEFs and DCMs already have policies and procedures in place to

[286] *Supra* Section IV(c).

prevent the misuse and disclosure of material non-public information, proposed §§ 37.1203 and 38.853 would likely require SEFs and DCMs to allocate employee administrative time dedicated to either draft new or amend existing policies to ensure the SEF and DCM are complying with any regulatory proposed rules on the limitations on the use and disclosure of material non-public information. The amount of time required would vary based on a number of factors, including whether the SEF or DCM already has policies complying with the proposed rules and the amount of time needed for each SEF and DCM to draft new or amended polices where necessary. For example, there will likely be costs associated with ensuring the policies and procedures apply to each class of individuals described in proposed §§ 37.1203 and 38.853. Costs associated with complying with proposed §§ 37.1203 and 38.853 may further vary based on the size of the SEF or DCM, available resources, and existing practices, rules, and procedures. Accordingly, those costs would be impracticable to reasonably quantify. Further, the Commission believes that the rules, policies and procedures required to implement the limitations on the use and disclosure of material non-public information would likely not change significantly from year to year, so after the initial creation of the policies and procedures, the time required to maintain those policies and procedures would be negligible.

Additionally, to the extent the SEF or DCM seeks to provide employee trading exemptions, there will likely be costs to revise or draft policies and procedures consistent with proposed §§ 37.1203 and 38.853 requirements, and to evaluate those exemptions on a case-by-case basis. Furthermore, any exemptions being granted would require review by the ROC and be individually documented by the SEF or DCM, all which would take administrative time.

SEFs and DCMs will incur additional costs if they grant employee trading exemptions, but do not already have processes in place to diligently monitor the trading by those employees. However, the Commission believes that SEFs and DCMs should have existing programs to monitor, detect, and deter abuses that may arise from trading conducted pursuant to an exemption from the employee trading prohibition. A SEF or DCM should, for example, utilize its existing surveillance program to monitor trading by employees or other insiders subject to proposed §§ 37.1203 and 38.853. Such existing resources may alleviate some of the burden and costs associated with compliance with proposed §§ 37.1203 and 38.853.

The Commission requests comments on the potential costs of proposed §§ 37.1203 and 38.853, including any costs that would be imposed on SEFs, DCMs, other market participants, or the financial system more broadly.

C. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of the proposed amendments to §§ 37.1203 and 38.853 in light of the specific considerations identified in Section 15(a) of the CEA. The Commission believes that proposed §§ 37.1203 and 38.853 may have a beneficial effect on protection of market participants and the public, as well as on the financial integrity of the markets. The Commission believes that preventing members of the board of directors, committee members, employees, consultants, and those with an ownership interest of 10 percent or more in the SEF or DCM with access to material non-public information from leveraging their access to benefit themselves, or others, commercially or otherwise, upholds the principle of fair markets. Furthermore, the Commission believes that the requirements related to granting and monitoring employee trading exemptions to will enhance employee accountability and promote transparency, which are essential for establishing the integrity of markets. The Commission has considered the other Section 15(a) Factors and believes that they are not implicated by proposed §§ 37.1203 and 38.853.

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

DCMs are not subject to a specific statutory or regulatory requirement to have a certain threshold of public directors.[287] Existing Commission regulation § 1.64(b)(1) requires SEFs to include at least 20 percent ''non-member'' directors in the board of directors.

The Commission proposes the following composition standards for the board of directors for both SEFs and DCMs by: (i) codifying in proposed § 38.854(a)(1) the DCM Core Principle 16 Acceptable Practice standards that DCM boards of directors be composed of at least 35 percent public directors; (ii) extending this requirement to SEF boards of directors under proposed § 37.1204(a)(1); [288] and (iii) adopting additional requirements to increase transparency and accountability of the board of directors. Proposed §§ 37.1204(b) and 38.854(b) require that each member of a SEF's or DCM's board of directors, including public directors, have relevant expertise to fulfill the roles and responsibilities of being a director.

Proposed §§ 37.1204(c) and 38.854(c) prohibit linking the compensation of public directors and other non-executive members of the board of directors, to either the business performance of the SEF or DCM or an affiliate. Proposed §§ 37.1204(d) and 38.854(d) require SEFs' and DCMs' board of directors to conduct an annual self-assessment to review their performance.

A. Benefits

In general, a board of directors plays a crucial role in an exchange's ability to identify, manage, and resolve conflicts of interest. Together with senior management, the board of directors set the ''tone at the top'' for a SEF's or DCM's governance and compliance culture. The Commission believes that the proposed 35 percent public director standard is likely to provide benefits for both SEFs and DCMs. For example, in comparison to the existing twenty-percent ''non-member'' requirement for SEFs in existing § 1.64(b)(1), which has created an unintentional consequence of allowing SEFs to compose their boards of directors entirely with ''insiders'' such as executives at the SEF's affiliate, the proposed rule will promote independent decision-making on the board of directors. Composition standards for the board of directors that promote a well-functioning governing body with the presence of directors that are independent from the executive team, coupled with clear, comprehensive policies and procedures, will minimize conflicts of interests at SEFs and DCMs, and the resulting impact that such conflicts could have on a SEF's or DCM's market regulation functions. Since all current DCMs have adopted the DCM Core Principle 16 Acceptable Practices, which include 35 percent public directors, the benefits of the proposed 35 percent composition requirement will be limited. It is important to note that the proposed 35 percent threshold is less than the

[287] However, the DCM Core Principle 16 Acceptable Practices set forth practices to demonstrate compliance with DCM Core Principle 16. Among other topics, the acceptable practices provide that a DCM's board of directors or executive committees would be comprised of at least 35 percent public directors. The Commission notes that currently all of the DCMs that are designated by the Commission rely on the acceptable practices to comply with Core Principle 16, in lieu of any other means for compliance.

[288] *See* proposed § 37.1204(a)(1), herein.

composition requirements applicable to publicly-traded companies, which require that the majority of the board of directors to be ''independent'' directors. While the proposed threshold is lower than the standard that applies to publicly-traded companies, the Commission seeks to strike the appropriate balance between promoting independence on the board of directors and providing enough flexibility to include directors with the necessary industry expertise.

By setting the percentage of public directors at 35 percent and requiring enhanced accountability by board of directors through an annual self-assessment, the Commission believes that proposed §§ 37.1204(a) and 38.854(a) will provide multiple benefits. First, public directors may offer perspectives and experiences that differ but complement the views of internal directors to aid decision-making at exchanges. Second, establishing clear roles and responsibilities for board of directors will enhance accountability. Third, the proposed §§ 37.1204(b) and 38.854(b) requirements that members of SEF's and DCM's board of directors have relevant expertise will ensure these individuals can contribute to a well-functioning board of directors that is capable of addressing complex problems that SEFs and DCMs face.

To further minimize conflicts of interest, proposed §§ 37.1204(c) and 38.854(c) prohibit the compensation of public directors and other non-executive members of the board of directors from being directly dependent on the business performance of either the SEF or DCM or an affiliate. This requirement helps to ensure that non-executive directors remain independent and make objective decisions for the SEF or DCM—not for their own financial benefit. This also should promote public confidence in the ability of the board of directors to effectively govern the SEF or DCM.

The Commission believes that proposed §§ 37.1204(c) and 38.854(c) requirements for SEF and DCM boards of directors to conduct annual self-assessments should enhance boards of directors' accountability and improve their ability to meet the standards of conduct expected by the proposed rules, which in turn will benefit SEFs, DCMs, market participants, and the financial system more broadly. The documentation process will also create benefits by allowing Commission staff to request to see the results of the self-assessment during the course of rule enforcement reviews. To the extent that SEFs and DCMs already conduct self-assessments of their boards of directors, these benefits will be limited or may already have been realized.

B. Costs

The requirements in proposed §§ 37.1204(a)(1) and (3) and 38.854(a)(1) and (3) requiring SEF and DCM board of directors and executive committees to be composed of 35 percent public directors could cause SEFs and DCMs to incur higher costs, compared to non-public directors, because public directors must meet additional qualifications and therefore it may take SEF and DCM staff additional time to identify such persons. Similarly, requiring members of the board of directors to have relevant expertise, under proposed §§ 37.1204(b) and 38.854(b) and will impose costs in terms of SEF and DCM staff time. When the composition requirements are first established, some SEFs and DCMs will incur initial costs to identify and appoint new members for their boards of directors that satisfy the composition requirements of proposed §§ 37.1204(b) and 38.854(b). Time requirements will vary based on SEFs and DCMs current composition of the board of directors.

Proposed §§ 37.1204(a)(2) and 38.854(a)(2) will require SEFs and DCMs to draft policies and procedures setting forth the requirements of the board of directors, including how the board oversees the entity's compliance with statutory, regulatory, and self-regulatory responsibilities. At a minimum, existing board of directors' policies would need to be reviewed, and, as necessary, such policies would need to be revised. To the extent that such policies are approved by the board of directors, the board of directors would need to devote additional meeting time to approve such policies.

Prohibiting compensation being directly linked to business performance, for public directors and other non-executive members, as required by proposed §§ 37.1204(c) and 38.854(c) will impose costs in terms of time necessary to review existing compensation plans, and revise such plans if they are not in compliance.

The requirements under proposed §§ 37.1204(d) and 38.854(d) for a SEF's and DCM's board of directors to conduct an annual self-assessment will impose costs in terms of conducting such a review, including reviewing policies and procedures and interviewing SEF or DCM staff. Additionally, there will be costs of the time of the board of directors evaluating and approving the self-assessment at board meetings.

Proposed §§ 37.1204(e) and 38.854(e) require procedures for removing members of the board of directors, when the conduct of a member is likely to be prejudicial to the sound and prudent management of the SEF or DCM. The proposed requirements will impose costs relating to reviewing existing procedures, drafting new procedures if necessary, and board of director's time in assessing situations where a member's conduct may be problematic.

The requirements in proposed §§ 37.1204(f) and 38.854(f) relating to reporting to the Commission within five business days of any change in board membership or any of its committees will require SEF and DCM staff time in notifying the Commission, as applicable, when changes to the membership of the board of directors or any of its committees occur.

Generally, costs associated with complying with proposed §§ 37.1204 and 38.854 may further vary based on the size of the SEF or DCM, available resources, and existing practices, rules, and procedures. Accordingly, those costs would be impracticable to reasonably quantify. Further, rules and procedures required for implementing the proposed board of director requirements would likely not change significantly from year to year, so after the initial creation of the rules and procedures, the time required to maintain those procedures would be negligible. To the extent that SEFs and DCMs have adopted existing board of director composition standards under DCM Core Principle 16 Acceptable Practices, some of the costs identified above will have already been realized.

The Commission requests comments on the potential costs of proposed §§ 37.1204 and 38.854, including any costs that would be imposed on SEFs, DCMs, other market participants, or the financial system more broadly.

C. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of proposed §§ 37.1204 and 38.854 in light of the specific considerations identified in Section 15(a) of the CEA. The Commission believes that proposed §§ 37.1204 and 38.854 may have a beneficial effect on protection of market participants and the public, as well as on the financial integrity of the markets. Public directors, with their independent perspective, might consider and advocate for stakeholders that non-public directors do not consider. As a result, this might lead to greater protection of the wider public. The Commission has considered the other Section 15(a) Factors and believes that they are not implicated by proposed §§ 37.1204 and 38.854.

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

The definition of ''public director'' in proposed §§ 37.1201(b)(12) and 38.851(b)(12) excludes a person who has a ''material relationship'' with the SEF or DCM from serving as a public director, and defines a ''material relationship'' as one that could affect the independent judgment or decision-making ability of the director. The public director definition enumerates certain relationships that are deemed to be material: (1) the director is an officer or an employee of the SEF or DCM, or an officer or an employee of its affiliate; (2) the director is a member of the DCM or is a director, officer, or an employee of either a member or an affiliate of a member; (3) the director directly or indirectly owns more than 10 percent of the SEF or DCM or an affiliate of the SEF or DCM, or is an officer or employee of an entity that directly or indirectly owns more than 10 percent of SEF or DCM; (4) the director, or an entity in which the director is a partner, an officer, an employee, or a director receives more than $100,000 in aggregate annual payments from the SEF or DCM, or an affiliate of the SEF or DCM. A material relationship disqualifies a person from being a public director. The material relationship disqualifier also applies to any person with whom the director has a ''family relationship,'' as set forth in proposed §§ 37.1201(b)(7) and 38.851(b)(7), and is subject to a one-year look-back period.

A. Benefits

The Commission believes that codifying the public director definition for both SEFs and DCMs in proposed §§ 37.1201(b)(12) and 38.851(b)(12) will provide several benefits. First, expanding the disqualifying factors to prohibit individuals who, directly or indirectly, own more than 10 percent of either the SEF or DCM or an affiliate will further prevent individuals with specific conflicts of interests, including personal financial interests, from serving as public directors and makes it more likely that decision-makers will remain independent. Second, applying the disqualifying factors to family relationships ensures that public directors are not influenced by familial connections. Third, requiring both an initial and annual review of the qualifications of public directors should reduce the risk that existing public directors may become disqualified in the course of the service on the board of directors and become conflicted in the SEFs' or DCMs' decision-making process.

B. Costs

The Commission does not believe that there are costs associated with the definition of ''public director'' in proposed §§ 37.1201(b)(12) and 38.851(b)(12). However, SEFs and DCMs will incur costs associated with making determinations on whether an individual is qualified to serve as a public director. Those costs include the process to identify, minimize, and resolve conflicts of interests as proposed by §§ 37.1201(a) and 38.851(a), and to determine whether a person meets fitness standards under proposed §§ 37.207 and 38.801, discussed above. Finally, the Commission notes that if an individual is found not to be eligible to serve, the SEF or DCM can mitigate the costs incurred with making such determination if it chooses to nominate the individual as a non-public director. Costs associated with complying with the proposed §§ 37.1201(b)(12) and 38.851(b)(12) may vary based on the size of the SEF and DCM, its available resources, and its existing practices and policies. To the extent that SEFs and DCMs have voluntarily adopted existing public director standards under the DCM Core Principle 16 Acceptable Practices, some of the costs identified above will have already been realized.

The Commission requests comments on the potential costs of proposed §§ 37.1201(b)(12) and 38.851(b)(12), including any costs that would be imposed on SEFs, DCMs, other market participants, or the financial system more broadly.

C. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of proposed §§ 37.1201(b)(12) and 38.851(b)(12) in light of the specific considerations identified in Section 15(a) of the CEA. The Commission believes that the public director definition under proposed §§ 37.1201(b)(12) and 38.851(b)(12) may have a beneficial effect on the protection of market participants and the public, as well as on the financial integrity of the markets.[289] Ensuring sufficient independent judgment through the inclusion of public directors will improve the overall decision-making of a SEF or DCM and protect the market regulation functions. The Commission has considered the other Section 15(a) Factors and believes that they are not implicated by proposed §§ 37.1201(b)(12) and 38.851(b)(12).

vii. Nominating Committee—Proposed §§ 37.1205 and 38.855

Currently, neither SEFs nor DCMs are obligated by Commission regulations to have a nominating committee to identify or manage the process for nominating potential members of the board of directors. DCM Core Principle 17 requires the governance arrangements of a board of directors of a DCM to permit consideration of the views of market participants. Similarly, pursuant to Commission regulation § 1.64(b)(3), an SRO, such as a SEF, must include a diversity of membership interests on their governing boards.

The Commission is proposing §§ 37.1205 and 38.855 to require SEFs and DCMs to have a nominating committee. The role of the nominating committee would be to identify a pool of candidates who are qualified to serve on the board of directors who represent diverse interests, including the interests of the participants and members of the SEF or DCM. Furthermore, proposed §§ 37.1205 and 38.855 would require: at least 51 percent of the nominating committee be comprised of public directors, the nominating committee be chaired by a public director, and the nominating committee report directly to the board of directors.

A. Benefits

The Commission believes that proposed §§ 37.1205 and 38.855 establishing SEF and DCM nominating committees will help protect the integrity of selecting members for the board of directors and assist SEFs and DCMs in identifying qualified candidates. The Commission believes that requiring 51 percent of the nominating committee to be public directors will help maintain independence and objectivity in selecting nominees for the board of directors. Additionally, the requirement in proposed §§ 37.1205 and 38.855 that the nominating committee identify individuals that reflect the views of market participants will help ensure that a broader pool of candidates with more diverse viewpoints are considered to serve on the board of directors. The Commission believes that these diverse viewpoints may improve the decision-making of the SEF or DCM. These benefits, in turn, will improve the governance and public perception of the SEF or DCM.

[289] See *supra,* Section V(b), ''public director'' definition—proposed §§ 37.1201(b)(12) and 38.851(b)(12).

B. Costs

Since SEFs and DCMs are not currently required to have nominating committees, some entities would need to revise their existing policies and procedures to create a nominating committee in accordance with proposed §§ 37.1205 and 38.855. Accordingly, proposed §§ 37.1205 and 38.855 would impose some costs on these SEFs and DCMs, including costs that could arise from additional hours SEF and DCM employees might need to spend time reviewing existing SEF and DCM policies and procedures, and designing and implementing new or amended rules and procedures, as necessary.

Specifically, drafting new policies and procedures to form a nominating committee would cost administrative time. Those administrative costs associated with complying with proposed §§ 37.1205 and 38.855 may vary based on the size of the SEF or DCM, available resources, and existing practices, rules, and procedures. Accordingly, those costs would be impracticable to reasonably quantify. Further, rules and procedures required to administer a nominating committee would likely not change significantly from year to year, so after the initial creation of the rules and procedures, the time required to maintain those procedures would be negligible.

When the nominating committee is first established, the SEF and DCM will incur initial costs related to identifying potential members for the nominating committee, including public directors that must comprise 51 percent of the committee. Ongoing implementation of proposed §§ 37.1205 and 38.855 would also impose costs whenever the nominating committee meets to identify new candidates for the board of directors, nominates individuals to the board of directors, and reports their decisions to the SEF or DCM board of directors.

The Commission requests comments on the potential costs of proposed §§ 37.1205 and 38.855, including any costs that would be imposed on SEFs, DCMs, other market participants, or the financial system more broadly.

C. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of proposed §§ 37.1205 and 38.855 in light of the specific considerations identified in Section 15(a) of the CEA. The Commission believes that proposed §§ 37.1205 and 38.855 may have a beneficial effect on protection of market participants and the public, as well as on the financial integrity of the markets. The Commission believes that the proposed rules requiring SEF and DCM nominating committees will have a beneficial effect on the identification of nominees for the board of directors who have independent and diverse experiences. Such characteristics, the Commission believes, will aid in recruiting members for the board of directors who will contribute to making sound decisions for SEFs and DCMs, and, ultimately, for the markets. The Commission has considered the other Section 15(a) Factors and believes that they are not implicated by proposed §§ 37.1205 and 38.855.

viii. Regulatory Oversight Committee—Proposed §§ 37.1206 and 38.857

Currently, the DCM Core Principle 16 Acceptable Practices provide that DCMs establish a ROC, consisting of only public directors, to assist in minimizing actual and potential conflicts of interest. The purpose of the ROC is to oversee the DCM's regulatory program on behalf of the board of directors, which in turn, delegates the necessary authority, resources, and time for the ROC to fulfill its mandate. The ROC is responsible for: (1) monitoring the DCM's regulatory program for sufficiency, effectiveness, and independence; (2) overseeing all facets of the regulatory program; (3) reviewing the size and allocation of the regulatory budget and resources; and the number, hiring and termination, and compensation of regulatory personnel; (4) supervising the DCM's CRO, who reports directly to the ROC; (5) preparing an annual report assessing the DCM's self-regulatory program for the board of directors and the Commission; (6) recommending changes that would ensure fair, vigorous, and effective regulation; and (7) reviewing regulatory proposals and advising the board as to whether and how such changes may impact regulation. In performing these functions, the ROC plays a critical role in insulating the CRO and the DCM's self-regulatory function from undue influence.

Currently, SEFs do not have any requirements for establishing a ROC but they are subject to Core Principle 15, which requires SEFs to designate a CCO to monitor its adherence to statutory, regulatory, and self-regulatory requirements and to resolve conflicts of interest that may impede such adherence. The CCO is required to report to the SEF board of directors (or similar governing body) or the senior SEF officer.

The Commission is proposing to codify the ROC component of the DCM Core Principle 16 Acceptable Practices for both SEFs and DCMs. Proposed §§ 37.1206(a) and 38.857(a), respectively, require SEFs and DCMs to establish a ROC composed of only public directors. In addition, the Commission is proposing §§ 37.1206(c) and 38.857(c), which require the board of directors to delegate sufficient authority, dedicate sufficient resources, and allow sufficient time to perform its functions to ensure that the ROC can fulfill its mandate and duties. Furthermore, proposed §§ 37.1206(d) and 38.857(d) would require SEF and DCM ROCs, respectively, to have oversight duties over the market regulation functions, including: (1) monitoring the SEF's or DCM's market regulation functions for sufficiency, effectiveness, and independence; (2) overseeing all facets of the market regulation functions; (3) approving the size and allocation of the regulatory budget and resources; and the number, hiring and termination, and compensation of staff; (4) recommending changes that would promote fair, vigorous, and effective self-regulation; and (5) reviewing all regulatory proposals prior to implementation and advising the board of directors as to whether and how such proposals may impact market regulation functions.

The Commission also is proposing several new requirements related to procedures and documentation for ROC meetings that reflect the best practices that have been identified during the Commission's oversight of DCMs. Proposed §§ 37.1206(f) and 38.857(f) would require SEF and DCM ROCs to meet quarterly. In addition, proposed §§ 37.1206(f)(1)(iii) and 38.857(f)(1)(iii) would require that ROC meeting minutes include: (a) list of the attendees; (b) their titles; (c) whether they were present for the entirety of the meeting or a portion thereof (and if so, what portion); and (d) a summary of all meeting discussions. Proposed §§ 37.1206(f)(2) and 38.857(f)(2) would require the ROC to maintain documentation of the committee's findings, recommendations, and any other discussions or deliberations related to the performance of its duties. The Commission also is proposing rules to require an annual ROC report, which would enhance the ROC report procedures currently set forth in the DCM Core Principle 16 Acceptable Practices. Specifically, the Commission is proposing §§ 37.1206(g)(1) and 38.857(g)(1) to require that ROC annual reports include a list of any actual or potential conflicts of interest that were reported to the ROC and a description

of how such conflicts of interest were managed and resolved and an assessment of the impact of any conflicts of interest on the SEF's or DCM's ability to perform its market regulation functions. In addition, proposed §§ 37.1206(g)(2) and 38.857(g)(2) would establish a process for filing the ROC annual report which mirrors the existing SEF annual compliance report requirements in Commission regulation § 37.1501(e). These proposed requirements would establish the following: (1) a filing deadline no later than 90 days after the end of the fiscal year; (2) a process for amendments and extension requests; (3) recordkeeping requirements; and (4) delegated authority to the Division of Market Oversight to grant or deny extensions. Finally, proposed §§ 37.1206(g)(3) and 38.857(g)(3) require SEFs and DCMs to maintain all records demonstrating compliance with the duties of the ROC and the preparation and submission of its annual report.

A. Benefits

Proposed §§ 37.1206 and 38.857 establish the creation and duties for SEF and DCM ROCs. These proposed rules will generate benefits by establishing effective structural governance protections to assist SEFs and DCMs in minimizing conflicts of interest that may impact their market regulation functions. The ROC will help to ensure that improper influences and pressures from a SEF's or DCM's commercial interest do not denigrate the integrity of the market regulation functions. Because both SEFs and DCMs are SROs, these benefits extend well beyond the internal functioning of a SEF or DCM. Since SEFs and DCMs have similar commercial interests that may conflict with their market regulation functions, the Commission believes that applying similar ROC structures across SEFs and DCMs will result in a more level and resilient marketplace, which in turn will promote competition in the derivatives markets.

The proposed rules address the types of conflicts of interest Commission staff has identified through its SEF and DCM oversight activities. Accordingly, the proposed rules are based on existing, identifiable solutions that have already benefitted SEFs and DCMs. To the extent that the existing SEF and DCM practices are similar to the proposed requirements, the benefits will be limited or already have been realized.

The requirements under proposed §§ 37.1206(f) and 38.857(f) relating to ROC meetings and documentation should provide a number of benefits. First, the quarterly meeting requirement facilitates the free-flow of information between the ROC and the SEF's CCO or the DCM's CRO. This is an opportunity to share information, discuss matters of mutual concern, and speak freely about potentially sensitive issues that may relate to the SEF's or DCM's management. Such communication may enable the SEF or DCM to more effectively fulfill its market regulation function. Similarly, restricting individuals with actual or potential conflicts of interest from attending ROC meetings ensures that sensitive information related to the market regulation function is not broadly disseminated. The documentation requirements, such as requiring ROC meeting minutes under proposed §§ 37.1206(f)(1)(iii) and 38.857(f)(1)(iii), and the ROC annual reporting requirements under proposed §§ 37.1206(g)(1) and 38.857(g)(1), are mechanisms to enhance the accountability of the ROC and promote transparency for all stakeholders. Ultimately, market participants will benefit from the improvements in SEF and DCM governance operations.

B. Costs

The proposed rules would impose some costs on SEFs and DCMs. To the extent that DCMs and some SEFs already have established a ROC, they may incur some costs related to updating their ROC policies and procedures to comply with proposed §§ 37.1204 and 38.854. Costs could arise from additional hours SEF and DCM employees might need to spend analyzing the compliance of their rules and procedures with these requirements, drafting and implementing new or amended rules and procedures, when necessary. While some SEFs have chosen to create ROCs, those SEFs that do not current have ROCs may incur additional costs associated with establishing the committee and identifying the public directors that will serve on the committee. Specifically, drafting new policies to form this committee would cost administrative time. The amount of time required to establish this committee would vary based on a number of factors, including whether the SEF's or DCM's existing policies complying with the proposed rules, and the amount of time necessary for each SEF and DCM to draft and implement new or amended polices, where necessary. Further, policies required for implementing the proposed rules would likely not change significantly from year to year, so after the initial creation of the policies, the time required to create rules and procedures would be negligible.

When the ROC is initially established, the SEF or DCM will incur costs for the time spent to identify potential members that meet public director composition requirement. Ongoing implementation of the proposed rules also would impose costs. For example, there may be costs associated with providing necessary information to the ROC for its consideration, and time spent by the members of a SEF's or DCM's board of directors or senior officer to meet and consult with the ROC, and consider and respond to any information requested by the ROC. A ROC's operation also would require time from its members to meet at least on a quarterly basis, as required by proposed §§ 37.1206(f) and 38.857(f). ROC members also will spend time on the duties outlined in proposed §§ 37.1206(d) and 38.857(d).

There may be additional costs related to ROC meetings, reporting, and recordkeeping. Proposed §§ 37.1206(f)(1)(iii) and 38.857(f)(1)(iii) require ROCs to keep minutes of their meetings and proposed §§ 37.1206(f)(2) and 38.857(f)(2) require ROCs to maintain documentation of findings, recommendations, and any other discussions or deliberations. Proposed §§ 37.1206(g)(1) and 38.857(g)(1) require ROCs to prepare an annual report for the board of directors and the Commission. The time spent drafting the annual report will include time spent assessing the SEF's or DCM's self-regulatory program and preparing the report with the information required in proposed §§ 37.1206(g)(1)(i)–(vi) and 38.857(g)(1)(i)–(vi). Finally, SEFs and DCMs may incur some initial costs associated with establishing a process to maintain all records demonstrating compliance with the duties of the ROC and the preparation and submission of annual reports, as required by proposed §§ 37.1206(g)(3) and 38.857(g)(3).

Costs associated with complying with proposed §§ 37.1206(f) and 38.857(f) may vary based on the size of the SEF and DCM, available resources, and existing practices and policies. To the extent that SEFs and DCMs have adopted existing ROC standards under the DCM Core Principle 16 Acceptable Practices, some of the costs identified above will have already been realized.

The Commission requests comments on the potential costs of proposed §§ 37.1206 and 38.857, including any costs that would be imposed on SEFs, DCMs, other market participants, or the financial system more broadly. In particular, for those SEFs and DCMs that already have ROCs in place, the

Commission requests comment on the extent to which the proposed rules would require changes to existing ROC policies and procedures.

C. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of proposed §§ 37.1206 and 38.857 in light of the specific considerations identified in Section 15(a) of the CEA. The Commission believes that proposed §§ 37.1206 and 38.857 may have a beneficial effect on protection of market participants and the public, as well as on the financial integrity of the markets by strengthening the boards oversight of the market regulation functions of SEFs and DCMs. The Commission has considered the other Section 15(a) Factors and believes that they are not implicated by proposed §§ 37.1206 and 38.857.

ix. Disciplinary Panel Composition—Proposed §§ 37.1207 and 38.858

Currently, the DCM Core Principle 16 Acceptable Practices provide that DCMs establish disciplinary panel composition standards. Those acceptable practices state that no group or class of industry participants may dominate or exercise disproportionate influence on such panels. Furthermore, the DCM Core Principle 16 Acceptable Practices provide that all disciplinary panels (and appellate bodies) include at least one person who would qualify as a public director, except in cases limited to decorum, attire, or the timely submission of accurate records required for clearing or verifying each day's transactions. Currently, Commission regulation § 1.64(c) requires SEF major disciplinary committees to include: (1) at least one member who is not a member of the SEF; and (2) sufficient different membership interests to ensure fairness and to prevent special treatment or preference for any person in the conduct of a committee's or the panel's responsibility.

The Commission is proposing §§ 37.1207 and 38.858 for both SEFs and DCMs, respectively, to adopt disciplinary panel composition requirements which prohibit any member of a disciplinary panel from participating in deliberations or voting on any matter in which the member has an actual or potential conflict of interest. With this proposed rulemaking, SEFs will be exempt from complying with Commission regulation § 1.64(c) since they will be subject to this new rule.

In addition, the Commission is proposing §§ 37.1207(a) and (b) and 38.858(a) and (b) to clarify that SEF and DCM disciplinary panels and appellate panels must consist of two or more persons. The Commission is also proposing §§ 37.1207(b) and 38.858(b) to extend the public participant requirement to any SEF and DCM committee to which disciplinary panel decisions may be appealed. Finally, the Commission is proposing technical amendments to Commission regulations §§ 37.206(b) and 38.702 to remove the references that disciplinary panels must meet the composition requirements of part 40 and replace these references with references to proposed regulations §§ 37.1207 and 38.858, respectively. The Commission also proposes changing the reference to ''compliance'' staff to ''market regulation'' staff. This is intended for clarity and is consistent with proposed changes to §§ 38.155(a) and 37.203(c).

A. Benefits

The requirement under proposed §§ 37.1207 and 38.858 for SEFs and DCMs to establish disciplinary panel requirements is likely to provide a number of benefits. The composition requirements of §§ 37.1207(a) and 38.858(a) instill fairness in the disciplinary process by requiring a minimum of two members, one of whom must be a public participant. This ensures that the disciplinary panels have a degree of independence from outside influences, and are capable of functioning impartially. Proposed §§ 37.1207(a)(1) and (2) and 38.858(a)(1) and (2) further these goals by precluding any group or class of participants from dominating or exercising disproportionate influence on a disciplinary panel, and prohibiting any member of a disciplinary panel from participating in deliberations or voting on any matter in which the member has an actual or potential conflict of interest. These safeguards increase the likelihood that disciplinary proceedings are handled by competent individuals that represent a diversity of perspectives, and are free of conflicts of interest. This, in turn, may benefit the overall integrity of the derivatives markets.

B. Costs

SEFs and DCMs are already required to establish disciplinary panels pursuant to Commission regulations §§ 37.206(b) and 38.702. Accordingly, the potential cost is limited to the changes necessary to comply with proposed §§ 37.1207 and 38.858. Initial costs could arise from additional administrative hours SEF and DCM employees might need to spend analyzing the compliance of their rules and procedures with these requirements, and drafting and implementing new or amended rules, as necessary. Once these rules and policies are established, they would likely not change significantly from year to year.

SEFs and DCMs may need to change the composition of their disciplinary panels to satisfy the requirements of proposed §§ 37.1207(a) and 38.858(a), and ensure that these requirements are extended to appellate panels, as required by proposed §§ 37.1207(b) and 38.858(b). Additionally, proposed §§ 37.1207 and 38.858 prohibit any member of the panel from voting on issues in which they have a conflict of interest, which may reduce the number of potential suitable individuals who may serve on the disciplinary panel.

Costs associated with complying with the proposed §§ 37.1207(b) and 38.858(b) may further vary based on the size of the SEF and DCM, its available resources, its existing practices and policies. To the extent that SEFs and DCMs have adopted existing disciplinary panel standards under the Acceptable Practices for DCM Core Principle 16, some of the costs identified above will have already been realized. The Commission requests comments on the potential costs of proposed §§ 37.1207 and 38.858, including any costs that would be imposed on SEFs, DCMs, other market participants, or the financial system more broadly. In particular, for those SEFs and DCMs that already have disciplinary panels in place, the Commission requests comment on the extent to which the proposed rules would require changes to existing policies and procedures regarding their disciplinary panels.

C. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of the proposed amendments to §§ 37.1207 and 38.858 in light of the specific considerations identified in Section 15(a) of the CEA. The Commission believes that proposed §§ 37.1207 and 38.858 may have a beneficial effect on protection of market participants and the public, as well as on the financial integrity of the markets. The Commission believes that by better ensuring the fairness of the disciplinary process, market participants can have greater trust in the oversight process of SEF and DCM rules. The Commission has considered the other Section 15(a) Factors and believes that they are not implicated by proposed §§ 37.1207 and 38.858.

x. DCM Chief Regulatory Officer—Proposed § 38.856

Commission regulations do not currently require DCMs to have a CRO. However, the framework created under the DCM Core Principle 16 Acceptable Practices includes a reference to a CRO, who reports directly to the ROC.

The Commission is proposing § 38.856(a)(1) to require DCMs to establish the position of a CRO to administer a DCM's market regulation functions. The proposed rules would require that (i) the position of CRO must carry with it the authority and resources necessary to fulfill the duties set forth in this section for CROs; and (ii) the CRO must have supervisory authority over all staff performing the DCM's market regulation functions.

In addition, the Commission is proposing § 38.856(a)(2) to require that the individual designated to serve as CRO must have the background and skills appropriate for fulfilling the duties of the position. A DCM, therefore, is expected to identify the needs of its own market regulation functions and ensure that the CRO has the requisite surveillance and investigatory experience necessary to perform the role. Moreover, individuals disqualified from registration pursuant to sections 8a(2) or 8a(3) of the CEA are ineligible to serve as a CRO.

Proposed § 38.856(b) requires the CRO to report directly to the DCM's board of directors or senior officer. The Commission is also proposing § 38.856(c) to require (1) the appointment or removal of a DCM's CRO to occur only with the approval of the DCM's ROC; (2) the DCM to notify the Commission within two business days of the appointment of any new CRO, whether interim or permanent; and (3) the DCM to notify the Commission within two business days of removal of the CRO. The Commission is proposing § 38.856(d) to require the board of directors or the senior officer of the DCM, in consultation with the DCM's ROC, to approve the compensation of the CRO.

The Commission is proposing § 38.856(e) to establish the duties of the CRO, which include: (1) supervising the DCM's market regulation functions; (2) establishing and administering policies and procedures related to the DCM's market regulation functions; (3) supervising the effectiveness and sufficiency of any regulatory services provided to the DCM by a regulatory service provider in accordance with existing § 38.154; (4) reviewing any proposed rule or programmatic changes that may have a significant regulatory impact and advising the ROC on such matters; and (5) in consultation with the DCM's ROC, identifying, minimizing, managing, and resolving conflicts of interest involving the DCM's market regulation functions.

Finally, proposed§ 38.856(f) requires DCMs to establish procedures for the CRO's disclosure of actual or potential conflicts of interest to the ROC, and designation of a qualified person to serve in the place of the CRO if the CRO has such a conflict of interest. The proposed rules also require documentation of any such disclosure regarding conflicts of interest.

A. Benefits

The Commission preliminarily believes that establishing a position of a CRO under proposed § 38.856(a)(1) will enable DCMs to comply with their statutory and regulatory obligation to fulfill their market regulation functions. Proposed § 38.856(a)(2) provides that the CRO must have the necessary background and skills appropriate for fulfilling the responsibilities of the position. This requirement will benefit DCMs by ensuring CROs have the requisite experience necessary to oversee the DCM's market regulation functions. CROs who lack appropriate background and skills for their position would have a harder time effectively fulfilling their duties, which could be detrimental to the DCM's role as a SRO.

Furthermore, proposed § 38.856(b), which requires the CRO to directly report to the board of directors or to the senior officer, would make it easier for the CRO to fulfill the duties critical to the DCM's market regulation functions. For example, having a direct line to the board of directors or the senior officer would allow the CRO to more easily gain approval for any new policies related to the DCM's market regulation functions that the CRO needed to implement, to the extent that they required approval of a senior officer or the board of directors. Since DCM rule changes often need to be approved by the board of directors, having the CRO report to the board of directors or to the senior officer (who likely regularly communicates with the board of directors) would allow the CRO to more easily explain the need for rule changes, and to answer questions from the board of directors or the senior officer about such changes.

Proposed §§ 38.856(c) and (d) require the ROC to (1) approve the appointment or removal of the CRO, and (2) consult with the board of directors or senior officer regarding the compensation of the CRO. The ROC is composed of exclusively public directors who have no material relationship with the exchange, and therefore, is well-positioned to protect the CRO from interference from commercial interests. If the senior officer or the board of directors sought to terminate the CRO or decrease the CRO's compensation, as retaliation for not advancing the DCM's commercial interests ahead of the interests of the market regulation function, the ROC could step in to protect the CRO. By requiring the DCM to notify the Commission upon the appointment of a new CRO, the proposed rule will facilitate Commission staff being able to contact the new CRO to discuss regulatory concerns. Additionally, Commission staff can ask questions about the removal of the old CRO, and identify whether the ROC was involved.

Additionally, proposed § 38.856(e), which establishes the duties of a CRO, will provide benefits by establishing 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.

Finally, proposed § 38.856(f), which requires the CRO to disclose to the ROC and document any actual or potential conflicts of interest identified by the CRO, is likely to provide benefits by promoting integrity and further allowing CROs to fulfill their duties. If the CRO did not have to disclose their own conflicts, the CRO's involvement in resolving conflicts of interest could exacerbate, rather than mitigate, conflicts of interest in the critical market regulation functions of the DCM. Therefore, proposed § 38.856(f) may further mitigate potential conflicts of interests in the DCM's role as an SRO.

B. Costs

Commission regulations do not currently require a DCM to appoint a CRO. However, the Commission noted that current industry practice is for DCMs to designate an individual to serve as CRO, and it would be difficult for a DCM to meet the staffing and resource requirements of § 38.155 without a CRO. However, even if all DCMs currently have a CRO, it is possible that some DCMs may incur costs by having to adjust their existing staffing structure to ensure it complies with the specific regulatory requirements of proposed § 38.856(a)(1). These costs could arise from additional hours DCM employees might need to spend analyzing their rules, policies,

and procedures for compliance with these requirements, and drafting and implementing new or amended rules, policies, and procedures, when necessary. Additionally, there may be costs incurred in implementing the appropriate policies and procedures to ensure that the CRO has the resources required to perform the duties set forth in proposed § 38.856(a)(1).

DCMs may also expend administrative time finding a suitable candidate for the CRO position if the DCM either does not have a CRO, or does not have a CRO that meets the requirements of proposed § 38.856(a)(2). If a DCM does not already have a CRO, the costs to identify and hire a new CRO could be significant. Where DCMs have existing CROs, the cost of implementing the proposed rules may be lower. Nevertheless, there may costs related to ensuring the existing CRO role satisfies all of the requirements set forth in proposed § 38.856. Ongoing costs may include employment costs for the position itself, as well as time spent by the board of directors or senior officer to supervise the CRO and the administrative costs associated with notifying the Commission of the appointment of a new CRO or the removal of an existing CRO. The Commission requests comments on the potential costs of proposed § 38.856, including any costs that would be imposed on DCMs, other market participants, or the financial system more broadly. In particular, for those DCMs that already have CROs, the Commission requests comment on the extent to which the proposed rules would require changes to existing policies and procedures regarding the CRO position.

C. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of proposed § 38.856 in light of the specific considerations identified in Section 15(a) of the CEA. The Commission believes that proposed § 38.856 may have a beneficial effect on protection of market participants and the public, as well as on the financial integrity of the markets. The Commission believes that designating a CRO to administer the market regulation functions of the DCM will promote compliance with the proposed rules related to identifying and minimizing DCM conflicts of interest, which, in turn, will allow the DCMs to better provide services as an exchange. The Commission has considered the other Section 15(a) Factors and believes that they are not implicated by proposed § 38.856.

xi. Staffing and Investigations—Proposed Changes to Commission Regulations §§ 38.155, 38.158, and 37.203

Commission regulation § 38.155(a) requires a DCM to: (1) establish and maintain sufficient compliance department resources and staff to ensure that it can conduct effective audit trail reviews, trade practice surveillance, market surveillance, and real-time market monitoring; (2) maintain sufficient compliance staff to address unusual market or trading events as they arise; and (3) conduct and complete investigations in a timely manner. Furthermore, Commission regulation § 38.155(b) requires a DCM to: (1) monitor the size and workload of its compliance staff annually and ensure that its compliance resources and staff are at appropriate levels; and (2) consider trading volume increases, the number of new products or contracts to be listed for trading, any new responsibilities to be assigned to compliance staff, the results of any internal review demonstrating that work is not completed in an effective or timely manner, and any other factors suggesting the need for increased resources and staff.

Similarly, existing Commission regulation § 37.203(c) requires SEFs to have sufficient compliance staff and resources to ensure it can conduct effective audit trail reviews, trade practice surveillance, market surveillance, and real-time market monitoring. Currently, SEFs are not subject to a regulation parallel to Commission regulation § 38.155(b) where DCMs are required to annually monitor the sufficiency of staff and resources.

Finally, existing regulations §§ 37.203(f) and 38.158, respectively, relate to SEF and DCM obligations regarding investigations and investigation reports. These provisions generally address investigation timeliness, substance of investigation reports, and the issuance of warning letters.

The Commission is proposing amendments to existing §§ 37.203(c) and 38.155(a). First, the Commission proposes to replace references to ''compliance staff'' with ''staff.'' Second, proposed §§ 37.203(c) and 38.155(a) would amend the first sentence of the existing regulations to provide that SEFs and DCMs must establish and maintain sufficient staff and resources to ''effectively perform market regulation functions'' rather than listing the individual functions. The Commission does not view these as substantive changes. References to ''staff'' rather than ''compliance staff'' are intended for clarity. As noted, Commission regulations §§ 37.203(c) and 38.155(a) are solely focused on staff dedicated to performing market regulation functions.

The Commission also proposes to amend § 37.203 to add a new paragraph (d). The proposed provision would require SEFs to annually monitor the size and workload of their staff, and ensure its resources and staff effectively perform market regulation functions at appropriate levels. In addition, paragraph (d) would include a reference to paragraph (c) to clarify that it applies to staff responsible for conducting market regulation functions. In addition, with respect to both proposed § 37.203(d) and amended § 38.155(b), the Commission is proposing to add to the list of factors that a SEF or DCM should consider in determining the appropriate level of resources and staff: (1) any responsibilities that staff have at affiliated entities; and (2) any conflicts of interest that prevent staff from working on certain matters.

Additionally, the Commission proposes certain non-substantive changes to existing Commission regulations §§ 38.155 and 38.158. Proposed § 38.155 would rename the regulation ''Sufficient staff and resources.'' Proposed § 38.155(b) would add an internal reference to paragraph (a). This change is intended to clarify that the annual staff and resource monitoring requirement pertains to staff performing market regulation functions required under § 38.155(a). Proposed § 38.158(a) would replace the reference to ''compliance staff'' with ''staff responsible for conducting market regulation functions.'' Proposed § 38.158(b) would delete the reference to ''compliance staff investigation'' being required to be completed in a timely manner, and instead provide, more simply, that ''[e]ach investigation must be completed in a timely manner.'' Finally, proposed §§ 38.158(c) and (d) would delete the modifier ''compliance'' when referencing to staff.

Finally, the Commission also proposes certain non-substantive changes to existing Commission regulation § 37.203. Proposed § 37.203(c) would rename the paragraph ''Sufficient staff and resources.'' The addition of proposed § 37.203(d) would result in redesignating the remaining paragraphs of § 37.203. Proposed § 37.203(g)(1), which would replace existing Commission regulation § 37.203(f)(1), and adds a reference to ''market regulation functions,'' consistent with the new proposed defined term. Proposed § 37.203(g)(1),

which would replace existing Commission regulation § 37.203(f)(1), adds a reference to ''market regulation functions,'' consistent with the new proposed defined term. Proposed § 37.203(g)(2)–(4) deletes the modifier ''compliance'' when referencing staff.

A. Benefits

As explained above, the Commission is proposing certain non-substantive changes to existing §§ 37.203(c) and 38.155(a). These changes include replacing references to ''compliance staff'' with ''staff.'' Proposed §§ 37.203(c) and 38.155(a) would also amend the first sentence of the existing regulations to provide that SEFs and DCMs must establish and maintain sufficient staff and resources to ''effectively perform market regulation functions'' rather than listing the individual functions. Additionally, as noted above, the Commission proposes non-substantive changes to existing Commission regulations §§ 38.155, 38.158 and § 37.203. Proposed § 37.203(c) and § 38.155 would both be renamed as ''Sufficient staff and resources.'' Proposed § 37.203(g)(1) would add reference to ''market regulation functions,'' and 38.155(b) would add an internal reference to paragraph (a) to achieve the same result. Proposed § 38.158(a) would replace the reference to ''compliance staff'' with ''staff responsible for conducting market regulation functions.'' Proposed § 38.158(b) would delete the reference to ''compliance staff investigation'' being required to be completed in a timely manner, and instead provide, more simply, that ''[e]ach investigation must be completed in a timely manner.'' Finally, proposed §§ § 37.203(g)(2)–(4) and 38.158(c) and (d) would delete the modifier ''compliance'' when referencing to staff. These amendments provide additional clarity to those regulations. Such changes may provide benefits through enhanced regulatory clarity for SEFs and DCMs. However, as they are non-substantive changes, benefits will not be significant.

The Commission also proposes to amend § 37.203 to add a new paragraph (d). The proposed rule would require SEFs to annually monitor the size and workload of its staff, and ensure its resources and staff effectively perform market regulation functions at appropriate levels. In addition, paragraph (d) would include a reference to paragraph (c) to clarify that it applies to staff responsible for conducting market regulation functions. In addition, as noted above, with respect to both proposed § 37.203(d) and amended § 38.155(b), the Commission is proposing to add to the list of factors that a SEF or DCM should consider in determining the appropriate level of resources and staff: (1) any responsibilities that staff have at affiliated entities; and (2) any conflicts of interest that prevent staff from working on certain matters. Market regulation functions are critical for the performance of a SEF's self-regulatory obligations. This amendment is beneficial because it will help ensure sufficiency of SEF staff responsible for performing market regulation functions and identify in a timely way any potential conflicts of interest relating to market regulations staff, particularly regarding a SEF's or DCM's affiliates.

B. Costs

The Commission also proposes to amend § 37.203 to add a new paragraph (d). The proposed provision would require SEFs to annually monitor the size and workload of its staff, and ensure its resources and staff effectively perform market regulation functions at appropriate levels. SEFs may need to adjust their policies and procedures to comply with this new monitoring requirement. Costs could arise from additional hours SEF employees might need to spend analyzing the compliance of their rules and procedures with these requirements, drafting new or amended rules and procedures when necessary, and implementing these new or amended rules and procedures. Costs may further vary based on the size of the SEF, available resources the SEF may have, and with existing practices and policies the SEF may have in place. If a SEF has insufficient staff, it will need to find suitable candidates and hire staff as necessary. As noted above, the Commission proposes to amend § 38.155(b), to add to the list of factors that a DCM should consider in determining the appropriate level of resources and staff: (1) any responsibilities that staff have at affiliated entities; and (2) any conflicts of interest that prevent staff from working on certain matters. The Commission believes that any costs imposed by such additional two factors will be negligible, as DCMs are currently obligated under existing Commission regulation § 38.155(b) to monitor the size and workload of its compliance staff annually, and already lists various factors they should consider in making that determination of sufficiency of resources.

Finally, as noted above, the Commission proposes various non-substantive changes to Commission regulations §§ 37.203, 38.155, and 38.158. These will provide additional clarity to SEFs and DCMs, and any costs associated with such changes will be negligible.

The Commission requests comments on the potential costs of the proposed amendments to §§ 37.203, 38.155, and 38.158, including any costs that would be imposed on SEFs, DCMs, other market participants, or the financial system more broadly. In particular, for those SEFs and DCMs that already have these requirements in place, the Commission requests comment on the extent to which the proposed rules would require changes to existing policies and procedures.

C. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of the proposed amendments to §§ 38.155, 38.158, and 37.203 in light of the specific considerations identified in Section 15(a) of the CEA. The Commission believes that the proposed amendments to §§ 38.155, 38.158, and 37.203 may have a beneficial effect on protection of market participants and the public, as well as on the financial integrity of the markets by requiring a more direct link between exchange management and the staff performing market regulation functions, hence providing a more direct way of effectuating compliance with Commission rules. The Commission has considered the other Section 15(a) Factors and believes that they are not implicated by the proposed amendments to §§ 38.155, 38.158, and 37.203.

xii. SEF Chief Compliance Officer—Proposed Changes to Commission Regulation § 37.1501

In general, the statutory framework provided in SEF Core Principle 15 requires each SEF to designate an individual to serve as a CCO.[290] SEF Core Principle 15 also provides requirements relating to the CCO's reporting structure and duties.[291]

Commission regulation § 37.1501 further implements the statutory CCO requirements. In particular, Commission regulation § 37.1501 currently establishes definitions for the terms ''board of directors'' and ''senior officer;'' addresses the authority of the CCO; establishes qualifications for the CCO; outlines the appointment and removal procedures for the CCO; requires the SEF's board of directors or senior officer to approve the CCO's compensation; and requires the CCO to

[290] CEA section 5h(f)(15); 7 U.S.C. 7b–3(f)(15)(A).

[291] *See id.*

meet with the SEF's board of directors or senior officer at least annually.[292]

Commission regulation § 37.1501(c) further outlines the duties of the CCO. For example, Commission regulation § 37.1501(c)(2) details that the CCO must take reasonable steps, in consultation with the board of directors or the senior officer of the SEF, to resolve any material conflicts of interest that may arise, including, but not limited to: (1) conflicts between business considerations and compliance requirements; (2) conflicts between business considerations and implementation of the requirement that the SEF provide fair, open, and impartial access as set forth in § 37.202; and (3) conflicts between a SEF's management and members of the board of directors. Commission regulation § 37.1501(c)(6) specifies that the SEF's CCO must establish and administer a compliance manual designed to promote compliance with the applicable laws, rules, and regulations and a written code of ethics for the SEF designed to prevent ethical violations and to promote honesty and ethical conduct by SEF personnel. Finally, Commission regulation §§ 37.1501(c)(7) and (c)(8) detail the requirement that the CCO supervise the SEF's self-regulatory program as well as the effectiveness and sufficiency of any regulatory service provider, respectively.

Commission regulation § 37.1501(d) addresses the statutory requirement under SEF Core Principle 15 requiring a CCO to prepare an annual compliance report. Commission regulation § 37.1501(d) details the information the report must contain.[293] Commission regulation § 37.1501(e) addresses the submission of the annual compliance report; Commission regulation § 37.1501(f) requires the SEF to maintain all records demonstrating compliance with the duties of the CCO and the preparation and submission of annual compliance reports consistent with Commission regulations §§ 37.1000 and 37.1001. Finally, Commission regulation § 37.1501(g) delegates to the Director of the Division of Market Oversight the authority to grant or deny a request for an extension of time for a SEF to file its annual compliance report under Commission regulation § 37.1501(e).

The Commission is proposing several amendments to § 37.1501. First, the Commission proposes amendments to the existing SEF CCO requirements to ensure that, to the extent applicable, these requirements are consistent with the proposed DCM CRO requirements. Second, the Commission is proposing additional SEF CCO requirements to harmonize the language with other aspects of this proposal, namely proposed amendments that pertain to the board of directors and conflicts of interest procedures. Third, the Commission is proposing amendments that will more closely align § 37.1501 with the language of SEF Core Principle 15.

The Commission is proposing to move the terms ''board of directors'' and ''senior officer'' from existing regulation § 37.1501(a) to proposed § 37.1201(b). The meaning of each term would remain unchanged, with one exception. Specifically, the Commission seeks to clarify the existing definition of ''board of directors'' by including the introductory language ''a group of people'' serving as the governing body of the SEF.

The Commission also is proposing a new § 37.1501(a)(3) that would require the CCO to report directly to the board of directors or to the senior officer of the SEF. This would be a new provision in § 37.1501, but it is consistent with the language of SEF Core Principle 15, as set out in § 37.1500. Proposed § 37.1501(a)(4)(i) would amend the language in existing Commission regulation § 37.1501(b)(3)(i) to provide that the board of directors or senior officer may appoint or remove the CCO ''with the approval of the [SEF's] regulatory oversight committee.'' [294] Finally, proposed § 37.1501(a)(5) would amend the existing requirement in Commission regulation § 37.1501(b)(4) that the board of directors or the senior officer of the SEF shall approve the compensation of the CCO, to now require this approval to occur ''in consultation with the [SEF's ROC].'' [295]

The duties of the CCO under proposed § 37.1501(b) are substantively similar to existing Commission regulation § 37.1501(c), with two exceptions. First, proposed § 37.1501(b)(2) provides that the CCO must take reasonable steps in consultation with the SEF's board of directors ''or a committee thereof'' to manage and resolve material conflicts of interest. The added reference to ''committee'' accounts for the ROC's role in resolving conflicts of interest, which is provided in proposed § 37.1206(d)(4). Second, proposed § 37.1501(b)(2)(i) specifies that conflicts of interest between business considerations and compliance requirements includes, with respect to compliance requirements, the SEF's ''market regulation functions.''

Existing Commission regulation § 37.1501(c)(7) provides that the CCO must supervise the SEF's ''self-regulatory program,'' which includes trade practice surveillance; market surveillance; real time market monitoring; compliance with audit trail requirements; enforcement and disciplinary proceedings; audits, examinations, and other regulatory responsibilities (including taking reasonable steps to ensure compliance with, if applicable, financial integrity, financial reporting, sales practice, recordkeeping, and other requirements). Proposed § 37.1501(b)(7) would amend this provision to state that the CCO is responsible for supervising the SEF's self-regulatory program, including the market regulation functions set forth in § 37.1201(b)(9).

Proposed § 37.1501(c) is an entirely new rule that addresses conflicts of interest involving the CCO. The proposed rules requires the SEF to establish procedures for the disclosure of actual or potential conflicts of interest to the ROC. In addition, the SEF must designate a qualified person to serve in the place of the CCO for any matter for which the CCO has such a conflict, and maintain documentation of such disclosure and designation.

Proposed § 37.1501(d)(5) amends the existing annual compliance report requirement under Commission regulation § 37.1501(d) to require the annual report to include any actual or potential conflicts of interests that were identified to the CCO during the coverage period for the report, including a description of how such conflicts of interest were managed or resolved, and an assessment of the impact of any conflicts of interest on the swap execution facility's ability to perform its market regulation functions.

A. Benefits

The Commission believes that proposed § 37.1201(b) and the proposed amendments to § 37.1501(a) are likely to provide benefits as they enhance the existing definition for the board of directors to include the introductory language ''a group of people,'' which provides clarity and ease of reference. This, in turn, should enhance the SEF's ability to comply with the regulation. Proposed § 37.1501(a)(3), which requires the CCO to directly report to the SEF's board of directors or to the senior officer of the SEF, is likely to provide benefits by allowing the CCO to report directly to the ROC, which insulates the CCO's role from commercial interests and allows that

[292] *See* Commission regulation § 37.1501(a)–(b).

[293] Commission regulation § 37.1500(d)(1)–(5).

[294] Proposed § 37.1501(a)(4)(i).

[295] Proposed § 37.1501(a)(5).

person to more effectively fulfill its critical market regulations functions and other self-regulatory obligations. This may result in improved overall SEF compliance with Commission regulations. It is, however, important to note that providing the SEF an option to have its CCO to report to a senior officer may introduce a possibility of interference by the management team, as senior officers are likely to have incentives that conflict with that of a CCO. For example, senior officers are sometimes responsible for performance evaluations and approving administrative requests, which might compromise the effectiveness of the CCO and may limit the benefits of the proposed rule.

Proposed § 37.1501(a)(4)(i), which will allow the board of directors or a senior officer to appoint or remove the CCO with the approval of the SEF's ROC, is likely to generate benefits as it further insulates the CCO from improper or undue influence from the commercial interests of the SEF. These benefits, however, are likely to be limited as SEFs have been operating under an existing similar standard. Furthermore, by requiring the board of directors or the senior officer to consult with the ROC in approving the compensation of the CCO, proposed § 37.1501(a)(5) is likely to provide benefits as it may further insulate the CCO from interference from the commercial interests of the SEF.

In addition, by requiring the ROC's involvement in resolving conflicts of interest and by explicitly including the SEF's market regulation function in the list of conflicts considered for compliance requirements, proposed § 37.1501(b) will allow the CCO to be in a better position to resolve conflicts of interest that relate to surveillance, investigations, and disciplinary functions which, in turn, will enhance the SEF's important role as an SRO.

The proposed amendment to § 37.1501(b)(7) will explicitly refer to a SEF's market regulation function in referring to the CCO's supervision responsibility. The term ''market regulation functions'' is defined in proposed § 37.1201(b)(9), and will provide clarity and ease of reference to compliance standards. Such clarity and ease of reference should enhance a SEF's ability to comply with core principle and regulatory requirements. To the extent that a SEF's CCO is already carrying out such responsibilities, the benefits may be less significant.

Proposed § 37.1501(c), requires SEFs to establish procedures for disclosing conflicts of interest to the ROC, designate a qualified person to serve in the place of the CCO for any matter in which the CCO has a conflict, and maintain documentation of such designation. These requirements are likely to provide benefits by better facilitating the ROC's assistance in managing and resolving conflicts of interest. This will allow the SEF to effectively perform its market regulation functions and maintain regulatory compliance. In addition, the requirement in proposed regulation § 37.1501(c) that the SEF have procedures to designate a qualified person to serve in the place of the CCO for any matter in which the CCO is conflicted is likely to provide benefits as it will increase the likelihood that the conflict of interest is managed and resolved by a person with sufficient independence, expertise and authority, which, in turn, will allow the SEF to effectively perform its market regulation functions.

In addition, proposed § 37.1501(d)(5), which amends the annual compliance report requirements to include a report of any actual or potential conflicts of interests and how such conflicts of interests were managed or resolved, will increase the chances that the Commission has timely notice and sufficient knowledge of conflicts of interest and how they are resolved. Such disclosures allow the Commission to have effective oversight over SEFs and enhances SEF governance transparency and accountability.

B. Costs

In order to comply with the proposed amendments to § 37.1501, SEFs may need to adjust their policies and procedures regarding CCOs. This may impose some administrative costs on SEFs. Costs could arise from additional hours SEF employees might need to spend analyzing the compliance of their rules and procedures with the proposed requirements, drafting new or amended rules and procedures when necessary, and implementing these new or amended rules and procedures.

More specifically, SEFs may have additional costs associated with the CCO position resulting from the time requirements on the board of directors or senior officer meeting with the CCO, and administrative costs associated with the ROC actions being required to hire or remove a CCO and to approve CCO compensation. To the extent that SEFs already have such rules and procedures in place, costs may have been already realized.

The Commission requests comment on the potential costs of the proposed amendments to § 37.1501, including any costs that would be imposed on SEFs, other market participants, or the financial system more broadly.

C. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of the proposed amendments to § 37.1501 in light of the specific considerations identified in Section 15(a) of the CEA. The Commission believes that the proposed amendments to § 37.1501 may have a beneficial effect on protection of market participants and the public, as well as on the financial integrity of the markets because the proposed amendments should support and effectuate better compliance with core principles. Increased independence of the CCO position and additional requirements pertaining to the resolution and documentation of conflicts of interest will enhance SEF governance, accountability, and promote transparency, which is an essential factor for establishing the integrity of derivatives markets. The Commission has considered the other Section 15(a) Factors and believes that they are not implicated by the proposed amendments to § 37.1501.

xiii. Transfer of Equity Interest—Proposed Changes to Commission Regulations §§ 37.5(c) and 38.5(c)

Currently, Commission regulations §§ 37.5(c)(1) and 38.5(c)(1) require SEFs and DCMs, respectively, to notify the Commission in the event of an equity interest transfer. The threshold that triggers the notification requirement when a DCM enters a transaction is the transfer of 10 percent or more of the DCM's equity. In comparison, a SEF is required to notify the Commission when it enters a transaction to transfer 50 percent or more of the SEF's equity. Commission regulation § 37.5(c)(1) provides that the Commission may ''upon receiving such notification, request supporting documentation of the transaction.'' Commission regulation § 38.5(c)(1) does not include a similar provision for DCMs.

Commission regulations §§ 37.5(c)(2) and 38.5(c)(2) govern the timing of the equity interest transfer notification to the Commission. These provisions require notification at the earliest possible time, but in no event later than the open of business 10 business days following the date upon which the SEF or DCM enters a firm obligation to transfer the equity interest. Commission regulations §§ 37.5(c)(3) and 38.5(c)(3) govern rule filing obligations that may be prompted by the equity interest transfer. Commission regulation § 37.5(c)(4) requires a SEF to certify to

the Commission no later than two days after an equity transfer takes place that the SEF meets all of the requirements of section 5h of the CEA and applicable Commission regulations. Commission regulation § 38.5(c) does not have an analogous certification requirement for DCMs.

Commission regulations §§ 37.5(d) and 38.5(d) establish Commission delegation of authority provisions to the Director of the Division of Market Oversight. The delegation authority under § 37.5(d) permits the Director to request any of the information specified in § 37.5, including information relating to the business of the SEF, information demonstrating compliance with the core principles, or with the SEF's other obligations under the CEA or the Commission's regulations, and information relating to an equity interest transfer. In contrast, the scope of the delegation of authority in Commission regulation 38.5(d) limits the Director to requesting information from a DCM pursuant to Commission regulation § 38.5(b) demonstrating compliance with the DCM core principles and the CEA. The Director's delegation authority does not extend to requests for information related to the business of the DCM or to equity interest transfers.

The Commission proposes to amend regulations §§ 37.5(c) and 38.5(c) to: (1) ensure the Commission receives timely and sufficient information in the event of certain changes in the ownership or corporate or organizational structure of a SEF or DCM; (2) clarify what information is required to be provided and the relevant deadlines; and (3) conform to similar requirements applicable to DCOs.

The Commission proposes to amend regulation § 37.5(c)(1) to require SEFs to file with the Commission notification of transactions involving the transfer of at least 10 percent of the equity interest in the SEF. The Commission also is proposing to amend regulations §§ 37.5(c)(1) and 38.5(c)(1) to expand the types of changes of ownership or corporate or organizational structure that would trigger a notification obligation to the Commission. The proposed amendments would require SEFs and DCMs to report any anticipated change in the ownership or corporate or organizational structure of the SEF or DCM, or its respective parent(s) that would: (1) result in at least a 10 percent change of ownership of the SEF or DCM, or a change to the entity or person holding a controlling interest in the SEF or DCM, whether through an increase in direct ownership or voting interest in the SEF or DCM, or in a direct or indirect corporate parent entity of the SEF or DCM; (2) create a new subsidiary or eliminate a current subsidiary of the SEF or DCM; or (3) result in the transfer of all or substantially all of the assets of the SEF or DCM to another legal entity.

The Commission also is proposing to amend regulations §§ 37.5(c)(2) and 38.5(c)(2) to clarify what information must be submitted to the Commission as part of a notification pursuant to Commission regulations §§ 37.5(c)(1) and 38.5(c)(1), as proposed to be amended. The Commission proposes to harmonize and enhance the requirements between SEFs and DCMs by amending regulations §§ 37.5(c)(2) and 38.5(c)(2) to state that, as part of a notification pursuant to Commission regulations §§ 37.5(c)(1) or 38.5(c)(1), a SEF or DCM must provide ''required information'' including: a chart outlining the new ownership or corporate or organizational structure, a brief description of the purpose or the impact of the change, and any relevant agreement effecting the change and corporate documents such as articles of incorporation and bylaws. As proposed, the Commission may, after receiving such information, request additional supporting documentation related to the change in ownership or corporate or organizational structure, such as amended Form SEF or Form DCM exhibits, to demonstrate that the SEF or DCM will, following the change, continue to meet all the requirements in section 5 or 5h of the CEA (as applicable) and applicable Commission regulations.

Proposed §§ 37.5(c)(3) and 38.5(c)(3) will require a notification pursuant to Commission regulations §§ 37.5(c)(1) or 38.5(c)(1) to be submitted no later than three months prior to the anticipated change, provided that the SEF or DCM may report the anticipated change later than three months prior to the anticipated change if it does not know and reasonably could not have known of the anticipated change three months prior to the anticipated change. In such event, the SEF or DCM shall immediately report such change to the Commission as soon as it knows of such change.

In addition to the new reporting requirements, the proposal includes a new certification requirement for DCMs. The Commission is proposing to amend Commission regulation § 38.5(c) by adding a certification requirement in regulation § 38.5(c)(5). The certification will require a DCM, upon a change in ownership or corporate organizational structure described in Commission regulation § 38.5(c)(1), file with the Commission a certification that the DCM meets all of the requirements of section 5 of the CEA and applicable Commission regulations. The certification must be filed no later than two business days following the date on which the change in ownership or corporate or organizational structure takes effect.

The Commission proposes a new §§ 37.5(c)(6) and 38.5(c)(6), which provide that a change in the ownership or corporate or organizational structure of a SEF or DCM that results in the failure of the SEF or DCM to comply with any provision of the Act, or any regulation or order of the Commission thereunder, shall be cause for the suspension of the registration or designation of the SEF or DCM, or the revocation of registration or designation as a SEF or DCM, in accordance with sections 5e and 6(b) of the CEA. The proposed rule further provides that the Commission may make and enter an order directing that the SEF or DCM cease and desist from such violation, in accordance with sections 6b and 6(b) of the CEA. Section 6(b) of the CEA authorizes the Commission to suspend or revoke registration or designation of a SEF or DCM if the exchange has violated the CEA or Commission orders or regulations. Section 6(b) includes a number of procedural safeguards, including that it requires notice to the SEF or DCM, a hearing on the record, and appeal rights to the court of appeals for the circuit in which the SEF or DCM has its principal place of business. It is imperative that SEFs and DCMs, regardless of ownership or control changes, continue to comply with the CEA and all Commission regulations to promote market integrity and protect market participants.

Finally, the Commission proposes to amend existing regulation § 38.5(d) by extending the delegation of authority provisions to the Director of the Division of Market Oversight to include information requests related to the business of the DCM in § 38.5(a) and changes in ownership or corporate or organizational structure in § 38.5(c).

A. Benefits

The proposed change to revise the reporting threshold for SEFs from 50 percent to 10 percent would harmonize the regulatory standard currently in place for DCMs and DCOs. In addition, lowering the notification standard for SEFs may better allow the Commission to fulfill its oversight obligations. The Commission recognizes that a notification based on a percentage of ownership change that is set too low will result in notifications of changes that do not have a consequential change

in who has control over the exchange or impact on SEF operations. In contrast, a threshold set too high will reduce the instances of notification of changes in ownership or corporate or organizational structure to the Commission that are consequential to the operations of a SEF. The Commission believes that lowering the threshold to 10 percent results in an appropriate balance. In this connection, the 10 percent threshold represents a level where the Commission would receive notice of a SEF's ownership or corporate or organizational structure changes, when such changes actually reflect meaningful changes in who potentially could impact a SEF's compliance with the CEA and Commission regulations. Therefore, the proposed amendment will benefit SEF market participants and the public given the increased transparency to the Commission in terms of who potentially controls the SEF.

As discussed in the preamble above, under the existing regulations, an increase in equity interest of less than 10 percent could still result in change of control of the exchange. Proposed §§ 37.5(c)(1) and 38.5(c)(1) expand the scope of corporate changes that require notification to include changes not only in ownership, but also corporate and organizational structural changes. These proposed changes will help ensure that the Commission has accurate knowledge of the individuals or entities that control a SEF or DCM and its activities, thereby promoting market integrity. The Commission believes that proposed §§ 37.5(c)(2) and 38.5(c)(2) will encourage SEFs and DCMs to remain mindful of their self-regulatory responsibilities when negotiating the terms of significant equity interest transfers or other changes in ownership or corporate or organizational structure. In addition, the proposed rules help maintain an orderly marketplace despite changes in the ownership or corporate or organizational structure of the exchange. The proposed amendments will enhance Commission staff's ability to undertake a timely and effective due diligence review of the impact, if any, of such changes. These enhanced requirements will allow Commission staff to seek updated copies of exhibits and other documents that provide valuable and timely information regarding the professional staff, legal proceedings, rulebook changes, third party service provider agreements, member and user agreements, and compliance manual changes. Those documents are important to confirm that the registrant will continue to be able to meet its regulatory obligations.

The Commission believes that new provisions §§ 37.5(c)(3) and 38.5(c)(3) that require the SEF or the DCM notification three months prior to the anticipated change or immediately as soon as it knows of such a change, will allow the Commission staff sufficient time to review the change and confirm compliance with applicable statutory and regulatory requirements. The new rules will also provide flexibility to the SEF or DCM if the anticipated change occurs more quickly than within three months.

Given their roles as SROs, the proposed amendments to § 38.5(c) are likely to provide benefits by establishing consistent regulations among SEFs and DCMs in the manner they certify their compliance with the CEA and Commission regulations. Furthermore, to the extent that the certification requirement will help ensure any changes to ownership or corporate or organizational structure do not result in non-compliance, the certification requirement will improve confidence in the marketplace and promote market integrity.

Finally, the proposal extends the delegation of authority provisions to the Director of the Division of Market Oversight regarding DCMs to include information requests related to the business and changes to ownership or corporate or organizational structure of a DCM. Proposed § 38.5(d) provides a standard for DCMs that conforms to the existing standard for SEFs and establishes a consistent regulatory framework. Furthermore, since changes to ownership or corporate or organizational structure of a DCM can occur relatively quickly with significant consequences, the amendments are likely to provide benefits by providing the Director of the Division of Market Oversight with the authority to immediately request information and documents to confirm continued compliance with the CEA and relevant regulations, which in turn should result in more effective DCM oversight.

B. Costs

As described above, the Commission proposes to amend regulations §§ 37.5(c) and 38.5(c) to ensure the Commission receives timely and sufficient information in the event of certain changes in the ownership or corporate or organizational structure of a SEF or DCM.

To comply with the proposed rules, SEFs and DCMs may need to adjust their policies and procedures, which would impose some costs. SEF and DCM costs could arise from additional hours employees might need to spend analyzing the compliance of their rules and procedures with these requirements, drafting new or amended rules and procedures when necessary, and implementing these new or amended rules and procedures. Costs associated with complying with the proposed §§ 37.5(c) and 38.5(c) may further vary based on the size of the SEF and DCM, available resources, and the existing practices and policies they may already have in place. Finally, costs will depend significantly on how often a change in ownership or corporate or ownership structure occurs.

More specifically, while DCMs are already required to notify the Commission in the event of a 10 percent change in ownership interest, this 10 percent threshold requirement is being extended to SEFs, which will impose additional costs whenever such a transfer occurs. Additionally, the proposed rules also require both SEFs and DCMs to report any anticipated change in the ownership or corporate or organizational structure of the SEF or DCM, or its respective parent(s) that would result in at least a 10 percent change of ownership of the SEF or DCM, or a change to the entity or person holding a controlling interest in the SEF or DCM. This additional reporting in the event of anticipated change will generate additional costs for both SEFs and DCMs. Under proposed §§ 37.5(c)(3) and 38.5(c)(3), this additional reporting is required to be submitted to the Commission no later than three months prior to the anticipated change which will add additional employee time and costs to any anticipated change in ownership or organizational structure event that requires notification under the proposed rules.

With respect to DCMs, proposed § 38.5(c)(5) will add a certification requirement in the event of a change in ownership or organizational structure similar to the existing requirements for SEFs. This certification must be no later than two business days following the date on which the change in ownership or corporate or organizational structure took effect, and will add direct costs to any such change event.

Finally, the Commission proposes to amend existing Commission regulation § 38.5(d) to delegate to the Director of the Division of Market Oversight the authority to request information related to the DCM's business and changes in ownership or corporate or organizational structure. Information or document requests initiated by the Director, as opposed to the Commission, should not, on its own, impose

additional costs on DCMs. Therefore, costs to DCMs relating to this change should be negligible. The Commission acknowledges that a streamlined process for requesting information and documents may result in more frequent information or document requests under § 38.5. In that respect, direct costs to DCMs could increase.

The Commission requests comments on the potential costs of the proposed amendments to §§ 37.5(c) and 38.5(c) and (d), including any costs that would be imposed on SEFs, DCMs, other market participants, or the financial system more broadly.

C. Section 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of the proposed amendments to §§ 37.5(c) and 38.5(c) and (d) in light of the specific considerations identified in Section 15(a) of the CEA. The Commission believes that the proposed amendments may have a beneficial effect on protection of market participants and the public, as well as on the integrity of the markets through improved Commission awareness and oversight of significant changes to ownership or corporate or organizational structure of SEFs. The Commission has considered the other Section 15(a) Factors and believes that they are not implicated by the proposed amendments to §§ 37.5(c) and 38.5(c)–(d).

Summary 15(a) Factors

In addition to the discussion above, the Commission has evaluated the costs and benefits of the proposed rules in light of the following five broad areas of market and public concern identified in Section 15(a) of the CEA: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission believes that the proposed rules will have a beneficial effect on sound risk management practices and on the protection of market participants and the public.

1. Protection of Market Participants and the Public

The Commission believes that the proposed rules will enhance the protection of market participants and the public by improving the ability of SEFs and DCMs to identify, manage and resolve conflicts of interest. The proposed rules will allow the exchanges to properly and orderly perform their function in facilitating markets, which in turn will reduce the likelihood that market participants and the public face unanticipated costs. The proposed rules will enhance the transparency and consistency of governance fitness standards, which in turn increases the likelihood that exchanges provide reliable services to the market participants. Finally, the proposed rules will provide the public and the Commission with transparent information regarding changes in ownership of SEFs or DCMs, which enhances the protection of the public.

2. Efficiency, Competitiveness, and Financial Integrity

The proposed rules will benefit the financial integrity of the derivatives markets by promoting the transparency and the integrity of the governance practices and proper identification and handling of conflicts of interest through the adoption of the proposed rules. The proposed rules will also benefit the marketplace by allowing a consistent approach on managing conflicts of interest and implementation of governance fitness standards. Additionally, the proposed rules will promote SEF's and DCM's ability to complete their self-regulatory obligations by promoting the resources necessary to effectively complete those obligations.

3. Price Discovery

Price discovery is the process of determining the price level for an asset through the interaction of buyers and sellers and based on supply and demand conditions. The Commission has not identified any effect of the proposed rules on the price discovery process.

4. Sound Risk Management Practices

The proposed rules seek to establish transparent and consistent governance fitness standards and proposes rules for proper identification and handling of conflicts of interest, which will support sound risk management practices at SEFs and DCMs. Nevertheless, the proposed rules will not necessarily impact the sound risk management practices by other market participants per se.

5. Other Public Interest Considerations

The Commission has not identified any effect of the proposed rule on other public interest considerations.

4. *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?

b. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA'') requires Federal agencies to consider whether the regulations they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis with respect to such impact.[296] The regulations proposed herein will directly affect SEFs, DCMs, and their market participants. The Commission has previously established certain definitions of ''small entities'' to be used by the Commission in evaluating the impact of its regulations on small entities in accordance with the RFA.[297] The Commission previously concluded that SEFs are not small entities for the purpose of the RFA.[298] The Commission has also previously stated its belief in the context of relevant rulemakings that SEFs' market participants, which are all required to be eligible contract participants (''ECPs'') [299] as defined in section 1a(18) of the CEA,[300] are not small entities for purposes of the RFA.[301] Similarly, Commission previously determined that DCMs are not small entities for purposes of the RFA because DCMs are required to demonstrate compliance with a number of core principles, including principles concerning the expenditure of sufficient financial resources to establish and maintain an adequate self-regulatory program.[302] Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the proposed rules will not have a significant economic impact on a substantial number of small entities.

[296] 5 U.S.C. 601 *et seq.*

[297] 47 FR at 18618–21 (Apr. 30, 1982).

[298] *See* Part 37 Final Rule, 78 FR 33476 at 33548 (citing 47 FR 18618, 18621 (Apr. 30, 1982) (discussing DCMs)).

[299] Commission regulation 37.703.

[300] 7 U.S.C. 1(a)(18).

[301] Opting Out of Segregation, 66 FR 20740 at 20743 (Apr. 25, 2001) (stating that ECPs by the nature of their definition in the CEA should not be considered small entities).

[302] *See* Policy Statement and Establishment of Definitions of ''Small Entities'' for Purposes of the Regulatory Flexibility Act, 47 FR 18618, 18619 (Apr. 30, 1982); *See also, e.g.,* DCM Core Principle 21 applicable to DCMs under section 735 of the Dodd-Frank Act.

The Commission invites the public and other federal agencies to comment on the above determination.

c. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (''PRA'') [303] imposes certain requirements on federal agencies, including the Commission, in connection with their conducting or sponsoring any ''collection of information,'' as defined by the PRA. Under the PRA, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number from the Office of Management and Budget (''OMB'').[304] The PRA is intended, in part, to minimize the paperwork burden created for individuals, businesses, and other persons as a result of the collection of information by federal agencies, and to ensure the greatest possible benefit and utility of information created, collected, maintained, sued, shared, and disseminated by or for the Federal Government.[305] The PRA applies to all information, regardless of form or format, whenever the Federal Government is obtaining, causing to be obtained, or soliciting information, and includes required disclosure to third parties or the public, of facts or opinions, when the information collection calls for answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, 10 or more persons.[306]

This NPRM, if adopted, would result in a collection of information within the meaning of the PRA, as discussed below. The proposal affects three collections of information for which the Commission has previously received a control number from OMB: OMB Control No. 3038–0052, ''Core Principles & Other Requirements for DCMs;'' [307] OMB Control No. 3038–0074, ''Core Principles and Other Requirements for Swap Execution Facilities;'' [308] and OMB Control No. 3038–0093, ''Part 40, Provisions Common to Registered Entities.'' [309]

The Commission is therefore submitting this NPRM to OMB for review.[310] Responses to this collection of information would be mandatory. The Commission will protect any proprietary information according to the Freedom of Information Act and part 145 of the Commission's regulations.[311] In addition, CEA section 8(a)(1) strictly prohibits the Commission, unless specifically authorized by the CEA, from making public any data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers.[312] Finally, the Commission is also required to protect certain information contained in a government system of records according to the Privacy Act of 1974.[313]

1. *Burden Estimates*

For PRA purposes, there are 23 registered SEFs and 16 designated DCMs. The proposed amendments would impose new one-time and ongoing reporting and recordkeeping requirements on SEFs and DCMs related to conflict of interest requirements and associated governance requirements under parts 37 and 38, along with associated rule submissions under part 40. The estimated aggregate burden imposed by the proposed amendments is set out below.

2. *Fitness Documentation and Written Procedures (§§ 37.207(d) and 38.801(d))*

The proposed amendments would add requirements that SEFs and DCMs establish appropriate procedures for the collection of information supporting compliance with appropriate fitness standards, including the creation of written procedures that are preserved for Commission review. The new provisions would codify and enhance existing guidance covering DCMs (Core Principle 15 Guidance) and Commission regulation § 1.63 covering SEFs and DCMs.

The Commission estimates that each SEF and DCM will spend an additional 10 hours annually on recordkeeping for §§ 37.207(d) and 38.801(d), plus a 40-hour one-time start-up cost for the initial written procedures. Accordingly, the aggregate annual estimate for the recordkeeping and reporting burden associated as with the proposal, is as follows:

DCMs—Recordkeeping § 38.801(d)

Estimated number of respondents: 16.
Estimated number of reports per respondent: 1.
Average number of hours per report: 10.
Estimated gross annual recordkeeping burden (hours): 160.
One-time start-up burden (hours): 40.
Estimated gross one-time start-up burden (hours): 640.

SEFs—Recordkeeping § 37.207(d)

Estimated number of respondents: 23.
Estimated number of reports per respondent: 1.
Average number of hours per report: 10.
Estimated gross annual recordkeeping burden (hours): 230.
One-time start-up burden (hours): 40.
Estimated gross one-time start-up burden (hours): 920.

3. Documentation of Conflict-of-Interest Provisions (§§ 37.1202(b) and 38.852(b))

Proposed §§ 37.1202(b) and 38.852(b) require the board of directors, committee, or disciplinary panel to document its processes for complying with the requirements of the conflict-of-interest rules, and such documentation must include: (1) the names of all members and officers who attended the relevant meeting in person where a conflict of interest was raised; and (2) the names of any members and officers who voluntarily recused themselves or were required to abstain from deliberations or voting on a matter and the reason for the recusal or abstention. Although these provisions currently exist for SEFs in § 1.69, they are new for DCMs.

The Commission estimates that each SEF and DCM will spend an additional one hour four times a year on recordkeeping associated with the proposal. Accordingly, the aggregate annual estimate for the reporting burden associated with proposed new §§ 37.1202(b) and 38.852(b) is as follows:

DCMs—Recordkeeping § 38.852(b)

Estimated number of respondents: 16.
Estimated number of reports per respondent: 4.
Average number of hours per report: 1.
Estimated gross annual recordkeeping burden (hours): 64.

SEFs—Recordkeeping § 37.1202(b)

Estimated number of respondents: 23.
Estimated number of reports per respondent: 4.

[303] 5 U.S.C. 601, *et seq.*

[304] *See* 44 U.S.C. 3507(a)(3); 5 CFR 1320.5(a)(3).

[305] *See* 44 U.S.C. 3501.

[306] *See* 44 U.S.C. 3502(3).

[307] For the previously approved PRA estimates for DCMs under OMB Control No. 3038–0052, see ICR Reference No. 202207–3038–003, Conclusion Date Aug. 24, 2022, at *https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=202207-3038-003.* The PRA analysis uses a count of 16 DCMs based on Commission data accurate as of Sept. 29, 2023.

[308] For the previously approved estimates for SEFs under OMB Control No. 3038–0074, see ICR Reference No. 202201–3038–002, Conclusion Date Apr. 30, 2022, at *https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=202201-3038-002.* The PRA analysis uses a count of 23 SEFs based on Commission data accurate as of Sept. 29, 2023.

[309] OMB Control Number 3038–0093 has two Information Collections: Part 40, Provisions Common to Registered Entities; and Part 150, Position Limits. *See https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=202102-3038-001.*

[310] *See* 44 U.S.C. 3507(d) and 5 CFR 1320.11.

[311] *See* 5 U.S.C. 552; *see also* 17 CFR part 145 (Commission Records and Information).

[312] 7 U.S.C. 12(a)(1).

[313] 5 U.S.C. 552a.

Average number of hours per report: 1.

Estimated gross annual recordkeeping burden (hours): 92.

4. Trading on Material Non-Public Information (§§ 37.1203 and 38.853)

The amendments include documentation and recordkeeping requirements connected to a new requirement that SEFs and DCMs take certain steps to prevent an employee, member of the board of directors, committee member, consultant, or owner with more than a 10 percent interest in the SEF or DCM, from trading commodity interests or related commodity interests based on, or disclosing, any non-public information obtained through the performance of their official duties. The proposal would replace an existing regulation applicable to SEFs and partially to DCMs (§ 1.59), and guidance applicable to DCMs (Core Principle 16 Guidance). Under the proposed amendments, SEFs and DCMs must continue to document any exemptions from trading restrictions, in accordance with requirements in existing Commission regulations §§ 37.1000 and 37.1001 or 38.950 and 38.951, respectively.

The Commission estimates that each SEF and DCM will spend an estimated additional 10 hours annually on recordkeeping associated with this proposal, with a one-time burden of 10 hours to review and update existing policies and procedures. Accordingly, the aggregate annual estimate for the reporting burden associated with proposed new §§ 37.1203 and 38.853, is as follows:

DCMs—Recordkeeping § 38.853

Estimated number of respondents: 16.

Estimated number of reports per respondent: 1.

Average number of hours per report: 10.

Estimated gross annual reporting burden (hours): 160.

One-time start-up burden (hours): 10.

Estimated gross one-time start-up burden (hours): 160.

SEFs—Recordkeeping § 37.1203

Estimated number of respondents: 23.

Estimated number of reports per respondent: 1.

Average number of hours per report: 10.

Estimated gross annual reporting burden (hours): 230.

One-time start-up burden (hours): 10.

Estimated gross one-time start-up burden (hours): 230.

5. Annual Self-Assessment §§ 37.1204(d) and 38.854(d)

Proposed §§ 37.1204(d) and 38.854(d) are new requirements that SEF and DCM Boards perform an annual self-assessment and performance review, and document the results for possible Commission review.

The Commission estimates that the documentation and recordkeeping for the annual review will take 25 hours. Accordingly, the aggregate annual estimate for the recordkeeping burden associated with §§ 37.1204(d) and 38.854(d) is as follows:

DCMs—§ 38.854(d)

Estimated number of respondents: 16.

Estimated number of reports per respondent: 1.

Average number of hours per report: 25.

Estimated gross annual reporting burden (hours): 400.

SEFs—§ 37.1204(d)

Estimated number of respondents: 23.

Estimated number of reports per respondent: 1.

Average number of hours per report: 25.

Estimated gross annual reporting burden (hours): 575.

6. Commission Notice of Membership Changes of the Board of Directors (§§ 37.1204(f) and 38.854(f))

This new proposed provision would require SEFs and DCMs to notify the Commission within five business days of any changes to the membership of the board of directors or its committees.

The Commission believes that although the ongoing burden will be low, it constitutes a burden for PRA purposes. Each notification will take an estimated one hour, and each SEF and DCM will on average change two board or committee members a year (in total). Accordingly, the aggregate annual estimate for the reporting burden associated with proposed §§ 37.1204(f) and 38.854(f) is as follows:

DCMs—§ 38.854(f) Reporting

Estimated number of respondents: 16.

Estimated number of reports per respondent: 2.

Average number of hours per report: 1.

Estimated gross annual reporting burden (hours): 32.

SEF—§ 37.1204(f) Reporting

Estimated number of respondents: 23.

Estimated number of reports per respondent: 2.

Average number of hours per report: 1.

Estimated gross annual reporting burden (hours): 46.

7. ROC Meeting Minutes and Documentation (§§ 37.1206(f)(1)(iii) and 38.857(f)(1)(iii); §§ 37.1206(f)(2) and 38.857(f)(2))

The proposed provisions in §§ 37.1206(f)(1)(iii) and 38.857(f)(1)(iii) would require that SEF and DCM ROC meeting minutes include the following specific information: (a) list of the attendees; (b) their titles; and (c) whether they were present for the entirety of the meeting or a portion thereof (and if so, what portion); and (d) a summary of all meeting discussions. In addition, new §§ 37.1206(f)(2) and 38.857(f)(2) would require the ROCs to maintain documentation of the committee's findings, recommendations, and any other discussions or deliberations related to the performance of its duties.

The Commission estimates that these new requirements will add an additional four hours of recordkeeping for an estimated four quarterly ROC meetings for each SEF and DCM. Accordingly, the aggregate annual estimate for the reporting burden associated with the proposal is as follows:

DCMs—§ 38.857(f)(1)(iii) and 38.857(f)(2) Recordkeeping

Estimated number of respondents: 16.

Estimated number of reports per respondent: 4.

Average number of hours per report: 4.

Estimated gross annual reporting burden (hours): 256.

SEFs—§§ 37.1206(f)(1)(iii) and 37.1206(f)(2) Recordkeeping

Estimated number of respondents: 23.

Estimated number of reports per respondent: 4.

Average number of hours per report: 4.

Estimated gross annual reporting burden (hours): 368.

8. ROC Annual Report ((§§ 37.1206(g)(1) and (g)(2) and 38.857(g)(1) and (g)(2))

Currently, DCMs prepare annual ROC reports pursuant to the Acceptable Practices for DCM Core Principle 16, but SEFs do not have a similar requirement. Proposed §§ 37.1206(g)(1) and 38.857(g)(1) would codify annual report requirements for SEFs and DCMs. Proposed §§ 37.1206(g)(2) and 38.857(g)(2) would set out the filing requirements for the reports.

The current PRA estimated burden for the DCM ROC reports is 70 hours for one annual report. The Commission has

reevaluated the ROC report burden and now revises its estimate down to 40 hours, including the new requirements. In the Commission's recent experience, the ROC report is less extensive and burdensome to prepare than the SEF Annual Compliance Report, which has a burden of 52 hours. 40 hours more accurately reflects the preparation required for the ROC report, including the new reporting requirements added by the proposal. The proposal would add a new burden of 40 hours for one annual SEF ROC report.

Accordingly, the aggregate annual estimate for the reporting burden associated the proposal is as follows:

DCMs—§ 38.857(g)(1) and (g)(2) Reporting

Estimated number of respondents: 16.
Estimated number of reports per respondent: 1.
Average number of hours per report: 40.
Estimated gross annual reporting burden (hours): 640.

SEFs—§ 37.1206(g)(1) and (g)(2) Reporting

Estimated number of respondents: 23.
Estimated number of reports per respondent: 1.
Average number of hours per report: 40.
Estimated gross annual reporting burden (hours): 920.

9. ROC Recordkeeping (§§ 37.1206(g)(3) and 38.857(g)(3))

Proposed §§ 37.1206(g)(3) and 38.857(g)(3) establish a recordkeeping requirement to maintain all records demonstrating compliance with the duties of the ROC and the preparation and submission of the annual report.

The Commission estimates that the proposal will add an additional two hours of burden per an estimated four quarterly ROC meetings. Accordingly, the aggregate annual estimate for the reporting burden associated with the proposal is as follows:

DCMs—§ 38.857(g)(3) Recordkeeping

Estimated number of respondents: 16.
Estimated number of reports per respondent: 4.
Average number of hours per report: 2.
Estimated gross annual reporting burden (hours): 128.

SEFs—§ 37.1206(g)(3) Recordkeeping

Estimated number of respondents: 23.
Estimated number of reports per respondent: 4.
Average number of hours per report: 2.
Estimated gross annual reporting burden (hours): 184.

10. DCM CRO Appointment and Removal Notification (§ 38.856(c))

Under proposed new § 38.856(c), DCMs must notify the Commission when a CRO is appointed or removed. A similar requirement for SEFs is proposed in § 37.1501(a)(4)(ii), but does not add a reporting burden since the requirement already exists in Commission regulation § 37.1501(b)(3)(ii) for SEF CCOs.

The Commission estimates that a CRO would be replaced on average every two years at a maximum, and the required notice would require 0.5 hours. Accordingly, the aggregate annual estimate for the reporting burden associated with the proposal is as follows:

DCMs—§ 38.856(c) Reporting

Estimated number of respondents: 16.
Estimated number of reports per respondent: 0.5.
Average number of hours per report: 0.5.
Estimated gross annual reporting burden (hours): 4.

11. Documentation of CCO/CRO Conflicts of Interest (§§ 37.1501(c) and 38.856(f))

Proposed §§ 37.1501(c) and 38.856(f) require SEFs and DCMs to maintain documentation when a CCO (SEF) or CRO (DCM) discloses a conflict of interest to the ROC.

The Commission estimates that the proposal would require an additional four hours of recordkeeping for each SEF and DCM once per year. Accordingly, the aggregate annual estimate for the reporting burden associated with is as follows:

DCMs—§ 38.856(f) Recordkeeping

Estimated number of respondents: 16.
Estimated number of reports per respondent: 1.
Average number of hours per report: 4.
Estimated gross annual reporting burden (hours): 64.

SEFs—§ 37.1501(c) Recordkeeping

Estimated number of respondents: 23.
Estimated number of reports per respondent: 1.
Average number of hours per report: 4.
Estimated gross annual reporting burden (hours): 92.

12. Conflicts of Interests Reported in SEF Annual Compliance Report (§ 37.1501(d)(5))

Proposed § 37.1501(d)(5) requires any actual or potential conflicts reported to the CCO to be included in the SEF Annual Compliance Report (ACR) to the Commission. The Commission estimates that this new requirement would add one hour to the existing 52 hours burden associated with the SEF ACR, for a total of 53 hours. Accordingly, the aggregate annual estimate for the reporting burden associated with the proposal is as follows:

SEFs—Reporting

Estimated number of respondents: 23.
Estimated number of reports per respondent: 1.
Average number of hours per report: 53.
Estimated gross annual reporting burden (hours): 1,219.

13. Reports of Anticipated Changes in Ownership or Corporate Structure (§§ 37.5(c)(1) and 38.5(c)(1)); §§ 37.5(c)(2) and 38.5(c)(2)

The proposal would amend §§ 37.5(c)(1) and 38.5(c)(1) to require that SEFs and DCMs report anticipated changes of corporate structure or ownership that would result in certain significant changes to ownership, subsidiaries, or transfer of assets to another legal entity. The amendments to §§ 37.5(c)(1) and 38.5(c)(1) would require SEFs and DCMs to file with the Commission reports of anticipated changes in ownership or corporate structure that would (i) result in at least a 10 percent change of ownership of the SEF or DCM or a change to the entity or person holding a controlling interest in the SEF or DCM; (ii) create a new subsidiary or eliminate a current subsidiary of the SEF or DCM; or (iii) result in the transfer of all or substantially all of the assets of the SEF or DCM to another legal entity.

The proposed amendments to §§ 37.5(c)(2) and 38.5(c)(2) would set out the documents that must be submitted to the Commission in such reports, including a chart outlining the new ownership or corporate or organizational structure; a brief description of the purpose and impact of the change; and any relevant agreements effecting the change and corporate documents such as articles of incorporation and bylaws; and any additional supporting documents requested by the Commission.

The Commission estimates that each SEF and DCM would file one report every four years, which would require

40 hours of burden. Accordingly, the aggregate annual estimate for the reporting burden associated with the proposal is as follows:

DCMs—§ 38.5(c)(1) and (c)(2) Reporting

Estimated number of respondents: 16.
Estimated number of reports per respondent: 0.25.
Average number of hours per report: 40.
Estimated gross annual reporting burden (hours): 160.

SEFs—§ 38.5(c)(1) and (c)(2)

Estimated number of respondents: 23.
Estimated number of reports per respondent: 0.25.
Average number of hours per report: 40.
Estimated gross annual reporting burden (hours): 230.

14. Change in Ownership/Structure Certification Requirement (§§ 37.4(c)(4) and 38.5(c)(5))

The Commission is proposing to amend § 38.5(c) by adding a certification requirement that will require a DCM, upon a change in ownership or corporate organizational structure, to certify that the DCM meets all of the requirements of section 5h of the Act and applicable Commission regulations. SEFs have an existing similar requirement in § 37.4(c)(4) with no new increase in burden from the proposed rule. However, the SEF burden will be listed here for clarity, since it is not separately accounted for in the current PRA approval.

The Commission estimates that each SEF and DCM would file one report under the proposed amendments every four years, and each report would require an additional two hours of burden. Accordingly, the aggregate annual estimate for the reporting burden associated with the proposed amendments is as follows:

DCMs—§ 38.5(c)(5) Reporting

Estimated number of respondents: 16.
Estimated number of reports per respondent: 0.25.
Average number of hours per report: 2.
Estimated gross annual reporting burden (hours): 8.

SEFs—§ 37.4(c)(4)—Reporting

Estimated number of respondents: 23.
Estimated number of reports per respondent: 0.25.
Average number of hours per report: 2.
Estimated gross annual reporting burden (hours): 11.5.

15. SEF and DCM Updates to Rulebooks and Internal Procedures (§§ 40.5 and 40.6; Parts 37 and 38)

The proposal would institute organizational changes that may require one-time updates to SEF and DCM rulebooks and internal procedures, such as compliance manuals, or require submissions to the Commission under part 40.

Under §§ 40.5 and 40.6, registered entities must submit a written certification to the Commission in connection with a new or amended rule. However, this burden is already covered in the existing part 40 PRA collection.[314]

To comply with parts 37 and 38, SEFs and DCMs must maintain policies and procedures for ensuring compliance with regulatory requirements, such as compliance manuals. The Commission estimates that the proposed rules would require one-time updates to SEF and DCM internal procedures, with an estimated burden of 20 hours. Accordingly, the aggregate annual estimate for the recordkeeping and reporting burden associated with the proposed amendments is as follows:

DCMs—Internal Procedures Recordkeeping and Reporting (Part 38)

Estimated number of respondents: 16.
Estimated number of reports per respondent: 1.
Average number of hours per report: 20.
Estimated gross one-time reporting and recordkeeping burden (hours): 320.

SEFs—Internal Procedures Manual Recordkeeping and Reporting (Part 37)

Estimated number of respondents: 23.
Estimated number of reports per respondent: 1.
Average number of hours per report: 20.
Estimated gross one-time reporting and recordkeeping burden (hours): 460.

[314] The Commission accounts for the burden associated with the part 40 filings under Collection No. 3038–0093, ''Part 40, Provisions Common to Registered Entities,'' which includes updates to rulebooks in response to new Commission regulations and other actions. The CFTC bases its burden estimates under this clearance on the number of annual rule filings with the Commission. Based on those numbers, the Commission has estimated that these reporting requirements entail a burden of approximately 2,800 hours annually for covered entities (70 respondents × 20 reports per respondent × 2 hours per report = 2,800 hours annually). The Commission is retaining its existing burden estimates under the existing clearance. The Commission believes that these estimates are adequate to account for any incremental burden associated with part 40 filings that may result from the proposed organizational changes.

16. Request for Comment

The Commission invites the public and other Federal agencies to comment on any aspect of the proposed information collection requirements discussed above. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission will consider public comments on this proposed collection of information in:

(1) Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;

(2) Evaluating the accuracy of the estimated burden of the proposed collection of information, including the degree to which the methodology and the assumptions that the Commission employed were valid;

(3) Enhancing the quality, utility, and clarity of the information proposed to be collected; and

(4) Minimizing the burden of the proposed information collection requirements on registered entities, including through the use of appropriate automated, electronic, mechanical, or other technological information collection techniques, *e.g.,* permitting electronic submission of responses.

Copies of the submission from the Commission to OMB are available from the CFTC Clearance Officer, 1155 21st Street NW, Washington, DC 20581, (202) 418–5160 or from *https://RegInfo.gov.* Organizations and individuals desiring to submit comments on the proposed information collection requirements should send those comments to:

- The Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503, Attn: Desk Officer of the Commodity Futures Trading Commission;
- (202) 395–6566 (fax); or
- *OIRAsubmissions@omb.eop.gov* (email).

Please provide the Commission with a copy of submitted comments so that comments can be summarized and addressed in the final rulemaking, and please refer to the **ADDRESSES** section of this rulemaking for instructions on submitting comments to the Commission. OMB is required to make a decision concerning the proposed information collection requirements between 30 and 60 days after publication of this release in the **Federal Register**. Therefore, a comment to OMB is best assured of receiving full consideration if OMB receives it within 30 calendar days of publication of this release. Nothing in the foregoing affects

the deadline enumerated above for public comment to the Commission on the proposed rules.

d. Antitrust Considerations

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the CEA, in issuing any order or adopting any Commission rule or regulation.[315]

The Commission believes that the public interest to be protected by the antitrust laws is the promotion of competition. The Commission requests comment on whether the proposed amendments implicate any other specific public interest to be protected by the antitrust laws. The Commission has considered the proposed rulemaking to determine whether it is anticompetitive and has identified no anticompetitive effects. The Commission requests comment on whether the proposed rulemaking is anticompetitive and, if it is, what the anticompetitive effects are.

Because the Commission has determined that the proposed rule amendments are not anticompetitive and have no anticompetitive effects, the Commission has not identified any less anticompetitive means of achieving the purposes of the CEA. The Commission requests comment on whether there are less anticompetitive means of achieving the relevant purposes of the CEA that would otherwise be served by adopting the proposed rule amendments.

List of Subjects

17 CFR Part 37

Compliance with rules, Conflicts of interest, Designation of Chief Compliance Officer, General Provisions.

17 CFR Part 38

Compliance with rules, Conflicts of Interest, Disciplinary procedures, General provisions.

For the reasons stated in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR chapter I as follows:

PART 37—SWAP EXECUTION FACILITIES

■ 1. The authority citation for part 37 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6c, 7, 7a–2, 7b–3, and 12a, as amended by Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376.

[315] 7 U.S.C. 19(b).

■ 2. Revise § 37.2 to read as follows:

§ 37.2 Exempt provisions.

A swap execution facility, the swap execution facility's operator and transactions executed on or pursuant to the rules of a swap execution facility must comply with all applicable requirements under Title 17 of the Code of Federal Regulations, except for the requirements of §§ 1.59(b) and (c), 1.63, 1.64, and 1.69.

■ 3. In § 37.5, revise paragraph (c) to read as follows:

§ 37.5 Information relating to swap execution facility compliance.

* * * * *

(c) *Change in ownership or corporate or organizational structure*—(1) *Reporting requirement.* A swap execution facility must report to the Commission any anticipated change in the ownership or corporate or organizational structure of the swap execution facility or its parent(s) that would:

(i) Result in at least a ten percent change of ownership of the swap execution facility or a change to the entity or person holding a controlling interest in the swap execution facility, whether through an increase in direct ownership or voting interest in the swap execution facility or in a direct or indirect corporate parent entity of the swap execution facility;

(ii) Create a new subsidiary or eliminate a current subsidiary of the swap execution facility; or

(iii) Result in the transfer of all or substantially all of the assets of the swap execution facility to another legal entity.

(2) *Required information.* The information reported under paragraph (c)(1) of this section must include: A chart outlining the new ownership or corporate or organizational structure; a brief description of the purpose and impact of the change; and any relevant agreements effecting the change and corporate documents such as articles of incorporation and bylaws.

(i) The Commission may, after receiving such report, request additional supporting documentation relating to the anticipated change in the ownership or corporate or organizational structure of the swap execution facility, including amended Form SEF exhibits, to demonstrate that the swap execution facility will continue to meet all of the requirements of section 5h of the Act and applicable Commission regulations following such change.

(ii) [Reserved]

(3) *Time of report.* The report under paragraph (c)(1) of this section must be submitted to the Commission no later than three months prior to the anticipated change, provided that the swap execution facility may report the anticipated change to the Commission later than three months prior to the anticipated change if the swap execution facility does not know and reasonably could not have known of the anticipated change three months prior to the anticipated change. In such event, the swap execution facility must immediately report such change to the Commission as soon as it knows of such change. The report must be filed electronically with the Secretary of the Commission at *submissions@cftc.gov* and with the Division of Market Oversight at *DMOSubmissions@cftc.gov.*

(4) *Rule filing.* Notwithstanding the provisions of paragraphs (c)(1) through (3) of this section, if any aspect of a change in ownership or corporate or organizational structure described in paragraph (c)(1) of this section requires a swap execution facility to file a rule as defined in § 40.1(i) of this chapter, then the swap execution facility must comply with the rule filing requirements of section 5c(c) of the Act and part 40 of this chapter, and all other applicable Commission regulations.

(5) *Certification.* Upon a change in ownership or corporate or organizational structure described in paragraph (c)(1) of this section, a swap execution facility must file electronically with the Secretary of the Commission at *submissions@cftc.gov* and with the Division of Market Oversight at *DMOSubmissions@cftc.gov,* a certification that the swap execution facility meets all of the requirements of section 5h of the Act and applicable Commission regulations, no later than two business days following the date on which the change in ownership or corporate or organizational structure described in paragraph (c)(1) of this section takes effect.

(6) *Failure to comply.* A change in the ownership or corporate or organizational structure of a swap execution facility that results in the failure of the swap execution facility to comply with any provision of the Act, or any regulation or order of the Commission thereunder—

(i) Shall be cause for the suspension of the registration of the swap execution facility or the revocation of registration as a swap execution facility, in accordance with the procedures provided in sections 5e and 6(b) of the Act, including notice and a hearing on the record; or

(ii) May be cause for the Commission to make and enter an order directing that the swap execution facility cease

and desist from such violation, in accordance with the procedures provided in sections 6b and 6(b) of the Act, including notice and a hearing on the record.

* * * * *

■ 4. Amend § 37.203 as follows:
■ a. Revise paragraph (c);
■ b. Redesignate paragraphs (d), (e), (f), and (g) as paragraphs (e), (f), (g), and (h);
■ c. Add a new paragraph (d); and
■ d. Revise newly redesignated paragraph (g).

The revisions and addition read as follows:

§ 37.203 Rule enforcement program.

* * * * *

(c) *Sufficient staff and resources.* A swap execution facility must establish and maintain sufficient staff and resources to effectively perform market regulation functions, as defined in § 37.1201(b)(9). Such staff must be sufficient to address unusual market or trading events as they arise, and to conduct and complete investigations in a timely manner, as set forth in § 37.203(g).

(d) *Ongoing monitoring of staff and resources.* A swap execution facility must monitor the size and workload of its staff required under paragraph (c) of this section annually and ensure that its staff and resources are at appropriate levels. In determining the appropriate level of staff and resources, the swap execution facility should consider trading volume increases, the number of new products or contracts to be listed for trading, any new responsibilities to be assigned to staff, any responsibilities that staff have at affiliated entities, the results of any internal review demonstrating that work is not completed in an effective or timely manner, any conflicts of interest that prevent staff from working on certain matters, and any other factors suggesting the need for increased staff and resources.

* * * * *

(g) *Investigations and investigation reports*—(1) *Procedures.* A swap execution facility shall establish and maintain procedures that require its staff responsible for market regulation functions to conduct investigations of possible rule violations. An investigation shall be commenced upon the receipt of a request from Commission staff or upon the discovery or receipt of information by the swap execution facility that indicates a reasonable basis for finding that a violation may have occurred or will occur.

(2) *Timeliness.* Each investigation shall be completed in a timely manner. Absent mitigating factors, a timely manner is no later than 12 months after the date that an investigation is opened. Mitigating factors that may reasonably justify an investigation taking longer than 12 months to complete include the complexity of the investigation, the number of firms or individuals involved as potential wrongdoers, the number of potential violations to be investigated, and the volume of documents and data to be examined and analyzed by staff.

(3) *Investigation reports when a reasonable basis exists for finding a violation.* Staff shall submit a written investigation report for disciplinary action in every instance in which staff determines from surveillance or from an investigation that a reasonable basis exists for finding a rule violation. The investigation report shall include the reason the investigation was initiated; a summary of the complaint, if any; the relevant facts; staff's analysis and conclusions; and a recommendation as to whether disciplinary action should be pursued.

(4) *Investigation reports when no reasonable basis exists for finding a violation.* If after conducting an investigation, staff determines that no reasonable basis exists for finding a rule violation, it shall prepare a written report including the reason the investigation was initiated; a summary of the complaint, if any; the relevant facts; and staff's analysis and conclusions.

(5) *Warning letters.* No more than one warning letter may be issued to the same person or entity found to have committed the same rule violation within a rolling twelve month period.

* * * * *

■ 5. In § 37.206, revise paragraph (b) to read as follows:

§ 37.206 Disciplinary procedures and sanctions.

* * * * *

(b) *Disciplinary panels.* A swap execution facility must establish one or more disciplinary panels that are authorized to fulfill their obligations under the rules of this subpart. Disciplinary panels must meet the composition requirements of § 37.1207, and must not include any members of the swap execution facility's market regulation staff or any person involved in adjudicating any other stage of the same proceeding.

* * * * *

■ 6. Add § 37.207 in subpart C to read as follows:

§ 37.207 Minimum fitness standards.

(a) *In general.* A swap execution facility must establish and enforce appropriate fitness standards for its officers and for members of its board of directors, committees, disciplinary panels, and dispute resolution panels (or anyone performing functions similar to the foregoing), for members of the swap execution facility, for any other person with direct access to the swap execution facility, any person who owns 10 percent or more of the SEF and who, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the management or policies of the SEF, and for any party affiliated with any person described in this paragraph.

(b) *Minimum standards for certain persons—bases for refusal to register.* Minimum standards of fitness for the swap execution facility's officers and for members of its board of directors, committees, disciplinary panels, and dispute resolution panels (or anyone performing functions similar to the foregoing), for members of the swap execution facility with voting privileges, and any person who owns 10 percent or more of the SEF and who, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the management or policies of the SEF, must include the bases for refusal to register a person under sections 8a(2) and 8a(3) of the Act.

(c) *Additional minimum fitness standards for certain persons—history of disciplinary offenses.* Minimum standards of fitness for the swap execution facility's officers and for members of its board of directors, committees, disciplinary panels, and dispute resolution panels (or anyone performing functions similar to the foregoing), must include ineligibility based on the disciplinary offenses listed in the following paragraphs (c)(1) through (6):

(1) Was found within the prior three years by a final, non-appealable decision of a self-regulatory organization, an administrative law judge, a court of competent jurisdiction, the Securities Exchange Commission, or the Commission to have committed:

(i) A violation of the rules of a self-regulatory organization, except rules related to decorum or attire, financial requirements, or reporting or recordkeeping resulting in fines aggregating $5,000 or less within a calendar year; or

(ii) A violation of any rule of a self-regulatory organization if the violation involved fraud, deceit, or conversion, or resulted in suspension or expulsion; or

(iii) Any violation of the Act or the regulations promulgated thereunder; or

(iv) Any failure to exercise supervisory responsibility in violation of the rules of a self-regulatory organization, or the Act, or regulations promulgated thereunder.

(2) Entered into a settlement agreement within the prior three years in which the acts charged, or findings included any of the violations described in paragraph (c)(1) of this section;

(3) Currently is suspended from trading on any designated contract market or swap execution facility, is suspended or expelled from membership with any self-regulatory organization, is serving any sentence of probation, or owes any portion of a fine imposed due to a finding or settlement described in paragraphs (c)(1) or (2) of this section;

(4) Currently is subject to an agreement with the Commission, the Securities Exchange Commission, or any self-regulatory organization, not to apply for registration with the Securities Exchange Commission, Commission or membership in any self-regulatory organization;

(5) Currently is subject to or has had imposed on him or her within the prior three years a Commission registration revocation or suspension in any capacity for any reason, or has been convicted within the prior three years of any of the felonies listed in section 8a(2)(D)(ii) through (iv) of the Act; or

(6) Currently is subject to a denial, suspension or disqualification from serving on the disciplinary panel, arbitration panel or governing board of any self-regulatory organization as that term is defined in section 3(a)(26) of the Securities Exchange Act of 1934.

(d) *Collection and verification of fitness information.* (1) A swap execution facility must have appropriate procedures for the collection and verification of information supporting compliance with appropriate fitness standards, including, at a minimum, the following:

(i) A swap execution facility must, on at least an annual basis, collect and verify fitness information for each person acting in the capacity subject to the fitness standards;

(ii) A swap execution facility must require each person acting in any capacity subject to the fitness standards to provide immediate notice if that person no longer meets the minimum fitness standards to act in that capacity;

(iii) An initial verification of fitness information must be completed prior to the person commencing to act in the capacity for which the person is subject to fitness standards; and

(iv) A swap execution facility must document its findings with respect to the verification of fitness information for each person acting in the capacity subject to the fitness standards.

(2) [Reserved]

■ 7. Add § 37.1201 in subpart M to read as follows:

§ 37.1201 General requirements.

(a) *Establishment of process.* A swap execution facility 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 swap execution facility'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.

(b) *Definitions.* For purposes of this section:

(1) *Affiliate* means a person that directly or indirectly controls, is controlled by, or is under common control with, the swap execution facility.

(2) *Board of directors* means a group of people serving as the governing body of a swap execution facility, or for a swap execution facility whose organizational structure does not include a board of directors, a body performing a function similar to a board of directors.

(3) *Commodity interest* means any commodity futures, commodity option or swap contract traded on or subject to the rules of a designated contract market, a swap execution facility or linked exchange, or cleared by a derivatives clearing organization, or cash commodities traded on or subject to the rules of a designated contract market.

(4) *Disciplinary panel* means a panel of two or more persons authorized to conduct hearings, render decisions, approve settlements, and impose sanctions with respect to disciplinary matters.

(5) *Dispute resolution* panel means a panel of two or more persons authorized to resolve disputes involving a swap execution facility's members, market participants, and any intermediaries.

(6) *Executive committee* means a committee of the board of directors that may exercise the authority delegated to it by the board of directors with respect to the decision-making of the company or organization.

(7) *Family relationship* means a person's relationship with a spouse, parents, children, or siblings, in each case, whether by blood, marriage, or adoption, or the person's relationship with any person residing in the home of the person.

(8) *Linked exchange* means:

(i) Any board of trade, exchange or market outside the United States, its territories or possessions, which has an agreement with a designated contract market or swap execution facility in the United States that permits positions in a commodity interest which have been established on one of the two markets to be liquidated on the other market;

(ii) Any board of trade, exchange or market outside the United States, its territories or possessions, the products of which are listed on a United States designated contract market, swap execution facility, or a trading facility thereof;

(iii) Any securities exchange, the products of which are held as margin in a commodity account or cleared by a securities clearing organization pursuant to a cross-margining arrangement with a futures clearing organization; or

(iv) Any clearing organization which clears the products of any of the foregoing markets.

(9) *Market regulation functions* means SEF functions required by SEF Core Principle 2, SEF Core Principle 4, SEF Core Principle 6, SEF Core Principle 10 and the applicable Commission regulations thereunder.

(10) *Material information* means information which, if such information were publicly known, would be considered important by a reasonable person in deciding whether to trade a particular commodity interest on a designated contract market or a swap execution facility, or to clear a swap contract through a derivatives clearing organization. As used in this section, ''material information'' includes, but is not limited to, information relating to present or anticipated cash positions, commodity interests, trading strategies, the financial condition of members of self-regulatory organizations or members of linked exchanges or their customers, or the regulatory actions or proposed regulatory actions of a swap execution facility or a linked exchange.

(11) *Non-public information* means information which has not been disseminated in a manner which makes it generally available to the trading public.

(12) *Pooled investment vehicle* means a trading vehicle organized and operated as a commodity pool within the meaning of § 4.10(d) of this chapter, and whose units of participation have been registered under the Securities Act of 1933, or a trading vehicle for which § 4.5 of this chapter makes available relief from regulation as a commodity

pool operator, *i.e.,* registered investment companies, insurance company separate accounts, bank trust funds, and certain pension plans.

(13) *Public director* means a member of the board of directors who has been found, by the board of directors of the swap execution facility, on the record, to have no material relationship with the swap execution facility. The board of directors must make such finding upon the nomination of the director and at least on an annual basis thereafter.

(i) For purposes of this definition, a ''material relationship'' is one that reasonably could affect the independent judgment or decision-making of the member of the board of directors. Circumstances in which a member of the board of directors shall be considered to have a ''material relationship'' with the swap execution facility include, but are not limited to, the following:

(A) Such director is an officer or an employee of the swap execution facility or an officer or an employee of its affiliate;

(B) Such director is a member of the swap execution facility, or a director, an officer, or an employee of either a member or an affiliate of a member. In this context, ''member'' shall have the meaning set forth in § 1.3 of this chapter;

(C) Such director directly or indirectly owns more than 10 percent of the swap execution facility or an affiliate of the swap execution facility, or is an officer or employee of an entity that directly or indirectly owns more than 10 percent of the swap execution facility;

(D) Such director, or an entity in which the director is a partner, an officer, an employee, or a director, receives more than $100,000 in aggregate annual payments from the swap execution facility, or an affiliate of the swap execution facility. Compensation for services as a director of the swap execution facility or as a director of an affiliate of the swap execution facility does not count toward the $100,000 payment limit, nor does deferred compensation for services rendered prior to becoming a director of the swap execution facility, so long as such compensation is in no way contingent, conditioned, or revocable; or

(E) The director shall be considered to have a ''material relationship'' with the swap execution facility when any of the circumstances described in paragraphs (b)(13)(i)(A) through (D) of this section apply to any person with whom the director has a family relationship.

(ii) All of the circumstances described in paragraph (b)(13)(i) of this section shall be subject to a one-year look back.

(iii) A public director of the swap execution facility may also serve as a public director of an affiliate of the swap execution facility if they otherwise meet the requirements of this section.

(iv) A swap execution facility must disclose to the Commission which members of its board are public directors, and the basis for those determinations.

(14) *Related commodity interest* means any commodity interest which is traded on or subject to the rules of a designated contract market, swap execution facility, linked exchange, or other board of trade, exchange, or market, or cleared by a derivatives clearing organization, other than the swap execution facility by which a person is employed, and with respect to which:

(i) Such employing swap execution facility has recognized or established intermarket spread margins or other special margin treatment between that other commodity interest and a commodity interest which is traded on or subject to the rules of the employing swap execution facility; or

(ii) Such other swap execution facility has recognized or established intermarket spread margins or other special margin treatment with another commodity interest as to which the person has access to material nonpublic information.

(15) *Self-regulatory organization* shall have the meaning set forth in § 1.3 of this chapter.

(16) *Senior officer* means the chief executive officer or other equivalent officer of the swap execution facility.

■ 8. Add § 37.1202 in subpart M to read as follows:

§ 37.1202 Conflicts of interest.

(a) *Conflicts of interest in the decision-making of a swap execution facility.* (1) A swap execution facility must establish policies and procedures that require any officer or member of its board of directors, committees, or disciplinary panels to disclose any actual or potential conflicts of interest that may be present prior to considering any matter. Such conflicts of interests include, but are not limited to, conflicts of interest that may arise when such member or officer:

(i) Is the subject of any matter being considered;

(ii) Is an employer, employee, or colleague of the subject of any matter being considered;

(iii) Has a family relationship with the subject of any matter being considered; or

(iv) Has any ongoing business relationship with or a financial interest in the subject of any matter being considered.

(2) Any relationship of the type listed in paragraphs (a)(1)(i) through (iv) of this section that is with an affiliate of the subject of any matter being considered would be deemed an actual or potential conflict of interest for purposes of this section.

(3) The swap execution facility must establish policies and procedures that require any officer or member of a board of directors, committee, or disciplinary panel of a swap execution facility that has an actual or potential conflict of interest, including any of the relationships listed in paragraphs (a)(1) and (2) of this section, to abstain from deliberating or voting on such matter.

(b) *Documentation of conflicts of interest determinations.* The board of directors, committees, and disciplinary panels of a swap execution facility must document in meeting minutes, or otherwise document in a comparable manner, compliance with the applicable requirements of this section. Such documentation demonstrating compliance must also include:

(1) The names of all members and officers who attended the relevant meeting in person or who otherwise were present by electronic means; and

(2) The names of any members and officers who voluntarily recused themselves or were required to abstain from deliberations or voting on a matter and the reason for the recusal or abstention.

■ 9. Add § 37.1203 in subpart M to read as follows:

§ 37.1203 Limitations on the use and disclosure of material non-public information.

(a) *In general.* A swap execution facility must establish and enforce policies and procedures on safeguarding the use and disclosure of material non-public information. Such policies and procedures must provide for appropriate limitations on the use or disclosure of material non-public information gained through the performance of official duties by members of the board of directors, committee members, and employees, or through an ownership interest in the swap execution facility.

(b) *Prohibited conduct by employees.* A swap execution facility must establish and enforce policies and procedures that, at a minimum, prohibit employees of the swap execution facility from the following:

(1) Trading directly or indirectly, in the following:

(i) Any commodity interest traded on the employing swap execution facility;

(ii) Any related commodity interest;

(iii) A commodity interest traded on designated contract markets or swap execution facilities or cleared by derivatives clearing organizations other than the employing swap execution facility if the employee has access to material non-public information concerning such commodity interest; or

(iv) A commodity interest traded on or cleared by a linked exchange if the employee has access to material non-public information concerning such commodity interest.

(2) Disclosing for any purpose inconsistent with the performance of the person's official duties as an employee any material non-public information obtained as a result of such person's employment at the swap execution facility; provided, however, that such policies and procedures shall not prohibit disclosures made in the performance by the employee, acting in the employee's official capacity or the employee's official duties, including to another self-regulatory organization, linked exchange, court of competent jurisdiction or representative of any agency or department of the federal or a state government.

(c) *Permitted exemptions.* A swap execution facility may grant exemptions from the trading prohibitions contained in paragraph (b)(1) of this section. Such exemptions must be:

(1) Consistent with policies and procedures established by the swap execution facility that set forth the circumstances under which such exemptions may be granted;

(2) Administered by the swap execution facility on a case-by-case basis;

(3) Approved by the swap execution facility's regulatory oversight committee;

(4) Granted only in limited circumstances in which the employee requesting the exemption can demonstrate that the trading is not being conducted on the basis of material non-public information gained through the performance of official duties, which limited circumstances may include participation by an employee in pooled investment vehicles where the employee has no direct or indirect control with respect to transactions executed for or on behalf of such vehicles; and

(5) Individually documented by the swap execution facility, with the documentation maintained by the swap execution facility in accordance with §§ 37.1000 and 37.1001.

(d) *Monitoring for Permitted Exemptions.* A swap execution facility must establish and enforce policies and procedures to diligently monitor the trading activity conducted under any exemptions granted under paragraph (c) of this section to ensure compliance with any applicable conditions of the exemptions and the swap execution facility's policies and procedures on the use and disclosure of material non-public information that are required pursuant to this section.

(e) *Prohibited conduct by members of the board of directors, committee members, employees, consultants, or owners.* A swap execution facility must establish and enforce policies and procedures that, at a minimum, prohibit members of the board of directors, committee members, employees, consultants, and those with an ownership interest of 10 percent or more in the swap execution facility, from the following:

(1) Trading for such person's own account, or for or on behalf of any other account, in any commodity interest or related commodity interest, on the basis of any material non-public information obtained through the performance of such person's official duties as a member of the board of directors, committee member, employee, consultant, or those with an ownership interest of 10 percent or more in the swap execution facility;

(2) Trading for such person's own account, or for or on behalf of any other account, in any commodity interest or related commodity interest, on the basis of any material non-public information that such person knows was obtained in violation of this section from a member of the board of directors, committee member, employee, consultant, or those with an ownership interest of 10 percent or more in the swap execution facility; or

(3) Disclosing for any purpose inconsistent with the performance of the person's official duties any material non-public information obtained as a result of their official duties at the swap execution facility; provided, however, that such policies and procedures shall not prohibit disclosures made in the performance of such person's official duties, including to another self-regulatory organization, linked exchange, court of competent jurisdiction or representative of any agency or department of the federal or state government acting in their official capacity.

■ 10. Add § 37.1204 in subpart M to read as follows:

§ 37.1204 Board of directors.

(a) *In general.* (1) The board of directors of a swap execution facility must be composed of at least thirty-five percent public directors.

(2) A swap execution facility must establish and enforce policies and procedures outlining the roles and responsibilities of the board of directors, including the manner in which the board of directors oversees the swap execution facility's compliance with all statutory, regulatory, and self-regulatory responsibilities of the swap execution facility under the Act and the regulations promulgated thereunder.

(3) Any executive committee (or any similarly empowered body) must be composed of at least thirty-five percent public directors.

(b) *Expertise.* Each member of the board of directors, including public directors, of the swap execution facility, must have relevant expertise to fulfill the roles and responsibilities of such member.

(c) *Compensation.* The compensation of public directors and other non-executive members of the board of directors of a swap execution facility must not be directly dependent on the business performance of such swap execution facility or any affiliate of the swap execution facility.

(d) *Annual self-assessment.* The board of directors of a swap execution facility must annually conduct a self-assessment of its performance and that of its committees. Such self-assessments must be documented and made available to the Commission for inspection.

(e) *Removal of a member of the board of directors.* A swap execution facility must have procedures to remove a member from the board of directors, where the conduct of such member is likely to be prejudicial to the sound and prudent management of the swap execution facility.

(f) *Reporting to the Commission.* A swap execution facility must notify the Commission within five business days of any changes to the membership of the board of directors or any of its committees.

■ 11. Add § 37.1205 in subpart M to read as follows:

§ 37.1205 Nominating committee.

(a) *In general.* A swap execution facility must have a board-level nominating committee, which must, at a minimum:

(1) Identify a diverse panel of individuals qualified to serve on the board of directors, consistent with the fitness requirements set forth in § 37.207, the composition requirements set forth in § 37.1204, and that reflect the views of market participants; and

(2) Administer a process for the nomination of individuals to the board of directors.

(b) *Applicability.* The requirements in paragraphs (a)(1) and (2) of this section apply to all nominations that occur after the initial establishment of the nominating committee and the appointment of members to the nominating committee.

(c) *Reporting.* The nominating committee must report to the board of directors of the swap execution facility.

(d) *Composition.* The nominating committee must be composed of at least fifty-one percent public directors. The chair of the nominating committee must be a public director.

■ 12. Add § 37.1206 in subpart M to read as follows:

§ 37.1206 Regulatory oversight committee.

(a) *In general.* Each swap execution facility must establish a regulatory oversight committee, as a standing committee of the board of directors, to oversee the swap execution facility's market regulation functions on behalf of the board of directors.

(b) *Composition.* The regulatory oversight committee must be composed entirely of public directors, and must include no less than two directors.

(c) *Delegation.* The board of directors must delegate sufficient authority, dedicate sufficient resources, and allow sufficient time for the regulatory oversight committee to fulfill its mandate and duties.

(d) *Duties.* The regulatory oversight committee must:

(1) Monitor the sufficiency, effectiveness, and independence of the swap execution facility's market regulation functions;

(2) Oversee all facets of the swap execution facility's market regulation functions;

(3) Approve the size and allocation of the regulatory budget and resources, and the number, hiring, termination, and compensation of staff required pursuant to § 37.203(c);

(4) Consult with the chief compliance officer in managing and resolving any actual or potential conflicts of interest involving the swap execution facility's market regulation functions;

(5) Recommend changes that would promote fair, vigorous, and effective self-regulation; and

(6) Review all regulatory proposals prior to implementation and advising the board of directors as to whether and how such proposals may impact the swap execution facility's market regulation functions.

(e) *Reporting.* The regulatory oversight committee must periodically report to the board of directors of the swap execution facility.

(f) *Meetings and documentation.* (1) The regulatory oversight committee must have processes related to the conducting of meetings, including, but not limited to, the following:

(i) The regulatory oversight committee must meet no less than on a quarterly basis;

(ii) The regulatory oversight committee must not permit any individuals with actual or potential conflicts of interest to attend any discussions or deliberations in its meetings that relate to the swap execution facility's market regulation functions; and

(iii) The regulatory oversight committee must maintain minutes of its meetings. Such minutes must include a list of the attendees; their titles; whether they were present for the entirety of the meeting or a portion thereof (and if so, what portion); and a summary of all meeting discussions.

(2) The regulatory oversight committee must maintain documentation of the committee's findings, recommendations, deliberations, or other communications related to the performance of its duties.

(g) *Annual report*—(1) *Preparation.* The regulatory oversight committee must prepare an annual report of the swap execution facility's market regulation functions for the board of directors and the Commission, which includes an assessment, at a minimum, of the following:

(i) Details of all market regulation function expenses;

(ii) A description of staffing, structure, and resources for the swap execution facility's market regulation functions;

(iii) A description of disciplinary actions taken during the year;

(iv) A review of the performance of the swap execution facility's disciplinary panels;

(v) A list of any actual or potential conflicts of interests reported to the regulatory oversight committee, including a description of how such conflicts of interest were managed or resolved, and an assessment of the impact of any conflicts of interest on the swap execution facility's ability to perform its market regulation functions; and

(vi) Details related to all actions taken by the board of directors of a swap execution facility pursuant to a recommendation of the regulatory oversight committee, which details must include the following:

(A) The recommendation or action of the regulatory oversight committee;

(B) The rationale for such recommendation or action of the regulatory oversight committee;

(C) The rationale of the board of directors for rejecting such recommendation or superseding such action of the regulatory oversight committee, if applicable; and

(D) The course of action that the board of directors decided to take that differs from such recommendation or action of the regulatory oversight committee, if applicable.

(2) *Submission of the annual report to the Commission*—(i) *Timing.* The annual report must be submitted electronically to the Commission no later than 90 days after the end of the swap execution facility's fiscal year.

(ii) *Request for extension.* A swap execution facility may request an extension of time to file its annual report from the Commission. Reasonable and valid requests for extensions of the filing deadline may be granted at the discretion of the Commission.

(iii) *Delegation of authority.* The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, the authority to grant or deny a request for an extension of time for a swap execution facility to file its annual report under paragraph (g)(2)(ii) of this section. The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

(3) *Records.* The swap execution facility must maintain all records demonstrating compliance with the duties of the regulatory oversight committee and the preparation and submission of annual reports consistent with §§ 37.1000 and 37.1001.

■ 13. Add § 37.1207 in subpart M to read as follows:

§ 37.1207 Disciplinary panel composition.

(a) *Composition.* Each disciplinary panel must include at least two persons, including one public participant. A public participant is a person who would meet the eligibility requirements of a public director in § 37.1201(b)(12), provided that such person need not be a member of the board of directors of the swap execution facility. A public participant must chair each disciplinary panel. In addition, a swap execution facility must adopt rules that would, at a minimum:

(1) Preclude any group or class of participants from dominating or exercising disproportionate influence on a disciplinary panel; and

(2) Prohibit any member of a disciplinary panel from participating in deliberations or voting on any matter in

which the member has an actual or potential conflict of interest as set forth in § 37.1202(a).

(b) *Appeals.* If the rules of the swap execution facility provide that the decision of a disciplinary panel may be appealed to another committee of the board of directors, then such committee must also include at least two persons, including one public participant, and such public participant must chair the committee.

(c) *Exception.* Paragraphs (a) and (b) of this section do not apply to a disciplinary panel convened for cases solely involving decorum or attire.

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■ 14. In § 37.1501, revise paragraphs (a) through (d) to read as follows:

§ 37.1501 Chief compliance officer.

(a) *Chief compliance officer*—(1) *Authority of chief compliance officer.* (i) The position of chief compliance officer must carry with it the authority and resources to develop, in consultation with the board of directors or senior officer, the policies and procedures of the swap execution facility and enforce such policies and procedures to fulfill the duties set forth for chief compliance officers in the Act and Commission regulations.

(ii) The chief compliance officer must have supervisory authority over all staff acting at the direction of the chief compliance officer.

(2) *Qualifications of chief compliance officer.* (i) The individual designated to serve as chief compliance officer must have the background and skills appropriate for fulfilling the responsibilities of the position.

(ii) No individual disqualified from registration pursuant to sections 8a(2) or 8a(3) of the Act may serve as a chief compliance officer.

(3) *Reporting line of the chief compliance officer.* The chief compliance officer must report directly to the board of directors or to the senior officer of the swap execution facility.

(4) *Appointment and removal of chief compliance officer.* (i) Only the board of directors or the senior officer, with the approval of the swap execution facility's regulatory oversight committee, may appoint or remove the chief compliance officer.

(ii) The swap execution facility must notify the Commission within two business days of the appointment or removal, whether interim or permanent, of a chief compliance officer.

(5) *Compensation of the chief compliance officer.* The board of directors or the senior officer, in consultation with the swap execution facility's regulatory oversight committee, must approve the compensation of the chief compliance officer.

(6) *Annual meeting with the chief compliance officer.* The chief compliance officer must meet with the board of directors or senior officer of the swap execution facility at least annually.

(7) *Information requested of the chief compliance officer.* The chief compliance officer must provide any information regarding the self-regulatory program of the swap execution facility as requested by the board of directors or the senior officer.

(b) *Duties of chief compliance officer.* The duties of the chief compliance officer must include, but are not limited to, the following:

(1) Overseeing and reviewing compliance of the swap execution facility with section 5h of the Act and any related rules adopted by the Commission;

(2) Taking reasonable steps, in consultation with the swap execution facility's board of directors, or a committee thereof, or the senior officer of the swap execution facility, to manage and resolve any material conflicts of interest that may arise relating to:

(i) Conflicts between business considerations and compliance requirements, including the swap execution facility's market regulation functions;

(ii) Conflicts between business considerations and implementation of 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.

(3) Establishing and administering written policies and procedures reasonably designed to prevent violations of the Act and the rules of the Commission;

(4) Taking reasonable steps to ensure compliance with the Act and the rules of the Commission;

(5) Establishing procedures reasonably designed to handle, respond, remediate, retest, and resolve noncompliance issues identified by the chief compliance officer through any means, including any compliance office review, look-back, internal or external audit finding, self-reported error, or validated complaint; and

(6) Establishing and administering a compliance manual designed to promote compliance with the applicable laws, rules, and regulations and a written code of ethics for the swap execution facility designed to prevent ethical violations and to promote honesty and ethical conduct by personnel of the swap execution facility.

(7) Supervising the swap execution facility's self-regulatory program, including the market regulation functions set forth in § 37.1201(b)(9); and

(8) If applicable, supervising the effectiveness and sufficiency of any regulatory services provided to the swap execution facility by a regulatory service provider in accordance with § 37.204.

(c) *Conflicts of interest involving the chief compliance officer.* Each swap execution facility must establish procedures for the chief compliance officer's disclosure of actual or potential conflicts of interest involving the chief compliance officer to the regulatory oversight committee and designation of a qualified person to serve in the place of the chief compliance officer for any matter in which the chief compliance officer has such a conflict, and documentation of such disclosure and designation.

(d) *Preparation of annual compliance report.* The chief compliance officer must, not less than annually, prepare and sign an annual compliance report that covers the prior fiscal year. The report must, at a minimum, contain:

(1) A description and self-assessment of the effectiveness of the written policies and procedures of the swap execution facility, including the code of ethics and conflict of interest policies, to reasonably ensure compliance with the Act and applicable Commission regulations;

(2) Any material changes made to policies and procedures related to the swap execution facility's self-regulatory functions during the coverage period for the report and any areas of improvement or recommended changes such policies and procedures;

(3) A description of the financial, managerial, and operational resources set aside for compliance with the Act and applicable Commission regulations;

(4) Any material non-compliance matters identified and an explanation of the corresponding action taken to resolve such non-compliance matters;

(5) Any actual or potential conflicts of interests that were identified to the chief compliance officer during the coverage period for the report, including a description of how such conflicts of interest were managed or resolved, and an assessment of the impact of any conflicts of interest on the swap execution facility's ability to perform its market regulation functions; and

(6) A certification by the chief compliance officer that, to the best of his or her knowledge and reasonable

belief, and under penalty of law, the annual compliance report is accurate and complete in all material respects.

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PART 38—DESIGNATED CONTRACT MARKETS

■ 15. The authority citation for part 38 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6c, 6d, 6e, 6f, 6g, 6i, 6j, 6k, 6l, 6m, 6n, 7, 7a–2, 7b, 7b–1, 7b–3, 8, 9, 15, and 21, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376.

■ 16. Revise § 38.2 to read as follows:

§ 38.2 Exempt provisions.

A designated contract market, the designated contract market's operator and transactions traded on or through a designated contract market under section 5 of the Act shall comply with all applicable regulations under Title 17 of the Code of Federal Regulations, except for the requirements of §§ 1.39(b), 1.54, 1.59(b) and (c), 1.63, 1.64, 1.69, 100.1, 155.2, and part 156 of this chapter.

■ 17. In § 38.5, revise paragraphs (c) and (d) to read as follows:

§ 38.5 Information relating to contract market compliance.

* * * * *

(c) *Change in ownership or corporate or organizational structure*—(1) *Reporting requirement.* A designated contract market must report to the Commission any anticipated change in the ownership or corporate or organizational structure of the designated contract market or its parent(s) that would:

(i) Result in at least a ten percent change of ownership of the designated contract market or a change to the entity or person holding a controlling interest in the designated contract market, whether through an increase in direct ownership or voting interest in the designated contract market or in a direct or indirect corporate parent entity of the designated contract market;

(ii) Create a new subsidiary or eliminate a current subsidiary of the designated contract market; or

(iii) Result in the transfer of all or substantially all of the assets of the designated contract market to another legal entity.

(2) *Required information.* The information reported under paragraph (c)(1) of this section must include: A chart outlining the new ownership or corporate or organizational structure; a brief description of the purpose and impact of the change; and any relevant agreements effecting the change and corporate documents such as articles of incorporation and bylaws.

(i) The Commission may, after receiving such report, request additional supporting documentation relating to the anticipated change in the ownership or corporate or organizational structure of the designated contract market, including amended Form DCM exhibits, to demonstrate that the designated contract market will continue to meet all of the requirements of section 5 of the Act and applicable Commission regulations following such change.

(ii) [Reserved]

(3) *Time of report.* The report under paragraph (c)(1) of this section must be submitted to the Commission no later than three months prior to the anticipated change, provided that the designated contract market may report the anticipated change to the Commission later than three months prior to the anticipated change if the designated contract market does not know and reasonably could not have known of the anticipated change three months prior to the anticipated change. In such event, the designated contract market must immediately report such change to the Commission as soon as it knows of such change. The report must be filed electronically with the Secretary of the Commission at *submissions@cftc.gov* and with the Division of Market Oversight at *DMOSubmissions@cftc.gov.*

(4) *Rule filing.* Notwithstanding the provisions of paragraphs (c)(1) through (3) of this section, if any aspect of a change in ownership or corporate or organizational structure described in paragraph (c)(1) of this section requires a designated contract market to file a rule as defined in § 40.1(i) of this chapter, then the designated contract market must comply with the rule filing requirements of section 5c(c) of the Act and part 40 of this chapter, and all other applicable Commission regulations.

(5) *Certification.* Upon a change in ownership or corporate or organizational structure described in paragraph (c)(1) of this section, a designated contract market must file electronically with the Secretary of the Commission at *submissions@cftc.gov* and with the Division of Market Oversight at *DMOSubmissions@cftc.gov,* a certification that the designated contract market meets all of the requirements of section 5 of the Act and applicable Commission regulations, no later than two business days following the date on which the change in ownership or corporate or organizational structure described in paragraph (c)(1) of this section takes effect.

(6) *Failure to comply.* A change in the ownership or corporate or organizational structure of a designated contract market that results in the failure of the designated contract market to comply with any provision of the Act, or any regulation or order of the Commission thereunder—

(i) Shall be cause for the suspension of the designation of the designated contract market or the revocation of designation as a designated contract market, in accordance with the procedures provided in sections 5e and 6(b) of the Act, including notice and a hearing on the record; or

(ii) May be cause for the Commission to make and enter an order directing that the designated contract market cease and desist from such violation, in accordance with the procedures provided in sections 6b and 6(b) of the Act, including notice and a hearing on the record.

(d) *Delegation of authority.* The Commission hereby delegates, until it orders otherwise, the authority set forth in this section to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time. The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

■ 18. Revise § 38.155 to read as follows:

§ 38.155 Sufficient staff and resources.

(a) *Sufficient staff and resources.* A designated contract market must establish and maintain sufficient staff and resources to effectively perform market regulation functions, as defined in § 38.851(b)(9). Such staff must be sufficient to address unusual market or trading events as they arise, and to conduct and complete investigations in a timely manner, as set forth in § 38.158(b).

(b) *Ongoing monitoring of staff and resources.* A designated contract market must monitor the size and workload of its staff required under paragraph (a) of this section annually and ensure that its staff and resources are at appropriate levels. In determining the appropriate level of staff and resources, the designated contract market should consider trading volume increases, the number of new products or contracts to be listed for trading, any new responsibilities to be assigned to staff, any responsibilities that staff have at affiliated entities, the results of any internal review demonstrating that work is not completed in an effective or

timely manner, any conflicts of interest that prevent staff from working on certain matters, and any other factors suggesting the need for increased staff and resources.

■ 19. In § 38.158, revise paragraphs (a) through (d) to read as follows:

§ 38.158 Investigations and investigation reports.

(a) *Procedures.* A designated contract market must establish and maintain procedures that require staff responsible for market regulation functions to conduct investigations of possible rule violations. An investigation must be commenced upon the receipt of a request from Commission staff or upon the discovery or receipt of information by the designated contract market that indicates a reasonable basis for finding that a violation may have occurred or will occur.

(b) *Timeliness.* Each investigation must be completed in a timely manner. Absent mitigating factors, a timely manner is no later than 12 months after the date that an investigation is opened. Mitigating factors that may reasonably justify an investigation taking longer than 12 months to complete include the complexity of the investigation, the number of firms or individuals involved as potential wrongdoers, the number of potential violations to be investigated, and the volume of documents and data to be examined and analyzed by staff.

(c) *Investigation reports when a reasonable basis exists for finding a violation.* Staff must submit a written investigation report for disciplinary action in every instance in which such staff determines from surveillance or from an investigation that a reasonable basis exists for finding a rule violation. The investigation report must include the reason the investigation was initiated; a summary of the complaint, if any; the relevant facts; staff's analysis and conclusions; and a recommendation as to whether disciplinary action should be pursued.

(d) *Investigation reports when no reasonable basis exists for finding a violation.* If after conducting an investigation, staff determines that no reasonable basis exists for finding a violation, it must prepare a written report including the reason(s) the investigation was initiated; a summary of the complaint, if any; the relevant facts; and staff's analysis and conclusions.

* * * * *

■ 20. Revise § 38.702 to read as follows:

§ 38.702 Disciplinary panels.

A designated contract market must establish one or more disciplinary panels that are authorized to fulfill their obligations under the rules of this subpart. Disciplinary panels must meet the composition requirements of § 38.858, and must not include any members of the designated contract market's market regulation staff or any person involved in adjudicating any other stage of the same proceeding.

■ 21. Revise § 38.801 to read as follows:

§ 38.801 Minimum fitness standards.

(a) *In general.* A designated contract market must establish and enforce appropriate fitness standards for its officers and for members of its board of directors, committees, disciplinary panels, and dispute resolution panels (or anyone performing functions similar to the foregoing), for members of the designated contract market, for any other person with direct access to the contract market, any person who owns 10 percent or more of the DCM and who, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the management or policies of the DCM, and for any party affiliated with any person described in this paragraph.

(b) *Minimum standards for certain persons—bases for refusal to register.* Minimum standards of fitness for the designated contract market's officers and for members of its board of directors, committees, disciplinary panels, and dispute resolution panels (or anyone performing functions similar to the foregoing), for members of the designated contract market with voting privileges, and any person who owns 10 percent or more of the DCM and who, either directly or indirectly, through agreement or otherwise, in any other manner, may control or direct the management or policies of the DCM, must include the bases for refusal to register a person under sections 8a(2) and 8a(3) of the Act.

(c) *Additional minimum fitness standards for certain persons—history of disciplinary offenses.* Minimum standards of fitness for the designated contract market's officers and for members of its board of directors, committees, disciplinary panels, and dispute resolution panels (or anyone performing functions similar to the foregoing), must include ineligibility based on the disciplinary offenses listed in the following paragraphs (c)(1) through (6):

(1) Was found within the prior three years by a final, non-appealable decision of a self-regulatory organization, an administrative law judge, a court of competent jurisdiction, the Securities Exchange Commission, or the Commission to have committed:

(i) A violation of the rules of a self-regulatory organization, except rules related to decorum or attire, financial requirements, or reporting or recordkeeping resulting in fines aggregating $5,000 or less within a calendar year; or

(ii) A violation of any rule of a self-regulatory organization if the violation involved fraud, deceit, or conversion, or resulted in suspension or expulsion; or

(iii) Any violation of the Act or the regulations promulgated thereunder; or

(iv) Any failure to exercise supervisory responsibility in violation of the rules of a self-regulatory organization, or the Act, or regulations promulgated thereunder.

(2) Entered into a settlement agreement within the prior three years in which the acts charged, or findings included any of the violations described in paragraph (c)(1) of this section;

(3) Currently is suspended from trading on any designated contract market or swap execution facility, is suspended or expelled from membership with any self-regulatory organization, is serving any sentence of probation, or owes any portion of a fine imposed due to a finding or settlement described in paragraphs (c)(1) or (2) of this section;

(4) Currently is subject to an agreement with the Commission, the Securities Exchange Commission, or any self-regulatory organization, not to apply for registration with the Securities Exchange Commission, Commission or membership in any self-regulatory organization;

(5) Currently is subject to or has had imposed on him or her within the prior three years a Commission registration revocation or suspension in any capacity for any reason, or has been convicted within the prior three years of any of the felonies listed in section 8a(2)(D) (ii) through (iv) of the Act; or

(6) Currently is subject to a denial, suspension or disqualification from serving on the disciplinary panel, arbitration panel or governing board of any self-regulatory organization as that term is defined in section 3(a)(26) of the Securities Exchange Act of 1934.

(d) *Collection and verification of fitness information.* (1) A designated contract market must have appropriate procedures for the collection and verification of information supporting compliance with appropriate fitness standards, including, at a minimum, the following:

(i) A designated contract market must, on at least an annual basis, collect and verify fitness information for each person acting in the capacity subject to the fitness standards;

(ii) A designated contract market must require each person acting in any capacity subject to the fitness standards to provide immediate notice if that person no longer meets the minimum fitness standards to act in that capacity;

(iii) An initial verification of fitness information must be completed prior to the person commencing to act in the capacity for which the person is subject to fitness standards; and

(iv) A designated contract market must document its findings with respect to the verification of fitness information for each person acting in the capacity subject to the fitness standards.

(2) [Reserved]

■ 22. Revise § 38.851 to read as follows:

§ 38.851 General requirements.

(a) *Establishment of process.* A designated contract market 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.

(b) *Definitions.* For purposes of this section:

(1) *Affiliate* means a person that directly or indirectly controls, is controlled by, or is under common control with, the designated contract market.

(2) *Board of directors* means a group of people serving as the governing body of a designated contract market, or for a designated contract market whose organizational structure does not include a board of directors, a body performing a function similar to a board of directors.

(3) *Commodity interest* means any commodity futures, commodity option or swap contract traded on or subject to the rules of a designated contract market, a swap execution facility or linked exchange, or cleared by a derivatives clearing organization, or cash commodities traded on or subject to the rules of a designated contract market.

(4) *Disciplinary panel* means a panel of two or more persons authorized to conduct hearings, render decisions, approve settlements, and impose sanctions with respect to disciplinary matters.

(5) *Dispute resolution panel* means a panel of two or more persons authorized to resolve disputes involving a designated contract market's members, market participants, and any intermediaries.

(6) *Executive committee* means a committee of the board of directors that may exercise the authority delegated to it by the board of directors with respect to the decision-making of the company or organization.

(7) *Family relationship* means a person's relationship with a spouse, parents, children, or siblings, in each case, whether by blood, marriage, or adoption, or the person's relationship with any person residing in the home of the person.

(8) *Linked exchange* means:

(i) Any board of trade, exchange or market outside the United States, its territories or possessions, which has an agreement with a designated contract market or swap execution facility in the United States that permits positions in a commodity interest which have been established on one of the two markets to be liquidated on the other market;

(ii) Any board of trade, exchange or market outside the United States, its territories or possessions, the products of which are listed on a United States designated contract market, swap execution facility, or a trading facility thereof;

(iii) Any securities exchange, the products of which are held as margin in a commodity account or cleared by a securities clearing organization pursuant to a cross-margining arrangement with a futures clearing organization; or

(iv) Any clearing organization which clears the products of any of the foregoing markets.

(9) *Market regulation functions* means DCM functions required by DCM Core Principle 2, DCM Core Principle 4, DCM Core Principle 5, DCM Core Principle 10, DCM Core Principle 12, DCM Core Principle 13, DCM Core Principle 17 and the applicable Commission regulations thereunder.

(10) *Material information* means information which, if such information were publicly known, would be considered important by a reasonable person in deciding whether to trade a particular commodity interest on a designated contract market or a swap execution facility, or to clear a swap contract through a derivatives clearing organization. As used in this section, ''material information'' includes, but is not limited to, information relating to present or anticipated cash positions, commodity interests, trading strategies, the financial condition of members of self-regulatory organizations or members of linked exchanges or their customers, or the regulatory actions or proposed regulatory actions of a designated contract market or a linked exchange.

(11) *Non-public information* means information which has not been disseminated in a manner which makes it generally available to the trading public.

(12) *Pooled investment vehicle* means a trading vehicle organized and operated as a commodity pool within the meaning of § 4.10(d) of this chapter, and whose units of participation have been registered under the Securities Act of 1933, or a trading vehicle for which § 4.5 of this chapter makes available relief from regulation as a commodity pool operator, *i.e.,* registered investment companies, insurance company separate accounts, bank trust funds, and certain pension plans.

(13) *Public director* means a member of the board of directors who has been found, by the board of directors of the designated contract market, on the record, to have no material relationship with the designated contract market. The board of directors must make such finding upon the nomination of the director and at least on an annual basis thereafter.

(i) For purposes of this definition, a ''material relationship'' is one that reasonably could affect the independent judgment or decision-making of the member of the board of directors. Circumstances in which a member of the board of directors shall be considered to have a ''material relationship'' with the designated contract market include, but are not limited to, the following:

(A) Such director is an officer or an employee of the designated contract market or an officer or an employee of its affiliate;

(B) Such director is a member of the designated contract market, or a director, an officer, or an employee of either a member or an affiliate of the member. In this context, ''member'' shall have the meaning set forth in § 1.3 of this chapter;

(C) Such director directly or indirectly owns more than 10 percent of the designated contract market or an affiliate of the designated contract market, or is an officer or employee of an entity that directly or indirectly owns more than 10 percent of the designated contract market;

(D) Such director, or an entity in which the director is a partner, an officer, an employee, or a director, receives more than $100,000 in aggregate annual payments from the designated contract market, or an affiliate of the designated contract market. Compensation for services as a director of the designated contract

market or as a director of an affiliate of the designated contract market does not count toward the $100,000 payment limit, nor does deferred compensation for services rendered prior to becoming a director of the designated contract market, so long as such compensation is in no way contingent, conditioned, or revocable; or

(E) The director shall be considered to have a ''material relationship'' with the designated contract market when any of the circumstances described in paragraphs (b)(13)(i)(A) through (D) of this section apply to any person with whom the director has a family relationship.

(ii) All of the circumstances described in paragraph (b)(13)(i) of this section shall be subject to a one-year look back.

(iii) A public director of the designated contract market may also serve as a public director of an affiliate of the designated contract market if they otherwise meet the requirements of this section.

(iv) A designated contract market must disclose to the Commission which members of its board are public directors, and the basis for those determinations.

(14) *Related commodity interest* means any commodity interest which is traded on or subject to the rules of a designated contract market, swap execution facility, linked exchange, or other board of trade, exchange, or market, or cleared by a derivatives clearing organization, other than the designated contract market by which a person is employed, and with respect to which:

(i) Such employing designated contract market has recognized or established intermarket spread margins or other special margin treatment between that other commodity interest and a commodity interest which is traded on or subject to the rules of the employing designated contract market; or

(ii) Such other designated contract market has recognized or established intermarket spread margins or other special margin treatment with another commodity interest as to which the person has access to material nonpublic information.

(15) *Self-regulatory organization* shall have the meaning set forth in § 1.3 of this chapter.

(16) *Senior officer* means the chief executive officer or other equivalent officer of the designated contract market.

■ 23. Add § 38.852 in subpart Q to read as follows:

§ 38.852 Conflicts of interest.

(a) *Conflicts of interest in the decision-making of a designated contract market.* (1) A designated contract market must establish policies and procedures that require any officer or member of its board of directors, committees, or disciplinary panels to disclose any actual or potential conflicts of interest that may be present prior to considering any matter. Such conflicts of interests include, but are not limited to, conflicts of interest that may arise when such member or officer:

(i) Is the subject of any matter being considered;

(ii) Is an employer, employee, or colleague of the subject of any matter being considered;

(iii) Has a family relationship with the subject of any matter being considered; or

(iv) Has any ongoing business relationship with or a financial interest in the subject of any matter being considered.

(2) Any relationship of the type listed in paragraphs (a)(1)(i) through (iv) of this section that is with an affiliate of the subject of any matter being considered would be deemed an actual or potential conflict of interest for purposes of this section.

(3) The designated contract market must establish policies and procedures that require any officer or member of a board of directors, committee, or disciplinary panel of a designated contract market that has an actual or potential conflict of interest, including any of the relationships listed in paragraphs (a)(1) and (2) of this section, to abstain from deliberating or voting on such matter.

(b) *Documentation of conflicts of interest determinations.* The board of directors, committees, and disciplinary panels of a designated contract market must document in meeting minutes, or otherwise document in a comparable manner, compliance with the applicable requirements of this section. Such documentation demonstrating compliance must also include:

(1) The names of all members and officers who attended the relevant meeting in person or who otherwise were present by electronic means; and

(2) The names of any members and officers who voluntarily recused themselves or were required to abstain from deliberations or voting on a matter and the reason for the recusal or abstention.

■ 24. Add § 38.853 in subpart Q to read as follows:

§ 38.853 Limitations on the use and disclosure of material non-public information.

(a) *In general.* A designated contract market must establish and enforce policies and procedures on safeguarding the use and disclosure of material non-public information. Such policies and procedures must provide for appropriate limitations on the use or disclosure of material non-public information gained through the performance of official duties by members of the board of directors, committee members, and employees, or through an ownership interest in the designated contract market.

(b) *Prohibited conduct by employees.* A designated contract market must establish and enforce policies and procedures that, at a minimum, prohibit employees of the designated contract market from the following:

(1) Trading directly or indirectly, in the following:

(i) Any commodity interest traded on the employing designated contract market;

(ii) Any related commodity interest;

(iii) A commodity interest traded on designated contract markets or swap execution facilities or cleared by derivatives clearing organizations other than the employing designated contract market if the employee has access to material non-public information concerning such commodity interest; or

(iv) A commodity interest traded on or cleared by a linked exchange if the employee has access to material non-public information concerning such commodity interest.

(2) Disclosing for any purpose inconsistent with the performance of the person's official duties as an employee any material non-public information obtained as a result of such person's employment at the designated contract market; provided, however, that such policies and procedures shall not prohibit disclosures made in the performance by the employee, acting in the employee's official capacity or the employee's official duties, including to another self-regulatory organization, linked exchange, court of competent jurisdiction or representative of any agency or department of the federal or a state government.

(c) *Permitted exemptions.* A designated contract market may grant exemptions from the trading prohibitions contained in paragraph (b)(1) of this section. Such exemptions must be:

(1) Consistent with policies and procedures established by the designated contract market that set forth

the circumstances under which such exemptions may be granted;

(2) Administered by the designated contract market on a case-by-case basis;

(3) Approved by the designated contract market's regulatory oversight committee;

(4) Granted only in limited circumstances in which the employee requesting the exemption can demonstrate that the trading is not being conducted on the basis of material non-public information gained through the performance of official duties, which limited circumstances may include participation by an employee in pooled investment vehicles where the employee has no direct or indirect control with respect to transactions executed for or on behalf of such vehicles; and

(5) Individually documented by the designated contract market, with the documentation maintained by the designated contract market in accordance with §§ 38.950 and 38.951.

(d) *Monitoring for Permitted Exemptions.* A designated contract market must establish and enforce policies and procedures to diligently monitor the trading activity conducted under any exemptions granted under paragraph (c) of this section to ensure compliance with any applicable conditions of the exemptions and the designated contract market's policies and procedures on the use and disclosure of material non-public information that are required pursuant to this section.

(e) *Prohibited conduct by members of the board of directors, committee members, employees, consultants, or owners.* A designated contract market must establish and enforce policies and procedures that, at a minimum, prohibit members of the board of directors, committee members, employees, consultants, and those with an ownership interest of 10 percent or more in the designated contract market, from the following:

(1) Trading for such person's own account, or for or on behalf of any other account, in any commodity interest or related commodity interest, on the basis of any material non-public information obtained through the performance of such person's official duties as a member of the board of directors, committee member, employee, consultant, or those with an ownership interest of 10 percent or more in the designated contract market;

(2) Trading for such person's own account, or for or on behalf of any other account, in any commodity interest or related commodity interest, on the basis of any material non-public information that such person knows was obtained in violation of this section from a member of the board of directors, committee member, employee, consultant, or those with an ownership interest of 10 percent or more in the designated contract market; or

(3) Disclosing for any purpose inconsistent with the performance of the person's official duties any material non-public information obtained as a result of their official duties at the designated contract market; provided, however, that such policies and procedures shall not prohibit disclosures made in the performance of such person's official duties, including to another self-regulatory organization, linked exchange, court of competent jurisdiction or representative of any agency or department of the federal or state government acting in their official capacity.

■ 25. Add § 38.854 in subpart Q to read as follows:

§ 38.854 Board of directors.

(a) *In general.* (1) The board of directors of a designated contract market must be composed of at least thirty-five percent public directors.

(2) A designated contract market must establish and enforce policies and procedures outlining the roles and responsibilities of the board of directors, including the manner in which the board of directors oversees the designated contract market's compliance with all statutory, regulatory, and self-regulatory responsibilities of the designated contract market under the Act and the regulations promulgated thereunder.

(3) Any executive committee (or any similarly empowered body) must be composed of at least thirty-five percent public directors.

(b) *Expertise.* Each member of the board of directors, including public directors, of the designated contract market, must have relevant expertise to fulfill the roles and responsibilities of such member.

(c) *Compensation.* The compensation of public directors and other non-executive members of the board of directors of a designated contract market must not be directly dependent on the business performance of such designated contract market or any affiliate of the designated contract market.

(d) *Annual self-assessment.* The board of directors of a designated contract market must annually conduct a self-assessment of its performance and that of its committees. Such self-assessments must be documented and made available to the Commission for inspection.

(e) *Removal of a member of the board of directors.* A designated contract market must have procedures to remove a member from the board of directors, where the conduct of such member is likely to be prejudicial to the sound and prudent management of the designated contract market.

(f) *Reporting to the Commission.* A designated contract market must notify the Commission within five business days of any changes to the membership of the board of directors or any of its committees.

■ 26. Add § 38.855 in subpart Q to read as follows:

§ 38.855 Nominating committee.

(a) *In general.* A designated contract market must have a board-level nominating committee, which must, at a minimum:

(1) Identify a diverse panel of individuals qualified to serve on the board of directors, consistent with the fitness requirements set forth in § 38.801, the composition requirements set forth in § 38.853, and that reflect the views of market participants; and

(2) Administer a process for the nomination of individuals to the board of directors.

(b) *Applicability.* The requirements in paragraphs (a)(1) and (2) of this section apply to all nominations that occur after the initial establishment of the nominating committee and the appointment of members to the nominating committee.

(c) *Reporting.* The nominating committee must report to the board of directors of the designated contract market.

(d) *Composition.* The nominating committee must be composed of at least fifty-one percent public directors. The chair of the nominating committee must be a public director.

■ 27. Add § 38.856 in subpart Q to read as follows:

§ 38.856 Chief regulatory officer.

(a) *Designation and qualifications of chief regulatory officer.* (1) Each designated contract market must establish the position of chief regulatory officer, and designate an individual to serve in that capacity, to administer the designated contract market's market regulation functions.

(i) The position of chief regulatory officer must carry with it the authority and resources necessary to fulfill the duties set forth in this section for chief regulatory officers.

(ii) The chief regulatory officer must have supervisory authority over all staff

performing the designated contract market's market regulation functions.

(2) The individual designated to serve as chief regulatory officer must have the background and skills appropriate for fulfilling the duties of the position. No individual disqualified from registration pursuant to sections 8a(2) or 8a(3) of the Act may serve as a chief regulatory officer.

(b) *Reporting line of the chief regulatory officer.* (1) The chief regulatory officer must report directly to the board of directors or to the senior officer of the designated contract market.

(2) The designated contract market's regulatory oversight committee must oversee the chief regulatory officer to minimize any actual or potential conflicts of interest, including conflicts of interest between the duties of the chief regulatory officer and the designated contract market's commercial interests.

(c) *Appointment and removal of the chief regulatory officer.* (1) The appointment or removal of a designated contract market's chief regulatory officer must occur only with the approval of the designated contract market's regulatory oversight committee.

(2) The designated contract market must notify the Commission within two business days of the appointment of any new chief regulatory officer, whether interim or permanent.

(3) The designated contract market must notify the Commission within two business days of removal of the chief regulatory officer.

(d) *Compensation of the chief regulatory officer.* The board of directors or the senior officer of the designated contract market, in consultation with the designated contract market's regulatory oversight committee, must approve the compensation of the chief regulatory officer.

(e) *Duties of the chief regulatory officer.* The chief regulatory officer's duties must include, but are not limited to, the following:

(1) Supervising the designated contract market's market regulation functions;

(2) Establishing and administering policies and procedures related to the designated contract market's market regulation functions.

(3) Supervising 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) Reviewing 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) In consultation with the designated contract market's regulatory oversight committee, identifying, minimizing, managing, and resolving conflicts of interest involving the designated contract market's market regulation functions.

(f) *Conflicts of interest involving the chief regulatory officer.* Each designated contract market must establish procedures for the chief regulatory officer's disclosure of actual or potential conflicts of interest involving the chief regulatory officer to the regulatory oversight committee and designation of a qualified person to serve in the place of the chief regulatory officer for any matter in which the chief regulatory officer has such a conflict, and documentation of such disclosure and designation.

■ 28. Add § 38.857 in subpart Q to read as follows:

§ 38.857 Regulatory oversight committee.

(a) *In general.* Each designated contract market must establish a regulatory oversight committee, as a standing committee of the board of directors, to oversee the designated contract market's market regulation functions on behalf of the board of directors.

(b) *Composition.* The regulatory oversight committee must be composed entirely of public directors, and must include no less than two directors.

(c) *Delegation.* The board of directors must delegate sufficient authority, dedicate sufficient resources, and allow sufficient time for the regulatory oversight committee to fulfill its mandate and duties.

(d) *Duties.* The regulatory oversight committee must:

(1) Monitor the sufficiency, effectiveness, and independence of the designated contract market's market regulation functions;

(2) Oversee all facets of the designated contract market's market regulation functions;

(3) Approve the size and allocation of the regulatory budget and resources, and the number, hiring, termination, and compensation of staff required pursuant to § 38.155(a);

(4) Consult with the chief regulatory officer in managing and resolving any actual or potential conflicts of interest involving the designated contract market's market regulation functions;

(5) Recommend changes that would promote fair, vigorous, and effective self-regulation; and

(6) Review all regulatory proposals prior to implementation and advising the board of directors as to whether and how such proposals may impact the designated contract market's market regulation functions.

(e) *Reporting.* The regulatory oversight committee must periodically report to the board of directors of the designated contract market.

(f) *Meetings and documentation.* (1) The regulatory oversight committee must have processes related to the conducting of meetings, including, but not limited to, the following:

(i) The regulatory oversight committee must meet no less than on a quarterly basis;

(ii) The regulatory oversight committee must not permit any individuals with actual or potential conflicts of interest to attend any discussions or deliberations in its meetings that relate to the designated contract market's market regulation functions; and

(iii) The regulatory oversight committee must maintain minutes of its meetings. Such minutes must include a list of the attendees; their titles; whether they were present for the entirety of the meeting or a portion thereof (and if so, what portion); and a summary of all meeting discussions.

(2) The regulatory oversight committee must maintain documentation of the committee's findings, recommendations, deliberations, or other communications related to the performance of its duties.

(g) *Annual report*—(1) *Preparation.* The regulatory oversight committee must prepare an annual report of the designated contract market's market regulation functions for the board of directors and the Commission, which includes an assessment, at a minimum, of the following:

(i) Details of all market regulation function expenses;

(ii) A description of staffing, structure, and resources for the designated contract market's market regulation functions;

(iii) A description of disciplinary actions taken during the year;

(iv) A review of the performance of the designated contract market's disciplinary panels; and

(v) A list of any actual or potential conflicts of interests reported to the regulatory oversight committee, including a description of how such conflicts of interest were managed or resolved, and an assessment of the impact of any conflicts of interest on the swap execution facility's ability to perform its market regulation functions; and

(vi) Details related to all actions taken by the board of directors of a designated

contract market pursuant to a recommendation of the regulatory oversight committee, which details must include the following:

(A) The recommendation or action of the regulatory oversight committee;

(B) The rationale for such recommendation or action of the regulatory oversight committee;

(C) The rationale of the board of directors for rejecting such recommendation or superseding such action of the regulatory oversight committee, if applicable; and

(D) The course of action that the board of directors decided to take that differs from such recommendation or action of the regulatory oversight committee, if applicable.

(2) *Submission of the annual report to the Commission*—(i) *Timing.* The annual report must be submitted electronically to the Commission no later than 90 days after the end of the designated contract market's fiscal year.

(ii) *Request for extension.* A designated contract market may request an extension of time to file its annual report from the Commission. Reasonable and valid requests for extensions of the filing deadline may be granted at the discretion of the Commission.

(iii) *Delegation of authority.* The Commission hereby delegates, until it orders otherwise, to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time, the authority to grant or deny a request for an extension of time for a designated contract market to file its annual report under paragraph (g)(2)(ii) of this section. The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

(3) *Records.* The designated contract market must maintain all records demonstrating compliance with the duties of the regulatory oversight committee and the preparation and submission of annual reports consistent with §§ 38.950 and 38.951.

■ 29. Add § 38.858 in subpart Q to read as follows:

§ 38.858 Disciplinary panel composition.

(a) *Composition.* Each disciplinary panel must include at least two persons, including one public participant. A public participant is a person who would meet the eligibility requirements of a public director in § 38.851(b)(13), provided that such person need not be a member of the board of directors of the designated contract market. A public participant must chair each disciplinary panel. In addition, a designated contract market must adopt rules that would, at a minimum:

(1) Preclude any group or class of participants from dominating or exercising disproportionate influence on a disciplinary panel; and

(2) Prohibit any member of a disciplinary panel from participating in deliberations or voting on any matter in which the member has an actual or potential conflict of interest as set forth in § 38.852(a).

(b) *Appeals.* If the rules of the designated contract market provide that the decision of a disciplinary panel may be appealed to another committee of the board of directors, then such committee must also include at least two persons, including one public participant, and such public participant must chair the committee.

(c) *Exception.* Paragraphs (a) and (b) of this section do not apply to a disciplinary panel convened for cases solely involving decorum or attire.

■ 30. Amend Appendix B to part 38 by revising ''Core Principle 15 of section 5(d) of the Act'' and ''Core Principle 16 of section 5(d) of the Act'' to read as follows:

Appendix B to Part 38—Guidance on, and Acceptable Practices in, Compliance With Core Principles

* * * * *

Core Principle 15 of section 5(d) of the Act [Reserved]

Core Principle 16 of section 5(d) of the Act [Reserved]

* * * * *

Issued in Washington, DC, on March 4, 2024, by the Commission.

Christopher Kirkpatrick,

Secretary of the Commission.

NOTE: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Requirements for Designated Contract Markets and Swap Execution Facilities Regarding Governance and the Mitigation of Conflicts of Interest Impacting Market Regulation Functions—Commission Voting Summary, Chairman's Statement, and Commissioners' Statements

Appendix 1—Commission Voting Summary

On this matter, Chairman Behnam and Commissioners Goldsmith Romero and Pham voted in the affirmative. Commissioners Johnson and Mersinger voted in the negative.

Appendix 2—Statement of Support of Chairman Rostin Behnam

I support the proposed rules for designated contract markets (DCMs) and swap execution facilities (SEFs) that would establish governance and fitness requirements with respect to market regulation functions and related conflict of interest standards. This action continues my commitment to ensure that conflicts of interest are appropriately mitigated, and that SEF and DCM governing bodies adequately incorporate an independent perspective. Advancements in technology, coupled with demand for ever greater efficiency and speed, are pushing markets and market structure in new directions. This new disruption raises new and novel policy issues in all aspects of markets, including conflicts of interest. This proposal is just one step towards addressing potential and existing conflicts of interest in CFTC markets, to ensure markets remain strong, resilient, and transparent.

The proposed rules would enhance substantive requirements for identifying, managing, and resolving conflicts of interest related to market regulation functions. The rules also establish structural governance requirements regarding the makeup of SEF and DCM governing bodies. Importantly, these proposed rules would simplify the CFTC's rules for conflicts and governance fitness standards by harmonizing the regulatory regimes for SEFs and DCMs. In addition, these proposed rules would harmonize and enhance rules for SEFs and DCMs regarding the notification of a transfer of equity interest in a SEF or DCM, and would confirm the CFTC's authority to obtain information concerning continued regulatory compliance in the event of a change in ownership of a SEF or DCM.

I look forward to hearing the public's comments on the proposed amendments to the regulations for SEFs and DCMs. I thank staff in the Division of Market Oversight, Office of the General Counsel, and the Office of the Chief Economist for all of their work on the proposal.

Appendix 3—Dissenting Statement of Commissioner Kristin N. Johnson

I. Introduction

I dissent from this conflicts of interest and equity ownership transfer proposal (Proposed Rule). For nearly two years, in Commodity Futures Trading Commission (Commission or CFTC) public meetings, speeches, and engaged conversations with my fellow Commissioners, staff, and diverse market participants, I have advocated for the Commission to address two critical gaps in our regulations: incomplete and disparate conflicts of interest rules as well as Commission rules governing the transfer of ownership interests in a registered entity.[1]

[1] Commissioner Kristin N. Johnson, Keynote Address at Digital Assets @Duke Conference (Jan. 26, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/opajohnson2;* Commissioner Kristin N. Johnson, Statement Calling for the CFTC to Initiate a Rulemaking Process for CFTC Registered DCOs Engaged in Crypto or Digital Asset Clearing Activities (May 30, 2023), *https://*

In the Commission's December 2023 open meeting, I expressly stated that I cannot support the Commission in permitting conflicts-laden market structures without effective regulation.[2] It is imperative to note that this Proposed Rule will not address the conflicts of interest that I and many others have advocated for the Commission to address.

The Proposed Rule is materially incomplete. The Proposed Rule ignores conflicts of interest in novel segments of our markets where the Commission lacks visibility and the market lacks the benefit of robust regulatory oversight. While the Commission could have used this rulemaking to address endemic conflicts of interest in emerging markets such as cryptocurrency or digital asset markets, this Proposed Rule does not address these deeply concerning, pernicious conflicts of interest.

The Proposed Rule undermines harmonization of conflicts regulations across our markets. Over a century ago, in passing the Grain Futures Act and, later, the Commodity Exchange Act (CEA), Congress expressly emphasized the necessity of governing conflicts of interest and registration standards in the oversight of the derivatives markets.

In 2010, in the wake of the financial crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and expressly tasked the Commission with introducing clearing infrastructure regulation in the bespoke, bilateral over-the-counter (OTC) swaps market. In 2011, the Commission adopted a rule proposal to establish conflicts of interest regulations for derivatives clearing organizations (DCOs), derivatives contract markets (DCMs) and swap execution facilities (SEFs).[3] This proposal was withdrawn. In an approach that splintered the proposed rule and may have stymied harmonization, the Commission proceeded with separate, disparate conflicts of interest final rulemakings. It adopted conflicts requirements in 2012 for DCMs, in 2013 for SEFs, and in 2020 for all DCOs.[4]

This fractured approach has led to entrenched challenges and resulted in different rules for different registered entities.

While some tailoring may be appropriate to acknowledge differences in market design and the role and obligation of registered entities, the Commission should not permit weaker conflicts rules in certain segments of our markets. It is imperative that any final rule governing conflicts address conflicts of interest comprehensively across our existing regulatory landscape.

Conflicts of interest have the potential to create governance risks. Governance plays a critical role in operational, market, credit and general risk management decision-making. Any post-mortem of the financial crisis offers dozens of illustrations regarding the potential for conflicts of interest to trigger the very types of disruption that may undermine enterprise risk management, market stability and integrity, and potentially generate risks that may be antecedents to systemic crises. Because we know well the consequences of failing to introduce effective risk management and governance regulation, the Commission must act now.

I have repeatedly called on the Commission to initiate a rulemaking that addresses the conflicts of interest that may arise from adopting vertically integrated market structures. This concern is intimately connected with the previously articulated concern. The CFTC's enforcement actions filed in the wake of FTX's bankruptcy detail the potential for a market participant to interface with retail market participants through a series of affiliated entities that share a common ownership structure among the exchange, market maker, broker dealer, and custodian. These concerns should prompt the Commission to act within our existing authority and as part of this conflicts rulemaking.

In an increasing number of instances, businesses with no history of operating in derivatives markets, no track record of compliance with federal financial market regulations, and limited evidence of corporate governance and risk management infrastructure have expressed interest in acquiring or have acquired CFTC-registered entities. Some may conclude that it is cheaper to purchase a business licensed to operate in our markets than to engage with the Commission in the rigorous and extensive licensing application process.

It is important for the Commission to carefully consider regulations governing equity interest transfers and ensure that anyone acquiring a registered entity is prepared to comply with the entire regulatory regime applicable to CFTC-registered firms. Similar to the proposed conflicts of interest rules, I am concerned that the Commission's actions are not commensurate with the risks presented by emerging market conditions.

For these reasons and as explained below, I dissent from the Commission's decision to adopt the Proposed Rule.

II. Background of the Proposed Rule

I support the Commission's efforts to enhance the integrity of the decision-making process of SEFs and DCMs and reduce conflicts of interest. The Proposed Rule seeks to ensure that conflicts of interest are mitigated for SEFs and DCMs. The Commission proposes enhancing conflicts of interest requirements to ensure that SEFs and DCMs identify, manage, and resolve conflicts related to ''market regulation functions.'' In the Proposed Rule, the Division of Market Oversight (DMO) identifies a set of issues that the Commission has carefully considered addressing for over a decade. I deeply respect and appreciate the tireless efforts and expertise of the Commission staff.

I applaud the staff's identification of and focus on addressing conflicts of interest in certain self-regulatory functions of SEFs and DCMs. The carefully developed rule text seeks to impose heightened governance fitness and structural standards to ensure that a SEF and DCM board of directors and disciplinary panels incorporate independent and expert perspectives.

For almost two decades, I have advocated for the Commission to enhance conflicts regulations. The Proposed Rule reflects a thoughtful commitment to addressing an area of conflicts that has not received sufficient attention. The Commission is also proposing to strengthen the notification requirements with respect to changes in the ownership or corporate or organizational structure of a SEF or DCM.

The Commission is proposing:

- new rules to implement DCM Core Principle 15 (*Governance Fitness Standards*) that are consistent with the existing Guidance on compliance with DCM Core Principle 15;
- new rules to implement DCM Core Principle 16 (*Conflicts of Interest*) that are consistent with the existing Guidance on, and Acceptable Practices in, compliance with DCM Core Principle 16;
- new rules to implement SEF Core Principle 2 (*Compliance with Rules*) that are consistent with the existing DCM Core Principle 15 Guidance;
- new rules to implement SEF Core Principle 12 (*Conflicts of Interest*) that are consistent with the existing DCM Core Principle 16 Guidance and Acceptable Practices;
- new rules under Part 37 of the Commission's regulations for SEFs and Part 38 of the Commission's regulations for DCMs that are consistent with existing conflicts of interest and governance requirements under Commission Regulations 1.59 and 1.63;
- new rules for DCM chief regulatory officers (CROs);
- amendments to certain requirements relating to SEF chief compliance officers (CCOs); and
- new rules for SEFs and DCMs relating to the establishment and operation of a Regulatory Oversight Committee (ROC).

www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement053023; Commissioner Kristin N. Johnson, Keynote Speech at the Salzburg Global Finance Forum (June 29, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/opajohnson4;* Commissioner Kristin N. Johnson, Opening Statement Before the Market Risk Advisory Committee (July 10, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement071023;* Commissioner Kristin N. Johnson, Opening Statement Before the Market Risk Advisory Committee Meeting (Dec. 11, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement121123;* Commissioner Kristin N. Johnson, Opening Statement Regarding the Open Commission Meeting on December 13, 2023 (Dec. 13, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement121323;* Commissioner Kristin N. Johnson, A Call for the CFTC to Begin a Formal Rulemaking to Address Vertical Integration (Dec. 18, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement121823c#:~:text=I%20strongly%20advocate%20for%20the,risk%20or%20financial%20stability%20concerns.*

[2] Opening Statement Regarding the Open Commission Meeting on December 13, 2023, *supra* note 1.

[3] Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest, 76 FR 722 (Jan. 6, 2011).

[4] Core Principles and Other Requirements for Designated Contract Markets, 77 FR 36612 (June 19, 2012); Core Principles and Other Requirements for Swap Execution Facilities, 78 FR 33476 (June 4, 2013); Derivatives Clearing Organization General Provisions and Core Principles, 85 FR 4800 (Jan. 27, 2020).

I thank the staff for their constructive engagement and cooperation with my office. DMO staff addressed and incorporated my comments into the Proposed Rule, which materially improve and strengthen both the conflicts of interest and governance requirements. Through coordinated efforts with my office, we have made our markets stronger and safer.

Section 5h of the CEA sets forth requirements for SEFs.[5] To be registered and maintain registration with the Commission, a SEF must comply with 15 core principles and any requirement that the Commission may impose by rule or regulation pursuant to Section 8a(5) of the CEA.[6] Similarly, Section 5 of the CEA sets forth requirements for DCMs.[7] The CEA requires that to be designated and maintain designation by the Commission, a DCM must comply with 23 core principles, and any requirement that the Commission may impose by rule or regulation pursuant to Section 8a(5) of the CEA.[8]

Section 8a(5) authorizes the Commission to make and promulgate rules and regulations that, 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.[9] As noted in the Preamble to the Proposed Rule, 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.'' [10]

A SEF or DCM has reasonable discretion to establish the manner in which it complies with a particular core principle unless the Commission adopts more prescriptive requirements by rule or regulation. In the Proposed Rule, the Commission is prescribing heightened requirements for SEFs and DCMs.

III. Limitations of the Conflicts Rules

SEFs, DCMs, and DCOs, as self-regulatory organizations, are tasked with the important responsibility of regulating the derivatives market and fostering market integrity. The CEA requires effective self-regulation of trading facilities, clearing systems (clearinghouses), market participants and market professionals under the oversight of the Commission.[11]

A SEF's or DCM's decision-making process encompasses a broad range of regulatory functions, including certain self-regulatory obligations subject to the influence or capture of interested decision-makers. Under the existing conflicts of interest framework, both SEFs and DCMs are subject to a respective core principle (DCM Core Principle 16 and SEF Core Principle 12) to minimize and have a process to resolve conflicts of interest in their decision-making processes.[12]

Under the Proposed Rule, SEFs and DCMs will be required, by regulation, to establish a process for identifying, managing, and resolving actual and potential conflicts of interest that may arise between and among any of the SEF's or DCM's ''market regulation functions'' and its commercial interests as well as the interests of its management, members, owners, customers, market participants, other industry participants, and other constituencies.

Specifically, both SEFs and DCMs are required to establish a ROC, a standing committee of the board consisting of only public directors tasked with minimizing conflicts of interest, overseeing the DCM's market regulation functions, and preparing an annual report assessing the market regulation functions for the Commission (among other responsibilities). The DCM is required to designate a CRO responsible for the market regulation function. A SEF is required to designate a CCO or a similar senior officer. The CRO and CCO must report to the board or a senior officer. SEFs and DCMs must also limit the use or disclosure of material non-public information by certain decision-makers, employees, and owners.

Notwithstanding my general support for the conflicts regulation that the Proposed Rule advances, I am unable to support the conflicts provisions in the Proposed Rule for several reasons.

First, the Proposed Rule is incomplete. The Proposed Rule fails to modernize similar conflicts of interest rules for DCOs. The Commission should take a comprehensive approach to conflicts of interest across our various market structures to avoid potential inconsistencies, contradictions, and inefficiencies.

Second, last year in a series of public statements and speeches, I clearly and unequivocally signaled to the Commission that we must adopt comprehensive conflicts rules.[13] The proposed conflicts regulation overlooks the need for conflicts regulation for certain market participants adopting vertically integrated market structures. I repeat my call for the Commission to commit to engage in a public rulemaking with formal notice and comment period on vertically integrated structures.[14]

A. Failure To Address Conflicts of Interest for DCOs

The Commission should adopt enhanced conflicts of interest rules that parallel today's proposed conflicts rules for DCOs. DCOs play a central role in derivatives markets. Since the passage of the Dodd-Frank Act, market participants have cleared significant volumes of OTC derivatives transactions through DCOs. Clearing OTC derivatives through registered clearinghouses may lead to greater concentration of risk.

In the Preamble to the Proposed Rule, DMO cited to an article I published a decade ago that explores how CCP boards of directors face persistent and pernicious conflicts of interest that impede objective risk oversight. The preamble acknowledges my view that:

While clearinghouses and exchanges are private businesses, these institutions provide a critical, public, infrastructure resource within financial markets. The self-regulatory approach adopted in financial markets presumes that clearinghouses and exchanges will provide a public service and engage in market oversight. The owners of exchanges and clearinghouses may, however, prioritize profit-maximizing strategies that de-emphasize or conflict with regulatory goals.[15]

It is imperative that, to the extent the Commission advances the Proposed Rule, it also adopts well-tailored governance reforms to address conflicts and prevent DCO owners' self-interested commercial incentives or other institutional constraints from triggering systemic risk concerns.

DCOs are subject to Core Principle P regarding conflicts of interest.[16] CFTC Regulation 39.25 implements DCO Core Principle P and is identical in all material respects to the existing SEF and DCM core principles and implementing regulations on conflicts of interest. A DCO is also required ''to establish and enforce rules to minimize conflicts of interest in the decision-making process,'' ''establish a process for resolving conflicts of interest,'' and ''have procedures for identifying, addressing, and managing conflicts of interest involving their members.'' [17]

The Commission has improved the conflicts requirements for SEFs and DCMs but did not propose parallel revised rules for DCOs. For example, the Proposed Rule introduces common scenarios in which a conflict of interest may arise and imposes requirements to document conflicts of interest determinations.[18]

At a minimum, the Commission should advance parallel rules to assist DCOs in identifying, managing, and resolving conflicts of interest in their decision-making process.[19]

B. Commit to a Conflicts Rulemaking on Vertical Integration

It is essential that the Commission adopt a comprehensive approach to addressing deep-seated conflicts of interest concerns, instead of its piece-meal and fragmented approach. I

[5] 7 U.S.C. 7b–3.

[6] 7 U.S.C. 7b–3(f).

[7] 7 U.S.C. 7.

[8] 7 U.S.C. 7(d)(1)(A).

[9] 7 U.S.C. 12a(5).

[10] 7 U.S.C. 5.

[11] *Id.*

[12] 7 U.S.C.A. 7, 7b–3.

[13] *See supra* note 1.

[14] A Call for the CFTC to Begin a Formal Rulemaking to Address Vertical Integration, *supra* note 1 (''I strongly advocate for the Commission to initiate a rulemaking. More market participants are adopting a vertically-integrated market structure, and the Commission must ensure that such structure does not raise systemic risk or financial stability concerns.'').

[15] *See* also Kristin N. Johnson, Governing Financial Markets: Regulating Conflicts, 88 Wash. L.Rev. 185, 221 (2013).

[16] 7 U.S.C. 7a–1.

[17] 17 CFR 39.25.

[18] Proposed 17 CFR 37.1202, 38.852.

[19] Commissioner Kristin N. Johnson, Statement of Commissioner Kristin N. Johnson Regarding the CFTC's Notice of Proposed Rulemaking on Operational Resilience Program for FCMs, SDs, and MSPs (Dec. 18, 2023); *https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement121823.*

have repeatedly called for the Commission to initiate a comprehensive rulemaking process across all market infrastructures—DCOs, SEFs, and DCMs—to address inherent conflicts of interest issues that arise in vertically integrated structures, including, most recently, in my statement on the Bitnomial DCM application where I outlined numerous important Commission conflicts of interest regulations.[20]

A Rulemaking on Vertical Integration Is Essential

The Preamble to the Proposed Rule notes that in 2021, Commission staff identified several SEFs and three DCMs that were in the same corporate family as intermediaries engaged in trading on the affiliated-SEF or DCM. Such organizational structures increase the risk of conflicts of interest.

The Commission's request for comment and staff advisory are helpful initial steps. On June 28, 2023, Commission staff issued a Request for Comment on the Impact of Affiliations Between Certain CFTC-Regulated Entities (RFC on Vertical Integration) to better understand a broad range of potential issues that may arise if a DCO, DCM, or SEF is affiliated with an intermediary that uses its platform.[21] On December 18, 2023, the Commission issued a staff advisory on affiliations between a DCM, DCO, or a SEF and an intermediary or other market participant to remind them of their regulatory obligations.[22]

The Commission staff indicates that we should anticipate proposed conflicts regulations addressing vertical integration, including responses to concerns related to market regulation functions posed by affiliations. It is, however, unacceptable that this commitment note appears only in a footnote that fails to provide a clear and unambiguous commitment to undertake a rulemaking.

Industry comments related to SEFs and DCMs with affiliated trading members highlight the urgent need for a regulatory response. Many of the comments to the RFC on Vertical Integration echo these concerns. It is particularly disappointing that the Commission is delaying a resolution of the matter when certain questions in the RFC on Vertical Integration directly implicate the narrowly-defined ''market regulation functions.''

A Piecemeal Approach Risks Inconsistencies and Contradictions

The Proposed Rule's significant gaps are likely to demand future rulemakings addressing them. For example, the Proposed Rule is silent on the sharing of certain key executive functions and other key personnel, which is not an unusual operating model for vertically integrated structures.[23]

While the Proposed Rule requires a DCM's CRO and an SEF's CCO to report to the board of directors or a senior officer of the SEF or DCM, it does not require that the CCO report to the ROC, which is comprised of only public directors.[24] A member of the board, including a shared officer—*e.g.,* the chief executive officer—may have supervisory authority over the CRO and CCO. This raises the question of whether the Commission has adequately insulated the CRO and CCO from commercial pressures when a CRO or CCO is required to make decisions about a member that is affiliated with the SEF or DCM. Compounding this issue, the Commission is allowing the CRO and CCO to be paid based on the profits of the SEF or DCM, which could create perverse incentives.

I am disappointed that the Commission has elected to proceed with the Proposed Rule on conflicts concerns without initiating a formal rulemaking to establish effective conflicts rules in the context of vertically integrated structures.[25] The Commission's piecemeal approach to regulating the derivatives market leaves key issues unaddressed.

IV. Failure To Adequately Reinforce the Commission's Right To Take Regulatory Action Upon a Change of Ownership

Since the early months of my tenure as a Commissioner, I have raised questions regarding a change of control in the ownership of a registered entity.

I welcome the Commission's efforts to address the disparate regulations that govern the two approaches for acquiring access to our markets. I find, however, that the Proposed Rule advances and codifies deficiencies and reinforces an antiquated understanding of markets.

In any instance in which an applicant seeks to register with the CFTC, transfer a designation, or acquire a controlling percentage of the equity interest in a licensed registrant, the CFTC must be confident that the party assuming control over a registrant will continue to comply with our regulations in a manner consistent with the Commission's expectations of the registrant at the time of the approval of the registrant's initial application.

While the Commission retains the authority to suspend or revoke the registration of or impose a cease and desist order on a SEF or DCM that fails to comply with the CEA and Commission regulations, our regulations should clearly state that the Commission will object to a transfer of ownership in such circumstances or has an outright approval right.

The efforts of the Commission staff are commendable but not sufficient. With respect to a change in ownership or corporation or organizational structure of the SEF or DCM, if a SEF or DCM does not have the ability to comply with the CEA and Commission regulations in connection with such a change, the Commission should have the ability to approve or object to such change.

New Equity Transfer Provisions

Commission Regulation 38.5(c)(1) currently provides that a DCM must file with the Commission a notification of each transaction it enters into involving the transfer of ten percent or more of the equity interest in the DCM.[26] The regulation does not indicate that Commission approval is required for the acquisition. Similar provisions apply to SEFs in CFTC Regulation 37.5(c), but the threshold that triggers a notice event is fifty percent or more of the equity interest of the SEF. Under Regulation 37.5(c), a SEF must also certify as to its compliance with the CEA and Commission regulations.[27] DMO staff review the relevant notifications.

The Commission proposes to amend CFTC Regulations 37.5(c) and 38.5(c) to:

- ensure the Commission receives timely and sufficient information in the event of certain changes in the ownership or corporate or organizational structure of a SEF or DCM;
- clarify what information is required to be provided and the relevant deadlines;
- conform to similar existing and proposed requirements applicable to DCOs; and
- impose a certification requirement.

The Proposed Rule emphasizes the importance of disclosures related to the ownership structure of registrants. In our registration process, staff carefully evaluates significant volumes of data regarding an entity that seeks to be licensed by and subject to the Commission's authority. The disclosures enable the Commission to assess whether the entity demonstrates the requisite ability to comply with our regulation.

The Proposed Rule acknowledges the significant business organizational shifts in our markets. For many years market participants were organized as cooperative structures or private partnerships. Demutualization and an increase in registrants choosing to become publicly-traded companies alters the market landscape. In addition to a transformation in how risks and default risks are managed, this approach has led to significant consolidation in some contexts.

A ten percent change in the equity ownership may create a notable difference in governance and risk management decision-making authority within a firm. Finally, our regulations note that an asset purchase may have the same effect as an equity interest

[20] Opening Statement Regarding the Open Commission Meeting on December 13, 2023, *supra* note 1.

[21] Request for Comment on the Impact of Affiliations of Certain CFTC-Regulated Entities, CFTC Release 8734–23, June 28, 2023, *https://www.cftc.gov/PressRoom/PressReleases/8734-23.*

[22] Staff Advisory on Affiliations Among CFTC-Regulated Entities, CFTC Release 8839–23, Dec. 18, 2023, *https://www.cftc.gov/PressRoom/PressReleases/8839-23.*

[23] *See* CME Comment Letter in response to General CFTC Request for Comment on the Impact of Affiliations of Certain CFTC-Regulated Entities at 16–17 (Sept. 20, 2023), *https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7401;* Global Association of Central Counterparties Comment Letter in response to General CFTC Request for Comment on the Impact of Affiliations of Certain CFTC-Regulated Entities at 3 (Sept. 28, 2023), *https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7401.*

[24] *See* Futures Industry Association Comment Letter in response to General CFTC Request for Comment on the Impact of Affiliations of Certain CFTC-Regulated Entities at 10 (Sept. 28, 2023), *https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7401.*

[25] A Call for the CFTC to Begin a Formal Rulemaking to Address Vertical Integration, *supra* note 1.

[26] 17 CFR 38.5(c).

[27] 17 CFR 37.5(c).

transfer. The Proposed Rule requires SEFs and DCMs to notify the CFTC if substantially all of the assets of the SEF or DCM are transferred to another legal entity.

Limitations of the Equity Transfer Provisions

The Proposed Rule should clearly state that the Commission has the regulatory authority to take traditional and well-recognized regulatory action in the context of a change in the ownership or corporate or organizational structure of a SEF or DCM. From as early as 2022, I have raised alarms with respect to the Commission's explicit and express authority under Commission regulations to engage in a robust dialogue with a registrant planning a significant equity interest transfer.[28] The Proposed Rule fails to fully address my concerns.

I am deeply concerned that some may mistakenly interpret the Proposed Rule to indicate that the Commission has no explicit or express legal authority to take regulatory action upon disclosure of an acquisition of our registrant where the Commission believes that the registrant will no longer comply with the CEA or Commission regulations.

In addition to this concern, I strongly believe that the Commission has missed an opportunity to ensure that all entities entering in our markets are subject to the same rules whether they are acquiring a significant equity interest in a registered entity or registering as a registrant. The best method of addressing these twin concerns is to first clarify the Commission's existing authority and to ensure that across our markets the equity interest transfer regulations are similar and that these regulations involve inquiries as robust and effectively enforced as disclosures provided at the time that an entity registers with the Commission.

Objecting to a Change in Equity Ownership

As part of the registration process, SEFs and DCMs are required to demonstrate, prior to registration, compliance with the CEA and related core principles. An entity seeking designation as a SEF or DCM must include ownership information in its Form DCM or Form SEF application. This authority is parallel to the authority the Commission exercises when a registered entity experiences a change of control.

The Proposed Rule should clarify that the Commission may object to a proposed change in ownership or corporate or organizational structure for SEFs and DCMs if such change could result in a failure of a registrant to comply with the CEA or Commission regulations. In parallel to the Commission's authority to grant registration is the Commission's authority to revoke registration.

Approving a Change in Ownership

The Proposed Rule should state that the Commission has an approval right in the event of a change in ownership or corporate or organizational structure. This approval authority parallels the authority that the Commission exercises at the time of registration. Rule text that explicitly states the same would clarify the Commission's authority for market participants.

For example, certain prudential regulations are consistent with this understanding. The Office of the Comptroller of the Currency (OCC), for example, requires that any party seeking to acquire control of a national bank give notice of such change to the OCC. Upon the filing of such notice, the OCC has the power to disapprove (*i.e.,* object to) such changes set out in the notice.[29] Similarly, under FINRA Rule 1017, a member is required to file an application with FINRA for approval of a 25% change in equity ownership of the member.

V. Conclusion

I believe the Commission should adopt parallel conflicts regulations across our markets and must adopt conflicts rules that effectively govern conflicts among affiliated entities. I believe that the Commission has notable authority with respect to any entity seeking to acquire a controlling equity interest in a business in our markets, including the authority to suspend, revoke, or enter a cease and desist order, should the ownership change result in a violation of a statutory or regulatory requirement or a Commission order. I would like to see the Commission go farther and adopt a rulemaking that gives the Commission the right to approve or object to a change in ownership or corporate or organizational structure to the same extent.

I would like to extend my sincere gratitude to the DMO team, including Rachel Berdansky, Swati Shah, Marilee Dahlman, Jennifer Tveiten-Rifman, David Steinberg, Lillian Cardona, Caitlin Holzem, and Rebecca Mersand.

Appendix 4—Statement of Commissioner Christy Goldsmith Romero

Conflicts of interest at exchanges and swap execution facilities (SEFs) present serious risk to market fairness, integrity, and financial stability. The CFTC plays a critical role in implementing strong rules to prevent conflicts from hurting customers, markets, market participants, and end users. As designated self-regulatory organizations, exchanges serve as the front line for market integrity.[1] And given the contribution to the financial crisis of opaque *caveat emptor* swaps markets,[2] the Dodd-Frank Act created SEFs and gave them important regulatory responsibilities to ensure transparency in the swaps markets.[3] In order for markets to function well and fairly, these important regulatory responsibilities must be performed free of conflicts of interest.

Existing CFTC rules already require exchanges and SEFs to establish and enforce rules to minimize conflicts of interest, and we have issued accompanying guidance to exchanges. Though I support the rule, I consider it to be a baseline minimum, largely codifying existing guidance,[4] extending it to swap execution facilities, and adding a few additional requirements.

This proposed rule would not create an adequate conflicts of interest regulatory regime to cover conflicts that come from affiliated entities serving multiple functions (*i.e.* broker, exchange, clearinghouse, etc.)–so called ''vertical integration,'' which the proposal acknowledges.[5] Therefore, this rule does not serve as a basis for future approval of additional vertically integrated structures that break from the traditional structure on which the Commodity Exchange Act and CFTC rules are based.

The proposal purposely attempts to carve out vertical integration from this rulemaking and commits to addressing it in the future in light of the recently completed request for comment on affiliated entities. By September, the CFTC received more than 100 comments expressing significant concern over conflicts of interest with vertically integrated market structures.[6] Serious concerns about vertically integrated market structures in digital assets had already been expressed by the White House in the Economic Report of the President,[7] the Financial Stability Oversight

[28] Commissioner Kristin N. Johnson, Keynote Address at UC Berkeley Law Crypto Regulation Virtual Conference (Feb. 8, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/opajohnson3* (''During a more recent speech at Duke University. . . I also called for Congress to consider including in any legislation expanding the CFTC's authority a provision that enables the Commission to have greater authority including, in the least, a robust dialogue in advance of the acquisition of a controlling equity ownership stake in any registered market participant.'').

[29] 12 CFR 5.50(f)(3).

[1] Exchanges are responsible for setting financial and reporting rules, including involving customer funds. Exchanges must also supervise compliance with exchange rules and Commission regulations related to capital, customer protection, risk management, financial reporting, and record keeping. They have a responsibility to investigate and discipline those who violate those requirements.

[2] *See* Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 FR 9734, 9805 (Feb. 17, 2012) (Comment of CFA/AFR).

[3] SEFs have important regulatory responsibilities, including reporting transactions and maintaining an audit trail. SEFs are required to establish and enforce rules for trading or processing swaps, and to have the capacity to investigate violations and enforce these rules.

[4] *See* 17 CFR part 38, Appendix B.

[5] *See* Proposal at note 118 (''The Commission received a number of comments raising concerns about the impact of affiliation, and anticipates proposing regulations that will address issues identified as a result of the [request for comment] RFC, including additional concerns raised by commenters about the conflicts of interest, specifically relating to market regulation functions, posed by affiliations. This rulemaking does not reflect the comments submitted in response to the Commission staff's RFC. Those comments will not be made part of the administrative record before the Commission in connection with this proposal'').

[6] The comments were in response to a request for comment on the impact of affiliated entities. I have raised concerns about the risk posed by these arrangements, including the immediately apparent risk of conflict of interest. *See* CFTC Commissioner Christy Goldsmith Romero, *https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement062823,* (June 28, 2023); *See also* CFTC Commissioner Christy Goldsmith Romero, *https://www.cftc.gov/PressRoom/SpeechesTestimony/oparomero3,* (Oct. 26, 2022).

[7] *See* The White House, *https://www.whitehouse.gov/wp-content/uploads/2023/03/ERP-2023.pdf,* (Mar. 2023).

Council (FSOC),[8] Treasury Secretary Janet Yellen,[9] then-Federal Reserve Vice Chair Lael Brainard,[10] and Acting Comptroller of the Currency Michael Hsu before we issued the request for comment.[11] The CFTC has not issued any new rules or guidance based on those comments. Last month, the Commission approved a vertically integrated market structure for the first time (on which I dissented given that we were in the middle of studying the risks and had not engaged in rulemaking),[12] and it was said in the open meeting that there are other pending applications. As this proposal's record will not reflect comments submitted in response to the request for comment on vertical integration, I encourage commenters to resubmit relevant sections of those comments in response to this proposal.

Requirements of the Proposed Rule

The rule would require an exchange or SEF to report any change to the entity or person that holds a controlling interest, either directly or indirectly, as opposed to the more limited notification requirements (10% change in ownership of an exchange or 50% ownership of a SEF). Any owners of exchanges and SEFs may have other interests (financial or otherwise) that may not align with the exchange's or SEF's responsibilities.

The rule would require officers or directors with an actual or potential conflict of interest in the subject of a matter to abstain from both voting and deliberation. The proposal also creates a baseline definition of what is a conflict of interest, and requires documentation of compliance with the rule, which facilitates oversight.

Officers, directors, those with an ownership interest in the exchange of at least 10%, and employees would be banned from trading on or disclosing material non-public information. I would like to hear from commenters if the 10% ownership threshold is appropriate or should be lowered. I would also like to hear whether commenters think the proposed requirements are sufficient to prevent the misuse of non-public information, especially in cases where employees, officers, directors or owners are also employed by a company that trades in contracts for commodities traded on the exchange. I am especially interested in comments about whether the Commission should ban use of material non-public information for trades on a spot exchange by an officer, director, owner or employee of an affiliated derivatives exchange.[13]

The proposal would codify guidance by requiring establishment of a regulatory oversight committee, comprised entirely of independent public directors tasked with monitoring the effectiveness of an exchange or SEF's regulatory functions and minimizing and resolving conflicts of interest, and requires every exchange to have a Chief Regulatory Officer (''CRO'').[14] Requirements for the regulatory oversight committee include approving the size and allocation of resources and the number of market regulation staff.

The proposal does not address the issue of shared resources of affiliated entities, including for example dual-hatted employees. Shared resources lead to concerns about whose interest will dominate when it counts the most, during times of stress. Shared resources also raise concerns over capacity to fulfill regulatory responsibilities, including for example, a derivatives exchange's ability to fulfill its front-line market integrity responsibility when using shared resources of an affiliated spot exchange.[15]

I want to thank the staff for working with me to strengthen this proposal, including in the way it incorporates affiliates in certain areas, particularly given that affiliated entities can raise conflicts of interest even outside of the vertical integration structure. I continue to urge further rulemaking to address conflicts of interest, including those associated with vertically integrated market structures.

Appendix 5—Statement of Commissioner Caroline D. Pham

I am voting to publish the Notice of Proposed Rulemaking on Requirements for Designated Contract Markets (DCMs) and Swap Execution Facilities (SEFs) Regarding Governance and the Mitigation of Conflicts of Interest Impacting Market Regulation Functions (DCM and SEF Conflicts of Interest Proposal or NPRM) because the public must have an opportunity to weigh in on these important issues that raise serious concerns. I would like to thank Lillian Cardona, Jennifer Tveiten-Rifman, Marilee Dahlman, Swati Shah, and Rachel Berdansky in the Division of Market Oversight for their time and efforts, and I take this opportunity to recognize the importance of their rule enforcement reviews program for DCMs and SEFs. I appreciate the staff working with me to make revisions to address my concerns. Unfortunately, while the NPRM has been improved, it is far from perfect.

Overall, I believe the public comment process is a critical component of good government. That is why, although I have serious concerns about the DCM and SEF Conflicts of Interest Proposal, I am voting to publish it for transparency and public engagement on this flawed rulemaking.

The CFTC cannot haphazardly codify guidance as rules. That goes against the very essence of the statutory framework to regulate derivatives markets under the Commodity Exchange Act (CEA). Here, public input will serve as a valuable tool in refining the NPRM by providing insights that may not have been considered in changing the CFTC's longstanding principles-based approach to oversight of self-regulatory organizations (SROs) such as DCMs and SEFs, who establish their own rule books and bring enforcement actions against market participants for violations.[1] In 2012, when the CFTC first adopted its DCM rules and decided to leave certain areas as guidance on acceptable best practices, the CFTC thoroughly examined each regulation and explained where guidance was more appropriate than a rule in recognition of the need to maintain flexibility for DCMs to establish rules that are appropriate for their products, markets, and participants, including associated risks.[2] I have serious concerns with the CFTC proceeding down a path to finalizing a rule that is overly prescriptive and unsupported by data or other evidence.

Specific Areas for Public Comment

Separately, I am highlighting two additional issues for commenters:

[8] *See* Financial Stability Oversight Council, *https://home.treasury.gov/system/files/261/FSOC-Digital-Assets-Report-2022.pdf,* (Oct. 3, 2022).

[9] *See https://home.treasury.gov/news/featured-stories/remarks-by-secretary-of-the-treasury-janet-l-yellen-at-the-national-association-for-business-economics-39th-annual-economic-policy-conference,* (Mar. 30, 2023).

[10] *See* Federal Reserve Board Vice-Chair Lael Brainard, *https://www.federalreserve.gov/newsevents/speech/brainard20220708a.htm,* (July 8, 2022).

[11] *See* Acting Comptroller of the Currency Michael J. Hsu, *https://www.occ.treas.gov/news-issuances/speeches/2022/pub-speech-2022-125.pdf,* (Oct. 11, 2022).

[12] *See* CFTC Commissioner Christy Goldsmith Romero, *https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement121823b,* (December 18, 2023).

[13] The Commission currently requires an exchange to provide for ''appropriate'' limitations on the use of material non-public information by employees, officers, and directors, but does not include a spot exchange trading ban as one of its specific requirements for such limitations.

[14] SEFs are required to have a Chief Compliance Officer with similar duties and responsibilities. The regulatory oversight committee would be required to minimize any conflicts of interest involving the CRO or CCO. Compensation of the position would require consultation with the public directors in the ROC. The exchange would also be required to disclose and minimize any conflicts of interest involving the CRO or CCO.

[15] *See* CFTC Commissioner Christy Goldsmith Romero, *https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement062823,* (June 28, 2023).

[1] *See* Statement of Commissioner Caroline D. Pham Regarding Request for Comment on the Impact of Affiliations Between Certain CFTC-Regulated Entities (June 28, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement062823;* Statement of Commissioner Caroline D. Pham on Effective Self-Regulation and Notice of Proposed Rulemaking to Amend Part 40 Regulations (July 26, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement072623b.*

[2] *See* Core Principles and Other Requirements for Designated Contract Markets, 77 FR 36612, 36614 (June 19, 2012), *https://www.federalregister.gov/documents/2012/06/19/2012-12746/core-principles-and-other-requirements-for-designated-contract-markets* (explaining the process as ''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.'').

Material Non-Public Information

The Commission is refusing to fix the references to ''material non-public information'' in Parts 37 and 38. Even though the NPRM cites Regulation 1.59(d) and its use of ''material, non-public information,'' and that the intent is to copy the requirements in Regulation 1.59(d) to Parts 37 and 38 purely for housekeeping purposes, the Commission is potentially creating a loophole by making a small but very substantive change in using ''material non-public information'' in Parts 37 and 38. The former—with a comma—broadly captures information that is material and non-public. The latter—with no comma—is an incorrect usage of a well-established term of art under securities laws that is too narrow to address the potential conflicts in derivatives markets, creates unnecessary confusion for market participants, and undermines robust compliance programs by introducing uncertainty.[3] ''Consistency'' is a goal repeated throughout the NPRM, and I do not understand why we are refusing to resolve the inconsistency here.

The Commission must protect all confidential information—not just material information—in order to effectively mitigate, prevent, or avoid conflicts of interest. In some circumstances, there must be a complete information barrier or segregation of activities between business units or personnel to protect sensitive and confidential information about customer trades or positions in order to prevent potential market manipulation or other abusive trading practices. The Commission's misguided approach is not enough to protect our markets from misconduct.[4]

Revocation of Registration

I am deeply concerned about proposed Regulations 37.5(c)(6) and 38.5(c)(6).[5] This is the first time that the CFTC has decided to promulgate a rule to revoke the registration of a registered entity since section 5e of the Commodity Exchange Act was enacted in 1998, with insufficient explanation to demonstrate a reasonable basis and reasoned decision-making as required by the Administrative Procedure Act,[6] and insufficient procedural safeguards to ensure due process for DCMs and SEFs. The government must ensure due process under the Constitution, including judicial review, before taking away the rights of the public in what may well be a death knell for trading venues. Anything less is an abuse of power.[7]

Further, the rules are clearly overbroad because the CFTC could revoke registration due to changes ''in the ownership or corporate or organizational structure'' of a DCM or SEF (emphasis added). This could include simple changes in headcount and other staffing reorganizations, making it all too easy for the CFTC to manufacture a reason to revoke registration. I sincerely hope that this is not the Commission's intent. What is even more puzzling is that the CFTC is choosing to propose structural changes as cause to revoke registration, but not grave misconduct such as fraud, abuse, or manipulation. This is nonsensical. I urge commenters to pay close attention to the full import of the revocation of registration proposed rules.

I look forward to reviewing the comments on the DCM and SEF Conflicts of Interest Proposal.

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[3] *See* Dissenting Statement of Commissioner Caroline D. Pham on Misappropriation Theory in Derivatives Markets (Sept. 27, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement092723*.

[4] *Id.*

[5] The language is the same for both SEFs and DCMs, so for brevity I will only include it for SEFs here: Reg. 37.5(c)(6) A change in the ownership or corporate or organizational structure of a SEF that results in the failure of the SEF to comply with any provision of the CEA, or any regulation or order of the Commission thereunder—(i) shall be cause for the suspension of the registration of the SEF or the revocation of registration as a SEF, in accordance with the procedures provided in sections 5e and 6(b) of the CEA, including notice and a hearing on the record; or (ii) may be cause for the Commission to make and enter an order directing that the SEF cease and desist from such violation, in accordance with the procedures provided in sections 6b and 6(b) of the CEA, including notice and a hearing on the record.

[6] The only justification provided is ''[i]t is imperative that SEFs and DCMs, regardless of ownership or control changes, continue to comply with the CEA and all Commission regulations to promote market integrity and protect market participants.''

[7] *See* Statement of Commissioner Caroline D. Pham on Effective Self-Regulation and Notice of Proposed Rulemaking to Amend Part 40 Regulations (July 26, 2023), *https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement072623b*.