



Commodity Futures Trading Commission

Office of Public Affairs

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Fact Sheet and Q&A – Notice of Proposed Rulemaking for Designated Contract Markets and Swap Execution Facilities Regarding Governance and the Mitigation of Conflicts of Interest Impacting Market Regulation Functions

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 requirements. The proposed 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 proposed amendments 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.

Background

In 2001, the Commission adopted a regulatory framework (“2001 Regulatory Framework”) implementing the Commodity Futures Modernization Act of 2000 (“CFMA”), which established a framework of flexible core principles for DCMs, which among other things, related to governance fitness standards and conflicts of interest. When the Commission adopted the 2001 Regulatory Framework, it also implemented guidance to certain core principles, to provide contextual information regarding the core principles, including important concerns which the Commission believes should be taken into account in demonstrating compliance with specific core principles, including the DCM core principles related to governance fitness standards and conflicts of interest. Guidance provides contextual information for DCMs to consider regarding the compliance with specific core principles. Between 2007 and 2009, the Commission adopted a set of “acceptable practices” for the DCM conflicts of interest core principle. Acceptable practices are non-exclusive practices that a DCM may adopt to demonstrate core principle compliance.

On June 19, 2012, the Commission adopted a final rule to implement the Dodd-Frank Act’s amendments to section 5 of the Commodity Exchange Act (“CEA”) pertaining to the designation and operation of contract markets (the “2012 Part 38 Final Rule”). At that time, the Commission chose to maintain the existing guidance on compliance with the DCM core principle on governance fitness standards, and to maintain the existing guidance on, and acceptable practices in, compliance with the DCM conflicts of interest core principle. In the 2012 Part 38 Final Rule, the Commission also adopted equity transfer notification requirements for DCMs. Finally, in the 2012 Part 38 Final Rule, 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”).

On June 4, 2013, the Commission adopted a final rulemaking (the “Part 37 Final Rule”) which, among other things, established registration and regulatory obligations that SEFs—a new category of regulated entity introduced under the Dodd-Frank Act. In the Part 37 Final Rule, the Commission did not adopt the guidance on, and acceptable practices for, compliance with the conflicts of interest core principle that the Commission had adopted for DCMs. Further, SEFs, unlike DCMs, were not exempt from the part 1 Commission regulations that address conflicts of interest and governance for SROs. 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 SEF Chief Compliance Officer core principle. Finally, the Part 37 Final Rule adopted equity transfer notification requirements for SEFs.

Summary of Proposal

The Commission is proposing new rules and amendments to existing regulations that would further implement requirements for SEFs and DCMs that establish governance and fitness requirements and address the manner in which they must account for, and mitigate, certain conflicts of interest that may have particular impact on their critical market regulation functions. For purposes of this rule proposal, “market regulation functions” is defined as 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. In addition, the Commission is proposing enhanced notification requirements with respect to changes in the ownership or corporate or organizational structure of a SEF or DCM.

As detailed further below in the Q & A section, the proposal generally addresses:

- (1) governance fitness requirements;
- (2) substantive requirements for identifying, managing and resolving actual and potential conflicts of interest related to the conflicts of interest in decision making and appropriate limitations on the use and disclosure of material nonpublic information;
- (3) governance rules for SEFs and DCMs that are substantially based on existing DCM Core Principle 16 Guidance and Acceptable Practices related to: Board of Directors Composition, Public Director Definition, Regulatory Oversight Committee (“ROC”) Requirements, Disciplinary Panel Composition and DCM Chief Regulatory Officer/SEF Chief Compliance Officer; and
- (4) proposed 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.

Proposed Rulemaking Q & A

1. What types of conflicts of interests are addressed by the proposed rules?

Conflicts involving the market regulation functions of the SEF or DCM, including 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.

2. Who would be subject to the proposed governance fitness requirements?

In general, individuals with responsibilities for governing the SEF or DCM or adjudicating disciplinary matters, or that have the ability to control or direct the operations, management, or policies of the SEF or DCM would be subject to the proposed governance fitness requirements. Many of these individuals are already subject to governance fitness requirements under DCM Core Principle 15 or Commission regulation § 1.63. Specifically, the proposed rules require SEFs and DCMs to establish “appropriate fitness standards” for: (1) SEF or DCM officers; (2) members of SEF or DCM board of directors; (3) members of SEF or DCM committees; (4) members of SEF or DCM disciplinary panels; (5) members of SEF or DCM dispute resolution panels; (6) members of the SEF or DCM; (7) any person with direct access to the SEF or DCM; and (8) owners of 10 percent or more 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.

3. What are the proposed minimum governance fitness requirements?

SEFs and DCMs would be required to adopt certain prescribed minimum fitness standards that include the bases for refusal to register from CEA section 8a(2) and 8a(3) for officers, members of its board of directors, committees, disciplinary panels, and dispute resolution panels, members with voting privileges, and any person who owns 10 percent or more 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. Furthermore, the proposed rules would require SEFs and DCMs to establish additional minimum fitness standards that generally track the disqualifying offenses set forth in existing Commission regulation § 1.63 for certain individuals—officers and for members of its board of directors, committees, disciplinary panels, and dispute resolution panels.

4. **What is a SEF's or DCM's obligation to minimize conflicts of interest under the proposed rules?**

SEFs and DCMs have identical core principle requirements regarding the obligation to minimize and resolve conflicts of interest in the decision-making process. The proposed rules would require SEFs and DCMs to 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 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.

5. **What substantive conflicts of interest requirements would the proposed rules require?**

- **Conflicts of Interest in Decision-making** - The proposed rules would require SEFs and DCMs 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, and abstain from voting on such matter. The proposed rules enumerate certain conflicts of interest in which the member or officer: (1) is the subject of any matter being considered; (2) is an employer, employee, or colleague 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. The member or officer would also be deemed to have a conflict of interest if any of the enumerated relationships exist with an affiliate of the subject of any matter being considered.
- **Limitations on the Use and Disclosure of Material Non-public Information** - The proposed rules are primarily based on existing part 1 obligations for SEFs and DCMs, specifically Commission regulation § 1.59. The proposed rules would require SEFs and DCMs to establish and enforce policies and procedures on safeguarding the use and disclosure of material non-public information. The proposed rules would also require SEFs and DCMs to prohibit their employees, members of the board of directors, committee members, consultants, or persons with an ownership interest of 10 percent or more in the SEF or DCM, from disclosing, or trading commodity interests (or related commodity interests) based on, any material non-public information obtained through the performance of their official duties.

6. **What structural governance requirements would the proposed rules require?**

- **Board of Directors** - The proposed rules address board composition standards by proposing to: (1) codify the practice under the DCM Core Principle 16 Acceptable Practices that DCM boards of directors be composed of at least 35 percent "public directors;" (2) extend the 35 percent "public directors" requirement to SEF boards of directors; and (3) adopt additional requirements to increase transparency and accountability of the board of directors.
- **Public Directors** - The proposed rules would adopt a public director definition, currently found in the DCM Core Principle 16 Acceptable Practices, for both SEFs and DCMs. To qualify as a public director, the proposed rules require that the director has no "material relationship" with the SEF or DCM. In addition, the proposed rules contain a list of per se material relationships that disqualify an individual from serving as a public director.
- **Nominating Committee** - The proposed rules 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.
- **Regulatory Oversight Committee** - The proposed rules would adopt, and enhance, the existing ROC standards currently found in the DCM Core Principle 16 Acceptable Practices by: (1) codifying the practice under the DCM Core Principle 16 Acceptable Practices that DCMs have a ROC comprised of only public directors; (2) proposing a similar requirement for SEFs; and (3) adopting additional requirements related to the conduct, meetings, and documentation of the ROC.

- **DCM Chief Regulatory Officer (“CRO”)/SEF Chief Compliance Officer (“CCO”) -**
 - **DCM CRO** - The proposed rules would require 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. Additionally: (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.
 - **SEF CCO** - In addition to removing and relocating certain definitions under existing Commission regulation § 37.1501(a), the proposal would require the CCO to report directly to the board of directors or to the senior officer of the SEF. Further, the proposed rules require that – in approving a CCO’s compensation - the board of directors or the senior officer of the SEF shall do so in consultation with the SEF’s ROC. The duties of the CCO remain substantively similar to their duties under existing part 37 regulations, with two exceptions: (1) the CCO must take reasonable steps in consultation with the SEF’s board of directors “or a committee thereof” to resolve material conflicts of interest; and (2) conflicts of interest between business considerations and compliance requirements includes, with respect to compliance requirements, the SEF’s “market regulation functions.”
- **Disciplinary Committee** - The Commission proposes to codify, with certain enhancements, the DCM Core Principle 16 Acceptable Practices with respect to disciplinary panel composition. The enhancements include: (1) clarifying that SEFs’ and DCMs’ disciplinary panels and appellate panels must consist of two or more persons; (2) 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; and (3) extending the public participant requirement to any SEF and DCM committee to which disciplinary panel decisions may be appealed.

7. How would the proposed requirements differ for DCMs and SEFs?

- **Scope of DCM CRO is narrower than the SEF CCO** - 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, for establishing and administering written policies to prevent violation of the CEA and Commission rules, and for establishing procedures to address noncompliance issues.

8. How does the proposal relate to Part 1 of the Commission’s regulations?

The proposal adopts 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, the proposal will amend Commission regulations §§ 37.2 and 38.2 to exempt SEFs and DCMs from those part 1 requirements.

9. What are the proposed changes to the notification requirement of equity interest transfers under Commission regulations §§ 37.5(c) and 38.5(c)?

- The proposed rules further identify and describe types of changes of ownership or corporate or organizational structure that would trigger a notification obligation to the Commission. The proposed rules 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 rules also amend Commission regulations §§ 37.5(c) and 38.5(c) to clarify what information is required to be submitted, establish a timing requirement for when such information must be submitted (no later than three months prior to the anticipated change), and propose a certification requirement.