REQUEST FOR COMMENT ON THE IMPACT OF AFFILIATIONS ON CERTAIN CFTC-REGULATED ENTITIES

I. Introduction

Staff of the Commodity Futures Trading Commission ("Commission") is seeking public comment in order to better inform their understanding of potential issues that may arise if a designated contract market ("DCM"), derivatives clearing organization ("DCO") or swap execution facility ("SEF") is affiliated with an intermediary, such as a futures commission merchant ("FCM"), or other market participant, such as a trading entity. Under the Commodity Exchange Act (the "Act")[1] and the Commission's regulations, DCOs, DCMs and SEFs have responsibilities for supervising the conduct of their members and participants. An affiliation between an intermediary or other market participant and a DCM, DCO or SEF raises questions as to how these supervisory responsibilities will be carried out with respect to the intermediary or market participant. In addition, an affiliation between an intermediary or market participant and a DCO, DCM or SEF may raise other potential concerns including possible anti-competitive effects, treatment of nonpublic information, and the adequacy of the applicable financial resources.

This request for comment seeks to better inform the staff's understanding of these issues and seeks input on possible mitigating measures. Comments must be received on or before [60 days from publication] to be assured of consideration.

II. DCO and affiliated FCM

A. Background

Under the Act, a DCO has extensive responsibilities to manage its risks. These include risk management generally (*see* Core Principle D(i),[2] "Each [DCO] shall ensure that the [DCO] possesses the ability to manage the risks associated with discharging the responsibilities of the [DCO] through the use of appropriate tools and procedures."), as well as more specific requirements. These latter include setting and collecting margin (which "shall be sufficient to cover potential exposures in normal market conditions," Core Principle D(iv)[3]), and maintenance of sufficient financial resources to withstand a default (Core Principle B).[4]

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[1] 7 U.S.C. 1 *et seq.*

[2] Sec. 5b(c)(2)(D)(i) of the Act (7 U.S.C. 7a-1(c)(2)(D)(i)).

[3] Sec. 5b(c)(2)(D)(i) of the Act (7 U.S.C. 7a-1(c)(2)(D)(i)).

[4] Sec. 5b(c)(2)(B) of the Act (7 U.S.C. 7a-1(c)(2)(B)).

Some of a DCO's risk management responsibilities under the Core Principles focus on the DCO's relationships with individual clearing members, and require the DCO to exercise discretion in fulfilling them. For example, Core Principle C(i)(I)[5] requires a DCO to establish "appropriate admission and continuing eligibility standards … for members of, and participants in," the DCO, and Core Principle H requires a DCO to both maintain adequate arrangements and resources for "the effective monitoring and enforcement of compliance" with its rules, and "the authority to discipline … a member or participant due to a violation … of any rule of the [DCO]."[6]

In other cases, the DCO's exercise of discretion arises from either the Commission's regulations implementing the Core Principles or from specific circumstances. For example, §39.13(h)(5)(iii)[7] requires a DCO to "review the risk management policies, procedures, and practices of each of its clearing members, which address the risks that such clearing members may pose to the [DCO, and] take appropriate action to address concerns identified in such reviews." Similarly, while many of the margin requirements addressed in §39.13(g) will be objective (that is, margin requirements are set based on parameters that are applied uniformly to all clearing members, without the exercise of discretion vis-à-vis individual clearing members), some margin-setting may be tailored to specific portfolios. In other cases, the DCO may have discretion to increase margin requirements for a particular clearing member due to, *e.g.*, concerns about the member's financial condition.

Part 39[8] of the Commission's regulations sets out a DCO's responsibilities to monitor (and to enforce) a clearing member's compliance with DCO rules and to manage the risk of clearing members.

The relevant provisions of Part 39 where DCO staff may exercise discretion include the following:

a. §39.12(a)(4) (verify compliance of clearing members with DCO participation requirements)

b. §39.12(a)(6) (enforce compliance with DCO participation requirements and suspend/remove non-compliant members)

c. §39.13(g) (margin requirements)

d. §39.13(h)(1) (risk limits on clearing members)

[5] Sec. 5b(c)(2)(C)(i)(I) of the Act (7 U.S.C. 7a-1(c)(2)(C)(i)(I)).

[6] Sec. 5b(c)(2)(H)(i)(I) and (ii) of the Act (7 U.S.C. 7a-1(c)(2)(H)(i)(I) and (ii)).

[7] 17 CFR 39.13(h)(5)(iii).

[8] 17 CFR Part 39.

e. §39.13(h)(5)(ii) (review the risk management policies of clearing members and take appropriate action)

f. §39.13(h)(6) (additional actions with respect to particular clearing members)

g. §39.16 (default rules and procedures)

h. §39.17 (rule enforcement)

B. Questions

Questions 1 - 4 below address how such Part 39 responsibilities will be affected by a DCO's affiliation with the relevant FCM.[9]

Question 1. **§39.13(g), Margin**. Margin requirements are generally based on parameters that are applied uniformly to all clearing members, without the exercise of discretion vis-à-vis individual clearing members. However, some margin-setting may be tailored to specific portfolios (and, thus, to specific clearing members) and there may be some discretion specific to individual clearing members. Are there ways in which such tailoring may be affected by a DCO's affiliation with an FCM? If so, how can this risk effectively be mitigated?

Question 2. §39.16, Default rules and procedures. A DCO has discretion to determine whether a clearing member is in default (and this discretion is particularly present for defaults other than payment defaults, *e.g.*, undercapitalization).[10] Moreover, in liquidating the positions of a defaulting clearing member, the DCO has discretion to determine how to do so; different actions may relatively benefit the positions of certain clearing members (including, the affiliate) while disfavoring the positions of other clearing members. Is this a relevant concern if a DCO has an affiliated FCM? If so, how can this issue effectively be mitigated?

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[9] As background, we note that FCMs are required to treat customer positions and assets separately from those of an affiliate, *see* §1.3 (definition of futures customer funds and proprietary account) and §1.20, because of the Commission's concerns that the FCM would not risk manage the accounts of affiliated entities as vigorously as they would risk manage the accounts of other customers, *see* 43 Fed. Reg. 56904, 56905 & n. 9 (December 5, 1978) (Supervisory experience of Commission and predecessor Commodity Exchange Authority of FCMs not calling for margin from under-margined accounts of proprietary persons, thereby allowing equity of customers to "carry" under-margined accounts, despite practice being prohibited by §1.22, thus placing firm in financial jeopardy, and subjecting customers to the risk of financial loss).

[10] See, for example, CME Rule 975 ("If the President of the Clearing House determines that the financial or operational condition of a clearing member or one of its affiliates is such that to allow that clearing member to continue its operation would jeopardize the integrity of the Exchange, or negatively impacts the financial markets by introducing an unacceptable level of uncertainty, volatility or risk, whether or not the clearing member continues to meet the required minimum financial requirements, he may [take specified actions] … .")

Question 3. §39.17, Rule enforcement. A DCO has discretion in determining whether a particular clearing member should be investigated, whether a particular course of conduct violates the DCO's rules, and, if so, what discipline is appropriate. If a DCO has an affiliated FCM, will this give rise to potential conflicts? If so, how can they effectively be mitigated?

Question 4. General risk management. How will a DCO perform the remaining responsibilities set out above with an affiliated FCM, given the potential conflict of interests? We note that Core Principle P of the Act[11] and §39.25 requires the DCO to "establish and enforce rules to minimize conflicts of interest in the decision-making process" of the DCO.

Question 5. Contagion risk to DCO. One risk to the DCO may be that clearing members and/or clients lose confidence in the DCO and consequently start a "run" (*e.g.,* through rapidly closing positions and withdrawing margin) because of a failure or perception of an imminent failure of an affiliated FCM. How can a DCO with an affiliated clearing member provide assurance that it possesses the ability to manage contagion risk in this context? How should the Commission consider and address contagion risk in this context?

Question 6. Contagion risk to FCM. An analogous risk to the affiliated FCM may be that customers or other counterparties lose confidence in the FCM and consequently start a "run" (*e.g.,* through rapidly closing positions and withdrawing margin or through refusing to extend normal credit) because of a failure of an affiliated DCO. How can an FCM with an affiliated DCO provide assurance that it possesses the ability to manage contagion risk in this context? How should the Commission consider and address contagion risk in this context?

Question 7. Financial/liquidity resources. The financial or liquidity resources of the DCO and affiliated FCM may need to be tapped effectively simultaneously in the case of FCM or DCO weakness/failure. Does this raise a significant concern? How could the relationship between a DCO and an affiliated FCM be structured to reduce this concern?

One potential mitigant for this risk might be a requirement for a DCO with an affiliated FCM to have additional financial resources, for example, sufficient supplementary default and liquidity resources to cover (under stress conditions) the default of the affiliate in addition to the DCO's current Cover 1 or Cover 2 requirements pursuant to, as appropriate, §39.11(a)(1)/§39.33(a) and §39.11(e)(1)(ii) /§39.33(c).

a. To what extent would this approach effectively mitigate conflict issues?

b. Might there be conflicts in designing and conducting stress testing to determine the amount of resources required?

c. Should there be restrictions on how a DCO could source any additional default resources? For example, should any supplemental resources be

[11] Sec. 5b(c)(2)(P) of the Act (7 U.S.C. 7a-1(c)(2)(P)).

sourced solely from the DCO and its affiliate, or should it be permissible for the supplemental resources to be sourced from non-affiliated clearing members?

Question 8. Information. If a DCO is affiliated with an FCM, what might be the impact on the DCO's ability, in its role as a risk manager, to obtain information from other clearing members? Might other members be less willing to provide information if they view the DCO as something other than as market neutral?

How can such impacts effectively be mitigated? Are the information sharing restrictions that DCOs typically have in their rulebooks sufficient to provide confidence to other members that they will not share information about those other clearing members with any affiliated FCMs?

Question 9. Resource sharing. What limits, if any, should there be on DCOs sharing resources (personnel, technology, etc.) with affiliated FCMs? Are there conceptual differences between the sharing of personnel between a DCO and DCM that has historically occurred, on the one hand, and the sharing of personnel between a DCO and an FCM, on the other? Might overlap of personnel exacerbate the concerns raised in Question 8 above with respect to clearing members providing information to a DCO with an affiliated FCM in its role as a risk manager? Might some required separation of duties mitigate these difficulties?

a. To the extent that DCO and FCM personnel are separate, are there "ethical walls" or other information barriers that might be appropriate? To make such information barriers effective, would there be a need for personnel to be located in separate physical space?

b. Are there certain areas, or instances, where the sharing of personnel, technology, etc. would provide benefits to the marketplace (e.g. cost efficiencies, reduced complexity), that would outweigh potential concerns?

c. Are there particular functional areas that present more or less potential for conflicts, *e.g.*, sales, operations, IT development, risk management, treasury, credit management?

Question 10. Competitive effects. Are there competitive implications of allowing a DCO to affiliate with an FCM? Are there specific effects of this affiliation which may be detrimental? Would any effects be helpful to competition? Are there effective mitigants?

Question 11. Organizational Structure – Single FCM. Are there concerns raised if a DCO operates with a single affiliated FCM clearing member (and has no other clearing members)? What concerns are raised if there is a single affiliated FCM and other non-affiliated, non-FCM clearing members? In either of those circumstances, are the concerns unique to the fact that the single FCM is an affiliate of the DCO? What concerns are raised if a DCO has an affiliated FCM, and one or

more non-affiliated FCMs, and the affiliated FCM is responsible for the bulk of the volume at the DCO?

Question 12. Other cross-affiliate risks. Other than the risks mentioned above, are there other examples of cross-affiliate risk if a DCO has an affiliated FCM – areas where risks at the first would be uniquely correlated with the risks of the second? Are there additional risk management requirements that could effectively mitigate both the presence, and the severity, of these risks?

Question 13. Mitigants – disclosure. Are there additional disclosures that, if required in cases of an affiliate relationship between a DCO and FCM, would help mitigate the concerns discussed in the questions above?

Question 14. Mitigants – conduct restrictions. Are there requirements or restrictions that, if instituted, would effectively ensure that affiliated FCMs interact on an "arms-length" basis with DCOs such that affiliated FCMs would be treated in a manner equivalent to non-affiliated FCMs (e.g., incentives available to affiliates are equivalently available to non-affiliates; information available to the affiliate is equivalently available to non-affiliates)? Are there documentation requirements that would contribute to achieving this goal?

Question 15. Mitigants – volume caps. Would the concerns discussed above be mitigated by a cap on the volume (expressed as a percentage) of clearing at the DCO that can be made through an affiliated FCM? What practical issues would be raised by enforcing such caps?

Question 16. Affiliated trader. If a DCO is affiliated with a market maker or other trader that settles through the DCO, does that raise concerns? If so, what mitigants would be effective?

Question 17. Affiliate spot market. If a DCO is affiliated with a spot market, does that raise concerns? If so, what mitigants would be effective?

Question 18. Affiliated direct clearing members. How would the responses to the questions above differ, if at all, if the DCO is affiliated with a non-FCM direct clearing member instead of an FCM clearing member?

Question 19. Affiliated DCO and DCM. How would the responses to the questions differ, if at all, if the FCM is affiliated with a DCM as well as a DCO?

III. DSRO and affiliated FCM

A. Background

The Act establishes a regulatory oversight structure that imposes an obligation on DCMs and registered futures associations ("RFAs"),[12] as self-regulatory organizations ("SROs"),[13] to perform frontline regulatory oversight of market intermediaries, including FCMs.[14] To further the objective of effective self-regulation of market participants and market professionals, the Act and Commission regulations require RFAs and DCMs to adopt financial and related reporting requirements for member FCMs, and to periodically examine FCMs for compliance with such requirements. In this regard, section 17(p) of the Act requires an RFA to establish and submit for Commission approval rules imposing minimum capital, segregation and other financial requirements applicable to its members for which such requirements are imposed by the Commission.[15] Section 17(p) further provides that the RFA must implement a program to audit and enforce compliance by its members with the RFA's minimum financial requirements.[16]

With respect to DCMs, section 5(d)(11)(B) of the Act and §38.600 require, in relevant part, each DCM to implement rules to ensure the financial integrity of any member FCM and the protection of customer funds.[17] DCMs also are required to monitor an FCM member's compliance with the DCM's minimum financial requirements by reviewing FCM financial information filed with the DCM and by conducting periodic examinations of the FCM.[18] In particular, §38.604 requires DCMs to routinely receive and promptly review financial information from its members, as well as continually surveil the obligations of member FCMs created by the positions of their customers.[19]

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[12] The National Futures Association ("NFA") is the only registered RFA. NFA's financial requirements for FCMs are available at its web site, www.nfa.futures.org.

[13] An SRO is defined in §1.52 to include a contract market (as defined in §1.3) or an RFA under section 17 of the Act. The term "SRO" as defined in §1.52(a)(2), however, does not include a swap execution facility (as defined in §1.3).

[14] Section 3(b) of the Act provides in relevant part that it is the purpose of the Act to serve the public interest through a system of effective self-regulation of market participants and market professionals under the oversight of the Commission.

[15] Section 17(p)(2) of the Act.

[16] *Id.*

[17] *See also,* §38.602 which provides that a DCM must provide for the financial integrity of its transactions by establishing and maintaining appropriate minimum financial standards for its members and non-intermediated market participants, and §38.603 which requires a DCM to have rules concerning the protection of customer funds.

[18] *See* 17 CFR 38.600-38.605.

[19] 17 CFR 38.604.

In recognition of SROs as frontline regulators and the importance of FCM oversight, §1.52 was adopted to establish minimum standards that all SRO programs must satisfy in conducting FCM financial oversight.[20] Regulation1.52 requires each SRO (defined for purposes of the regulation to include DCMs and RFAs, including NFA) to adopt rules prescribing minimum financial and related reporting requirements for member FCMs that are the same as, or more stringent than, the requirements imposed by the Commission.[21] Regulation 1.52 also requires each SRO to maintain a financial surveillance oversight program that includes detailed examinations of member FCMs' books and records to assess their compliance with SRO and Commission minimum financial and related reporting and recordkeeping requirements.[22]

Regulation 1.52 also permits two or more SROs to file a plan with the Commission to delegate primary, but not exclusive, responsibility to monitor and to examine the financial condition of an FCM that is a member of two or more SROs to a designated self-regulatory organization ("DSRO").[23] The participating SROs form a Joint Audit Committee ("JAC") and submit a Joint Audit Program ("JAC Program") to the Commission, which may approve such plan after providing an opportunity for public notice and comment.[24]

The delegation of an FCM that is a member of two or more SROs to a DSRO under a Joint Audit Program allows for a more efficient use of SRO resources, while also reducing burdens that otherwise would be imposed on an FCM from duplicative supervision, including periodic on-site examinations from multiple SROs.[25] All DCM and RFA SROs, with the exception of DCMs that do not permit FCMs to intermediate positions on behalf of customers, are currently members of a single JAC and operate pursuant to one JAC Program approved by the Commission.

As noted above, DCMs and RFA SROs provide a vital role in FCM oversight ensuring the financial integrity of transactions executed on the contract market and the protection of customer funds. With respect to financial surveillance obligations of the DCM, an affiliated FCM can present potential conflict of interest concerns in two scenarios: 1) potential conflicts attributable to a DSRO from an affiliated FCM, and 2) potential conflicts attributable to a DCM from an affiliated FCM (despite the DCM being a signatory to the JAC Program).

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[20] *See* Minimum Financial Requirements, 43 FR 39956 (Sept. 8, 1978) (*citing* at 39967: "the most important theoretical basis for exchange self-regulation is that exchanges can move more promptly and more effectively in certain situations than can an agency of the Government").

[21] 17 CFR 1.52(b)(1).

[22] 17 CFR 1.52(c)(1)(iv).

[23] 17 CFR 1.52(d)(1).

[24] 17 CFR 1.52(j).

[25] *See* Financial Surveillance Examination Program Requirements for Self-Regulatory Organizations, 84 FR 12882, 12883 (April 3, 2019).

B. Questions

The following questions address the DSRO's relationship with an affiliated FCM that it supervises.

Question 20. DSRO Examinations. There are currently 13 SROs, including the NFA, that are signatories to the JAC Program.[26] Under the current JAC Program, the CME Group ("CME") is the DSRO for all FCMs that are clearing members of the CME, and NFA is the DSRO for all FCMs that are not clearing members of the CME.[27] DSRO Examinations are a primary mechanism for carrying out financial surveillance over FCMs as critical market participants. An affiliated FCM of a DSRO with this responsibility can present several potential conflicts of interest.

a. What potential conflicts of interest may arise from an SRO performing the DSRO functions set forth in §1.52 for an affiliated FCM?

b. Could these potential conflicts of interest adversely impact other members, including other member FCMs, of the same DSRO? If so, how might those other members be impacted?

c. What DSRO and/or FCM risk management requirements, policies, and/or procedures could help to mitigate these potential conflicts of interest?

d. Are there existing SRO rules, policies, and/or procedures that ensure that all FCMs, including affiliated FCMs, are subject to the same standards of financial supervision and oversight, and that potential financial and financial reporting rule violations identified by the DSRO are subject to comparable review and assessment by SRO disciplinary bodies?

e. Should a DCM be prohibited from acting as the affiliated FCM's DSRO pursuant to the JAC Program?

f. Does the current regulatory structure of §1.52, which imposes an obligation on DCMs to perform financial surveillance over member FCMs, including on-site examinations, adequately address situations where the DCM and FCM are affiliated

[26] Current signatories (DCMs, and one Registered Futures Association) to the JAC Program are listed on the JAC website, *available at*: http://www.jacfutures.com/jac/default.aspx (In alphabetical order: Bitnomial Exchange, LLC; Board of Trade of the City of Chicago, Inc.; Cboe Digital Exchange, LLC; Cboe Futures Exchange, LLC; Chicago Mercantile Exchange, Inc.; Commodity Exchange Inc.; ICE Futures U.S., Inc.; LMX Labs, LLC; Minneapolis Grain Exchange, Inc.; National Futures Association; New York Mercantile Exchange, Inc.; Nodal Exchange, LLC; North American Derivatives Exchange, Inc.; and Small Exchange, Inc.)

[27] The CME was DSRO for 42 of the 60 FCMs registered with the Commission as of February 28, 2023. NFA was the DSRO for the remaining 18 FCMs. Because the current implementation of the JAC Program results in the allocation of each FCM to either CME or NFA as the FCM's DSRO, at present only CME and NFA engage in routine, periodic on-site examinations of FCMs pursuant to the JAC Program.

entities? Please identify what specific additions or changes should be considered and why such changes should be made.

Question 21. Information. As a natural extension of their financial surveillance obligations, DSROs must have access to detailed information from FCMs, such as books and records, including confidential financial, trading, and other information. In addition, DSROs function as an enforcement mechanism and are expected to remain impartial and conduct their examinations pursuant to accepted auditing standards.[28]

a. Should DSROs be obligated to adopt appropriate firewalls and/or internal procedures to ensure that staff of an affiliated FCM are prevented from accessing or utilizing confidential information in possession of DSRO staff?

b. Are there governance structures, or other steps, that could be implemented to effectively mitigate the potential conflicts of interest that may arise from an SRO being the DSRO of an affiliated FCM? For example, would requiring DSRO examination staff to report directly to the board of the DSRO or a Board-level committee ensure that their activities remain impartial and unbiased?

IV. DCM/SEF and affiliated intermediary.

A. Background

As part of its self-regulatory responsibilities, each DCM and RFA SRO (whether or not it is a DSRO) is obligated to perform financial surveillance over member FCMs, including, for example, reviewing regulatory notices under §1.12, and reviewing periodic audited and unaudited financial reports submitted under §1.10. DCMs are responsible for oversight of member FCMs' compliance with the DCM's minimum financial requirements and for continued surveillance of the financial obligations of FCMs and their customers.

DCMs also have additional self-regulatory responsibilities, including obligations to establish and enforce rules governing access to and trading on the exchange, to surveil trading on the exchange, to prevent manipulation and other abusive trade practices, to investigate potential DCM rule violations, and to bring disciplinary action against participants to prosecute violations. SEFs have similar self-regulatory responsibilities, including obligations to establish and enforce

[28] *See* 17 CFR 1.52(c)(2)(ii) (listing required examination standards addressing, but not limited to, the following: (A) the ethics of an examiner; (B) the independence of the examiner; …(I) quality control procedures to ensure the examinations maintain the level of quality expected). *See also,* 17 CFR 1.52(d)(2)(ii)(C)(1) (requiring adequate levels and examination staff); Financial and Segregation Interpretation 4-1, Division of Trading and Markets (July 29, 1985) *available at*: https://www.cftc.gov/sites/default/files/tm/finseginterp_4-1.htm; and, Financial and Segregation Interpretation 4-2, Division of Trading and Markets, CFTC Letter No. 99-32 (August 20, 1999) *available at*: https://www.cftc.gov/sites/default/files/tm/letters/99letters/tm99-32.htm.

exchange rules, surveil trading, prevent abusive trading practices, investigate potential rule violations and take disciplinary action for violative conduct.

The questions below address considerations where a DCM has an affiliated FCM that intermediates any transactions, executes proprietary trades, or carries accounts for customers executing trades on the exchange, or a SEF has an affiliated introducing broker ("IB"), commodity trading advisor ("CTA") or commodity pool operator ("CPO") that facilitates the execution of trades on the exchange.

B. Questions.

Question 22. DCM Supervision of FCM Financial Requirements.

Regulation 38.604 provides that a DCM must monitor a member's compliance with the DCM's minimum financial standards and, therefore, must routinely receive and promptly review financial and related information from its members, and continuously monitor the positions of members and their customers.[29] Regulation 38.604 further provides that a DCM must continually survey the obligations of each FCM created by the positions of its customers; as appropriate, compare those obligations to the financial resources of the FCM; and take appropriate steps to use this information to protect customer funds.[30]

a. Does the current regulatory structure of §38.604, which imposes an obligation on DCMs to monitor the financial condition of member FCMs and to monitor the positions of the customers of member FCMs, adequately address situations where the DCM and FCM are affiliated entities? If not, please identify what changes should be made to the regulatory structure of §38.604 and why such changes should be made.

b. What potential conflicts of interest may arise from a DCM monitoring an affiliated FCM and the customer positions of an affiliated FCM pursuant to §38.604? Could the potential conflicts of interest adversely impact other FCMs that execute customer or non-customer transactions on the DCM? If so, how?

c. What risk management requirements, policies, and/or procedures, if any, might mitigate conflicts of interest that may arise from the obligation of the DCM to monitor the financial condition and positions of an affiliated FCM and the positions of the customers of an affiliated FCM?

[29] 17 CFR 38.604.

[30] 17 CFR 38.604(a).

d. Should a DCM program for monitoring compliance with Commission Regulation 38.604's requirements set forth specific procedures beyond the existing requirements that the DCM would undertake to monitor and assess intra-day financial risk resulting from market moves on open positions of its affiliated FCM and the affiliate FCM's customers, and the financial risk resulting from an affiliated FCM establishing new positions for its own account or for the accounts of its customers?

e. Regulation1.71 addresses conflicts of interest concerning an FCM's publication of research reports.[31] Should §1.71 be revised to address conflicts between a DCM and an FCM affiliate? If so, what revisions to §1.71 would be appropriate and why?

Question 23. Other DCM/SEF SRO Supervisory Responsibilities.

a. In addition to financial supervision requirements, a DCM has responsibilities to surveil, investigate and discipline participants on its market (see, e.g., §§ 38.152–153, 38.155–158, 38.250–258, 38.550–38.553, and 38.700–38.712). DCMs are further subject to DCM Core Principle 16[32] and corresponding § 38.850, which require them to "minimize conflicts of interest in the decision-making process of the contract market." How can a DCM minimize conflicts of interest while performing its surveillance, investigation and enforcement obligations with respect to an affiliated FCM that intermediates transactions, executes proprietary trades, or carries accounts for customers executing trades on the DCM?

b. SEFs have similar responsibilities to surveil, investigate and discipline participants on their markets (see, e.g., §§ 37.203, 37.205, and 37.206). They also are subject to SEF Core Principle 12, and corresponding § 37.1200, which requires a SEF to "minimize conflicts of interest in its decision-making process." How can a SEF minimize conflicts of interest while performing its surveillance, investigation and enforcement obligations with respect to an affiliated IB, CTA or CPO that facilitates the execution of trades on the SEF?
   i. Should a SEF and an affiliated IB be permitted to share a chief compliance officer and/or staff performing SEF surveillance, investigation, or enforcement functions? If yes, what steps should the SEF take to minimize conflicts of interest?

[31] 17 CFR 1.71.

[32] Sec. 5(d)(16) of the Act (7 U.S.C. 7(d)(16)).

Question 24. Impartial Access. Regulation 38.151(b) requires a DCM to provide impartial access to members, persons with trading privileges and independent software vendors. This means, pursuant to §38.151(b)(1), establishing and maintaining access criteria that are "impartial, transparent, and applied in a non-discriminatory manner." §37.202(a)(1) provides similar requirements for SEFs.

a. Are there potential impartial access concerns when a DCM has an affiliated FCM intermediating transactions, executing proprietary trades or carrying accounts for customers executing trades on the DCM? Are there potential impartial access concerns when a SEF has an affiliated IB, CTA or CPO facilitating the execution of trades on the exchange? What measures, if any, should be implemented to ensure that affiliated and non-affiliated intermediaries, and their respective customers, clients and participants, all receive impartial access?

b. Are impartial access considerations different when there is only one FCM intermediating transactions, executing proprietary trades or carrying accounts for customers executing trades on the DCM as opposed to multiple FCMs (or where there is only one IB/CTA/CPO, as opposed to multiple IBs/CTAs/CPOs)? Please explain.

Question 25. Market Integrity. DCM Core Principle 4[33] and corresponding regulations require a DCM to have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures. Similarly, SEF Core Principle 4[34] and corresponding regulations require a SEF to monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures.

a. Could structures where a DCM has an affiliated FCM have any negative impacts on market integrity, meaning, for example, price distortion or disruptive effects on the DCM's market? Are there FCM risk management practices that are particularly critical when an FCM is affiliated with the DCM, to help safeguard against these impacts?

b. Could the failure of an affiliated FCM adversely impact a DCM and cause price distortion or market disruption, to a greater or different extent than failure of a non-affiliated FCM? If so, should DCMs implement additional safeguards to help address such adverse impacts, such as limits or prohibitions on auto-liquidation? Conversely, could auto-liquidation practices have a positive impact on market integrity in such circumstances? Could prohibitions or limits on auto-liquidation

[33] Sec. 5(d)(4) of the Act (7 U.S.C. 7(d)(4)).
[34] Sec. 5h(f)(4) of the Act (7 U.S.C. 7b-3(f)(4)).

or other FCM risk management procedures that may result in the liquidation of certain customer positions have the potential to impose risks or costs on other customers of the FCM?

c. Similar to the above, could structures where a SEF has an affiliated IB, CTA or CPO have any negative impacts on market integrity, meaning, for example, price distortion or disruptive effects on the SEF's market?

Question 26. Competitive Effects. Are there potential competitive implications if a DCM has an affiliated FCM, and/or if a SEF has an affiliated IB, CTA or CPO?

a. DCM Core Principle 19[35] provides that a DCM may not "[i]mpose any material anticompetitive burden on trading on the contract market." Do structures where a DCM has an affiliated FCM raise potential Core Principle 19 concerns? Please explain.

b. Generally, could such structures potentially have problematic competitive impacts, such as decreased competition or increased costs? Conversely, are there potentially positive competitive impacts resulting from such structures?

c. SEF Core Principle 11[36] provides that a SEF may not "[i]mpose any material anticompetitive burden on trading or clearing." Please explain whether there are potential competitive implications when a SEF has an affiliated IB, CTA or CPO. Are there potentially positive outcomes resulting from such structures?

Question 27. Resource Sharing.

a. What limits, if any, should there be on DCMs or SEFs sharing personnel with affiliated FCMs, IBs, CTAs or CPOs?

b. Are there conceptual differences between a sharing of personnel between a DCO and DCM, on the one hand, and a sharing of personnel between a DCM and an FCM, on the other (or a SEF sharing personnel with an IB, CTA or CPO)? Might overlap of personnel contribute to difficulties with respect to the DCM or SEF effectively performing its surveillance, investigatory or disciplinary obligations with respect to the affiliated intermediary? Might some required separation of duties mitigate these difficulties?

c. To the extent that DCM and FCM (or SEF and IB/CTA/CPO) personnel are separate, are there "ethical walls" or other information barriers that might be

[35] Sec. 5(d)(19) of the Act (7 U.S.C. 7(d)(19)).
[36] Sec. 5h(f)(11) of the Act (7 U.S.C. 7b-3(f)(11)).

appropriate? To make such information barriers effective, would there be a need for personnel to be located in separate physical space?

d. Are there certain areas, or instances, where the sharing of personnel, technology, etc. would provide benefits to the marketplace (e.g. cost efficiencies, reduced complexity), that would outweigh potential concerns?

e. Are there particular functional areas that present more or less potential for conflicts, e.g., sales, operations, IT development, risk management, treasury, credit management?

Question 28. Information. As an extension of its role as a trade execution platform with surveillance, investigation and enforcement obligations, a DCM or SEF has access to detailed information that could be used to manipulate, or to engage in other behavior that could disrupt, the market. Should DCMs and SEFs be obligated to adopt firewalls and/or other internal procedures (in addition to existing requirements) to ensure that staff of an affiliated intermediary are prevented from accessing or utilizing confidential information in possession of DCM or SEF staff?

Question 29. Execution. The DCM and SEF regulatory frameworks currently impose requirements regarding trade execution. For example, DCM Core Principle 9 requires that "The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade."

Regulation 37.9 sets forth methods of execution requirements for SEFs. Regulation 37.201 requires that a SEF establish and impartially enforce compliance with the rules of the SEF, including the terms and conditions of any swaps traded or processed on or through the SEF and rules regarding access to the SEF.

Do existing regulatory requirements effectively address the potential for a DCM to favor an affiliated FCM and/or its customers in trade execution? Similarly, with respect to a SEF, is it possible that the SEF might favor an affiliated IB, CTA or CPO, and/or its customers, clients or participants, in trade execution? Are there ways to mitigate any risk of favorable treatment?

Question 30. Customer Impact. If a DCM has an affiliated FCM or a SEF has an affiliated IB, CTA, or CPO, might the FCM, IB, CTA, or CPO favor its affiliates' product listings in advising or otherwise serving customers, clients or participants? If so, are there ways to mitigate this possibility?

Question 31. Contagion risk. Could problems at the intermediary (FCM/IB/CTA/CPO) spread to the affiliated DCM or SEF? Or vice versa (i.e. risk at the DCM/SEF spreading to the intermediary)? How should the Commission consider and address any contagion risk in this context?

Question 32. Mitigants – disclosure. Are there additional disclosures that should be required in cases of an affiliate relationship between a DCM/SEF and an FCM/IB/CTA/CPO?

Question 33. Mitigants – conduct restrictions. What requirements, policies and/or procedures, if instituted, would effectively ensure that affiliated FCMs/IBs/CTAs/CPOs interact on an "arms-length" basis with DCMs/SEFs such that affiliated intermediaries would be treated in a manner equivalent to non-affiliated intermediaries (e.g., incentives available to affiliates are equivalently available to non-affiliates; information available to the affiliate is equivalently available to non-affiliates)? What documentation requirements, policies and/or procedures would contribute to achieving this goal?

Question 34. Affiliated trader. If a DCM or SEF is affiliated with a market maker or other trader that executes trades on the DCM/SEF, does that raise concerns? If so, what mitigants would be effective?

Question 35. Affiliate spot market. If a DCM or SEF is affiliated with a spot market, does that raise concerns? If so, what mitigants would be effective?

Question 36. Affiliated DCO. How would the responses to the questions in this section IV. differ, if at all, if the FCM/IB/CTA/CPO is affiliated with a DCO as well as a DCM or SEF?

Question 37. Other Potential Risks. Other than the matters addressed above, are there other potential risks when a DCM is affiliated with an FCM, or a SEF is affiliated with an IB, CTA or CPO? Do existing DCM and SEF Core Principles and corresponding regulations adequately address such potential risks? What additional measures could effectively mitigate against such potential risks?