



# BETTER MARKETS

By Electronic Submission

May 13, 2024

Christopher Kirkpatrick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, N.W.  
Washington, DC 20581

Re: Requirements for Designated Contract Markets and Swap Execution Facilities Regarding Governance and the Mitigation of Conflicts of Interest Impacting Market Regulation Functions (RIN 3038-AF29)

Dear Mr. Kirkpatrick:

Better Markets<sup>1</sup> appreciates the opportunity to comment on the Commodity Futures Trading Commission’s (“CFTC”) proposed rulemaking<sup>2</sup> (“Proposed Rule”) that proposes new rules and amendments to its existing regulations for designated contract markets (“DCMs”) and swap execution facilities (“SEFs”). The Proposed Rule would establish governance and fitness requirements concerning market regulation functions and 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 SEFs and DCMs governing bodies adequately incorporate an independent perspective.

Better Markets acknowledges the steps the CFTC has proposed to unify and strengthen the regulatory framework for DCMs and SEFs. These changes seek to enhance market integrity by establishing robust governance fitness standards and comprehensive conflict of interest regulations. Notably, the proposed rules seek to harmonize the somewhat divergent standards that

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<sup>1</sup> Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans’ jobs, savings, retirements, and more.

<sup>2</sup> Requirements for Designated Contract Markets and Swap Execution Facilities Regarding Governance and the Mitigation of Conflicts of Interest Impacting Market Regulation Functions; 89 Fed. Reg. 19646 (March 19, 2024).

currently govern SEFs and DCMs, despite their shared responsibilities in market regulation functions. By aligning these standards, the Commission will promote greater consistency and transparency across platforms, which is crucial for maintaining fair and efficient markets.

### **Summary of Proposed Rule**

The Proposed Rule introduces important changes in how SEFs and DCMs manage and report conflicts of interest, reflecting the Commission's commitment to rigorous oversight. The establishment of enhanced governance fitness standards, including the formalization of requirements that were previously guided by less stringent principles, marks a pivotal shift towards more stringent regulatory expectations. This shift is particularly evident in the proposed implementation of new rules under DCM Core Principle 15 and SEF Core Principle 2, which are set to replace existing guidance with legally binding regulations. These changes are intended to ensure that entities adhere to high standards of conduct and are held accountable through clearer and more enforceable regulations.

The CFTC's proposal to bolster the roles of Chief Regulatory Officers (CROs) and Chief Compliance Officers (CCOs) underscores an approach to governance that prioritizes internal compliance and oversight. By defining and expanding the responsibilities of CROs and amending the requirements for CCOs, the Commission seeks to ensure that key compliance figures within SEFs and DCMs possess the authority and resources needed to effectively oversee regulatory practices and address potential conflicts of interest proactively. Additionally, the introduction of new rules concerning the establishment and operation of Regulatory Oversight Committees (ROCs) will facilitate more independent and objective assessments of compliance efforts, further embedding integrity within the operational structures of these entities.

The Commission's focus on enhancing transparency and accountability is further demonstrated through proposed amendments regarding equity transfer notifications. These amendments aim to standardize notification procedures and thresholds, thereby facilitating a more consistent approach to managing changes in ownership or organizational structure across both SEFs and DCMs. Such standardization is critical to ensuring that the Commission can effectively monitor and respond to any changes that may impact regulatory compliance or market functioning.

### **Conflicts of Interests in Vertically Integrated Markets Structures**

Better Markets acknowledges the CFTC's efforts in proposing new regulations to enhance market governance. However, the Proposed Rule does not address conflicts of interest in vertically integrated market structures, where a single entity controls multiple market functions—such as exchange, broker-dealer, market maker, and custodian—under common ownership. This is a significant concern, as highlighted by the CFTC's enforcement actions following the FTX bankruptcy.<sup>3</sup> Although the Proposed Rule recognizes these concerns, it does not provide adequate

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<sup>3</sup> Dissenting Statement of Commissioner Kristin N. Johnson, Requirements for Designated Contract Markets and Swap Execution Facilities Regarding Governance and the Mitigation of Conflicts of Interest Impacting Market Regulation Functions; 89 Fed. Reg. 19646, 19720 (March 19, 2024).

regulatory measures to manage these structures' considerable risks to market integrity and customer protection. Instead, the rule defers addressing such issues to future rulemakings, despite an urgent need for regulatory action and a recently completed request for comments on affiliated entities.<sup>4</sup> This postponement indicates a delayed commitment to addressing critical vulnerabilities and leaves significant gaps in the regulatory framework, undermining the effective mitigation of conflicts of interest.

Furthermore, Better Markets agrees with Commissioner Johnson that the CFTC should propose enhanced conflicts of interest regulations for Derivatives Clearing Organizations similar to those outlined in the Proposed Rule.<sup>5</sup> As emphasized by the Dodd-Frank Act's mandates, the central role of DCOs in the derivatives markets underscores the potential for risk concentration that could threaten financial stability. Therefore, it is imperative that the Commission introduces specific governance reforms designed to specifically address these conflicts.

## **Comments**

### **A. Proposed Governance Fitness Requirements**

Better Markets supports the Commission's proposal to implement minimum fitness standards for individuals involved in significant governance and management roles within SEFs and DCMs. This initiative is crucial to ensure that those with disciplinary or criminal backgrounds do not influence the operations and governance of these critical market infrastructures. We appreciate the Commission's effort to standardize fitness requirements across both SEFs and DCMs, recognizing that the responsibilities of their governing bodies are identical and vital to market integrity.<sup>6</sup> This uniformity is essential for maintaining consistent regulatory standards and expectations across the market landscape.

The inclusion of members with voting privileges and owners holding more than a 10% interest is a commendable step. These individuals can significantly influence the management and policies of SEFs and DCMs, and thus, holding them to rigorous fitness standards is reasonably necessary.<sup>7</sup>

Better Markets acknowledges the provisions requiring SEFs and DCMs to establish procedures for the verification and documentation of compliance with the fitness standards. We suggest the Commission provide further details on acceptable verification methods to ensure these procedures are rigorous and uniformly applied. Regular and independent verification of compliance, as proposed, is essential.<sup>8</sup> Better Markets recommends that the Commission consider

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<sup>4</sup> Statement of Commissioner Christy Goldsmith Romero, Requirements for Designated Contract Markets and Swap Execution Facilities Regarding Governance and the Mitigation of Conflicts of Interest Impacting Market Regulation Functions; 89 Fed. Reg. 19646, 19724 (March 19, 2024).

<sup>5</sup> Dissenting Statement of Commissioner Kristin N. Johnson, 89 Fed. Reg. 19646, 19722.

<sup>6</sup> Fed. Reg. at 19656.

<sup>7</sup> Fed. Reg. at 19657.

<sup>8</sup> Fed. Reg. at 19659.

requirements for external audits or reviews to supplement self-reported compliance, thereby enhancing the rigor and reliability of the verification process.

## **B. Proposed Substantive Requirements for Identifying, Managing and Resolving Actual and Potential Conflicts of Interest**

Better Markets acknowledges the foundational requirement for SEFs and DCMs to establish comprehensive processes for managing both actual and potential conflicts of interest. This initiative is crucial, especially in light of the complex interdependencies that can exist between a SEF's or DCM's market regulation functions, its commercial interests, and the varied interests of its stakeholders.

We recognize the Commission's efforts to clearly define critical terms such as "material information," "non-public information," "commodity interest," "related commodity interest," "linked exchange," "public director," and "family relationship."<sup>9</sup> The proposed modifications to these definitions in §§37.1201(b) and 38.851(b) are appropriate and provide clarity to SEFs and DCMs, enhancing compliance and enforcement capabilities.

The proposed redefinition of "family relationship" to include a broader and more contemporary range of relational dynamics reflects modern social structures and is prudent. This change will likely lead to more effective governance by acknowledging the nuances of familial and residential relationships that could influence decision-making within SEFs and DCMs.

The proposed rules for requiring disclosures of conflicts of interest by officers and members of the board of directors, committees, or disciplinary panels before considering any matter, as detailed in §§37.1202(a) and 38.852(a), are critical. We agree with the requirement for these disclosures to encompass a wide range of potential conflicts, including employment, familial, and financial relationships.<sup>10</sup> Furthermore, the necessity for detailed documentation of these disclosures and any decisions related to recusal or abstention from voting is a commendable step towards transparency and accountability.

Better Markets acknowledges the Commission's decision not to adopt exemptions that would allow board members or committee members with conflicts to deliberate but not vote on matters from which they should be recused.<sup>11</sup> Ensuring that decision-making remains entirely free from conflicts is essential for maintaining trust and integrity in the governance of SEFs and DCMs. If a lack of expertise is a concern, seeking external, unbiased advice is a sensible solution.<sup>12</sup>

To further strengthen these proposals, Better Markets suggests that the Commission consider additional guidelines on how SEFs and DCMs should handle conflicts that may arise from newer forms of trading and technology-driven market practices. Additionally, periodic

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<sup>9</sup> Fed. Reg. at 19661.

<sup>10</sup> *Id.*

<sup>11</sup> Fed. Reg. at 19662.

<sup>12</sup> *Id.*

reviews and updates to these conflict of interest rules could be beneficial to keep pace with evolving market dynamics and technological advancements.

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

Better Markets supports the proposed requirement that SEFs and DCMs' boards of directors and executive committees include a significant representation of public directors, specifically at least 35 percent.<sup>13</sup> This inclusion aims to ensure that regulatory considerations are given due weight, promoting decisions that consider the broader market and public interest rather than being narrowly focused on the interests of a limited group of constituencies.

The proposal to establish a nominating committee and a Regulatory Oversight Committee (ROC) comprised mainly or entirely of public directors is a positive step toward ensuring that the governance of SEFs and DCMs remains transparent and dedicated to upholding market integrity.<sup>14</sup> The ROC, being composed solely of public directors, is particularly noteworthy as it protects the market regulation functions from commercial biases.

We commend the emphasis on the crucial roles that public directors play in mitigating conflicts of interest. Ensuring that public directors are not compensated based on the business performance of the SEF or DCM helps maintain their decision-making independence. The prohibition of compensation directly tied to business performance is essential for fostering objective and unbiased governance.<sup>15</sup>

The requirement for boards of directors to conduct annual self-assessments is a constructive tool for continuous improvement.<sup>16</sup> These assessments should critically evaluate the board's effectiveness in governance and oversight. We suggest that the Commission consider requiring that summaries of these assessments be made available to the public to further enhance transparency and accountability.

The enhanced role of the ROC in overseeing the market regulation functions and its authority to require changes that promote effective self-regulation are vital for maintaining the integrity of the markets. It is crucial that the ROC be provided with sufficient resources and authority to perform its duties effectively.

### **D. Transfer of Equity Interest**

Better Markets supports the proposal to standardize the threshold for equity interest transfers at 10% for both SEFs and DCMs.<sup>17</sup> This change is crucial in ensuring that the Commission is informed of significant ownership changes that could potentially affect these

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<sup>13</sup> Fed. Reg. at 19667.

<sup>14</sup> Fed. Reg. at 19671.

<sup>15</sup> *Id.*

<sup>16</sup> Fed. Reg. at 19667.

<sup>17</sup> Fed. Reg. at 19680.

entities' operational integrity and compliance. Such alignment between SEFs and DCMs is necessary to maintain consistent regulatory standards and prevent potential oversight gaps.

Additionally, the requirement for SEFs and DCMs to provide comprehensive documentation at the time of notification, including organizational charts, descriptions of the purpose or impact of the changes, and copies of relevant agreements and corporate documents, is a positive step towards ensuring that the Commission has all necessary information to assess the implications of ownership and structural changes effectively.<sup>18</sup> This detailed approach will enable the Commission to perform a more effective and timely review, thereby enhancing the overall regulatory oversight process.

Furthermore, the amendments proposed to §§37.5(c) and 38.5(c) clarify the responsibilities and requirements for SEFs and DCMs in the event of equity interest transfers. These clarifications are essential for these entities to fully understand their compliance obligations and ensure they maintain their responsibilities as self-regulating organizations.

### **E. Vertical Integration**

The Proposed Rule failed to address conflicts of interest in vertically integrated market structures, notwithstanding the recent passage of Bitnomial's DCO application in December 2023.<sup>19</sup> Bitnomial, acting as an exchange, broker-dealer, and custodian under one ownership, highlights the need for regulatory frameworks that address conflicts of interest and manipulation. The absence of these protective measures within the current rulemaking underscores a significant oversight by the CFTC. This oversight is particularly troubling in light of the significant concerns underscored by the fallout from the FTX bankruptcy. Despite acknowledging the potential risks these structures pose to market integrity and customer protection, the CFTC has regrettably opted not to enact measures within this rulemaking to mitigate such risks. Instead, the agency has deferred these crucial issues to future rulemakings. This delay is especially disconcerting given the recently completed request for comments on affiliated entities. By postponing, the CFTC has missed a critical opportunity to tackle these vulnerabilities head-on, thereby perpetuating significant gaps in the regulatory framework and undermining efforts to effectively mitigate conflicts of interest that compromise market fairness.

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<sup>18</sup> *Id.*

<sup>19</sup> See CFTC Press Release, CFTC Approves Two Proposals and a DCO Application (December 18, 2023), available at <https://www.cftc.gov/PressRoom/PressReleases/8838-23>.

**CONCLUSION**

We hope these comments are helpful as the Commission finalizes its Proposed Rule.

Sincerely,

A handwritten signature in black ink, appearing to read "Cantrell Dumas". The signature is fluid and cursive, with the first name being the most prominent.

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