This document is scheduled to be published in the
Federal Register on 2026-08-06 and available online at
https://www.federalregister.gov/d/2026-15948, and on
https://govinfo.gov

6351-01-P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 37, 38, and 39

RIN 3038-AF76

Conflicts and Affiliations

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission ("CFTC" or "Commission") is proposing new rules and amendments to its existing regulations for futures commission merchants ("FCMs"), swap execution facilities ("SEFs"), designated contract markets ("DCMs"), and derivatives clearing organizations ("DCOs") (the "Proposal"). The Proposal addresses requirements relating to financial oversight of FCMs by self-regulatory organizations ("SROs") and designated self-regulatory organizations ("DSROs"), as well as disclosure requirements by FCMs regarding affiliate relationships that an FCM has with a SEF, DCM, or DCO. For SEFs, DCMs, and DCOs, the Proposal would also establish requirements, including conflicts of interest rules, to address those registered entities' relationships with certain affiliates, such as FCM affiliates and affiliated principal trading firms. The Proposal includes guidance regarding the implementation of safeguards to protect the impartiality of SEFs, DCMs, and DCOs, including where applicable in their role as SROs or performing SRO functions with respect to certain affiliates. The guidance addresses the sharing of resources including staffing, technology, and office space, and limitations on the sharing of non-public information.

DATES: Comments must be in writing and received by [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments, identified by "Conflicts and Affiliations" and RIN 3038-AF76, by any of the following methods:

- **Regulations.gov:** Go to *https://www.regulations.gov* and press the "Search" button, then proceed as follows:

1. Under Refine Documents Results – check the box to "Only show documents open for comment";

2. Under Agency – select "See More" and check the box for "Commodity Futures Trading Commission," then press the Apply button;

3. Identify this proposal in the list of CFTC documents open for comment, press the "Comment" button to open the submission form, and follow the instructions on the form.

Alternatively, if you are viewing this proposal on *www.federalregister.gov*, click the "Submit A Public Comment" button at the top of the page to open the comment form. Follow the instructions on the form to submit your comment to Regulations.gov.

- **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:** Address to – CFTC Comment Submission, Attn: Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

Please submit your comments using only one of these methods. To avoid possible delays with mail or in-person deliveries, submissions through Regulations.gov are encouraged.

All comments must be submitted in English, or if not, accompanied by an English translation. Do not include in your comment text or attachments any personal identifying information or business information that you do not want published online. Comments (regardless of submission method) will be published without review for, and without removal of, any personal identifying information or information your business may consider confidential.

If you wish to submit confidential information for the Commission's consideration, please contact the CFTC personnel listed in this Notice under FOR FURTHER INFORMATION CONTACT before making any submission. Please also carefully review the Commission's procedures in 17 CFR § 145.9 for requesting confidential treatment under the Freedom of Information Act ("FOIA") of information submitted to the Commission.

The CFTC reserves the right, but shall have no obligation, to review, pre-screen, filter, or redact all or any part of your comment submission. The CFTC also reserves the right, without further notification, to refuse to publish or to remove from public view all or any part of your submission to the extent it contains content inappropriate for publication in a comment file, such as—without limitation—obscene language, threats of violence, solicitations for commercial sales or illegal activity, or obvious spam. If a submission that is refused for or withdrawn from publication because of inappropriate content also contains comments on the merits of this proposal, such submission will be retained in the record for the matter and will be considered as required under the Administrative Procedure Act ("APA") and other applicable laws, and may be accessible under the FOIA.

Pursuant to the APA at 5 U.S.C. 553(b)(4), a plain language summary of the proposed rule is available at Regulations.gov.

FOR FURTHER INFORMATION CONTACT: Stephen Andrews, Deputy General Counsel for Regulation, *sdandrews@cftc.gov*, 202-418-5000, Office of the General Counsel, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581; Aaron Levine, *alevine@cftc.gov*, 646-746-9700, Office of the General Counsel, Commodity Futures Trading Commission, 290 Broadway, New York, NY 10007.

SUPPLEMENTARY INFORMATION:

Table of Contents

I. Introduction

A. Background

The Commission proposes new rules and amendments to its existing regulations for SEFs, DCMs, DCOs, and FCMs that would further establish requirements and guidance applicable to those entities' relationships with certain affiliated entities. Exchanges, DCOs, and intermediaries are already subject to requirements addressing conflicts of interest, reporting, and disclosure. However, the Commission preliminarily believes that the regulated entities would benefit from new regulations and amendments to increase the detail and specificity of the existing regulations in order to mitigate potential risks particularly given the increasing number of affiliate relationships among market participants.

In 2023, Commission staff published a request for comment in part in response to growing interest among market participants in affiliated structures (the "Affiliations RFC").[1] From the comments it received, and through its experience, the Commission has observed applicants for SEF, DCM, and DCO registration or designation and existing registered entities changing the traditional market structure of a separately-owned and independently operated exchange, market participant, and clearinghouse to an "affiliated" market structure in which these distinct entities share common ownership. Some forms of affiliate relationships have a long history, such as those between DCMs and DCOs, while other forms of affiliate relationships, such as those between a DCM and an affiliate market maker, are comparatively new.

The Commission preliminarily believes that this market structure may provide benefits to the derivatives markets and market participants. In this regard, the

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[1] *See* CFTC Staff of the Divisions of Market Oversight, Clearing and Risk, and Market Participants, "Request for Comment on the Impact of Affiliations on Certain CFTC-Regulated Entities" (Jun. 27, 2023) ("Affiliations RFC").

Commission believes that facilitating market structure innovation and competition, subject to appropriate safeguards, advances the Commission's mission of promoting the integrity, resilience, and vibrancy of the U.S. derivatives markets.[2] The Commission recognizes, however, that there may be risks as well, including to unaffiliated market participants such as retail customers. One risk that this Proposal seeks to address is conflicts of interest arising in an affiliated market structure. For example, a situation in which an exchange and a market participant (such as a market maker) on that exchange share common ownership presents conflict of interest concerns regarding an exchange's enforcement of its rules for the affiliated participant. Similar concerns arise regarding the oversight and enforcement functions of a clearinghouse that shares common ownership with a clearing member. This Proposal would require registered entities to have procedures in place to mitigate such potential conflicts of interest, including specifically regarding systems, personnel, and office space, and provides guidance regarding appropriate practices in connection with such procedures. This Proposal also would subject DCMs with affiliate principal trading firms to additional requirements, given the heightened conflicts of interest concerns that may arise in that context.

The financial oversight of FCMs is governed by the longstanding principle of self-regulation, in which DCMs and registered futures associations are responsible, in their capacity as SROs, to adopt financial and related reporting requirements for member FCMs, and to periodically examine FCMs for compliance with such requirements. The Commission also permits two or more SROs to enter into an agreement to assign to one of the SROs (the DSRO) the function of examining member FCMs for compliance with minimum capital and related financial reporting obligations. Given the inherent potential conflict of interest that exists when an SRO or a DSRO surveils their affiliate FCM, the

[2] CFTC Mission Statement, *https://www.cftc.gov/About/AboutTheCommission#:~:text=The%20mission%20of%20the%20C*.

Proposal comprises requirements designed to minimize potential risks resulting from the conflict, including a requirement for an SRO with an affiliate FCM to establish a separate reporting line for staff performing self-regulatory functions and a prohibition against an SRO acting as the DSRO for its affiliate FCM. The Proposal also strengthens the disclosure requirements imposed on FCMs pursuant to Regulation 1.55 with respect to such affiliate relationships. Additionally, the Proposal would allow an FCM to select its DSRO, subject to certain requirements.

In this Proposal, the Commission is drawing on comments from the Commission staff-issued Affiliations RFC, Commission staff's other discussions with market participants (including DCMs, DCOs, FCMs, and market makers), Commission staff's experience in conducting its routine oversight of SEFs, DCMs, and DCOs, including SEF application registration reviews, DCM designation application reviews, SEF and DCM rule enforcement reviews, DCO applications for registration, and regular engagement with SEFs, DCMs, and DCOs. The Commission has also consulted with DCMs and the National Futures Association ("NFA"),[3] in their role as SROs and DSROs, and reviewed market practices concerning affiliate relationships between DCMs and FCMs.

In developing the Proposal, the Commission has consulted with the Securities and Exchange Commission ("SEC") and the prudential regulators, pursuant to section 712(a)(1) of the Dodd-Frank Act.[4]

B. Regulatory Background

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[3] NFA is currently the only registered futures association.

[4] 15 U.S.C. 8302 ("Before commencing any rulemaking or issuing an order regarding swaps, swap dealers, major swap participants, swap data repositories, derivatives 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 this subtitle, the Commodity Futures Trading Commission shall consult and coordinate to the extent possible with the Securities and Exchange Commission and the prudential regulators for the purposes of assuring regulatory consistency and comparability, to the extent possible.").

Section 8a(5) of the Commodity Exchange Act ("CEA" or the "Act")[5] authorizes the Commission "to make and promulgate such rules and regulation 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 Commission preliminarily believes that the Proposal is reasonably necessary to accomplish the purposes of section 3(b) of the CEA which states "[i]t is the purpose of this Act to serve the public interests . . . through a system of *effective self-regulation* of trading facilities, clearing systems [and] market participants . . . ."[6] This Proposal addresses critical issues that the Commission believes are necessary for effective self-regulation that have been raised because of affiliations between trading facilities and/or clearing systems and participants in those facilities and/or systems. This Proposal sets out rules and guidance for SEFs and DCMs, which are trading facilities, DCOs, which are clearing systems, and FCMs, which are market participants. In each instance, SEFs, DCMs, and DCOs have self-regulatory obligations.[7] An affiliation between a SEF, DCM, or DCO and an FCM or other market participant raises questions about the (a) quality of oversight of self-regulation, (b) discretionary decision-making by the DCO, DCM, or SEF, and (c) potential conflicts of interest. The Commission has observed increasing numbers of affiliations in "affiliated" corporate structures of SEFs, DCMs, and DCOs, so the Commission believes it is

[5] 7 U.S.C. 12a(5).

[6] 7 U.S.C. 5(b) (emphasis added). As noted above, section 8a(5) of the CEA authorizes the Commission to make and promulgate such rules and regulation as in the Commission's judgment are reasonably necessary to effectuate any of the provisions, or to accomplish any of the purposes, of the CEA. The Commission is of the view that the best interpretation of section 8a(5) of the CEA is that it delegates to the Commission discretionary authority to establish the proposed rules.

[7] *See* 17 CFR 1.3 (definition of "self-regulatory organization") and CEA sections 5b(c)(2)(A)-(R), 7 U.S.C. 7a-1(c)(2)(A)-(R) (DCO Core Principles). Also, for purposes of section 1.52 of the CEA, only DCMs and registered futures associations are included in the definition of SRO because only DCMs and registered futures associations are required to adopt minimum capital and financial reporting requirements for their member firms. SEFs, DCMs, and DCOs are all subject to requirements under the Act and the Commission's regulations to supervise the conduct of their members and participants.

reasonably necessary to issue this Proposal to specifically address these market structures.

In addition, the Commission, pursuant to section 8a(5) of the CEA, is proposing rules applicable to SEFs, DCMs, DCOs, and FCMs, in order to effectuate the relevant Core Principles and/or provisions of the CEA, as appropriate, for each particular entity. For SEFs, the Commission believes that the Proposal is reasonably necessary to effectuate the Core Principles set out in section 5h(f)(2) (impartial access),[8] section 5h(f)(10) (reporting),[9] 5h(f)(12) (conflicts of interest),[10] and section 5h(f)(13) (adequate financial, operational, and managerial resources).[11]

For DCMs, the Commission believes that the Proposal is reasonably necessary to effectuate the Core Principles in section 5(d)(2) (access requirements),[12] section 5(d)(11) (rules to ensure the financial integrity of any FCM and the protection of customer funds),[13] section 5(d)(12) (promote fair and equitable trading),[14] section 5d(16) (conflicts of interest),[15] and section 5(d)(21) (adequate financial, operational and managerial resources).[16]

For DCOs, the Commission believes that the Proposal is reasonably necessary to effectuate the Core Principles in CEA section 5b(c)(2)(C) (participant and product

[8] CEA 5h(f)(2), 7 U.S.C. 7b-3(f)(2).

[9] CEA 5h(f)(10), 7 U.S.C. 7b-3(f)(10).

[10] CEA 5h(f)(12), 7 U.S.C. 7b-3(f)(12).

[11] CEA 5h(f)(13), 7 U.S.C. 7b-3(f)(13).

[12] CEA 5(d)(2), 7 U.S.C. 7(d)(2).

[13] CEA 5(d)(11), 7 U.S.C. 7(d)(11).

[14] CEA 5(d)(12), 7 U.S.C. 7(d)(12).

[15] CEA 5(d)(16), 7 U.S.C. 7(d)(16).

[16] CEA 5(d)(21), 7 U.S.C. 7(d)(21).

eligibility),[17] section 5b(c)(2)(D) (risk management),[18] section 5b(c)(2)(J) (reporting),[19] section 5b(c)(2)(L) (public information),[20] and section 5b(c)(2)(P) (conflicts of interest).[21]

With respect to FCMs, the Proposal includes rules for those FCMs that are affiliated with an exchange or DCO. The Commission believes that these rules are reasonably necessary to effectuate Section 4f(b) (Commission authority to adopt regulations imposing minimum financial requirements).[22]

Accordingly, the Commission believes that the amendments in this Proposal relating to affiliations of SEFs, DCOs, DCMs, and FCMs are reasonably necessary to implement the purposes and provisions of the CEA. The application of these statutory provisions for each proposed amendment to current Commission regulations is described in detail below.

C. SEF and DCM Statutory and Regulatory Requirements

The Core Principles in parts 37 and 38, and corresponding regulations, are relevant to the proposed regulations in this Proposal. Their applicability is addressed in more detail with respect to each proposed regulation. Below is a summary of relevant Core Principles and regulations.

SEF Core Principle 12 requires a SEF to (a) establish and enforce rules to minimize conflicts of interest in its decision-making process and (b) establish a process for resolving the conflicts of interest.[23] DCM Core Principle 16 likewise provides that a board of trade shall establish and enforce rules: (a) to minimize conflicts of interest in the

[17] CEA 5b(c)(2)(C), 7 U.S.C. 7a-1(c)(2)(C).

[18] CEA 5b(c)(2)(D), 7 U.S.C. 7a-1(c)(2)(D).

[19] CEA 5b(c)(2)(J), 7 U.S.C. 7a-1(c)(2)(J).

[20] CEA 5b(c)(2)(L), 7 U.S.C. 7a-1(c)(2)(L).

[21] CEA 5b(c)(2)(P), 7 U.S.C. 7a-1(c)(2)(P).

[22] CEA 4f(b), 7 U.S.C. 6f(b).

[23] 17 CFR 37.1200.

decision-making process of the contract market and (b) to establish a process for resolving conflicts of interest described in paragraph (a) of this section.[24] Commission Regulation 38.851 refers to the guidance and/or Acceptable Practices in appendix B of part 38 to advise on how DCMs may comply with the Core Principle and implementing regulations.

The part 38 Guidance to Core Principle 16 provides that the means to address conflicts of interest in the DCM's decision-making should include methods to ascertain the presence of conflicts of interest and to make decisions in the event of such a conflict.[25] In addition, the DCM should provide for 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.[26]

The Core Principle 16 Acceptable Practices provide additional details to assist DCMs in demonstrating compliance with the Core Principle by outlining specific compliance practices. Among other things, they provide that DCMs "bear special responsibility to regulate effectively, impartially, and with due consideration of the public interest, as provided for in section 3 of the Act."[27] The Acceptable Practices also state that DCMs "should be particularly vigilant for such conflicts between and among any of their self-regulatory responsibilities, their commercial interests, and the several interests of their management, members, owners, customers and market participants, other industry participants, and other constituencies."[28] Additionally, the Acceptable Practices

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[24] 17 CFR 38.850.

[25] *See* 17 CFR part 38, app. B—Guidance on, and Acceptable Practices in, Compliance with Core Principles, Core Principle 16, sec. (B)(a).

[26] *See id.*

[27] *See id*.

[28] *See id*.

provide several key provisions relating to board composition, the regulatory oversight committee ("ROC"), and disciplinary panels.[29]

The Commission's parts 37 and 38 regulations also provide impartial access requirements, which highlight the importance of a SEF's and a DCM's responsibility to treat its market participants fairly. Commission Regulation 37.202 requires that a SEF shall provide any eligible contract participant ("ECP") and any independent software vendor with impartial access to its market(s) and market services, including any indicative quote screens or any similar pricing data displays, provided that the facility has: (1) criteria governing such access that are impartial, transparent, and applied in a fair and nondiscriminatory manner; (2) procedures whereby ECPs provide the SEF with written or electronic confirmation of their status as ECPs; and (3) comparable fee structures for ECPs and independent software vendors receiving comparable access to, or services from, the SEF.[30]

Similarly, Commission Regulation 38.151 provides that a DCM must provide its members, persons with trading privileges, and independent software vendors with impartial access to its markets and services, including: (1) access criteria that are impartial, transparent, and applied in a non-discriminatory manner; and (2) comparable fee structures for members, persons with trading privileges and independent software vendors receiving equal access to, or services from, the DCM.[31]

Parts 37 and 38 of the Commission's regulations also require SEFs and DCMs to maintain adequate financial, operational, and managerial resources. SEF Core Principle 13 (Financial Resources) provides that a SEF shall have adequate financial, operational, and managerial resources to discharge each responsibility of the SEF.[32] It further

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[29] *See id.*

[30] 17 CFR 37.202.

[31] 17 CFR 38.151.

[32] 17 CFR 37.1300(a).

provides that the financial resources of a SEF shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the SEF to cover the operating costs of the SEF for a one-year period, as calculated on a rolling basis.[33] DCM Core Principle 21 (Financial Resources) provides similar requirements, requiring that a DCM shall have adequate financial, operational, and managerial resources to discharge each of its responsibilities.[34] In addition, a DCM's financial resources shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the contract market to cover the operating costs of the contract market for a 1-year period, as calculated on a rolling basis.[35]

Finally, pursuant to DCM Core Principle 11 (Financial Integrity of Transactions), DCMs are required to establish and enforce rules to: (a) ensure the financial integrity of transactions entered into on or through the facilities of the contract market and (b) ensure the financial integrity of any FCM or IB.[36] In this connection, Commission Regulation 38.602 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.[37] In addition, Commission Regulation 38.604 provides that a DCM must monitor its members' compliance with the DCM's minimum financial standards, and therefore, must routinely receive and promptly review financial and related information from its members, as well as continuously monitor the positions of its members and their customers.[38]

D. FCM Statutory and Regulatory Requirements

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[33] 17 CFR 37.1300(b).

[34] 17 CFR 38.1100.

[35] 17 CFR 38.1100(b).

[36] 17 CFR 38.600.

[37] 17 CFR 38.602.

[38] 17 CFR 38.604.

One of the chief functions of DCMs and registered futures associations is the financial oversight of their member FCMs. FCMs perform critical functions to facilitate the efficient operation of Commission-regulated exchange-traded derivatives markets.[39] In addition to trading for their own accounts and carrying the accounts of their affiliates, FCMs act as market intermediaries, standing between customers trading futures and swaps on one side and DCMs and DCOs on the other side. As market intermediaries, FCMs carry customer accounts and hold customer funds to margin futures and cleared swap transactions. Additionally, FCMs fulfill daily settlement obligations on behalf of customers by posting sufficient funds to DCOs to support their customers' futures and swap positions, including paying mark-to-market losses associated with such positions. FCMs are also essential to the efficient operation of Commission-regulated markets in that they guarantee each customer's financial performance for futures and swap positions to DCOs by agreeing to use their own financial resources to cover any shortfall resulting from a customer default.[40]

The Act established the critical role performed by FCMs and authorizes the Commission to adopt regulations to help ensure that they maintain the necessary financial resources to properly perform such duties. Section 4f(b) of the CEA authorizes the Commission to adopt regulations imposing minimum capital and financial reporting requirements on FCMs to help ensure that they maintain adequate financial resources to fulfill their obligations.[41] Under this statutory authorization, the Commission adopted

[39] An FCM is defined in 17 CFR 1.3, in relevant part, as: (i) an entity that is engaged in soliciting or accepting orders for the purchase or sale of any commodity for future delivery or a swap and, in connection with the solicitation and acceptance of such orders, accepts money, securities or property (or extends credit in lieu thereof) to margin, guarantee or secure futures or swaps transactions, or (ii) an entity registered as an FCM.

[40] 17 CFR 39.16(c)(2)(vi).

[41] Section 4f(b) of the Act provides, in relevant part, that no person shall be registered as an FCM unless such person meets the minimum financial requirements that the Commission may prescribe by regulation as necessary to insure such person meets its obligations as a registrant, and each person registered as an FCM shall at all times continue to meet such prescribed minimum financial requirements. 7 U.S.C. 6f(b).

regulations requiring FCMs to, among other requirements, maintain a minimum level of regulatory capital,[42] segregate customer funds from their own funds in specially designated customer accounts,[43] and maintain appropriate risk management programs to monitor and manage the risks associated with their activities as FCMs.[44] FCMs are also required to provide a notice if they experience certain events that could impact their financial condition.[45] In addition, FCMs are bound by specific public disclosure requirements to promote the protection of customer funds and to minimize the systemic risk posed by certain actions of market participants.[46]

The financial oversight of FCMs and other market intermediaries is primarily performed by the respective DCMs and registered futures associations[47] in their role as SROs.[48] In 2000, Congress affirmed this regulatory structure of industry self-regulation by amending section 3 of the CEA to state: "It is the purpose of this Act to serve the public interests . . . through a system of effective self-regulation of trading facilities, clearing systems, market participants, and market professionals under the oversight of the

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[42] 17 CFR 1.17.

[43] 17 CFR 1.20; 17 CFR 22.2; 17 CFR 30.7.

[44] 17 CFR 1.11. FCMs are also subject to a requirement to address certain conflicts of interest within the firm. Specifically, pursuant to section 4d(c) of the Act, the Commission adopted Commission Regulation 1.71, which requires FCMs to adopt and implement written conflicts of interest policies and procedures. 7 U.S.C. 6d(c) and 17 CFR 1.71. Commission Regulation 1.71 focuses on the potential conflicts that could arise between individuals conducting research and analysis, on the one hand, and individuals involved in trading and clearing, on the other hand. The regulation, however, does not more broadly address the sharing of non-public information between FCMs and their affiliates. *Id.*; *see also Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants*, 77 FR 20120 at 20144-20146 (Apr. 3, 2012) and *Implementation of Conflicts of Interest Policies and Procedures by Futures Commission Merchants and Introducing Brokers*, 75 FR 70152 (Nov. 17, 2010).

[45] 17 CFR 1.12.

[46] 17 CFR 1.55.

[47] NFA's financial requirements for FCMs are available at its website, *www.nfa.futures.org*.

[48] Section 3(b) of the Act. Commission Regulation 1.3 defines an SRO as a DCM, a registered futures association, or a SEF. For purposes of Commission Regulation 1.52, however, SEFs are excluded from the SRO definition. SEFs are not required to adopt minimum capital and financial reporting requirements for their member firms and, as a result, the oversight program required under Commission Regulation 1.52 is not applicable to SEFs. With respect to the SEF's obligation to monitor its members for financial soundness, the obligation extends only to a requirement to ensure that the members continue to qualify as ECPs as defined in section 1a(18) of the Act. *See* 78 FR 68506 at 68560.

Commission."[49] Pursuant to such objective, the Act, as further implemented through Commission regulations, requires SROs to adopt financial and related reporting requirements for member FCMs, and to periodically examine FCMs for compliance with such requirements.

Specifically, section 17(p) of the CEA requires a registered futures association 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, which must be at least as stringent as those set by the Act or Commission regulations.[50] Section 17(p) further provides that a registered futures association must implement a program to audit and enforce compliance by its members with the registered futures association's minimum financial requirements.[51]

Similarly, section 5(d)(11)(B) of the Act and Commission Regulation 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.[52] Pursuant to Commission Regulation 38.602, DCMs must further establish and maintain appropriate minimum financial standards for its members.[53] Additionally, Commission Regulations 38.604 and 38.605 require each DCM to be responsible for the financial surveillance of its FCM members. As discussed above, Commission Regulation 38.604 requires each DCM to monitor the FCM members' compliance with the DCM's minimum financial standards.[54] To that effect, a DCM must review financial and related information from its FCM

[49] Commodity Futures Modernization Act of 2000, Sec. 108, Pub. L. No. 106-554, 114 Stat. 2763 (2000).

[50] CEA 17(p)(2), 7 U.S.C. 21(p)(2).

[51] *See Id*.

[52] CEA 5(d)(11)(B), 7 U.S.C. 7(d)(11)(B); 17 CFR 38.600.

[53] 17 CFR 38.602.

[54] 17 CFR 38.604.

members and engage in intra-day surveillance by monitoring the positions of its FCM members and their customers.[55] In connection with the intra-day surveillance requirement, Commission Regulation 38.604 specifies that each DCM must survey the obligations of each FCM created by its customers' positions and compare such obligations to the financial resources of the FCM.[56] Pursuant to Commission Regulation 38.604(c), if a DCM, in its professional judgement, determines that the obligations of an FCM member are excessive, the DCM must take appropriate action to protect customer funds, including by contacting the FCM or the FCM's DSRO.[57] Commission Regulation 38.605 requires a DCM, in its role as an SRO, to comply with the standards of Commission Regulation 1.52 to ensure the financial integrity of its member FCMs by establishing and carrying out a financial surveillance program.[58] As further discussed below, Commission Regulation 1.52 sets forth the required elements of SRO supervisory programs and permits one or more SROs to establish, subject to Commission approval, a Joint Audit Plan to provide for the SRO supervision of members of more than one SRO.[59]

Pursuant to Commission Regulation 38.606, DCMs may, but are not obligated to, satisfy their financial surveillance responsibilities under Commission Regulations 38.604 and 38.605 by designating a regulatory service provider ("RSP") to conduct such financial surveillance, provided that the RSP is a registered futures association or a registered entity,[60] the DCM ensures that the RSP has the capacity and resources to

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[55] *Id*. Specifically, Commission Regulation 38.604 further provides that a DCM must: (a) continually surveil the obligations of each FCM created by the positions of its customers, (b) compare those obligations to the resources of the FCM, and (c) take appropriate steps to use this information to protect customer funds.

[56] 17 CFR 38.604(b).

[57] *Id*. *See also Core Principles and Other Requirements for Designated Contract Markets*, 77 FR 36612 at 36647 (Jun. 19, 2012).

[58] 17 CFR 38.605. A DCM's financial surveillance program must comply with Commission Regulation 1.52, which is discussed below.

[59] 17 CFR 1.52.

[60] 17 CFR 1.3.

conduct the necessary financial surveillance and, notwithstanding the use of an RSP, the DCM remains responsible for compliance with its financial surveillance obligations.[61] Pursuant to Commission Regulation 38.606, the appointment of an RSP must be governed by a written agreement that specifically documents the services to be performed as well as the capacity and resources of the RSP with respect to the services performed.[62]

Consistent with the CEA's purpose of serving the public interest through a system of effective self-regulation, Commission Regulation 1.52 establishes the minimum standards that all SROs must satisfy in conducting FCM financial oversight. Commission Regulation 1.52 directs SROs to adopt rules prescribing minimum financial and related financial reporting requirements for member FCMs that are the same as, or more stringent, than the Commission's requirements.[63] Commission Regulation 1.52 also requires SROs to establish and operate a supervisory program that includes examination of member FCMs to assess whether such FCMs are in compliance with SRO rules and Commission regulations governing, among other requirements, minimum net capital and related financial requirements, the appropriate segregation of customer funds, and financial reporting requirements.[64] As part of the supervisory program, an SRO must perform ongoing surveillance of FCMs through, among other actions, review and analysis of financial statements and regulatory notices, and must conduct routine periodic on-site examinations.[65]

Commission Regulation 1.52(d) also permits two or more SROs to enter into an agreement to establish a Joint Audit Plan for the purpose of assigning to one of the SROs

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[61] 17 CFR 38.604 and 38.605. The term "registered entity" is defined in section 1a(40) of the Act and includes DCMs, SEFs, and DCOs. 7 U.S.C. 1a.

[62] 17 CFR 38.606.

[63] 17 CFR 1.52(b)(1). NFA's FCM capital and financial reporting requirements are set forth in section 1 of the NFA's Financial Requirements section of its rulebook and may be accessed at NFA's web site: *https://www.nfa.futures.org/rulebook/index.aspx*.

[64] 17 CFR 1.52(c)(1).

[65] 17 CFR 1.52(c)(1)(ii) and 17 CFR 1.52(c)(1)(iv)(A).

(the “DSRO”) of the Joint Audit Plan the function of examining member FCMs for compliance with minimum capital and related financial reporting obligations.[66] The audit plan must be submitted to the Commission for approval.[67] Currently all active SROs are members of a Joint Audit Plan that was approved by the Commission on March 18, 2009.[68] The delegation of primary responsibility for monitoring and examining the financial condition of FCMs that are members of two or more SROs to a DSRO under the Joint Audit Plan allows for a more efficient use of SRO resources, while also reducing burdens that would otherwise be imposed on an FCM from duplicative supervision, including periodic on-site examinations from multiple SROs.[69]

Both SROs and DSROs are required to maintain adequate levels and independence of examination staff.[70] In this regard, Commission Regulations 1.52(c) and 1.52(d), which govern SROs and DSROs respectively, contain identical language that requires SROs and DSROs to maintain staff of an adequate size, training, and experience to effectively implement a supervisory program.[71] In addition, staff “must maintain

[66] The purpose of delegation of financial surveillance to DSROs is to promote an effective and efficient market through applying financial standards for FCMs that are often members of multiple DCMs. The Commission has previously noted the inefficiencies that may be caused by duplicative financial surveillance amongst different SROs over the same FCM, stating that “it may be advantageous for the contract markets to engage in a joint enforcement or audit program to monitor compliance with such uniform minimum financial and related reporting requirements.” *Futures Commission Merchants Financial and Reporting Requirements,* 41 FR 45705 at 45706 (Oct. 15, 1976). In addition, the Commission, in proposing to authorize the delegation of financial surveillance responsibilities to DSROs, highlighted the efficiencies of such delegation, noting that it would benefit both FCMs and SROs. *Minimum Financial Requirements,* 42 FR 39032 at 39037 (Aug. 1, 1977).

[67] 17 CFR 1.52(d)(3) and 1.52(h).

[68] The original signatories of the Joint Audit Plan approved on March 18, 2009 are as follows: Board of Trade of the City of Chicago, Inc.; Board of Trade of Kansas City; CBOE Futures Exchange, LLC; Chicago Climate Futures Exchange, L.L.C.; Chicago Mercantile Exchange Inc.; Commodity Exchange, Inc.; ELX Futures, L.P.; HedgeStreet, Inc.; ICE Futures U.S., Inc.; INET Futures Exchange, L.L.C.; Minneapolis Grain Exchange; NASDAQ OMX Futures Exchange; NFA; New York Mercantile Exchange, Inc.; NYSE Liffe US, L.L.C.; and One Chicago, L.L.C. The Joint Audit Plan is available at *https://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/frcomment/08-007b001.pdf*. The current signatories (DCMs, and one registered futures association) are listed on the JAC website, available at: *http://www.jacfutures.com/jac/default.aspx*.

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

[70] 17 CFR 1.52(c)(1)(i) and 1.52(d)(2)(ii)(C).

[71] *Id*.

independent judgment and its actions must not impair its independence nor appear to impair its independence in matters related to the supervisory program."[72] This language is consistent with the longstanding guidance to SROs contained in the Financial and Segregation Interpretation No. 4-1 (Advisory Interpretation for Self-Regulatory Organization Surveillance Over Members' Compliance with Minimum Financial, Segregation, Reporting, and Related Recordkeeping Requirements), and Addendums A and B to Financial and Segregation Interpretation No. 4-1, and Financial and Segregation Interpretation No. 4-2 (Risk-Based Auditing), which guided the practices of members of the Joint Audit Committee ("JAC")[73] voluntarily operating a Joint Audit Plan that had since been approved by the Commission.[74] Commission Regulation 1.52 also provides that the members of the JAC must establish, operate and maintain a joint audit program, meeting the requirements specified in Commission Regulation 1.52(d)(2)(ii) ("Joint Audit Program").[75] The Joint Audit Program sets forth the policies and procedures to be followed by each DSRO in the conduct of examinations and financial reviews of FCMs.[76]

E. DCO Statutory and Regulatory Requirements

Section 5b(c)(2) of the CEA sets forth Core Principles with which a DCO must comply to be registered and to maintain registration as a DCO,[77] and part 39 of the Commission's regulations implements the DCO Core Principles. Under the DCO Core

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[72] *Id*.

[73] The JAC is a voluntary, cooperative organization comprised of representatives of the financial surveillance staff of DCMs and NFA, formed for the purpose of coordinating the monitoring and examination of common FCM members of such entities.

[74] *See Joint Audit Committee Operating Agreement*, 73 FR 52832 (Sept. 11, 2008) (requesting comments prior to the Commission's approval of the most recent JAC agreement, which was granted on Mar. 18, 2009).

[75] Commission staff letters are available on the Commission's website, *www.cftc.gov*.

[76] 17 CFR 1.52(d)(2)(i). *See also Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations*, 78 FR 68506 at 68580 (Nov. 14, 2013) and *Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations*, 77 FR 67866 at 67892 (Nov. 14, 2012).

[77] CEA 5b(c)(2), 7 U.S.C. 7a-1(c)(2).

Principles and related Commission regulations, a DCO has extensive responsibilities to manage its risks and supervise the conduct of its members and participants. A DCO's affiliation with a clearing member may raise questions regarding the impartiality with which these responsibilities will be carried out. For example, an affiliation between a clearing member and a DCO may incentivize the DCO to act with partiality in favor of its affiliate when making decisions regarding the treatment of non-public information or the adequacy of applicable financial resources, with possible anti-competitive effects.

Several existing DCO Core Principles and related regulations target potential risks posed by clearing members generally and partially address some of the concerns and risks raised by affiliated relationships in the clearing context. For example, Core Principle C (Participant and Product Eligibility) requires a DCO to: (1) establish appropriate admission and continuing eligibility standards (including sufficient financial resources and operational capacity to meet obligations arising from participation in the DCO) for members of, and participants in, the DCO; (2) establish appropriate standards for determining eligibility of agreements, contracts, or transactions submitted to the DCO for clearing; and (3) establish and implement procedures to verify, on an ongoing basis, compliance with the DCO's participation and membership requirements, which must be objective, be publicly disclosed, and permit fair and open access. Commission Regulation 39.12 implements Core Principle C.

Core Principle D (Risk Management) requires a DCO to, among other things: (1) measure and monitor its credit exposures to each clearing member daily; (2) through margin requirements and other risk control mechanisms, limit its exposure to potential losses from a clearing member default; and (3) require sufficient margin from its clearing members to cover potential exposures in normal market conditions. Commission Regulation 39.13 implements Core Principle D and, among other things, requires that a DCO: (1) have an appropriate risk management framework that, at a minimum, clearly identifies and documents the range of risks to which the DCO is exposed, addresses the monitoring and management of the entirety of those risks, and provides a mechanism for internal audits; (2) measure and monitor its credit exposure to each clearing member on a daily basis; (3) limit its exposure to potential losses from defaults by its clearing members; and (4) have rules that require its clearing members to maintain current written risk management policies and procedures, which address the risks that such clearing members may pose to the DCO.

Furthermore, Core Principle L (Public Information) requires a DCO to provide market participants with sufficient information to enable them to identify and evaluate accurately the risks and costs associated with using the DCO's services, and to publicly disclose, among other items, any information relevant to participation in the DCO's settlement and clearing activities. Commission Regulation 39.21 implements Core Principle L and, among other things, requires a DCO to make certain information readily available to the general public by posting it on its website. Core Principle N (Antitrust Considerations) requires a DCO to avoid, unless necessary or appropriate to achieve the purposes of the CEA, adopting any rule or taking any action that results in any unreasonable restraint of trade, or imposing any material anticompetitive burden. Commission Regulation 39.23 codifies Core Principle N. Core Principle P (Conflicts of Interest) requires a DCO to establish and enforce rules to minimize conflicts of interest in the decision-making process of the DCO, and establish a process for resolving such conflicts of interest. Commission Regulation 39.25 implements Core Principle P and further requires the DCO to describe procedures for identifying, addressing, and managing conflicts of interest involving members of the board of directors.

F. Current Affiliated Relationships

i. *Current SEF and DCM Affiliated Relationships*

Certain SEFs and DCMs have affiliated relationships, including with entities that trade or facilitate trades on their own markets. The Commission notes that there are 20 SEFs currently registered with the Commission. Some of these SEFs have affiliated relationships with market participants, such as IBs and CTAs, that execute, introduce, or otherwise facilitate trades on the SEFs. Similarly, there are 27 DCMs currently designated by the Commission. The Commission is aware that certain DCMs have affiliated relationships including with market makers, liquidity providers, FCMs, and IBs that execute, introduce, intermediate, or otherwise facilitate trades on the DCMs.

The Commission acknowledges that some SEFs and DCMs already have publicly available rules and disclosures regarding their affiliate relationships. For example, certain SEFs acknowledge affiliate relationships in their rulebooks. Among other things, some DCM rulebooks provide conditions on affiliate participation, including that the affiliate does not have access to the DCM's material non-public information, that the DCM maintains operational independence from the affiliate, and that the affiliate will not receive preferential treatment. Some DCMs also provide website disclosures that identify the affiliated market participant.

Finally, as discussed above, DCMs have self-regulatory responsibilities with respect to their members. In this regard, while Commission Regulation 1.52 does not expressly prohibit an SRO from acting as a DSRO for its affiliated FCM, to date, no DCM with an affiliate FCM has attempted to act as DSRO for its affiliate FCM. Instead, CME or NFA, the two DSROs under the current Joint Audit Plan, perform the periodic financial surveillance of FCMs that are affiliated with a DCM.[78]

ii. *Current DCO Affiliated Relationships*

[78] A DCM may, in its capacity as an SRO, delegate primary responsibility for monitoring and examining the financial condition of member FCMs to a DSRO.

The Commission has also observed various affiliated relationships in the clearing context—historically, DCO-exchange affiliations, and more recently, DCO-clearing member affiliations. There are 24 DCOs currently registered with the Commission; approximately 5 of those DCOs have an affiliated clearing member. The Commission notes that the DCOs with affiliated clearing members have implemented a variety of measures to address potential concerns regarding these relationships. For example, certain of these DCOs provide public disclosure of the affiliated relationships and have rules which prohibit access to non-public information by the affiliated clearing member.

iii. *Current Affiliated Market Makers*

The Commission has more recently observed a growing number of registered entities, including DCMs, that have affiliated market makers trading on the exchange. There are approximately eight DCMs with affiliated market makers. The Commission understands that this market structure is particularly prominent in prediction markets and that the operators of such markets believe that an affiliated market maker can be especially important in the creation and maintenance of new markets. The Commission notes that the exchanges with affiliated market makers have implemented a variety of measures to address potential concerns regarding these relationships. For example, these measures include public disclosure of affiliate relationships, rules to prohibit access to non-public information by the affiliated market maker, and adjustments to the traditional price-time priority execution method on central limit order books.

As the preceding discussion reflects, a number of SEFs, DCMs, and DCOs have voluntarily adopted measures designed to identify and address the potential conflicts of interest associated with affiliated relationships—including public disclosure of affiliations, information barriers limiting affiliate access to material non-public information, and requirements that affiliated participants receive no preferential treatment. The Commission recognizes the value of these measures and preliminarily believes that they have contributed to the integrity of these markets and to the confidence of market participants in their fairness.

At the same time, the Commission preliminarily believes that the existing framework of voluntary practices, however constructive, is uneven. As described above and below, various measures have been adopted to differing degrees and stringency, and they are memorialized in disparate forms. Because each measure is adopted at the discretion of the individual entity, it may be narrowed, modified, or discontinued, and such voluntary undertakings are not uniformly subject to the Commission's examination and enforcement processes. Market participants who transact across multiple registered entities therefore cannot presently rely on a consistent baseline of protections, and the public may find it difficult to identify, compare, or verify the safeguards that apply to any particular affiliated relationship.

The Commission preliminarily believes that establishing a consistent regulatory baseline—one that draws on the sound practices responsible registered entities have already developed—would promote the consistency, clarity, and transparency that voluntary measures alone have not achieved. A codified framework would afford registered entities and market participants predictable expectations; help ensure that comparable conflicts are subject to comparable safeguards regardless of the venue on which they arise; and render those safeguards durable and subject to Commission oversight. The Commission preliminarily believes that such a framework would advance the conflict-of-interest, customer-protection, and market-integrity objectives reflected in the Core Principles applicable to SEFs, DCMs, and DCOs discussed above, and that, by doing so, it would reinforce—rather than displace—the practices registered entities have adopted and the confidence those practices have helped to build. The proposed amendments set forth in the following sections are intended to establish that framework.

II. DCM Obligations—Proposed Amendments to Commission Regulations 1.52, 38.604, and 38.606.

A. Proposed Amendments to Commission Regulation 1.52—SRO Surveillance of Financial Requirements for Affiliate FCMs

i. *Background*

DCMs and registered futures associations play a foundational role in the surveillance of FCM's compliance with Commission and SRO financial requirements. Section 5(d)(11)(B) of the CEA requires each DCM to establish and enforce rules to ensure the financial integrity of any FCM that is a member of the contract market and to ensure the protection of customer funds.[79] Section 17(p) of the CEA imposes parallel obligations on registered futures associations, requiring NFA—the sole such association—to establish, subject to Commission approval, minimum financial requirements applicable to its FCM members and a program to audit and enforce compliance with those requirements.[80]

Commission Regulation 1.52 establishes the minimum standards that all SROs must satisfy in carrying out their financial supervisory programs. Commission Regulation 1.52(c) requires each SRO to establish and operate a supervisory program—including written policies and procedures—for examining its member FCMs for compliance with applicable SRO rules and Commission regulations governing minimum net capital, segregation of customer funds, risk management, financial reporting, recordkeeping, and sales-practice requirements.[81] Commission Regulations 1.52(c)(2)(i) and (d)(2)(ii)(C)(1) further require SROs and DSROs to maintain examination staff of "adequate size, training, and experience" to effectively implement the supervisory program and the Joint

[79] CEA 5(d)(11)(B), 7 U.S.C. 7(d)(11)(B).

[80] CEA 17(p), 7 U.S.C. 21(p).

[81] 17 CFR 1.52(c)(1).

Audit Program, respectively, and provide that such staff "must maintain independent judgment" and that their "actions must not impair its independence nor appear to impair its independence in matters related to" those programs.[82] These existing independence requirements are important, but they do not specifically address the concerns presented when an SRO has an affiliate FCM.

As described above, Commission Regulation 1.52 permits two or more SROs to file with the Commission a plan for delegating to a DSRO, for any FCM that is a member of more than one such SRO, the function of monitoring and examining that FCM for compliance with minimum financial and related reporting requirements.[83] The SROs participating in such a plan form a JAC which establishes and operates a Commission-approved Joint Audit Program and designates the DSRO responsible for the examination of each FCM.[84] Under this framework, the assignment of a particular FCM to a particular DSRO is made by the JAC pursuant to the plan; the FCM itself plays no role in selecting its DSRO and is notified of the DSRO to which it has been assigned.[85]

There is currently one Joint Audit Program, which has its origins in a Joint Audit Agreement entered into in 1984 by a number of futures exchanges and NFA, under which an FCM that is a member of more than one SRO is assigned a single DSRO primarily responsible for conducting periodic financial examinations, the results of which are shared with the FCM's other SROs.[86] Although the 1984 Agreement was entered into by

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[82] 17 CFR 1.52(c)(2)(i), (d)(2)(ii)(C)(1).

[83] 17 CFR 1.52(d)(1).

[84] 17 CFR 1.52(d)(2)(i).

[85] *See* 17 CFR 1.52(i)(2).

[86] *See* Joint Audit Plan, 49 FR 28906 (July 17, 1984) (approved by Commission letter dated Oct. 10, 1984); 73 FR 52832 (Sept. 11, 2008) (describing the 1984 Agreement and a proposed replacement addressing JAC governance, voting rights, membership criteria, information-sharing arrangements, and DSRO designation criteria); and 78 FR 65806 at 68559 (Nov. 14, 2013) (noting that the Commission approved the Joint Audit Plan on March 18, 2009). The current version of the Joint Audit Agreement, which has been shared with Commission staff and is unchanged in all material respects from the 2009 Joint Audit Agreement, was entered into on September 1, 2017 and is *available at*: *https://www.cftc.gov/media/11981/JACagreement_2017/download*.

NFA and numerous independent futures exchanges, consolidation among the exchanges in the intervening decades has substantially reduced the number of SROs that serve as DSROs.[87] Today, as a result of the delegations elected by SROs under the Joint Audit Program, CME serves as the DSRO for FCMs that are clearing members of CME, and NFA serves as the DSRO for FCMs that are not CME clearing members.[88]

In October 2024, NFA approved the FCM application of F&O Financial LLC, an FCM jointly owned by CME and an unaffiliated firm.[89] Accordingly, CME—which serves as the DSRO for all FCMs that are clearing members of CME—is now affiliated with an FCM, while continuing to serve as the DSRO for FCMs that may compete with that affiliate. [90]

Commission Regulation 1.52(b) requires each SRO to adopt rules prescribing minimum financial and related reporting requirements for its member FCMs that are the same as, or more stringent than, the Commission's requirements.[91] Commission Regulations 1.52(c) and 1.52(d) require an SRO and, where applicable, a DSRO to operate a financial supervisory program that includes routine surveillance through the review and analysis of financial statements and regulatory notices, and periodic on-site examinations of member FCMs.[92] Both regulations require that examination staff be of adequate size, training, and experience to effectively implement the program, and that such staff "maintain independent judgment" such that the staff's "actions must not impair

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[87] The current signatories to the Joint Audit Agreement are listed on the JAC website, *available at*: *http://www.jacfutures.com/jac/default.aspx*.

[88] *See* Financial Surveillance Examination Program Requirements for Self-Regulatory Organizations, 84 FR 12882, 12884 & n.22 (Apr. 3, 2019).

[89] *See* Press Release, CME Group, *CME Group Receives Approval to Establish Futures Commission Merchant* (Oct. 29, 2024), *https://www.cmegroup.com/media-room/press-releases/2024/10/29/cme_group_receivesapprovaltoestablishfuturescommissionmerchant.html*.

[90] CME delegated the DSRO function of its affiliated FCM to NFA to mitigate the potential conflict of interest associated with acting as DSRO for an affiliated FCM.

[91] 17 CFR 1.52(b).

[92] 17 CFR 1.52(c), (d).

its independence nor appear to impair its independence in matters related to the supervisory program."[93]

Because NFA is the only futures association registered under section 17 of the Act,[94] and a registered futures association is an SRO for purposes of Commission Regulation 1.52,[95] every FCM is a member of NFA. NFA does not operate a market, does not trade, and has no affiliate FCMs or other market participants.[96] Consequently, NFA is, for every FCM, an SRO with no commercial interest in the FCM's trading activity and, but for the current Joint Audit Program and any resource constraints, is available to serve as that FCM's DSRO.

Commission Regulation 1.52 does not currently address SRO oversight of an affiliate FCM expressly, nor does it prohibit an SRO from acting as DSRO for its own affiliate FCM. To date, however, no DCM with an affiliate FCM has acted as DSRO for that affiliate FCM. Instead, in each such case, the DCM has voluntarily requested that NFA perform the DSRO function for the affiliate FCM.[97]

ii. *Comments on the Affiliations RFC*

The Commission received substantial comment on DSRO oversight of FCMs in response to the 2023 Affiliations RFC.[98] The relevant comments addressed three distinct questions: (1) whether a DCM should be permitted to serve as the DSRO for its own affiliate FCM; (2) whether a DCM with an affiliate FCM should serve as the DSRO for non-affiliate FCMs that may compete with that affiliate; and (3) what information

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[93] 17 CFR 1.52(c)(1)(i), (d)(2)(ii)(C)(1).

[94] *See* 7 U.S.C. 21.

[95] *See* 17 CFR 1.52(a)(2).

[96] *See* Letter from Carol Wooding, SVP, General Counsel and Secretary, on behalf of the NFA to Christopher Kirkpatrick, Sec'y, CFTC at 1 (Sept. 26, 2023) (hereinafter "NFA Comment"). The letter is available on the Commission's website.

[97] *See* NFA Comment, *supra* note 96, at 4-5.

[98] *See* Affiliations RFC, *supra* note 1.

barriers and structural safeguards should apply to a DSRO's oversight of FCMs. The Commission addresses each in turn.

A DCM serving as DSRO for its own affiliate FCM. The Commission received six comment letters related to the conflicts of interest implications for the self-regulatory framework of SROs and DSROs having an affiliate FCM. All six commenters agreed that a DCM should not act as the DSRO for its affiliate FCM.[99]

NFA—the DSRO for FCMs that are not CME clearing members under the current Joint Audit Plan—observed that although each DCM with an affiliate FCM has to date voluntarily requested that NFA perform the DSRO function, the Commission should nonetheless amend Commission Regulation 1.52 to ensure that a DCM could not be the DSRO for its affiliate FCM in the future.[100] The Futures Industry Association ("FIA") and Professor Ronald Filler emphasized the centrality of DSRO examination to FCM financial surveillance and the risk of impartial treatment if a DSRO oversees its own affiliate FCM.[101] The Global Association of Central Counterparties ("CCP Global") expressed support for the existing Commission Regulation 1.52 framework while emphasizing the importance of explicit rules and procedures to ensure that affiliated FCMs are not afforded preferential treatment relative to non-affiliate FCMs.[102]

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[99] Letter from Jonathan Marcus, Senior Managing Director and General Counsel, on behalf of CME Group Inc., to Christopher Kirkpatrick, Sec'y, CFTC at 14 (Sept. 20, 2023) (hereinafter "CME Comment"); Letter from Kara Dutta, Assistant General Counsel, on behalf of Intercontinental Exchange, Inc., to Christopher Kirkpatrick, Sec'y, CFTC at 2 (Sept. 28, 2023) (hereinafter "ICE Comment"); Letter from Patrick Sexton, EVP, General Counsel & Corporate Secretary, on behalf of Cboe Global Markets, Inc. to Christopher Kirkpatrick, Sec'y, CFTC at 3 (Sept. 28, 2023) (hereinafter "Cboe Comment"); Letter from Ronald H. Filler, Professor Emeritus, New York Law School, to Office of the Secretary, CFTC at 8 (Nov. 3, 2023) (hereinafter "Filler Comment"); *See* Letter from Allison Lurton, General Counsel & Chief Legal Officer, on behalf of the Futures Industry Association, to Christopher Kirkpatrick, Sec'y, CFTC at 9-10 (Sept. 28, 2023) (hereinafter "FIA Comment"); NFA Comment, *supra* note 96, at 4.

[100] NFA Comment, *supra* note 96, at 4-5.

[101] FIA Comment, *supra* note 99, at 9; Filler Comment, at 8.

[102] Letter from The Global Association of Central Counterparties at 2-3 (Sept. 28, 2023) (hereinafter "CCP Global Comment").

A DCM with an affiliate FCM serving as DSRO for non-affiliate FCMs. Several commenters separately addressed whether a DCM that has an affiliate FCM should be able to serve as the DSRO for *non-affiliate* FCMs—that is, the FCMs that may compete with the DCM's own affiliate. Commenters identified this relationship as raising distinct conflict-of-interest and competition concerns arising from the DSRO's access to the confidential information of the FCMs it examines.

NFA characterized this as an issue that SROs and DSROs "have not previously faced" and explained that a DCM with an affiliate FCM serving as DSRO for its non-affiliate FCM members "may raise conflicts and competitive issues that may be heightened by the DSRO's access to its non-affiliate FCMs' confidential information and a perception that actions taken in overseeing its unaffiliated FCM members benefit its affiliate FCM."[103] ICE Futures U.S., Inc. ("ICE") likewise urged the Commission to "consider whether it is appropriate for an entity to be tasked with auditing entities with which it competes" and stated that, at a minimum, robust information barriers should be required "to ensure that information derived from an examination does not flow to the affiliated entity that competes with the firms being audited."[104] Professor Filler questioned whether a DCM with an affiliate FCM should "even serve as a DSRO . . . for another FCM given the confidential information that each DSRO obtains from the other FCMs" and suggested that "[o]ne possible model would only allow [NFA] . . . to serve as the DSRO for all FCMs, even [CME] clearing member firms, if a DCM becomes affiliated with an FCM."[105]

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[103] NFA Comment, *supra* note 96, at 4.

[104] ICE Comment, *supra* note 99, at 2-3.

[105] Filler Comment, *supra* note 99, at 8.

CME recommended that persons affiliated with an FCM not be permitted to participate in or receive reports from the JAC, "which could include sensitive information pertaining to other unaffiliated FCMs."[106]

Information barriers and structural safeguards. Commenters were broadly supportive of information barriers and confidentiality safeguards to govern a DSRO's access to and handling of the non-public information of the FCMs it examines. CME, NFA, ICE, and Professor Filler each agreed that appropriate firewalls and information barriers should be in place.[107] NFA emphasized the importance of separate boards of directors, separate key management personnel, information-sharing barriers, and conflicts-of-interest policies.[108] ICE, while supportive of information barriers generally, separately cautioned that information barriers alone "will not mitigate the conflicts of interest" presented by a DSRO's oversight of an affiliate FCM.[109]

Commenters that operate affiliated structures described their existing safeguards. MIAX described its rule providing that its affiliate FCM "will not receive preferential treatment in any respect," a company-wide information-barrier policy, and a representation that affiliates do not share senior compliance and risk-management personnel, such as the CRO or CCO, or physical office space, although certain functions such as cybersecurity and internal audit may be shared.[110]

Views supporting the existing framework or a principles-based approach. CME, ICE, CCP Global, Cboe, and the World Federation of Exchanges ("WFE") urged the Commission to retain its principles-based regulatory approach and cautioned against

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[106] CME Comment, *supra* note 99, at 14.

[107] CME Comment, *supra* note 99, at 14-15; NFA Comment, *supra* note 96, at 3; ICE Comment, *supra* note 99 at 3; Filler Comment, *supra* note 99, at 5.

[108] NFA Comment, *supra* note 96, at 3.

[109] ICE Comment, *supra* note 99, at 2.

[110] *See* Letter from Thomas F. Gallagher, Chairman and CEO, on behalf of Miami International Holdings, Inc. and Mark G. Bagan, President and CEO, on behalf of Minneapolis Grain Exchange, LLC, to Christopher Kirkpatrick, Sec'y, CFTC at 4-7 (Sept. 26, 2023) (hereinafter "MIAX/MGEX Comment").

prescriptive structural requirements, even while several of them supported particular targeted measures.[111]

iii. *Identified Concerns*

After considering these comments, the Commission has identified four sets of concerns regarding SRO and DSRO oversight of FCMs that the Commission preliminarily believes the existing Commission Regulation 1.52 framework does not specifically address. The first three concern an SRO's oversight of its own affiliate FCM. The fourth concerns the position of non-affiliate FCMs that are examined by a DSRO whose affiliate FCM competes with them, and the absence of any mechanism by which such an unaffiliated FCM may be subject to examination by an SRO that has no competing commercial interest in its activities.

Impartiality of supervision. An SRO with an affiliate FCM has a commercial interest in that affiliate's success that does not exist with respect to its other, unaffiliated member FCMs. That commercial interest could affect, or appear to affect, the rigor with which the SRO applies its supervisory program to the affiliate FCM, including the timeliness and intensity of any enforcement response to identified deficiencies. Commission Regulations 1.52(c)(2)(i) and (d)(2)(ii)(C)(1) already require that examination staff maintain independent judgment and avoid actions that "impair . . . or appear to impair" their independence.[112] The Commission preliminarily believes that, in the affiliate FCM context, additional structural safeguards are warranted to give effect to those existing independence requirements.

[111] CME Comment, *supra* note 99,at 1-2, 16-17 (cautioning against "comprehensive and prescriptive rules" while supporting a prohibition on an SRO serving as DSRO for its own affiliate); CCP Global Comment, *supra* note 102, at 2 (the Commission should not "deviate from its principles-based approach"); ICE Comment, *supra* note 99, at 1 (expressing support for "the CFTC's principles-based approach); Cboe Comment, *supra* note 99, at 3; Letter from Charlie Ryder, Regulatory Affairs Manager, on behalf of World Federation of Exchanges, to the CFTC at 3-4 (Sept. 28, 2023) (hereinafter "WFE Comment").

[112] 17 CFR 1.52(c)(1)(i), (d)(2)(ii)(C)(1).

Use of non-public information. Through its supervisory program, an SRO acquires non-public information concerning the financial condition, customer activity, risk profile, and proprietary trading of its member FCMs. Access to, or sharing with an affiliate FCM of, non-public information of non-affiliate member FCMs could afford the affiliate FCM a competitive advantage and could disadvantage non-affiliate member FCMs that compete with the affiliate FCM. Reciprocally, the SRO's access to its affiliate FCM's non-public information—outside of what is necessary for the SRO's regulatory functions—could blur the boundary between regulatory and commercial information flows within the affiliated group.

Reporting lines for examination staff. SRO examination staff implementing the supervisory program may report to SRO management that also bears commercial responsibility for the affiliated enterprise. Such reporting relationships could undermine, or appear to undermine, the independent judgment that Commission Regulation 1.52 already requires of supervisory staff.

Oversight of non-affiliate FCMs by a DSRO whose affiliate FCM competes with them. The first three concerns address an SRO's oversight of its own affiliate FCM. A distinct concern arises with respect to the non-affiliate FCMs that a DSRO examines when that DSRO has an affiliate FCM competing in the same markets. In conducting the supervisory program and the on-site examinations required by Commission Regulation 1.52(c) and the Joint Audit Program, a DSRO obtains detailed non-public information—including financial condition, customer activity, positions, and risk profile—concerning each FCM it examines.[113] Where the DSRO has an affiliate FCM, the DSRO acquires this information about firms that compete with its affiliate, giving rise to both a competitive concern—that such information could advantage the affiliate FCM—and a concern that

[113] *See* 17 CFR 1.52(c)(1), (d)(2)(ii)(C).

the DSRO's oversight decisions affecting non-affiliate FCMs could be perceived as benefiting its affiliate.

The Commission preliminarily believes that, although the information-barrier and separation safeguards proposed herein mitigate this concern by restricting the flow of non-affiliate FCMs' non-public information to an affiliate FCM, those safeguards operate only as constraints on the DSRO. They do not afford a non-affiliate FCM any means of being subject to examination by an SRO that has no commercial interest in the FCM's activities. Because NFA operates no market and has no affiliate FCM, NFA is, for every FCM, such an SRO. The Commission preliminarily believes that affording each FCM the option to elect NFA as its DSRO would provide a direct, registrant-side response to this concern, complementing the constraints imposed on the DSRO by the safeguards described above.

iv. *Proposed Amendments*

The Commission preliminarily believes that targeted amendments to Commission Regulation 1.52—calibrated to the specific circumstance of an SRO with an affiliate FCM—would address the concerns identified above while preserving the existing framework for SROs and DSROs that do not have an affiliate FCM. Each element of the proposed amendments is discussed below.

Definitions—Proposed Commission Regulations 1.52(a)(3) and (a)(4).

The Commission proposes to add definitions of "affiliate futures commission merchant," "control," and "non-public information" to Commission Regulation 1.52(a) in order to effectuate the proposed substantive revisions to Commission Regulation 1.52.

Proposed Commission Regulation 1.52(a)(3) would define "affiliate futures commission merchant" as an FCM (as defined in Commission Regulation 1.3) that directly or indirectly controls, is controlled by, or is under common control with an SRO. The same paragraph would define "control"—including the terms "controlled by" and "under common control with"—to mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. This control formulation tracks well-established usage under the federal securities laws[114] and is intended to capture the range of relationships that give rise to the concerns identified above. The Commission preliminarily believes a control-based definition (rather than a fixed ownership-percentage threshold) is appropriate because the relevant concerns (i.e., commercial alignment, information flow, reporting-line pressure) turn on the ability to direct management and policies rather than on any particular equity stake.

Proposed Commission Regulation 1.52(a)(4) would define "non-public information" as information that has not been disseminated in a manner which makes it generally available to the trading public. This formulation reflects the existing concept of non-public information used in Commission guidance and Acceptable Practices[115] and is intended to capture, for example, the categories of financial, operational, customer-position, risk-management, and proprietary-trading information that an SRO acquires through its supervisory program.

Reporting Lines for Examination Staff—Proposed Commission Regulation 1.52(c)(1)(i)(B).

Proposed Commission Regulation 1.52(c)(1)(i)(B) would require that, if an SRO has an affiliate FCM, the examination staff implementing the supervisory program required by Commission Regulation 1.52(c) report directly to the board of directors or other designated committee or officer responsible for regulatory compliance of the SRO. The proposed regulation would further require that, if examination staff report to an officer responsible for regulatory compliance of the self-regulatory organization, such

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[114] *See, e.g.*, 17 CFR 230.405 (Securities Act); 17 CFR 240.12b-2 (Exchange Act).

[115] *See, e.g.*, 17 CFR part 38, app. B, Core Principle 16(a).

officer must, in turn, report directly to the board of directors or other designated committee. The proposal would not displace the existing Commission Regulation 1.52(c)(1)(i) requirement that staff maintain independent judgment. Rather, it would supplement that general independence standard with a specific reporting-line safeguard for the circumstance the Commission has identified as presenting heightened risk to that independence (i.e., the existence of an affiliate relationship). The Commission preliminarily believes that a reporting line that runs to the board (or to a designated committee or officer with regulatory-compliance responsibility) rather than to commercial management, would insulate examination staff from reporting pressures that could affect their independent judgment given the commercial interest at play with respect to an affiliate FCM.

In practice, the Commission preliminarily expects that most DCMs would implement this requirement by having examination staff report directly to its ROC[116] or to a chief regulatory officer ("CRO") or similar officer who, in turn, reports to the ROC, thus preserving a reporting line insulated from commercial pressures. The Commission requests comment on existing SRO reporting lines and its understanding of how SROs would comply with this proposed regulation.

Mandatory Independent Third-Party SRO—Proposed Commission Regulation 1.52(c)(1)(i)(C).

Proposed Commission Regulation 1.52(c)(1)(i)(C) would require an SRO that has an affiliate FCM to designate an independent third-party SRO to conduct the surveillance of the affiliate FCM otherwise required of the SRO under existing Commission Regulation 1.52(c). The SRO with the affiliate FCM would be required to ensure that the third-party SRO implements a supervisory program that satisfies both Commission

[116] The Acceptable Practices in app. B to part 38 notes that a ROC must consist only of public directors (i.e., those directors that have no material relationship to the DCM that "reasonably could affect the independent judgment or decision-making of the director").

Regulation 1.52(c) and the RSP requirements of Commission Regulation 38.606. The SRO would at all times remain responsible for compliance with its obligations under the CEA and the Commission's regulations, and for the third-party SRO's performance on its behalf—consistent with the existing Commission Regulation 38.606 framework for RSP arrangements.[117] The Commission requests comment on whether it is appropriate for the designating SRO to be responsible for the third-party's performance on its behalf where such designation is mandatory as opposed to voluntary, as in the Commission Regulation 38.606 circumstance. The Commission also requests comment on the appropriate liability standard for the designating SRO.

This proposal would codify—and extend across the full Commission Regulation 1.52(c) supervisory function—the practice that the Commission understands that DCMs with affiliate FCMs already follow on a voluntary basis. The Commission preliminarily believes that codification is appropriate to ensure the practice continues to make the requirement transparent to FCMs and their customers, and to provide an enforceable regulatory baseline against which the Commission can monitor compliance. The Commission also preliminarily believes that such codification would mitigate the inherent conflicts of interest arising out of an SRO fulfilling its regulatory obligations in the context of its affiliate FCM.

Restrictions on Access to and Sharing of Non-Public Information—Proposed Commission Regulation 1.52(c)(1)(i)(D).

Proposed Commission Regulation § 1.52(c)(1)(i)(D) would impose two related restrictions on an SRO that has an affiliate FCM. First, proposed Commission Regulation 1.52(c)(1)(i)(D)(1) would prohibit an SRO from accessing the non-public information of its affiliate FCM, except as necessary to comply with the SRO's responsibilities and

[117] *See* 17 CFR 38.606.

obligations as a DCM under part 38 of the Commission's Regulations. Second, proposed Commission Regulation 1.52(c)(1)(i)(D)(2) would prohibit an SRO from sharing, directly or indirectly, non-public information obtained from its supervisory program of its non-affiliate member FCMs with its affiliate FCM for any purpose, except as necessary to comply with the SRO's responsibilities and obligations as an SRO under Commission Regulation 1.52 or as a DCM under part 38 of the Commission's regulations. The Commission preliminarily believes that an SRO sharing such information with its affiliate FCM would be extremely rare.

The Commission recognizes that a DCM's compliance with its part 38 obligations—including financial surveillance under Commission Regulations 38.604 and 38.605 and the trade-practice surveillance and audit-trail functions associated with DCM Core Principles 2, 4, and 11—necessarily entail receipt and use of information that is non-public as to particular member FCMs, including an affiliate FCM. The part 38 compliance carve-out preserves the SRO's ability to carry out those required functions, while prohibiting the use, access, or sharing of non-public information for any purpose outside those regulatory responsibilities. The "directly or indirectly" language is intended to prevent circumvention by routing non-public information to the affiliate FCM via another affiliated entity. Indirect routing may nevertheless occur—or, at least, appear to occur to market participants. This fact informs the Commission's preliminary view, as outlined below, that market participants should be able to elect a neutral SRO.

Parallel Amendments to the Joint Audit Plan Provisions—Proposed Commission Regulation 1.52(d)(2)(ii)(C)(1).

The Commission proposes parallel amendments to Commission Regulation 1.52(d)(2)(ii)(C)(1), which governs DSROs operating under the Joint Audit Plan.

Proposed Commission Regulation 1.52(d)(2)(ii)(C)(1)(ii)[118] would expressly require that a DSRO that has an affiliate FCM may not perform the function of a DSRO for that affiliate FCM. This proposal codifies the practices currently followed under the Joint Audit Plan, under which NFA performs the DSRO function for an FCM affiliated with a DCM. The Commission preliminarily believes that an express prohibition, codified in the Commission's regulations, is preferable to continued reliance on voluntary practice for the reasons described above (i.e., conflict of interest risk mitigation and enhanced market integrity), including that, absent a regulatory prohibition, voluntary practice could change thus allowing a surveillance structure that the Commission preliminarily believes results in unmitigable conflicts of interest. The Commission requests comment on whether this proposed regulation should include a similar liability standard as proposed in proposed Commission Regulation 1.52(c)(2)(i)(B).

Proposed Commission Regulation 1.52(d)(2)(ii)(C)(1)(iii) would, consistent with the proposed regulations applicable to SROs, require that if a DSRO has an affiliate FCM, the examination staff implementing the DSRO's supervisory program must report directly to the board of directors or other designated committee or officer responsible for regulatory compliance of the DSRO. Further, the proposed regulation would require that, if such examination staff report to an officer responsible for regulatory compliance of the DSRO, such officer must, in turn, report directly to the board of directors or other designated committee. The Commission's reasoning is consistent with that provided above; namely, to insulate examination staff from reporting pressures that could affect their independent judgment given the commercial interest at play with respect to an affiliate FCM.

[118] The text in current Commission Regulation 1.52(d)(2)(C)(1) is proposed to be moved to proposed Commission Regulation 1.52(d)(2)(C)(1)(i) without any changes to the rule text.

Proposed Commission Regulation 1.52(d)(2)(ii)(C)(1)(iv) would impose on DSROs the same restrictions on access to and sharing of non-public information that the Commission would impose on SROs more generally, with the same carve-out for compliance with part 38 obligations. The Commission preliminarily believes that uniform treatment is appropriate because the DSRO function under the Joint Audit Plan and the broader supervisory program under Commission Regulation 1.52(c) raises materially similar concerns when an affiliate FCM is involved.

FCM Election of a Registered Futures Association as Designated Self-Regulatory Organization—Proposed Commission Regulation 1.52(d)(2)(i)(A).

The safeguards described above operate as constraints on the SRO and the DSRO. They do not, however, afford a non-affiliate FCM any affirmative means of obtaining examination by an SRO that has no commercial interest in its activities, including by virtue of that SRO having an affiliate FCM. Proposed Commission Regulation 1.52(d)(2)(i)(A) would supply that means.[119] It would permit an FCM that is a member of a registered futures association to elect, in writing to the JAC, to have such registered futures association serve as its DSRO.[120] Upon receipt of a valid election, the JAC would designate NFA as that FCM's DSRO and reflect the designation in the Joint Audit Program.[121] In the absence of an election, the JAC would designate the FCM's DSRO

[119] The CEA authorizes a futures association to register with the Commission pursuant to the terms and conditions set out in the Act. CEA sec. 17. The Commission's rules regarding futures associations require a registered futures association to, among other things, demonstrate that it will be able to carry out the purposes of section 17 of the Act. For example, a registered futures association "should be prepared to establish and maintain in accordance with § 1.52 of this chapter, a financial compliance program for those members of the association who are futures commission merchants." 17 CFR 170.1.

[120] The Commission recognizes that there currently is only one registered futures association—NFA—and so this proposed regulation would function to allow FCMs that are NFA members to select NFA as their DSRO. The Commission further recognizes that, while today there is only one JAC, Commission Regulation 1.52(d) allows any two (or more) SROs to form a JAC and there could be more than one in the future. To the extent another JAC consistent with Commission regulations, the Commission preliminarily believes that an FCM subject to such JAC should, likewise, be able to elect a registered futures association its DSRO, to the extent this proposal is adopted as proposed.

[121] Such DSRO designations are made public on a monthly basis through the Commission's publication of selected FCM financial data. *See* Financial Data for FCMs, *https://www.cftc.gov/MarketReports/financialfcmdata/index.htm*.

under the existing process. The Proposal would provide expressly that an election does not alter the examination standards applicable to the FCM under the Joint Audit Program and does not relieve any SRO of the residual responsibility it retains under Commission Regulations, including Commission Regulations 1.52(d)(1)(ii) and (i)(2).

The Commission preliminarily believes that affording each FCM this option is warranted for three reasons. First, the election provides the option of a neutral examiner available to every FCM. The safeguards described above reduce the risk that a DSRO's relationship to its affiliate FCM affects its oversight of the non-affiliate FCMs it examines, but they leave the non-affiliate FCMs dependent on the efficacy of those constraints. A non-affiliate FCM that prefers examination by an SRO with no commercial stake in its business has, under the current framework, no means of established process to obtain it (absent abstaining from trading on CME). Because NFA operates no market and has no affiliate FCM or other affiliate market participant, NFA is, for every FCM, an SRO without the same sort of commercial interest in the FCM's trading activity. The election would allow any FCM to obtain examination by such an organization directly, rather than relying solely on constraints imposed on its assigned DSRO.

Second, the Commission preliminarily believes that the election option would introduce a measure of market discipline that supplements, but does not supplant, the Commission's oversight of the self-regulatory framework. Under the current structure, an FCM has no ability to decline examination by an assigned DSRO, so an FCM's continued examination by a particular DSRO conveys no information about whether the FCM regards that DSRO's oversight as impartial. By making elections observable, the Proposal would allow the degree to which FCMs elect or decline to elect away from a particular DSRO to serve as an indicator—to the Commission and to other market participants—of confidence in that DSRO's application of the Joint Audit Program. A DSRO that retains Commission Regulation 1.52 authority over the FCMs it examines after acquiring an affiliate FCM would have demonstrated such confidence; a significant pattern of elections away from a DSRO would identify a circumstance likely warranting the Commission's attention. For example, this pattern may indicate a "race to the bottom"—FCMs may elect a DSRO based on the perceived "difficulty" of the DSRO's supervisory program. The Commission emphasizes that the election would not permit any FCM to alter the standards under which it is examined, and that the election supplements rather than replaces the Commission's independent supervisory judgment. The Commission further notes that the notice period and minimum-duration provisions described below are designed so that an election reflects a considered determination rather than transient or strategic switching; the Commission preliminarily believes these features would cause election activity to surface durable, rather than ephemeral, assessments of a DSRO's oversight.

Third, the Commission preliminarily believes that a standing and universally available election option would address the relevant concerns without requiring the Commission or the JAC to make case-by-case determinations and would accommodate future changes in market structure. Conditioning the election on a finding that a particular FCM's DSRO is affiliated with a competitor would require contestable determinations regarding affiliation and competition of the kind that may be difficult to draw. A universal election option available to every FCM requires no such triggering determination. It also would ensure that the option is available automatically as affiliate relationships arise in the future—a consideration of practical importance given both the consolidation of DSROs under the Joint Audit Program over the past four decades and the recent emergence of an affiliate FCM at a DSRO. The Commission recognizes that, for an FCM whose DSRO has no affiliate FCM, the election's practical significance is limited; the universal availability of the election rests on the administrability and forward-looking considerations described here rather than on a present benefit common to all FCMs.

The Commission recognizes that there may be potential drawbacks to this approach. For example, the Commission understands that existing DSROs, including CME, have experience and resources dedicated to fulfilling their roles as DSROs. In this regard, a DSRO and its staff likely have developed significant familiarity with the particular FCMs that it examines, including historical records and observations that may facilitate future examinations. An election option may disrupt this historical knowledge and expertise. The Commission requests feedback with respect to these observations and how they may affect any final rule.

Membership Predicate—Proposed Commission Regulation 1.52(d)(2)(i)(B).

Proposed Commission Regulation 1.52(d)(2)(i)(B) would confirm that no FCM may be designated to, and the JAC may not designate to an FCM, an SRO of which the FCM is not a member, and that nothing in the election provision requires any SRO other than a registered futures association (i.e., NFA) to serve as the DSRO for an FCM that is not its member. Because NFA membership is a practical prerequisite to FCM registration, every FCM may make a valid election of NFA. The membership predicate ensures that the election provision does not disturb the existing arrangement under which an SRO other than NFA serves as DSRO only for FCMs that are its members; the Proposal would create no right to elect an exchange SRO, and any assignment of an FCM to an SRO other than NFA would continue to occur through the JAC's existing designation process and only as to FCMs that are members of that SRO.

Notice Period and Effective Date of Election—Proposed Commission Regulation 1.52(d)(2)(i)(C).

Proposed Commission Regulation 1.52(d)(2)(i)(C) would provide that an election takes effect on the later of the first day of the next examination cycle under Commission

Regulation 1.52(d)(2)(ii)(C)(4) or six months after the JAC's receipt of the election, and that an election does not interrupt or shorten an examination then in progress. The Proposal would further authorize the JAC, where it determines that elections received within a common period would, if given immediate effect, impair a DSRO's ability to maintain examination staff of adequate size, training, and experience as required under Commission Regulation 1.52(d)(2)(ii)(C)(1), to establish a reasonable schedule phasing in the effective dates of such elections, provided that no election is delayed beyond twelve months after its receipt.

The Commission preliminarily believes that a defined notice period, together with the phasing authority, is necessary to ensure that a DSRO receiving elected FCMs has sufficient time to recruit, train, and deploy qualified examination staff, and to prevent a concentration of elections within a short period from compromising examination quality.

Minimum Duration of Election—Proposed Commission Regulation 1.52(d)(2)(i)(D).

Proposed Commission Regulation 1.52(d)(2)(i)(D) would require an FCM, following the effective date of an election, to retain its elected DSRO for not fewer than three complete examination cycles under Commission Regulation 1.52(d)(2)(ii)(C)(4) before electing a different DSRO or revoking its election.

The Commission preliminarily believes a minimum-duration requirement is warranted to prevent repeated switching that would impose recurring transition burdens on DSROs and complicate continuity of examination, and to support the staffing investment that a DSRO must make to absorb electing FCMs. The proposed three-examination-cycle period—corresponding to approximately four and one-half years — reflects the Commission's preliminary judgment as to the period necessary to balance these continuity and staffing interests against an FCM's interest in its ability to revisit its election. In this regard, the Commission preliminarily believes that a shorter period of time would hinder a DSRO's ability to manage its resources effectively, develop expertise and deepen its understanding of the FCMs it examines. The minimum-duration requirement would not affect an FCM's obligations, or any SRO's residual responsibilities, including under Commission Regulations 1.52(d)(1)(ii) and (i)(2). As noted below, the Commission requests comment on the appropriate length of these cycles.

Conforming Amendment to the Member-Notification Provision—Proposed Commission Regulation 1.52(i)(2).

The Commission proposes a conforming amendment to Commission Regulation 1.52(i)(2), which requires a delegating SRO to notify each affected member of the identity of the DSRO to which the member has been assigned. The amendment would provide that this notification includes, where applicable, a registered futures association where the member has elected such registered futures association as its DSRO under proposed Commission Regulation 1.52(d)(2)(i)(A). This conforming change ensures that the existing notification mechanism accurately reflects an elected, rather than solely an assigned, DSRO.

v. *Statutory Authority*

The Commission proposes the amendments to Commission Regulation 1.52 pursuant to section 8a(5) of the Act, which authorizes the Commission to promulgate such rules and regulations as, in its judgment, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of the Act.[122] The Commission's authority to prescribe minimum financial-surveillance standards for SROs, and to establish the framework for delegated financial oversight of FCMs through the Joint Audit Program, is longstanding: Commission Regulation 1.52 has been in effect since

[122] CEA 8a(5), 7 U.S.C. 12a(5).

1978, and the Commission last comprehensively revised the Commission Regulation 1.52 framework in 2013.[123] The proposed amendments do not expand the scope of that authority; rather, they calibrate the existing framework to address a specific circumstance—an SRO's oversight of an affiliate FCM, and a DSRO's oversight of non-affiliate FCMs that compete with its affiliate—that the current framework does not address.

The proposed FCM option to elect a registered futures association as DSRO rests on the same section 8a(5) authority, supplemented by section 17 of the Act, which vests the Commission with oversight authority over registered futures associations,[124] and section 4f(b) of the Act, under which registered futures association membership is a practical prerequisite to FCM registration.[125] The Commission preliminarily believes that section 8a(5)—read together with sections 17 and 4f(b)—and the Commission's existing approval-and-conditioning authority over Joint Audit Plans under § 1.52(d)(1) and (h)—supplies sufficient authority to require a registered futures association, including NFA, to accept an FCM's election in the circumstance addressed by the proposal.

vi. *Alternatives Considered*

The Commission considered, and requests comment on, several alternative approaches to the issues addressed by the proposed amendments to Commission Regulation 1.52.

1. Reliance on existing voluntary practice

The Commission considered relying on the current voluntary practice—under which NFA performs DSRO functions for FCMs affiliated with DCMs—without codification. The Commission preliminarily concluded that relying on this voluntary

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[123] *Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations*, 78 FR 68506 (Nov. 14, 2013).

[124] CEA 17, 7 U.S.C. 21.

[125] CEA 4f(b), 7 U.S.C. 6f(b).

practice is untenable, given the increasing number of DCMs with affiliate FCMs and the possibility that such voluntary practice could change. In this regard, the Commission preliminarily determined that codification is preferable to ensure continuity of that voluntary practice, to extend safeguards beyond the DSRO context to the broader Commission Regulation 1.52(c) supervisory function, and to make the requirements transparent to market participants. The Commission requests comment on whether reliance on existing voluntary practice is sufficient.

2. Independent DSRO for all member FCMs

The Commission considered, as suggested by Professor Filler and reflected in part in NFA's comment, requiring that NFA (or another independent third-party SRO) serve as DSRO for *all* member FCMs of an SRO that has an affiliate FCM—not only for the affiliate FCM itself.[126] The rationale for this alternative is that an SRO's access to non-public information of *non-affiliate* FCMs—which may compete with the affiliate FCM—raises competitive concerns even when the SRO does not directly examine the affiliate FCM. The Commission preliminarily declines to take this approach for two reasons. First, the Commission understands that FCM examinations provide valuable information to DSROs that also operate an exchange, and that such information may bear on risk management decisions made by the exchange. In this regard, removing FCM examination authority from such DSROs may result in blind spots that increase systemic risk. Second, the Commission preliminarily concludes that the proposed approach is sufficient to address the relevant competitive concerns while enabling market forces to show revealed preferences. The Commission requests comment on this alternative, including whether the proposed access and sharing restrictions adequately mitigate the competitive concerns that this alternative would address.

[126] Filler Comment, *supra* note 99, at 8; *see also* NFA Comment, *supra* note 96, at 4-5.

3. Prescriptive separation requirements

The Commission considered prescriptive separation requirements—including physical office separation, technical specifications for information barriers, and dual-hatting prohibitions for senior officers—for SRO personnel involved in the supervisory program of an affiliate FCM. The Commission notes that a DCM with an affiliate FCM would be subject to the Commission's proposed conflicts-of-interest-procedures rule described below, and that the Commission's proposed acceptable practices in implementing such procedures likewise would apply. As described below, the Commission preliminarily believes that a principles-based rule, together with detailed acceptable practices, provides the market with appropriate guidance regarding the Commission's expectations, while allowing for some flexibility in approaches. The Commission, therefore, preliminarily concludes that the targeted requirements in the current proposal—combined with the existing Commission Regulation 1.52 independence-of-staff standards and the aforementioned proposed conflicts procedures rule—are sufficient to address the concerns identified. The Commission requests comment on this preliminary conclusion.

vii. *Request for Comment*

The Commission requests comment on all aspects of the proposed amendments to Commission Regulation 1.52, including:

1) Whether the proposed definition of "affiliate futures commission merchant"—and the related "control" formulation—captures the appropriate scope of relationships. Should the definition encompass partial ownership interests that do not rise to the level of "control"? If so, at what threshold or under what criteria?
2) Whether the proposed definition of "non-public information" is appropriately scoped. Should this concept be expressed in terms of materiality, enumerated

categories of information (e.g., customer positions, financial condition, risk-management policies), as proposed, or based on some other criteria?

3) Whether the Commission should adopt the alternative under which an SRO with an affiliate FCM would be required to designate an independent third-party DSRO for examination of all of its member FCMs, rather than only for the affiliate FCM.

4) Whether, in circumstances where the Proposal would mandate delegation of SRO or DSRO functions under Commission Regulations 1.52(c) or (d), it is reasonable for the delegating SRO to be responsible and liable for the third-party's performance on its behalf. Should the delegating SRO be subject to a strict liability standard such that any examination failure on the part of the third-party SRO is the responsibility of the delegating SRO, or, alternatively, should the delegating SRO be liable only if it is negligent in its selection of the third-party SRO?

5) Whether the part 38 carve-out, which would allow an SRO or DSRO to access or share certain non-public information to comply with part 38 obligations, is appropriately scoped, including whether additional specificity is warranted regarding the categories of non-public information access and sharing permitted under the carve-out.

6) Whether the reporting-line requirements, which would require examination staff to be insulated from commercial pressures, is appropriately calibrated, including whether the Commission should specify the level of the board or committee to which examination staff must report.

7) Whether the proposed Commission Regulation 1.52 amendments should apply to SRO oversight of affiliated entities other than FCMs (e.g., IBs or market makers).

8) Whether the Commission should afford FCMs an election of a registered futures association as DSRO at all, and whether the information-access, reporting-line, and prohibition safeguards proposed above—together with the conflicts-of-interest framework proposed elsewhere in this Proposal—would adequately address the concerns regarding a DSRO's oversight of non-affiliate FCMs that compete with its affiliate, without an election option.
9) Whether the election provision should be limited to a registered futures association, as proposed, or should instead permit an FCM to elect any SRO of which it is a member; and if an open election was permitted, what conditions should apply, including how the membership predicate and examination-standard consistency would be preserved.
10) Whether the proposed six-month minimum notice period provides an appropriate balance between an electing FCM's interest in a timely transition and a receiving DSRO's need to recruit, train, and deploy qualified examination staff; and whether a shorter or longer period would be preferable.
11) Whether the authority of the JAC to phase in clustered elections, subject to the proposed twelve-month outer limit, is appropriately calibrated to protect examination quality and DSRO staffing; whether the outer limit should be shorter or longer; and what criteria the JAC should apply in determining that a phase-in schedule is warranted.
12) Whether the proposed three-cycle minimum-duration requirement appropriately balances continuity of examination and DSRO staffing stability against an FCM's interest in revisiting its election; and whether a shorter or longer minimum duration would be preferable.
13) Whether an FCM that has elected a registered futures association should be permitted to revoke its election before the minimum duration elapses in

defined circumstances, for example, upon a change in the FCM's clearing membership or upon a material change in the circumstances that prompted the election, and, if so, what circumstances should qualify.

14) Whether the proposed election option could result in unintended consequences to a DSRO that also operates an exchange including, for example, with respect to risk management activities. For example, could the election option result in a DSRO that loses the ability to examine an FCM as a result of an election revising its DCM or DCO rulebook to require similar examinations to ensure that it receives risk management information regarding its member FCMs, ultimately resulting in duplicative examinations and surveillance?

15) Whether the proposed election option would have effects on the resources, staffing, or funding of NFA or of any other DSRO that the Commission should consider, including, whether a substantial volume of elections could affect the cost or quality of examinations; and the Commission specifically requests that NFA, CME, and any other SRO, DSRO, FCM, or market participant with relevant information describe the anticipated operational and cost effects of the proposed election option.

16) The Commission understands that DCOs conduct examinations of their clearing members apart from the obligations imposed by Commission Regulation 1.52. Will the election mechanism result in clearing members becoming subject to duplicative examinations—one by the DCO and one by a registered futures association?

The Commission specifically requests that SROs and DSROs with an affiliate FCM—and any other SRO, DSRO, FCM, or market participant with relevant information—describe:

17) The arrangements currently in place for the financial surveillance and DSRO oversight of any affiliate FCM, including the identity of the third-party SRO performing those functions and the terms (including cost) of the arrangement.

18) The reporting lines through which examination staff implementing the Commission Regulation 1.52(c) supervisory program currently report, including the highest organizational level at which that reporting line terminates and the independence of that level from commercial management of the SRO and the affiliate FCM. Whether the reporting-line requirements are consistent with existing reporting structures at SROs and DSROs.

19) The existing policies, procedures, information barriers, or technological controls governing an SRO's access to non-public information of an affiliate FCM and the SRO's sharing of non-public information obtained from the Commission Regulation 1.52(c) supervisory program with the affiliate FCM, including any exceptions for compliance with part 38 obligations.

20) The nature and estimated incremental cost of any change to existing arrangements that would be required to comply with the proposed Commission Regulation 1.52 amendments.

21) Whether the proposed definitions of "affiliate futures commission merchant," "control," and "non-public information" would capture relationships or categories of information that differ in any material respect from those addressed by existing arrangements.

B. Proposed Amendments to Commission Regulations 38.604 and 38.606—DCM Financial Surveillance of Members and Third-Party Regulatory Service Providers

i. *Background*

DCMs bear responsibility for the financial surveillance of their member FCMs under DCM Core Principle 11 (Financial Integrity of Transactions) and Commission Regulations 38.602, 38.604, and 38.605.[127] In particular, Commission Regulation 38.604 requires that a DCM "monitor members' compliance with the [DCM's] minimum financial standards" by, among other things, routinely receiving and promptly reviewing financial and related information from its members, "continuously monitor[ing] the positions of members and their customers,"[128] continually surveying the obligations of each FCM created by the positions of its customers, comparing those obligations to the financial resources of the FCM as appropriate, and taking appropriate steps to use this information to protect customer funds.[129] Commission Regulation 38.605 requires a DCM to comply with the standards of Commission Regulation 1.52 in carrying out this financial surveillance program.[130]

Commission Regulation 38.606 currently permits—but does not require—a DCM to comply with the requirements of Commission Regulations 38.604 and 38.605 through the regulatory services of an RSP.[131] Where a DCM elects to engage an RSP, Commission Regulation 38.606 requires the DCM to ensure that the RSP has the capacity and resources necessary to provide timely and effective regulatory services, including adequate staff and surveillance systems; to enter into a written agreement that specifically documents the services to be performed; and to retain ultimate responsibility for compliance with its obligations under the CEA and the Commission's regulations.[132]

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[127] CEA 5(d)(11), 7 U.S.C. 7(d)(11); 17 CFR 38.602, 38.604, 38.605.

[128] 17 CFR 38.604.

[129] 17 CFR 38.604(a)-(c).

[130] 17 CFR 38.605.

[131] 17 CFR 38.606.

[132] *Id*.

In administering Commission Regulation 38.604, Commission staff has fielded interpretative questions regarding the frequency at which a DCM must monitor positions and survey FCM obligations. The phrases "continuously monitor the positions of members and their customers" and "continually survey the obligations of each [FCM]" in current Commission Regulation 38.604 could be read to require literal real-time monitoring of trading activity. The Commission's intent in adopting those phrases was to direct DCMs to perform risk-based, intra-day assessments of the positions carried by each FCM throughout the trading day—not to impose a continuous real-time monitoring obligation.[133]

ii. *Comments on the Affiliations RFC*

The Commission sought comment on whether and how a DCM with an affiliate FCM may carry out its financial surveillance obligations under Commission Regulation 38.604 consistent with its impartiality responsibilities, what mitigants and safeguards might be appropriate, and whether existing regulations are sufficient.[134] Commenters' views fell into three categories:

Acknowledgment of potential conflicts. A number of commenters acknowledged that a DCM's financial surveillance of an affiliate FCM presents potential conflict-of-interest concerns. As described above, CME, NFA, ICE, Cboe, FIA, and Professor Filler each indicated that a DCM should not be permitted to act as DSRO for its affiliate FCM.[135] Although these comments are most directly relevant to the proposed Commission Regulation 1.52 amendments described above—which would govern the periodic supervisory and examination program—the underlying concern about partiality

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[133] *See Core Principles and Other Requirements for Designated Contract Markets*, 77 FR 36612 (June 19, 2012) (adopting Commission Regulation 38.604).

[134] *See* Affiliations RFC, *supra* note 1.

[135] CME Comment, *supra* note 99, at 14; NFA Comment, *supra* note 96, at 4; ICE Comment, *supra* note 99, at 2-3; Cboe Comment, *supra* note 99, at 3; FIA Comment, *supra* note 99, at 9-10; Filler Comment, *supra* note 99, at 8.

in supervision of an affiliated FCM applies as well to the intra-day financial surveillance required by Commission Regulation 38.604.

Views on mitigants. Commenters offered a range of views on how potential conflicts in DCM financial surveillance of an affiliate FCM might be mitigated. Several commenters supported information barriers and confidentiality controls. CME, NFA, ICE, and Professor Filler each agreed that appropriate firewalls and information barriers should be in place between a DCM and its affiliate FCM.[136] NFA emphasized the importance of separate boards of directors, separate key management personnel, information-sharing barriers, and conflict-of-interest policies.[137]

Other commenters addressed personnel and resource separations in the surveillance context. CME stated that "sufficient separation between DCM or SEF personnel performing surveillance, investigation and enforcement duties and an affiliated intermediary should be implemented and conflicts of interest policies maintained," but cautioned against "overly prescriptive rules" given the obligations that DCMs already have under the existing Core Principles to enforce rules, treat members impartially, and minimize conflicts of interest in decision-making.[138] MIAX commented that DCM and SEF affiliates should not share senior compliance and risk management personnel—including the CRO and CCO—although certain functional roles, such as cybersecurity, physical security, internal audit, and information security, present no conflicts of interest and may be shared.[139] AEGIS described its existing approach, under which its SEF compliance and surveillance staff are dedicated to the SEF and not shared with any affiliate, and the SEF's staff is segregated into separate physical office space, although

[136] CME Comment, *supra* note 99, at 14-15; NFA Comment, *supra* note 96, at 3; ICE Comment, *supra* note 99, at 3; Filler Comment, *supra* note 99, at 5.

[137] NFA Comment, *supra* note 96, at 3.

[138] CME Comment, *supra* note 99, at 16-17.

[139] MIAX/MGEX Comment, *supra* note 110, at 4, 7.

certain marketing, treasury, and technology functions are shared with affiliates pursuant to a shared-services agreement.[140] CCP Global emphasized that there should be separation of resources, including key personnel and offices, between affiliated entities.[141]

Views supporting the existing framework. Several commenters viewed the existing principles-based framework as sufficient to address concerns about a DCM's financial surveillance of an affiliate FCM. Coinbase did not believe that the affiliation between a DCM and an FCM by itself would affect financial surveillance, citing the requirements for the ROC under DCM Core Principle 16 and existing financial-oversight regulations such as Commission Regulation 38.553 applicable to FCMs and NFA.[142] MIAX described its existing internal controls—including a compliance manual that disallows treating affiliates differently than other members and an Audits and Investigations department that reports directly to the CRO, who in turn reports directly to the ROC—as a means of ensuring equal treatment of affiliated and unaffiliated participants.[143] MGEX commented that, so long as an affiliate FCM can demonstrate that it meets the applicable regulatory financial-resources requirements without access to the affiliated entity's funds, affiliation with a DCM should not pose a problem.[144] Cboe did not support new regulations limiting the sharing of personnel or office space and encouraged the Commission to continue a principles-based approach that allows for the

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[140] Letter from Andrew Furman, Chief Compliance Officer, on behalf of AEGIS SEF, LLC, to CFTC at 3-4 (Sep. 28, 2023) ("AEGIS Comment").

[141] CCP Global Comment, *supra* note 102, at 3.

[142] Letter from Faryar Shirzad, Chief Policy Officer, and Gregory Compa, Senior Director, Head of Institutional Compliance, on behalf of Coinbase Global, Inc., to CFTC, (Sep. 28, 2023) at 3, 7-8 ("Coinbase Comment").

[143] MIAX/MGEX Comment, *supra* note 110, at 5.

[144] *Id*.

flexibility necessary to address particular facts and circumstances rather than developing an entirely new framework.[145]

The Commission notes that none of the commenters specifically recommended that the Commission mandate use of an RSP under Commission Regulation 38.606 for a DCM's surveillance of its affiliate FCM. Commenters who addressed mitigation generally emphasized information barriers, personnel separations, and other structural safeguards as appropriate means of addressing the potential conflict, rather than mandatory third-party outsourcing of the intra-day financial surveillance function.

iii. *Identified Concerns*

After considering the comments, the Commission preliminarily believes that a DCM's financial surveillance of an affiliate FCM under Commission Regulation 38.604 presents potential conflicts of interest that warrant attention beyond those addressed by existing regulations.

Specifically, in monitoring the positions of an affiliate FCM, comparing those positions to the FCM's financial resources, and determining the appropriate steps to protect customer funds, a DCM exercises judgment that may be influenced—or appear to be influenced—by its commercial interest in the affiliate FCM. The decision to escalate concerns regarding the affiliate FCM's financial condition (including by contacting the FCM, the FCM's DSRO, or Commission staff under Commission Regulation 38.604(c)) is similarly subject to potential conflict or appearance of a conflict. Although the proposed amendments to Commission Regulation 1.52 described above address the periodic supervisory and examination program that an SRO conducts under Commission Regulation 1.52(c) and the Joint Audit Plan under Commission Regulation 1.52(d), the intra-day financial surveillance required by Commission Regulation 38.604 is distinct as

[145] Cboe Comment, *supra* note 99, at 3.

it involves the intraday monitoring of positions and obligations and may require intraday judgment calls about the financial integrity of FCMs and the protection of customer funds that are not present in the Commission Regulation 1.52 context.

Separately, the Commission preliminarily believes that the existing "continuously monitor" and "continually survey" language in Commission Regulation 38.604 would benefit from specifically reflecting the Commission's intent that the surveillance obligation is risk-based and intra-day, not continuous in a literal real-time sense.

iv. *Proposed Amendments*

The Commission proposes two sets of amendments to address the concerns identified above.

Clarifying Amendments to Commission Regulation 38.604.

The Commission proposes to amend Commission Regulation 38.604 regarding the frequency of the financial surveillance obligation. As proposed, Commission Regulation 38.604(a) would retain the existing requirement that a DCM monitor its members' compliance with the DCM's minimum financial standards and routinely receive and promptly review financial and related information from its members but would remove the word "continuously" from the requirement to monitor the positions of members and their customers. Instead, proposed Commission Regulation 38.604(a) would require the DCM to (1) monitor the obligations of each FCM created by the positions of its customers "throughout the day"; (2) as appropriate, compare those obligations to the financial resources of the FCM; and (3) take appropriate steps to use this information to protect customer funds.

These amendments are intended to confirm that the surveillance obligation requires intra-day, risk-based monitoring—taking into account factors such as the size of an FCM and its customers' positions, the margin required on open positions, market volatility, the capital levels of an FCM, and the amount of excess segregated funds held by the FCM—rather than literal real-time monitoring of every trade. The Commission preliminarily believes that this clarification codifies existing Commission expectations and market practices and is appropriate independent of the affiliate-FCM context, although it has practical importance for that context as well.

New Conflicts Procedures Requirements—Proposed amendments to Commission Regulation 38.606.

The Commission proposes to amend Commission Regulation 38.606 to add a new paragraph providing that a DCM that has an affiliate FCM (as defined in proposed Commission Regulation 1.52(a)(3)) may comply with the requirements of Commission Regulation 38.604 by designating an independent third-party RSP, and that if such a DCM does not engage an independent third-party RSP, the DCM must have procedures for identifying, addressing, and managing conflicts of interests involving its affiliate FCM that may arise in connection with the DCM's obligations under Commission Regulation 38.604. The amendments would further provide that such procedures must address, at a minimum: (1) applications and systems, such that a DCM's applications and systems are maintained and operated in a manner that prevents the sharing of non-public information with any affiliate FCM; (2) personnel, such that a DCM does not share staff with any affiliate FCM, except with respect to administrative functions; (3) office space, such that a DCM maintains office space for itself that is separate from the office space of any affiliate FCM; (4) documentation, such that a DCM documents all conflicts of interest that arise with respect to an affiliate FCM and how any such conflict of interest is resolved; and (5) disclosures, such that a DCM provides disclosure of the existence of an affiliate FCM in its rulebook and in a clear, prominent, and readily available manner on its website and any other application portal or similar means through which a DCM directly or indirectly connects electronically with its market participants.

This Proposal would not require a DCM with an affiliate FCM to engage an RSP for Commission Regulation 38.604 purposes. The Commission preliminarily believes—in part based on the comments described above—that a principles-based conflicts mitigation requirement, leaving the DCM with the choice between (i) outsourcing Commission regulation 38.604 surveillance to an independent third-party RSP and (ii) implementing procedures to address the conflicts arising from in-house Commission Regulation 38.604 surveillance of an affiliate FCM, would appropriately accommodate the range of arrangements that DCMs may adopt to satisfy DCM Core Principle 11 with respect to affiliated FCMs. This approach is consistent with the principles-based posture recommended by Cboe and is informed by the structural-safeguard recommendations of CME, NFA, MIAX, AEGIS, and CCP Global.

The proposed approach is intended to operate alongside, rather than duplicate, the proposed Commission Regulation 1.52 requirements described above. The proposed Commission Regulation 1.52 changes would require an SRO with an affiliate FCM to designate an independent third-party SRO to conduct the periodic supervisory program and prohibit the SRO from acting as DSRO for the affiliate FCM. The proposed Commission Regulation 38.606 amendment, by contrast, would govern the distinct intra-day financial surveillance function under Commission Regulation 38.604 and would leave the DCM with discretion to determine how best to address the related conflicts.

The Commission also is proposing to amend Appendix B to part 38 to provide DCMs with guidance regarding the Commission's views concerning acceptable practices for conflict-of-interest procedures. The current guidance provided with respect to Core Principle 16 (conflicts of interest) in Appendix B to part 38 notes that DCMs "bear special responsibility to regulate effectively, impartially, and with due consideration of the public interest" and that they "should be particularly vigilant for such conflicts between and among any of their self-regulatory responsibilities, their commercial interests, and the several interests of their management, members, owners, customers and market participants, other industry participants, and other constituencies."[146] The Appendix provides various acceptable practices to manage conflicts of interest. This proposal would add guidance regarding appropriate separations between a DCM and an affiliate market participant (described below and including an affiliate FCM) as follows:

Separate systems. The guidance would provide that a DCM's applications and systems should be maintained and operated in a manner that prevents the sharing of non-public information with any affiliate FCM, with a carveout to allow such sharing if the DCM shares such non-public information with all of the DCM's market participants or if the information relates only to the affiliate FCM or the affiliate FCM's customers. The guidance would provide further color on appropriate systems separations including that a DCM should: (1) keep logically separate its trading platform, surveillance systems and recordkeeping systems from an affiliate FCM's applications and systems; (2) apply controls across all other applications, information and systems to prevent improper sharing of non-public information with an affiliate FCM; and (3) monitor for instances where an affiliate FCM has gained access to the DCM's applications, information, or systems.

Separate personnel. The guidance would provide that a DCM should not share staff with an affiliate FCM, with the exception of administrative staff (for example, accounting, human resources and payroll staff) and technology staff responsible for Core Principle 20 (Systems Safeguards) functions.

Separate office space. In order to prevent the inappropriate sharing of non-public information, the guidance would provide that a DCM should establish office space for itself that is separate from the office space of any affiliate FCM, and that the separation

[146] CFR 17 part 38, app. B.

should include physical barriers and the ability of the DCM to monitor for any instances where an affiliate FCM has gained physical access to the DCM.

The Commission preliminarily believes that this guidance sets out best practices with respect to mitigating conflicts of interest between affiliates. The core of the proposed guidance, together with the proposed rule amendments, recommends physical separations between affiliates' systems, personnel, and offices. The Commission preliminarily believes that such separations will reduce the possibility of affiliates and their personnel from inappropriately sharing non-public information. Furthermore, the Commission preliminarily believes that such separations will provide other market participants with confidence regarding the DCM's ability to manage conflicts.

The Commission requests comment on all aspects of the proposed guidance. The Commission specifically requests comment on whether each aspect of the proposed guidance is adequate or, instead, should be modified or removed, and if the Commission should provide specific guidance with respect to any other aspects of a conflicts of interest program.

v. *Statutory Authority*

The Commission proposes the amendments to Commission Regulations 38.604 and 38.606 pursuant to section 8a(5) of the Act, which authorizes the Commission to promulgate such rules and regulations as, in its judgment, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of the Act[147] and DCM Core Principles 11 (Financial Integrity of Transactions) and 16 (Conflicts of Interest). Core Principle 11 requires each DCM to establish and enforce rules and procedures for ensuring the financial integrity of transactions entered into on or through the facilities of the contract market and for the protection of customer and member

[147] CEA 8a(5), 7 U.S.C. 12a(5).

property. Core Principle 16, in turn, requires each DCM to "establish and enforce rules to minimize conflicts of interest in the decision-making process of the contract market and establish a process for resolving [such] conflicts of interest." Under section 5(d)(1)(B) of the Act, as amended by section 735(b) of the Dodd-Frank Act, a DCM has reasonable discretion in establishing the manner in which it complies with the Core Principles "unless otherwise determined by the Commission by rule or regulation."[148] That reservation supplies the affirmative authority for the Commission to specify particular means of compliance where a specific circumstance not adequately addressed by the general Core Principle formulation warrants targeted regulation. Section 5c(a)(1) of the Act further authorizes the Commission to issue interpretations of the DCM Core Principles to describe acceptable business practices, on a non-exclusive basis.[149]

The proposed amendments exercise those authorities to address a discrete conflict of interest—a DCM's financial surveillance of an affiliate FCM—that the general Core Principle 11 framework, and the current §§ 38.604 and 38.606 implementing regulations, do not specifically address. The Commission preliminarily believes that the proposed amendments neither displace the DCM's reasonable discretion in complying with the Core Principles nor exceed the Commission's statutory authority under section 8a(5) and section 5(d).

vi. *Alternatives Considered*

The Commission considered, and requests comment on, two alternatives to the proposed approach.

1. Mandatory independent third-party RSP for affiliated-FCM surveillance

The Commission considered requiring a DCM with an affiliate FCM to designate an independent third-party RSP to perform Commission Regulation 38.604 financial

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

[149] CEA 5c(a)(1), 7 U.S.C. 7a-2(a)(1)-(2).

surveillance of that affiliate FCM. The Commission preliminarily concluded that the principles-based approach reflected in proposed amendments to Commission Regulation 38.606—combined with the proposed Appendix B guidance—would be sufficient to address the identified concerns at lower cost and is consistent with the principles-based mitigation approach favored by many commenters. The Commission requests comment on whether a mandatory independent third-party RSP requirement for Commission Regulation 38.604 compliance purposes is necessary or appropriate.

2. *Prescriptive separation requirements in rule text*

The Commission considered further codifying in rule text the specific separations that the Commission considers appropriate for a DCM that performs Commission Regulation 38.604 surveillance of an affiliate FCM in-house. This approach would give effect to the structural-separation recommendations of certain commenters,[150] but would not accommodate the principles-based flexibility favored by others.[151] The Commission preliminarily concluded that adding Appendix B guidance, rather than new rule text, provides DCMs with appropriate flexibility to design conflicts of interest procedures suited to their specific organizational structures and operational arrangements while providing market participants with information on what the Commission considers to be appropriate conflicts of interest procedures. The Commission requests comment on whether some or all of the Appendix B content should be codified in rule text instead.

vii. *Request for Comment*

The Commission requests comment on all aspects of the proposed amendments to Commission Regulations 38.604 and 38.606 including:

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[150] *See, e.g.*, MIAX/MGEX Comment, *supra* note 110, at 4, 7 (no shared senior compliance or risk personnel); AEGIS Comment, *supra* note 140, at 3-4 (separate physical office space); CCP Global Comment, *supra* note 102, at 3 (separation of resources including key personnel and offices); NFA Comment, *supra* note 96, at 3 (separate boards and key management personnel).

[151] *See, e.g.*, Cboe Comment, supra note 99, at 3; CME Comment, *supra* note 99, at 16-17 (urging the Commission not to implement overly prescriptive rules).

22) Whether the clarifying amendments to Commission Regulation 38.604—including the removal of the word "continuously" and the substitution of "throughout the day"—appropriately capture the Commission's intent regarding the frequency and risk-based nature of the intra-day financial surveillance requirement.

23) Whether the principles-based approach in proposed Commission Regulation 38.606 is appropriately calibrated, including whether the proposed regulation should specify additional procedural elements that a DCM electing to conduct in-house Commission Regulation 38.604 surveillance of an affiliate FCM must include in its conflicts of interest procedures.

24) Whether the Commission should adopt the alternative under which a DCM with an affiliate FCM would be required to designate an independent third-party RSP for Commission Regulation 38.604 surveillance of the affiliate FCM.

25) Whether the Commission should adopt the alternative under which additional separation requirements would be codified in the rule text.

The Commission also specifically requests that DCMs with an affiliate FCM—and any other DCM, FCM, or market participant with relevant information—describe:

26) Whether the DCM currently engages an RSP for Commission Regulation 38.604 purposes (including for surveillance of an affiliate FCM); and if so, the identity of the RSP and the terms (including cost) of the arrangement;

27) Where the DCM conducts Commission Regulation 38.604 surveillance in-house, the policies, procedures, organization separations, and other measures currently in place to address potential conflicts of interest arising from financial surveillance of an affiliate FCM;

28) The nature and estimated incremental cost of any change to existing arrangements that would be required to comply with Commission Regulation 38.606 as proposed; and

29) The nature and estimated incremental cost of complying with the mandatory independent third-party RSP alternative described above, including any market-capacity considerations that would arise if additional DCMs were required to engage NFA or another RSP for Commission Regulation 38.604 surveillance of affiliate FCMs.

III. Exchange-Related Conflicts Mitigation.

DCM Core Principle 16 and SEF Core Principle 12 each require an exchange to establish and enforce rules to minimize conflicts of interest in its decision-making process.[152] This section of the Proposal addresses conflicts of interest that arise when a DCM or SEF is affiliated with a market participant that directly or indirectly executes, introduces, or otherwise facilitates trades on that exchange. Two distinct kinds of affiliation are at issue, and the distinction between them is central to the regulatory approach the Commission proposes. The first is an affiliation between an exchange and an intermediary—such as an FCM or IB—that acts on behalf of customers. The second is an affiliation between an exchange and a principal trading firm, such as a hedge fund or market maker, that trades for its own account on the exchange. As discussed below, an affiliated intermediary acts as agent for customers, whereas an affiliate principal trading firm trades as principal; every transaction the latter executes against an unaffiliated participant implicates the exchange's own economic interests directly. The Commission preliminarily believes these two affiliations present conflicts that differ in kind and proposes to address them through two distinct mechanisms: a principles-based conflicts-

[152] CEA 5(d)(16), 7 U.S.C. 7(d)(16) (DCM Core Principle 16); CEA 5h(f)(12), 7 U.S.C. 7b-3(f)(12) (SEF Core Principle 12).

of-interest framework applicable to any affiliate market participant, and, for an affiliate principal trading firm, a more prescriptive set of requirements. This section of the Proposal also addresses conflicts of interest matters related to DCM board composition, ROCs, and disciplinary panels.

A. Proposed New Commission Regulations 38.852 and 37.1201—Conflicts of Interest Involving an Affiliate Market Participant

i. *Background*

DCM Core Principle 16 directs each DCM to establish and enforce rules to minimize conflicts of interest in its decision-making process and to establish a process for resolving such conflicts of interest.[153] The Commission's guidance and acceptable practices for Core Principle 16 appear in Appendix B to part 38.[154] SEF Core Principle 12 imposes a parallel obligation on each SEF to minimize conflicts of interest in its decision-making process and to establish a process for resolving them.[155] Both Core Principles are principles based: the exchange must minimize conflicts in its decision-making and have a process to resolve them, but the manner in which it does so is left to the exchange's reasonable discretion, subject to the Commission's rules and informed by Commission guidance and acceptable practices.[156]

Neither Core Principle, however, specifically addresses the conflicts of interest that arise when the exchange is affiliated with one of its own market participants. Appendix B to part 38 speaks to conflicts between a DCM's self-regulatory responsibilities and its commercial interests generally, but neither the part 38 regulations

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[153] CEA 5(d)(16), 7 U.S.C. 7(d)(16) (DCM Core Principle 16).

[154] 17 CFR part 38, app. B, Core Principle 16. app. B currently does not provide any guidance with respect to compliance with Core Principle 16.

[155] CEA 5h(f)(12), 7 U.S.C. 7b-3(f)(12) (SEF Core Principle 12); 17 CFR part 37 2.

[156] *See* CEA 5(d)(1)(B), 7 U.S.C. 7(d)(1)(B) (DCM reasonable discretion); CEA 5h(f)(1)(B), 7 U.S.C. 7b-3(f)(1)(B) (SEF reasonable discretion).

nor the part 38 guidance specifically addresses conflicts arising from an exchange's affiliation with an FCM, IB, or principal trading firm participating on its market.

ii. *Comments on the Affiliations RFC*

The Commission received substantial comment in response to the 2023 Affiliations RFC on conflicts arising from an exchange's affiliation with a market participant.[157] Commenters generally agreed that affiliations between an exchange and a market participant can create conflicts of interest warranting management, but a substantial majority favored addressing those conflicts through a principles-based framework rather than prescriptive structural requirements or an outright prohibition.

Views supporting a principles-based framework. Commenters that operate exchanges with affiliated intermediaries trading on their markets and others urged the Commission to address potential conflicts through a principles-based approach with accompanying guidance rather than prescriptive rules. AEGIS, which operates a SEF affiliated with a CTA and IB that executes transactions on the SEF, described the existing combination of regulations and the registration process as "effective in avoiding conflicts of interest."[158] The Wholesale Markets Brokers' Association, Americas ("WMBAA"), whose members operate SEFs with affiliated IBs, similarly commented that the matters raised in the RFC "are addressed by current CFTC regulations and current market practices" and cautioned that an "overly prescriptive implementation of the Core Principles" could "dissuade future entrants into the swaps market and reduce competition."[159]

Cboe, which operates DCMs, a SEF, and DCO, commented that "existing CFTC regulations provide an appropriate, principles-based framework" for evaluating and

[157] Affiliations RFC, *supra* note 1.

[158] AEGIS Comment, *supra* note 140, at 1.

[159] Letter from Shawn Bernardo, on behalf of WMBAA, to CFTC at 2 (Sep. 28, 2023) ("WMBAA Comment").

disclosing the risks associated with intermediary affiliations and urged the Commission to "continue embracing a principles-based approach that allows for necessary flexibility to address particular facts and circumstances rather than develop an entirely new framework."[160] Coinbase observed that existing law and regulations already "prohibit DCMs from engaging in anticompetitive behavior and require them to maintain impartial access to their market, enforce their rulebooks consistently across participants, maintain adequate staffing, safeguard confidential information and manage conflicts of interest" and encouraged the Commission to revise existing provisions "only to the extent that" a gap is identified, rather than adopt "overly prescriptive regulations."[161] CCP Global, while stating that it "does not believe that the CFTC should deviate from its principles-based approach," suggested it "could be beneficial" for the Commission to provide additional guidance—for example, "an illustrative list of conflicts to be mitigated, managed, and/or disclosed and a list of tools that entities may use to mitigate these conflicts."[162] CME, while cautioning the Commission "against adopting comprehensive and prescriptive rules" and emphasizing that the existing principles-based approach "has worked well" supported "requiring a marketplace SRO that is affiliate with an FCM (or other CFTC registrant) to adopt and implement rules, policies, and/or procedures to assure that its operations and those of the CFTC registrant are sufficiently separated."[163]

Views on specific mitigants and disclosures. Some commenters described the specific separations, safeguards, and disclosures they viewed as appropriate, and many reported that such measures are already standard market practice. AEGIS described an approach under which staff responsible for compliance and surveillance are "dedicated to the SEF and not shared with any affiliate" and are "segregated into separate physical"

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[160] Cboe Comment, *supra* note 99, at 2.

[161] Coinbase Comment, *supra* note 142, at 2.

[162] CCP Global, *supra* note 102, at 2.

[163] CME Comment, *supra* note 99, at 1, 4.

office space, with certain marketing, treasury, and technology functions shared with affiliates only pursuant to a CFTC-reviewed shared-services agreement; it also described independent governance through a SEF board and regulatory oversight committee with public directors, the use of a third-party RSP for trade-practice surveillance, and public disclosure of its affiliated broker firm.[164] WMBAA reported that its members' SEFs manage affiliated-intermediary conflicts through "rulebooks, distinct and transparent governance structures and operational policies," a third-party RSP, and "data separation barriers," while emphasizing the cost and efficiency benefits of "properly segmented" shared resources.[165] CCP Global emphasized that an affiliate FCM should "neither be afforded preferential treatment, nor be disadvantaged or subject to more restrictive treatment" relative to unaffiliated FCMs, and should be subject to the "same access criteria and rules as non-affiliated" members "in areas including, but not limited to, fees, surveillance, and disciplinary processes"; it further supported "separation of resources, including key personnel, offices, and information systems" and robust information barriers.[166]

MIAX identified a "well-conceived, thorough, and rigorously enforced" information-barrier policy; a prohibition on affiliates sharing "senior compliance and risk management personnel, such as the Chief Risk Officer, the Chief Compliance Officer, and the Chief Regulatory Officer"; physically and logically separate information-technology systems and separate office space; and a public rule that the affiliate "will not receive preferential treatment in any respect" disclosed on its website.[167] It identified cybersecurity, physical security, internal audit, and information security as functions that

[164] AEGIS Comment, *supra* note 140, at 1.

[165] WMBAA Comment, *supra* note 159, at 4-5.

[166] CCP Global Comment, *supra* note 102, at 3.

[167] MIAX/MGEX Comment, *supra* note 110, at 4, 15.

may be shared without conflict.[168] CME recommended that an affiliated registrant's operations be "sufficiently separated" from the exchange's and agreed that the exchange should adopt firewalls and internal procedures to prevent the affiliate from accessing confidential information held by exchange staff.[169]

Regarding disclosure, MIAX and AEGIS each described public disclosure of the affiliate relationship as their existing practice, and CCP Global, Cboe, and Coinbase each treated transparency regarding the affiliation as an element of an adequate conflicts framework.[170]

Views opposing affiliation. Public Citizen and Better Markets opposed permitting exchange-affiliate relationships, with Public Citizen taking the view that the conflicts "cannot be successfully mitigated" and that the Commission "must therefore establish rules prohibiting" such affiliations, and Better Markets opposing affiliation structures generally while recommending robust disclosure and conflicts-of-interest requirements if the Commission permits such structures.[171]

Views distinguishing agents from principals. Finally, several commenters distinguished an affiliated intermediary that acts as an agent for customers from an affiliated firm that trades on a proprietary basis on the exchange. CME distinguished between an affiliate FCM that "acts solely on an agency basis" and a trading firm that "trades on a proprietary basis on the DCM," observing that the latter "raises conflict of interest concerns of a very different type and magnitude."[172] Cboe questioned whether a

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[168] *Id*.

[169] CME Comment, *supra* note 99, at 4, 15.

[170] MIAX/MGEX Comment, *supra* note 110, at 5 & n.13; AEGIS Comment, supra note 140, at 1; CCP Global Comment, *supra* note 102, at 2-3; Cboe Comment, *supra* note 99, at 2; Coinbase Comment, *supra* note 142, at 2.

[171] *See* Letter from Tyson Slocum, Energy Program Director, on behalf of Public Citizen, Inc., to the CFTC at 1-2 (Sep. 28, 2023) (hereinafter "Public Citizen Comment"); Letter from Cantrell Dumas, Director of Derivatives Policy, on behalf of Better Markets, Inc., to the CFTC at 1, 4 (Sep. 28, 2023) (hereinafter "Better Markets Comment").

[172] CME Comment, *supra* note 99, at 3, 5.

DCM or SEF should be permitted to have an affiliated liquidity provider trade on its market.[173] And Coinbase observed that the degree of conflict "varies depending on whether the trader is trading on behalf of others . . . or whether the trader is solely trading for its own profit."[174]

iii. *Identified Concerns*

After considering the comments described above, the Commission preliminarily identifies the following concerns with respect to an exchange's affiliation with a market participant.

First, an exchange exercises substantial discretion across functions that bear directly on the competitive position of its market participants. That discretion includes market and trade-practice surveillance, investigations and rule enforcement, product listing decisions, and fee and incentive arrangements. Where the exchange is affiliated with a market participant, the structural incentive to exercise that discretion in a manner that favors the affiliate, or that disadvantages the affiliate's competitors, can compromise the exchange's role as a neutral, self-regulatory operator of the market.

Second, an exchange acquires non-public information about its market participants—including regarding order flow and positions, and, through its surveillance and examination functions, financial and risk information. Affiliation creates the risk that such information could be shared with, or used to benefit, the exchange's affiliate. As several commenters recognized, robust information barriers between the exchange and its affiliate are a principal safeguard against this risk; unaffiliated participants may be reluctant to provide non-public information to an exchange if they perceive that it could reach a competitor.

[173] Cboe Comment, *supra* note 99, at 3.

[174] Coinbase Comment, *supra* note 142, at 7.

Third, even where an exchange in fact treats it affiliate on an arms-length basis, the Commission believes that the perception of preferential treatment can itself have anti-competitive effects and understands that many market participants share this concern. Unaffiliated participants may conclude that they are systematically disadvantaged in surveillance, enforcement, listing, trading or fee decisions, and may direct activity away from the venue, undermining the integrity of the exchange as a market-neutral operator. It is possible that unaffiliated participants may decide not to trade due to perceived unfairness, which could have a negative impact on liquidity, or that non-affiliate participants may have to trade on certain venues—in some cases due to a lack of viable alternatives—despite these concerns.

The Commission preliminarily believes these concerns warrant Commission action and that the Commission's existing regulations and guidance are not sufficient. At the same time, the Commission is preliminarily persuaded by the substantial body of comment indicating that exchanges with affiliated market participants generally already maintain the kinds of governance separations, information barriers, and disclosures that mitigate these concerns. The Commission's proposed approach, described below, is calibrated accordingly.[175]

iv. *Proposed Amendments*

The Commission proposes to add a new Commission Regulation 38.852 to part 38 and a parallel new Commission Regulation 37.1201 to part 37, each establishing a principles-based requirement that an exchange with an affiliate market participant

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[175] The mission of the Commodity Futures Trading Commission is to promote the integrity, resilience, and vibrancy of the U.S. derivatives markets through sound regulation. *See* Mission Statement, available at *https://www.cftc.gov/About/AboutTheCommission*. *See also* Chairman Michael Selig's April 1, 2026 public statement that "regulators must be disciplined enough to administer the minimum effective dose of regulation, otherwise innovation moves elsewhere and our nation suffers the consequences," available at *https://www.cftc.gov/PressRoom/SpeechesTestimony/seligstatement040126*.

maintain procedures to identify, address, and manage the related conflicts of interest, together with conforming acceptable practices in Appendix B to each part.

Definition of "affiliate market participant"—Proposed Commission Regulations 38.852(a), 37.1201(a).

Proposed Commission Regulation 38.852(a) would define "affiliate market participant" as any person (including any affiliate FCM or affiliate principal trading firm) that (i) directly or indirectly executes, introduces, or otherwise facilitates trades on or subject to the rules of the DCM, and (ii) directly or indirectly controls, is controlled by, or is under common control with the DCM. Proposed Commission Regulation 37.1201(a) would adopt a parallel definition for SEFs that additionally enumerates an affiliate introducing broker, reflecting the central role of introducing brokers in the SEF market structure. Each definition uses the same "control"-based formulation the Commission proposes to use for the parallel definitions of "affiliate futures commission merchant" and "affiliate clearing member".[176]

The Commission preliminarily believes that a control-based definition, rather than a fixed ownership-percentage threshold, is appropriate because the relevant conflicts turn on the power to direct management and policies rather than on any particular equity stake, and that consistency across the parallel definitions will promote clarity and ease of compliance for corporate groups with multiple CFTC-registered entities.[177] The Commission solicits comment on the proposed definition.

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[176] *See supra* Sec. II.A.iv.a, *infra* Sec. IV.D.

[177] The terms "affiliate" and "affiliated" are consistent with how the Commission has defined such terms elsewhere in its regulations, including Commission Regulations 49.2 and 23.23(a)(1). The Commission also believes that its definition is generally consistent with how SEFs and DCMs have defined the term "affiliate" in their rulebooks. See, e.g., LedgerX LLC (d/b/a MIAX Derivatives Exchange) (defining affiliate as "a Person who, directly or indirectly, controls, is controlled by, or is under common control with another Person"); Kalshi LLC (defining affiliate as, with respect to any Person, any Person who, directly or indirectly, Controls, is Controlled by, or is under common Control with, such other Person"); AEGIS SEF (defining affiliate as "a Person who directly or indirectly, controls, is controlled by, or is under common control with another Person"); BGC SEF (defining Affiliate as any other Person which directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, such Person.").

Principles-based conflicts requirement—Proposed Commission Regulations 38.852(b), 37.1201(b).

Proposed Commission Regulation 38.852(b)(1) would require that a DCM have procedures for identifying, addressing, and managing conflicts of interest involving an affiliate market participant. The proposed regulation would further require that such procedures address, at a minimum, applications and systems, personnel, office space, documentation of conflicts, and disclosures. Proposed Commission Regulation 37.1201(b) would impose the identical requirement on a SEF. This formulation parallels the requirement the Commission proposes below for DCOs in proposed Commission Regulation 39.25(d) and the existing procedures-based formulation in Commission Regulation 39.25(c).[178]

The Commission preliminarily believes a principles-based requirement is preferable to prescriptive structural separation rules in this context. Whether an exchange has an affiliate market participant is an objective inquiry, as is whether the exchange maintains procedures to identify, address, and manage the associated conflicts, including with respect to the specifically enumerated categories. The Commission can examine for compliance, and the requirement places the burden on the exchange to design and implement procedures suited to its particular structure and risk profile. This approach is consistent with the principles-based posture favored by most commenters and is informed by the specific safeguards that exchanges with affiliated participants report already maintaining.

Acceptable practices—Appendix B to parts 37 and 38.

The Commission proposes to add conforming acceptable practices to Appendix B of both parts 37 and 38, identifying the separations the Commission would consider

[178] *See infra* Sec. IV.D.

appropriate for an exchange with an affiliate market participant. This Proposal would add guidance regarding appropriate separations between a DCM or a SEF and an affiliate market participant as follows:

Separate systems. The guidance would provide that a DCM's or SEF's applications and systems should be maintained and operated in a manner that prevents the sharing of non-public information with any affiliate market participant, with a carveout to allow such sharing if the DCM or SEF shares such non-public information with all of the DCM's or SEF's market participants or if the information relates only to the affiliate market participant or the affiliate market participants customer's. The guidance would provide further color on appropriate systems separations including that a DCM or SEF should: (1) keep logically separate its trading platform, surveillance systems and recordkeeping systems from an affiliate market participant's applications and systems; (2) apply controls across all other applications and systems to prevent improper sharing of non-public information with an affiliate market participant; and (3) monitor for instances where an affiliate market participant has gained access to the DCM's applications, information, or systems.

Separate personnel. The guidance would provide that a DCM or SEF should not share staff with an affiliate market participant, with the exception of administrative staff (for example, accounting, human resources, and payroll staff) and technology staff responsible for Core Principle 20 (or 14, with respect to SEFs) (Systems Safeguards) functions. The Commission preliminarily believes that legal and compliance personnel do not constitute administrative staff for these purposes, such that a DCM or a SEF would not be able to share such personnel with an affiliate market participant. The Commission requests comment on the appropriate classification of legal and compliance staff.

Separate office space. In order to prevent the inappropriate sharing of non-public information, the guidance would provide that a DCM or SEF should establish office space for itself that is separate from the office space of any affiliate market participant, and that the separation should include physical barriers and the ability of the DCM or SEF to monitor for any instances where an affiliate market participant has gained physical access to the DCM or SEF.

As described above, the Commission preliminarily believes that this guidance sets out best practices with respect to mitigating conflicts of interest between an exchange and an affiliate market participant. The core of the proposed guidance recommends physical separations between affiliates' systems, personnel, and offices. The Commission preliminarily believes that such separations will reduce the possibility of affiliates and their personnel from inappropriately sharing non-public information of an unaffiliated market participant, which the Commission understands to be a core concern of such unaffiliated market participants. Furthermore, the Commission preliminarily believes that such separations will provide unaffiliated market participants with confidence regarding a DCM's or SEF's ability to manage conflicts.

The Commission preliminarily believes that placing these additional details in acceptable practices, rather than in rule text, gives exchanges clear notice of the Commission's expectations and appropriate flexibility to design conflicts procedures suited to their own structures.

v. *Statutory Authority*

The Commission proposes Commission Regulations 38.852 and 37.1201 pursuant to its authority under DCM Core Principle 16 and SEF Core Principle 12, respectively—each of which directs the exchange to "establish and enforce rules to minimize conflicts of interest in [its] decision-making process" and "establish a process for resolving such conflicts of interest"—and its general rulemaking authority under CEA section 8a(5) 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 this Act."[179] The conflicts of interest addressed by proposed Commission Regulations 38.852 and 37.1201 also implicate additional Core Principle obligations under which the Commission has authority to regulate: DCM Core Principle 12 and SEF Core Principle 3 direct exchanges to establish and enforce rules to protect markets and market participants from abusive practices and to promote fair and equitable trading, and DCM Core Principle 9 directs each contract market to provide a competitive, open, and efficient market.[180] The exchange's exercise of surveillance, listing, and fee authority in a manner that favors an affiliated intermediary bears directly on each of these obligations, and the proposed conflicts framework supports the exchange's compliance with all of them.

Additionally, the Core Principles establish that, "[u]nless otherwise determined by the Commission by rule or regulation," each exchange has "reasonable direction in establishing the manner" in which it complies.[181] The reasonable-discretion clause expressly contemplates that the Commission may specify the manner of compliance by rule or regulation, and thereby authorizes proposed Commission Regulations 38.852 and 37.1201, which require the exchange to maintain conflicts procedures without dictating their content.

vi. *Alternatives Considered*

The Commission considered, and requests comment on, several alternatives to the proposed principles-based approach.

1. Additional prescriptive separation requirements in rule text

The Commission considered codifying additional specific separation requirements—including dedicated systems, dedicated staff, and separate physical

[179] CEA 5(d)(16), 7 U.S.C. 7(d)(16); CEA 5h(f)(12), 7 U.S.C. 7b-3(f)(12); CEA 8a(5), 7 U.S.C. 12a(5).

[180] CEA 5(d)(12), 7 U.S.C. 7(d)(12); CEA 5(d)(9), 7 U.S.C. 7(d)(9); CEA 5h(f)(2), 7 U.S.C. 7b-3(f)(2).

[181] CEA 5(d)(1)(B), 7 U.S.C. 7(d)(1)(B); CEA 5h(f)(1)(B), 7 U.S.C. 7b-3(f)(1)(B).

locations—in rule text rather than as guidance regarding acceptable practices. The Commission preliminarily declines to adopt it, principally because the record indicates that exchanges with affiliated participants already maintain such separations and that a prescriptive mandate could impose costs (such as restricting firms from taking reasonable approaches that vary from those set out in the acceptable practices) without corresponding benefit and deter entry and competition. Moreover, the Commission understands that it regulates an evolving industry with unique market structures and it wants to support innovation. The Commission requests comment on whether some or all of the acceptable practices should instead be codified in rule text.

2. Prohibition

The Commission considered, but preliminarily declines to propose, a prohibition on exchange-affiliate relationships. The Commission preliminarily concludes that affiliations involving an intermediary can produce efficiencies and competitive benefits, including with respect to market access and liquidity, that the CEA does not bar them, and that conflicts procedures and disclosure as provided in the proposed Acceptable Practices adequately mitigate the relevant risks. The Commission requests comment on this alternative.

vii. *Request for Comment*

The Commission requests comment on all aspects of proposed Commission Regulations 38.852 and 37.1201 and the conforming acceptable practices, including:

30) This Proposal generally applies to FCM and IB intermediaries, as well as market participants such as principal trading firms, market makers, and liquidity providers. Should the scope be expanded to specifically refer to any other types of entities? If so, please identify and explain.

31) Whether the proposed definition of "affiliate market participant"—and the related "control" formulation—captures the appropriate scope of relationships.

Should the definition reach partial ownership interests that do not rise to "control"? Should the SEF definition's express inclusion of an affiliate introducing broker be mirrored in the DCM definition?

32) Whether the principles-based formulation in proposed Commission Regulations 38.852(b)(1) and 37.1201(b) is appropriately calibrated, or whether the rule text should instead enumerate additional specific procedures an exchange must adopt. If applicable, please specify which Acceptable Practices should be moved to regulation text.

33) Whether the proposed Acceptable Practices are complete and appropriately scoped.

34) Whether DCMs and SEFs should be able to share legal and compliance staff with an affiliate market participant.

35) Whether any additional disclosures should be required. If so, please specify the nature of such additional proposed disclosure.

36) Whether the proposed approach should differ as between a DCM and a SEF, and whether the SEF context in particular warrants any distinct treatment given the nature of the market participants typically active on a SEF versus those on a DCM. Conversely, given that retail participation is prevalent on some DCMs, does the nature of such participants warrant any distinct treatment?

37) The Commission preliminarily understands that the proposed requirements are consistent with existing practice at exchanges that have an affiliate market participant. The Commission requests comment on whether this understanding is correct, and requests that such exchanges describe the policies, procedures, governance separations, information barriers, and disclosures currently in

place, and the nature and estimated incremental cost of any change required to comply with the Proposal as drafted.

38) Are there benefits of affiliations between exchanges and market participants, such as enhanced liquidity, broader market options for customers, resource efficiencies, and increased competition and innovation that the Commission has not described in this Proposal? If so, please describe.

B. Proposed New Commission Regulations 38.852(b) and (c)—Prohibition on Affiliate Principal Trading Firms and Conditional Affiliate Market Maker Exception

i. *Background*

DCM Core Principle 16 requires each DCM to establish and enforce rules to minimize conflicts of interest in its decision-making process and to establish a process for resolving them.[182] DCM Core Principle 12 separately requires a DCM to establish and enforce rules to protect the market and market participants from abusive practices and to promote fair and equitable trading.[183] Each Core Principle is principles-based, and a DCM ordinarily has reasonable discretion in establishing the manner in which it complies.[184] That discretion applies, however, only "[u]nless otherwise determined by the Commission by rule or regulation."[185] The Commission may therefore prescribe by rule the manner in which a DCM complies with Core Principles 12 and 16 where it determines that general exchange discretion would not adequately address a particular conflict. [186]

[182] CEA 5(d)(16), 7 U.S.C. 7(d)(16).

[183] CEA 5(d)(12), 7 U.S.C. 7(d)(12).

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

[185] CEA 5(d)(1)(A)-(B), 7 U.S.C. 7(d)(1)(A)-(B) (discretion limited by Commission rule or regulation).

[186] Part 38 already contains many implementing regulations. *See e.g.* Commission Regulations 38.151-38.159, and 38.251-38.258.

Section III.A addressed, through a principles-based framework, the conflicts that arise when a DCM is affiliated with a market participant generally. An affiliate that trades as principal for its own account on an affiliated exchange presents a conflict that differs in kind. An affiliated FCM or IB acts as agent and stands between the exchange and its customers that trade on an exchange; an affiliate principal trading firm is itself a trading counterparty on the exchange. Each transaction it executes against an unaffiliated market participant situates the exchange's own affiliate as a counterparty to a trade with a participant the exchange is simultaneously obligated to, among other things, treat impartially.

In the response to the Affiliations RFC, CME characterized an exchange's affiliation with a proprietary trading firm as presenting the "most acute" risks and as an "inherent and stark conflict arising from a firm trading its own account on its affiliated exchange."[187] CME accordingly urged the Commission to consider "stringent restrictions and heightened supervisory obligations" on a DCM that permits an affiliate to trade for its own account.[188] Cboe questioned whether there is any need to permit an affiliate liquidity provider to trade on an exchange on an ongoing basis, observing that an exchange can instead incentivize unaffiliated liquidity providers through incentive-program rule filings.[189]

Neither Core Principles 12 and 16, nor the existing Acceptable Practices in Appendix B to part 38, specifically address the conflict presented by an affiliate that trades as principal on an affiliated exchange.

This conflict has acquired practical significance with the emergence of affiliated structures, particularly in prediction markets. In these markets, the affiliate principal

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[187] CME Comment, *supra* note 99, at 4, 12, 20.

[188] *Id*. at 4, 12.

[189] Cboe Comment, *supra* note 99, at 3.

trading firm may serve as a significant source of liquidity on the affiliated exchange. In such a structure, the exchange's commercial dependence on its affiliate's trading is structural rather than incidental, and unaffiliated liquidity providers may decline to trade or quote on a venue where they perceive that an affiliate trades on advantaged terms. The Commission preliminarily understands that at least six DCMs currently permit an affiliate to trade as principal on their markets, though due to constantly evolving market structure, this estimation could change.

For the reasons set out in the Identified Concerns section below, the Commission preliminarily determines that the principles-based procedures proposed in Section III.A, while sufficient to address conflicts arising from an affiliated intermediary, do not adequately minimize the conflicts presented by an affiliate principal trading firm. Exercising its authority to prescribe the manner of compliance with Core Principles 12 and 16, and under its authority under Section 8a(5) of the Act, the Commission proposes in this section to allow an affiliate principal trading firm to trade for its own account, subject to certain safeguards to ensure the affiliated exchange treats such firm on equal footing to non-affiliates. In this way, any benefits of affiliation are preserved while striking a balance with goals of market integrity and fairness.

The Commission notes that this section of the Proposal applies only to DCMs, not to SEFs. It is the Commission's understanding that market makers and liquidity providers are not as prevalent on SEFs, and therefore the proposed requirements related to affiliate principal trading should not apply to SEFs at this time. The Commission requests comment on the scope limitation to DCMs.

ii. *Identified Concerns*

After considering the comments described above and the nature of the affiliate principal trading relationship, the Commission preliminarily identifies the following concerns, which it preliminarily believes differ in kind from those presented by an affiliated intermediary addressed in Section III.A. The defining feature of an affiliate principal trading firm is that it trades as principal for its own account, with the result that the exchange and its affiliate through direct or indirect corporate affiliations, via a parent entity or otherwise, may ultimately share the affiliate's profits from trading on the exchange. The conflict therefore does not arise merely in the exchange's decision-making process, where it might be managed through procedures and disclosures; it inheres in the exchange's economic position and persists, however scrupulously the exchange administers its conflicts procedures.

First, an exchange controls the operational terms on which participants trade—including ability to trade on the market, generally, the latency and market-data access afforded to participants, the priority accorded to competing orders at the same price, and the fees and incentives available to liquidity providers. An affiliation gives the exchange a direct financial incentive to set those terms to advantage its affiliate. Because the affiliate trades as principal, any such advantage converts directly into trading gains in which the exchange ultimately could share, at the expense of the unaffiliated market participants on the other side of those trades. Matching priority, market-data and connectivity arrangements, and market-maker incentive programs are ordinary features of exchange operation, and the Commission preliminarily believes that an exchange administering them for the benefit of an affiliate counterparty would compromise its obligation under Core Principle 16 to minimize conflicts and its obligation under Core Principle 12 to protect market participants from unfair treatment.[190]

Second, an exchange acquires non-public information about its participants—for example, order flow and resting order-book information—that would be of substantial value to a firm trading for its own account. An affiliation creates both the means and the

[190] CEA 5(d)(12), (16), 7 U.S.C. 7(d)(12), (16).

incentive to share that information with, or exploit it for the benefit of, the affiliate. The affiliate's status as a principal trader is what makes the information particularly valuable: unlike an intermediary executing customer orders, a principal trader can convert an informational advantage directly into proprietary profit through its own positions. The Commission preliminarily believes that the conflicts of interest procedures, discussed in Section III.A, reduce this risk but may not be sufficient in the context of an affiliate principal trading firm because the exchange's incentive to tolerate leakage runs in the same direction as the affiliate's incentive to exploit it.

Third, and most fundamentally, the exchange's self-regulatory functions run directly against its commercial interest in the affiliate's trading. A DCM is responsible for conducting market and trade-practice surveillance of activity on its market and for investigating and disciplining misconduct.[191] Where the firm under surveillance is the exchange's own affiliate and a potential profit center, the exchange is asked to investigate and, if warranted, discipline the source of its own revenue.[192] The concern is compounded in an affiliated structure in which the exchange is also affiliated with the organization that clears its trades, which adds discretion over margin, auto-liquidation, and default management that could be exercised to favor the affiliate. The Commission is concerned that an exchange cannot credibly perform these self-regulatory functions in the context of an affiliate upon which it may be dependent for profits, and that the mitigants cited by commenters—equal-treatment and impartial-access requirements, ROC review, and Commission examination—ultimately depend on the exchange's policing its own conduct in the face of a significant conflict of interest. This concern is most acute where the affiliate is the exchange's dominant or sole source of liquidity, such that the

[191] *See* CEA 5(d)(2), 7 U.S.C. 7(d)(2) (Core Principle 2); CEA 5(d)(4), 7 U.S.C. 7(d)(4) (Core Principle 4).

[192] The Commission recognizes that an affiliated FCM or IB also could be a source of revenue for an affiliated exchange. However, the Commission preliminarily understands that the value proposition of an affiliated FCM or IB stems more from its ability to connect customers to the exchange rather than through trading profits. The Commission welcomes comment, including any relevant data, on this understanding.

exchange's continued viability depends on the affiliate's activity precisely when impartial enforcement matters most.

Taken together, the Commission preliminarily concludes that the conflicts presented by an affiliate principal trading firm are inherent in the relationship and are not adequately minimized by conflicts procedures and disclosure alone, as they would be for an affiliated intermediary. Consistent with the comment record, the Commission views this as the most acute of the affiliation conflicts.

The Commission does not, however, preliminarily propose to bar affiliate principal trading altogether. Instead, the Commission proposes to distinguish bona fide market making from directional proprietary trading. Such a bona fide market maker would be a firm that is contractually obligated to maintain continuous two-sided quotations, that is filled only after unaffiliated members at every price level (even where such affiliate placed its bids or offers prior to such unaffiliated members), and that may not establish directional positions other than in connection with its obligation to maintain two-sided quotations. The harms identified above turn on the affiliate's ability to convert operational and information advantages into proprietary profit, and on the exchange's stake in the affiliate's directional gains; the Commission preliminarily believes that confining such an affiliate to bona fide market making removes the principal mechanisms by which those harms are realized.

The Commission also preliminarily credits an affirmative rationale for permitting a bona fide affiliate market maker. A new exchange faces a coordination problem—unaffiliated market makers are reluctant to commit capital and bear the fixed costs of participation until a market demonstrates sufficient volume to make participation worthwhile, yet volume is difficult to attract without quoted liquidity—and an affiliate principal trading firm aligned with the venue's success may supply that initial liquidity when independent firms will not. The Commission preliminarily understands this dynamic to be especially pronounced in prediction markets, which characteristically list a large and continually refreshed population of individual small, short-lived, and idiosyncratic contracts; unaffiliated market makers will rationally concentrate on the few deepest contracts and decline to quote the long tail, so that much of a venue's listed contracts may lack liquidity unless an affiliate provides it. Because contracts of this kind are listed continuously, the Commission preliminarily views the need as recurring rather than confined to a venue's initial launch, which informs its preliminary decision to propose a standing exception rather than one-time accommodation. The Commission recognizes that an exchange may instead seek to attract unaffiliated liquidity providers through incentive-program rule filings[193] but preliminarily believes that incentive programs and affiliate market making are not perfect substitutes for an unproven venue or across a broad and thin contract universe.

The order-priority subordination condition described below operates, in light of this rationale, as a self-adjusting limit on the affiliate's role. Because the affiliate market maker would be filled only after unaffiliated members at each price level (regardless of time priority), it supplies liquidity when no competing liquidity exists but recedes to a residual role as unaffiliated market makers arrive and quote competitively—without any administratively complex phase-out, and while earning correspondingly less revenue and thereby reducing the exchange's reliance on its activity. The Commission emphasizes that this rationale justifies permitting an affiliate to make markets; it does not justify permitting the affiliate to do so on terms more favorable than those available to

[193] The Commission stated in the part 40 adopting release that registered entities must submit all incentive programs as proposed rules under Commission Regulations 40.5 or 40.6. 76 FR at 44777. As the Commission explained, such filings allow staff "to ensure that, among other things, [the proposed incentive programs] do not incentivize manipulative activities, unreasonably restrain competition on or between exchanges, or otherwise interfere with the fair and efficient functioning of the marketplace." *Id*. at 44777-78. To this end, the Division of Market Oversight has consistently required that incentive program filings contain complete terms in five categories to review for compliance with the Act and Commission regulations: (1) participation eligibility, (2) product scope, (3) obligations, (4) incentives, and (5) duration.

unaffiliated members, which is why the exception would be available only on the conditions set out below.

For these reasons, the Commission preliminarily concludes that a narrow, conditioned exception for a bona fide affiliate market maker, with compliance verified by an independent RSP, is a more calibrated response than a flat prohibition. The Commission requests comment generally, as well as on a prohibition without any market-maker exception and on whether the exception should instead be time-limited or subject to a cap that tightens as unaffiliated liquidity develops as alternatives.

iii. *Proposed Amendments*

The Commission proposes to implement the prohibition and conditioned exception described above through additions to Commission Regulation 38.852: two new definitions in paragraph (a), an incentive-parity requirement in paragraph (b)(2), and the prohibition, exception, and associated conditions in paragraph (c). Each is discussed below. As explained above, the Commission's authority to prescribe these requirements derives from its authority under section 5(d)(1)(B) of the Act[194] to determine by rule the manner in which a DCM complies with the Core Principles, together with the specific Core Principles identified for each provisions and the Commission's general rulemaking authority under section 8a(5) of the Act.

Definitions—Proposed Commission Regulation 38.852(a).

In addition to the definition of "affiliate market participant" discussed above, the Commission proposes two additional definitions. An "affiliate principal trading firm" would be a member of a DCM that is under common control with the exchange—using the same control formulation as the parallel definitions elsewhere in this proposal—and that trades on a principal basis for its own account on that exchange as a market maker,[195]

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

[195] As defined in the CFTC's Futures Glossary, *available at*: *https://www.cftc.gov/LearnAndProtect/AdvisoriesAndArticles/CFTCGlossary/index.htm*, a market maker is

liquidity provider,[196] or otherwise. While the proposed regulatory text specifically includes market makers and liquidity providers, the Commission includes "or otherwise" as a catchall category in order to elevate substance over form and cautions that the rule text should be interpreted to include market maker and liquidity provider-equivalent entities, as well as any other DCM affiliate that trades on a principal basis. Regardless of what those entities are called under exchange rules or in any other context, if they are acting as a market maker or liquidity provider, or otherwise engaging in proprietary trading, this section of the Proposal applies.

An "affiliate market maker" would be an affiliate principal trading firm that satisfies the conditions in paragraph (c) of proposed Commission Regulation 38.852; the defined term thus identifies the affiliate that qualifies for the exception and would be permitted to trade on the DCM. In this regard, the Commission notes that an entity that only acts as a market maker for certain products would be subject to the requirements of proposed Commission Regulation 38.852 with respect to all of its trading activity and not just its market making activity. The Commission solicits comment on whether some or all

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a professional securities dealer or person with trading privileges on an exchange who has an obligation to buy when there is an excess of sell orders and to sell when there is an excess of buy orders. By maintaining an offering price sufficiently higher than their buying price, these firms are compensated for the risk involved in allowing their inventory of securities to act as a buffer against temporary order imbalances. In the futures industry, this term is sometimes loosely used to refer to a floor trader or local who, in speculating for his own account, provides a market for commercial users of the market. Occasionally a futures exchange will compensate a person with exchange trading privileges to take on the obligations of a market maker to enhance liquidity in a newly listed or lightly traded futures contract.

[196] FIA Principal Traders Group has described liquidity providers as follows: "Liquidity providers can be on either side of a transaction, as buyer or seller. By entering and holding positions they bridge the gap between market participants. In this way, they quite literally make a market for an asset. This allows long-term investors to buy or sell stock whenever they want to, without having to wait for another long-term investor looking to do the opposite; it allows farmers to hedge against a drop in crop prices and food production companies to hedge against a rise in the cost of ingredients. Liquidity provision is commonly understood as acting as an intermediary by continually trading in and out of relatively short-term positions. Liquidity providers tend to send orders to the marketplace at prices that reflect available information regarding asset prices including the risk associated with transacting and holding that asset. The hallmark of liquidity providers is that they continually provide liquidity in all market conditions, not just when they desire to accumulate or close-out longer term investment positions." *See* FIA PTG, *What is a liquidity provider?* (Mar. 3, 2017), *available at*: *https://www.fia.org/ptg/articles/what-liquidity-provider*.

of the requirements should apply only with respect to such an entity's market making activity.

The Commission preliminarily believes that defining the qualifying affiliate by reference to continuing satisfaction of the conditions, rather than by one-time status, appropriately ties the exception to ongoing compliance: an affiliate principal trading firm that ceases to satisfy any condition ceases to be an "affiliate market maker" and would not be authorized to trade on the DCM.

Incentive parity—Proposed Commission Regulation 38.852(b)(2).

Proposed Commission Regulation 38.852(b)(2) would require a DCM that offers an incentive or similar program that applies to affiliate principal trading firms to ensure that unaffiliated members can participate on terms no less favorable than those offered to an affiliate principal trading firm. This requirement complements the principles-based procedures requirement in proposed Commission Regulation 38.852(b)(1) by closing a specific channel through which an exchange could advantage its affiliate. While the Proposal is a new conflict of interest regulation, the Commission considers additional CEA provisions, including Core Principle 2 (Compliance with Rules), which addresses access requirements—including the impartial access requirement—and Core Principle 9 (Execution of Transactions) to serve as legal authority for this proposed regulation as well.[197]

Permitted affiliate market makers—Proposed Commission Regulation 38.852(c)(1).

Proposed Commission Regulation 38.852(c)(1) would set the conditions pursuant to which a DCM may permit an affiliate market maker to trade on the DCM. Under no other conditions would an affiliate principal trading firm be permitted trade on an

[197] CEA 5(d)(2), (9), 7 U.S.C. 7(d)(2), (9).

affiliated DCM and, if any of the conditions in proposed Commission Regulation 38.852(c)(1) cease to be satisfied, the affiliate principal trading firm would be required to cease trading activity on the DCM. The Commission proposes this requirement under Core Principles 12 and 16.[198] The Commission requests comment on whether the proposed rules should explicitly state that the affiliate must stop trading if the conditions cease to be satisfied. If so, the Commission requests comment on how such cessation should be operationalized; for example, should the affiliate market maker be required to close out its open positions immediately, and should there be limitations on when the affiliate should be able to restart market making activity once the conditions are satisfied?

Condition 1: Order-priority subordination—Proposed Regulation 38.852(c)(1)(i).

Proposed Commission Regulation 38.852(c)(1)(i) would require the exchange to ensure that its trade-matching system, including any price/time priority matching algorithm, does not favor the affiliate market maker. Specifically, a DCM's trade matching system must fill the bid or offer of any unaffiliated member before the bid or offer of the affiliate market maker at the same price, without regard to the time priority of the affiliate market maker's order, such that the bids and offers of the affiliate market maker are filled last at every price level.

As discussed above, subordination both protects unaffiliated members and operates as a self-adjusting limit on the affiliate's role, permitting it to supply liquidity where none competes while ceding priority to unaffiliated liquidity as it develops. The Commission proposes this condition principally under Core Principle 9 (Execution of Transactions), Core Principle 2 (Compliance with Rules), and Core Principle 16.[199] Because subordination has effect only where unaffiliated orders are present at a price, where the affiliate is the sole source of liquidity the remaining conditions in proposed

[198] CEA 5(d)(12), (16), 7 U.S.C. 7(d)(12), (16).

[199] CEA 5(d)(2), (9), (16), 7 U.S.C. 7(d)(2), (9), (16).

Commission Regulation 38.852(c)(1) are the operative protections; the Commission requests comment on whether they are sufficient in that circumstance.

The Commission is also aware that a DCM may operate a trade matching system other than a central limit order book ("CLOB") (for example, by offering a request for quote ("RFQ") mechanism).[200] The Commission requests comment on whether the proposed subordination provision adequately addresses circumstances where a DCM's trade matching system is other than a CLOB. In this regard, the Commission requests comment on whether the proposed subordination provision would be effective if market making activity occurs through other execution methods, such as block trades.

Condition 2: Market Making and Incentive Agreement Requirements — Proposed Commission Regulation 38.852(c)(1)(ii).

Proposed Commission Regulation 38.852(c)(1)(ii) would require a DCM to ensure that any market maker or incentive program filed under part 40 that applies to the affiliate market maker enumerates the affiliate market maker's market making or liquidity providing obligations, the performance standards applicable to those obligations, and the consequences of any failure to satisfy them, on terms no less favorable to the DCM than those offered to unaffiliated members participating in the same or a comparable program. The proposed rule would require that such program must also: (A) require an affiliate market maker to maintain continuous two-sided quotations in each product in which it is obligated to make a market; (B) specify the minimum number of trading hours in the relevant trading period during which the affiliate market maker is subject to such obligation; (C) specify limitations on permissible bid-ask spreads; and (D) ensure that the trading of the affiliate market maker on the DCM is reasonably calculated to contribute to the maintenance of a fair and orderly market, and the affiliate market

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[200] *See, e.g.*, *https://help.kalshi.com/en/articles/13823820-combos*.

maker does not make bids or offers, or enter into transactions, inconsistent with that purpose, including by taking directional proprietary positions other than in connection with its obligation to maintain two-sided quotations. The Commission proposes these under Core Principles 12 and 16.[201]

The Commission considered whether to specify in the rule text the minimum trading hours requirement and the bid-ask spread limitations. The Commission preliminarily believes that a single fixed set of parameters may not suit the heterogenous products to which the requirements would apply and that a better approach would be to allow DCMs to set such parameters, subject to Commission review and oversight through the part 40 process. The Commission requests comment on whether to specify these parameters in rule text, to set minimum standards while requiring the market maker agreement to fix product-specific parameters, or to take another approach, and on the appropriate values in each case.

The Commission also considered whether to require a market-making program to set restrictions on an affiliate market maker's ability to end a particular trading period with a net position in any particular contract exceeding a particular threshold on the basis that such a requirement would ensure that a market making firm, consistent with the Commission's understanding of the typical trading practices of such firms, ended such trading period "flat" (or near "flat") rather than with a material directional position. The Commission preliminarily declines to include such a requirement in the Proposal since the Commission expects that this requirement could vary across products and also that a firm may be engaging in market making activity—rather than directional trading—even if it holds a net directional position under some circumstances. The Commission requests comment on whether the rule should include such a limitation or any alternatives that

[201] CEA 5(d)(12), (16), 7 U.S.C. 7(d)(12), (16).

could help to ensure that affiliate market makers only engage in bona fide market making activities.

The Commission also considered whether to include a capital independence condition, which would require that no capital underlying the affiliate market maker's trading on the DCM originates, directly or indirectly, from that affiliated DCM. The Commission preliminarily believes that, while it has the authority to impose such a requirement under Core Principle 11 (Financial Integrity of Transactions),[202] a DCM may face challenges in complying with such requirement, given the likelihood of a parent entity supplying capital to both the DCM and the affiliate market maker. The Commission requests comment on whether the rule should include a capital independence standard. The Commission also requests comment on whether DCM Core Principle 21 (Financial Resources),[203] which generally requires a DCM to have adequate financial, operational, and managerial resources to discharge its responsibilities, is adequate in this regard.

Independent verification and certification—Proposed Regulation 38.852(c)(2).

Proposed Commission Regulation 38.852(c)(2) would require a DCM that permits an affiliate market maker to trade to designate an independent third-party RSP to (i) conduct financial surveillance of the affiliate market maker under Commission Regulation 38.604 as if it were an FCM (except to the extent Commission Regulation 38.604 applies with respect to customers); (ii) review and monitor the exchange's compliance with its conflicts-of-interest procedures under paragraph (b)(1); and (iii) certify to the Commission and the DCM's board of directors or other designated committee or officer responsible for regulatory compliance annually that the affiliate market maker satisfies the affiliate market maker conditions in proposed paragraph (c)(1)

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[202] CEA 5(d)(11), 7 U.S.C. 7(d)(11).

[203] CEA 5(d)(21), 7 U.S.C. 7(d)(21).

and the DCM is operating in compliance with its conflicts of interest procedures as required under proposed Commission Regulation 38.852(b)(1). The certification would be required to include the submission of appropriate written documentation and analysis to support such certification. The DCM would remain responsible for compliance and for the RSP's performance.

Proposed Commission Regulation 38.852(c)(2)(i) builds on the RSP framework in Commission Regulation 38.606 as discussed in Section II.B, but, unlike the optional engagement contemplated there for surveillance of an affiliate FCM, 38.852(c)(2)(i) would require an independent provider, because the affiliate market maker has the potential to, directly or indirectly, financially benefit the exchange and the Commission has preliminarily determined that an exchange cannot credibly verify its own compliance in these circumstances. The Commission proposes this requirement under Core Principles 11 and 16.[204]

Commission Regulation 38.604 is directed to a DCM's financial surveillance of its member FCMs and to the protection of customer funds; an affiliate market maker trades for its own account and carries no customer funds. The cross-reference is intended to require an RSP to monitor the affiliate market maker's compliance with the DCM's minimum financial standards by routinely receiving and promptly reviewing financial and related information from the affiliate, and by continuously monitoring the positions of affiliate. The proposed rule carves out any aspect of Commission Regulation 38.604 that would apply with respect to FCM customers. The Commission requests comment on whether Commission Regulation 38.604 is the appropriate vehicle or whether a tailored financial-resources standard would be more effective.

[204] CEA 5(d)(11), (16), 7 U.S.C. 7(d)(11), (16).

As noted, proposed Commission Regulation 38.852(c)(2)(ii) would require an RSP to review and monitor the DCM's compliance with its conflicts of interest procedures regarding affiliate market participants, including in connection with affiliate principal trading firms. Given the conflicts of interest concerns described above, the Commission preliminarily believes that independent oversight of conflicts policies in this context is reasonable and necessary. In this regard, the Commission understands that independent oversight will provide other, unaffiliated market participants with confidence that the DCM is appropriately managing conflicts arising from its relationship with an affiliate market maker, thus supporting market liquidity, competition, and innovation. The Commission requests comment on whether such independent oversight is appropriate and whether the Commission should further specify what such independent oversight would entail. Additionally, the Commission requests comment on whether the Commission should address circumstances in which the DCM's CRO or ROC may disagree with the RSP regarding the DCM's conflicts of interest program.

Finally, proposed Commission Regulation 38.852(c)(2)(iii) would require the RSP to annually certify to the Commission, as well as the board of directors or other designated committee or officer responsible for regulatory compliance, that an affiliate market maker satisfies the conditions set forth in proposed Commission Regulation 38.852(c) and that the DCM is operating in compliance with its conflicts of interest procedures. The Commission preliminarily believes that such certification, along with supporting documentation and analysis, will help to ensure, on a periodic and predictable basis, that a DCM and its affiliate market maker are in compliance with the Commission's regulations in this regard. The Commission requests comment on the certification requirement, generally, the certification frequency, and whether the Commission should further specify standards with respect to the certification requirement. In addition, the Commission preliminarily intends that an affiliate market maker for which the required certification is not provided, or for which the DCM or RSP determines at any other point is no longer in compliance with the requirements of Commission Regulation 38.852(c), will immediately cease to qualify as an affiliate market maker eligible to trade on the DCM.

Additional disclosures—Commission Regulation 38.852(c)(3).

Proposed Commission Regulation 38.852(c)(3) would require that a DCM must disclose to any party trading on the DCM, on a per-session basis and prior to that party entering any orders, the existence of, and the DCM's relationship with, an affiliate market maker. The disclosure would have to be presented in a clear and conspicuous manner, in plain language reasonably understandable to a non-specialist, and in full rather than through a reference or link to another disclosure. The disclosure also would have to disclose the conditions and limitations imposed on the affiliate market maker, including the order subordination condition. The DCM would be required to establish a rule that its intermediary participants, and any other operator of an electronic order-entry interface that provides access to the DCM, deliver the notice as well. The Commission proposes this requirement under Core Principles 12 (Protection of Markets and Market Participants) and 9 (Execution of Transactions)[205] and believes that this disclosure is necessary to ensure that unaffiliated market participants are made aware of the existence of an affiliate market maker prior to trading.

The Commission requests comment on the delivery mechanism. A DCM can require delivery by its members through its rules but reaches non-member interfaces operators only indirectly; the Commission is considering, as an alternative, requiring the DCM to deliver the notice directly for direct-access orders while placing the delivery obligations for intermediated orders on the FCM or other interface operator, coordinating

[205] CEA 5(d)(9), (12), 7 U.S.C. 7(d)(9), (12).

with the disclosure obligations addressed in Section V. The Commission also requests comment on the operational burdens of an interruptive, affirmatively acknowledged notice and on whether the obligation should attach per product, per session, or otherwise.

iv. *Statutory Authority*

The Commission proposes the amendments in this Section III.B pursuant to section 8a(5) of the Act, which authorizes the Commission to promulgate such rules and regulations as, in its judgment, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of the Act,[206] as well as under several DCM Core Principles. The conflict that an affiliate market maker presents implicates, most directly, DCM Core Principle 16, which requires a DCM to establish and enforce rules to minimize conflicts of interest in its decision-making process and to establish a process for resolving them.[207] It also implicates DCM Core Principle 12, which requires the exchange to protect markets and market participants from abusive practices and to promote fair and equitable trading; DCM Core Principle 9, which requires the exchange to provide a competitive, open, and efficient market and mechanisms for executing transactions that protects the price discovery process; and DCM Core Principle 2, which requires the exchange to establish, monitor, and enforce compliance with its rules, including the obligation to provide impartial access to its market.[208] Each proposed condition is directed at one or more of these obligations: the order-priority subordination condition and the incentive-parity requirement protect the competitive neutrality of execution and access under Core Principles 9 and 2, while the market-making-agreement, independent-verification, and disclosure conditions address the conflict-of-interest and market-protection concerns under Core Principle 16 and 12.

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[206] CEA 8a(5), 7 U.S.C. 12a(5).

[207] CEA 5(d)(16), 7 U.S.C. 7(d)(16).

[208] CEA 5(d)(12), 7 U.S.C. 7(d)(12); CEA 5(d)(9), 7 U.S.C. 7(d)(9); CEA 5(d)(2), 7 U.S.C. 7(d)(2).

The Commission's authority to prescribe these requirements by rule derives from two sources that operate together. First, although a DCM ordinarily "shall have reasonable discretion in establishing the manner in which" it complies with the Core Principles, that discretion applies only "[u]nless otherwise determined by the Commission by rule or regulation."[209] The Commission may therefore determine, by rule, the manner in which a DCM complies with Core Principles 16, 12, 9, and 2 where it concludes that general exchange discretion would not adequately address the conflict, as the Commission preliminarily concludes with respect to the conditions set out in proposed Commission Regulation 38.852(c). Second the Commission's general rulemaking authority under section 8a(5) of the Act authorizes it to promulgate such rules as are reasonably necessary to effectuate the provisions, or to accomplish the purposes, of the Act.[210] The Commission preliminarily believes that the conditions in proposed Commission Regulation 38.852(c)(1)—which, in effect, bar an affiliate principal trading firm from trading on an affiliated DCM unless it satisfies the affiliate market maker conditions—is best understood as an exercise of this general rulemaking authority in service of Core Principles 12 and 9, rather than solely as a specification of the "manner of compliance." A default prohibition subject to a conditioned exception is reasonably necessary to accomplish the market-protection and competitive-execution objectives those Core Principles embody in circumstances where procedural safeguards alone would leave the underlying conflict unaddressed.

These authorities are reinforced by, and the proposed requirements are designed to further, the purposes of the Act. Section 3 of the Act provides that it is the purpose of the Act to serve the public interest, including by deterring and preventing disruptions to market integrity, by protecting market participants from abusive practices, and by

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

[210] CEA 8a(5), 7 U.S.C. 12a(5).

promoting fair competition among boards of trade, other markets, and market participants.[211] The proposed conditions advance those purposes by preserving an affiliate market maker's ability to supply liquidity while ensuring that it does so on terms no more favorable than those available to unaffiliated members, thereby protecting the integrity of the market and the competitive position of unaffiliated participants.

v. *Alternatives Considered*

The Commission considered, and requests comment on, the following alternatives to the proposed approach.

1. Permitting affiliate principal trading firms subject only to conflicts procedures and disclosure

The Commission considered permitting an affiliate principal trading firm to trade for its own account subject only to the principles-based conflicts procedures and disclosure that would apply to any affiliate market participant, without the additional requirements, including with respect to order-priority subordination and independent verification, proposed here. The Commission preliminarily believes that this more principles-based approach would impose lower costs and would treat the affiliate principal trading conflict like other affiliation conflicts addressed in this Proposal.

For the reasons given above, however, the Commission preliminarily concluded that procedures and disclosure alone cannot adequately minimize a conflict that arises from a DCM's economic stake in its affiliate's proprietary trading. The Commission requests comment on whether the principles-based approach would suffice and, if so, what additional procedural elements, if any, should be required.

2. Prohibiting affiliate principal trading with no exception for market makers

[211] CEA 3(b), 7 U.S.C. 5(b).

The Commission considered prohibiting an affiliate principal trading firm from trading for its own account on an affiliated exchange altogether, with no exception for a bona fide affiliate market maker.

The Commission preliminarily declined to propose a flat prohibition because, as discussed above, a bona fide market maker can supply liquidity that unaffiliated firms may not, particularly across the broad and continually refreshed contract universes characteristic of prediction markets. A flat prohibition would also be the most disruptive to existing market structure. The Commission requests comment on whether it should instead adopt a prohibition on affiliate principal trading firms with no exception.

3. A volume- or value-based cap on affiliate market maker activity, including a phased or sunset cap

The Commission considered limiting an affiliate market maker's activity through a cap on its share of volume or value in a product, an end-of-day net-position limit, as well as a phased or "sunset" cap that would be more permissive at a product's or venue's launch and tighten as unaffiliated liquidity develops.

The Commission preliminarily believes that order-priority subordination operates as a self-adjusting limit—the affiliate supplies liquidity when none competes and recedes as unaffiliated members provide liquidity—and accomplishes much of what a phased cap would, without the administrative complexity of measuring and enforcing a moving threshold. The Commission requests comment on whether a volume- or value-based cap, fixed or phased, should be adopted in addition to subordination requirement, particularly where the affiliate is the sole source of liquidity and subordination has no competing orders to which to defer.

4. Splitting delivery of the point-of-transaction disclosure by access path

The Commission considered requiring the DCM to deliver the point-of-transaction notice directly for orders entered through direct access, while placing the delivery obligation for intermediated orders on the FCM or other operator of the order-entry interface. This approach would address the limits on a DCM's ability to compel delivery by non-member interface operators and would coordinate the notice with the customer-disclosure obligations addressed below in Section V. The Commission requests comment on whether to adopt this split-delivery approach in place of the mechanism in proposed Commission Regulation 38.852(c)(3).

5. Relying on general disclosure in place of a per-trading-session notice

The Commission considered a lighter disclosure regime that would not require the interruptive, affirmatively acknowledged point-of-transaction notice in proposed Commission Regulation 38.852(c)(3). Under this alternative, a DCM that permits an affiliate market maker to trade would instead be required to disclose publicly—for example, on its website and in its rulebook—the existence of the affiliate relationship and the conditions and limitations imposed on the affiliate under this section, including order-priority subordination, and to provide that disclosure to each customer once, at account opening or before the customer first trades on the exchange, rather than prior to the start of any trading session. This approach could substantially reduce the operational burden of building and maintaining the required disclosure infrastructure and also could reduce friction at the point of trading.

The Commission preliminarily proposed the additional disclosure requirements instead because the information that the venue's affiliate may be the counterparty, and is filled only after unaffiliated members at the same price, is most salient to a customer at the moment of trading, and a standing public or one-time disclosure may not reach a customer when such information is most relevant.

vi. *Request for Comment*

The Commission requests comment on all aspects of the proposed Commission Regulation 38.852(c), and on the related definitions and incentive-parity requirement, including the following:

39) Whether the principles-based framework of Section III.A, without the conditions proposed here, would adequately minimize conflicts, and if not, what additional procedural elements should be required.

40) Whether the Commission should instead prohibit affiliate principal trading altogether with no market-maker exception.

41) Whether the requirements should apply uniformly to all affiliate principal trading activity or be limited—for example, by market access (for example, to markets accessible to customers who are not ECPs), by a measure of the affiliate's significance in a product, or by other criteria—and how any such threshold should be defined and monitored.

42) Whether the Commission's proposed definitions of "control" and "affiliate" are appropriately scoped.

43) Whether and how the prohibition and exception should extend to affiliate principal trading on SEFs, including whether order-priority subordination is compatible with SEF execution methods and whether the per-trading-session notice is appropriate for markets limited to ECPs.

44) Whether quantitative parameters—for example, a minimum percentage of trading hours quoted, a maximum spread, a minimum size, and an end-of-day net-position limit—should be fixed in Commission rule text rather than established in the market maker or incentive agreement subject to Commission review, as proposed, and what values or standards are appropriate across prediction-market products with differing characteristics.

45) Whether order-priority subordination is technically and operationally feasible across the matching systems in use, and whether it should be required, replaced by a volume- or value-based cap, or supplemented by such a cap, including a phased or sunset cap. Could an exchange or market maker circumvent the spirit of the requirement by switching to pro rata caps?

46) Where an affiliate is the sole source of liquidity in a product and the affiliate's orders face no competing orders against which to be subordinated, whether the remaining conditions adequately protect customers or whether additional protections should apply.

47) What other conditions the Commission could set to mitigate the potential conflicts present with an affiliate market maker trading on exchange while preserving the ability for exchanges to use affiliate market makers for bootstrapping purposes.

48) Whether a capital-independence condition should be applied and, if so, how it can be implemented and verified where a common parent funds both the exchange and the affiliate. Is it possible for the DCM to determine whether the trading affiliate is independently funded? How would it do so? Is it possible for any trading affiliate to actually be financially independent from an affiliated exchange?

49) Whether Commission Regulation 38.604 is the appropriate vehicle for financial surveillance of an affiliate market maker, which carries no customer funds, or whether a tailored financial-resources standard would be preferable.

50) Whether the standard, scope, and frequency of the certification required by proposed Commission Regulation 38.852(c)(2)(iii) is appropriate, and whether the rule should state expressly that an affiliate market maker for

which the certification is not provided ceases to qualify as an affiliate eligible to trade on the DCM.

51) How “independent” should be defined for the third-party RSP, and whether the framework in Commission Regulation 38.606 affords sufficient capacity for this function.

52) Whether the interruptive, affirmatively acknowledged per-trading-session notice in proposed Commission Regulation 38.852(c)(3) is warranted, or whether a lighter regime—public disclosure together with a one-time disclosure at account opening or before a customer first trades—would adequately protect customers at lower cost, and whether the two approaches should be combined.

53) Whether the notice should be delivered by members under exchange rule or split so that the exchange delivers directly for direct-access orders while the FCM or other interface operator delivers for intermediated orders.

54) Whether the notice should attach the first time a customer trades a product in which an affiliate market maker is active or on another basis—rather than on a per-session basis—and the operational burden of each alternative approach.

55) The Commission requests that DCMs on which an affiliate market maker trades, and any other market participant with relevant information describe:

i. The number and identity of DCMs on which an affiliate currently trades for its own account, the products involved, and the affiliate’s share of liquidity or volume in those products.

ii. The terms on which any such affiliate currently trades, including any market maker or liquidity provider agreement, quoting obligations, position limits, and the source of the affiliate’s capital.

iii. The nature and estimated cost of modifying trade-matching systems to implement order-priority subordination.

iv. The nature and estimated cost of engaging an independent third-party RSP to perform the surveillance, monitoring, and certification required by proposed Commission Regulation 38.852(c)(2), including any market-capacity considerations. Please identify who are the most likely entities to perform this independent third-party RSP role. Would it most likely be NFA? Would other entities enter the market in this capacity?

v. The nature and estimated cost of implementing the per-trading-session disclosure across members and non-member order-entry interfaces, and of any lighter disclosure alternatives.

vi. The Commission requests comment on the time DCMs, SEFs and applicable affiliates would need to comply, and on whether the rule should provide a transition period for affiliate trading arrangements in existence on the effective date.

C. Proposed New Commission Regulation 38.853—Board Composition, Regulatory Oversight Committee, and Disciplinary Panels

i. *Background*

As described above, the current acceptable practices for Core Principle 16 compliance for DCMs note that DCMs "bear special responsibility to regulate effectively, impartially, and with due consideration of the public interest" and that DCMs "should be particularly vigilant for such conflicts between and among any of their self-regulatory responsibilities, their commercial interests, and the several interests of their management, members, owners, customers and market participants, other industry participants, and other constituencies." The current Appendix B language provides that acceptable practices for minimizing conflicts of interest include the following:

Board composition. At least 35% of a DCM's board of directors should be public directors and at least 35% of any executive committees or similarly empowered bodies should likewise be public.[212] To qualify as a public director, an individual must be found by the DCM's board of directors to have no "material relationship" with the DCM, which is defined as a relationship that "reasonably could affect the independent judgment or decision-making of the director."[213]

The acceptable practices enumerate specific scenarios that would constitute a material relationship, including: (1) the director is an officer or employee of the DCM or an affiliate;[214] (2) the director is a member (as defined in section 1a(34) of the Act and Commission Regulation 1.3) of the DCM, or an officer or director of a member;[215] (3) the director, or a firm with which the director is an officer, director, or partner, receives more than $100,000 in combined annual payments from the DCM or any affiliate for legal, accounting, or consulting services, but excluding compensation for services as a director to the DCM or an affiliate, or deferred compensation for services prior to becoming a director, so long as such compensation is not contingent, conditioned, or revocable;[216] or (4) any of the aforementioned relationships apply to a member of a director's immediate family.[217] These circumstances are subject to a one-year look back period.[218] The acceptable practices further provide that a public director may also serve as a director of a DCM's affiliate if the director otherwise meets the public director definition.[219] A DCM

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[212] 17 CFR, part 38, app. B, Core Principle 16 (B)(1).

[213] *Id.* Core Principle 16 (B)(2)(i).

[214] *Id.* Core Principle 16 (B)(2)(ii)(A).

[215] *Id.* Core Principle 16 (B)(2)(ii)(B).

[216] *Id.* Core Principle 16 (B)(2)(ii)(C).

[217] *Id.* Core Principle 16 (B)(2)(ii)(D).

[218] *Id.* B, Core Principle 16 (B)(2)(iii).

[219] *Id.* Core Principle 16 (B)(2)(iv).

must also disclose to the Commission which members of its board are public directors and the basis for those determinations.[220]

Regulatory Oversight Committee. The acceptable practices provide that a DCM shall establish a ROC as a standing committee, consisting of only public directors, to assist it in minimizing actual and potential conflicts of interest.[221] The ROC also is tasked with overseeing the DCM's regulatory program on behalf of the board and the acceptable practices require the board to delegate sufficient authority, dedicate sufficient resources, and allow sufficient time for the ROC to fulfill its mandate.[222]

The acceptable practices enumerate certain responsibilities that a ROC should have, including: (1) monitoring the DCM's regulatory program for sufficiency, effectiveness, and independence;[223] (2) overseeing all facets of the 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;[224] (3) reviewing the size and allocation of the regulatory budget and resources; and the number, hiring and termination, and compensation of regulatory personnel;[225] (4) supervising the CRO, who reports directly to the ROC;[226] (5) preparing an annual report assessing the DCM's self-regulatory program for the board and the Commission, which sets forth the regulatory program's expenses, describes its staffing and structure, catalogues disciplinary actions taken during

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[220] *Id.* Core Principle 16 (B)(2)(v).

[221] *Id.* Core Principle 16 (B)(3)(i).

[222] *Id*.

[223] *Id.* Core Principle 16 (B)(3)(ii)(A).

[224] *Id.* Core Principle 16 (B)(3)(ii)(B).

[225] *Id.* Core Principle 16 (B)(3)(ii)(C).

[226] *Id.* Core Principle 16 (B)(3)(ii)(D).

the year, and reviews the performance of disciplinary committees and panels;[227] (6) recommending changes that would ensure fair, vigorous, and effective regulation;[228] and (7) reviewing regulatory proposals and advising the board as to whether and how such changes may impact regulation.[229]

Disciplinary panels. The acceptable practices also require that a DCM minimize conflicts of interest in their disciplinary processes through disciplinary panel composition rules that preclude any group or class of industry participants from dominating or exercising disproportionate influence on such panels.[230] A DCM can further minimize conflicts by including in all disciplinary panels at least one person who would qualify as a public director, subject to limited exceptions.[231] The acceptable practices further provide that if DCM rules provide for appeal to the board of directors, or to a committee of the board, then that appellate body shall also include at least one person who would qualify as a public director.[232]

ii. *Identified Concerns*

The Commission preliminarily understands that compliance with these acceptable practices is common across DCMs. In this regard, the Commission believes that codification will provide additional clarity and certainty regarding the Commission's expectations for DCMs and applicants for designation. Furthermore, the rising number of affiliate relationships between DCMs and market participants has increased the potential for conflicts of interest and, therefore, the necessity of safeguards and other mitigants.

iii. *Proposed Amendments*

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[227] *Id.* Core Principle 16 (B)(3)(ii)(E).

[228] *Id.* Core Principle 16 (B)(3)(ii)(F).

[229] *Id.* Core Principle 16 (B)(3)(ii)(G).

[230] *Id.* Core Principle 16 (B)(4).

[231] *Id.*

[232] *Id.*

The Commission proposes to codify these existing acceptable practices into rule text within part 38 of the Commission's regulations without material changes. The Commission specifically proposes the following rules:

Board composition—Proposed Commission Regulation 38.853(a), (b).

Proposed Commission Regulation 38.853(a) would codify the requirement for a DCM's board to have at least 35% public directors and for any executive committees (or similar bodies) to likewise consist of at least 35% public directors. Proposed Commission Regulation 38.853(b) would codify the standard for who qualifies as a public director, the types of relationships that are considered "material relationships," and the requirement for a DCM to disclose to the Commission the individuals who are public directors and the bases for those determinations, consistent with the existing acceptable practices.

Regulatory Oversight Committee—Proposed Commission Regulation 38.853(c).

Proposed Commission Regulation 38.853(c) would codify the requirement for a DCM to have a ROC composed of public directors and would further codify the ROC's obligations as currently set forth in the acceptable practices. Proposed Commission Regulation 38.853(c)(2)(iv) would clarify that the ROC supervises the DCM's CRO or other officer responsible for regulatory compliance—the current acceptable practices only reference a CRO.

Disciplinary panels—Proposed Commission Regulation 38.853(d).

Proposed Commission Regulation 38.853(d) would codify the requirement for a DCM to minimize conflicts of interest in its disciplinary processes. While the existing acceptable practices provide that a DCM "can" further minimize conflicts of interest by including in all disciplinary panels at least one person who would qualify as a public director, proposed Commission Regulation 38.853(d)(2) would require all disciplinary panels to include at least one public director, subject to the same exceptions provided for in the existing acceptable practices.

As noted, the Commission preliminarily understands that most, if not all, DCMs, already comply with the acceptable practices and so codification should not result in significant costs. And the Commission preliminarily believes that compliance with these acceptable practices has mitigated conflicts of interest. For example, the Commission believes that having public directors on a DCM's board, together with other practices put in place to comply with Core Principle 17 (which requires a DCM to have governance arrangements that permit consideration of the views of market participants), results in the DCM considering the views of individuals who are independent of the commercial interests of the DCM. The Commission further understands that the requirement for a ROC to consist only of public directors helps to ensure that oversight of a DCM's regulatory compliance program likewise is insulated from commercial pressures. The Commission also believes that including public directors on disciplinary panels helps to ensure fairness in such proceedings. The Commission requests comment on its understanding of how DCMs currently comply with the acceptable practices, the proposed codification, and whether there should be any changes to the proposed requirements.

iv. *Statutory Authority*

The Commission proposes the amendments in this Section III.C pursuant to section 8a(5) of the Act, which authorizes the Commission to promulgate such rules and regulations as, in its judgment, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of the Act,[233] as well as under several DCM Core Principles. This proposed rule implicates DCM Core Principle 16, which requires a DCM to establish and enforce rules to minimize conflicts of interest in its decision-making process and to establish a process for resolving them.[234] Given current

[233] CEA 8a(5), 7 U.S.C. 12a(5).

[234] CEA 5(d)(16), 7 U.S.C. 7(d)(16).

market practice and the Commission's growing concerns regarding conflicts of interest, the Commission preliminarily believes that these proposed rules are reasonably necessary to ensure DCM's effectively manage conflicts of interest.

v. *Alternatives Considered*

The Commission considered keeping the board composition, ROC, and disciplinary panel acceptable practices as guidance withing Appendix B rather than proposing to codify them as requirements in rule text. The Commission preliminarily declines to take this approach given, as described above, the expected benefits of codification and the Commission's understanding that the costs of compliance should be minimal.

vi. *Request for Comment*

The Commission requests comment on all aspects of proposed Commission Regulation 38.853 including the following:

56) Whether the Commission's understanding that most, if not all, DCMs already comply with the acceptable practices is correct.

57) Whether the Commission's estimation that costs of compliance are likely to be minimal is correct. Will costs be different for new registrants as compared to currently registered DCMs?

58) Whether any of the requirements that the Commission proposes to codify should be modified.

59) Whether any additional requirements should apply with respect to a DCM's board of directors or ROC.

IV. DCO-Affiliate Clearing Member—Proposed Amendments to Commission Regulations 39.2, 39.21, and 39.25.

A. Background

Section 5b(c)(2)(P) of the CEA—DCO Core Principle P—requires each DCO to "establish and enforce rules to minimize conflicts of interest in the decision-making process of the [DCO]."[235] The Commission has implemented Core Principle P through Commission Regulation 39.25.[236] As currently in effect, Commission Regulation 39.25 requires a DCO to: (a) establish and enforce rules to minimize conflicts of interest in the DCO's decision-making process; (b) establish a process for resolving such conflicts of interest; and (c) have procedures for identifying, addressing, and managing conflicts of interest involving members of the board of directors.[237] Commission Regulation 39.25 does not currently address, in specific terms, conflicts arising from an affiliation between a DCO and one of its clearing members.

Four other DCO Core Principles bear on this part of the Proposal. Core Principle L—set forth at section 5b(c)(2)(L) of the CEA and implemented through Commission Regulation 39.21—requires a DCO to provide market participants with sufficient information to identify and evaluate accurately the risks and costs associated with using the DCO's services and to make specified categories of information readily available to the general public by posting them on the DCO's website.[238] Commission Regulation 39.21(c) enumerates nine categories of information that must be publicly disclosed, ranging from the terms and conditions of cleared contracts to clearing fees, margin-setting methodology, the financial resource package available in the event of a clearing member default, daily settlement data, the DCO's rulebook, the current list of clearing members, the list of swaps accepted for clearing, and a residual catch-all covering "[a]ny other information that is relevant to participation in the clearing and settlement activities

[235] CEA 5b(c)(2)(P)(i)-(ii), 7 U.S.C. 7a-1(c)(2)(P)(i)-(ii).

[236] 17 CFR 39.25.

[237] 17 CFR 39.25(a)-(c).

[238] CEA 5b(c)(2)(L), 7 U.S.C. 7a-1(c)(2)(L); 17 CFR 39.21.

of the [DCO]."[239] Core Principle C—set forth at section 5b(c)(2)(C) of the CEA and implemented through Commission Regulation 39.12—requires a DCO to establish appropriate admission and continuing eligibility standards for clearing members and participants, including standards that are "objective, publicly disclosed, and permit fair and open access."[240] Core Principle D—set forth at section 5b(c)(2)(D) of the CEA and implemented through Commission Regulation 39.13—requires a DCO to possess the ability to manage the risks associated with discharging its responsibilities through the use of appropriate tools and procedures. Core Principle H—set forth at section 5b(c)(2)(H) of the CEA and implemented through Commission Regulation 39.17—requires a DCO to maintain adequate arrangements for the effective monitoring and enforcement of compliance with its rules and the ability to discipline a participant due to a violation of any rule.

Part 39 of the Commission's regulations currently contains no definition of "affiliate clearing member." Of the 24 DCO's currently registered with the Commission, five have an affiliate clearing member. The Commission preliminarily understands that all of these DCOs have, to varying degrees, voluntarily adopted policies, rulebook provisions, and disclosures intended to address the affiliate relationship, including provisions restricting the affiliated clearing member's access to non-public information of the DCO and providing for public disclosure of the affiliation.

B. Comments on the Affiliations RFC

The Commission received substantial comment on these issues in response to the Affiliations RFC.[241] The RFC posed specific questions concerning whether a DCO's affiliation with a clearing member would affect the DCO's decision-making regarding

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[239] 17 CFR 39.21(c)(1)-(9).

[240] CEA 5b(c)(2)(C), 7 U.S.C. 7a-1(c)(2)(C); 17 CFR 39.12(a).

[241] *See* Affiliations RFC, *supra* note 1.

margin, default rules and procedures, rule enforcement, and risk management; whether such affiliation would affect contagion risk between the DCO and the affiliated clearing member; and what mitigants—including information barriers, personnel and resource separations, governance measures, disclosures, conduct restrictions, volume caps, and additional financial or liquidity resources—would be effective.[242]

Views on the adequacy of existing regulations. Several commenters viewed existing regulations as sufficient to address the conflicts of interest presented by a DCO's affiliation with a clearing member. Cboe, ICE, the WMBAA, and FMX each commented that current rules adequately address the relevant concerns.[243] ICE commented that it "is supportive of the CFTC's principles-based approach to regulation and oversight of affiliated entities which fosters growth and innovation for derivatives markets" and that a group's ownership of both an FCM and a DCO "does not raise anti-competitive concerns if the affiliated regulated entities adopt appropriate rules and policies and procedures for managing conflicts."[244] CME also stated that "[t]he CEA wisely does not prohibit conflicts of interest. Instead, it recognizes that conflicts of interest can and will exist and that they generally can be managed" and that "a DCO should have reasonable discretion for determining how it complies with" relevant regulations and DCO Core Principles.[245] The WFE similarly endorsed the Commission's principles-based approach but recognized that "recent developments in the industry whereby a group owns a [FCM] and DCO, DCM, and/or SEF suggest that the Commission should take additional steps to affirm that

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[242] *Id*.

[243] Cboe Comment, *supra* note 99, at 3; ICE Comment, *supra* note 99, at 2; WMBAA Comment, *supra* note 159, at 3-4; Letter from John Steel, Chief Operating Officer, on behalf of FMX Futures Exchange, L.P., to CFTC (Sep. 28, 2023) (hereinafter "FMX") at 2-3.

[244] ICE Comment, *supra* note 99, at 1-2.

[245] CME Comment, *supra* note 99, at 8.

[conflicts of interest] continue to be managed effectively, as this ownership has not as commonly been observed."[246]

Other commenters identified specific concerns with the existing framework. FIA commented that current regulations do not provide adequate insulation between the business interests and SRO functions of a DCO, that common ownership may incentivize a DCO to delay placing an affiliate FCM into default—which raises a number of systemic risk and customer protection issues—and that a DCO may exercise its risk-management discretion (including in setting initial margin levels and in margin calculations) in ways biased in favor of the affiliate FCM and against unaffiliated FCMs.[247] FIA observed that its concerns regarding default management were exemplified by Alameda Research's tacit exemption from FTX's auto-liquidation rules.[248] FIA also expressed concern that customer perceptions of unfair favoritism by a DCO toward its affiliate FCM could have anti-competitive effects on FCM competition, and that existing regulations do not mitigate the appearance of favoritism.[249]

ISDA reported divergent views among its members. ISDA stated that "[a]ssuming the Commission does not prohibit affiliation between a DCO and one or FCMs, we would prefer the CFTC to provide new principles-based rules to address these conflicts, with granular guidance on potential ways to satisfy the principles, where appropriate."[250] ISDA further reported, however, that "[s]ome ISDA members disagree that mitigants . . . would address the potential risks and believe that the CFTC should not permitted affiliated FCMs in this situation."[251] ISDA also noted that "the current regulatory

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[246] WFE Comment, *supra* note 111, at 3.

[247] FIA Comment, *supra* note 99, at 1, 4-5 & n.13.

[248] *Id*. at 4-5 & n.13.

[249] *Id*. at 5.

[250] Letter from Ulrich Karl, Head of Clearing, on behalf of International Swaps and Derivatives Association, to Christopher Kirkpatrick, Sec'y, CFTC at 2 (Sep. 28, 2023) ("ISDA Comment").

[251] *Id.* at 2.

landscape is an ecosystem of checks and balances that should not be undervalued or discarded without careful consideration."[252]

Professor Filler commented that "[i]t is important to recognize that DCMs and DCOs have powers to make determinations . . . effectively unchecked, in a unilateral manner and binding on the entire market, as a result of their rule-making and enforcement powers as SROs," and that affiliations have the potential to "intensify conflicts of interest and misalignment of incentives in market structure."[253] Professor Filler pointed to the London Metal Exchange's 2022 cancellation of trades in its nickel market—undertaken, in Professor Filler's framing, "in order to prevent its affiliated clearinghouse from having to exercise its default management plan"—as a cautionary example.[254]

Public Citizen commented in opposition to affiliation structures and stated that the conflicts of interest "cannot be successfully mitigated" and "the CFTC must therefore establish rules prohibiting [DCOs], [DCMs], and [SEF] facilities from operating with affiliates in CFTC-jurisdictional markets."[255] Better Markets similarly took a position generally against affiliation structures but suggested a variety of policies to address the issues that such affiliations present, including disclosure requirements, robust conflicts-of-interest policies with explicit prohibitions on preferential treatment, equal access requirements, regulatory oversight, and whistleblower procedures and protections to allow employees to report suspicions about preferential treatment.[256]

A number of commenters did not opine specifically on whether existing regulations are adequate but emphasized the importance of robust procedures and rules.

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[252] *Id*. at 2.

[253] Filler Comment, *supra* note 99, at 1, 3.

[254] *Id*. at 6.

[255] Public Citizen Comment, *supra* note 171, at 1.

[256] Better Markets Comment, *supra* note 171, at 2.

CCP Global stated that "well-defined and robust policies, procedures, rules, and disclosures should be implemented at . . . affiliated regulated entities to reduce the risk of conflicts of interest and prevent misuse of material non-public information," and that the Commission could consider "proposing additional rules establishing expectations for the rules, policies, and/or procedures that the entities of such groups would be expected to maintain to comply with current applicable CFTC conflicts of interest regulations," including "an illustrative list of conflicts to be mitigated, managed, and/or disclosed and a list of tools that entities may use to mitigate these conflicts."[257] CCP Global also commented that "FCMs affiliated with a DCM/DCO/SEF [must] neither be afforded preferential treatment, nor be disadvantage or subject to more restrictive treatment," and that this principle could be effectuated "by a combination of explicit rules, policies, and procedures stating that these affiliated FCMs are subject to and obligated to follow the same access criteria and rules as unaffiliated FCM clearing members in areas including, but not limited to, fees, surveillance, and disciplinary processes."[258] WFE similarly observed that "transparent governance arrangements, independent oversight, disclosure requirements, and compliance frameworks are some of the measures that have been proven to mitigate [conflicts of interest] effectively."[259]

MIAX commented that it is imperative that DCOs and other entities establish and rigorously enforce comprehensive rules, policies, and internal processes to help ensure affiliates receive the same treatment as non-affiliates, and that such rules be made public," and described its own public provisions stating that affiliates will not receive preferential treatment in matters such as clearing member applications, surveillance, rule compliance and disciplinary processes, pricing, and access criteria.[260] Cboe, while

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[257] CCP Global Comment, *supra* note 102, at 2.

[258] CCP Global Comment, *supra* note 102, at 3.

[259] WFE Comment, *supra* note 111, at 3.

[260] MIAX/MGEX Comment, *supra* note 110, at 4

emphasizing its preference for a principles-based framework generally, specifically "encourage[d] the Commission to extend existing DCO Core Principles to DCO affiliations with FCMs, such as regulation 39.24 on Governance, to ensure that all governance arrangements are (i) written, (ii) clear and transparent, and (iii) place a high priority on safety and efficiency."[261]

Information Barriers and Personnel Separations. Commenters broadly supported information barriers and personnel separations as means of mitigating the conflicts of interest presented by DCO-clearing-member affiliations. ISDA commented that information barriers between the DCO and an affiliated clearing member "have been applied successfully for decades in other parts of the financial services sector where conflicts may arise, and are supported by a long history of case law."[262]

Views on additional financial resources and volume caps. Commenters expressed divergent views on whether the Commission should require additional financial resources of a DCO with an affiliated clearing member or impose volume caps. ISDA and Professor Filler supported additional financial resources, with ISDA recommending increased capital, skin-in-the-game, and liquidity resources at both the DCO and the affiliated clearing member, and Professor Filler recommending that an affiliated FCM be subject to heightened net capital, residual interest, and guaranty-fund requirements (including that its guaranty-fund deposit "support loss mutualization before unaffiliated FCMs in the DCO's default waterfall").[263] CME and CCP Global disagreed, with CME observing that "requiring a DCO to have supplemental resources when it has an affiliated FCM is unnecessary" and CCP Global stating that "the current cover-1 or cover-2 standards, as applicable under current CFTC regulations, are sufficient."[264] On volume

[261] Cboe Comment, *supra* note 99, at 3.

[262] ISDA Comment, *supra* note 250, at 3.

[263] ISDA Comment, *supra* note 250, at 3-4, 9; Filler Comment, *supra* note 99, at 9.

[264] CME Comment, *supra* note 99, at 9; CCP Global Comment, *supra* note 102, at 3.

caps, certain ISDA members supported caps on the ground that conflicts increase with the affiliate's relative size.[265] CME, FIA, and MIAX did not support caps, with CME observing that "volume is not representative of risk," FIA stating that caps would be difficult to enforce, and MIAX proposing in the alternative that the Commission consider minimum thresholds for the number of unaffiliated clearing members.[266]

Views on disclosure. Commenters generally supported additional disclosure regarding DCO-clearing-member affiliations. ISDA recommended disclosure of "[t]he existence of an affiliated FCM, and a detailed description of the nature of the affiliation," together with "a description of the measures taken to manage the conflicts."[267] CME stated that it "would not be opposed to a requirement that a DCO publicly disclose its relationships to affiliates."[268] Cboe commented that "[w]hether existing or new DCMs/DCOs/SEFs propose affiliations with FCMs, it is important that there be full transparency, as well as sufficient assessment and analysis to ensure that the market fully understands the extent of these relationships, how these relationships will be managed, and how all known and potential conflicts are to be mitigated."[269] MIAX described its existing practice of publicly disclosing its affiliates on its website.[270] Better Markets and WFE similarly supported transparency regarding affiliate relationships and conflicts-management measures.[271] Public Citizen recommended that DCOs be required to "produce publicly-accessible affiliate maps that clearly identify all upstream ownership over 5%" and to disclose "LLC agreements of all Commission-jurisdictional entities."[272]

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[265] ISDA Comment, *supra* note 250, at 9, 17.

[266] CME Comment, *supra* note 99, at 12-13; FIA Comment, *supra* note 99, at 7; MIAX/MGEX Comment, *supra* note 110, at 2.

[267] ISDA Comment, *supra* note 250, at 16.

[268] CME Comment, *supra* note 99, at 13.

[269] Cboe Comment, supra note 99, at 3.

[270] MIAX/MGEX Comment, *supra* note 110, at 5 n.13.

[271] Better Markets Comment, *supra* note 171, at 4-5; WFE Comment, *supra* note 111, at 3-4.

[272] Public Citizen Comment, *supra* note 171, at 2.

C. Identified Concerns

Following the Commission's review of the Affiliations RFC record, the Commission preliminarily identifies the following concerns with respect to DCO-clearing-member affiliations.

First, a DCO exercises substantial discretion in carrying out core risk-management functions—including setting margin requirements, determining whether and when a clearing member is in financial distress or default, enforcing the DCO's rules, and conducting default management. Where the DCO has an affiliate clearing member, the structural incentives to exercise that discretion in a manner that favors the affiliate, or to delay taking action to limit the activities of the affiliate, or to place the affiliate in default, can compromise the DCO's role as a neutral risk manager. As FIA observed, the consequences of a delayed default of an affiliated clearing member can extend beyond the DCO itself: non-defaulting, unaffiliated clearing members' guaranty-fund contributions may be drawn upon, and contagion risk may spread to other market participants. The Commission preliminarily believes that this concern is particularly acute because—unlike in the DCM context, where the Acceptable Practices for DCM Core Principle 16 provide a framework for separating regulatory functions from commercial interests—the existing Commission Regulation 39.25 framework contains no comparable structural separation requirement specific to clearing-member affiliations.

Second, even where a DCO does in fact treat its affiliate clearing members on an arms-length basis, the perception of preferential treatment can have anti-competitive effects on unaffiliated clearing members. Market participants may direct clearing activity to the affiliate on the assumption that the DCO will favor it; unaffiliated clearing members may conclude that they are systematically disadvantaged in margin, default, or rule-enforcement decisions; and the integrity of the DCO's role as a market-neutral risk manager may be undermined.

Third, market participants do not have a specific means of knowing which DCOs have affiliated clearing members or of evaluating how related conflicts are managed. The existing Commission Regulation 39.21 public-disclosure framework requires that DCOs provide "sufficient information to enable the market participants to identify and evaluate accurately the risks and costs associated with using" the DCO, and it requires disclosure of specified categories of information relevant to participation in clearing, but it does specify affiliate relationships.

The Commission preliminarily believes these concerns warrant Commission action, both because they are not specifically addressed by the existing Commission Regulation 39.25 framework and because the number of DCO-clearing-member affiliations has grown in recent years.[273]

D. Proposed Amendments

To address these concerns, the Commission proposes three amendments: (1) a new definition of "affiliate clearing member" in Commission Regulation 39.2; (2) a new principles-based requirement in Commission Regulation 39.25(d) requiring procedures to identify, address, and manage conflicts of interest involving an affiliate clearing member; and (3) a new public-disclosure requirement in Commission Regulation 39.21(c)(9) regarding the existence of, and the DCO's relationship with, any affiliate clearing member.

Definition of "affiliate clearing member" (Commission Regulation 39.2).

The Commission proposes to define affiliate clearing member to mean a person that: (1) is a clearing member of a derivatives clearing organization; and (2) directly or indirectly controls, is controlled by, or is under common control with, the derivatives clearing organization. As used in the previous sentence, control (including the terms

[273] As noted above, the Commission is aware of at least five DCOs that have affiliate clearing members today.

“controlled by” and “under common control with”) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a derivatives clearing organization or clearing member, whether through the ownership of voting securities, by contract, or otherwise.

This definition uses the same “control”-based formulation that the Commission proposes to use elsewhere in this rulemaking for the parallel definitions of “affiliate futures commission merchant” and “affiliate market participant”.[274] The Commission preliminarily believes that consistency across these parallel definitions will promote clarity and ease of compliance for registrants that are part of corporate groups with multiple CFTC-registered entities.

Procedures requirement (proposed Commission Regulation 39.25(d)).

The Commission proposes to add a new paragraph (d) to Commission Regulation 39.25 providing that a DCO shall have procedures for identifying, addressing, and managing conflicts of interest involving an affiliate clearing member. Further, the proposed rule would require such procedures to address, at a minimum: (1) applications and systems, such that a DCO’s applications, information and systems are maintained and operated in a manner that prevents the sharing of non-public information with any affiliate clearing member; (2) personnel, such that a DCO does not share staff with any affiliate clearing member, except with respect to administrative functions; (3) office space, such that a DCO maintains office space for itself that is separate from the office space of any affiliate clearing member; and (4) documentation, such that a DCO documents all conflicts of interest that arise with respect to an affiliate DCO and how any such conflict of interest is resolved. This addition would leave intact Commission Regulations 39.25(a), (b), and (c) and would parallel the structure of Commission

[274] See *supra* at III.A.iv, B.iii.

Regulation 39.25(c), which addresses board-of-director conflicts. This requirement also would be substantially identical to the conflicts of interest procedures requirements proposed for DCMs and SEFs.[275]

The Commission preliminarily believes that a principles-based requirement is preferable to prescriptive structural separation rules in this context. DCO discretion is essential to effective risk and default management: a DCO must be able to respond to the particular circumstances of a clearing member in financial distress or default in real time, and overly prescriptive rules constraining how the DCO must structure its operations could impede that response. Moreover, as part of its risk management responsibilities, a DCO needs to have a complete understanding of the risks involved in carrying particular products (and portfolios of products) cleared at that DCO, which makes the DCO particularly well-qualified to carry out its obligations. At the same time, the principles-based formulation in proposed Commission Regulation 39.25(d)—like the parallel formulation already in Commission Regulation 39.25(c)—provides an enforceable baseline. Whether a DCO has an affiliate clearing member is an objective inquiry, as is whether the DCO maintains procedures for identifying, addressing, and managing the associated conflicts of interest. The Commission can examine for compliance objectively, and the requirement places the burden on the DCO to design procedures appropriate to its particular structure and risk profile.

The Commission proposes to provide guidance, in the form of acceptable practices in a new Appendix D to part 39, regarding the procedures that the Commission would consider appropriate in this regard. The Commission proposes that such guidance be substantially identical to the Proposal's guidance regarding appropriate conflicts of interest policies for a DCM or SEF.

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[275] The proposed DCM and SEF rules include a disclosure requirement, which also is proposed to be substantially similar for DCOs, but is addressed separately below.

However, the Commission recognizes that a DCO is differently situated from an exchange and that it may be beneficial to provide additional guidance. The Commission considered, for example, providing guidance that a DCO's conflict of interest procedures also should address: (i) documentation of decisions affecting the affiliate clearing member, including margin determinations, default-related decisions, and rule-enforcement decisions; (ii) independent governance of decisions affecting the affiliate clearing member, including the role of independent directors and risk management committees; and (iii) treatment of the affiliate clearing member on terms no more favorable than those applicable to non-affiliate clearing members. The Commission requests comment on all aspects of the proposed guidance, including if there are specific elements of guidance that would be beneficial.

Public disclosure (proposed Commission Regulation 39.21(c)(9)).

The Commission proposes to add a new Commission Regulation 39.21(c)(9) requiring a DCO to disclose the existence of, and the derivatives clearing organization's relationship with, any affiliate clearing member. Existing Commission Regulation 39.21(c)(9), which provides a residual catchall for "[a]ny other information that is relevant to participation in the clearing and settlement activities of the derivatives clearing organization," would be redesignated as Commission Regulation 39.21(c)(10) without substantive change.

The Commission preliminarily believes that public disclosure of the existence and nature of any affiliate clearing member relationship is an important complement to the procedures requirement in proposed Commission Regulation 39.25(d). Public disclosure permits unaffiliated clearing members, customers, and other market participants to evaluate the DCO's conflicts-management framework, to make informed decisions about where to direct clearing activity, and to monitor whether the DCO is treating affiliate and non-affiliate clearing members on comparable terms. As Cboe observed, "it is important that there be full transparency, as well as sufficient assessment and analysis to ensure that the market fully understands the extent of these relationships, how these relationships will be managed, and how all known and potential conflicts are to be mitigated."[276] CME and other comments likewise stated that they would not object to a disclosure requirement of this kind.[277]

E. Statutory Authority

The Commission proposes the amendments to Commission Regulations 39.2, 39.21, and 39.25 pursuant to section 8a(5) of the Act[278] and DCO Core Principles A (Compliance), C (participant and Product Eligibility), L (Public Information), and P (Conflicts of Interest). Core Principle P—the principal statutory hook—requires each DCO to "establish and enforce rules to minimize conflicts of interest in the decision-making process of the [DCO]" and to "establish a process for resolving such conflicts of interest."[279] Core Principle L supplies direct statutory authority for the proposed public-disclosure requirement in Commission Regulation 39.21(c)(9). Core Principle C, which requires appropriate participation standards for clearing members, provides supporting authority for a mitigation framework calibrated to the risks presented by a particular category of clearing member.

Core Principle A, as amended by section 725(c) of the Dodd-Frank Act, requires each DCO to comply with the Core Principles set forth in section 5b(c)(2) of the Act "and any requirement that the Commission may impose by rule or regulation pursuant to section 8a(5)."[280] Under Core Principle A(ii), a DCO has reasonable discretion in establishing the manner in which it complies with the Core Principles "[u]nless otherwise

[276] Cboe Comment, *supra* note 99, at 3.

[277] CME Comment, *supra* note 99, at 13; ISDA Comment, *supra* note 250, at 16; WFE Comment, *supra* note 111, at 3-4.

[278] CEA 8a(5), 7 U.S.C. 12a(5).

[279] 7 U.S.C. 7a-1(c)(2)(L).

[280] 7 U.S.C. 7a-1(c)(2)(A)(i).

determined by the Commission by rule or regulation."[281] The proposed amendments are a targeted exercise of those authorities: they identify a category of conflicts—those involving an affiliated clearing member—that the existing implementing framework does not specifically reach, prescribe a principles-based procedural requirement in Commission Regulation 39.25(d), and calibrate a related public-disclosure requirement in Commission Regulation 39.21(c)(9). The Commission preliminarily believes that this measured exercise of Core Principle P and section 8a(5) authority is both necessary to address the concerned identified above and appropriately tailored to preserve the DCO discretion that is essential to effective risk and default management.

F. Alternatives Considered

The Commission considered a number of alternatives to the proposed approach, including alternatives suggested by Affiliations RFC commenters. The Commission discusses each below and solicits comments on each.

1. No additional rules

Cboe, ICE, and CME each commented that the existing principles-based framework is substantially adequate to address the conflicts of interest presented by DCO-clearing-member affiliations.[282] The Commission preliminarily declines to take this approach. Commission Regulation 39.25 in its current form contains no provision specifically addressing affiliate-clearing-member conflicts, and Commission Regulations 39.25(a) and (b)—which speak generically to minimizing and resolving conflicts in the DCO's decision-making process—do not provide registrants, market participants, or the Commission with a clear framework for evaluating whether a DCO's conflicts-management arrangements with respect to an affiliate clearing member are adequate. The

[281] 7 U.S.C. 7a-2(a)(1)-(2).

[282] Cboe Comment, *supra* note 99, at 2; ICE Comment, *supra* note 99, at 1-2; CME Comment, *supra* note 99, at 1, 4.

growing prevalence of DCO-clearing-member affiliations and the specific conflicts those affiliations present—particularly with respect to margin discretion, management of a clearing member in financial distress or in default, and rule enforcement—warrant a targeted procedures requirement modeled on the existing Commission Regulation 39.25(c) framework for board-of-director conflicts. The Commission preliminarily believes that the proposed rule does not impose meaningful incremental burdens on registrants that already have appropriate conflicts-management arrangements in place, while providing clear regulatory expectations for new registrants.

2. Prohibition on DCO affiliations with clearing members

Public Citizen commented that the conflicts of interest associated with affiliated structures "cannot be successfully mitigated" and that "the CFTC must therefore establish rules prohibiting [DCOs], [DCMs], and [SEFs] from operating with affiliates in CFTC-jurisdictional markets."[283] Better Markets similarly opposed affiliated structures as a general matter. And ISDA reported that "[s]ome ISDA members . . . believe that the CFTC should not permit affiliated FCMs in this situation."[284]

The Commission preliminarily declines to adopt this alternative. The CEA does not prohibit DCOs from having affiliate clearing members, and DCO affiliations with FCMs have existed for many years under the Commission's principles-based framework. As CME observed, "[t]he CEA wisely does not prohibit conflicts of interest. Instead, it recognizes that conflicts of interest can and will exist and they generally can be managed."[285] The Commission preliminarily agrees that affiliations between DCOs and clearing members can produce efficiencies and competitive benefits, and that a targeted procedures-and-disclosure framework can adequately mitigate the relevant risks without

[283] Public Citizen Comment, *supra* note 171, at 1.

[284] ISDA Comment, *supra* note 250, at 2.

[285] CME Comment, *supra* note 99, at 8.

foreclosing efficiency-enhancing structures. The Commission solicits comment on whether the prohibition urged by various commenters would be more effective than the proposed approach.

3. A prescriptive separations approach

Under this alternative, the Commission would adopt prescriptive rule text—rather than guidance—specifying additional required separations between a DCO and its affiliate clearing member. The Commission has preliminarily declined to adopt this alternative for the reasons described above—principally, that prescriptive requirements could impede the DCO discretion that is essential to effective risk and default management. The Commission solicits comment on whether a prescriptive approach would be preferable and, if so, how it should be calibrated.

4. Supplemental financial resources at the DCO

ISDA proposed that a DCO with an affiliate clearing member be required to "reserve[] more capital, SITG [skin-in-the-game] and liquidity resources,"[286] and elsewhere proposed that the DCO hold "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, Commission Regulations 39.11(a)(1), 39.11(e)(1)(ii), and 39.33(c)."[287] CME and CCP Global, by contrast, opposed supplemental financial-resources requirements. CME observed that "requiring a DCO to have supplemental resources when it has an affiliated FCM is unnecessary,"[288] and CCP Global stated that "the current cover-1 or cover-2 standards . . . are sufficient."[289]

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[286] ISDA Comment, *supra* note 250, at 9.

[287] *Id*.

[288] CME Comment, *supra* note 99, at 9.

[289] CCP Global Comment, *supra* note 102, at 3.

The Commission preliminarily declines to require supplemental financial resources. The Commission preliminarily agrees with CME and CCP Global that the existing financial-resources requirements applicable to DCOs are appropriate to the risks DCOs face and that imposing additional financial-resources requirements based solely on the existence of an affiliation is unnecessary. The Commission also notes that supplemental financial-resources requirements might create their own conflicts—for example, in stress-test design, as ISDA acknowledged.[290] The Commission solicits comment on whether supplemental financial resources should be required and, if so, how they should be sized, sourced, and stress-tested.

5. Segmented skin-in-the-game and restrictions on mutualization of affiliate clearing member losses

Related to but distinct from a general supplemental-resources requirement, ISDA proposed that the Commission "[i]ncrease the tranche of DCO equity in the default waterfall, so called 'skin-in-the-game' ('SITG'), or incorporate a segmented section SITG that applies in the case of losses associated with the affiliated [clearing member]."[291] ISDA also proposed that "[i]f the DCO would not be allowed to mutualize losses from the default of its affiliated [clearing member], conflicts of interest would reduce significantly. DCOs should have the same reputation risk as bank holding companies have with their subsidiaries, and stand behind these entities."[292]

The Commission preliminarily declines to require either a segmented SITG tranche or a restriction on mutualization of affiliate clearing member losses in this Proposal. It is not apparent that a segmented SITG requirement would be a proportionate means of mitigating any increased risk caused by the affiliation. Moreover, a DCO would

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[290] ISDA Comment, *supra* note 250, at 10.

[291] *Id.* at 4.

[292] *Id*. at 10.

have reputational risk linked to the failure of an affiliate clearing member, and this reputational risk may create incentives for the DCO to take sufficient steps to mitigate the risk of the failure of that affiliate. In this regard, as noted, a DCO has discretion with respect to its default management procedures. A DCO with an affiliate clearing member may determine to put more of its own capital into the default waterfall and to prevent loss mutualization for its affiliate clearing member's losses if it determines such procedures are appropriate. Another DCO may decline to take such an approach. In either case, market participants, in determining where to clear transactions, will be aware, through DCO disclosures, of these differences and may make decisions on that basis. For these reasons, the Commission preliminarily believes that a prescriptive approach in this regard is unnecessary. The Commission solicits comment on whether either measure should be proposed and on the merits and operational implications of each.

6. Heightened capital, residual interest, and guaranty-fund-priority requirements for affiliate FCMs

Professor Filler proposed a related but distinct alternative directed at the affiliated FCM rather than at the DCO: an affiliated FCM should be subject to (i) adjusted net capital of "two or three times that of other, unaffiliated FCMs"; (ii) enhanced residual interest "higher than the range . . . customarily maintained by unaffiliated FCMs"; and (ii) a minimum guaranty-fund deposit that "should support loss mutualization before unaffiliated FCMs in the DCO's default waterfall."[293]

The Commission preliminarily declines to adopt these requirements. As noted above, a DCO may, in its discretion, determine to place additional financial requirements on its affiliate FCM. Another DCO may decline to do so and unaffiliated market participants, aware of these policies, will be able to make determinations as to where to

[293] Filler Comment, *supra* note 99, at 9.

clear their transactions. Furthermore, the Commission preliminarily believes that the FCM capital and residual-interest requirements addressed under Commission Regulations 1.17 and 1.22, respectively, are sufficient. Additionally, subordinating an affiliate FCM's guaranty-fund contribution to unaffiliated members' contributions in the default waterfall would require an amendment to the default-waterfall provisions of Commission Regulation 39.16 and to each DCO's rulebook, and would represent a significant departure from the cover-1/cover-2 framework that has historically applied uniformly in this context. Moreover, there does not appear to be evidence to support the conclusion that an enhanced capital, residual, or guaranty fund requirement would be proportionate to, or would reliably mitigate, any increased risk created by the affiliation. Finally, as noted above, the Commission also preliminarily believes it would be inappropriate to impose prescriptive requirements with respect to default management, given the importance of a DCO's discretionary authority to manage defaults. The Commission solicits comment on whether any of these measures should be proposed.

7. Volume caps

Certain ISDA members supported capping the share of transactions that a DCO's affiliate clearing member can clear, on the basis that conflicts increase with the affiliate's relative size.[294] CME, by contrast, observed that "volume is not representative of risk,"[295] and FIA observed that volume caps would be difficult to enforce and that "it is not clear what remedy would be available to the other FCMs if the caps were breached."[296]

The Commission preliminarily declines to propose a volume cap. The Commission preliminarily agrees with CME that volume—without more—is not necessarily a reliable proxy for risk, and with FIA that volume caps would present

[294] ISDA Comment, *supra* note 250, at 9, 17.

[295] CME Comment, *supra* note 99, at 12-13.

[296] FIA Comment, *supra* note 99, at 7.

significant administrability concerns. The Commission solicits comment on whether this approach should be reconsidered.

8. Pre-approval and heightened-supervision alternatives

ISDA proposed that the Commission consider "[p]otential requirement[s] for explicit regulatory approval for use of discretion by the DCO impacting the affiliated [clearing member] (e.g., in default/recovery/resolution)" and "[e]nhanced supervisory focus by the Commission on decisions affecting affiliated entities."[297] CCP Global also supported close Commission supervision.[298]

The Commission preliminarily declines to require pre-approval of specific DCO decisions affecting an affiliate clearing member in the default management context. Pre-approval requirements could materially impede the DCO's ability to respond to situations where the affiliate clearing member is in financial distress or default in real time, and the Commission preliminarily believes that the appropriate locus of decision-making for time-sensitive risk-management decisions is the DCO rather than the Commission. Indeed, to the extent that the concern is that the fact of the affiliation would delay the DCO in addressing situations of financial distress or default, a pre-approval requirement would exacerbate rather than mitigate that concern. In any case, the Commission also expects that a DCO managing a clearing member default will be in close communication with the Commission throughout the process.[299] The Commission preliminarily intends, however, to focus its supervisory attention on the conflicts-management arrangements of DCOs with affiliate clearing members, consistent with its existing supervisory authority. The Commission solicits comment on whether pre-approval requirements or other heightened-supervision measures should be incorporated into the Proposal.

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[297] ISDA Comment, *supra* note 250, at 3-4.

[298] CCP Global, *supra* note 102, Comment at 3.

[299] *See* 17 CFR 39.19(c)(4)(viii).

9. Stakeholder complaint forum

ISDA proposed that the Commission "[e]stablish a forum for stakeholders to bring complaints if they feel that discretion has been misused."[300] The Commission notes that unaffiliated clearing members and other stakeholders may currently bring concerns to the Commission's attention through existing channels, including the tips, complaints, and referrals process. The Commission preliminarily declines to establish a separate stakeholder complaint forum specific to affiliate-clearing-member conflicts but solicits comment on whether such a forum would be useful.

10. DCO-adopted prescriptive rules applicable to affiliate clearing members

ISDA proposed that the Commission consider requiring DCOs to "set[] more prescriptive rules for affiliate[] [clearing members], even though additional prescription might restrict the required level of flexibility in managing unforeseen risks. Such increased prescriptiveness needs to be carefully balanced against the flexibility required for prudent risk management."[301] Under this alternative, the Commission would not adopt prescriptive rules; rather, the DCO would be required to adopt rules in its rulebook that bind only the affiliate clearing member. The Commission preliminarily believes that proposed Commission Regulation 39.25(d) permits but does not require this approach, and that whether a DCO should adopt such prescriptive rules concerning affiliate clearing members is best left to the DCO's discretion as part of its conflicts-management procedures. The Commission solicits comment on whether the rule should affirmatively require DCOs to adopt differentiated rules for affiliate clearing members.

11. Codified non-preference principle

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[300] ISDA Comment, *supra* note 250, at 4.

[301] ISDA Comment, *supra* note 250, at 4.

ISDA proposed "a principle that the DCO treats all members equally, regardless of affiliation,"[302] and CCP Global, MIAX, and Better Markets each emphasized that affiliate clearing members should not receive preferential treatment.[303] The Commission preliminarily believes that the proposed Commission Regulation 39.25(d) procedures requirement, combined with existing Commission Regulation 39.12(a)(1) (requiring fair and open access for participant) and the DCO Core Principles regarding fair and open access (Core Principle C) and competition (Core Principle N), provide an adequate framework for non-preference. The Commission solicits comment on whether a non-preference principle should be codified in rule text or addressed in guidance.

12. Codified independent reporting line for DCO Chief Compliance Officer or Chief Risk Officer

Some commenters observed that a DCO's CCO or CRO should have independent reporting lines to protect the compliance function of undue influence from the associated business. For example, FIA recommended that "[w]here registered entities have affiliated entities, CFTC rules should ensure the CRO/CCOs of such registered entities have independent reporting structures that adequately insulate them from commercial pressures which may conflict with their supervisory responsibilities."[304]

The Commission preliminarily declines to codify a specific independent-reporting-line requirement for the DCO's CCO or CRO in this Proposal. Such a requirement would have implications far beyond the context of a DCO and its affiliate clearing member. In this regard, the Commission preliminarily believes that any such requirement may be better suited to a separate rulemaking process focused on any potential changes and improvements to the existing DCO CCO framework. Furthermore,

[302] *Id*.

[303] CCP Global Comment, *supra* note 102, at 3; MIAX/MGEX Comment, *supra* note 110, at 2-3; Better Markets Comment, *supra* note 171, at 4-5.

[304] FIA Comment, *supra* note 99, at 10.

the Commission recognizes that the Act already requires a DCO's CCO to report directly to the DCO's board or a senior officer. The Commission also notes that another aspect of this rulemaking contemplates that a DCO's CCO annual report will cover the conflicts-of-interest rules described herein, which the Commission preliminarily believes may be sufficient. The Commission solicits comment on whether such a requirement should be added and, if so, how it should be calibrated.

G. Request for Comment

60) Is the proposed definition of "affiliate clearing member" appropriately calibrated? Should it be broadened or narrowed? Should "control" be defined differently—for example, by reference to a specific ownership threshold or by reference to specific contractual or governance-based indicia of control? Should the Commission include a presumption of control based on ownership of voting securities at a specified percentage?

61) Is the principles-based formulation in proposed Commission Regulation 39.25(d) appropriately calibrated? Should the rule text instead enumerate additional specific procedures the DCO must adopt? If so, which procedures, and why?

62) What elements should the Commission address in guidance accompanying Commission Regulation 39.25(d)? Is the guidance contemplated for DCMs and SEFs and described above sufficient? Should other elements be addressed? Should the guidance address the role of independent directors or independent risk management committees in decisions affecting an affiliate clearing member?

63) Should the Commission prohibit a DCO from having an affiliate clearing member? If so, should any such prohibition be subject to grandfathering for existing affiliate clearing members?

64) The Commission has not proposed prescriptive requirements addressing the exercise of DCO discretion in management of situations where an affiliate clearing member is in financial distress or default. Should the rule or guidance address discretion with respect to these situations specifically—for example, by requiring that decisions to declare an affiliate clearing member in default, to grant any exemption from auto-liquidation rules, or to depart from the DCO's default-management playbook with respect to an affiliate clearing member be documented, reviewed by a designated independent committee, and reported to the Commission?

65) Should the rule or guidance specifically address margin-setting and risk-management discretion with respect to an affiliate clearing member?

66) Should the Commission require a DCO with an affiliate clearing member to maintain additional financial or liquidity, or have "skin-in-the-game" resources beyond those required of DCOs without an affiliate clearing member, as some commenters have suggested? Should any such requirement be calibrated to the affiliate clearing member's share of the DCO's volume, open interest, or risk exposure? What costs, benefits, and competitive consequences would such a requirement entail?

67) Should the Commission require that any additional financial resources sourced from the DCO or the affiliate clearing member be allocated to losses arising from a default of the affiliate clearing member before non-affiliate clearing members' guaranty-fund contributions are drawn upon? Should the affiliate clearing member's guaranty-fund contribution be subordinated in the default waterfall?

68) Should the Commission impose a cap on the share of a DCO's clearing volume attributable to an affiliate clearing member? If so, how should the cap be calibrated, and how would compliance be administered?

69) Is the proposed disclosure requirement in Commission Regulation 39.21(c)(9) appropriately calibrated? Should the Commission also require disclosure of (i) the upstream ownership chain of the affiliate clearing member, (ii) the specific conflicts-management measures the DCO has adopted, or (iii) the financial and operational interconnections between the DCO and the affiliate clearing member? Should the Commission expand disclosure to reach partial (non-controlling) ownership relationships?

70) Do any of the concerns that animate this Proposal change to the extent a DCO is a systemically important derivatives clearing organization ("SIDCO")? For example, are conflict of interest concerns greater with respect to a SIDCO with an affiliate clearing member as compared to a DCO with an affiliate clearing member? If so, should the Commission impose additional safeguards or limitations with respect to SIDCO-affiliate clearing member relationships? Should the Commission consider a prohibition on a SIDCO having an affiliate clearing member?

71) The Commission requests that DCOs with an affiliate clearing member—and any other DCO, clearing member, FCM, or market participant with relevant information—describe:

(a) The policies, procedures, rulebook provisions, organizational separations, and other measures currently in place to address the conflicts of interest arising from the DCO's affiliation with a clearing member;

(b) The current public disclosures the DCO makes regarding affiliate relationships, the location and prominence of such disclosures, and any additional disclosures the DCO would expect to make to comply with proposed Commission Regulation 39.21(c)(9).

(c) The nature and estimated incremental cost of any change to existing arrangements that would be required to comply with the proposed amendments as currently drafted; and

(d) The nature and estimated incremental cost of complying with each of the alternatives described above.

V. Public Disclosures by FCMs—Proposed Amendment to Commission Regulation 1.55

A. Background

Commission Regulation 1.55 provides that no FCM may enter into a customer account agreement or first accept funds from a customer, unless the FCM discloses to the customer all information about the FCM, including its business, operations, risk profile, and affiliates, that would be material to the customer's decision to entrust such funds to and otherwise do business with the FCM and that is otherwise necessary for full and fair disclosure.[305] In connection with the disclosure, the FCM must provide certain material information to its customers, including information regarding the material risks of entrusting customer funds with an FCM created by the FCM's affiliates.[306] The disclosures in Commission Regulation 1.55 are designed to enable customers to make informed judgments regarding the appropriateness of selecting an FCM and to enhance the diligence that a customer can conduct prior to opening an account and on an ongoing basis.[307] The disclosure requirements mandated by Commission Regulation 1.55 also are designed to promote the protection of customer funds and to minimize the systemic risk

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305 17 CFR 1.55(i).

306 17 CFR 1.55(k)(5).

307 78 FR 68506 at 68564 (Nov. 14, 2013).

posed by certain actions of market participants. While Commission Regulation 1.55 references affiliate relationships, it does not explicitly require that an FCM disclose an affiliate relationship with a SEF, DCM, or DCO.

B. Comments on the Affiliations RFC

The Affiliations RFC also sought public comment as to whether any additional disclosures should be required regarding an affiliate relationship between a SEF or DCM and an FCM, IB, CPO, or CTA. Better Markets recommended that the Commission mandate clear and comprehensive disclosures by FCMs, IBs, CTAs, and CPOs of their affiliations with DCMs or SEFs and that customers and clients should be informed about affiliations upfront.[308] CME noted that existing FCM disclosure obligations ensure that clients are aware of any affiliations between a marketplace and the intermediary firm and that adequate disclosure regarding any such affiliations, including any impacts on the intermediary's product offerings due to such affiliations, is appropriate.[309] WFE noted that disclosure requirements are among the measures that have been proven to mitigate conflicts of interest effectively.[310] ICE likewise stated that disclosures should be implemented at affiliated regulated entities to reduce risks related to conflicts of interest.[311]

C. Proposed Amendments

Commission Regulation 1.55(k)(5)—Public disclosures by FCMs.

The Commission believes it is important for FCMs to disclose to their customers any affiliate relationships it may have with CFTC-regulated entities. Where a DCO, SEF, or DCM is affiliated with an FCM or other market participant, potential concerns may arise, including with respect to conflicts of interest, especially when that entity is

[308] Better Markets Comment, *supra* note 171, at 7.

[309] CME Comment, *supra* note 99, at 20.

[310] WFE Comment, *supra* note 111, at 3.

[311] ICE Comment, *supra* note 99, at 2.

responsible for supervising an affiliate. Disclosure can mitigate these risks. The Commission, therefore, considers it necessary that FCMs make customers aware of the FCM's affiliate relationships to enable them to make informed decisions when selecting an FCM. To that effect, the Commission is proposing to amend Commission Regulation 1.55(k) to enhance the disclosures provided to customers and potential customers regarding any affiliate relations that an FCM has with an exchange or a clearing organization. Specifically, the amendment to Commission Regulation 1.55(k)(5) would require that an FCM disclose any affiliate relationship it has with a SEF, DCM, or DCO along with any risks created by such affiliate relationship.

D. Statutory Authority

The Commission proposes the amendment to Commission Regulation 1.55(k)(5) pursuant to its authority to regulate FCMs under the Act, together with its general rulemaking authority. Section 4d of the Act establish the framework governing FCMs, including the registration of FCMs, the treatment of segregation of customer funds, and the Commission's authority to prescribe the terms and conditions under which an FCM may accept and hold customer money, securities, and property.[312] Section 4f of the Act provides for the registration and regulation of FCMs, including minimum financial and related requirements and the Commission's authority to prescribe rules governing FCM conduct.[313] The customer-protection and disclosure obligations codified in Commission Regulation 1.55 were adopted under this authority.[314]

The Commission's general rulemaking authority under section 8a(5) of the Act separately authorizes the Commission to promulgate such rules and regulations as are reasonably necessary to effectuate the provisions, or to accomplish the purposes, of the

[312] CEA 4d, 7 U.S.C. 6d.

[313] CEA 4f, 7 U.S.C. 6f.

[314] 17 CFR 1.55(i), (k)(5).

Act.[315] The proposed amendment to Commission Regulation 1.55(k)(5) is a direct extension of the existing 1.55(k)(5) obligation to disclose affiliate-related risks and of the Regulation's broader purpose of enabling customers to make informed judgments about entrusting funds to, and doing business with, a particular FCM. The Commission preliminarily believes that requiring disclosure of an FCM's affiliation with a registered exchange or clearing organization is reasonably necessary to accomplish that customer-protection purpose, particularly where such an affiliation may bear on the conflicts of interest and other risks a customer assumes in selecting the FCM, and that the proposed amendment is therefore authorized under sections 4d, 4f, and 8a(5) of the Act.

E. Alternatives Considered

The Commission considered whether to prescribe the disclosures that an FCM must provide to its customers regarding any affiliate relationship it has with a SEF, DCM, or DCO. Other aspects of Commission Regulation 1.55 prescribe FCM disclosures in this manner. Commission Regulation 1.55(a), for example, provides that no FCM can open a customer account, subject to certain exceptions, unless it furnishes to the customer the written disclosure statement provided in Commission Regulation 1.55(b). The Commission preliminarily declines to adopt a prescriptive disclosure requirement in connection with an FCM's affiliate relationships. The relevant contours of any individual FCM-affiliate relationship may differ and the Commission believes that FCMs should tailor their disclosure to match their particular circumstances. In this regard, the Commission preliminarily determines that adding a disclosure requirement, consistent with the existing Commission Regulation 1.55(k) requirement for FCMs to disclose material information regarding certain enumerate topics, is appropriate.

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[315] CEA 8a(5), 7 U.S.C. 12a(5).

The Commission solicits comment on whether the prescriptive disclosure alternative is preferable.

F. Request for Comment

72) Is the proposed revision to Commission Regulation 1.55(k) appropriate? Will the proposed revision result in sufficient FCM disclosures regarding affiliate relationships?

73) Should the Commission instead draft and require FCMs to provide their customers with specific affiliate relationship disclosure materials? If so, what should that disclosure say? Should it differ depending on whether the affiliate is a SEF, DCM or DCO?

74) Are there any other disclosures that an FCM should be required to make to customers regarding its affiliate relationships?

VI. Compliance Responsibility

The Commission's regulations require FCMs, SEFs, and DCOs to have a CCO responsible for the overall compliance program of the registered entity. Among other responsibilities, a CCO must submit an annual report to the Commission discussing the registered entity's compliance program, including any material noncompliance issues. Furthermore, the CCO or CEO of the registered entity must certify, under penalty of law, that the report is accurate and complete in all material respects. While a DCM is not required to have a CCO, Appendix B to part 38 of the Commission's regulations contemplates a DCM having a ROC and CRO. The Commission understands that ROCs and CROs are common among DCMs and that they play a substantially similar role at a DCM that a CCO plays at an FCM, SEF, or DCO.

The Commission expects that the CCO or CRO of a registered entity will ensure reasonable compliance with the rules set forth in this Proposal, including, among other things, that the CCO or CRO report for each such entity will address any material noncompliance issues.

The Commission considered proposing to amend its rules specifically to require a CCO report to address compliance with this Proposal. For example, the Commission considered proposing to amend Commission Regulation 3.3 to ensure a CCO is responsible for compliance with the regulations set forth in this Proposal, including that the CCO Annual Report addresses any areas for improvement or other changes to the registered entity's compliance program with respect to the conflicts of interest requirements set forth in the Proposal. The Commission preliminarily concluded that no changes to existing regulations are required given the general nature of the CCO's obligations and the content already required to be included by regulation in the CCO Annual Report. Nevertheless, the Commission solicits comments in this regard. Specifically:

75) Should the Commission amend its rules regarding the CCO's obligations or the CCO Annual report?

76) Are there any other measures the Commission should take to ensure registered entities comply with the regulations set forth in this Proposal?

77) Should the Commission codify the DCM ROC and CRO requirements or otherwise subject a DCM to the same CCO requirements to which other registered entities are subject?

VII. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA")[316] requires Federal agencies, in promulgating regulations, to consider the impact of those regulations on small businesses.

[316] 5 U.S.C. 601 *et seq*.

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.[317] The proposed regulations would affect futures commission merchants ("FCMs"), designated contract markets ("DCMs"), derivatives clearing organizations ("DCOs"), and swap execution facilities ("SEFs").

The Commission has previously determined that FCMs, DCMs, and DCOs are not small entities for purposes of the RFA.[318] Likewise, the Commission previously concluded that SEFs are not small entities for the purpose of the RFA.[319] 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)[320] as defined in section 1a(18) of the CEA,[321] are not small entities for purposes of the RFA.[322] As a result, the Commission does not expect the regulations, as proposed herein, to have a significant economic impact on a substantial number of small entities. Accordingly, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the proposed regulations will not have a significant economic impact on a substantial number of small entities. This document serves as notification to the Small Business Administration of the agency's certification of no effect.

B. Paperwork Reduction Act

[317] 47 FR 18618-21 (Apr. 30, 1982).

[318] 47 FR 18618, 18619 (Apr. 30, 1982) (discussing contract markets); 66 FR 45604, 45609 (Aug. 29, 2001) (discussing DCOs); 67 FR 53146, 53171 (Aug. 14, 2002). (discussing clearing organizations and FCMs).

[319] 78 FR 33476, 33548 (June 4, 2013) (discussing SEFs).

[320] 17 CFR 37.703.

[321] 7 U.S.C. 1(a)(18).

[322] 66 FR 20740, 20743 (Apr. 25, 2001) (stating that ECPs by the nature of their definition in the CEA should not be considered small entities).

The Paperwork Reduction Act of 1995 ("PRA")[323] imposes certain requirements on federal agencies, including the Commission, in connection with 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 currently valid control number from the Office of Management and budget ("OMB").[324] 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, used, shared, and disseminated by or for the Federal Government.[325] 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, ten or more persons.[326]

This proposed rulemaking would result in new collection of information requirements within the meaning of the PRA. The Commission is therefore submitting this proposal to the Office of Management and Budget (OMB) for review. The title for this collection of information is "Requirements for Designated Contract Markets, Swap Execution Facilities, Derivatives Clearing Organizations, and Intermediaries Regarding Affiliated Relationships." OMB has not yet assigned this collection a control number.

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[323] 44 U.S.C. 3501 *et seq*.

[324] *See* 44 U.S.C. 3507(a)(3); 5 CFR 1320.5(a)(3).

[325] *See* 44 U.S.C. 3501.

[326] *See* 44 U.S.C. 3502(3).

The Commission therefore is submitting this proposal to the OMB for its review in accordance with the PRA.[327]

If the proposed regulations are adopted, 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.[328] In addition, section 8(a)(1) of the CEA 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."[329] Finally, the Commission is also required to protect certain information contained in a government system of records according to the Privacy Act of 1974.[330]

1. Information Collection Requirements

The proposed regulations would require registered entities with covered affiliate relationships to provide disclosures necessary to prevent potential conflicts of interest and, with respect to DCMs with an affiliate principal trading firm, make certifications to the Commission regarding compliance with required conflicts of interest procedures. For purposes of the PRA, the term "burden" means the "time, effort, or financial resources expended by persons to generate, maintain, or provide information to or for a Federal Agency."[331] This total includes the anticipated burden associated with the disclosure and reporting obligations contained in the proposed rules.[332]

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[327] See 44 U.S.C. 3507(d); *see also* 5 CFR 1320.11.

[328] *See* 5 U.S.C. 552; *see also* 17 CFR part 145 (Commission Records and Information).

[329] 7 U.S.C. 12(a)(1).

[330] 5 U.S.C. 552a.

[331] 44 U.S.C. 3502(2).

[332] In addition to the requirements described below, the proposed amendments include a principles-based framework under which the affected entities are called upon to establish appropriate processes and procedures to ensure compliance with the rules' substantive obligations. This principles-based framework does not prescribe the format or content of any necessary policies and procedures but instead affords affected entities substantial discretion in formulating their internal policies to ensure compliance.

As of July 2026, the Commission estimates that there are 142 covered entities that would become subject to the proposed rules, including 20 SEFs, 27 DCMs, 24 DCOs, and 71 FCMs. The estimated burden associated with the proposed information collections is calculated as follows:[333]

A. Information Collections

Disclosure Requirements

Proposed Commission Regulation 1.52 would require that a SEF disclose the existence of affiliate market participants in both its rulebook and in a clear, prominent, and readily available manner on its website and on any application portal or similar means by which a DCM directly or indirectly connects electronically with its market participants. The Commission anticipates that this disclosure requirement will entail limited additional costs for registered SEFs with affiliate market participants. To comply, SEFs will be required to include this information in their rulebooks and to update their websites to reflect the affiliate relationships.

Commission Regulation 37.201, and related part 37 requirements already require SEFs to establish and provide access to their rulebooks and, based on existing practice,

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Accordingly, each entity's means of complying will vary according to its size, complexity, the nature and scope of its activities, and the sensitivity of the information involved. As a result, the discretionary balancing of factors and circumstances that is involved here does constitute a response to "identical questions" or constitute a covered information collection for purposes of the PRA. *See* 44 U.S.C. 3502(3)(A).

[333] For these requirements, the Commission is adopting a blended rate using estimated industry-specific wages for Financial Specialists, Lawyers, and Paralegals. Per the U.S. Bureau of Labor Statistics, national industry-specific occupational employment and wage estimates with data collected from employers in the securities, commodity contracts, and other financial investments and related activities provides that the mean hourly wage for Paralegal and Legal Assistants (occupation code 23-2011) is $47.95, Financial Specialist (occupation code 13-2000) is $73.94, and Lawyer (occupation code 23-1011) is $131.91. *See* Department of Labor's Bureau of Labor Statistics' May 2025 National Occupational Employment and Wage Estimates, United States, *available at*: https://data.bls.gov/oes/#/industry/523000/2025. For requirements information systems, the Commission is using a wage rate based on industry-specific wages for Database Architects in the securities, commodity contracts, and other financial investments and related activities is $100. *See id*. The Commission also notes that it took the foregoing data and then increased its hourly wage estimate in recognition of the fact that some respondents may be large financial institutions whose employees' salaries may exceed the mean wage. In addition, the Commission applied a multiplier of 2.5 to for additional costs such as overhead and other benefits, including office space, pension benefits, health care, IT support, and HR support. This yields a total hourly labor cost of $250 per hour.

SEFs regularly provide information on their websites regarding changes to their rulebooks and post such information on their website. Accordingly, the Commission anticipates that the proposed amendments will add minimal burden for SEFs with affiliates. The Commission does not have specific data establishing how many SEFs have covered affiliate relationships, so for purposes of its PRA analysis, the Commission is estimating that an estimated 5 SEFs will have such relationships.

If adopted, the Commission estimates the annual burden associated with the proposed regulation as follows:

Estimated number of respondents: 5.

Estimated frequency/timing of responses: On occasion.

Estimated number of annual responses per respondent: 1.

Estimated number of annual responses for all respondents: 5.

Estimated annual burden hours per response: 1 hour.

Estimated total annual burden hours per respondent: 1.

Estimated total annual burden hours for all respondents: 5.

Estimated total annual labor costs for all respondents: $1,250.

The Commission does not anticipate that the proposed amendments will result in additional capital and start-up or operations and maintenance costs. Affected market participants already have in place systems and processes for updating their rulebooks and their websites or any similar application portals to update any information required in the normal course of business. Accordingly, the Commission anticipates that affected market participants can leverage these existing systems and processes and will not be required to purchase new systems or undertake other capital improvements to comply with this disclosure requirement. Proposed Commission Regulations 1.52(d)(2)(i)(A) would require an FCM that chooses to elect NFA as its self-regulatory organization to make such an election in writing and provide that election to the Joint Audit Committee. The

Commission anticipates that the proposed amendments would entail only minimal burden for FCMs that choose to elect NFA as their SRO. The Commission has not mandated the format or content of such an election, leaving substantial flexibility to DCMs. Instead, the proposal would merely require a simple written election. Accordingly, the Commission estimates that the burden associated with preparing the written election will total only about 1 hour.

The Commission has estimated that approximately 10 FCMs will have qualifying affiliate relationships that may make them subject to the proposed amendments. Assuming for the purposes of this analysis that all 10 DCMs may elect NFA as their SRO (an assumption that may overstate the number of FCMs subject to this obligation), the Commission estimates that the burden associated with this requirement will total 5 burden hours (5 FCMs × 1 response × 1 hour per response).

If adopted, the Commission estimates the annual burden associated with the proposed regulation as follows:

Estimated number of respondents: 10.

Estimated frequency/timing of responses: On occasion.

Estimated number of annual responses per respondent: 1.

Estimated number of annual responses for all respondents: 10.

Estimated annual burden hours per response: 1.

Estimated total annual burden hours per respondent: 1.

Estimated total annual burden hours for all respondents: 10.

Estimated total annual labor costs for all respondents: $2,500.

The Commission does not anticipate that the proposed amendments will result in additional capital and start-up or operations and maintenance costs. The Commission does not expect that affected FCMs will be required to undertake additional capital expenditures to draft the required election.

The proposed amendments to Commission Regulation 1.55 would require FCMs to disclose the existence of any affiliate relationships with SEFs, DCMs, or DCOs and the material risks associated with such relationships. To comply, FCMs will be required to assess the material risks associated with covered affiliate relationships in the public disclosure materials they already prepare to comply with Commission Regulation 1.55.[334] The Commission anticipates that the proposed amendments will add only minimal burden to these existing requirements for the limited number of FCMs with affiliates, who are already subject to requirements to disclose material risks. Accordingly, the Commission is adopting new burden estimates to address the potential burden associated with disclosing material risks related to affiliates.

The Commission does not have definitive data on the number of FCMs with covered affiliate relationship, but estimates for purposes of its PRA analysis, that 10 FCMs have such relationships and would be subject to this requirement. As noted, these FCMs are already required to disclose material risks pursuant to Commission Regulation 1.55. Nonetheless, to ensure it is adequately accounting for the potential burden of the proposed amendments, the Commission estimates that covered FCMs will likely expend some limited additional time to provide the additional disclosures.

If adopted, the Commission estimates the annual burden associated with the proposed regulation as follows:

Estimated number of respondents: 10.

Estimated frequency/timing of responses: On occasion.

Estimated number of annual responses per respondent: 1.

Estimated number of annual responses for all respondents: 10.

[334] Section 1.55, 17 CFR 1.55, already requires an FCM to provide public disclosures of material risks to its customers. The Commission has previously estimated that these public disclosure requirements entail an estimated 1,180 burden hours (59 respondents × 1 annual response per respondent × 20 burden hours per response = 1,180 burden hours (rounded)). The associated labor costs total an estimated $1,180 (59 respondents × 20 burden hours per response × $100 per hour labor costs.)

Estimated annual burden hours per response: 2.

Estimated total annual burden hours per respondent: 2.

Estimated total annual burden hours for all respondents: 20.

Estimated total annual labor costs for all respondents: $5,000.

The Commission does not anticipate that the proposed amendments will result in additional capital and start-up or operations and maintenance costs. Affected market participants already have in place systems and processes for updating their rulebooks and their websites and any similar application portals to update any information required in the normal course of business. Accordingly, the Commission anticipates that affected market participants can leverage these existing systems and processes and will not be required to purchase new systems or undertake other capital improvements to comply with this disclosure requirement.

Proposed Commission Regulation 38.852(b)(1)(v) would require that a DCM disclose the existence of affiliate market participants in both its rulebook and in a clear, prominent, and readily available manner on its website and on any application portal or similar means by which a DCM directly or indirectly connects electronically with its market participants. The Commission anticipates that this disclosure requirement will entail limited additional costs for registered DCMs with affiliate market participants. To comply, DCMs will be required to include this information in their rulebooks and to update their websites to reflect the affiliate relationships.

Commission Regulations 38.401(c) and (d), 17 CFR 38.401(c), (d), already require a DCM to provide information on their websites regarding changes to their rulebooks and to post such information on its website concurrent with the filing of such information or submission to the Commission, and to ensure that the rulebook posted on its website is accurate, complete, current and readily accessible to the public.[335] The Commission anticipates that the proposed amendments will add minimal burden for DCMs with affiliates who must already comply with these existing disclosure requirements. The Commission does not have specific data establishing how many DCMs have covered affiliate relationships, so for purposes of its PRA analysis, the Commission is estimating that an estimated 5 DCMs will have such relationships.

If adopted, the Commission estimates the annual burden associated with the proposed regulation as follows:

Estimated number of respondents: 5.

Estimated frequency/timing of responses: On occasion.

Estimated number of annual responses per respondent: 1.

Estimated number of annual responses for all respondents: 5.

Estimated annual burden hours per response: 1 hour.

Estimated total annual burden hours per respondent: 1.

Estimated total annual burden hours for all respondents: 5.

Estimated total annual labor costs for all respondents: $1,250.

The Commission does not anticipate that the proposed amendments will result in additional capital and start-up or operations and maintenance costs. Affected market participants already have in place systems and processes for updating their rulebooks and their websites and any similar application portals to update any information required in the normal course of business. Accordingly, the Commission anticipates that affected

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[335] The Commission has previously estimated that the requirement for website publication requirement for rule and product filings entails an estimated 34 burden hours (21 respondents × 95 annual response per respondent × 1.6 burden hours per response = 34 burden hours (rounded)). The associated labor costs total an estimated $3,024 (21 respondents × 1.6 burden hours per response × $90 per hour labor cost). Likewise, the Commission estimated that the website publication requirement for rulebook updates entails an additional 34 burden hours (21 respondents × 95 annual response per respondent × 1.6 minutes pers response = 34 burden hours (rounded)). The associated labor costs total an estimated $3,024 (21 respondents × 1.6 burden hours per response × $90 per hour labor cost). For information, *see* OMB Control No. 3038-0052, ICR Ref. No: 202503-3038-001 (concluded Sep. 5, 2025).

market participants can leverage these existing systems and processes and will not be required to purchase new systems or undertake other capital improvements to comply with this disclosure requirement.

Proposed Commission Regulation 38.852(c)(3) would require that, where a DCM permits an affiliate principal trading firm to trade on the DCM, the DCM must disclose, on a per-session basis, the existence of, and the DCM's relationship with, the affiliate principal trading firm. The notice would disclose the affiliate relationship and the conditions imposed on the affiliate, including that the affiliate's orders are filled after those of unaffiliated members at the same price.

The Commission anticipates that this proposed amendment will require covered DCMs with affiliate principal trading firms to expend time to prepare such notices as well as to ensure the automated delivery of the required disclosures. Specifically, the proposed rule would require that covered DCMs deliver these notices at the beginning of each trading session. The Commission anticipates that an estimated 5 covered DCMs with covered affiliate relationships will incur a one-time cost to draft such notices and modify their systems to deliver the notices, yielding a one-time initial burden of 100 hours. This estimate is derived based on an estimate that 10 hours will be required for internal review and development of a compliant notice and an additional 10 hours will be required to modify systems to deliver the notices. The Commission estimates that the total associated labor cost will total \$25,000 (100 hours × \$250 hour per burden hour).

Accordingly, if adopted, the Commission estimates the annual burden associated with the proposed regulation as follows:

Estimated number of respondents: 5.

Estimated frequency/timing of responses: On occasion.

Estimated number of annual responses per respondent: 1.

Estimated number of annual responses for all respondents: 12.

Estimated annual burden hours per response: 20.

Estimated total annual burden hours per respondent: 20.

Estimated total annual burden hours for all respondents: 100.

Estimated total annual labor costs for all respondents: $25,000.

In addition, the Commission anticipates that covered DCMs will incur costs associated with the delivery of individual disclosures. The Commission anticipates that the burden associated with each notice will be minimal, or no more than 5 seconds per notice, because such notices will be highly automated. Given the requirement that affiliated DCMs deliver an automated click-through disclosure notice about its affiliate relationships each time a customer begins a trading session, the Commission anticipates that covered DCMs will be required to deliver a large volume of notices. The Commission anticipates that covered DCMs may be required to deliver on average 250,000 notices annually. The Commission estimates that this will yield an overall burden of 1,736 hours (5 DCMs × 250,000 notices annually × 5 seconds per notice). The Commission estimates that the total associated labor cost will total $434,000 (1,736 hours × $250 hour per burden hour).

Estimated number of respondents: 5.

Estimated frequency/timing of responses: On occasion.

Estimated number of annual responses per respondent: 250,000.

Estimated number of annual responses for all respondents: 1,250,000.

Estimated annual burden hours per response: 5 seconds.

Estimated total annual burden hours per respondent: 347 hours.

Estimated total annual burden hours for all respondents: 1,736 hours.

Estimated total annual labor costs for all respondents: $434,000.

The Commission does not anticipate that the proposed amendments will result in additional capital and start-up or operations and maintenance costs. DCMs already have in place sophisticated automated systems to comply with required disclosures and perform trading functions. Accordingly, the Commission anticipates that affected market participants can leverage these existing systems and processes and will not be required to purchase new systems or undertake other capital improvements to comply with this disclosure requirement.

The Commission proposes to add a new Commission Regulation 39.21(c)(9) requiring a DCO to make publicly available on its website the existence of, and the DCO's relationship with, any affiliate clearing member. The Commission anticipates that this requirement will entail only limited burden for DCOs with affiliate clearing members. The information required to be posted will be readily known to covered DCOs and such entities already have in place websites and means to provide other required disclosures to their customers via their websites. Accordingly, the Commission anticipates the burden associated with this required disclosure will be small.

The Commission does not possess definitive data estimating the total number of DCOs with affiliate clearing members. Accordingly, for purposes of its PRA analysis, the Commission estimates that 6 DCOs will be subject to these disclosure requirements relating to affiliate clearing members. The Commission estimates that these 6 DCOs will be required to expend approximately 2 hours to update their websites to provide the required disclosures. This yields an overall burden estimate of 12 annual burden hours (6 respondents × 1 response per respondent × 2 hours per response = 24 burden hours).

If adopted, the Commission estimates the annual burden associated with the proposed regulation as follows:

Estimated number of respondents: 6.

Estimated frequency/timing of responses: On occasion.

Estimated number of annual responses per respondent: 1.

Estimated number of annual responses for all respondents: 6.

Estimated annual burden hours per response: 2.

Estimated total annual burden hours per respondent: 2.

Estimated total annual burden hours for all respondents: 12.

Estimated total annual labor costs for all respondents: $3,000.

Reporting Requirements

Proposed Commission Regulation 38.852(c)(2)(iii) would require DCMs to annually certify to the Commission that the affiliate principal trading firm satisfies the conditions specified in proposed Commission Regulation 38.852(c)(1), including that the DCM ensures that its trading matching system, including any price/time priority matching algorithm, does not favor the affiliate principal trading firm, and that any market maker or incentive program filed under part 40 that applies to the affiliate principal trading firm enumerates the affiliate principal trading firm's market making or liquidity providing obligations, the performance standards applicable to those obligations, and the consequences of any failure to satisfy them, on terms no less favorable to the DCM than those offered to unaffiliated members participating in a comparable program.

The Commission anticipates that preparation of the required annual certifications will require an estimated 5 DCMs with qualifying affiliate relationships to expend an estimated 20 hours to review and prepare the required certifications. This estimate includes the time necessary to review and confirm the accuracy of its certification and to complete and submit the required certification. Accordingly, the Commission estimates the associated burden will entail an annual burden of 100 hours (5 DCMs × 1 annual response × 20 hours).

If adopted, the Commission estimates the annual burden associated with the proposed regulation as follows:

Estimated number of respondents: 5.

Estimated frequency/timing of responses: Annual.

Estimated number of annual responses per respondent: 1.

*Estimated number of annual responses for all respondents:*1.

Estimated annual burden hours per response: 20 hours.

Estimated total annual burden hours per respondent: 20.

Estimated total annual burden hours for all respondents: 100.

Estimated total annual labor costs for all respondents: $25,000.

The Commission does not anticipate that the proposed amendments will result in additional capital and start-up or operations and maintenance costs. The Commission does not expect that affected market participants will be required to put in place any specific information systems or make other capital expenditures to facilitate the preparation of the required certifications.

Proposed Commission Regulation 38.853(b)(5) would require DCMs to report to the Commission which members of their board of directors are public directors and the basis for those determinations. This reporting obligation encompasses all associated activities necessary to prepare the required disclosure, including reviewing director qualifications against the material relationship criteria set forth in proposed Commission Regulation 38.853(b)(2), applying the one-year look-back requirement under proposed Commission Regulation 38.853(b)(3), and compiling and transmitting the required information to the Commission.

The Commission anticipates that preparation of the required disclosures will require an estimated 27 DCMs to expend an estimated 2 hours annually to review and prepare the required disclosures. DCMs are sophisticated organizations that routinely maintain corporate governance records—including documentation of director qualifications and independence determinations—in the ordinary course of their business operations. As a result, the Commission anticipates that much of the underlying information necessary to satisfy this reporting requirement will already be assembled and current, and the incremental burden associated with preparing the required report is expected to be limited primarily to reviewing, organizing, and transmitting existing information rather than conducting new or extensive research. Accordingly, the Commission estimates the associated burden will entail an annual burden of 54 hours (27 DCMs × 1 annual response × 2 hours).

If adopted, the Commission estimates the annual burden associated with the proposed regulation as follows:

Estimated number of respondents: 27.

Estimated frequency/timing of responses: Annual.

Estimated number of annual responses per respondent: 1.

Estimated number of annual responses for all respondents: 27.

Estimated annual burden hours per response: 2 hours.

Estimated total annual burden hours per respondent: 2.

Estimated total annual burden hours for all respondents: 54.

Estimated total annual labor costs for all respondents: $13,500.

The Commission does not anticipate that the proposed amendments will result in additional capital and start-up or operations and maintenance costs. The Commission does not expect that affected market participants will be required to put in place any specific information systems or make other capital expenditures to facilitate the preparation of the required disclosures.

Proposed Commission Regulation 38.853(c)(2)(v) would require the ROC of each DCM to prepare an annual report assessing the DCM's self-regulatory program for the board of directors and the Commission. The required annual report must set forth the regulatory program's expenses, describe its staffing and structure, catalogue disciplinary actions taken during the year, and review the performance of disciplinary committees and panels.

The Commission anticipates that preparation of the required annual report will require an estimated 27 DCMs to expend an estimated 20 hours annually to compile, review, and prepare the required report. This estimate reflects the anticipated time necessary to prepare the annual report, including gathering and organizing data on regulatory program expenses, staffing, and structure; compiling records of disciplinary actions taken during the year; and reviewing and assessing the performance of disciplinary committees and panels. This estimate is tempered by the recognition that DCMs are sophisticated organizations that maintain regulatory program records, budgetary information, disciplinary action logs, and related documentation in the ordinary course of their business operations. As a result, much of the underlying information necessary to prepare the annual report will already be available, and the primary burden associated with the requirement is expected to consist of organizing, synthesizing, and presenting existing information in the form of the required report rather than conducting new or extensive data collection. Accordingly, the Commission estimates the associated burden will entail an annual burden of 540 hours (27 DCMs × 1 annual response × 20 hours).

If adopted, the Commission estimates the annual burden associated with the proposed regulation as follows:

Estimated number of respondents: 27.

Estimated frequency/timing of responses: Annual.

Estimated number of annual responses per respondent: 1.

Estimated number of annual responses for all respondents: 27.

Estimated annual burden hours per response: 20 hours.

Estimated total annual burden hours per respondent: 20.

Estimated total annual burden hours for all respondents: 540.

Estimated total annual labor costs for all respondents: $135,000.

The Commission does not anticipate that the proposed amendment will result in additional capital and start-up or operations and maintenance costs. The Commission does not expect that affected market participants will be required to put in place any specific information systems or make other capital expenditures to facilitate the preparation of the required annual reports.

2. Request for Comment

The Commission invites the public and other federal agencies to comment on any aspect of the information collection burdens 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 practical utility;

(2) Evaluating the accuracy of the Commission's estimate of the 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) Mitigating the burden of the collection of information on covered entities, including through the use of appropriate automated, electronic, mechanical, or other technological information collection techniques, *e.g.*, permitting electronic submission of responses.

A copy of the supporting statements for the collections of information discussed above are available from the CFTC Clearance Officer, 1155 21st Street NW, Washington, DC 20581, 202-418–5714, or from *https://www.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 Building, New Executive Office Building, Washington, DC 20503, Attn: Desk Officer of the Commodity Futures Trading Commission;

- Submit comments electronically via *www.RegInfo.gov* by searching for the relevant OMB control number to locate the information collection request associated with this rulemaking.

- Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rulemaking. Please refer to the ADDRESSES section of this notice of proposed rulemaking for comment submission instructions to the Commission. OMB is required to decide concerning the collection of information between 30 and 60 days after publication of this document in the Federal Register. Therefore, a comment is best assured of receiving full consideration if OMB (and the Commission) receives it within 30 calendar days of publication of this notice. Nothing in the foregoing affects the deadline enumerated above for public comment to the Commission on the proposed rule.

C. Consideration of Costs and Benefits

i. Introduction

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its discretionary actions before promulgating a regulation under the CEA or issuing certain orders. Section 15(a) further specifies that the costs and benefits shall be evaluated considering 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 five enumerated areas of concern, and may, in its discretion, determine that, notwithstanding its costs, a particular rule is necessary or appropriate to protect the public interest, or to effectuate any of the provisions, or to accomplish any of the purposes of the CEA. The Commission begins by assessing both a regulatory baseline and a status quo baseline. The regulatory baseline reflects current conditions based only on existing regulatory requirements. The status quo baseline reflects actual industry practice—including voluntary actions of market participants not currently required by regulations—as best the Commission can determine it. The Commission then considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors relative to the status quo baseline.

Some aspects of this assessment require the Commission to consider the relative costs and benefits of competing relevant factors. For example, sharing systems, personnel and/or office space likely afford affiliates the benefit of operational efficiencies (which in turn could enhance competitiveness). Such sharing, however, can incur the cost of compromised market integrity and unfairly impair competitors if shared information is used to disadvantage an unaffiliated entity vis-a-vis an affiliate. As another example, an entity seeking to gain entry as a new exchange or clearinghouse could benefit from access to information regarding an affiliate FCM's clients, potentially allowing that entity to offer products or services in a way that better competes with incumbents. But such an affiliation could pose a significant risk to market participants and the public, market financial integrity, and sound risk management if the affiliate is favored in a margin-setting or default management situation. For reasons discussed previously and expanded upon below, the Commission preliminarily views the rules and guidance anticipated in this Proposal as making appropriate tradeoffs between opposing interests: they would install stronger, targeted protections against potential harms without imposing unduly stringent restraints on affiliation.

The Commission has endeavored to assess the expected costs and benefits of the proposed amendments, including PRA-related costs, in quantitative terms where possible. Two chief reasons make it difficult, and in some cases wholly impracticable, for the Commission to quantify many of these benefits and costs. First, while the Commission knows of many of the affiliate relationships that could be impacted by this Proposal, it may not be aware of the full universe of existing affiliate relationships—or the extent of those relationships—that may fall within the ambit of the proposed regulations. For example, affiliate principal trading firms typically need not register with the Commission, and thus the scope of certain affiliate relationships may not be readily apparent to the Commission. The Commission invites comments about any sources of information the Commission could use to better estimate the number of existing affiliate relationships that the Proposal may impact.

Second, the details of how registered entities manage conflicts vary from each other and over time. For example, while DCMs, DCOs, and SEFs provide the Commission with information about staffing, systems, and physical office space arrangements for registration and oversight purposes, these arrangements (particularly concerning systems sharing) are unique to each registered entity and its affiliated enterprise. Across the universe of potentially impacted registered entities and registrants, these varying arrangements are complex and subject to change—conditions antithetical to generalized assumptions and estimates.

Notwithstanding these difficulties, the Commission, where feasible, has employed cost benchmarks to illustrate costs under hypothetical scenarios and invites comment on their applicability for affected registered entities and registrants, along with all other aspects of these cost-benefit considerations.

The other non-compliance costs and benefits considered here—e.g., those concerning competition, risk management, transparency—are ill-suited to quantification because metrics for doing so in this particular and forward-looking context are either inapplicable or not known by the Commission to exist. In situations where the Commission is unable to quantify the costs and benefits, the Commission identifies and considers the costs and benefits of the applicable provisions in qualitative terms. The Commission also invites comment to the extent that the public is aware of any data, studies, reports, or other information that would enhance the Commission's ability to identify and quantify such costs and benefits.

The consideration of costs and benefits below is based on the understanding that the derivatives market regulated by the Commission functions internationally, with many transactions involving U.S. covered entities taking place across international boundaries. Additionally, some covered entities are organized outside of the U.S. or conduct operations both within and outside the U.S. but 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 this Proposal on all activity subject to the Proposal, whether by virtue of the activity's physical location in the United States or by virtue of the activity's connection with or effect on U.S. commerce under CEA section 2(i).[336]

ii. Overall Regulatory Baseline

For purposes of evaluating the potential costs and benefits of the amendments under consideration, the Commission identifies the current legal framework and current market conditions as its baseline. Specifically, this cost-benefit considerations section proceeds on the understanding that neither the CEA nor the Commission's regulations prohibit vertical integration between Commission registrants and other market participants. Indeed, as described throughout, affiliated structures have existed for years

[336] CEA 2(i), 7 U.S.C. 2(i).

and, in some cases, decades.[337] In this regard, firms have sought registration with the Commission for the explicit intention of creating affiliated structures and the Commission has granted licenses on that basis.[338] Instead of prohibiting affiliated structures, the Commission's existing rules impose certain requirements on firms, primarily, though not exclusively, through the application of the Core Principles to DCOs, DCMs, and SEFs. Those regulations have been described above and, as noted, are also discussed, as relevant, in each section below.

iii. Proposed Amendments

The cost and benefit considerations relevant to the Commission's proposed amendments are organized in the same order as in sections II through V above: proposed regulatory changes relevant to (1) DCMs with affiliate FCMs, (2) DCMs and SEFs with affiliate market participants (including affiliate principal trading firms), (3) DCOs with affiliate clearing members, and (4) the public disclosure requirements of FCMs with affiliate relationship. Each subsection states regulatory and status quo baselines. Then, the proposed regulations are discussed with costs and benefits considered relative to the status quo baseline. Next, alternatives to the proposed amendments at issue are discussed relative to the status quo baseline, after which any relevant topics on which the Commission is requesting comments are listed. Finally, a summary of how the Commission assesses the proposed changes under the factors of section 15(a) of the CEA concludes each subsection.

(1) Proposed Amendments to § 1.52: SRO surveillance of financial requirements for Affiliate FCMs

(a) Regulatory Baseline

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[337] For example, CME first established a clearinghouse in 1919.

[338] *See* Rostin Benham, Chairman, CFTC, *Statement in Support of the Bitnomial Clearinghouse LLC Application for Registration as a DCO* (Dec. 18, 2023) (specifically noting "vertically integrated DCOs are not novel structures for the Commission"), available at: *https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement121823*.

As discussed above,[339] section 5(d)(11)(B) of the CEA requires each DCM to establish and enforce rules to ensure the financial integrity of any FCM that is a member of the contract market and to ensure the protection of customer funds.[340] Section 17(p) of the CEA imposes parallel obligations on registered futures associations, requiring them to establish, subject to Commission approval, minimum financial requirements applicable to its FCM members and a program to audit and enforce compliance with those requirements.[341] Commission Regulation 1.52 effectuates these provisions of the Act by establishing the minimum standards that all SROs must satisfy in carrying out their financial supervisory programs. Among other things, Commission Regulation 1.52 requires each SRO to establish and operate a supervisory program for examining its FCMs for compliance with SRO and Commission regulations and maintain examination staff to effectively implement the supervisory program. Commission Regulation 1.52 also permits SROs to delegate to a DSRO the function of monitoring and examining that FCM for compliance with relatively little financial and related reporting requirements.

(b) Status Quo Baseline

Commission Regulation 1.52 does not currently address SRO oversight of an affiliate FCM expressly. Likewise, neither § 1.52 nor any other regulation prohibits an SRO from acting as DSRO for its own affiliate FCM. To date, however, no DCM with an affiliate FCM has acted as DSRO for that affiliate FCM. Instead, in each such case, the DCM has voluntarily requested that a third party (specifically, NFA or CME) perform the DSRO function for the affiliate FCM[342]—though there is no regulatory requirement that they continue to do so in the future.[343] Nevertheless, the Commission is aware of at least

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[339] *See* discussion *supra* Sections I.D, II.A.i.

[340] CEA 5(d)(11)(B), 7 U.S.C. 7(d)(11)(B).

[341] CEA 17(p), 7 U.S.C. 21(p).

[342] *See* NFA Comment, *supra* note 96, at 4-5.

[343] The Commission is aware of four SROs with Affiliate FCMs: Coinbase Derivatives, LLC; ForecastEx LLC; Bitnomial Exchange, LLC; and MIAX Futures Exchange, LLC. F&O Financial, an affiliate of CME

one DCM that is affiliated with an FCM which also serves as a DSRO for FCM(s) that are clearing members of its DCO, even though these FCM(s) compete with its affiliate FCM.

(c) Proposal

The proposed amendments to Commission Regulation 1.52 are intended to address conflicts of interest concerns present when an SRO or DSRO, respectively, has supervisory authority for an affiliate FCM. As detailed in Section II.A.iv. above, the proposed amendments would: (1) require an SRO with an affiliate FCM to ensure that its examination staff report directly to the board of directors or other designated committee or officer responsible for regulatory compliance of the SRO; (2) require an SRO that has an affiliate FCM to designate an independent third-party SRO to conduct the surveillance of the affiliate FCM otherwise required of the SRO under existing Commission Regulation 1.52(c); (3) prohibit an SRO from accessing the non-public information of its affiliate FCM, except as necessary to comply with the SRO's responsibilities and obligations as a DCM under part 38 of the Commission's Regulations and prohibit an SRO from sharing, directly or indirectly, non-public information obtained from its supervisory program of its non-affiliate member FCMs with its affiliate FCM for any purpose, except as necessary to comply with the SRO's responsibilities and obligations as an SRO under Commission Regulation 1.52 or as a DCM under part 38 of the Commission's regulations; (4) apply substantially the same requirements to DSROs; and (5) create a process through which an FCM could elect NFA as its DSRO.

(d) Benefits

By codifying explicit, enforceable requirements that SROs or DSROs must take to help ensure the independence of their financial examination and financial surveillance of

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Group, has recently received NFA approval to launch an FCM. Each of these entities is a signatory to the JAC agreement. *See supra* note 68.

affiliate FCMs, the proposed amendments to Commission Regulation 1.52 would better protect against the damage to fair competition and trust in market integrity, noted above, that could occur if an SRO's or DSRO's duties under the CEA are subordinated to the competing interests of their affiliate FCM. If this damage were to occur (or circumstances supported a perception that it could occur), the potential knock-on effects—including liquidity drainage, compromised price discovery and reduced risk-management utility—could impact registered entities, market participants, and the public generally, perhaps significantly.

Accordingly, the proposed amendments to Commission Regulation 1.52 would provide safeguards including new financial examination-staff reporting lines to mitigate potential conflicts; requiring designation and appointment of an independent, third-party SRO to conduct financial surveillance of the affiliate FCM; and prohibiting non-public information access and sharing. These safeguards should enhance support for the same beneficial interests that are at risk if SRO/DSRO affiliations with member FCMs are not checked. That is, the Commission preliminarily believes that the proposed amendments to Commission Regulation 1.52 would benefit the interests of market participants and the public, fair FCM competition, financial market integrity, price discovery, and sound risk management by providing stronger protections for them than now exists. The Commission is not aware of a ready means to monetize or otherwise quantify these benefits but welcomes comment on any practical means of doing so.

To the extent SROs with an FCM that could qualify as an affiliate FCM to date have requested NFA act as the DSRO for the affiliate FCM, the benefits of the proposed amendments to Commission Regulation 1.52 are somewhat, but not completely, reduced. The current surveillance arrangements do not implement all components of the Proposal. First, SROs are currently not subject to formal examination staff reporting line requirements and non-public information sharing prohibitions. Second, while SROs with an affiliate FCM have voluntarily designated NFA or CME as the DSRO for their affiliate, absent regulation, there is no assurance that the practice will continue in the future. By providing this assurance, as well as additional protections beyond those provided by the current arrangements, the Commission preliminarily believes that the proposed amendments to Commission Regulation 1.52 would provide significant benefits.

The Commission also preliminarily believes that the FCM DSRO election proposal will provide significant benefits to the derivatives markets. In particular, the election would provide a measure of market discipline that supplements, and does not supplant, the Commission's oversight of the self-regulatory framework, as it affords FCMs the ability to decline examination by an assigned DSRO, including in circumstances where the FCM may believe that the DSRO cannot be fully impartial or effective in fulfilling its duties. In this regard, the election proposal will provide the Commission and market participants with an indicator of FCMs' confidence in a DSRO to apply the Joint Audit Program.

(e) Costs

The SROs (and DSRO) with an FCM that could qualify as an affiliate FCM may incur costs in the form of administrative time related to analyzing the compliance of their existing procedures regarding lines of reporting and non-public information with the proposed requirements and implementing changes as necessary. They would not, however, incur additional costs for the periodic surveillance required under Commission Regulation 1.52, as SROs with an affiliate FCM have already arranged to designate an independent DSRO to oversee their affiliate FCM.

The SROs that do not have affiliate FCMs currently should incur no additional costs for surveillance. If in the future an existing SRO admits an affiliate FCM or a new SRO with an affiliate FCM enters the market, the Commission expects it may incur costs associated with hiring an independent third-party DSRO to conduct the necessary surveillance. An FCM that uses or explores the DSRO election option may also incur costs. While the cost of the election itself should be minimal (consisting just of a written election), there may be administrative costs associated with interfacing with a new DSRO. While the Commission Regulation 1.52 examination standards will not change, DSROs may vary in how they perform their examination duties. The Commission estimates the disclosure costs in the PRA section for § 1.52(d) at $2,500. The Commission is not aware of a ready means to monetize or otherwise quantify other costs but welcomes comment on any practical means of doing so.

(f) Alternative(s)

1) Reliance on existing voluntary practice. The Commission considered relying on the current voluntary practice—under which CME and NFA perform DSRO functions for FCMs affiliated with DCM SROs—without codification. This is the status quo baseline; therefore, relative to the status quo there would be no costs and benefits. However, the benefits of codifying the voluntary practice—as described above—would be foregone. Additionally, existing voluntary practice does not allow FCMs to elect their DSRO and so the costs and benefits of that proposal—also described above—would not apply.

2) Independent DSRO for all member FCMs. The Commission considered requiring that NFA (or another independent third-party SRO) serve as DSRO for *all* member FCMs of an SRO that has an affiliate FCM—not only for the affiliate FCM itself.[344] The rationale for this alternative is that an SRO's access to non-public information of *non-affiliate* member FCMs—which compete with the affiliate FCM—raises competitive concerns even when the SRO does not directly examine the affiliate

[344] Filler Comment, *supra* note 99, at 8; *see also* NFA Comment, *supra* note 96, at 4-5.

FCM. The Commission understands that FCM examinations provide valuable information to DSROs that also operate an exchange, and that such information may bear on risk management decisions made by the exchange. In this regard, removing FCM examination authority from such DSROs may result in blind spots that increase systemic risk. The Commission is not aware of any method to quantify the costs associated with this risk but takes seriously any potential actions that could increase systemic risk. Additionally, the Commission notes that requiring the use an independent third-party SRO would impose certain direct costs on FCMs. In particular, according to its website, NFA assesses an annual fee of $5,625 per FCM to be that FCM's DSRO.[345]

3) Prescriptive separation requirements. The Commission considered prescriptive separation requirements—including physical office separation, technical specifications for information barriers, and dual-hatting prohibitions for senior officers—for SRO personnel involved in the supervisory program of an affiliate FCM. The Commission preliminarily believes that the benefit of this approach over the proposed approach would be to ensure that the Commission's desired separations are in place at all affected registered entities. However, this benefit likely is limited in practice given the Commission's understanding of the existing status quo baseline and its expectation that registered entities likely will conform to the acceptable practices set forth by the Commission in guidance. Furthermore, the Commission sees substantial costs to this approach. For example, codified, prescriptive requirements would leave firms without flexibility, meaning that they may not be able to adopt new practices or procedures that may be more effective, without the Commission revising its rules or granting an exemption.

(g) Request for Comments

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[345] See the NFA website at *https://www.nfa.futures.org/registration-membership/dues-revenue-structure.html* for schedule of dues and assessments.

(1) How can the Commission better quantify the costs and benefits of its proposed amendments to Commission Regulation 1.52 as well as the alternatives discussed?

(2) Would NFA performing examinations for FCMs harm DCM's ability to conduct market surveillance to prevent market manipulation (or other disorderly trading)?

(3) Further, would NFA performing examinations hamper DCMs and the Commission from conducting investigations of potential market manipulation?

(h) Section 15(a) Considerations

Protection of Market Participants and the Public

The Commission preliminarily believes, subject to consideration of comments, that the amendments it is proposing for Commission Regulation 1.52 of its regulations will enhance protections for market participants and the public in important ways.

Proposed Commission Regulations 1.52(c) and (d) would better ensure the impartiality of FCM supervision and that FCM supervision is not a conduit for sharing of non-public information and that FCM affiliations are publicly disclosed. More specifically, this Proposal—in combination with other proposed changes—would guard against an unaffiliated entity such as an FCM (and its customers) being competitively disadvantaged because a DCM inappropriately favored its affiliate FCM by: (a) sharing non-public information with it, and/or (b) discriminating in the exercise of its supervisory oversight of participants/members.

As such, by helping to ensure a level and competitive playing field at the exchange, these regulations directly benefit the unaffiliated market participants—and their customers—who trade on exchanges against the affiliate FCM or its customers. Further, by safeguarding against conflicts of interests skewing supervisory oversight decisions to unduly favor affiliate FCMs, the proposed regulations likewise safeguard against harmful market events (e.g., market manipulation) that could result from such compromised oversight. As such, the proposed regulations also better protect market participants and the public—both those most immediately impacted because, for example, a trade was cancelled, as well as a wider group that could be impacted if the event erodes confidence in market integrity sufficiently to degrade liquidity (with, in a potential worst case, systemic negative ramifications). This wider group of beneficiaries would include (1) market participants generally who may look to exchange prices more broadly to manage risks and inform their trading strategies, and (2) the public that benefits generally from more efficient, accurate pricing that liquidity fosters, and that could suffer economic harm if a systemic event occurs.

Efficiency, Competitiveness, and Financial Integrity of Futures Markets

The Commission preliminarily believes, subject to consideration of comments, that the amendments it is proposing for § 1.52 of its regulations will impact efficiency, competitiveness and financial integrity of the derivatives markets in multiple, overall positive, ways. Negative impacts, to a limited degree, are possible in certain respects but are, in the Commission's view, warranted by the import of the overall positive impacts.

The Commission expects overall market efficiency to be better served by the Proposal's suite of regulatory amendments. This expectation is grounded in the view that the suite of amendments in the Proposal, working together, will bolster market participants' and the public's faith in the integrity of the U.S. derivatives markets—faith essential to sustain and promote market participant's willingness to engage in the markets. Increased market participation and trading volumes, in turn, are likely to improve market liquidity, rendering the markets more efficient.

Regarding competitiveness, the Commission designed the Proposal to enhance guardrails against the potential that FCMs that were not affiliated with an exchange could be competitively disadvantaged because an exchange either shared competitively significant non-public information with its affiliate FCM or disfavored these unaffiliated intermediaries through other operational avenues, including SRO supervision and oversight. By proposing provisions to better seal off the avenues through which this type of anticompetitive behavior could occur, the Commission, for reasons discussed in the sections above,[346] preliminarily believes the Proposal provides necessary support for the interest of fair and vibrant horizontal competition among market intermediaries, including FCMs.

The Proposal's protections to preserve and energize fair market intermediary-level competition, as reflected in the proposed changes to Commission Regulation 1.52 and elsewhere, should likewise support the financial integrity of the derivatives markets. This is because intermediary-level competition tainted (actually or potentially) by conflicts-of-interests to favor an affiliate FCM would likewise undermine financial market integrity. This undermining, as previously discussed,[347] could occur in any number of ways. For example, an affiliate FCM's use of non-public information to gain an anticompetitive trading advantage on an exchange would not only financially damage the unaffiliated market participants (and customers of the unaffiliated market participants) on the exchange but could also likely shake faith in the system's fairness, potentially spiraling into lost market liquidity with a concordant drop in market utility. This similar pattern (i.e., anticompetitive financial loss, leading to lost trust, leading to lost market liquidity and utility) can be expected to play out in any number of scenarios in which a DCM favored its affiliate FCM by facilitating access to non-public information. The Proposal would provide conflicts-of-interest guardrails to prevent financial market integrity being drained in this way.

Price Discovery

The Commission preliminarily believes, subject to consideration of comments, that the proposed amendments should provide a positive, indirect influence on price

[346] See Sections II.B.iv. and III.A.iv, above.

[347] *Id*.

discovery. To the extent that the members of the public are unwilling, or have reduced participation, in financial markets due to perceived conflicts-of-interest driven favoritism for affiliate FCMs, proposed amendments to Commission Regulation 1.52(c) and (d) may mitigate these negative perceptions and thus increase participation in derivatives markets. Increased trading activity and volume by the public has the potential to improve price discovery in financial markets. Secondly, the integrity of prices that result from exchange trading is affected by an affiliate FCM's anticompetitive access to non-public information or other favored treatment by their affiliated DCM may be compromised. Accordingly, the guardrails the Proposal seeks to erect to prevent this from occurring should serve the interest of high-quality price discovery.

Sound Risk Management Practices

The Commission preliminarily believes, subject to consideration of comments, that the Proposal enhances support for sound risk management practices. Conflicted SRO staff may choose to prioritize the commercial interests of the affiliate FCM over the self-regulatory obligations of the exchange, including obligations regarding financial resource sufficiency, at the cost of weakening the risk management practices of the exchange. The proposed amendments to Commission Regulation 1.52 add safeguards to mitigate this conflict and strengthen risk management practices of DCMs by adding guardrails to strengthen the enforcement of financial resource obligations of the DCM.

(2) Proposed Amendments to §§ 38.604 and 38.606: DCM Financial Surveillance of Affiliate FCMs

(a) Regulatory Baseline

As described in Section II.B, DCMs bear responsibility for the financial surveillance of their member FCMs under DCM Core Principle 11 (Financial Integrity of Transactions) and Commission Regulations 38.602, 38.604, and 38.605. In particular, Commission Regulation 38.604 requires that a DCM "monitor members' compliance with the [DCM's] minimum financial standards" by, among other things, routinely receiving and promptly reviewing financial and related information from its members, "continuously monitor[ing] the positions of members and their customers," continually surveying the obligations of each FCM created by the positions of its customers, comparing those obligations to the financial resources of the FCM as appropriate, and taking appropriate steps to use this information to protect customer funds. Commission Regulation 38.605 requires the DCM to comply with the standards of Commission Regulation 1.52 in carrying out this financial surveillance program.

Commission Regulation 38.606 currently permits—but does not require—a DCM to comply with the requirements of Commission Regulations 38.604 and 38.605 through the regulatory services of an RSP. Where a DCM elects to engage an RSP, Commission Regulation 38.606 requires the DCM to ensure that the RSP has the capacity and resources necessary to provide timely and effective regulatory services, including adequate staff and surveillance systems; to enter into a written agreement that specifically documents the services to be performed; and to retain ultimate responsibility for compliance with its obligations under the CEA and the Commission's regulations.

(b) Status Quo Baseline

The status quo baseline appears to be the regulatory baseline. That is, the Commission is not aware of any voluntary practices or other behavior by regulated entities that are meaningfully different from what Commission regulations require.

(c) Proposal

The Commission is proposing a clarifying amendment to Commission Regulation 38.604(a). As proposed, the regulation would retain the existing requirement that a DCM monitor its members' compliance with the DCM's minimum financial standards and routinely receive and promptly review financial and related information from its members but would remove the word "continuously" from the requirement to monitor the positions of members and their customers. Instead, proposed Commission Regulation 38.604(b) would require the DCM to (1) monitor the obligations of each FCM created by the positions of its customers "throughout the day"; (2) as appropriate, compare those obligations to the financial resources of the FCM; and (3) take appropriate steps to use this information to protect customer funds. These changes are intended to confirm that the surveillance obligation requires intra-day, risk-based monitoring rather than literal real-time monitoring of every trade, consistent with existing Commission expectations and its understanding of market practice. In this regard, as discussed below, the Commission preliminarily does not expect there to be significant costs associated with this proposed change.

The Commission also proposes to amend Commission Regulation 38.606 to add a new paragraph providing that a DCM that has an affiliate FCM may comply with the requirements of Commission Regulation 38.604 by designating an independent third-party RSP, and that if such a DCM does not engage an independent third-party RSP, the DCM must have procedures for identifying, addressing, and managing conflicts of interests involving its affiliate FCM that may arise in connection with the DCM's obligations under Commission Regulation 38.604. Such procedures shall address, at a minimum:

(1) Applications and systems, such that a DCM's applications, information and systems are maintained and operated in a manner that prevents the sharing of non-public information with any affiliate FCM;

(2) Personnel, such that a DCM does not share staff with any affiliate FCM, except with respect to administrative functions;

(3) Office space, such that a DCM maintains office space for itself that is separate from the office space of any affiliate FCM;

(4) Documentation, such that a DCM documents all conflicts of interest that arise with respect to an affiliate FCM and how any such conflict of interest is resolved; and

(5) Disclosures, such that a DCM provides disclosure of the existence of an affiliate FCM in its rulebook and in a clear, prominent, and readily available manner on its website and any other application portal or similar means through which a DCM directly or indirect connects electronically with its market participants.

Finally, the Commission is proposing to amend Appendix B to part 38 to provide DCMs with guidance regarding the Commission's views regarding acceptable practices for conflict-of-interest procedures.

(d) Benefits

The Commission preliminarily believes the proposed amendments to Commission Regulations 38.604 will provide benefits primarily in the form of conforming the regulatory text with the Commission's expectations and existing market practice. In this regard, the Commission believes that the benefits of this proposed amendment will accrue primarily to DCMs. Such benefits likely will consist of reduced costs. For example, a DCM need not expend resources interfacing with the Commission to confirm its understanding of the scope of Commission Regulation 38.604. In addition, a DCM will benefit from increased confidence that its financial surveillance capabilities are appropriately scoped and that it need not, for example, expand those capabilities solely to attempt to comply with a "continuous" monitoring standard.

The Commission preliminarily believes the proposed amendments to Commission Regulation 38.606 will better protect against the damage to fair competition and trust in market integrity that could occur if a DCM's duties under the CEA are subordinated to the competing interests of their affiliate FCM. Such damage could be mitigated either through the use of an independent, third-party RSP or through conflicts of interest procedures specific to the DCM-affiliate FCM relationship. If this damage were to occur (or circumstances supported a perception that it could occur), the potential knock-on effects—including liquidity drainage, compromised price discovery and reduced risk-management utility—could impact registered entities, market participants, and the public generally, perhaps significantly.

The Commission also believes there will be significant benefits for DCMs and other market participants stemming from the proposed conflicts of interest procedures in Commission Regulation 38.606. For example, such procedures requirements will put DCMs on notice of the Commission's expectations and will also inform other market participants of the types of conflict mitigants that the Commission expects to be in place. Such information could provide the market with increased confidence that a DCM is appropriately managing potential conflicts. The Commission also believes conflicts of interest procedures required by rule text provide greater benefits with respect to the protection of market participants and the financial integrity of futures markets when compared with guidance as they are easier to enforce.

The Commission is not aware of any information that would allow these benefits to readily be quantified but welcomes any comments that may assist the Commission in doing so.

(e) Costs

The Commission preliminarily believes that there will not be material costs associated with the proposed changes to Commission Regulation 38.604. As discussed above, these proposed changes serve to conform the regulatory text to the Commission's existing understanding of the financial surveillance requirement as it has applied to DCMs. In this regard, a DCM that is in compliance with its Commission Regulation 38.604 obligations today should not be subject to increased costs under the Proposal.

The Commission also preliminarily believes that the costs associated with the proposed changes to Commission Regulation 38.606 will be negligible for most of the affected registered entities. First, the Commission understands that many, if not most, DCMs with an affiliate FCM today already use NFA as a regulatory service provider for intra-day financial surveillance. For those firms, the proposed amendments would not result in any additional costs, as the proposed changes are consistent with such market practice. Second, the Commission also understands that most, if not all, DCMs with affiliate FCMs, have in place procedures intended to manage and mitigate potential conflicts of interest. For such firms, the Commission preliminarily expects that costs to comply with proposed Commission Regulation 38.604(a) to be small. Such DCMs may incur costs in the form of administrative time related to analyzing their existing procedures for compliance with the Commission's proposed procedures on acceptable practices. The Commission acknowledges there may be costs associated with this prescriptive approach as compared with issuing guidance, primarily by limiting firms' ability to take approaches that differ from the proposed procedures rule text. Of course, DCMs that do not have an affiliate FCM should incur no additional costs in this regard.

A DCM with an affiliate FCM that does not currently engage a third-party RSP and does not have in place conflicts-of-interest policies (or a DCM that newly has an affiliate FCM) will incur the most costs under these proposed changes. Such a DCM may incur direct costs by choosing to hire an independent third-party RSP to conduct intra-day financial surveillance. The Commission is unable to quantify these costs as they would vary based on the business of the affiliate FCM, including its trading volume on the affiliated DCM, as well as the terms, including price, assessed by the RSP for performing the service. The Commission seeks public feedback on these costs.

Such a DCM may, alternatively, incur costs by conducting financial surveillance in-house and having procedures to manage its conflicts of interest. Keeping information systems separated between affiliates reduces conflicts of interest and mitigates conferring a competitive advantage to affiliates over its unaffiliated competitors. Unfortunately, these costs are challenging to quantify without specific data about the information systems and arrangements involved, but the Commission preliminarily believes that these would be minor relative to the status quo (although some DCMs and affiliate FCMs might have to purchase new hardware and software to accomplish the needed separation). Data segmentation requires management of data security from the DCM to make sure that the affiliate FCM does not have access to any inappropriate non-public information. Cost will vary by the complexity of the affiliated entity, making such costs impractical to quantify.

Requiring that personnel are not shared between the DCM and affiliate FCM helps to maintain information firewalls. However, it may impose costs if personnel are being shared at present. For instance, new personnel may need to be onboarded to perform separate tasks for the affiliate FCM or the DCM. Similarly, requiring physical separation between employees performing the functions of the affiliate FCM and the DCM helps to mitigate information being shared. It will impose costs relative to the status quo if they are not currently separated. At the extremes, this may require new office space or require personnel to be located on separate floors or might only require a lock being installed between offices of relevant personnel. Without specific information about the arrangements and personnel at issue, however, the Commission cannot effectively quantify the costs of a DCM and affiliate FCM not sharing and physically separating personnel.

Requiring the disclosure of an affiliate FCM in DCM rulebooks, web pages, and marketing materials will inform market participants of potential conflicts of interest so that they can assess the situation properly and make appropriate decisions. The Commission preliminarily believes that these costs should be minor.

Requiring the disclosure of conflicts of interest policies and procedures and how any such conflict of interest are resolved between the DCM and affiliate FCM will help inform other market participants of conflicts and provided needed transparency to keep parties publicly accountable. This requirement will impose costs if policy and procedures are not properly developed and they need review and reworking. Further, when a conflict has been resolved, it will impose costs to disseminate it to the public. The Commission lacks adequate specific information to effectively quantify these costs but preliminarily believes they will be minor.

The Commission seeks public feedback on these costs. In particular, the Commission seeks feedback on the costs associated with creating, maintaining, and implementing conflict-of-interest procedures consistent with proposed Commission Regulation 38.606. Specifically, what are the costs associated with a DCM: (1) maintaining and operating applications, information, and systems in a manner that prevents the sharing of non-public information with any affiliate market participant; (2) not sharing certain staff with an affiliate; (3) maintaining separate office space; (4) disclosing affiliate relationships; and (5) documenting conflicts and how they are resolved?

(f) Alternative(s)

1) Mandatory third-party RSP for affiliated-FCM surveillance. The Commission is considering requiring, rather than allowing, a DCM with an affiliate FCM to designate an independent third-party RSP to perform § 38.604 financial surveillance of that affiliate FCM.

The Commission preliminarily believes the benefits of this alternative are not substantially different from the Proposal. Relative to the baseline, this alternative would impose direct costs on DCMs that have an affiliate FCM but do not currently employ an independent third-party RSP for financial surveillance. As noted, the Commission is unable to quantify these costs as they would vary based on the business of the affiliate FCM. The Commission believes there could be benefits to this approach, particularly by limiting the possible harms stemming from conflicts of interest that could arise from a DCM surveilling its affiliate. As noted, the Commission believes these harms can be adequately mitigated through procedures, but requests comment on the potential costs and benefits of this alternative approach.

2) Guidance rather than rule text regarding separation. Under this alternative, the Commission would only amend Appendix B to part 38 to adopt guidance—rather than providing rule text—specifying desired separations between a DCM and its affiliate FCM, including with respect to information barriers, personnel, physical separation of office space, documentation, disclosures, and systems. The Commission preliminarily believes that, although guidance might afford more flexibility to the DCM, rules will provide better protection of market participants and the public and the financial integrity of derivatives markets. Further, the Commission preliminarily believes that the costs of any guidance on separation requirements would be comparable to those of the prescriptive separation rules.

(g) Request for Comments

(4) Has the Commission accounted for the costs of the proposed amendments to Commission Regulations 38.604 and 38.606 rule adequately? Is there additional information the Commission could use to quantify those costs?

(5) Are there other costs related to contracting with an independent third-party RSP for intra-day financial surveillance for which the Commission has not accounted?

(6) What are the costs associated with a DCM: (1) maintaining and operating applications, information, and systems in a manner that prevents the sharing of non-public information with any affiliate market participant; (2) not sharing certain staff with

an affiliate; (3) maintaining separate office space; (4) disclosing affiliate relationships; and (5) documenting conflicts and how they are resolved?

(h) Section 15(a) Considerations

Protection of Market Participants and the Public

The Commission preliminarily believes, subject to consideration of comments, that the amendments it is proposing for Commission Regulations 38.604 and 38.606, along with the proposed changes to Appendix B in part 38, will enhance protections for market participants and the public in important ways.

By requiring DCMs to publicly disclose participant/member affiliates and adopt conflict-of-interest policies and procedures specifically addressed to participant/member affiliates, the proposed regulations reduce the likelihood that market participants and the public will be harmed because a DCM subordinated its core principle obligations to its affiliate commercial interests.

As discussed with regard to the changes to Commission Regulation 1.52, such changes would guard against an unaffiliated participant/member such as an FCM (and that unaffiliated participant's/member's customers) being competitively disadvantaged because a DCM inappropriately favored its affiliate FCM.

Efficiency, Competitiveness, and Financial Integrity of Futures Markets

The Commission preliminarily believes, subject to consideration of comments, that these amendments it is proposing for parts 38 of its regulations will impact efficiency, competitiveness and financial integrity of the derivatives markets in multiple, overall positive, ways. Negative impacts, to a limited degree, are possible in certain respects but are, in the Commission's view, warranted by the importance of the overall positive impacts.

As discussed with regard to the proposed amendments to Commission Regulation 1.52, the Commission expects overall market efficiency to be better served by the

Proposal's suite of regulatory amendments because such changes will bolster market participants' and the public's faith in the integrity of the U.S. derivatives markets

Regarding competitiveness, the Commission designed and aimed these changes to enhance guardrails against the potential that FCMs that were not affiliated with an exchange could be competitively disadvantaged because an exchange compromised its financial surveillance obligations vis-à-vis its affiliate FCM. In this regard, the proposed changes should enhance market integrity by helping to ensure that FCM financial surveillance is consistent across unaffiliated and affiliate FCMs.

Price Discovery

As already discussed with regard to the amendments to Commission Regulation 1.52, to the extent that the members of the public are unwilling, or have reduced participation, in financial markets due to perceived conflicts-of-interest driven favoritism or affiliate FCMs—or concern that an affiliate FCM is not being subject to appropriate financial surveillance, the proposed changes have the potential to aid price discovery by increasing market participation and liquidity.

Sound Risk Management Practices

As with the amendments to Commission Regulation 1.52, the Commission preliminarily believes, subject to consideration of comments, that the Proposal's proposed amendments to Commission Regulations 38.604 and 38.606 and to Appendix B to part 38 would enhance support for sound risk management practices by adding safeguards to mitigate conflicts of interest and strengthen risk management practices of DCMs by adding guardrails around its financial surveillance obligations with respect to an affiliate FCM.

(3) Proposed New Commission Regulations 38.852 and 37.1201—Conflicts of Interest Involving an Affiliate Market Participant Generally

(a) Regulatory Baseline

DCM Core Principle 16 stipulates that DCMs establish and enforce rules to minimize conflicts of interest in their decision-making process and to establish a process for resolving them.[348] SEF Core Principle 12 imposes a parallel obligation on each SEF to minimize conflicts of interest in its decision-making process and to establish a process for resolving them.[349] Separately, DCM Core Principle 12 requires DCMs to establish and enforce rules to protect the market and market participants from abusive practices and to promote fair and equitable trading.[350] SEF Core Principle 2 likewise requires SEFs to establish rules to, among other things, prohibit abusive trading practices.[351] Appendix B to part 37 and Appendix B to part 38 both provide guidance, to SEFs and DCMs, respectively, regarding compliance with the Core Principles. Neither the Core Principles nor the guidance specifically address conflicts of interest that may arise in affiliated structures.

(b) Status Quo Baseline

The Commission is aware of approximately eight DCMs that currently have affiliate market participants and that certain SEFs operate affiliates as well (including IBs and CTAs). The Commission believes that certain DCMs and SEFs already have public disclosures and conflict of interest policies compliant with those that would be required by the Commission's Proposal.

(c) Proposal

The Commission proposes new regulations regarding conflicts of interest involving an affiliate market participant and a DCM or SEF. The rules regarding DCMs are proposed as additions to Commission Regulation 38.852(b)(1) and (2), including regarding conflict-of-interest policies and related disclosures. The Commission also

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[348] CEA 5(d)(16), 7 U.S.C. 7(d)(16).

[349] CEA 5h(f)(12), 7 U.S.C. 7b-3(f)(12) (SEF Core Principle 12); 17 CFR 37.1200.

[350] CEA 5(d)(12), 7 U.S.C. 7(d)(12).

[351] 17 CFR 37.203(a).

would make parallel procedures and disclosure requirements for SEFs through additions to Commission Regulation 37.1201. For SEFs and DCMs, the Commission also proposed related changes to the acceptable practices in Appendix B to part 37 and Appendix B to part 38.

(d) Benefits

The Commission assesses costs and benefits relative to the status quo baseline. As noted, the Commission understands that DCMs and SEFs with affiliate market participants generally provide disclosures of such relationships and have procedures to manage conflicts of interest. In this regard, the benefits of the Proposal are twofold: First, the Proposal would codify existing practice, which will help to ensure that current and future DCMs and SEFs continue to adhere to their voluntary practices. Second, the Proposal would establish the Commission's requirements regarding conflicts of interest procedures, which the Commission believes will benefit DCMs and SEFs in assessing the adequacy of their procedures.

(e) Costs

Because the Proposal in this regard codifies existing practices, the Commission does not expect substantial costs associated with compliance as compared to the status quo baseline. It is possible that some firms may incur administrative costs in reviewing or updating their conflicts of interest procedures. The Commission is unable to quantify such costs, given the differences in market practice, but expects preliminarily any such costs to be low. The Commission estimates the disclosure cost to SEFs under 37.1201(b)(5) to be $1,250, and the cost of updating DCM rulebooks under 38.852(b)(2) at $1,250 in the PRA section.

(f) Alternative

1) Guidance rather than rule text regarding separation. Under this alternative, the Commission would only amend Appendix B to part 37 and Appendix B to part 38 to adopt guidance—rather than providing rule text—specifying desired separations between a DCM or SEF and its affiliate market participants, including with respect to information barriers, personnel, physical separation of office space, and systems. The Commission preliminarily believes that, although guidance might afford more flexibility to the regulated entities, regulations would provide better protection of market participants and the public and the financial integrity of derivatives markets. Further, the Commission preliminarily believes that the costs and benefits of any guidance on separation requirements would be comparable to those of the prescriptive separation and allow for easier enforcement of physical separation.

(g) Request for Comments

(7) Has the Commission accounted for the costs and benefits of these proposed regulations adequately?

(8) Are there other costs or benefits for which the Commission has not accounted?

(h) Section 15(a) Considerations

Protection of Market Participants and the Public

The Commission preliminarily believes, subject to consideration of comments, that the proposed Commission Regulations will enhance protections for market participants and the public in important ways. The Commission believes that public disclosure of affiliate relationships will help to ensure that market participants and the public are aware of such relationships and can make decisions, including with respect to where to trade and which market intermediaries to use, with such information available to them. The Commission also believes that conflicts of interest procedures will protect market participants and the public by ensuring that DCMs and SEFs have systems to monitor for, mitigate, and address conflicts, including those that could result in a DCM or SEF benefiting its affiliate at the expense of market participants.

Efficiency, Competitiveness, and Financial Integrity of Futures Markets

The Commission preliminarily believes, subject to consideration of comments, that the proposed Commission Regulations will impact efficiency, competitiveness and financial integrity of the derivatives markets in multiple, overall positive, ways. The proposed disclosure rules will enhance competitiveness by ensuring that market participants are aware of affiliate relationships before they make decisions as to where to trade and which market intermediaries to employ. The conflicts of interest procedures requirement will, in particular, support financial integrity of futures markets by ensuring that DCMs and SEFs have systems to monitor for, mitigate, and address conflicts, including those that could result in a DCM or SEF benefiting its affiliate at the expense of other market participants.

Price Discovery

The Commission preliminarily believes, subject to consideration of comments, that the proposed amendments should provide a positive, indirect influence on price discovery. Disclosure and conflict of interest procedures requirements should provide unaffiliated market participants with increased confidence that trading on a DCM or SEF with an affiliate will not expose them to unfair disadvantages vis-à-vis an affiliate market participant, and such confidence may increase market participants' likelihood to trade, thus benefiting market volume, liquidity, and price discovery.

Sound Risk Management Practices

The Commission preliminarily believes, subject to consideration of comments, that the Proposal enhances support for sound risk management practices. The Commission believes that clear disclosure of important information is a core risk management practice. In this regard, the proposed requirement for DCMs and SEFs to disclose affiliate market participant relationships will result in such DCMs and SEFs engaging in such sound risk management. The Commission further believes that procedures and systems to mitigate conflicts of interest represent another core risk management practice, and so mandating that DCMs and SEFs have such procedures will further support sound risk management practices.

(4) Proposed New Commission Regulations 38.852(b) and (c): Affiliate Principal Trading Firms

(a) Regulatory Baseline

DCM Core Principle 16 stipulates that DCMs establish and enforce rules to minimize conflicts of interest in their decision-making process and to establish a process for resolving them. Separately, DCM Core Principle 12 requires DCMs to establish and enforce rules to protect the market and market participants from abusive practices and to promote fair and equitable trading. Neither these Core Principles, nor the existing acceptable practices in Appendix B of part 38, specifically address the conflict presented by an affiliate that trades as principal on an affiliated exchange. At the same time, neither the CEA nor the Commission's Regulations prohibit affiliate principal trading firms.

(b) Status Quo Baseline

The Commission is aware of approximately eight DCMs that currently have affiliate market participants, some of which the Commission understands are affiliate principal trading firms. The Commission is also aware of at least one DCM that imposes an order-priority subordination requirement on its affiliate principal trading firm, i.e., where the affiliate's limit orders rest behind all other limit orders at a price tick regardless of time priority. In this regard, the Commission believes that certain DCMs already impose conditions on affiliate principal trading firms that are comparable, in some respects to those in proposed Commission Regulation 38.852(c).

(c) Proposal

The Commission proposes to implement the prohibition and conditioned exception discussed in section III.B above through additions to Commission Regulation 38.852: two new definitions in paragraph (a), an incentive-parity requirement in paragraph (b)(2), and the prohibition, exception, and associated conditions themselves in paragraph (c)(1). Paragraphs (c)(2) and (3), respectively, impose an independent verification requirement and an additional disclosure requirement on DCMs that have an affiliate principal trading firm.

Through these proposals, the Commission would limit conflicts of interest by prohibiting a DCM's affiliate principal trading firm from trading on that DCM unless it complies with certain conditions. These conditions include order-priority subordination in paragraph (c)(1)(i) and the market-making agreement requirements in paragraph (c)(1)(ii).

Additionally, paragraph (c)(2) of the proposed regulation would require a DCM permitting an affiliate principal trading firm to trade to designate an independent third-party RSP to conduct financial surveillance of the affiliate principal trading firm, review and monitor the exchange's conflict-of-interest procedures under paragraph (b), and to annually certify to the Commission that an affiliate principal trading firm satisfies the conditions set forth in proposed Commission Regulation 38.852(c).

Finally, paragraph (c)(3) of the proposed regulation would require a DCM to disclose to any party trading on the DCM, on a per-session basis and prior to that party entering any orders, the existence of, and the DCM's relationship with, the affiliate principal trading firm. The DCM would be required to establish a rule that its intermediary participants, and any other operator of an electronic order-entry interface that provides access to the DCM, deliver the notice.

(d) Benefits

Proposed Commission Regulation 38.852(b)(2) requires that an exchange does not advantage an affiliate principal trading firm by requiring the DCM to offer to the non-affiliates the same, or better, incentive or similar programs offered to affiliate principal trading firms. This proposal complements proposed Commission Regulation

38.852(b)(1), discussed previously, which requires a DCM with an affiliate principal trading firm to have conflicts of interest procedures. The Commission preliminarily believes that requiring incentive parity will protect against the harm to fair competition and enhance trust in market integrity. The Commission believes that if market integrity and trust in derivatives markets were to erode, its impact could result in significant reduction of major risk-management functions in financial markets and in compromised price discovery, resulting in adverse impacts to market participants, registered entities, and the public.

The Commission believes incentive parity also will improve competitiveness in financial markets, leading to better trading efficiency and improved price discovery, since non-affiliate principal trading firms will have access to the same, if not better, incentives that are offered to the affiliate principal trading firm by a DCM. The Commission further believes requiring incentive parity, combined with the paragraph (c) requirements, will incentivize non-affiliate principal trading firms to provide liquidity on DCMs, ultimately improving competition, enhancing price discovery, and providing opportunities to market participants for improved risk management practices. The Commission preliminarily expects increased competition and liquidity to also shrink the bid-ask spread in the affected markets, resulting in a reduction in transaction costs for market participants.

Proposed Commission Regulation 38.852(c)(1) would set the conditions under which a DCM may permit an affiliate principal trading firm to trade on the DCM. Given the large number of markets DCMs would like to make available to market participants, the Commission recognizes the challenges DCMs would face in attracting non-affiliate principal trading firms willing to provide liquidity in at least certain of those markets. Without affiliate principal trading firms, the Commission expects many markets to face liquidity challenges or trading to cease to exist in extreme cases, ultimately harming price discovery function that those markets bring to the public. Additionally, absent affiliate principal trading firms providing market making services, market participants would find it challenging to use these illiquid markets for risk management purposes.[352]

The Commission believes these adverse effects will be averted, partially or fully, by allowing for the affiliate principal trading firm exception for market makers, subject to the conditions described above.

By prohibiting DCMs from having an affiliate principal trading firm trade in its markets unless the affiliate meets the proposed stringent conditions, the prohibition would protect against the harm to fair competition and trust in market integrity, as described above. If market integrity and trust in derivatives markets were to erode, its impact could result in significant harm to the risk-management functions of financial markets, as well as in compromised price discovery. This would have adverse impact on market participants, registered entities, and the public.

As mentioned above in Section II.B, the Commission preliminarily expects affiliate principal trading firms to be the initial liquidity providers in many markets, especially in new markets that may otherwise have thin liquidity. This allows for initial price discovery to take place in these markets and provides risk management opportunities for market participants. Order-priority subordination allows an affiliate principal trading firm to provide liquidity when non-affiliate principal trading firms are not present in the market, while allowing non-affiliate principal trading firms to have confidence in their ability to profitably engage on these DCMs because they get filled first when they have orders in the limit order book at the same price level as the affiliate. The Commission preliminarily believes this condition will encourage non-affiliate principal trading firms to find it advantageous to provide liquidity in more markets, improving overall competition, liquidity, and price discovery. In addition, the

[352] Rebecca Baird-Remba, *Liquidity on Kalshi, Polymarket 'too thin' for institutional use*, Risk.net (Jun. 11, 2026), *available at https://www.risk.net/markets/7963633/liquidity-on-kalshi-polymarket-%E2%80%98too-thin%E2%80%99-for-institutional-use*.

Commission expects improved liquidity to lower transaction costs for market participants, in the form of lower bid-ask spreads.

Similarly, the conditions outlined in paragraph (c)(1)(ii) would confine the affiliate principal trading firm to bona fide market making, rather than allowing it to trade in a speculative or directional manner. The requirement to provide continuous two-sided quotes for a minimum amount of trading hours would ensure that there is ample liquidity during the trading hours most relevant to a market, helping price discovery and allowing for effective risk management by market participants. Similarly, the Commission believes specifying limitations on permissible bid-ask spreads would ensure the affiliate principal trading firm provides liquidity at reasonable prices on both sides of the market, such that the liquidity they provide is useful to market participants. If the bid-ask spreads were to be too large, the Commission believes market participants would not find those prices favorable to trade at, and market liquidity would be adversely affected. The last prong of the market making agreement requirement would ensure that the affiliate principal trading firm contributes to the maintenance of a fair and orderly market, also improving liquidity in the market so the market participants and the public can benefit from efficient risk management opportunities, as well as price discovery.

Proposed Commission Regulation 38.852(c)(2) would require a DCM that permits trading by an affiliate principal trading firm to designate an independent third-party RSP to conduct financial surveillance of the affiliate principal trading firm; review and monitor the exchange's compliance with its conflicts-of-interest procedures under paragraph (b); and annually certify to the Commission that the affiliate principal trading firm satisfies the conditions in paragraph (c)(1). Requiring the RSP to be independent of the DCM and its affiliate principal trading firm would protect the financial integrity of the market. If market integrity and trust in derivatives markets were to erode, its impact could impede the risk-management function of financial markets and result in compromised price discovery. The Commission expects the third-party RSP to ensure the financial soundness of the affiliate principal trading firm, as well as to confirm that the conditions outlined in paragraph (c)(1) are met. The certification requirement would help to ensure that the affiliate principal trading firm conditions continue to be met, such that the benefits of the affiliate's trading continue to accrue to the market. The Commission believes this would foster liquidity and price discovery.

Proposed Commission Regulation 38.852(c)(3) would require that customers are made aware that an affiliate principal trading firm is trading in the market in which they may want to trade. This disclosure would include the conditions and limitations imposed on the affiliate principal trading firm. The Commission believes this requirement is in the interest of market participants, allowing them the choice of trading in a market with an active affiliate principal trading firm, or not.

(e) Costs

The Commission expects there to be no burdens or costs associated with the relevant definitions in proposed Commission Regulation 38.852(a) as those definitions themselves do not impose obligations, merely clarify the meaning of the other proposed provisions.

The proposed incentive parity requirement of 38.852(b)(2) would likely impose limited, if any, direct costs because, as the Commission preliminarily understands, DCMs generally already offer similar incentives or similar programs to every market maker. While an incentive parity requirement may reduce the flexibility of a DCM with an affiliate principal trading firm in terms of the incentive programs the DCM offers, the Commission believes the cost associated with this reduction in flexibility to be de minimis. The Commission, however, requests public feedback on whether the Commission's understanding that DCMs offer similar incentives or programs to most, if not all market makers is not accurate, and that more substantial costs should be considered.

Because proposed Commission Regulation 38.852(c)(1) sets conditions under which a DCM can permit an affiliate principal trading firm to trade on the DCM, the Commission preliminarily expects there to be costs to the affiliate principal trading firms and DCMs

Specifically, to the extent that currently there are affiliate principal trading firms trading in markets offered by their affiliate DCM, they would be required to cease trading in these markets if they choose not to comply—or cannot comply—with the conditions in proposed paragraph (c)(1). The Commission preliminarily expects the main cost for these affiliate principal trading firms to be the loss of trading profits, or hedging protections, they would forego as a result. The Commission also preliminarily expects the main costs to the DCMs to be the loss of liquidity in certain markets (and perhaps the loss in the ability to maintain or launch certain markets), which could result in lower revenues.

The Commission preliminarily expects an affiliate principal trading firm today to be trading derivatives for hedging purposes, for speculation purposes, market making purposes, or combination. If for hedging purposes, the Commission expects the affiliate principal trading firm would lose access to risk management vehicles offered by the derivatives markets if the firm had to cease trading. The affiliate principal trading firm then might have to find potentially more costly methods to put on their hedge, or to have an unhedged position if that is not feasible. If the affiliate principal trading firm is trading for speculative purposes, then they would have to forego the potential profits they would have made while trading in the markets offered by their affiliated DCM. The Commission does not have information about the trading motives of affiliate principal trading firms and as a result is not able to quantify the costs associated with the prohibition. The

Commission requests public feedback on these trading motives and would welcome data on the costs associated with the prohibition to these affiliate principal trading firms.

If the DCM and its affiliate principal trading firm instead choose to comply with the conditions in proposed paragraph (c)(1), there will be separate costs associated with these conditions. For example, the Commission expects order-priority subordination will impose costs for the affiliate principal trading firm. When there is an unaffiliated market maker active in the market at the same price levels, their limit orders will be executed before those of the affiliate principal trading firm. The Commission believes this restriction could cause the affiliate principal trading firm to trade against informed market participants since unaffiliated market makers can choose to enter the market and trade with uninformed market participants ahead of the affiliate at any time.

In economic terms, this leads to adverse selection concerns for the affiliate principal trading firm because they are trading with a participant who could possess better observations or analysis. While it is hard to quantify such costs, the Commission preliminarily believes the methodology described in a 1985 *Econometrica* article by A.S. Kyle can be used to create a proxy for these two costs.[353] The measurement, known as Kyle's lambda in the literature, gauges how much prices move because of net taker trading volume in the market. This price movement captures the new information being incorporated into prices through trading.

The Commission has used Kyle's lambda to estimate the order-priority subordination cost that would be imposed on affiliate principal trading firms by the conditions of proposed paragraph (c)(1). To do so, the Commission used the Kyle's lambda estimate from a 2026 working paper by Robert Bartlett and Maureen O'Hara because they provide the most comprehensive estimate recently reported in the

[353] A. S. Kyle, *Continuous auctions and insider trading*, Econometrica 53(6), 1315–35 (1985) ("Kyle").

literature.[354] Bartlett and O'Hara report their Kyle's lambda estimate for markets traded on Kalshi Exchange to be 0.001.[355] Combining this with internal Commission data from one of the most liquid Kalshi Exchange markets,[356] the 15-minute Bitcoin prediction markets, between March 1, 2026 and June 15, 2026, the Commission estimates the per-minute average net taker trading volume for that market and period to be 520 contracts. This suggests the average daily cost of adverse selection in the 15-minute Bitcoin prediction markets to be $750 if the affiliate principal trading firm were active in the 15-minute Bitcoin prediction market every minute of the day and was predominantly trading with informed market participants.[357]

The Commission preliminarily believes this $750 daily average cost is a useful estimate of the order-priority subordination cost. The Commission realizes this is a coarse estimate and that the estimate can change considerably depending on the market, the composition of market participants, and the trading intensity in the market. The Commission requests public feedback on the methodology used to capture the order-priority subordination cost.

Additionally, DCMs that currently have any affiliate principal trading firms trading in their markets would need to subject their affiliate principal trading firm to the order-priority subordination condition described in paragraph (c)(1)(i).[358] The Commission expects doing so would reduce the number of affiliate principal trading

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[354] Robert Bartlett, Maureen O'Hara, *Adverse Selection in Prediction Markets: Evidence from Kalshi* (Apr. 16, 2026) ("Bartlett and O'Hara"), *available at https://ssrn.com/abstract=6615739*.

[355] *Id*., Table 2.

[356] In order to estimate dollar cost of adverse selection, the Commission needs net taker trading volume (also known as order flow). Because Bartlett and O'Hara do not provide that in their study, the Commission used this internal data.

[357] The Commission notes that adverse selection cost is only a small piece of a market maker's profit and loss calculation. Bartlett and O'Hara show in Table 5 that on average market makers make around $300 for single-name markets and $70 for broad-based markets on Kalshi Exchange.

[358] The Commission is aware of at least one DCM that already implements order-priority subordination for its affiliate principal trading firm.

firms trading in those DCMs' markets, potentially reducing the profits a DCM collects from transactions in their markets. This cost to the DCM would depend on the number of the affiliate principal trading firms they currently have, the number of these firms' transactions, as well as how frequently non-affiliate principal trading firms are active in the market. The Commission lacks this relevant information and is unable to reliably estimate the costs for these DCMs. The Commission requests public feedback, or data, on these costs. For DCMs with no affiliate principal trading firms, the Commission does not expect there to be costs associated with paragraph (c)(1)(i).

The Commission does not expect there to be any substantive costs to DCMs associated with the market maker or liquidity provider agreement enumerating the affiliate's obligations, performance standards, and consequences of non-performance, on terms no less favorable to the exchange than those offered to unaffiliated members in a comparable program under proposed Commission Regulation 38.852(c)(1)(ii). The Commission preliminarily believes that DCMs already have such agreements in place with their designated market makers and anticipates that the terms of these agreements to be similar for every market maker, including an affiliate principal trading firm. The Commission, however, expects that some DCMs may need to update their programs to account for the proposed regulations, and requests public feedback, generally, on the Commission's expectations, and on whether DCMs have such agreements in place and if those agreements are the same for every market maker.

The Commission realizes that the market maker or incentive provider program specifications listed in clauses (A) through (D) under proposed Commission Regulation 38.852(c)(1)(ii) are not defined in detail in the rule. The Commission believes any cost associated with proposed Commission Regulation 38.852(c)(1)(ii) can be mitigated since every DCM can define the details of these specifications in the most efficient way possible, provided requirements of 38.852(c)(1)(ii) are satisfied. The Commission preliminarily does not expect DCMs to specify these details in a different manner than how they specify them for their current designated market makers.

For example, the Commission is aware that certain exchanges implement designated market maker programs with conditions similar to any details the Commission might specify.[359] Hence, the Commission expects costs associated with conditions described in proposed paragraph (c)(1)(ii) to be lower if an affiliate principal trading firm is already complying with similar requirements due to being an existing designated market maker for the exchange. The Commission requests feedback on the types of market maker conditions required by DCMs, whether they are different for affiliated and unaffiliated principal trading firms. The Commission would also like feedback on the costs associated with affiliated market maker programs, if they are different than unaffiliated ones.

Proposed Commission Regulation 38.852(c)(2) requires a designated third-party RSP to conduct financial surveillance of the affiliate principal trading firm and review and monitor the exchange's compliance with its conflicts-of-interest procedures under paragraph (b). Designated third-party RSPs will certify to the Commission that the affiliate market maker satisfies the conditions in proposed paragraphs (c)(1)(i) and (c)(1)(ii).

The Commission preliminarily believes that many DCMs already have contractual relationships with NFA, which can be extended to provide financial surveillance of the affiliate principal trading firm as well as review and monitor the exchange's compliance with its conflicts-of-interest procedures under paragraph (b). Direct costs of implementing financial surveillance of a DCM's affiliate principal trading firms would vary based on the number of such affiliates, and the details of the

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[359] *See, e.g.*, ForecastEx LLC Rulebook (May 20, 2026), Rule 416, *available at https://data.forecastex.com/regulatory/ForecastEx_LLC_Rulebook.pdf*.

surveillance service performed. The Commission believes review and monitoring of a DCM's conflict-of-interest procedures will be less burdensome. If these services were outsourced to NFA, a DCM's annual fee assessment would be $150,000 for contract market members with a transaction volume of more than 20 percent of aggregate contract market transaction volume, and $100,000 for contract market members with less than 20 percent of aggregate contract market transaction volume under the current NFA fee structure.[360] However, it is probable that these fees would be adjusted to reflect the kinds of services the DCM would request from NFA. The Commission seeks public feedback on these costs. For instance, what are appropriate fees for NFA to charge for these services? How would these fees change if a DCM chose to outsource these services to a provider other than NFA?

In addition, proposed paragraph (c)(2)(iii) requires certification to the Commission annually that the affiliate principal trading firm satisfied conditions in proposed paragraph (c)(1). The Commission preliminarily believes that certifying order-priority subordination, as well as the requirements listed in a market maker agreement by a third-party RSP, would require message and transaction data at a high-frequency from every market in which an affiliate market maker is active. The Commission expects the data to identify the bids and offers of the affiliate principal trading firm, as well as many details such as price levels and timestamps associated with those bids and offers.

While the Commission does not have direct cost estimates associated with such data-intensive certification process, the Commission staff expects these costs to be in the form of implementation, software, and cloud costs for raw data. While actual costs will depend on the number of markets an affiliate principal trading firm is active in, and the

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[360] *See* NFA Rulebook, Bylaw 1301(a) (schedule of dues and assessments for contract markets), *available at https://www.nfa.futures.org/rulebooksql/rules.aspx?Section=3&RuleID=BYLAW%201301#:~:text=(a)%20Contract%20Markets.,for%20purposes%20of%20the%20computation)*.

frequency of activity in those markets, the Commission staff preliminarily expects implementation cost to be around $500,000, software cost to be around $1,000,000 and cloud costs to be around $700,000, on an annual basis. The Commission expects these costs to be mitigated if the third-party RSP already has cloud connectivity or possesses relevant software for the required data analysis. The Commission seeks public feedback on the types of costs that would be associated with satisfying the requirements listed in proposed paragraph (c)(2)(iii) and the dollar estimates associated with them.

Proposed Commission Regulation 38.852(c)(3) requires that a DCM disclose to any party trading on the DCM, on a per-session basis and prior to that party entering any orders, the existence of, and the DCM's relationship with, the affiliate principal trading firm. Additionally, the DCM would be required to establish a rule that its intermediary participants, and any other operator of an electronic order-entry interface that provides access to the DCM, deliver the notice. The Commission expects DCMs to already have built-in systems that allow them to push notifications to their customers.[361] As such, the Commission expects the cost of modifying these systems to disclose the affiliate relationship to be negligible. The Commission estimates in the PRA section the costs associated with a DCM establishing a rule that its intermediary delivers the notice to be $25,000 since DCMs establish similar rules frequently. Similarly, the Commission does not expect the costs to the intermediary to be substantial either, since many intermediaries already push notifications to their customers. The Commission estimates the associated costs with proposed Commission Regulation 38.852(c)(3) in the PRA section at $434,000 for all DCMs combined.

(f) Alternative(s)

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[361] The Commission notes that Commission Regulations 38.401(c) and (d) (17 CFR 38.401(c), (d)) already require a DCM to provide information on their websites regarding changes to their rulebooks and to post such information on its website concurrent with the filing of such information or submission to the Commission.

1) Permitting affiliate principal trading subject only to conflicts procedures and disclosure. The Commission considered permitting an affiliate principal trading firm to trade for its own account subject only to the principles-based conflicts procedures and disclosure. This is a less restrictive approach, and should, therefore, result in lower costs compared to the proposed requirements.

However, the Commission preliminarily believes that procedures and disclosure alone do not adequately mitigate conflicts that arise from the exchange's economic stake in its affiliate's proprietary trading and the economic benefits associated with avoidance of conflict of interest would be lost. The Commission requests comment on how the cost savings associated with principles-based approach would compare to the costs associated with conflict of interest, as described above.

2) Prohibiting affiliate principal trading with no exceptions. The Commission considered not providing a bona fide affiliate market maker exception and prohibiting an affiliated principal trading firm from trading on an affiliated DCM altogether. The Commission realizes that the liquidity supplied by a bona fide market maker is important for price discovery and for providing risk management opportunities to market participants, and that in newly introduced markets this service may not be provided by unaffiliated market makers. The Commission believes the conflict of interest between a DCM and an affiliated market maker would be substantially reduced by the Proposal and the additional benefits of not providing a market maker exception would be small. The Commission requests comment on whether the costs and benefits of not providing bona fide affiliate market maker exception are different than what is considered here.

3) A volume- or value-based cap on affiliate market maker activity, including a phased or sunset cap. The Commission considered limiting an affiliate principal trading firm's activity through a cap on its share of volume or value in a product, an end-of-day net-position limit, as well as a phased or "sunset" cap that would be more permissive at a product's or venue's launch and tighten as unaffiliated liquidity develops.

The Commission preliminarily believes the proposed order-priority subordination already provides the benefit of the affiliate principal trading providing liquidity when no other market maker is active at a particular price level. The alternative of being subject to volume- or value-based cap, as opposed to order-priority subordination, may not be enough to attract unaffiliated market makers, may be difficult to set in practice given the number and variation of markets, and may eventually hurt overall liquidity and harm price discovery and potential hedging.

The Commission requests comment on whether a volume- or value-based cap, fixed or phased, would be costly for the affiliated market maker, as well as market participants.

4) Prescriptive separation requirements in rule text. The Commission considered requiring specific separations, including dual-hatted staffing prohibitions, physical office separations, and technical separations for information barriers, between DCMs and affiliated market makers. As discussed in other sections, the relevant costs and benefits of such an approach would be difficult to discuss without additional information.

6) Relying on general disclosure in place of per-trading-session notice. The Commission considered a lighter disclosure regime that would not require disclosures on a per-trading-session basis and prior to that party entering any orders as proposed Commission Regulation 38.852(c)(3). Under this alternative, a DCM that permits an affiliate principal trading firm to trade would instead be required to disclose publicly—for example, on its website and in its rulebook—the existence of the affiliate relationship and the conditions and limitations imposed on the affiliate under this section, including order-priority subordination, and to provide that disclosure to each customer once, at account opening or before the customer first trades on the exchange, rather than at per-trading-session frequency.

This approach would substantially reduce the cost associated with building and maintaining a per-trading-session notice. However, the Commission realizes that the information regarding whether liquidity in a market is provided solely by an affiliate, or whether there are unaffiliated market makers and the order-priority subordination rule applies, is beneficial for a customer at the point of trading. The benefit of this information is even more salient since the firm that provides liquidity in a market is a dynamic situation and could change depending on when the customer arrives at the market to trade and the conditions in the market at that time. The Commission requests comment on the costs and benefits associated with this alternative.

(g) Request for Comments

(9) Has the Commission accounted for the costs of the proposed Commission Regulation 38.852(c) adequately?

(10) Are there other costs related to prohibiting affiliated principal trading firm from trading, while allowing for bona fide market making exceptions, for which the Commission has not accounted?

(11) Is the Commission correct that DCMs offer similar incentives or programs to most, if not all market makers?

(12) What are the trading motives of affiliate principal trading firms and how common is each motive?

(13) Does the Commission's methodology accurately capture the order-priority subordination cost of affiliate principal trading firms complying with the conditions of proposed Commission Regulation 38.852(c)(1)?

(14) How many affiliate principal trading firms do DCMs currently have, how many transactions do they engage in, and how frequently are non-affiliate principal trading firms active in these markets?

(15) The Commission is aware that a DCM may operate a trade matching system other than a central limit order book. Would the costs of the order-priority subordination provision of proposed Commission Regulation 38.852(c)(1)(i) apply in a similar manner to a DCM operating a different trade matching system?

(16) Do DCMs already have agreements with affiliate principal trading firms enumerating the affiliate's obligations, performance standards, and consequences of non-performance? If so, are those agreements the same for every firm?

(17) What the types of market maker conditions are currently required by DCMs? Do they differ for affiliated and unaffiliated principal trading firms?

(18) What costs are typically associated with a DCM's affiliated market maker programs? Do these costs differ from those of unaffiliated market maker programs?

(19) What would be appropriate fees for NFA to charge for financial surveillance of a DCM's affiliate market maker as well as review and monitor the exchange's compliance with its conflicts-of-interest procedures? How would these fees change if a DCM chose to outsource these services to a designated third-party regulatory service provider other than NFA?

(20) What costs would be associated with satisfying the certification requirements listed in proposed Commission Regulation 38.852(c)(2)(iii)?

(21) What costs would be required to satisfy the proposed disclosure and notification requirement of proposed Commission Regulation 38.852(c)(3)?

(22) What costs and benefits would be associated with the alternatives discussed?

(23) Are there any other costs or benefits associated with this aspect of the Proposal that the Commission should consider?

(h) Section 15(a) Considerations

Protection of Market Participants and the Public

The Commission preliminarily believes, subject to consideration of comments, that proposed Commission Regulation 38.852(c) and related proposals will enhance protections for market participants and the public in important ways.

The incentive parity of proposed Commission Regulation 38.852(b)(2) will require a DCM to offer the same incentives and programs to non-affiliate principal trading firms on no less favorable terms than what is offered to an affiliate principal trading firm. This proposal closes down the channel through which an exchange could advantage its affiliate and guard market participants—and their customers—from being competitively disadvantaged.

By prohibiting a DCM from permitting an affiliate principal trading firm to trade on its own account, unless subject to the bona fide market making exception, the Commission is protecting market participants from being disadvantaged in a market where a DCM may inappropriately share non-public information with its affiliate principal trading firm. The proposed regulations also better protect market participants and the public where both groups could be impacted if an inappropriate non-public information sharing event erodes confidence in market integrity sufficiently to degrade liquidity. This would adversely affect market participants and the public who benefit from efficient and accurate pricing that liquidity fosters.

The Commission believes that benefiting market participants and the public through efficient and accurate pricing also is achieved through required incentive parity, as well as through the conditions permitting affiliate principal trading firms to trade on an affiliated DCM. As outlined in the proposed rule, incentive parity would attract unaffiliated market participants to be active in making markets, fostering liquidity and price discovery. Similarly, the Commission believes that conditions listed in proposed

Commission Regulation 38.852(c)(1)(i) will entice non-affiliate principal trading firms to trade and provide liquidity on the DCM. Additionally, conditions listed in proposed Commission Regulation 38.852(c)(1)(ii) will also require the affiliate principal trading firm to contribute to the maintenance of a fair and orderly market by actively making markets. The Commission believes that these proposed regulations will protect market participants and the public by providing them with efficient and accurate prices.

Proposed Commission Regulation 38.852(c)(2) would require a DCM that permits an affiliate market maker to designate an independent third-party regulatory service provider to conduct financial surveillance; review and monitor the exchange's compliance with its conflicts-of-interest procedures under paragraph (b); and certify to the Commission, at least annually, that the affiliate market maker satisfies the conditions in paragraphs (c)(1)(i) and (c)(1)(ii). This requirement minimizes the likelihood that market participants and the public will be harmed in the unlikely event that the requirements of the affiliate principal trading firm exception are not met. This would protect market participants and the public through improved market integrity.

Proposed Commission Regulation 38.852(c)(3) would require that customers are made aware of, on a per-session basis and prior to customers entering any orders, that the affiliate principal trading firm is active in the market they want to trade in. This requirement protects market participants from unknowingly trading in a market where liquidity is provided by an affiliate principal trading firm since every trader may not choose to enter into transactions against an affiliate principal trading firm.

Efficiency, Competitiveness, and Financial Integrity of Futures Markets

The Commission preliminarily believes, subject to consideration of comments, that proposed Commission Regulation 38.852(c) will impact efficiency, competitiveness and financial integrity of the derivatives markets in multiple, overall positive, ways.

By closing down the channel through which an exchange could advantage its affiliate, Proposed Regulation 38.852(b)(2) will enhance market competitiveness and financial integrity through requiring incentive parity, which would lead more market participants to be active in the market.

The bona fide market maker exception in the proposed Commission Regulation 38.852(c)(1) also including order-priority subordination, as well as market making requirements. The Commission preliminary believes these requirements will improve competitiveness and financial integrity of derivatives markets by attracting more non-affiliate firms and customers who would be willing to trade in a market with affiliate principal trading firms, given the protections afforded by these requirements. As a result, the Commission expects efficiency and competitiveness in the market to improve.

The Commission preliminarily believes that the independent verification requirement would also help with the financial integrity of the derivatives markets since market participants and the public would be able to trust that an independent third-party RSP would be conducting financial surveillance of the affiliate principal trading firm, reviewing and monitoring exchange's its conflicts-of-interest procedures under paragraph (b) and certifying that the affiliate satisfies conditions listed in paragraphs (c)(1)(i) and (c)(1)(ii). The Commission also believes financial integrity will be enhanced through the additional disclosure requirements listed in paragraph (c)(3).

Price Discovery

The Commission preliminarily believes, subject to consideration of comments, that the proposed amendments should provide a positive, indirect influence on price discovery.

Proposed Commission Regulation 38.852(b)(2) would ensure that non-affiliate principal trading firms participate in the market at the same terms, if not better, as the affiliate members. The Commission preliminarily believes this will improve price discovery in the market by increasing the total amount of information embedded in prices through better participation in trading.

While limiting affiliate principal trading firms from trading on their own account could have an adverse effect on price discovery, the Commission preliminarily believes this will be mitigated through the market maker exception. First, some affiliate principal trading firms may choose to comply with the conditions and increase their participation in the market. Second, having bona fide market makers who are subject to the conditions outlined in paragraphs (c)(1)(i) and (c)(1)(ii) will likely entice other market participants, both customers and market makers, to trade in that market. The Commission expects this to help price discovery in the market. The Commission also notes that without the bona fide market maker exception, several of the newly introduced markets may have no market makers, and hence no price discovery. Proposed Commission Regulation 38.852(c) will likely provide early price discovery to most, if not all, of those newly introduced markets.

The Commission also preliminarily believes that to the extent proposed Commission Regulation 38.852(c)(2) and 38.852(c)(3) improve customer confidence in the market, it is likely to increase price discovery through improved trading participation.

Sound Risk Management Practices

The Commission preliminarily believes, subject to consideration of comments, that the Proposal enhances support for sound risk management practices.

Proposed Commission Regulation 38.852(b)(2) would require incentive parity, which would increase liquidity and price discovery in the market as described above. The Commission believes the risk management needs of market participants can be better met when markets are more liquid and that prices reflect the relevant fundamental information. The Commission also believes that similar benefits to risk management practices will come from the proposed bona fide market making exception, which will likely enhance liquidity and price discovery in existing markets, as well as provide initial liquidity in newly introduced markets.

The Commission also preliminarily believes that to the extent Commission Regulation 38.852(c)(2) and 38.852(c)(3) improve customer confidence in the market, it will motivate increased participation in the market, which is likely to enhance risk management practices by market participants.

(5) Proposed New Commission Regulation 38.853: Board composition, Regulatory Oversight Committee, and disciplinary panels

(a) Regulatory Baseline

DCM Core Principle 16 stipulates that DCMs establish and enforce rules to minimize conflicts of interest in their decision-making process and to establish a process for resolving them. DCM Core Principle 15 sets certain governance standards for DCMs and requires that a DCM must establish and enforce appropriate fitness standards for directors and members of any disciplinary committees. Core Principle 17 regards the composition of the governing boards of DCMs and requires that the governance arrangements of a DCM be designed to permit consideration of the views of market participants.

(b) Status Quo Baseline

The acceptable practices for Core Principle 16 in Appendix B to Part 38 currently contain guidance that is substantially identical to proposed Commission Regulation 38.853. It is the Commission's preliminary understanding that all registered DCMs today substantially comply with those acceptable practices.

(c) Proposal

The Commission proposes to codify the existing acceptable practices into rule text. Specifically, proposed Commission Regulation 38.853(a) would codify the public director requirement for boards of directors and proposed Commission Regulation

38.853(b) would codify the conditions for an individual to qualify as a public director. Proposed Commission Regulation 38.853(c) would codify the requirement for a DCM to have a Regulatory Oversight Committee (ROC), as well as the ROC's obligations. Proposed Commission Regulation 38.853(d) would codify the requirement for disciplinary panels to include public directors.

(d) Benefits

The Commission is proposing to codify existing guidance to ensure compliance with practices that the Commission believes are beneficial with respect to mitigating conflicts of interest. A core benefit of this aspect of the Proposal is to minimize the potential for slippage (non-compliance with the existing acceptable practices) by existing DCMs or potential applicants for designation. This aspect of the Proposal should serve to protect market participants and the public in a number of ways, including by ensuring that DCM boards include independent voices, regulatory compliance is overseen by individuals who are insulated from commercial pressures, and disciplinary panels have independent voices as well.

(e) Costs

There would be costs in connection with this aspect of the Proposal as compared to the regulatory baseline. While, as noted, certain Core Principles are relevant to board composition, Part 38 does not include the specific requirements that are now being proposed (since those currently exist in guidance). Certain aspects can be quantified—as described above the Commission expects costs associated with the two proposed Commission reporting requirements. However, the Commission is not aware of a way to quantify the costs associated with DCMs complying with the obligations to have public directors, constitute a ROC, and have public directors on disciplinary panels. Given the Commission's understanding of current market practice, the Commission does not expect there to be material costs as compared to the status quo baseline.

(f) Alternative

1) Keep the acceptable practices as guidance. The Commission considered keeping the acceptable practices as guidance in Appendix B. However, the Commission preliminarily believes that codification would provide the benefits described above and that the costs would be minor to market participants given its understanding of the status quo baseline.

(g) Request for Comments

(24) Has the Commission accounted for the costs of the proposed Commission Regulation 38.853 adequately?

(25) The Commission preliminarily believes that DCMs are for the most part already complying with these requirements. Is this belief correct or is there some slippage; that is, some aspects of this Proposal for which DCMs do not currently comply?

(26) Does potential slippage justify codifying the guidance into rule text?

(h) Section 15(a) Considerations

The Commission preliminarily believes that one 15(a) factor primarily is affected by this rulemaking.

Protection of Market Participants and the Public

The Commission preliminarily believes, subject to consideration of comments, that proposed Commission Regulation 38.853 and related proposals will enhance protections for market participants and the public through the having DCM boards making fairer decisions, disciplinary panels have an independent voice, and the requirement for DCMS to establish ROCs consisting only of public directors that protects market participants from favoritism or bias that may arise due to conflicts of interest.

(6) Proposed Amendments to Commission Regulations 39.2, 39.21, and 39.25—DCO-Affiliate Clearing Members

(a) Regulatory Baseline

Under the CEA and the Commission's regulations promulgated thereunder, a DCO has extensive responsibilities to manage its business and the risks associated with it. These responsibilities manifest in the DCO Core Principles. While the Core Principles do not specifically reference affiliated structures, they are generally applicable to DCOs, including those that have an affiliated clearing member, such as an FCM or an affiliate market maker. Of particular importance to this Proposal is Core Principle P, which requires a DCO to establish and enforce rules to minimize conflicts of interest in the decision-making process of the DCO and to establish a process for resolving such conflicts of interest.[362]

In addition, Core Principle D generally requires a DCO to ensure that it possesses the ability to manage the risks as sociated with discharging the responsibilities of the DCO through the use of appropriate tools and procedures.[363] This Core Principle specifically requires a DCO to set and collect margin that is sufficient to cover potential exposures in normal market conditions.[364] Relatedly, Core Principle B requires a DCO to have adequate financial, operational, and managerial resources, as determined by the Commission, to discharge each of its responsibilities.[365]

Some of a DCO's risk management responsibilities under the Core Principles relate to a DCO's relationships with individual clearing members (including any affiliate clearing members) and require a DCO to exercise discretion in fulfilling them. For

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[362] CEA 5b(c)(2)(P), 7 U.S.C. 7a-1(c)(2)(P). Commission Regulation 39.25 restates the requirements of Core Principle P.

[363] CEA 5b(c)(2)(D)(i), 7 U.S.C. 7a-1(c)(2)(D)(i).

[364] *Id.*

[365] CEA 5b(c)(2)(B), 7 U.S.C. 7a-1(c)(2)(B).

example, Core Principle C(i)(I)[366] 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 maintain adequate arrangements and resources for "the effective monitoring and enforcement of compliance" with its rules, and "the authority and ability to discipline . . . a member or participant due to a violation . . . of any rule of the [DCO]."[367]

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, Commission Regulation 39.13(h)(5)(iii)[368] 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 Commission Regulation 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[369] 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: Commission Regulations 39.12(a)(4) (verify compliance of clearing members with DCO participation requirements), 39.12(a)(6) (enforce

[366] CEA 5b(c)(2)(C)(i)(I), 7 U.S.C. 7a-1(c)(2)(C)(i)(I).

[367] CEA 5b(c)(2)(H)(i)(I), (ii), 7 U.S.C. 7a-1(c)(2)(H)(i)(I),ii).

[368] 17 CFR 39.13(h)(5)(iii).

[369] 17 CFR part 39.

compliance with DCO participation requirements and suspend/remove non-compliant members), 39.13(g) (margin requirements), 39.13(h)(1) (risk limits on clearing members), 39.13(h)(5)(ii) (review the risk management policies of clearing members and take appropriate action), 39.13(h)(6) (additional actions with respect to particular clearing members), 39.16 (default rules and procedures), and 39.17 (rule enforcement).

The Core Principles also impose certain disclosure requirements on DCOs. DCO Core Principle L requires a DCO to provide to market participants sufficient information to enable the market participants to identify and evaluate accurately the risks and costs associated with using the services of the DCO.[370] The Core Principle further requires a DCO to make information concerning the rules and operating and default procedures governing the clearing and settlement systems of the DCO available to market participants.[371] Additionally, a DCO must disclose publicly and to the Commission information concerning any matter relevant to participation in the settlement and clearing activities of the DCO.[372]

(b) Status Quo Baseline

The Commission preliminarily believes that the status quo baseline is consistent with the regulatory baseline. That is, the registered DCOs that have affiliate clearing members today generally comply with the DCO Core Principles as they apply to such affiliate clearing members. In particular, the Commission understands that certain such DCOs have policies and procedures in place that specifically concern their affiliate clearing members. These policies and procedures address potential conflicts of interest and how to mitigate them, including through information barriers and separations between personnel and offices.

[370] CEA 5b(c)(2)(L)(i), 7 U.S.C. 7a-1(c)(2)(L)(i).

[371] CEA 5b(c)(2)(L)(ii), 7 U.S.C. 7a-1(c)(2)(L)(ii).

[372] CEA 5b(c)(2)(L)(iii)(V), 7 U.S.C. 7a-1(c)(2)(L)(iii)(V).

(c) Proposal

The Proposal would provide a definition for “affiliate clearing member,” add a new principle-based requirement in Commission Regulation 39.25(d) requiring procedures to identify, address, and manage conflicts of interest involving an affiliate clearing member, and require a DCO to disclose affiliate clearing member relationships. As with other categories of affiliated entities, the Commission is also proposing to require DCOs to have procedures to manage conflicts of interest with affiliate clearing members, including by maintaining separations between a DCO and its affiliated clearing members through information barriers, not sharing personnel, physical separation of office space, and systems. Such procedures would also require DCOs to make certain disclosures.

(d) Benefits

The Commission believes that the proposed amendments applicable to DCOs with affiliate clearing members will provide benefits to registered entities, market participants, and the derivatives markets overall. A DCO’s disclosure of any affiliate clearing members will provide other market participants, including unaffiliated clearing members in particular, with notice of such relationships. Unaffiliated clearing members will, therefore, be on notice, of such relationships and can make decisions—for example, on where to clear their transactions—accordingly. Requiring a DCO with an affiliate clearing member to have procedures regarding conflicts of interest will likewise provide benefits, including by mitigating actual conflicts, as well as the negative impacts that the perception of a conflict could create.

The Commission preliminarily believes that procedures requiring separation between affiliate clearing members and DCOs would improve the protection of market participants and the public and the financial integrity of derivatives markets and provide potentially better enforcement than guidance.

(e) Costs

The Commission preliminarily believes that the proposed DCO rule amendments would not result in substantial costs to DCOs, particularly as compared to the status quo baseline. As noted, the Commission understands that DCOs with affiliate clearing members today already have procedures to mitigate conflicts of interest and provide disclosure of such relationships. To the extent a DCO does not have such procedures, or determines to update such procedures in light of the Commission's rules and guidance, the Commission believes that there will be direct costs associated with creating and then maintaining and implementing such procedures. As noted above, the Commission does not believe it is possible to quantify these costs, given the differences between DCOs and the approaches they may take with respect to such policies. To the extent a DCO does not provide the proposed disclosure, the Commission estimates these costs at $3,000 for all DCO in the PRA section.

The Commission notes that physically separating affiliate clearing members and DCOs will be costly if these entities are not currently separated. New personnel may need to be onboarded if employees are dual-hatted. New office space may need to be rented or acquired. Computer software may need to be updated to ensure logical separation, too. Without more details on DCOs and affiliate clearing members the Commission cannot quantify these costs, however.

(f) Alternatives

This section considers certain of the alternatives set forth above.

1) No additional rules. The Commission is considering whether it need not promulgate new rules regarding DCOs with affiliate clearing members on the basis of its understanding of the status quo baseline. This approach would reduce costs to zero, but also would negate the benefits of the proposed approach, which would ensure, without relying on voluntary practice, that DCOs with affiliate clearing member relationships continue to have appropriate procedures and disclosures.

2) Prohibition of DCO affiliations with clearing members. The CEA does not prohibit DCOs from having affiliated clearing members, and DCO affiliations with clearing members have existed for many years under the Commission's principles-based framework. As noted, the Commission preliminarily believes that affiliations between DCOs and clearing members can produce efficiencies and competitive benefits, and that a targeted procedures-and-disclosure framework can adequately mitigate the relevant risks without foreclosing efficiency-enhancing structures. In this regard, a prohibition would cut off these benefits and would impose a number of significant costs. For example, existing DCO-affiliate clearing member relationships would have to be terminated, resulting in disruption to existing market structure. There may be certain benefits to a prohibition. For example, a prohibition would eliminate the possibility that the default of an affiliate clearing member could lead to the failure of the DCO itself.

3) Guidance rather than rule text regarding separation. Under this alternative, the Commission would only adopt guidance—rather than providing rule text—specifying desired separations between a DCO and its affiliated clearing member, including with respect to information barriers, personnel, physical separation of office space, and systems. The Commission preliminarily believes that, although guidance might afford more flexibility to DCOs, rules will provide better protection of market participants and the public and the financial integrity of derivatives markets. Further, the Commission preliminarily believes that the costs and benefits of any guidance on separation requirements would be comparable to those of the prescriptive separation and allow for easier enforcement of physical separation.

4) Supplemental financial resources at the DCO. A commenter on the Affiliations RFC proposed that a DCO with an affiliate clearing member be required to "reserve[e] more capital, SITG [skin-in-the-game] and liquidity resources,"[373] and elsewhere proposed that the Commission require such a DCO to hold "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, [Commission Regulations] 39.11(a)(1)[,] 39.11(e)(1)(ii)[, and] 39.33(c)."[374]

5) The Commission preliminarily declines to require supplemental financial resources. The direct, quantifiable costs of this alternative would depend on the specific financial resources requirement proposed. However, in any case, such a requirement would result in more capital and other resources being tied up at the DCO (e.g., sitting in a guaranty fund), relative to the status quo, where such resources could be deployed toward other purposes, such as being invested to earn a return elsewhere in the business. However, this alternative would have the added benefit of making the DCO less susceptible to failing—thus mitigating systemic risk—or making it less likely that unaffiliated clearing members have losses tied to the deployment of guaranty fund resources.

The Commission also preliminarily believes that the existing financial-resources requirements applicable to DCOs are appropriate and, that imposing additional financial-resources requirements based solely on the existence of an affiliate relationship could distort risk management practices by imposing requirements based on the affiliate relationship alone rather than on potential exposures as is the case in the existing cover-1/cover-2 framework.

6) Segmented skin-in-the-game and restrictions on mutualization of affiliate clearing member losses. Under this alternative, the Commission would "[i]ncrease the

[373] ISDA Comment, *supra* note 250, at 9.

[374] *Id.* at 9.

tranche of DCO equity in the default waterfall, so called "skin-in-the-game" ("SITG"), or incorporate a segmented section SITG that applies in the case of losses associated with the affiliated FCM."[375] The Commission preliminarily declines to require either a segmented SITG tranche or a restriction on mutualization of affiliate clearing member losses. It is not apparent that a segmented SITG requirement would be a proportionate means of mitigating any increased risk caused by the affiliation. However, the Commission acknowledges that there may be some benefits to this approach. For example, this alternative might protect other clearing members from incurring losses in an affiliate clearing member default.

However, there are costs associated with imposing SITG requirements or preventing loss mutualization. Today, a DCO has discretion with respect to its default management procedures and this requirement would impose prescriptive restrictions that may have unintended consequences in the ordinary course risk management activities of the DCO, as well as in the case of clearing member distress or default. There are other potential costs associated with this alternative. For example, the alternative would require the DCO to increase its equity contribution in the default waterfall rather than employing such funds elsewhere. Additionally, the increased equity could change how a DCO determines to set initial margin requirement. For instance, if the SITG sat in front of the mutualized default funds but behind the initial margin of clearing members initial margin, then the DCO might want to require more initial margin from clearing members to protect its SITG. Nevertheless, more SITG would, all else equal, make it less likely that an affiliate clearing member could result in the DCO's failure.

7) Pre-approval and heightened supervision alternatives. The Commission is considering including "[p]otential requirement[s] for explicit regulatory approval for use

[375] ISDA Comment, *supra* note 250, at 4.

of discretion by the DCO impacting the affiliated CM (e.g., in default/recovery/resolution)" and "[e]nhanced supervisory focus by the Commission on decisions affecting affiliated entities."[376] The Commission preliminarily believes that pre-approval requirements could materially impede the DCO's ability to exercise sound risk management and respond to default situations in real time, which would increase systemic risk, perhaps substantially. The Commission, through an approval right, may, for example, be able to prevent DCO actions that unfairly favor its affiliate in these circumstances, but given the time sensitive nature of default risk management any such benefits have to be considered against the costs of a delay. The Commission preliminarily believes that the appropriate locus for decision-making for time-sensitive risk-management decisions rests with the DCO and not the Commission. The Commission preliminarily intends, however, to continue to focus its supervisory attention on the conflicts-management arrangements of DCOs with affiliated clearing members, consistent with its existing supervisory authority.

Again, the Commission preliminarily believes that it is challenging to assess the costs and benefits relative to the status quo quantitatively in this context.

8) DCO-adopted rules applicable to affiliate clearing members. ISDA proposed that the Commission consider requiring DCOs to "set[] more prescriptive rules for affiliated FCMs, even though additional prescription might restrict the required level of flexibility in practicing sound risk management with unforeseen risks." Under this alternative, the Commission would not adopt prescriptive rules; rather, the *DCO* would. The Commission preliminarily believes that preserving DCO discretion in the context of risk management is paramount and that pre-approval would hamper flexibility. Nevertheless, some DCOs exhaust all of a clearing member's default fund contributions

[376] ISDA Comment, *supra* note 250, at 3-4.

before exposing other clearing members to default fund losses. The Commission is considering requiring that all DCOs do this, at least for affiliated clearing members, to mitigate conflicts of interests in their default resolution.

9) Codified non-preference principle. The Commission is considering whether it is appropriate to add a Core Principle explicitly stating that a DCO must treat all of its members equally, regardless of affiliation. The Commission preliminarily believes that the proposed Commission Regulation 39.25(d) procedures requirement, combined with existing Commission Regulation 39.7 (Open Access) and the DCO Core Principles regarding fair and open access (Core Principle C) and competition (Core Principle N), provides an adequate framework for non-preference.

In this regard, the Commission preliminarily believes that status quo is sufficient and that this alternative would not result in any additional benefits to the DCO or other market participants. Nevertheless, the alternative might clarify, together with the existing Core Principle requirements, that an affiliate clearing member may not receive preferential treatment under any circumstances. Such clarification may provide unaffiliated clearing members with additional comfort that they will not be disadvantaged vis-à-vis the affiliate—in a default scenario or otherwise—which could increase participation and liquidity on the markets that clear through the relevant DCO. The Commission believes it would be challenging to attempt to quantify these indirect benefits.

(g) Request for Comments

(27) Is there data available to quantify any of the costs or benefits described above in connection with the Proposal or the alternatives?

(28) Are there any costs or benefits to the Proposal or any of the alternatives that the Commission has not mentioned?

(h) Section 15(a) Considerations

Protection of Market Participants and the Public

Proposed Commission Regulation 39.21(c)(9) requiring a DCO to make publicly available on its website the existence of an affiliated clearing member will help other clearing members assess potential conflicts of interest resulting from affiliation and to take appropriate actions. Likewise, DCO-affiliate clearing member procedures will help to ensure that such conflicts are, in fact, identified and mitigated, which should protect market participants and the public from the potential consequences of, for example, DCO favoritism of its affiliate.

Efficiency, Competitiveness, and Financial Integrity of Futures Markets

Mandatory disclosures and procedures will help to ensure the efficiency, competitiveness, and financial integrity of the futures markets. For example, disclosure will provide unaffiliated clearing members with information that will help them determine where to trade and clear their transactions. The transparency afforded by such disclosures will support market competitiveness by making plain to the market relevant information regarding the clearinghouses available to them. Conflicts procedures will help to bolster financial integrity as well by reducing the likelihood that a DCO will unfairly favor their affiliate over other clearing members.

Price Discovery

Affiliate clearing member disclosures and conflict procedures may indirectly support price discovery by providing other market participants with transparency and confidence in the markets associated with such DCO, which may support additional trading activity.

Sound Risk Management Practices

The Commission believes that the Proposal will enhance sound risk management practices. First, conflicts procedures will ensure that DCOs identify and mitigate conflicts, which is a fundamental risk management program feature. Furthermore, the

Commission proposes to preserve a DCO's discretion with respect to default management. As noted above, the Commission believes that DCO direction in this regard is essential in limiting systemic risk and ensuring that clearing member defaults are contained and managed efficiently, with less impacts to other clearing members or the derivatives markets.

(7) Proposed Amendment to Commission Regulation 1.55—Public Disclosures by FCMs

(a) Regulatory Baseline

Commission Regulation 1.55 provides that no FCM may enter into a customer account agreement or first accept funds from a customer, unless the FCM discloses to the customer all information about the FCM, including its business, operations, risk profile, and affiliates, that would be material to the customer's decision to entrust such funds to and otherwise do business with the FCM and that is otherwise necessary for full and fair disclosure.[377] In connection with the disclosure, the FCM must provide certain material information to its customers, including information regarding the material risks of entrusting customer funds with an FCM created by the FCM's affiliates.[378]

(b) Status Quo Baseline

The Commission understands that many FCMs already disclose their affiliate relationships in connection with their Commission Regulation 1.55 obligations.

(c) Proposal

The Commission proposes to amend Commission Regulation 1.55(k) to enhance the disclosures provided to customers and potential customers regarding any affiliate relations that an FCM has with an exchange or a clearing organization. Specifically, the amendment to Commission Regulation 1.55(k)(5) would require that an FCM disclose

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[377] 17 CFR 1.55(i).

[378] 17 CFR 1.55(k)(5).

any affiliate relationship it has with a SEF, DCM, or DCO along with any risks created by such affiliate relationship.

(d) Benefits

The proposed changes would have the benefit of ensuring that an FCM's customers and potential customers are aware of any affiliate relationships and the risks associated with such relationships.

(e) Costs

The Commission estimated the costs of this proposal relative to the status quo in the PRA section as $5,000.

(f) Alternative(s)

1) Prescriptive Disclosure. The Commission considered whether to prescribe the disclosures that an FCM must provide to its customers regarding any affiliate relationship it has with a SEF, DCM, or DCO, consistent with how other aspects of Commission Regulation 1.55(k) function. The Commission does not believe that there would be benefits to this approach compared to the proposed approach. The Commission believes that there may be additional costs to this approach, including that such prescriptive disclosures will prevent an FCM from tailoring its disclosure to its circumstances, which may result in less helpful information being provided to customers and the public.

(g) Request for Comments

(29) Is there data available to quantify any of the benefits described above in connection with the proposed changes to Commission Regulation 1.55(k)? Is data available to quantify the costs or benefits of the alternative noted?

(30) Has the Commission correctly monetized the costs of this proposed amendment? If not, why not?

(31) Are there any costs or benefits to the proposed amendment or the alternative that the Commission has not mentioned?

(h) Section 15(a) Considerations

The Commission believes only 15(a) factor (1), the protection of market participants and the public, is impacted by this proposal through the public possibly making better informed decisions relative to the status quo.

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 (including any exemption under section 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market established pursuant to section 17 of the CEA.[379]

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requests comment on whether the Proposal implicates any other specific public interest to be protected by the antitrust laws. The Commission has considered the Proposal to determine whether it is anticompetitive and has preliminarily identified no anticompetitive effects. The Commission requests comment on whether the Proposal is anticompetitive and, if it is, what the anticompetitive effects are.

Because the Commission has preliminarily determined that the Proposal is not anticompetitive and has 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 Proposal.

E. Executive Orders 12866, 13563, and 14192

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[379] CEA 15(b), 7 U.S.C. 19(b).

Executive Orders ("E.O.") 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select those regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages and distributive impacts). Section 3(f) of E.O. 12866 defines a "significant regulatory action" as any regulatory action that is likely to result in a rule that may: (1) have an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities; (2) create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (3) materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raise novel legal or policy issues arising out of legal mandates, or the President's priorities.

The Office of Management and Budget has determined that the proposed action is not a significant regulatory action as defined in section 3(f)(1) of E.O. 12866, and therefore it was subject to E.O. 12866 review.

This Proposal, if finalized as proposed, is not expected to be an E.O. 14192 regulatory action because the proposed rule is not a significant regulatory action under E.O. 12866.

List of Subjects

17 CFR Part 1

Brokers; Commodity futures; Consumer protection; Designated self-regulatory organizations; Futures commission merchants; Reporting and recordkeeping requirements; Risk management.

17 CFR Part 37

Conflicts of interest; Reporting and recordkeeping requirements; Risk management; Swap execution facilities; Swaps.

17 CFR Part 38

Designated contract markets; Commodity futures; Conflicts of Interest; Reporting and recordkeeping requirements; Risk management.

17 CFR Part 39

Commodity futures; Definitions; Reporting and recordkeeping requirements; Risk management; Swaps.

For the reasons stated in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR chapter I as follows:

PART 1 – GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for part 1 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6l, 6m, 6n, 6o, 6p, 6r, 6s, 7, 7a-1, 7a-2, 7b, 7b-3, 8, 9, 10a, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23, and 24 (2012).

2. Amend § 1.52 by:

a. Adding paragraphs (a)(3) and (a)(4);

b. Revising paragraph (c)(1)(i);

c. Adding paragraphs (d)(2)(i)(A) through (D);

d. Revising paragraph (d)(2)(ii)(C)(*1*); and

e. Revising paragraph (i)(2).

The additions and revisions read as follows:

§ 1.52 Self-regulatory organization adoption and surveillance of minimum financial requirements.

(a) * * *

(3) *Affiliate futures commission merchant* means a futures commission merchant (as defined in § 1.3) that directly or indirectly controls, is controlled by, or is under common control with a self-regulatory organization. For purposes of this paragraph (a)(3), *control* (including the terms *controlled by* and *under common control with*) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

(4) *Non-public information* means information that has not been disseminated in a manner that makes it generally available to the trading public.

* * * * *

(c) * * *

(1) * * *

(i) *Independence of examination staff and reporting structure.* (A) A self-regulatory organization must maintain staff of an adequate size, training, and experience to effectively implement a supervisory program. Staff of the self-regulatory organization, including officers, directors, and supervising committee members, must maintain independent judgment and its actions must not impair its independence nor appear to impair its independence in matters related to the supervisory program. The self-regulatory organization must provide annual ethics training to all staff with responsibilities for the supervisory program.

(B) If a self-regulatory organization has an affiliate futures commission merchant, the examination staff implementing the supervisory program required by paragraph (c) of this section must report directly to the board of directors or other designated committee or officer responsible for regulatory compliance of the self-regulatory organization. If examination staff report to an officer responsible for regulatory compliance of the self-regulatory organization, such officer must, in turn, report directly to the board of directors or other designated committee.

(C) A self-regulatory organization which has an affiliate futures commission merchant must designate an independent third-party self-regulatory organization to conduct surveillance of the affiliate futures commission merchant under paragraph (c) of this section. The self-regulatory organization must ensure that the independent third-party self-regulatory organization engaged under this paragraph implements a supervisory program that satisfies this paragraph and also satisfies the requirements of §38.606 of this chapter applicable to a "regulatory service provider." The self-regulatory organization will at all times remain responsible for compliance with its obligations under the Act and Commission regulations, and for the independent third-party self-regulatory organization's performance on its behalf.

(D)(*1*) A self-regulatory organization may not access non-public information of its affiliate futures commission merchant, except as necessary to comply with its responsibilities and obligations as a designated contract market under part 38 of this chapter.

(*2*) A self-regulatory organization is prohibited from sharing, directly or indirectly, non-public information obtained from its supervisory program of its member futures commission merchants established under this section with its affiliate futures commission merchant for any purpose, except as necessary to comply with its responsibilities and obligations as a self-regulatory organization under this section or as a designated contract market under part 38 of this chapter.

* * * * *

(d) * * *

(2) * * *

(i) * * *

(A) *Election of a registered futures association as designated self-regulatory organization.* Notwithstanding the authority of the Joint Audit Committee under this paragraph (d)(2)(i) to designate the designated self-regulatory organizations responsible for the examinations of futures commission merchants, a futures commission merchant that is a member of a registered futures association may elect, in writing to the Joint Audit Committee, to have such registered futures association serve as its designed self-regulatory organization. Upon receipt of such an election, the Joint Audit Committee shall designate such registered futures association as that futures commission merchant's designated self-regulatory organization and shall reflect such designation in the Joint Audit Program. In the absence of such an election, the Joint Audit Committee shall designate the futures commission merchant's designated self-regulatory organization in accordance with this paragraph (d)(2)(i). An election under this paragraph (d)(2)(i)(A) does not alter the examination standards applicable to the futures commission merchant under the Joint Audit Program and does not relieve any self-regulatory organization of any of its responsibilities, including those described in paragraphs (d)(1)(ii) and (i)(2) of this section.

(B) *Membership predicate*. A futures commission merchant may not be designated to, and the Joint Audit Committee shall not designate to a futures commission merchant, a self-regulatory organization of which the futures commission merchant is not a member. Nothing in paragraph (d)(2)(i)(A) of this section requires a self-regulatory organization other than a registered futures association to serve as the designated self-regulatory organization of a futures commission merchant that is not its member.

(C) *Notice period and effective date of election*. An election under paragraph (d)(2)(i)(A) of this section shall take effect on the later of the first day of the next examination cycle under paragraph (d)(2)(ii)(C)(4) of this section or six months after the Joint Audit Committee's receipt of the election. An election shall not interrupt or shorten any examination then in progress. Where the Joint Audit Committee determines that elections received within a common period would, if given immediate effect, impair the ability of a designated self-regulatory organization to maintain examination staff of adequate size, training, and experience as required under paragraph (d)(2)(ii)(C)(1) of this section, the Joint Audit Committee may establish a reasonable schedule phasing in the effective dates of such elections; provided, however, that no election shall be delayed beyond twelve months after its receipt.

(D) *Minimum duration of election*. Following the effective date of an election under paragraph (d)(2)(i)(A) of this section, a futures commission merchant must retain the registered futures association as its designated self-regulatory organization for not fewer than three complete examination cycles under paragraph (d)(2)(ii)(C)(4) of this section before electing a different designated self-regulatory organization or revoking its election. This paragraph (d)(2)(i)(D) does not affect a futures commission merchant's obligations, or any self-regulatory organization's responsibility, including under paragraphs (d)(1)(ii) and (i)(2) of this section.

(ii) * * *

(C) (*1*) *Independence of examination staff and reporting structure.* (*i*) A designated self-regulatory organization must maintain staff of an adequate size, training, and experience to effectively implement the Joint Audit Program. Staff of the designated self-regulatory organization, including officers, directors, and supervising committee members, must maintain independent judgment and its actions must not impair its independence nor appear to impair its independence in matters related to the Joint Audit Program. The designated self-regulatory organization must provide annual ethics training to all staff with responsibilities for the Joint Audit Program.

(*ii*) A designated self-regulatory organization which has an affiliate futures commission merchant may not perform the function of a designated self-regulatory organization for the affiliate futures commission merchant for the purposes of paragraph (c)(1)(i) requirements in this section. Such self-regulatory organization remains responsible for performing the other applicable self-regulatory organization functions required hereunder.

(*iii*) If a designated self-regulatory organization has an affiliate futures commission merchant, the examination staff implementing the supervisory program required by this paragraph must report directly to the board of directors or other designated committee or officer responsible for regulatory compliance of the designated self-regulatory organization. If examination staff report to an officer responsible for regulatory compliance of the designated self-regulatory organization, such officer must, in turn, report directly to the board of directors or other designated committee.

(*iv*) A designated self-regulatory organization may not access non-public information of its affiliate futures commission merchant except as necessary to comply with its responsibilities and obligations as a designated contract market under part 38 of this chapter. A designated self-regulatory organization is prohibited from sharing, directly or indirectly, non-public information obtained from its supervisory program of its member futures commission merchants established under this section with its affiliate futures commission merchant for any purpose, except as necessary to comply with its responsibilities and obligations as a designated self-regulatory organization under this section or as a designated contract market under part 38 of this chapter.

* * * * *

(i) * * *

(2) Of the identity of the designated self-regulatory organization that has been delegated responsibility for such a member, including a registered futures association where the member has elected such registered futures association as its designated self-regulatory organization under paragraph (d)(2)(i)(A) of this section; *provided, however,*

that the self-regulatory organization that delegates, pursuant to paragraph (d) of this section, the functions set forth in paragraphs (b) and (c) of this section shall remain responsible for its member registrants' compliance with the regulatory obligations, and if such self-regulatory organization becomes aware that a delegated function is not being performed as required under this section, the self-regulatory organization shall promptly take any necessary steps to address any noncompliance.

* * * * *

3. In § 1.55, revise paragraph (k)(5) to read as follows:

§ 1.55 Public disclosures by futures commission merchants.

* * * * *

(k) * * *

(5) The material risks, accompanied by an explanation of how such risks may be material to its customers, of entrusting funds to the futures commission merchant, including, without limitation:

(i) The nature of investments made by the futures commission merchant (including credit quality, weighted average maturity, and weighted average coupon);

(ii) The futures commission merchant's creditworthiness, leverage, capital, liquidity, principal liabilities, balance sheet leverage and other lines of business;

(iii) Risks to the futures commission merchant created by:

(A) Its affiliates and their activities, including investment of customer funds in an affiliated entity and

(B) Any other affiliate relationships with a swap execution facility, designated contract market or a derivatives clearing organization; and

(iv) Any significant liabilities, contingent or otherwise, and material commitments;

* * * * *

PART 37 – SWAP EXECUTION FACILITIES

4. 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.

5. Add § 37.1201 to read as follows:

§ 37.1201 Affiliate conflicts of interest.

(a) *Definitions.* For purposes of this part:

(1) *Affiliate market participant* means any person (including any affiliate introducing broker) that:

(i) Directly or indirectly controls, is controlled by, or is under common control with, a swap execution facility and

(ii) Directly or indirectly executes, introduces, or otherwise facilitates trades on or subject to the rules of the swap execution facility.

(2) *Control* (including the terms "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

(b) *Procedures.* A swap execution facility shall have procedures for identifying, addressing, and managing conflicts of interest involving an affiliate market participant. Such procedures shall address, at a minimum:

(1) Applications and systems, such that a swap execution facility's applications, information and systems are maintained and operated in a manner that prevents the sharing of non-public information with any affiliate market participant;

(2) Personnel, such that a swap execution facility does not share staff with any affiliate market participant, except with respect to administrative functions;

(3) Office space, such that a swap execution facility maintains office space for itself that is separate from the office space of any affiliate market participant;

(4) Documentation, such that a swap execution facility documents all conflicts of interest that arise with respect to an affiliate market participant and how any such conflict of interest is resolved; and

(5) Disclosures, such that a swap execution facility provides disclosure of the existence of an affiliate market participant in its rulebook and in a clear, prominent, and readily available manner on its website and any other application portal or similar means through which a swap execution facility directly or indirect connects electronically with its market participants.

6. Amend appendix B to part 37 by revising Core Principle 12 of Section 5h of the Act—Conflicts of Interest to read as follows:

Appendix B to Part 37—Guidance on, and Acceptable Practices in, Compliance with Core Principles

* * * * *

Core Principle 12 of Section 5h of the Act—Conflicts of Interest:

The swap execution facility shall:

(A) Establish and enforce rules to minimize conflicts of interest in its decision-making process; and

(B) Establish a process for resolving the conflicts of interest.

(a) *Guidance.* [Reserved]

(b) *Acceptable Practices*—(1) *Procedures for conflicts of interest involving an affiliate market participant.* (i) A swap execution facility's applications and systems should be maintained and operated in a manner that prevents the sharing of non-public information (i.e., information which has not been disseminated in a manner which makes it generally available to the trading public) with any affiliate market participant;

provided, however that a swap execution facility may share non-public information with an affiliate market participant if: the information is shared with all of the swap execution facility's market participants; or the information relates only to the affiliate market participant or the affiliate market participant's customers.

(A) The swap execution facility's trading platform, surveillance systems and recordkeeping systems should be logically separate from an affiliate market participant's applications and systems.

(B) The swap execution facility should apply controls across all other applications and systems in order to prevent improper sharing of non-public information with an affiliate market participant.

(C) The swap execution facility should monitor for any instances where an affiliate market participant has gained access to the swap execution facility's applications, information or systems.

(D) A swap execution facility should not share staff with any affiliate market participant; provided, however, that staff responsible for administrative functions such as accounting, human resources and payroll matters, as well as technology staff responsible for carrying out Core Principle 14 (Systems Safeguards) functions, may be shared.

(E) In order to prevent the unauthorized sharing of non-public information, a swap execution facility should establish office space for itself that is separate from the office space of any affiliate market participant. This separation should include physical barriers and the ability of the swap execution facility to monitor for any instances where an affiliate market participant has gained physical access to the swap execution facility.

* * * * *

PART 38 – DESIGNATED CONTRACT MARKETS

7. 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.

8. Revise § 38.604 to read as follows:

§ 38.604 Financial surveillance.

A designated contract market must monitor members' compliance with the designated contract market's minimum financial standards and, therefore, must routinely receive and promptly review financial and related information from its members, as well as monitor the positions of members and their customers. A designated contract market must have rules that prescribe minimum capital requirements for member futures commission merchants and introducing brokers.

(a) A designated contract market must:

(1) Monitor the obligations of each futures commission merchant created by the positions of its customers throughout the day;

(2) As appropriate, compare those obligations to the financial resources of the futures commission merchant; and

(3) Take appropriate steps to use this information to protect customer funds.

(b) [Reserved]

9. Revise § 38.606 to read as follows:

§ 38.606 Financial regulatory service provided by a third party.

(a) A designated contract market may comply with the requirements of § 38.604 (Financial Surveillance) and § 38.605 (Requirements for Financial Surveillance Program) through the regulatory services of a registered futures association or a registered entity (collectively, "regulatory service provider"), as such terms are defined under the Act. A designated contract market must ensure that its regulatory service provider has the capacity and resources necessary to provide timely and effective regulatory services, including adequate staff and appropriate surveillance systems. A designated contract market will at all times remain responsible for compliance with its obligations under the Act and Commission regulations, and for the regulatory service provider's performance on its behalf. Regulatory services must be provided under a written agreement with a regulatory services provider that shall specifically document the services to be performed as well as the capacity and resources of the regulatory service provider with respect to the services to be performed.

(b) A designated contract market that has an affiliate futures commission merchant (as defined in § 1.52(a)(3) of this chapter) may comply with the requirements of § 38.604 by designating an independent third-party regulatory service provider. If a designated contract market that has an affiliate futures commission merchant does not designate an independent third-party regulatory service provider, such designated contract market shall have procedures for identifying, addressing, and managing conflicts of interest involving an affiliate futures commission merchant that may arise connection with its obligations under § 38.604. Such procedures shall address, at a minimum:

(1) Applications and systems, such that a designated contract market’s applications, information and systems are maintained and operated in a manner that prevents the sharing of non-public information with any affiliate futures commission merchant;

(2) Personnel, such that a designated contract market does not share staff with any affiliate futures commission merchant, except with respect to administrative functions;

(3) Office space, such that a designated contract market maintains office space for itself that is separate from the office space of any affiliate futures commission merchant;

(4) Documentation, such that a designated contract market documents all conflicts of interest that arise with respect to an affiliate futures commission merchant and how any such conflict of interest is resolved; and

(5) Disclosures, such that a designated contract market provides disclosure of the existence of an affiliate futures commission merchant in its rulebook and in a clear, prominent, and readily available manner on its website and any other application portal or similar means through which a designated contract market directly or indirect connects electronically with its market participants.

10. Add § 38.852 to subpart Q to read as follows:

§ 38.852 Affiliate conflicts of interest.

(a) *Definitions.* For purposes of this part:

Affiliate market maker means an affiliate principal trading firm that satisfies all of the conditions set out in paragraph (c) of this section.

Affiliate market participant means any person (including any affiliate futures commission merchant or affiliate principal trading firm) that:

(i) Directly or indirectly executes, introduces, or otherwise facilitates trades on or subject to the rules of the designated contract market.

(ii) [Reserved]

Affiliate principal trading firm means a member of a designated contract market that:

(i) Directly or indirectly controls, is controlled by, or is under common control with, that designated contract market; and

(ii) Trades on a principal basis, as a market maker, liquidity provider, or otherwise, for its own account on that designated contract market.

Control (including the terms "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

(b) *Conflicts of interest framework.* A designated contract market shall:

(1) Have procedures for identifying, addressing, and managing conflicts of interest involving an affiliate market participant. Such procedures shall address at a minimum:

(i) Applications and systems, such that a designated contract market's applications and systems are maintained and operated in a manner that prevents the sharing of non-public information with any affiliate futures commission merchant;

(ii) Personnel, such that a designated contract market does not share staff with any affiliate futures commission merchant, except with respect to administrative functions;

(iii) Office space, such that a designated contract market maintains office space for itself that is separate from the office space of any affiliate futures commission merchant; and

(iv) Documentation, such that a designated contract market documents all conflicts of interest that arise with respect to an affiliate futures commission merchant and how any such conflict of interest is resolved; and

(v) Disclosures, such that a designated contract market provides disclosure of the existence of an affiliate futures commission merchant in its rulebook and in a clear, prominent, and readily available manner on its website and any other application portal or similar means through which a designated contract market directly or indirect connects electronically with its market participants; and

(2) If the designated contract market offers an incentive or similar program filed under part 40 of the Commission's regulations in this chapter that applies to affiliate principal trading firms, the designated contract market must have procedures to ensure that unaffiliated members of the designated contract market can participate in such programs on terms no less favorable than those offered to an affiliate principal trading firm.

(c) *Affiliate market makers*—(1) *Permitted affiliate market maker conditions.* A designated contract market that permits an affiliate principal trading firm to trade on the designated contract market must, at all times:

(i) Ensure that its trading matching system, including any price/time priority matching algorithm, does not favor the affiliate market maker. Specifically, the designated contract market's trade matching system shall fill the bid or offer of any unaffiliated member before the bid or offer of the affiliate market maker at the same price, without regard to the time priority of the affiliate principal trading firm's order. The bids and offers of the affiliate principal trading firm shall be filled last at every price level; and

(ii) Ensure that any market maker or incentive program filed under part 40 of this chapter that applies to the affiliate market maker must enumerate the affiliate market maker's market making or liquidity providing obligations, the performance standards applicable to those obligations, and the consequences of any failure to satisfy them, on terms no less favorable to the designated contract market than those offered to unaffiliated members participating in the same or a comparable program. Such program must, at a minimum,

(A) Require an affiliate market maker to maintain continuous two-sided quotations in each product in which it is obligated to make a market;

(B) Specify the minimum number of trading hours in the relevant trading period during which the affiliate market maker is subject to such obligation;

(C) Specify limitations on permissible bid-ask spreads; and

(D) Ensure that the trading of the affiliate market maker on the designated contract market is reasonably calculated to contribute to the maintenance of a fair and orderly market, and the affiliate market maker does not make bids or offers, or enter into transactions, inconsistent with that purpose, including by taking directional proprietary positions other than in connection with its obligation to maintain two-sided quotations.

(2) *Independent verification.* A designated contract market that permits an affiliate market maker to trade on the designated contract market shall designate an independent third-party regulatory service provider to:

(i) Comply with the requirements of § 38.604 with respect to the affiliate market maker as if the affiliate market maker were a futures commission merchant (except to the extent § 38.604 applies with respect to customers);

(ii) Review and monitor the designated contract market's compliance with its conflicts of interest procedures promulgated under paragraph (b)(1) of this section; and

(iii) Annually certify to the Commission and the designated contract market's board of directors or other designated committee or officer responsible for regulatory compliance that the affiliate market maker satisfies each of the conditions set out in paragraph (c)(1) of this section and that the designated contract market is operating in compliance with its conflicts of interest procedures as required under paragraph (b)(1) of this section. The certification shall include the submission of appropriate written documentation and analysis in support of the certification.

(iv) The designated contract market shall at all times remain responsible for compliance with its obligations under the Act and Commission regulations, and for the independent third-party regulatory service provider's performance on its behalf.

(3) *Additional disclosures.* Where a designated contract market permits an affiliate market maker to trade on the designated contract market, the designated contract market must disclose, on a per-session basis, the existence of, and the designated contract market's relationship with, the affiliate market maker. The notice shall:

(i) Be presented to the customer through the electronic interface used to enter orders, before the customer first enters an order during a session;

(ii) Be presented in a clear and conspicuous manner and in plain language reasonably understandable to a non-specialist market participant, directly and in full and not solely by means of a reference or hyperlink;

(iii) Disclose the conditions and limitations imposed on the affiliate market maker under this section, including that the affiliate market maker's orders are filled after those of unaffiliated members at the same price; and

(iv) Not be capable of being dismissed without the customer's affirmative acknowledgment.

(v) The designated contract market shall require, by rule, that its intermediary participants and any other person operating an electronic interface through which customers enter orders deliver the notice in accordance with this paragraph (c)(3).

11. Add § 38.853 to subpart Q to read as follows:

§ 38.853 Board composition, regulatory oversight committee, and disciplinary panels.

(a) *Board composition for designated contract markets.* (1) At least thirty-five percent of the directors on a designated contract market's board of directors shall be public directors; and

(2) The executive committees (or similarly empowered bodies) of the board of directors shall consist of at least thirty-five percent public directors.

(b) *Public director.* (1) To qualify as a public director of a designated contract market, an individual must first be found, by the board of directors, on the record, to have no material relationship with the contract market. A "material relationship" is one that reasonably could affect the independent judgment or decisionmaking of the director.

(2) In addition, a director shall be considered to have a material relationship with the designated contract market if any of the following circumstances exist:

(i) The director is an officer or employee of the designated contract market or an officer or employee of its affiliate. An affiliate for purposes of this section includes parents or subsidiaries of the designated contract market or entities that share a common parent with the designated contract market.

(ii) The director is a member of the designated contract market, or an officer or director of a member. For purposes of this section, "member" is defined according to section 1a(34) of the Act and § 1.3 of this chapter;

(iii) The director, or a firm with which the director is an officer, director, or partner, receives more than $100,000 in combined annual payments from the designated contract market, or any affiliate of the designated contract market, for legal, accounting, or consulting services. 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 prior to becoming a director, so long as such compensation is in no way contingent, conditioned, or revocable;

(iv) Any of the relationships in paragraphs (b)(2)(i) – (iii) of this section apply to a member of the director's immediate family (spouse, parents, children and siblings).

(3) All of the disqualifying circumstances described in paragraph (b)(2) of this section shall be subject to a one-year look back.

(4) A designated contract market's public directors may also serve as directors of the designated contract market's affiliate if they otherwise meet the definition of public director.

(5) A designated contract market shall disclose to the Commission which members of its board are public directors, and the basis for those determinations.

(c) *Regulatory Oversight Committee.* (1) A board of directors of any designated contract market shall establish a Regulatory Oversight Committee as a standing committee, consisting of only public directors, to assist it in minimizing actual and potential conflicts of interest. The Regulatory Oversight Committee shall oversee the designated contract market's regulatory program on behalf of the board of directors. The board of directors shall delegate sufficient authority, dedicate sufficient resources, and allow sufficient time for the Regulatory Oversight Committee to fulfill its mandate.

(2) The Regulatory Oversight Committee shall:

(i) Monitor the designated contract market's regulatory program for sufficiency, effectiveness, and independence;

(ii) 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;

(iii) Review the size and allocation of the regulatory budget and resources; and the number, hiring and termination, and compensation of regulatory personnel;

(iv) Supervise the designated contract market's chief regulatory officer (or other officer responsible for regulatory compliance), who will report directly to the ROC;

(v) Prepare an annual report assessing the designated contract market's self-regulatory program for the board of directors and 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;

(vi) Recommend changes that would ensure fair, vigorous, and effective regulation; and

(vii) Review regulatory proposals and advise the board of directors as to whether and how such changes may impact regulation.

(d) *Disciplinary panels.* (1) A designated contract market shall minimize conflicts of interest in its disciplinary processes through disciplinary panel composition rules that preclude any group or class of industry participants from dominating or exercising disproportionate influence on such panels.

(2) A designated contract market shall further minimize conflicts of interest by including in all disciplinary panels 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.

(3) If a designated contract market's rules provide for appeal to the board of directors, or to a committee of the board or directors, then that appellate body shall also include at least one person who would qualify as a public director.

12. Amend appendix B to part 38 by revising paragraph (b), "Acceptable Practices," to Core Principle 16 of section 5(d) of the Act: CONFLICTS OF INTEREST to read as follows:

Appendix B to Part 38—Guidance on, and Acceptable Practices in, Compliance With Core Principles

* * * * *

Core Principle 16 of section 5(d) of the Act: CONFLICTS OF INTEREST. * * *

(b) *Acceptable Practices.* All designated contract markets ("DCMs" or "contract markets") bear special responsibility to regulate effectively, impartially, and with due consideration of the public interest, as provided for in section 3 of the Act. Under Core Principle 15, they are also required to minimize conflicts of interest in their decisionmaking processes. To comply with this Core Principle, contract markets should be particularly vigilant for such conflicts between and among any of their self-regulatory responsibilities, their commercial interests, and the several interests of their management, members, owners, customers and market participants, other industry participants, and other constituencies. Acceptable practices for minimizing conflicts of interest shall include the following elements:

(1) *Appropriate separations between the DCM and an affiliate market participant.* A designated contract market's applications and systems should be maintained and operated in a manner that prevents the sharing of non-public information (i.e., information which has not been disseminated in a manner which makes it generally available to the trading public) with any affiliate market participant (i.e., an affiliate futures commission merchant or an affiliate principal trading firm); provided, however that a designated contract market may share non-public information with an affiliate market participant if: the information is shared with all of the designated contract market's market participants; or the information relates only to the affiliate market participant or the affiliate market participant's customers.

(i) The designated contract market's trading platform, surveillance systems and recordkeeping systems should be logically separate from an affiliate market participant's applications and systems.

(ii) The designated contract market should apply controls across all other applications and systems in order to prevent improper sharing of non-public information with an affiliate market participant.

(iii) The designated contract market should monitor for any instances where an affiliate market participant has gained access to the designated contract market's applications, information, or systems.

(iv) A designated contract market should not share staff with any affiliate market participant; provided, however, that staff responsible for administrative functions such as accounting, human resources and payroll matters, as well as technology staff responsible for carrying out Core Principle 20 (Systems Safeguards) functions, may be shared.

(v) In order to prevent the unauthorized sharing of non-public information, a designated contract market should establish office space for itself that is separate from the office space of any affiliate market participant. This separation should include physical barriers and the ability of the designated contract market to monitor for any instances where an affiliate market participant has gained physical access to the designated contract market.

* * * * *

PART 39 – DERIVATIVES CLEARING ORGANIZATIONS

13. The authority citation for part 39 continues to read as follows:

Authority: 7 U.S.C. 2, 6(c), 7a-1, and 12a(5); 12 U.S.C. 5464; 15 U.S.C. 8325; Section 752 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, title VII, sec. 752, July 21, 2010, 124 Stat. 1749.

14. In § 39.2, add the following definition in alphabetical order to read as follows:

§ 39.2 Definitions.

* * * * *

Affiliate clearing member means a person that:

(1) Is a clearing member of a derivatives clearing organization; and

(2) Directly or indirectly controls, is controlled by, or is under common control with, the derivatives clearing organization. As used in the preceding sentence, *control* (including the terms "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a derivatives clearing organization or clearing member, whether through the ownership of voting securities, by contract, or otherwise.

* * * * *

15. Amend § 39.21 by:

a. Revising paragraph (c)(8);

b. Redesignating paragraph (c)(9) as (c)(10); and

c. Adding a new paragraph (c)(9).

The revision and addition read as follows:

§ 39.21 Public information.

* * * * *

(c) * * *

(8) A list of all swaps that the derivatives clearing organization will accept for clearing that identifies which swaps on the list are required to be cleared, in accordance with § 50.3(a) of this chapter;

(9) The existence of, and the derivatives clearing organization's relationship with, any affiliated clearing member, provided that such disclosure shall also be made in the derivatives clearing organization's rulebook; and

16. Amend § 39.25 by revising paragraphs (b) and (c) and adding paragraph (d) to read as follows:

§ 39.25 Conflicts of interest.

* * * * *

(b) Establish a process for resolving such conflicts of interest;

(c) Have procedures for identifying, addressing, and managing conflicts of interest involving members of the board of directors; and

(d) Have procedures for identifying, addressing, and managing conflicts of interest involving an affiliated clearing member. Such procedures shall address at a minimum:

(1) Applications and systems, such that a derivatives clearing organization's applications and systems are maintained and operated in a manner that prevents the sharing of non-public information with any affiliate clearing member;

(2) Personnel, such that a derivatives clearing organization does not share staff with any affiliate clearing member, except with respect to administrative functions;

(3) Office space, such that a derivatives clearing organization maintains office space for itself that is separate from the office space of any affiliate clearing member; and

(4) Documentation, such that a derivatives clearing organization documents all conflicts of interest that arise with respect to an affiliate clearing member and how any such conflict of interest is resolved.

17. Amend part 39 by adding appendix D to part 39 to read as follows:

Appendix D to Part 39—Guidance on, and Acceptable Practices in, Compliance with Core Principles

1. This appendix provides guidance on complying with core principles, both initially and on an ongoing basis, to maintain registration under section 5b of the Act and part 39. Where provided, guidance is set forth in paragraph (a) following the relevant heading in this appendix and can be used to demonstrate to the Commission compliance with the selected requirements of a core principle of part 39. The guidance for the core principle is illustrative only of the types of matters a derivatives clearing organization may address, as applicable, and is not intended to be used as a mandatory checklist. Addressing the issues set forth in this appendix would help the Commission in its consideration of whether the derivatives clearing organization is in compliance with the selected requirements of a core principle; provided however, that the guidance is not intended to diminish or replace, in any event, the obligations and requirements of applicants and derivatives clearing organizations to comply with the regulations provided under part 39.

2. Where provided, acceptable practices meeting selected requirements of core principles are set forth in paragraph (b) following the guidance in this appendix. Derivatives clearing organizations that follow specific practices outlined in the acceptable

practices for a core principle in this appendix will meet the selected requirements of the applicable core principle; provided however, that the acceptable practice is not intended to diminish or replace, in any event, the obligations and requirements of applicants and derivatives clearing organization to comply with the regulations provided under part 39. The acceptable practices are for illustrative purposes only and do not state the exclusive means for satisfying a core principle.

Core Principle P of Section 5b of the Act – CONFLICTS OF INTEREST. Each derivatives clearing organization shall—

(i) Establish and enforce rules to minimize conflicts of interest in the decision-making process of the derivatives clearing organization; and

(ii) Establish a process for resolving conflicts of interest described in the preceding paragraph (i) of this Core Principle.

(a) *Guidance.* [Reserved]

(b) *Acceptable Practices*—(1) *Appropriate separations between the DCM and an affiliate market participant.* (i) A derivatives clearing organization's applications and systems should be maintained and operated in a manner that prevents the sharing of non-public information (i.e., information which has not been disseminated in a manner which makes it generally available to the trading public) with any affiliate clearing member; provided, however that a derivatives clearing organization may share non-public information with an affiliate clearing member if: the information is shared with all of the derivatives clearing organization's clearing members; or the information relates only to the affiliate clearing member or the affiliate clearing member's customers.

(A) The derivatives clearing organization's clearing systems, surveillance systems and recordkeeping systems should be logically separate from an affiliate clearing member's applications and systems.

(B) The derivatives clearing organization should apply controls across all other applications and systems in order to prevent improper sharing of non-public information with an affiliate clearing member.

(C) The derivatives clearing organization should monitor for any instances where an affiliate clearing member has gained access to the derivative clearing organization's applications, information, or systems.

(ii) A derivatives clearing organization should not share staff with any affiliate clearing member; provided, however, that staff responsible for administrative functions such as accounting, human resources and payroll matters, as well as technology staff responsible for carrying out Core Principle I (Systems Safeguards) functions, may be shared.

(iii) In order to prevent the unauthorized sharing of non-public information, a derivatives clearing organization should establish office space for itself that is separate from the office space of any affiliate clearing member. This separation should include physical barriers and the ability of the derivatives clearing organization to monitor for any instances where an affiliate clearing member has gained physical access to the derivatives clearing organization.

Issued in Washington, DC, on August 3, 2026, by the Commission.

Christopher Kirkpatrick,

Secretary of the Commission.

NOTE: The following appendix will not appear in the Code of Federal Regulations.

Appendix to Conflicts and Affiliations – Commission Voting Summary

On this matter, Chairman Selig voted in the affirmative. No Commissioner voted in the negative.

[FR Doc. 2026-15948 Filed: 8/5/2026 8:45 am; Publication Date: 8/6/2026]