

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 37, 38, 39, and 40

RIN 3038-AD01

Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (the “Commission”) hereby proposes regulations to further implement new statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). Specifically, the Commission proposes certain substantive requirements on the resolution of conflicts of interest, in order to further implement core principles applicable to derivatives clearing organizations (“DCOs”), designated contract markets (“DCMs”), and swap execution facilities (“SEFs”). Such substantive requirements address reporting, transparency in decision-making, and limitations on use or disclosure of non-public information, among other things. For DCOs and DCMs, the Commission also proposes regulations to implement core principles concerning governance fitness standards and the composition of governing bodies. Finally, for publicly-traded DCMs, the Commission proposes regulations to implement the core principle on diversity of Boards of Directors.

The Commission welcomes comments on all aspects of the proposed regulations.

DATES: Submit comments on or before March 7, 2011.

ADDRESSES: You may submit comments, identified by RIN 3038-AD01 number, by any of the following methods:

- *Agency Web site, via its Comments Online process:* <http://comments.cftc.gov>. Follow the instructions for submitting comments through the Web site.

- *Mail:* David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

- *Hand Delivery/Courier:* Same as mail above.

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments. Please submit your comments using only one method.

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

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

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:

I. Background

On July 21, 2010, President Obama signed the Dodd-Frank Act.² Title VII of the Dodd-Frank Act³ amended the

¹ 17 CFR 145.9.

² See Dodd-Frank Act, Public Law 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at <http://www.cftc.gov/LawRegulation/OTCDERIVATIVES/index.htm>.

³ Pursuant to Section 701 of the Dodd-Frank Act, Title VII may be cited as the “Wall Street Transparency and Accountability Act of 2010.”

Commodity Exchange Act (“CEA”)⁴ to establish a comprehensive new regulatory framework for swaps and certain security-based swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (i) Providing for the registration and comprehensive regulation of swap dealers and major swap participants;⁵ (ii) imposing mandatory clearing and trade execution requirements on clearable swap contracts; (iii) creating robust recordkeeping and real-time reporting regimes; and (iv) enhancing the rulemaking and enforcement authorities of the Commission with respect to, among others, all registered entities and intermediaries subject to the oversight of the Commission.

In order to ensure the proper implementation of the comprehensive new regulatory framework, the Dodd-Frank Act requires the Commission to promulgate regulations regarding the mitigation of conflicts of interest in the operation of certain DCOs, DCMs, and SEFs. On October 1, 2010, the Commission identified possible conflicts. Section II below briefly summarizes these conflicts. To address these conflicts, the Commission proposed⁶ both (i) structural governance requirements⁷ and (ii) limits on ownership of voting equity and exercise of voting power⁸ (the “Conflicts of Interest NPRM”).

⁴ 7 U.S.C. 1 *et seq.*

⁵ In this release, the terms “swap dealer” and “major swap participant” shall have the meanings set forth in Section 721(a) of the Dodd-Frank Act, which added Sections 1a(49) and (33) of the CEA. However, Section 721(c) of the Dodd-Frank Act directs the Commission to promulgate rules to further define, among other terms, “swap dealer” and “major swap participant.” The Commission is in the process of this rulemaking. See, e.g., http://www.cftc.gov/LawRegulation/DoddFrankAct/OTC_2_Definitions.html. The Commission anticipates that such rulemaking will be completed by the statutory deadline of July 15, 2011.

⁶ 75 FR 63732 (Oct. 18, 2010).

⁷ According to the Conflicts of Interest NPRM: (i) Each DCO, DCM, or SEF must have a Board of Directors with at least 35 percent, but no less than two, public directors; (ii) each DCO, DCM, or SEF must have a nominating committee with at least 51 percent public directors; (iii) each DCO, DCM, or SEF must have one or more disciplinary panels, with a public participant as chair; (iv) each DCM or SEF must have (A) a regulatory oversight committee (“ROC”), with all public directors, and (B) a membership or participation committee, with 35 percent public directors; and each DCO must have a risk management committee (“RMC”), with at least (A) 35 percent public directors and (B) 10 percent customer representatives. See generally 75 FR 63732 (Oct. 18, 2010).

⁸ According to the Conflicts of Interest NPRM, no DCM or SEF member (and related persons) may (i) beneficially own more than 20 percent of any class of voting equity or (ii) directly or indirectly vote an interest exceeding 20 percent of the voting power of any class of equity.

The Conflicts of Interest NPRM primarily aims to implement Sections 726 and 725(d) of the Dodd-Frank Act.⁹ However, the Commission drew additional authority to propose the abovementioned requirements from

A DCO may choose one of the following alternatives. Under the first alternative, no individual member may beneficially own more than 20 percent of any class of voting equity or directly or indirectly vote an interest exceeding 20 percent of the voting power of any class of equity. In addition, the enumerated entities, whether or not they are DCO members, may not collectively own on a beneficial basis more than 40 percent of any class of voting equity, or directly or indirectly vote an interest exceeding 40 percent of the voting power of any class of equity.

Under the second alternative, no DCO member or enumerated entity, regardless of whether it is a DCO member, may own more than five (5) percent of any class of voting equity or directly or indirectly vote an interest exceeding five (5) percent of the voting power of any class of equity. Notwithstanding the foregoing, the Conflicts of Interest NPRM provides a procedure for the DCO to apply for, and the Commission to grant, a waiver of the abovementioned limits. *See generally* 75 FR 63732 (Oct. 18, 2010).

“Enumerated entities” are those entities listed in Section 726(a) of the Dodd-Frank Act and include: (i) Bank holding companies with over \$50,000,000,000 in total consolidated assets; (ii) a nonbank financial company supervised by the Board of Governors of the Federal Reserve System; (iii) an affiliate of (i) or (ii); (iv) a swap dealer; (v) a major swap participant; or (vi) an associated person of (iv) or (v).

⁹ First, Section 726(a) of the Dodd-Frank Act specifically empowers the Commission to adopt “numerical limits * * * on control” or “voting rights” that enumerated entities may hold with respect to such DCOs, DCMs, and SEFs. Second, Section 726(b) of the Dodd-Frank Act directs the Commission to determine the manner in which its rules may be deemed necessary or appropriate to improve the governance of certain DCOs, DCMs, or SEFs or to mitigate systemic risk, promote competition, or mitigate conflicts of interest in connection with the interaction between swap dealers and major swap participants, on the one hand, and such DCOs, DCMs, and SEFs. Finally, Section 726(c) of the Dodd-Frank Act directs the Commission to consider the manner in which its rules address conflicts of interest in the abovementioned interaction arising from equity ownership, voting structure, or other governance arrangements of the relevant DCOs, DCMs, and SEFs.

Section 725(d) of the Dodd-Frank Act states: “[t]he Commodity Futures Trading Commission shall adopt rules mitigating conflicts of interest in connection with the conduct of business by a swap dealer or a major swap participant with a derivatives clearing organization, board of trade, or a swap execution facility that clears or trades swaps in which the swap dealer or major swap participant has a material debt or material equity investment.”

Sections 725(c),¹⁰ 735(b),¹¹ and 733¹² of the Dodd-Frank Act. Together, such sections contain DCO, DCM, or SEF core principles that require each such entity to (i) establish and enforce rules to minimize conflicts of interest in its decision-making process and (ii) establish a process for resolving such conflicts.¹³ This proposed rulemaking (the “Governance NPRM”) aims to more fully implement such core principles. Therefore, the Governance NPRM proposes the following requirements, which complement those in the Conflicts of Interest NPRM:

- Each DCO must report to the Commission when its Board of Directors rejects a recommendation from or supersedes an action of the RMC;¹⁴
- Each DCM or SEF must report to the Commission when its Board of Directors rejects a recommendation from or supersedes an action of the ROC or the Membership or Participation Committee;¹⁵

¹⁰ Section 725(c) of the Dodd-Frank Act amends Section 5b(c) of the CEA to include new DCO Core Principle O (*Governance Fitness Standards*), P (*Conflicts of Interest*), and Q (*Composition of Governing Boards*). Together, such core principles empower the Commission to develop performance standards for determining whether a DCO has: (i) Governance arrangements that are transparent to fulfill public interest requirements and to permit consideration of the views of owners and participants; (ii) appropriate fitness standards for directors, members, and others; (iii) rules to minimize and resolve conflicts of interest in DCO decision-making; and (iv) governing boards or committees that include market participants.

¹¹ Section 735(b) of the Dodd-Frank Act retains the existing DCM core principle on conflicts of interest and governance fitness standards, but (i) amends the existing DCM core principle on composition of governing boards of contract markets to state: “[t]he governance arrangements of the board of trade shall be designed to permit consideration of the views of market participants,” and (ii) adds a new DCM core principle on diversity of the Board of Directors. Together, such core principles empower the Commission to develop performance standards for determining whether a DCM has: (i) Appropriate fitness standards for directors, members, and others; (ii) rules to minimize conflicts of interest in DCM decision-making; (iii) appropriate governance arrangements to permit the Board of Directors to consider the views of market participants; and (iv) rules, if the DCM is a publicly-traded company, regarding the cultural diversity of the Board of Directors.

¹² Section 733 of the Dodd-Frank Act includes SEF Core Principle 12 (*Conflicts of Interest*) in new Section 5h of the CEA. Such core principle empowers the Commission to establish performance standards for determining whether a SEF has rules to minimize and resolve conflicts of interest in SEF decision-making.

¹³ The conflicts of interest core principles are DCO Core Principle P, DCM Core Principle 16, and SEF Core Principle 12. Such core principles shall hereinafter be referred to as “Conflicts of Interest Core Principles.”

¹⁴ In addition, a DCO would be required to report to the Commission when its RMC rejects a recommendation from or supersedes an action of a subcommittee of the RMC.

¹⁵ The proposed regulations would also require the ROC of a DCM or SEF to prepare an annual

- Each DCO, DCM, or SEF must:
 - Implement a regulatory program to identify, on an ongoing basis, existing and potential conflicts of interest, as well as a method for making fair and non-biased decisions in the event of such a conflict;
 - Prescribe limits on the use or disclosure of non-public information by owners, members of the Board of Directors, members of any committee, officers or other employees; and
 - Make certain information on governance arrangements available to the public and relevant authorities, including summaries of significant decisions.

In addition to containing the Conflicts of Interest Core Principles, Sections 725(c), 735(b), and 733 of the Dodd-Frank Act add or amend DCO or DCM core principles on (i) governance fitness standards and (ii) composition of the Board of Directors or other governing bodies. Section 735(b) of the Dodd-Frank Act also adds a DCM core principle on diversity of certain Boards of Directors. To implement such core principles, the Governance NPRM proposes the following requirements:

- Each DCO or DCM must specify and enforce fitness standards for its members, directors, members of any Disciplinary Panel or Disciplinary Committee, persons with direct access, and certain affiliates;
- Each publicly-traded DCM must evaluate the breadth and cultural diversity of its Board of Directors;
- Each DCM must design and institute a process for considering the range of opinions that market participants¹⁶ hold with respect to (i) the functioning of an existing market and (ii) new rules or rule amendments; and
- Each DCO must have 10 percent customer representation on its Board of Directors, in lieu of having such representation on the RMC (or the RMC Subcommittee). Alternatively, each DCO must have 10 percent customer representation on the RMC (or the RMC Subcommittee), in lieu of having such representation on the DCO Board of Directors.¹⁷

report to the Board of Directors assessing various components of the regulatory program of such DCM or SEF.

¹⁶ In general, the Commission interprets the term “market participants” to be more expansive than the term “member” (as defined in Section 1a(34) of the CEA). Therefore, with respect to DCMs, DCOs, and SEFs, the Commission construes the term “market participants” to encompass customers of members (to the extent that such customers do not fall within Section 1a(34) of the CEA).

¹⁷ As Section IV(c)(ii) below describes further, the Commission is reconsidering that portion of the

Continued

Sections 725(c), 735(b), and 733 explicitly authorize the Commission to promulgate regulations implementing DCO, DCM, and SEF core principles under Section 8a(5) of the CEA. Section 8a(5) of the CEA states that “[t]he Commission is authorized * * * to make or promulgate such rules and regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of [the CEA].” The requirements that the Governance NPRM proposes apply to all DCOs and DCMs, regardless of whether they clear or list swap contracts or only commodity futures or options.¹⁸

The Governance NPRM reflects consultation with staff of the following agencies: (i) The Securities and Exchange Commission (the “SEC”);¹⁹

Conflicts of Interest NPRM that requires 10 percent customer representation on the RMC. The Commission notes that it has authority under both Section 726 of the Dodd-Frank Act, as well as under DCO Core Principles P (*Conflicts of Interest*) and Q (*Composition of Governing Boards*) to adopt either a Board or RMC composition requirement.

¹⁸ As the Conflicts of Interest NPRM states:

In applying such requirements and limits, the Commission does not propose to distinguish between DCMs and SEFs listing swap contracts. As mentioned above, such DCMs and SEFs may experience sustained competition with respect to the same swap contract, and therefore would face the same pressures on self-regulation. Additionally, the Commission does not propose to distinguish between (i) DCMs listing swap contracts and (ii) DCMs listing only commodity futures and options. As mentioned above, clearable swap contracts may share sufficiently similar characteristics with certain commodity futures and options as to compete with respect to execution. Therefore, a DCM listing only commodity futures and options may face competition from a SEF with fewer self-regulatory requirements, in the same manner as a DCM listing swap contracts. Given that the same conflicts of interest may concern both types of DCM, it would appear that the same (i) structural governance requirements and (ii) limits on the ownership of voting equity and the exercise of voting power should apply.

In addition, the Commission does not propose to distinguish between (i) DCOs clearing swap contracts and (ii) DCOs clearing only commodity futures and options. Certain standardized swap contracts have sufficiently similar risk profiles to commodity futures and options that the Commission has, on occasion, permitted such products to be commingled and margined within the segregated customer account under Section 4d of the CEA. If the Commission applied differential (i) structural governance requirements and (ii) limits on the ownership of voting equity and the exercise of voting power, the Commission risks creating an incentive for regulatory arbitrage between the two types of DCO.

75 FR at 63737. The Commission has requested comment in the Conflicts of Interest NPRM regarding this approach. The Commission reiterates its request for comment in the context of the Governance NPRM.

¹⁹ Section 765 of the Dodd-Frank Act requires the SEC to promulgate rules to mitigate conflicts of interest in the operation of (i) a clearing agency that clears security-based swaps, (ii) a security-based swap execution facility, or (iii) a national securities exchange that posts or makes available for trading

(ii) the Board of Governors of the Federal Reserve; (iii) the Office of the Comptroller of the Currency; (iv) the Federal Deposit Insurance Corporation; and (v) the Treasury Department. The Governance NPRM has been further informed by (i) the joint roundtable that Commission and SEC staff conducted on August 20, 2010 (the “Roundtable”)²⁰ and (ii) public comments posted to the Web site of the Commission.²¹ Finally, mindful of the importance of international harmonization,²² the Governance NPRM incorporates certain elements of: (i) *The Proposal for a Regulation of the European Parliament and of the Council on OTC Derivatives, Central Counterparties, and Trade Repositories* (the “European Commission Proposal”);²³ and (ii) the *Recommendations for Central Counterparties*, drafted by the Committee on Payment and Settlement Systems of the Bank for International Settlements and the Technical Committee of the International Organization of Securities Commissions, dated November 2004 (the “CCP Recommendations”).²⁴

The Commission requests comment on all aspects of the Governance NPRM.

II. Conflicts of Interest

As mentioned above, Title VII of the Dodd-Frank Act amended the CEA to establish a comprehensive new framework for swaps and certain security-based swaps. This framework imposes mandatory clearing and trade execution requirements with respect to clearable swap contracts. Some market participants, investor advocates, and academics have expressed a concern that the enumerated entities have economic incentives to minimize the number of swaps subject to mandatory clearing and trading. They contend that control of a DCO by the enumerated entities, whether through ownership or otherwise, constitutes the primary means for keeping swap contracts out of the mandatory clearing requirement, and therefore also out of the trading

security-based swaps. Core Principles for security-based swap execution facilities are set forth in Section 763 of the Dodd-Frank Act.

²⁰ The transcript from the roundtable (the “Roundtable Tr.”) is available at: <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/derivative9sub082010.pdf>.

²¹ Such comments are available at: http://www.cftc.gov/LawRegulation/DoddFrankAct/OTC_9_DCOGovernance.html.

²² Currently, the Commission regulates certain entities based outside of the United States (e.g., LCH.Clearnet Limited and ICE Clear Europe Limited, each of which is based in the United Kingdom).

²³ COM(2010) 484/5.

²⁴ The CCP Recommendations are available at: <http://www.bis.org/publ/cpss61.pdf>.

requirement. A further contention is that sustained competition between DCMs or SEFs may exacerbate certain structural conflicts of interest.²⁵

As the Conflicts of Interest NPRM further describes, the potential conflicts of interest that the Commission has identified are: Conflicts of interest that a DCO may confront when determining (i) whether a product is capable of being cleared, (ii) the minimum criteria that an entity must meet in order to become and remain a clearing member, and (iii) whether a particular entity satisfies such criteria; and conflicts of interest that a DCM or SEF may confront in balancing advancement of commercial interests and fulfillment of self-regulatory responsibilities.

In addition, the Commission has identified misuse or disclosure of non-public information as a conflict of interest that a DCO, DCM, or SEF may confront. Certain individuals (e.g., owners, members of the Board of Directors, officers, or other employees) will be privy to non-public information. Such non-public information could be used or disclosed improperly (e.g., to the detriment of competitors), whether advertently or inadvertently.

III. Mitigation of Conflicts of Interest

To more fully implement the Conflicts of Interest Core Principles, the Commission proposes certain requirements related to (i) reporting, (ii) identification and mitigation of conflicts of interest, (iii) transparency of governance arrangements, and (iv) limitations on use or disclosure of non-public information.

A. Reporting Requirements

1. DCOs, DCMs, and SEFs

As mentioned above, the Conflicts of Interest NPRM imposes specific compositional requirements on the Boards of Directors and certain committees of DCOs, DCMs, and SEFs. In order to facilitate the responsibility of the Commission to oversee compliance with such requirements, the Governance NPRM proposes to mandate that each DCO, DCM, or SEF submit to the Commission within 30 days after each election of its Board of Directors:

- A list of all members of the Board of Directors, each committee with a composition requirement (including any Executive Committee²⁶), and each other

²⁵ This term is defined in 72 FR 6936 (Feb. 14, 2007), which includes acceptable practices that the Commission previously adopted for the DCM core principle on conflicts of interest.

²⁶ The Conflicts of Interest NPRM defines “Executive Committee” as a committee of the Board of Directors that may exercise the authority delegated to it by the Board of Directors with

committee that has the authority to amend or constrain the action of the Board of Directors,

- A description of the relationship, if any, between such directors and the registered entity or the members of the registered entity (and, in each case, any affiliates thereof),
- The basis for any determination that a director qualifies as a Public Director, and ²⁷
- A description of how the composition of the Board of Directors and each of the abovementioned committees allows the registered entity to comply with applicable core principles, regulations, as well as to the rules of the registered entity.

2. DCOs

As the Conflict of Interest NPRM states:

swap clearing members at DCOs that currently clear large volumes of swap contracts are exclusively enumerated entities. Some have argued that the enumerated entities have an incentive to influence DCO risk assessments regarding (i) whether a swap contract is capable of being cleared, (ii) the appropriate membership criteria for a swap clearing member, and (iii) whether a particular entity meets such criteria. Therefore, the Commission must carefully consider the composition of the Risk Management Committee, in order to achieve (i) the increased clearing of swap contracts that the Dodd-Frank Act contemplates without compromising (ii) DCO safety and soundness.²⁸

The Conflicts of Interest NPRM proposes to require each DCO to have an RMC, with at least (i) 35 percent public directors and (ii) 10 percent customer representatives.²⁹ If a DCO would like to have greater clearing member participation in risk management, then it may cause its RMC to delegate to a subcommittee (the "RMC Subcommittee") decisions implicating whether (i) a product is capable of being cleared and (ii) particular entities or categories of entities are capable of performing such clearing. After such delegation the RMC would be free of any composition requirements.

In the abovementioned structure, the RMC Subcommittee reports to the RMC, whereas the RMC reports to the DCO Board of Directors. Therefore, a DCO

respect to the management of the company or organization. *See* proposed § 1.3(ccc). 75 FR at 63747.

²⁷ With respect to DCOs, the Commission also requires the basis for any determination that a director qualifies as a customer representative.

²⁸ 75 FR at 63740.

²⁹ *See* Section IV(c)(ii) below on Commission reconsideration of requiring customer representation on the RMC, rather than on the DCO Board of Directors.

governing body that is not subject to the same compositional requirements as the RMC or the RMC Subcommittee may reject a recommendation or supersede an action thereof.³⁰ To enable the Commission to determine whether such a rejection or supersession originates from a conflict of interest, the Governance NPRM proposes to require a DCO to submit a written report to the Commission, whenever such a rejection or supersession occurs.³¹ Such report would detail, among other things, the rationale for such rejection or supersession. This requirement parallels the requirements for central counterparties ("CCPs") in the European Commission Proposal.³² The Commission anticipates that such a reporting requirement may serve to deter conflicts from arising in the first place.

3. DCMs or SEFs

The Conflicts of Interest NPRM emphasizes the importance of the ROC and Membership or Participation Committees in ensuring that the DCM or SEF does not prioritize commercial interests over self-regulatory responsibilities, including restricting access or imposing burdens on access in a discriminatory manner.³³ As mentioned above, the Conflicts of Interest NPRM proposes to require each DCM or SEF to have (i) a ROC with all public directors and (ii) a Membership or Participation Committee with 35 percent public directors. However, the Conflicts of Interest NPRM contemplates that such ROC or Membership or Participation Committee would report to the DCM or SEF Board of Directors. As such DCM or SEF Board of Directors may not be subject to the same composition requirements (or may not have the same members) as the ROC or Membership or Participation Committee, the Governance NPRM proposes to require a DCM or SEF to submit a written report to the

³⁰ This observation would be true regardless of whether the Commission ultimately requires customer representation on the RMC or the DCO Board of Directors. However, the Commission requests comment on whether the reporting requirement described herein should apply to a DCO if the Commission requires the latter and not the former.

³¹ If, after examination, the Commission determines that such rejection or supersession originates from a conflict of interest, the Commission may find that the DCO regulatory program (as referenced in Section III(b) herein) is non-compliant with DCO Core Principle P. Upon making such a finding, the Commission may resort to certain administrative remedies (e.g., pursuant to Section 5c(d) of the CEA).

³² *See* Article 26(5) of the European Commission Proposal.

³³ 75 FR 63741.

Commission whenever such Board of Directors rejects a recommendation of the ROC or the Membership or Participation Committee or supersedes an action. Such report would detail among other things, the rationale for such action. The Commission believes that such a reporting requirement would alert it to potential conflicts of interests, as well as deter such conflicts from arising in the first place.

In addition to the above, the Governance NPRM proposes to require the ROC to prepare an annual report to the Board of Directors assessing various components of the DCM or SEF regulatory program. Such a requirement generally parallels current acceptable practices under DCM Core Principle 15.³⁴

4. Questions ³⁵

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

- Pursuant to Article 31(2) of the European Commission Proposal, if a CCP cannot manage, through structural or substantive governance arrangements, conflicts of interest that may disadvantage a specific member or customer, then that CCP must disclose to that member (or customer, if known) the general nature or sources of such conflicts. The CCP must make such disclosure before accepting new transactions from the affected member, presumably so that such member (or customer thereof) may choose to discontinue clearing with the CCP. Should the Commission consider imposing a similar requirement on DCOs? Why or why not?

- If the Commission decides to impose a similar requirement on DCOs, should the Commission extend such a requirement to cover DCMs and SEFs? Why or why not?

B. Regulatory Program

The Governance NPRM proposes to require that, as part of its regulatory program, each DCO, DCM, or SEF must establish, maintain, and enforce written procedures to:

- Identify, on an ongoing basis, existing and potential conflicts of interest; and

³⁴ Such regulatory program is described further in section III(b) herein. The Dodd-Frank Act has redesignated DCM Core Principle 15 as DCM Core Principle 16, but has left the actual language of the core principle substantively unchanged. *See* section 3(ii)(E) under Acceptable Practices for Core Principle 15 in Appendix B to Part 38 of the Commission's regulations.

³⁵ *See* note 30 *supra*.

- Make fair and non-biased decisions in the event of a conflict of interest. Such procedures would include rules regarding the recusal, when appropriate, of parties involved in the making of decisions. The Chief Compliance Officer (for DCOs and SEFs), or the Chief Regulatory Officer (for DCMs), shall, in consultation with the Board of Directors of the entity or a senior officer of the entity, resolve any conflicts of interest.

The Commission anticipates that the potential conflicts of interest that each DCO, DCM, or SEF confronts may change as the swaps market evolves under regulation. Consequently, the Commission believes that it is appropriate to require a DCO, DCM, or SEF to have a regulatory program to monitor existing and potential conflicts of interest on an ongoing basis. The Commission intends to permit a DCO, DCM, or SEF to contract with a third-party regulatory service provider to fulfill such requirement, subject to Commission guidance generally applicable to such contractual relationships.³⁶

To protect the integrity of trade execution and clearing, the Commission believes that it is appropriate to require each DCO, DCM, or SEF to have procedures, including recusal procedures, to make fair and non-biased decisions in the event of a conflict of interest. Article 26(4) of the European Commission Proposal includes a similar recusal requirement for CCP risk committees. Specifically, if the chairman of a CCP risk committee determines that a member has an actual or potential conflict of interest on a particular matter, that member would not be allowed to vote on that matter.

1. Questions

The Commission requests comment on all aspects of the regulatory program. The Commission further requests comment on the questions set forth below:

- As mentioned above, the Commission intends to permit a DCO, DCM, or SEF to contract with a third-party regulatory service provider (*e.g.*, the National Futures Association) to implement the abovementioned regulatory program. Would a third-party regulatory service provider itself ever experience a conflict of interest from the performance of its obligations under

such a contract? If so, under what circumstances?

- Should the Commission propose any other substantive requirements with respect to the decision-making process of a DCO, DCM, or SEF?

C. Transparency Requirements

At the Roundtable, certain market participants emphasized that DCO governance arrangements must be transparent to permit the Commission, as well as the public, to (i) learn of decisions that have systemic importance (*e.g.*, whether a product is capable of being cleared), and (ii) identify the governing bodies (*e.g.*, the RMC) responsible for making such decisions.³⁷ Previously, when the Commission proposed acceptable practices for current DCM Core Principle 15 (*Conflicts of Interest*), the Commission recognized the value of transparency in “maintaining market integrity and public trust.”³⁸ Such a rationale would appear to also apply to DCOs and SEFs.³⁹

In light of the above, the Governance NPRM proposes to establish minimum standards for the transparency of the governance arrangements of each DCO, DCM, or SEF to relevant authorities (including the Commission) as well as the public.⁴⁰ These minimum

³⁷ See, *e.g.*, Comments from Jason Kastner, Vice Chairman, Swaps and Derivatives Markets Association (“I think that the issue is making sure that the risk committees of these DCOs are transparent, that you know who the membership is, that the decisions that are taken about whether to permit new clearing members and whether to permit new products to be listed are transparent and readily appraisable, and so that everyone knows, you know, what’s going on. * * * So this is an open hearing, right? There’s a public record. There’s cameras. There’s recordings. The same type of transparency should apply to DCO governance so that everyone is clear about how decisions are taken and how they’re made and who’s making them.”), Roundtable Tr. at 74–75; and Comments from Randy Kroszner, Professor of Economics, Booth School of Business, University of Chicago (“I think this gets back to the transparency point, but I do think it’s extremely important to have people with the knowledge, the wherewithal, and with their money on the line having input into these risk-management decisions, and I think the best way to ensure that is to ensure a very, very transparent process so that outsiders can evaluate and provide the commentary and the independent directors will have enough wherewithal, enough knowledge to know what is going on.”), Roundtable Tr. 78–79.

³⁸ 71 FR 38741 (July 7, 2006) (which proposed the acceptable practices for current DCM core principle 15) (“* * * the current market environment mandates enhanced and transparent governance as an essential business practice for maintaining market integrity and public trust.”).

³⁹ According to Section 4.13.3 of the CCP Recommendations, “[g]overnance arrangements should be clearly specified and publicly available.”

⁴⁰ The Commission intends to promulgate the transparency requirements for DCMs and SEFs pursuant to its authority under DCM Core Principle P, SEF Core Principle 12 (in each case, *Conflicts of Interest*), and Section 8a(5) of the CEA. The

standards⁴¹ require each DCO, DCM, or SEF to:

- Make available certain information to the public and relevant authorities;⁴²
- Ensure that the information made available is current, accurate, clear and readily accessible; and
- Disclose summaries of certain significant decisions.

DCM, SEF, and DCO significant decisions involve those areas in which conflicts of interest identified in Section II above may be most manifest. With respect to a DCM or a SEF, significant decisions would relate to access, membership, and disciplinary procedures. With respect to a DCO, significant decisions would relate to open access, membership, and the finding of products acceptable (or not acceptable) for clearing. The Commission proposes to require that the DCO specifically disclose whether (i) its Board of Directors has rejected a recommendation or superseded an action of the RMC, or (ii) the RMC has rejected a recommendation or superseded an action of the RMC Subcommittee. The Commission does not intend the foregoing to require a DCM, SEF, or DCO to disclose any “non-public information” (as proposed § 1.3(ggg) defines such term), including, without limitation, minutes from meetings of its Board of Directors or committees or information that it may have received on a confidential basis from an applicant for membership.

Commission intends to promulgate the transparency requirements for DCOs pursuant to its authority under DCO Core Principle O (*Governance Fitness Standards*), and Section 8a(5) of the CEA. This core principle requires that a DCO establish governance arrangements that are transparent to, among other things, fulfill public interest requirements. This core principle is interrelated to DCO Core Principle P (*Conflicts of Interest*), since transparency requirements enhance the ability of the Commission to detect conflicts of interest, and may serve to deter such conflicts. The Commission believes that it has the authority to promulgate transparency requirements under either DCO Core Principle O or P.

⁴¹ As Section III discusses in greater detail, the Commission proposes to require DCOs and DCMs to meet additional standards regarding the manner in which the Board of Directors considers the opinions of market participants, among others.

⁴² Such information includes (i) the charter (or mission statement) of the registered entity; (ii) the charter (or mission statement) of the Board of Directors and certain committees; (iii) the Board of Directors nominations process for the registered entity, as well as the process for assigning members of the Board of Directors or other persons to certain committees; (iv) names of all members of (a) the Board of Directors and (b) certain committees; (v) the identities of all Public Directors (and with respect to a DCO, all customer representatives); (vi) the lines of responsibility and accountability for each operational unit of the registered entity; and (vii) summaries of significant decisions implicating the public interest.

³⁶ See “Trading Facilities, Intermediaries, and Clearing Organizations; New Regulatory Framework; Final Rule,” 66 FR 42256, 42266 (August 10, 2001). Although the relevant discussion focuses on DCMs, a similar logic would apply to DCOs. Further, pursuant to the Dodd-Frank Act, the Commission is contemplating proposing regulations regarding such contractual relationships.

1. Questions

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

- Are the abovementioned proposals necessary or appropriate to mitigate DCO, DCM, or SEF conflicts of interest or to ensure that DCO governance arrangements are transparent to, among other things, fulfill public interest requirements? If not, why not? What would be a better alternative?
- Should the Commission require that a DCO, DCM, or SEF make available to the public and relevant authorities information other than that identified above?
- Has the Commission accurately identified DCO, DCM, or SEF significant decisions? Should the Commission explicitly deem any other DCO, DCM, or SEF decisions as significant? Conversely, should the Commission deem any of the DCO, DCM, or SEF decisions that it has identified to be not significant? Why?
- Should the Commission permit a DCO, DCM, or SEF to keep confidential any information identified above? If so, why?

D. Limitation on Use or Disclosure of Non-Public Information

1. Requirements

The Governance NPRM proposes to require each DCO, DCM, or SEF to establish and maintain written policies and procedures on safeguarding non-public information. These policies and procedures must, at a minimum, preclude a DCO, DCM, or SEF owner, director, officer, or employee from using or disclosing any non-public information gained through their interest or position, absent prior written consent from the DCO, DCM, or SEF, as applicable.⁴³ The Commission intends for such requirements to prohibit those in a position of power, either by holding a certain position in the organization or through an ownership interest, from leveraging such power to benefit, commercially or otherwise, from non-public information.⁴⁴ The Commission believes that such leveraging would

⁴³ The Commission recognizes that the disclosure of non-public information may be necessary in certain instances, even without the written consent of the DCO, DCM, or SEF. Such instances include if disclosure is compelled by valid legal process (provided that the individual or entity notifies the registered SDR) or required by a regulatory authority.

⁴⁴ For example, a DCO, DCM, or SEF member may use or disclose non-public information (e.g., the possibility of disciplinary action) to the detriment of its competitor.

constitute a clear conflict of interest. The Commission notes that such requirements comport with certain aspects of the European Commission Proposal.⁴⁵

The Governance NPRM proposes to define “non-public information” as any information that the DCO, DCM, or SEF owns or any information that such entity otherwise deems confidential, such as intellectual property belonging to (A) such registered entity or (B) a third party, which property such registered entity receives on a confidential basis. The Commission will not preclude a DCO, DCM, or SEF from adopting a more expansive definition of “non-public information.”

2. Questions

The Commission requests comment on all aspects of the limitation on use of non-public information. The Commission further requests comment on the questions set forth below.

- Are the abovementioned proposals necessary or appropriate to mitigate DCO, DCM, and SEF conflicts of interests? If not, why not? What would be a better alternative?
- Has the Commission proposed an appropriate definition for “non-public information”? If not, why not? What would be a better alternative?
- Should the Commission consider any other concerns regarding the use of “non-public information”?

IV. Regulations Implementing Governance Core Principles

In addition to regulations more fully implementing the Conflicts of Interest Core Principles, the Commission also proposes regulations implementing DCO and DCM core principles on governance fitness and the composition of governing boards. Further, the Commission proposes regulations to implement the DCM core principle on diversity of certain Boards of Directors.

A. Governance Fitness Standards

DCO Core Principle O,⁴⁶ as added by Section 725(c) of the Dodd-Frank Act, provides that each DCO shall (i) establish governance arrangements that are transparent to fulfill public interest requirements and to permit the consideration of the views of owners and participants and (ii) establish and enforce appropriate fitness standards for (A) directors, (B) members of any disciplinary committee, (C) members of

⁴⁵ See Statement 26(4) of the European Commission Proposal (stating that “[w]ithout prejudice to the right of competent authorities to be duly informed, the members of the risk committee shall be bound by confidentiality.”).

⁴⁶ 7 U.S.C. 5b(c)(2)(O).

the DCO, (D) any other individual or entity with direct access to the settlement or clearing activities of the DCO, and (E) any party affiliated with any entity mentioned above. DCM Core Principle 15, as retained by Section 735(b) of the Dodd-Frank Act, provides that a DCM shall establish and enforce appropriate fitness standards for (i) directors, (ii) members of any disciplinary committee, (iii) members of the DCM, (iv) any other person with direct access to the facility, and (v) any person affiliated with any entity mentioned above.

1. Fitness Requirements

To implement DCM Core Principle 15 and partially implement DCO Core Principle O, the Governance NPRM proposes to require each DCM and DCO to specify and enforce fitness standards for (i) directors, (ii) members of any Disciplinary Panel,⁴⁷ and (iii) members of the Disciplinary Committee.⁴⁸ These standards shall include, at a minimum, (i) those bases for refusal to register a person under Section 8a(2) of the CEA,⁴⁹ and (2) the absence of a significant history of serious disciplinary offenses, such as those that would be disqualifying under § 1.63 of the Commission’s regulations.⁵⁰

Also, the Governance NPRM proposes to require each DCM and DCO to specify and enforce fitness standards for (i) its members and affiliates⁵¹ thereof, (ii) persons with direct access to the DCM or, in the case of a DCO, to its settlement and clearing activities, (iii) natural persons who, directly or indirectly, own greater than ten percent of any one class

⁴⁷ The Conflicts of Interest NPRM defines “Disciplinary Panel” as a panel that shall be responsible for conducting hearings, rendering decisions, and imposing sanctions with respect to disciplinary matters. See proposed § 40.9(c)(3)(i). 75 FR at 63752.

⁴⁸ Section 1.63 of the Commission’s regulations defines “Disciplinary Committee” as a person or committee of persons, or any subcommittee thereof, that is authorized by a self-regulatory organization to issue disciplinary charges, to conduct disciplinary proceedings, to settle disciplinary charges, to impose disciplinary sanctions or to hear appeals thereof. See 17 CFR 1.63.

⁴⁹ 7 U.S.C. 12(a)(2). Bases for refusal to register a person under Section 8a(2) of the CEA include, among other things, suspension or revocation of registration, certain court orders prohibiting action in the capacity of a registrant under the CEA, certain felony convictions, or findings of violation of the CEA or certain other Federal statutes.

⁵⁰ 17 CFR 1.63. Such offenses include violations of certain self-regulatory organization rules and violations of the CEA or the Commission’s regulations thereunder.

⁵¹ The Governance NPRM proposes to define “affiliate” as a person that directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, a registered entity.

of equity interest in a DCM or DCO,⁵² and (v) parties affiliated with (A) directors, (B) members of any Disciplinary Panel, and (C) members of the Disciplinary Committee.⁵³ At a minimum, such standards shall include those bases for refusal to register a person under Section 8a(2) of the CEA.⁵⁴

Further, the Governance NPRM proposes to require each DCM and DCO to collect and verify information that supports compliance with the standards articulated above and provide that information to the Commission annually.

The abovementioned proposals codify the acceptable practices under current DCM Core Principle 14 (*Governance Fitness Standards*) and extend such practices to DCOs.⁵⁵ The Commission believes that such proposals are appropriate to ensure the integrity of individuals and entities specified above. Such integrity, in turn, allows DCMs and DCOs to operate in the best interests of the public.⁵⁶

In addition to the above, the Governance NPRM proposes to mandate that members and certain other persons must agree to become subject to the jurisdiction of the DCM or the DCO, as a condition of access. Such a proposal ensures that a DCM or DCO, each of which has self-regulatory responsibilities, would be able to appropriately discipline a member or such other person for violation of DCM or DCO rules. The Commission believes that a DCM or DCO must have the ability to exert such discipline in order to ensure the fitness of members or such other persons.

2. Questions

The Commission requests comment on all aspects of the governance fitness standards. Specifically, the Commission requests comment on the questions set forth below.

- Are the abovementioned proposals necessary or appropriate to implement

⁵² This provision is a clarification of acceptable practices under current DCM Core Principle 14.

⁵³ Currently, the Governance NPRM does not propose to impose any requirement on each DCM and DCO with respect to fitness standards for affiliates of persons with direct access. Therefore, under Section 5(d)(1)(B) of the CEA, as added by Section 735 of the Dodd-Frank Act, each DCM has reasonable discretion in comporting with DCM Core Principle 15 with respect to such affiliates. Also, under Section 5b(c)(2)(A)(ii) of the CEA, as added by Section 725 of the Dodd-Frank Act, each DCO retains similar discretion.

⁵⁴ See note 49 *supra*.

⁵⁵ DCM Core Principle 14 is redesignated as DCM Core Principle 15 under the Dodd-Frank Act.

⁵⁶ DCMs facilitate the execution of, and DCOs provide clearing for, “* * * transactions * * * affected with a national public interest.” See Section 3(a) of the CEA, 7 U.S.C. 5.

DCM Core Principle 15 and DCO Core Principle O? If not, why not? What would be a better alternative?

- Should the Commission propose any minimum fitness standards other than those specified above?
- Is the Commission’s proposed definition of affiliate appropriate? If not, why?

B. Transparency Requirements

As mentioned above, DCO Core Principle O⁵⁷ provides that each DCO shall establish governance arrangements that are transparent to fulfill public interest requirements.⁵⁸ Section III(C) of the Governance NPRM discusses proposals to implement such portion of the core principle. However, DCO Core Principle O also provides that each DCO shall establish governance arrangements that are transparent to permit the consideration of the views of owners and participants. Such language appears unique to DCOs. Hence, the Governance NPRM sets forth the following additional proposals for DCOs:

- Each DCO shall make available to the public, as well as relevant authorities (including the Commission), a description of the manner in which its governance arrangements permit the consideration of the views of owners (whether voting or non-voting) and its participants, including, without limitation, clearing members and customers;
- Such description shall include, at a minimum:
 - The general method by which the DCO learns of the views of owners (other than through the exercise of voting power) and participants (other than through representation on the DCO Board of Directors or any DCO committee); and
 - The manner in which the DCO considers such views.

1. Questions

The Commission requests comment on all aspects of the additional proposals. Specifically, the Commission requests comment on the questions set forth below.

- Are such additional proposals necessary or appropriate to implement DCO Core Principle O? If not, why not? What would be a better alternative?
- Should the Commission propose to require that each DCO make available to

⁵⁷ 7 U.S.C. 5b(c)(2)(O).

⁵⁸ To comport with the European Commission Proposal, the Commission has additionally interpreted DCO Core Principle O to require governance arrangements that are well-defined and that include a clear organizational structure with consistent lines of responsibility and effective internal controls.

the public, as well as relevant authorities, information other than that identified above?

C. Composition of the Board of Directors

1. DCMs

DCM Core Principle 17,⁵⁹ as amended by Section 735(b) of the Dodd-Frank Act,⁶⁰ provides that the governance arrangements of a DCM shall be designed to permit consideration of the views of market participants. To implement this provision, the Governance NPRM proposes to require each DCM to design and institute a process for considering the range of opinions that market participants hold with respect to (i) the functioning of an existing market (including governance arrangements) and (ii) new rules or rule amendments. The Commission intends to permit each DCM to have the flexibility to determine the process that is most appropriate for its market participants. The Commission notes that one process by which a DCM may fulfill DCM Core Principle 17 is to have market participants on its Board of Directors (or other governing bodies). Regardless of the process that a DCM chooses, the Governance NPRM requires the DCM to make a description of such process available to the public and to relevant authorities (including the Commission) as part of its compliance with the transparency requirements described in Section III(C) above.⁶¹

a. Questions.

The Commission requests comment on this proposal. Specifically, the Commission requests comment on the questions set forth below.

- Is the abovementioned proposal appropriate to implement DCM Core Principle 17? What would be a better alternative? What are the costs and benefits of the abovementioned proposals? What are the costs and benefits of any alternative?
- Does the Commission need to consider proposing any additional requirements in order to implement DCM Core Principle 17? What would be the costs and benefits of any such requirement?

⁵⁹ 7 U.S.C. 7(d)(17).

⁶⁰ The Dodd-Frank Act redesignated DCM Core Principle 16 (*Composition of Boards of Mutually Owned Contract Markets*) as DCM Core Principle 17 (*Composition of Governing Boards of Contract Markets*), and amended the language of the core principle. Former DCM Core Principle 16 stated: “In the case of a mutually owned contract market, the board of trade shall ensure that the composition of the governing board reflects market participants.” DCM Core Principle 17, as amended by the Dodd-Frank Act states that “[t]he governance arrangements of the board of trade shall be designed to permit consideration of the views of market participants.”

2. DCOs

DCO Core Principle Q, as added by Section 725(c) of the Dodd-Frank Act, provides that each DCO shall ensure that the composition of the governing board or committee of the DCO includes market participants. In partial reliance on this core principle, the Conflicts of Interest NPRM proposed requiring that the RMC (or the RMC Subcommittee) be composed of at least 10 percent customer representatives. However, based on comments that the Commission received on the Conflicts of Interest NPRM,⁶² certain market participants would prefer that the DCO Board of Directors, rather than the RMC, include customer representation.⁶³ Therefore, the Commission is reconsidering whether requiring customer representation on the RMC or the DCO Board of Directors would better implement both Section 726 of the Dodd-Frank Act and DCO Core Principle Q. Preliminarily, the Commission is not inclined to require customer representation on both the RMC and the DCO Board of Directors, as

⁶² The comment period for the Conflicts of Interest NPRM closed on November 17, 2010. Comments are available at: <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=861>.

⁶³ See, e.g., Comment from the Investment Company Institute, dated November 17, 2010 (stating that "[t]he Commissions' proposals include provisions that would allow for industry representation on board advisory committees. The CFTC proposal, for example, specifically includes a requirement that 10 percent of the Risk Management Committee of a swap entity be composed of customers of clearing members who also routinely execute swap contracts and who have experience in using pricing models for such contracts. We strongly support investor representation on board advisory committees. These committees are designed to facilitate meaningful discussion on important issues before the board. Nevertheless, such advisory committee representation should not be a substitute for investor representation on the board itself. This is particularly true in the developing swap markets where, at this time, investors have access to only a handful of swap entities for clearing and trading."). C.f. Comment from BlackRock, dated November 15, 2010 (stating that "[t]he essence of BlackRock's comments is that buy-side participants, like customers of clearing members, need meaningful representation on the committees that make the critical determinations on the core functions of the organization that impact all of its participants. Such representation is more important than fair representation on the Board of Directors because the governance committees, such as the Risk Management Committee, will have significant influence over the day-to-day affairs of DCOs. The Proposing Release would charge the Risk Management Committee with determining products eligible for clearing, setting standards and requirements for initial and continuing clearing membership eligibility, and advising the Board of Directors on the DCO's risk model and default procedures. See Proposed Rule 39.13(g)(1), 75 FR at 63,750. In other words, decisions of the Risk Management Committee will have profound and immediate impacts on all DCO constituencies, including customers.").

the former reports to the latter. As members of the DCO Board of Directors, customer representatives would have the opportunity to (i) review recommendations and actions of the RMC, (ii) request the rationale behind such recommendations and actions, and (iii) vote to reject such recommendations and to supersede such actions.

Based on the above, the Commission is proposing to require that a DCO Board of Directors include at least 10 percent customer representatives. However, in case the Commission decides to keep such requirement at the RMC level, the Commission is alternatively re-proposing that the RMC (or the RMC Subcommittee) be composed of at least 10 percent customer representatives. As mentioned above, the Commission is preliminarily anticipating that it would adopt only one requirement on customer representation. The Commission is not anticipating making a final decision regarding customer representation until it finishes reviewing comments on the Governance NPRM.

a. Questions.

The Commission requests comment on all aspects of the abovementioned proposal. Specifically, the Commission requests comment on the questions set forth below.

- Should the Commission require customer representation on the DCO Board of Directors instead of the RMC (or RMC Subcommittee)? Why or why not? What are the benefits and costs of such requirement?
- Alternatively, should the Commission require customer representation on the RMC (or the RMC Subcommittee) instead of the DCO Board of Directors? Why or why not? What are the benefits and costs of such requirement?
- Should the Commission consider requiring customer representation on both the DCO Board of Directors and the RMC? Why or why not?
- Alternatively, should the Commission consider requiring customer representation on another committee, but neither the DCO Board of Directors nor the RMC? Why or why not? Which committee would be most appropriate? For example, the Nominating Committee?
- What percentage or number of customer representatives should the Commission require on the DCO Board of Directors? Should such percentage be higher or lower than 10 percent? What should such number be? What are the benefits and costs of each percentage or number?

- Alternatively, what percentage or number of customer representatives should the Commission require on the RMC? Should such percentage be higher or lower than 10 percent? What should such number be? What are the benefits and costs of each percentage or number?

- To the extent that the Commission requires customer representatives on either the DCO Board of Directors or the RMC, should the Commission consider imposing any additional requirement to ensure that these representatives appropriately weigh the interests of all customers, rather than just advocate on behalf of the entity to which such representative belongs?

D. Diversity of DCM Board of Directors

DCM Core Principle 22, as added by Section 735(b) of the Dodd-Frank Act, provides that a DCM, if a publicly-traded company, shall endeavor to recruit individuals to serve on its Board of Directors and its other decision-making bodies (as determined by the Commission) from among, and to have the composition of the bodies reflect, a broad and culturally diverse pool of qualified candidates.

To implement DCM Core Principle 22, the Governance NPRM proposes to permit each publicly-traded DCM the flexibility to determine (i) the standards by which a Board of Directors could be deemed broad and culturally diverse, and (ii) the manner in which the DCM Board of Directors meets that standard. The Governance NPRM proposes that each such DCM make available its diversity standards to the public and relevant authorities (including the Commission) as part of its compliance with the transparency requirements described in Section III(C) above. Further, the Governance NPRM proposes that each such DCM provide the Commission with an annual certification of the manner in which its Board of Directors meets its diversity standards. If such a DCM concludes that its Board of Directors does not yet meet such standards, then the Governance NPRM proposes that the DCM describe the manner in which its Nominating Committee is structuring recruiting efforts to meet such standards. The Commission is not currently proposing diversity requirements for any other DCM decision-making bodies. The Commission interprets DCM Core Principle 22 to apply only to DCMs that are publicly-traded. This does not include DCMs that are not publicly-traded but have one or more affiliates that are.

1. Questions

The Commission requests comment on all aspects of the diversity requirement. Specifically, should the Commission extend such requirement to other DCM decision-making bodies? Why or why not? If the Commission proposes to extend such requirement, which decision-making bodies should it consider?

V. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA)⁶⁴ requires that agencies consider whether the regulations they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact.⁶⁵ The proposed rules detailed in the Governance NPRM would only affect DCOs, DCMs, and SEFs. The Commission has previously determined that DCOs⁶⁶ and DCMs⁶⁷ are not “small entities” for purposes of the RFA. In contrast, SEFs are a new category of registrant that the Dodd-Frank Act created. Accordingly, the Commission has not addressed the question of whether SEFs are, in fact, “small entities” for purposes of the RFA.

The Dodd-Frank Act defines a SEF to mean “a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility that (A) facilitates the execution of swaps between persons and (B) is not a designated contract market.”⁶⁸ The Commission hereby determines that SEFs not be considered “small entities” for essentially the same reasons that DCMs and DCOs have previously been determined not to be small entities. These reasons include the fact that the Commission designates a contract market or registers a derivatives clearing organization only when it meets specific criteria including expenditure of sufficient resources to establish and maintain adequate self-regulatory programs. Likewise, the Commission will register an entity as a SEF only after it has met specific criteria including the

expenditure of sufficient resources to establish and maintain an adequate self-regulatory program.⁶⁹ Accordingly, the Commission does not expect the rules, as proposed herein, to have a significant impact on a substantial number of small entities. Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the proposed amendments will not have a significant economic impact on a substantial number of small entities. The Commission invites the public to comment on whether SEFs covered by these rules should be considered small entities for purposes of the RFA.

B. Paperwork Reduction Act

The Governance NPRM contains information collection requirements. The Paperwork Reduction Act of 1995 (“PRA”)⁷⁰ imposes certain requirements on Federal agencies (including the Commission) in conducting or sponsoring any “collection of information” (as the PRA defines such term). Pursuant to the PRA, the Commission has submitted to the Director of the Office of Management and Budget (“OMB”), an explanation, as well as details, of the information collection and recordkeeping requirements which would be necessary to implement the Governance NPRM.

1. Information Provided by Reporting Entities/Persons

If the Governance NPRM is promulgated in final form, they would require DCOs, DCMs, and new SEF registrants to collect and submit, pursuant to parts 37 to 40 of the Commission’s regulations, certain information to the Commission, which such regulations have never previously required. For each such proposed requirement, set forth below are estimates of: (i) The number of respondents; (ii) the number of annual responses by each respondent; (iii) the average hours per response; and (iv) the aggregate annual reporting burden (in hours as well as dollars). New OMB control numbers will be assigned to these proposed information collection requirements.

New Collection 3038–NEW

Sections 37.1201(b)(5) and 38.851(b)(5) of the Commission’s regulations require each SEF and DCM, respectively, to provide to the Commission on an annual basis a report assessing the regulatory program of the SEF or DCM, including (i) the

description of such program, (ii) expenses, (iii) staffing and structure, (iv) certain disciplinary matters, and (v) with respect to a SEF only, the performance of the chief compliance officer (as referenced in Section 5(f)(15) of the Act).

OMB Control Number 3038–NEW.

Estimated number of respondents: 51.
Annual responses by each respondent: 1.

Estimated average hours per response: 20.

Aggregate annual reporting burden in hours: 1,020.

Aggregate annual reporting burden in dollars: \$121,125.00.

New Collection 3038–NEW

Sections 37.1201(d) and 38.851(d) of the Commission’s regulations require a SEF and DCM, respectively, to submit a report to the Commission detailing five items of information in the event that the SEF or DCM Board of Directors rejects a recommendation or supersedes an action of the Regulatory Oversight Committee or the Membership or Participation Committee (or entity performing the functions of such committee). Similarly, § 39.25(b) of the Commission’s regulations requires a DCO to submit a report to the Commission detailing five items of information in the event that (i) the DCO Board of Directors rejects a recommendation or supersedes an action of the RMC or (ii) the RMC rejects a recommendation or supersedes an action of the RMC Subcommittee.

OMB Control Number 3038–NEW

Estimated number of respondents: 70.
Annual responses by each respondent: 1.

Estimated average hours per response: 15.

Aggregate annual reporting burden in hours: 1,050.

Aggregate annual reporting burden in dollars: \$124,688.

New Collection 3038–NEW

Sections 38.801(d) and 39.24(b)(4) of the Commission’s regulations require each DCM and DCO, respectively, to provide to the Commission information on an annual basis that supports compliance with certain governance fitness standards.

OMB Control Number 3038–NEW

Estimated number of respondents: 35.
Annual responses by each respondent: 1.

Estimated average hours per response: 8.

Aggregate annual reporting burden in hours: 280.

Aggregate annual reporting burden in dollars: \$33,250.00.

⁶⁴ 5 U.S.C. 601 *et seq.*

⁶⁵ *Id.*

⁶⁶ 66 FR 45604, 45609 (August 29, 2001).

⁶⁷ 47 FR 18618, 18619 (April 30, 1982).

⁶⁸ See Section 721 of the Dodd-Frank Act. The Commission is contemplating proposing regulations that would further specify those entities that must register as a SEF. The Commission does not believe that such proposals would alter its determination that a SEF is not a “small entity” for purposes of the RFA.

⁶⁹ See Core Principle 2 applicable to SEFs under Section 733 of the Dodd-Frank Act.

⁷⁰ 44 U.S.C. 3501 *et seq.*

New Collection 3038–NEW

Section 38.901(c) of the Commission's regulations requires each DCM to make available to the public and the Commission a description of its process for considering the range of opinions that market participants hold with respect to (i) the functioning of an existing market (including governance arrangements) and (ii) new rules or rule amendments. Section 39.24(a) of the Commission's regulations requires each DCO to make available to the public and to the relevant authorities, including the Commission, a description of the manner in which its governance arrangements permit the consideration of the views of its owners, whether voting or non-voting, and its participants, including, without limitation, clearing members and customers.

OMB Control Number 3038–NEW

Estimated number of respondents: 35.
Annual responses by each respondent: 1.

Estimated average hours per response: 15.

Aggregate annual reporting burden in hours: 525.

Aggregate annual reporting burden in dollars: \$62,344.00.

New Collection 3038–NEW

Section 38.1151(d) of the Commission's regulations requires each DCM that is publicly listed on a domestic exchange to (i) make available to the public and the Commission the standards by which its Board of Directors shall be deemed broadly and culturally diverse, and (ii) certify to the Commission on an annual basis whether and how its Board of Directors has met certain diversity standards.

OMB Control Number 3038–NEW

Estimated number of respondents: 16.
Annual responses by each respondent: 1.

Estimated average hours per response: 15.

Aggregate annual reporting burden in hours: 240.

Aggregate annual reporting burden in dollars: \$28,500.00.

New Collection 3038–NEW

Section 40.9(b) of the Commission's regulations requires each DCO, DCM, or SEF to submit to the Commission, within 30 days after the election of the Board of Directors, (i) a list of all members of the Board of Directors, each committee with a composition requirement (including any Executive Committee), and each other committee with the authority to amend or constrain

the action of the Board of Directors, (ii) a description of the relationship, if any, between such directors and the registered entity or the members of the registered entity (and, in each case, any affiliates thereof), (iii) the basis for any determination that a director qualifies as a Public Director (and with respect to DCOs only, as a customer representative), and (iv) a description of how the composition of the Board of Directors and each of the abovementioned committees allows the DCO, DCM, or SEF to comply with applicable core principles, regulations, as well as to its rules.

OMB Control Number 3038–NEW

Estimated number of respondents: 70.

Annual responses by each respondent: 1.

Estimated average hours per response: 2.

Aggregate annual reporting burden in hours: 140.

Aggregate annual reporting burden in dollars: \$16,625.00.

New Collection 3038–NEW

Section 40.9(d) of the Commission's regulations requires each DCO, DCM or SEF to make certain information regarding its governance arrangements available to the public and the Commission on a current basis.⁷¹

OMB Control Number 3038–NEW

Estimated number of respondents: 70.

Annual responses by each respondent: 4.

Estimated average hours per response: 10.

Aggregate annual reporting burden in hours: 2,800.

Aggregate annual reporting burden in dollars: \$332,500.

The Commission invites the public and other Federal agencies to comment on any aspect of the proposed information collection requirements discussed above. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission will consider public comments on such proposed requirements in:

- Evaluating whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;
- Evaluating the accuracy of the estimated burden of the proposed information collection requirements, including the degree to which the methodology and the assumptions that the Commission employed were valid;

- Enhancing the quality, utility, and clarity of the information proposed to be collected; and

- Minimizing the burden of the proposed information collection requirements on DCOs, DCMs, and SEFs, including through the use of appropriate automated, electronic, mechanical, or other technological information collection techniques, e.g., permitting electronic submission of responses.

Copies of the submission from the Commission to OMB are available from the CFTC Clearance Officer, 1155 21st Street, NW., Washington, DC 20581, (202) 418–5160 or from <http://RegInfo.gov>. Organizations and individuals desiring to submit comments on the proposed information collection requirements should send those comments to the OMB Office of Information and Regulatory Affairs at:

- The Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503, *Attn:* Desk Officer of the Commodity Futures Trading Commission;
- (202) 395–6566 (fax); or
- OIRASubmissions@omb.eop.gov (e-mail).

2. Information Collection Comments

Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rule preamble. Please refer to the **ADDRESSES** section of the Governance NPRM for instructions on submitting comments to the Commission.

OMB is required to make a decision concerning the proposed information collection requirements between thirty (30) and sixty (60) days after publication of the Governance NPRM in the **Federal Register**. Therefore, a comment to OMB is best assured of receiving full consideration if OMB (as well as the Commission) receives it within thirty (30) days of publication of the Governance NPRM.

C. Cost-Benefit Analysis

Section 15(a) of the CEA⁷² requires that the Commission, before promulgating a regulation or issuing an order, consider the costs and benefits of its action. By its terms, section 15(a) of the CEA does not require the Commission to quantify the costs and benefits of a new regulation or to determine whether the benefits of the regulation outweigh its costs. Rather, section 15(a) of the CEA simply requires

⁷¹ See note 42 *supra*.

⁷² 7 U.S.C. 19(a).

the Commission to “consider the costs and benefits” of its action. Section 15(a) of the CEA further specifies that costs and benefits shall be evaluated in light of the following considerations: (1) Protection of market participants and the public; (2) efficiency and competition; (3) financial integrity of the futures markets and price discovery; (4) sound risk management practices; and (5) other public interest considerations. Accordingly, the Commission could in its discretion, give greater weight to any one of the five considerations and could determine that, notwithstanding its costs, a particular regulation was necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the Act.

1. The Conflicts of Interest Core Principles: Proposed Regulations

a. Reporting.

As mentioned above, §§ 37.1201(b)(5) and 38.851(b)(5) of the Commission’s proposed regulations require each SEF and DCM, respectively, to provide to the Commission an annual assessment report.

In addition, as mentioned above, §§ 37.1201(d) and 38.851(d) of the Commission’s proposed regulations require a DCO, DCM, or SEF, as appropriate, to submit a report to the Commission whenever certain committees are overruled and § 40.9(b) of the Commission’s proposed regulations requires each DCO, DCM, or SEF to submit to the Commission post-Board election information.

b. Transparency of Governance Arrangements.

As mentioned above, § 40.9(d) of the Commission’s proposed regulations requires each DCO, DCM or SEF to make certain information regarding its governance arrangements available to the public and the Commission on a current basis.

c. Identification and Mitigation of Conflicts of Interest.

Section 40.9(e) of the Commission’s proposed regulations require each DCO, DCM, or SEF to establish, maintain, and enforce written procedures to identify existing and potential conflicts of interest, and to make decisions in the event of a conflict of interest. The Commission recognizes that such requirements impose costs. Such costs may be ameliorated to the extent that certain DCOs or DCMs may modify existing practices to accommodate proposed § 40.9(e).⁷³

d. Limitations on Use or Disclosure of Non-Public Information.

As more fully described above, § 40.9(f) of the Commission’s proposed regulations requires each DCO, DCM, or SEF to establish and maintain written policies and procedures on safeguarding non-public information. The Commission recognizes that such requirements impose costs. Such costs may be ameliorated to the extent that certain DCOs or DCMs may modify existing practices to accommodate proposed § 40.9(f).⁷⁴

2. The Costs and Benefits of Regulations Implementing the Conflicts of Interest Core Principles

As Section II herein mentions, a DCO may face conflicts of interest resulting from control by enumerated entities. Such conflicts may have detrimental effects on the public because they may impede the mandatory clearing of swaps.⁷⁵ Also, such conflicts may evidence less sound risk management practices, as such conflicts may cause a DCO to make decisions regarding, e.g., membership, based on the commercial interests of certain clearing members, rather than on objective risk criteria. Further, such conflicts may also have detrimental effects on market participants, as well as on efficiency and competition, because such conflicts may result in non-risk-based constraints on the number of futures commission merchants available to clear swaps, which may increase the price that certain market participants must bear in order to obtain clearing. Finally, such conflicts may have detrimental effects on price discovery because, by impeding the mandatory clearing of swaps, they may also impede the trading of swaps on a SEF or DCM.

Section II also states that sustained competition between DCMs or SEFs may exacerbate certain structural conflicts of interest. Such structural conflicts may lead a DCM or SEF to prioritize commercial interests over self-regulatory responsibilities, including restricting access or imposing burdens on access in a discriminatory manner.

“Significant Actions”), available at: <http://www.cmegroup.com/rulebook/CME/1/2/34.html>.

⁷⁴ See, e.g., CME Confidentiality Policy for Market Regulation and Audit Departments, available at: <http://www.cmegroup.com/market-regulation/overview/files/confidentialitypolicy.pdf>.

⁷⁵ The Conflicts of Interest NPRM states: “The framers of the Dodd-Frank Act observe that the clearing of swap contracts constitutes a key means for managing systemic risk, because clearing removes the type of interconnectedness between financial institutions that contributed to the financial crisis resulting from the failure and bankruptcy of firms such as Bear Stearns, Lehman Brothers, and AIG.” 75 FR at 63736.

Such structural conflicts may have a detrimental effect on price discovery, as prices are best discovered in a market with broad participation. Broad participation generally results in higher liquidity. Because of its effect on price discovery, such structural conflicts may also have a detrimental effect on market participants, and ultimately, the public. Certain market participants may face higher fees to access a DCM or SEF. Others may not be able to access a DCM or SEF at all. To the extent that such market participants are executing transactions to hedge price risk (whether their own or those of end-users), increased costs associated with a hedge (or the inability to execute a hedge) may be passed on to consumers. Finally, such structural conflicts may have a detrimental effect on efficiency and competition, as certain market participants may be precluded from competing to execute at a lower price for end-users.

As mentioned above, the Governance NPRM proposes substantive requirements that, together with the proposals in the Conflicts of Interest NPRM (i.e., structural governance requirements and limitations on ownership of voting equity and the exercise of voting rights), mitigate the conflicts of interest described in Section II, and therefore, the detrimental effects resulting from such conflicts. The Commission believes that the benefits of such mitigation exceed the costs for DCOs, DCMs, and SEFs to implement the Governance NPRM. The Commission welcomes comment on its determination.

3. Regulations Implementing DCM and DCO Core Principles

a. Governance Fitness.

As mentioned above, §§ 38.801(d) and 39.24(b)(4) of the Commission’s proposed regulations require each DCM and DCO, respectively, to (i) specify and enforce fitness standards for directors, members, and certain other persons, and (ii) provide to the Commission information on an annual basis that supports compliance with such standards. For DCMs, the proposed regulations are simply codifications of current acceptable practices. Therefore, the proposed regulations should impose minimal additional costs. For DCOs, governance fitness standards are necessary to ensure sound risk management practices, and therefore the protection of market participants and the public. The proposed regulations should impose minimal costs on DCOs.

Certain DCOs are divisions of DCMs, which means that they may already apply current acceptable practices to

⁷³ See, e.g., Rule 234 of the Chicago Mercantile Exchange (“CME”) (*Avoiding Conflicts of Interest in*

their directors, members, and other persons. All DCOs are currently subject to DCO Core Principle B,⁷⁶ which requires each to have “adequate * * * managerial resources to discharge the responsibilities of a DCO.” Thus, the Commission preliminary believes that the benefits of DCM and DCO governance fitness standards exceed the costs of such standards. The Commission welcomes comment on its determination.

b. *Composition of Governing Boards.*

As mentioned above, § 38.901(a) of the Commission’s proposed regulations requires DCM governance arrangements to be designed to permit consideration of the views of market participants. Preliminarily, the Commission believes that such benefit exceeds any costs associated with § 38.901(c), which may be idiosyncratic to each DCM. However, the Commission notes that it has specifically requested comment on the costs and benefits of § 38.901(c), as well as any alternative thereto.

Core Principle Q requires each DCO to ensure that its governing board or committee includes market participants. Section 39.26 of the Commission’s proposed regulations requires each DCO Board of Directors to include 10 percent representatives of customers. Preliminarily, the Commission believes that the benefit of such customer representation exceeds any cost associated with § 39.26.⁷⁷ However, the Commission notes that it has specifically requested comment on the costs and benefits of § 39.26, as well as any alternative thereto.

Alternatively, § 39.13(g)(3)(i) of the Commission’s proposed regulations requires each RMC (or RMC Subcommittee) to include 10 percent representatives of customers. As mentioned above, the Conflicts of Interest NPRM had previously proposed such requirement. Therefore, the costs and benefits of § 39.13(g)(3)(i) have been addressed in the Conflicts of Interest NPRM.⁷⁸

c. *Regulation Implementing the DCM Core Principle on Diversity of Certain Boards of Directors.*

As mentioned above, DCM Core Principle 22, as added by Section 735(b) of the Dodd-Frank Act, provides that a DCM, if a publicly-traded company,

shall endeavor to recruit individuals to serve on its Board of Directors and its other decision-making bodies (as determined by the Commission) from among, and to have the composition of the bodies reflect, a broad and culturally diverse pool of qualified candidates.

Section 38.1151(d) of the Commission’s proposed regulations affords flexibility to each such DCM⁷⁹ to determine the standards by which a Board of Directors may be deemed broadly and culturally diverse. Further, such section requires the DCM to (i) make available to the public and the Commission such standards, and (ii) certify to the Commission on an annual basis whether and how its Board of Directors has met certain standards. The benefit of cultural diversity on Boards of Directors in enhancing the efficiency of organizations has been recognized.⁸⁰ Preliminarily, the Commission believes that the benefit of § 38.1151(d) exceeds its costs. The Commission welcomes comment on its preliminary determination.

4. Conclusion

Accordingly, after considering the five factors specified in Section 15(a) of the CEA, the Commission has determined to propose the regulations set forth below. The Commission invites public comment on its evaluation of the costs and benefits of all aspects of the Governance NPRM.

List of Subjects

17 CFR Part 1

Brokers, Commodity futures, Consumer protection, Reporting and recordkeeping requirements.

⁷⁹ Currently, no such DCM exists.

⁸⁰ For example, SEC Commissioner Luis Aguilar made the following remarks at an SEC Open Meeting held on July 1, 2009:

Because of the importance of boards of directors, investors increasingly care about how directors are appointed, and what their background is. This is especially true as American businesses increasingly compete in both a global environment, and in a domestic marketplace that is, itself, increasingly diverse. In this ever more challenging business environment, the ability to draw on a wide range of viewpoints, backgrounds, skills, and experience is critical to a company’s success.

It should be no surprise that studies indicate that diversity in the boardroom can result in real value for companies—and for shareholders. It also should be no surprise that many investors—from individual investors to sophisticated institutions—have asked the Commission to provide for disclosures about the diversity of corporate boards and a company’s policies related to board diversity.

Also, the SEC issued a rule on *Proxy Disclosure Enhancements* which, among other things, requires public companies to disclose if they have a formal policy to consider diversity with respect to board nominees. See 74 FR 68334 (Dec. 16, 2009).

17 CFR Parts 37, 38 and 40

Commodity futures, Reporting and recordkeeping requirements.

17 CFR Part 39

Commodity futures, Consumer protection, Reporting and recordkeeping requirements.

For the reasons stated in this release, the Commission proposes to amend 17 CFR parts 1, 37, 38, 39, and 40 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, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, and 24 as amended by Pub. L. 222–203, 124 Stat. 1376.

2. In § 1.3, as proposed to be amended at 75 FR 63732, October 18, 2010, 75 FR 65586, October 26, 2010, 75 FR 77576, December 13, 2010, and 75 FR 80211, December 21, 2010, redesignate paragraphs (zz) to (eee) as paragraphs (bbb) to (ggg), redesignate paragraphs (fff) to (ggg) as (iii) to (jjj), add and reserve paragraph (zz), and add new paragraphs (aaa) and (hhh) to read as follows:

* * * * *

(zz) [Reserved].

(aaa) *Affiliate*. The term “affiliate” means a person that directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, another person.

* * * * *

(hhh) *Non-Public Information*.

(1) This term means any information that a registered derivatives clearing organization, a designated contract market, or a registered swap execution facility owns or any information that such entity otherwise deems confidential, such as intellectual property belonging to:

- (i) Such registered entity; or
- (ii) A third party, which property such registered entity receives on a confidential basis.

(2) Nothing in this paragraph shall preclude a registered entity from adopting a definition of “non-public information” that is more expansive than the definition in this paragraph.

* * * * *

PART 37—SWAP EXECUTION FACILITIES

3. The authority citation for part 37 continues to read as follows:

⁷⁶ 7 U.S.C. 7a–1(c)(B).

⁷⁷ For example, in addition to implementing DCO Core Principle Q, certain comments on the Conflicts of Interest NPRM state that customer representation on the DCO Board of Directors would be a better method of ameliorating conflicts of interest under Section 726 of the Dodd-Frank Act. See note 63 *supra*. See generally, 75 FR at 63746 (discussing the costs and benefits of the Conflicts of Interest NPRM).

⁷⁸ See generally, 75 FR at 63746.

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 Pub. L. 111–203, 124 Stat. 1376.

4. Section 37.19, as proposed at 75 FR 63747, October 18, 2010, is redesignated as § 37.1201 and amended by adding new paragraph (b)(5), redesignating paragraph (d) as paragraph (e), adding new paragraph (d), and revising newly designated paragraph (e)(1) introductory text, to read as follows:

§ 37.19 Conflicts of Interest.

* * * *

(b) * * *

(5) *Annual Report.* The Regulatory Oversight Committee shall prepare an annual report assessing, for the Board of Directors and the Commission, the regulatory program of the registered swap execution facility. Such report shall:

- (i) Describe the self-regulatory program;
- (ii) Set forth the expenses of the regulatory program;
- (iii) Describe the staffing and structure of the same;
- (iv) Catalogue investigations and disciplinary actions taken during the year; and
- (v) Review the performance of disciplinary committees and panels, as well as the performance of the Chief Compliance Officer (as referenced in Section 5(f)(15) of the Act).

* * * *

(d) *Reporting to the Commission.* In the event that the Board of Directors of a registered swap execution facility rejects a recommendation or supersedes an action of the Regulatory Oversight Committee or the Membership or Participation Committee (or entity performing the functions of such committee), the registered swap execution facility shall submit a written report to the Commission detailing:

- (1) The recommendation or action of the Regulatory Oversight Committee or the Membership or Participation Committee (or entity performing the functions of such committee);
- (2) The rationale for such recommendation or action;
- (3) The rationale of the Board of Directors for rejecting such recommendation or superseding such action; and
- (4) The course of action that the Board of Directors decided to take contrary to such recommendation or action.

(e) * * *

(1) *Definitions.* For purposes of this § 37.1201(e):

* * * *

PART 38—DESIGNATED CONTRACT MARKETS

5. The authority citation for part 38 continues to read as follows:

Authority: 7 U.S.C. 2, 4c, 6, 6a, 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 Pub. L. 111–203, 124 Stat. 1376.

6. Add § 38.801 to subpart P, as proposed at 75 FR 80612, December 22, 2010, to read as follows:

§ 38.801 Governance Fitness Standards.

(a) *General.* The designated contract market shall establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract market, and any other person with direct access to the facility (including any party affiliated with any person described in this paragraph).

(b) *Fitness Standards for Directors and Members of the Disciplinary Panel and Disciplinary Committee.* Each designated contract market must specify and enforce fitness standards for directors, members of any Disciplinary Panel (as defined in § 1.3(bbb) of this chapter), and members of the Disciplinary Committee (as defined in § 1.63 of this chapter). At a minimum, such standards shall include:

- (1) Those bases for refusal to register a person under Section 8a(2) of the Act; and
- (2) The absence of a significant history of serious disciplinary offenses, such as those that would be disqualifying under § 1.63 of this chapter.

(c) *Fitness Standards for Members, Persons with Direct Access, and Certain Affiliates.* Each designated contract market must specify and enforce fitness standards for its members and affiliates thereof; persons with direct access to the facility; natural persons who, directly or indirectly, own greater than ten percent of any one class of equity interest in a designated contract market; and parties affiliated with the persons enumerated in paragraph (b) of this section. At a minimum, such standards shall include those bases for refusal to register a person under Section 8a(2) of the Act.

(d) *Verification.* Each designated contract market must collect and verify information that supports compliance with the standards in paragraphs (b) and (c) of this section and provide that information to the Commission on an annual basis. Such information may take the form of a certification based on verifiable information, an affidavit from the general counsel of the designated contract market, registration

information, or other substantiating information.

(e) *Jurisdiction.* As a condition of access, members and non-member market participants must agree to become subject to the jurisdiction of the designated contract market.

7. In § 38.851, as proposed at 75 FR 80612, December 22, 2010, add new paragraph (b)(5) redesignate paragraph (d) as paragraph (e), add new paragraph (d), and revise newly designated paragraph (e)(1) introductory text, to read as follows:

§ 38.851 Conflicts of Interest.

* * * *

(b) * * *

(5) *Annual Report.* The Regulatory Oversight Committee shall prepare an annual report assessing, for the Board of Directors and the Commission, the regulatory program of the designated contract market. Such report shall:

- (i) Describe the self-regulatory program;
- (ii) Set forth the expenses of the regulatory program;
- (iii) Describe the staffing and structure of the same;
- (iv) Catalogue investigations and disciplinary actions taken during the year; and
- (v) Review the performance of disciplinary committees and panels.

* * * *

(d) *Reporting to the Commission.* In the event that the Board of Directors of a designated contract market rejects a recommendation or supersedes an action of the Regulatory Oversight Committee or the Membership or Participation Committee (or entity performing the functions of such committee), the designated contract market shall submit a written report to the Commission detailing:

- (1) The recommendation or action of the Regulatory Oversight Committee or the Membership or Participation Committee (or entity performing the functions of such committee);
- (2) The rationale for such recommendation or action;
- (3) The rationale of the Board of Directors for rejecting such recommendation or superseding such action; and
- (4) The course of action that the Board of Directors decided to take contrary to such recommendation or action.

(e) * * *

(1) *Definitions.* For purposes of this § 38.851(e):

* * * *

8. Add § 38.901 to subpart R, as proposed at 75 FR 80612, December 22, 2010, to read as follows:

§ 38.901 Composition of governing boards of contract markets.

(a) *General.* The governance arrangements of each designated contract market shall be designed to permit consideration of the views of market participants.

(b) *Notice.* Each designated contract market shall design and institute a process for considering the range of opinions that market participants hold with respect to:

(1) The functioning of an existing market (including governance arrangements) and

(2) New rules or rule amendments.

(c) *Transparency.* As part of its compliance with § 40.9(d) of this chapter, each designated contract market shall make available to the public and to the relevant authorities, including the Commission, a description of such process.

(1) Such description shall include, at a minimum:

(i) The manner in which the designated contract market obtains opinions from market participants;

(ii) The manner in which the designated contract market considers such opinions; and

(iii) A summary of the lines of responsibility and accountability for considering such opinions, from the relevant operational unit to the Board of Directors (and any committee thereof).

(2) Nothing in paragraph (c) of this section shall be construed to constrain the Commission from requiring the designated contract market to describe any other element of its process for obtaining a fair understanding of the opinions of market participants.

9. Add § 38.1151 to subpart W, as proposed at 75 FR 80612, December 22, 2010, to read as follows:

§ 38.1151 Diversity of Board of Directors.

(a) *General.* A designated contract market, if publicly-listed on a domestic exchange, shall endeavor to recruit individuals to serve on its Board of Directors and its other decision-making bodies (as determined by the Commission) from among, and to have the composition of the bodies reflect, a broad and culturally diverse pool of qualified candidates.

(b) *Standards.* Each such designated contract market shall formulate, describe, and enforce the standards by which its Board of Directors shall be deemed broadly and culturally diverse.

(c) *Transparency.* As part of its compliance with § 40.9(d) of this chapter, each such designated contract market shall make available to the public and to the relevant authorities, including the Commission, such standards.

(d) *Annual Certification.* (1) On an annual basis, each such designated contract market shall certify to the Secretary of Commission whether and how its Board of Directors has met such standards. If the designated contract market determines that its Board of Directors has failed to meet such standards, then the designated contract market must describe the manner in which its Nominating Committee is endeavoring to structure recruitment to meet such standards.

(2) Such certification shall be in the form of a letter or an affidavit signed by the general counsel of the designated contract market.

PART 39—DERIVATIVES CLEARING ORGANIZATIONS

10. Revise the authority citation for part 39 to read as follows:

Authority: 7 U.S.C. 2, 5, 6, 6d, 7a–1, 7a–2, and 7b as amended by Pub. L. 111–123, 124 Stat. 1376.

11. Amend § 39.13, as proposed at 75 FR 63750, October 18, 2010, by revising paragraph (g)(3)(i) to read as follows:

§ 39.13 Risk management.

* * * * *

(g) * * *

(3) * * *

(i) The Risk Management Committee shall be composed of at least thirty-five percent Public Directors of a derivatives clearing organization and at least ten percent representatives of customers. In this context, a “customer” means any customer of a clearing member, including, without limitation:

(A) Any “customer” or “commodity customer” within the meaning of § 1.3(k) of this chapter;

(B) Any “foreign futures or foreign options customer” within the meaning of § 30.1(c) of this chapter; and

(C) Any customer entering into a cleared swap (as defined in Section 1a(7) of the Act).

* * * * *

12. Add § 39.24 to read as follows:

§ 39.24 Governance Fitness Standards.

(a) *Governance Arrangements.*

(1) *General.*

(i) Each derivatives clearing organization shall establish governance arrangements that are transparent:

(A) To fulfill public interest requirements; and

(B) To permit the consideration of the views of owners and participants.

(ii) Each derivatives clearing organization shall establish governance arrangements that are well-defined and include a clear organizational structure with consistent lines of responsibility and effective internal controls.

(2) *Transparency.* As part of its compliance with § 40.9(d) of this chapter, each derivatives clearing organization shall make available to the public and to the relevant authorities, including the Commission, a description of the manner in which its governance arrangements permit the consideration of the views of its owners, whether voting or non-voting, and its participants, including, without limitation, clearing members and customers. Such description shall include, at a minimum:

(i) The general method by which the derivatives clearing organization learns of (A) the views of owners, other than through their exercise of voting power, and (B) the views of participants, other than through representation on the Board of Directors or any committee of the derivatives clearing organization; and

(ii) The manner in which the derivatives clearing organization considers such views.

(3) *Construction.* Nothing in paragraph (a)(2) of this section shall be construed to constrain the Commission from requiring the derivatives clearing organization to describe any other element of the manner in which its governance arrangements permit the consideration of the views of its owners and participants.

(b) *Fitness Standards.* (1) *General.* Each derivatives clearing organization shall establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the derivatives clearing organization, any other individual or entity with direct access to the settlement or clearing activities of the derivatives clearing organization, and any party affiliated with any individual or entity described in this paragraph.

(2) *Fitness Standards for Directors and Members of the Disciplinary Panel and Disciplinary Committee.* Each derivatives clearing organization must specify and enforce fitness standards for directors, members of any Disciplinary Panel (as defined in § 1.3(bbb) of this chapter), and members of the Disciplinary Committee (as defined in § 1.63 of this chapter). At a minimum, such standards shall include (i) those bases for refusal to register a person under Section 8a(2) of the Act, and (ii) the absence of a significant history of serious disciplinary offenses, such as those that would be disqualifying under § 1.63 of this chapter.

(3) *Fitness Standards for Clearing Members, Persons with Direct Access, and Certain Affiliates.* Each derivatives clearing organization must specify and enforce fitness standards for its clearing

members and affiliates thereof; persons with direct access to its settlement and clearing activities; natural persons who, directly or indirectly, own greater than ten percent of any one class of equity interest in the derivatives clearing organization; and parties affiliated with the persons enumerated in paragraph (b)(2) of this section. At a minimum, such standards shall include those bases for refusal to register a person under Section 8a(2) of the Act.

(4) *Verification.* Each derivatives clearing organization must collect and verify information that supports compliance with the standards in paragraphs (b)(2) and (3) of this section, and provide that information to the Commission on an annual basis. Such information may take the form of a certification based on verifiable information, an affidavit from the general counsel of the derivatives clearing organization, registration information, or other substantiating information.

(5) *Jurisdiction.* As a condition of access, clearing members and other persons with direct access to the settlement and clearing activities of a derivatives clearing organization must agree to become subject to the jurisdiction of the derivatives clearing organization.

13. In § 39.25, as proposed at 75 FR 63750, October 18, 2010, redesignate paragraph (b) as paragraph (c), add new paragraph (b), and revise newly designated paragraph (c)(1) introductory text to read as follows:

§ 39.25 Conflicts of interest.

* * * * *

(b) *Reporting to the Commission.* In the event that:

(1) The Board of Directors of a derivatives clearing organization rejects a recommendation or supersedes an action of the Risk Management Committee, or

(2) The Risk Management Committee rejects a recommendation or supersedes an action of its subcommittee (as described in § 39.13(g)(5) of this part), the derivatives clearing organization shall submit a written report to the Commission detailing:

(i) The recommendation or action of the Risk Management Committee (or subcommittee thereof);

(ii) The rationale for such recommendation or action;

(iii) The rationale of the Board of Directors (or the Risk Management Committee, if applicable) for rejecting such recommendation or superseding such action; and

(iv) The course of action that the Board of Directors (or the Risk

Management Committee, if applicable) decided to take contrary to such recommendation or action.

(c) * * *

(1) *Definitions.* For purposes of this § 39.25(c):

* * * * *

14. Add § 39.26 to read as follows:

§ 39.26 Composition of Governing Boards.

(a) *General.* (1) Each derivatives clearing organization shall ensure that the composition of the governing board or committee of the derivatives clearing organization includes market participants.

(2) Nothing in this section shall supersede any other section of this part or any requirement applicable to a derivatives clearing organization under § 40.9 of this chapter.

(b) *Composition Requirement.* The Board of Directors of a derivatives clearing organization shall be composed of at least ten percent representatives of customers. In this context, a “customer” means any customer of a clearing member, including, without limitation:

(1) Any “customer” or “commodity customer” within the meaning of § 1.3(k) of this chapter;

(2) Any “foreign futures or foreign options customer” within the meaning of § 30.1(c) of this chapter; or

(3) Any customer entering into a cleared swap (as defined in Section 1a(7) of the Act).

PART 40—PROVISIONS COMMON TO REGISTERED ENTITIES

15. Revise the authority citation for part 40 to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 7, 7a, 8, and 12a, as amended by Pub. L. 111–203, 124 Stat. 1376.

16. Revise the heading and add new paragraphs (b)(1)(iii), (d), (e), and (f) to § 40.9 as proposed at 75 FR 63751, October 18, 2010, to read as follows:

§ 40.9 Governance and conflicts of interest.

* * * * *

(b) * * *

(1) * * *

(iii) Each registered entity referenced in paragraph (b)(1)(i) of the section must submit to the Commission, within thirty days after each election of its Board of Directors:

(A) A list of all members of the Board of Directors, each committee with a composition requirement (including any Executive Committee), and each other committee that has the authority to amend or constrain actions of the Board of Directors;

(B) A description of the relationship, if any, between such directors and the

registered entity or the members of the registered entity (and, in each case, any affiliates thereof, as § 1.3(aaa) of defines such term); and

(C) The basis for any determination that a director qualifies as a Public Director, and, for derivatives clearing organizations only, the basis for any determination that a director qualifies as a representative of customers; and

(D) A description of how the composition of the Board of Directors and each of the committees allows the registered entity to comply with applicable core principles, regulations, as well as the rules of the registered entity.

* * * * *

(d) *Transparency of Governance Arrangements.* (1) Each registered derivatives clearing organization, designated contract market, or registered swap execution facility shall, at a minimum, make the following information available to the public and relevant authorities, including the Commission:

(i) The charter (or mission statement) of the registered entity;

(ii) The charter (or mission statement) of the registered entity’s Board of Directors, each committee with a composition requirement (including any Executive Committee), as well as each other committee that has the authority to amend or constrain actions of the Board of Directors;

(iii) The Board of Directors nomination process for the registered entity, as well as the process for assigning members of the Board of Directors or other persons to any committee referenced in paragraph (d)(1)(ii) of this section;

(iv) For the Board of Directors and each committee referenced in paragraph (d)(1)(ii) of this section, the names of all members;

(v) The identities of: all Public Directors; and with respect to a registered derivatives clearing organization, all representatives of customers;

(vi) The lines of responsibility and accountability for each operational unit of the registered entity;

(vii) Summaries of significant decisions implicating the public interest. Such significant decisions shall include:

(A) With respect to a designated contract market or a registered swap execution facility, all decisions relating to access, membership, and disciplinary procedures; and

(B) With respect to a derivatives clearing organization, all decisions relating to open access (as described in

Section 2(h)(1)(B) of the Act), membership (as described in Section 5(b)(c)(2)(C) of the Act), and the finding of products acceptable or not acceptable for clearing. In describing such decisions, the derivatives clearing organization shall specifically disclose whether:

(1) Its Board of Directors has rejected a recommendation or superseded an action of the Risk Management Committee; or

(2) The Risk Management Committee has rejected a recommendation or superseded an action of its subcommittee (as described in § 39.13(g)(5) of this part).

(C) Nothing in the foregoing shall be construed as requiring a designated contract market, a registered swap execution facility, or a derivatives clearing organization to disclose any "non-public information" (as § 1.3(ggg) of this chapter defines such term), including, without limitation, minutes from meetings of its Board of Directors or committees and information that it may have received on a confidential basis from an applicant for membership.

(2) The registered entity must ensure that the information specified in paragraphs (d)(1)(i) to (vii) of this section is current, accurate, clear, and readily accessible, for example, on its Web site. The registered entity shall set forth such information in a language commonly used in the commodity futures and swap markets and at least one of the domestic language(s) of the jurisdiction in which the registered entity is located.

(e) *Regulatory Program.* (1) As part of its regulatory program, each registered derivatives clearing organization, designated contract market, or registered swap execution facility must establish, maintain, and enforce written procedures to:

(i) Identify, on an ongoing basis, existing and potential conflicts of interest; and

(ii) Make fair and non-biased decisions in the event of a conflict of interest. Such procedures shall include rules regarding the recusal, in applicable circumstances, of parties involved in the making of decisions. The Chief Compliance Officer of a registered derivatives clearing organization or registered swap execution facility shall, in consultation with the Board of Directors of the entity, an equivalent body, or a senior officer of the entity, resolve any such conflicts of interest.

(f) *Limitations on Use or Disclosure of Non-Public Information.* (1) Each registered entity must establish and maintain written policies and

procedures on safeguarding non-public information gained through either an ownership interest or through the performance of official duties (including duties associated with self-regulatory or regulatory purposes) by members of its Board of Directors, members of any committee, or officers and other employees.

(2) Such policies and procedures shall comport, at a minimum, with the following principles:

(i) No individual or entity described in paragraph (f)(1) of this section shall use or disclose any non-public information, absent prior written consent from the relevant registered entity. A registered entity shall establish guidelines that specify the information that must be included in the written consent.

(ii) No individual or entity described in paragraph (f)(1) of this section shall, either during or after service with the relevant registered entity:

(A) Use, directly or indirectly, information that the registered entity deems to be non-public information; or

(B) Disclose non-public information to others, except:

(1) To others within the relevant registered entity or to outside advisors thereof, provided that such advisors are subject to confidentiality obligations, and that such disclosure is necessary for the performance of official duties by the individual or entity;

(2) If required by regulatory authority; or

(3) If compelled to so by valid legal process, provided that the individual or entity notifies the relevant registered entity.

Issued in Washington, DC, on December 9, 2010, by the Commission.

David A. Stawick,
Secretary of the Commission.

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding the Mitigation of Conflicts of Interest—Commission Voting Summary and Statements of Commissioners

Appendix 1—Commission Voting Summary

On this matter, Chairman Gensler and Commissioners Dunn, Sommers, Chilton and O'Malia voted in the affirmative; no Commissioners voted in the negative.

Appendix 2—Statement of Chairman Gary Gensler

I support the proposed rule on further governance and conflicts of interest requirements for derivatives clearing organizations (DCOs), designated contract markets (DCMs) and swap execution facilities (SEFs). The proposed rule complements the conflicts of interest provisions that the Commission proposed on October 1st by keeping regulators up to date about the composition of boards, board committees and ownership, promoting transparency in decision-making and ensuring limitations on use or disclosure of non-public information. The proposed rule also provides guidance to industry and the public on appropriate minimum governance fitness standards for DCOs and DCMs, as well as the manner in which market participants must be heard or included in DCO or DCM governance arrangements. The proposed rule would enhance the integrity of clearing and trading and would increase public trust in the facilities on which such important activities occur.

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DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Parts 16 and 1107

[Docket No. FDA-2010-N-0646]

RIN 0910-AG39

Tobacco Products, Exemptions From Substantial Equivalence Requirements

AGENCY: Food and Drug Administration, HHS.

ACTION: Proposed rule.

SUMMARY: The Food and Drug Administration (FDA) is issuing this proposed rule to establish procedures for requesting an exemption from the substantial equivalence requirements of the Family Smoking Prevention and Tobacco Control Act (Tobacco Control Act). The proposed rule would describe the process and statutory criteria for requesting an exemption and explain how FDA would review requests for exemptions. Once finalized, this regulation will satisfy the requirement in the Tobacco Control Act that FDA issue regulations implementing the exemption provision.

DATES: Submit either electronic or written comments on the proposed rule by March 22, 2011. Submit comments on information collection issues under the Paperwork Reduction Act of 1995 by February 7, 2011, (see the "Paperwork Reduction Act of 1995" section of this document).