sifma

asset management group

December 20, 2017

Mr. David Van Wagner, Chief Counsel
Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Proposal to Revise Part 40

Dear Mr. Van Wagner:

The Asset Management Group of the Securities Industry and Financial Markets Association ("**SIFMA AMG**" or "**AMG**")[1] provides the following proposal to amend Part 40 of the regulations promulgated by the Commodity Futures Trading Commission ("**CFTC**" or the "**Commission**").[2] AMG believes that the current process for registered entities to propose new and amended rules does not sufficiently take into account the Commission's policies and the impact of new rules and rule changes upon market participants. As such, we believe the Commission should strengthen both its process for rule change certifications and Commission review of new and amended rules.

I. Existing Rule Certification and Review Process Is Insufficient to Advance Commission Policies and Protect Market Participants from Registered Entity Rule Changes Motivated by Commercial Purposes

Under Part 40 of the Commission's regulations as amended in 2011 in response to the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**"), the Commission aimed to provide a tiered review process for new rules, rule amendments, and changes to contractual terms prescribed by designated contract markets ("**DCMs**"), registered swap execution facilities ("**SEFs**"), registered derivatives clearing organizations ("**DCOs**"), and registered swap data repositories ("**SDRs**") (collectively, "**registered entities**").[3] For non-material changes to

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1 SIFMA AMG brings the asset management community together to provide views on policy matters and to create industry best practices. SIFMA AMG's members represent U.S. and multinational asset management firms whose combined global assets under management exceed $39 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS, and private funds such as hedge funds and private equity funds.

2 7 U.S.C. § 1, et seq.

3 See Provisions Common to Registered Entities, 76 Fed. Reg. 44,776 (July 27, 2011).

agricultural contracts, minor changes, and changes to non-agricultural contracts, the Commission provided methods for registered entity self-certification. At the same time, the Commission sought to maintain oversight over important rule changes, which were material changes to a term or condition of a contract for future delivery of an enumerated agricultural commodity listed in Section 1a(9) of the Commodity Exchange Act of 1974, as amended ("**CEA**" or the "**Act**"),[4] or an option on such a contract or commodity, in a delivery month having open interest.

As we noted in our comment with respect to Project KISS,[5] AMG has observed that, notwithstanding the Commission's objective to maintain oversight over important rule changes, in practice, Part 40's exception for less important rule changes has swallowed the rule, leaving little that is reviewed or capable of challenge by the Commission. Over time, more changes—even those affecting agricultural contracts—have been submitted for certification with a mere 10 business days for market participants to react, and no formal process to allow market participants to object to a submission or meaningful legal standard by which registered entities are bound to consider such objections. Typically, registered entity decisions to adopt or modify rules by certification are made by the registered entity's board or a committee, with market participants only learning that a rule has been adopted or amended after the registered entity has self-certified the rule or amendment to the Commission, and it is posted on the Commission's website.

Even when objections can be raised and considered, unless the rule or rule amendment presents a clear conflict between the rule or contractual change and the CEA—a low bar for registered entities to pass—the Commission's regulations do not give the Commission or its staff the power to halt the change. Rules or rule amendments presenting novel or complex issues or potential inconsistencies with the Act can be stayed for up to 90 days and put out for public comment but, again, this standard has not been tied to the overall policy objectives of the Commission. Moreover, the stay has rarely been invoked by the Commission. On only a handful of occasions since 2011 when Part 40 was amended into its current form has the Commission stayed registered entity rules for further review and solicited public comment. Such limited invocation of the stay and review provisions does not reflect meaningful oversight or opportunity for the public to comment on material rules or rule changes.

Some of these concerns recently came to the fore with the self-certification of CME Group's and CBOE Futures Exchange's bitcoin futures contracts. Under Commission regulations, exchanges may self-certify new product listings and then list them for trading the next business day, without Commission review or opportunity for public input. The Futures Industry Association ("FIA") sent a letter to Chairman Giancarlo expressing the view that while such expedited new product certifications may be appropriate for standardized products, it is not appropriate for novel products such as bitcoin futures, which might have benefited from a more considered process involving robust public comment on significant issues including margin levels, trading limits, stress

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4 7 U.S.C. 1a(9).

5 See Letter from Timothy Cameron and Laura Martin, SIFMA AMG to Christopher Kirkpatrick, Secretary, CFTC, dated Sept. 29, 2017, available at: https://www.sifma.org/resources/submissions/sifma-amg-comments-on-cftcs-project-kiss/.

testing and guarantee fund protections.[6] While our recommendations in this letter address the certification process for rules and rule amendments that are material, as opposed to initial product listings, similar concerns about the lack of opportunity for public input and consideration that were expressed for new product listings also arise in the rule and rule amendment context. And FIA's letter further underscores that the self-certification processes under Commission regulations are broken and should be amended.

II. The Commission Should Update Registered Entity Rule Certification Procedures

A key problem with the current Part 40 process is that it does not provide sufficient time for market participants to react to changes. We recommend that the Commission add a number of steps to the self-certification procedures that would increase public participation in the adoption of registered entity rules or rule amendments that are material and generally enhance the quality of such rules and Commission review.

Specifically, we recommend that the Commission require by regulation that registered entities, for "material" rules or rule amendments (as we would propose to describe below):

- post proposed certifications of such rules or rule amendments on their websites 30 days prior to filing the applicable certifications with the Commission;
- request comment from members and market participants during the 30-day period;
- afford members and market participants the opportunity to comment on whether a rule or rule amendment is "novel or complex" requiring a stay and further review by the Commission under Section 5c(c)(2) of the CEA; and
- address any objections that were made (including an explanation of why objections were disregarded) and any comments that the rule or rule amendment is novel or complex requiring a stay and further Commission review in their certification filing.

For this purpose, and to provide legal certainty regarding what is a material rule or rule amendment, the Commission could define what is *not* a material rule or rule amendment in its regulations. Rules or rule amendments not deemed material could include those types of rules or rule amendments for which certification is not required in current Reg. 40.6(d), which govern matters like administration, standards of decorum, non-substantive corrections, etc., that generally are not considered material rules or changes.[7] Rules or changes deemed non-material could also include those specified under Reg. 40.4(b),[8] such as for cancellation ranges and trading hours, that are required to be certified but are not deemed material rule changes for contracts involving enumerated agricultural commodities. We believe this list could be expanded to all commodities as well. All other rules or rule amendments should be considered material, and therefore would be subject to our recommended

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6 See Letter from Walt Lukken, CEO, FIA, to J. Christopher Giancarlo, Chairman, CFTC, dated December 6, 2017.

7 17 C.F.R. 40.6(d).

8 17 C.F.R. 40.4(b).

changes to the certification process, including the 30-day comment period prior to certification. We believe this approach strikes a reasonable balance so that rules or rule amendments that clearly are not material are not subject to our recommended certification procedures, while ensuring that any rules or changes that do not fall within the category of non-material rules are subject to those procedures.

With regard to the posting of rule and rule change certifications and obtaining comment, current Part 40 regulations require registered entities to post the certification on their websites at the same time as filing the certification with the Commission,[9] but this provides an inadequate 10-business day review period for market participants to react and respond. And there is no statutory requirement that certifications be posted on registered entity websites at the same time as the certification filing. In this regard, Section 5c(c)(2) of the CEA provides that a rule or rule amendment becomes effective "pursuant to the certification of the registered entity and notice of such certification to its members (in a manner to be determined by the Commission)," on a date 10 business days after the Commission receives it. There is no simultaneity requirement; the Commission simply chose that timing requirement when it promulgated the 2011 Part 40 amendments.

We believe the emphasized language above, which allows the Commission to establish the manner of notice, provides ample authority for the Commission to require registered entities to adopt rules requiring pre-notice of certification filings of material rules and rule amendments by posting them on their websites 30 days prior to such filings with the Commission and requesting comment from the public. Additional authorities in the Act for the Commission to require registered entities to issue such rules may also be relied upon, including Section 8a(5).[10] Such a period would allow market participants adequate time to comment on proposed material rule changes before they are self-certified.

Such a requirement also is consistent with and would facilitate registered entity compliance with existing Part 40 requirements for certified rules and rule amendments, which require that registered entities explain any substantive opposing views.[11] Indeed, it is difficult to see how a registered entity can explain "any substantive opposing views" in a fair and open manner if that entity is not required to solicit public comment. We think that these existing requirements also could be bolstered by requiring that registered entities explain why they chose to disregard or reject opposing views in their certification filing. The Commission is required to consider and respond to significant comments in a concise general statement of a rule's basis and purpose under the

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9 See 17 C.F.R. 40.6(a)(2).

10 See CEA Section 5(d)(1)(A)(ii), 7 U.S.C. 7(d)(1)(A)(ii) (DCMs); CEA Section 5b(c)(2)(A)(i), 7 U.S.C. 7a-1(c)(2)(A)(i) (DCOs); CEA Section 5h(f)(1)(A)(ii), 7 U.S.C. 7b-3(f)(1)(A)(ii) (SEFs); and CEA Section 21(a)(3)(A)(ii), 7 U.S.C. 24a(a)(3)(A)(ii) (SDRs) (authorities to impose requirements on registered entities by rule or regulation pursuant to 8a(5), 7 U.S.C. 12a(5)).

11 See, e.g., 17 CFR 40.6(a)(7)(vi).

Administrative Procedure Act,[12] and we think a similar requirement to provide explanation regarding comments should apply to registered entities as well. We also think that registered entities should be required to afford members and market participants the opportunity to comment on whether a rule or rule amendment is novel or complex such that it would be subject to stay and review by the Commission, and explain, in the face of comments that a rule is novel or complex, why a rule is not novel or complex in their certification filings if they believe that is the case.

Requiring that registered entities obtain public comment and address those comments prior to certification is also justified in light of the post-Dodd-Frank requirement that designated contract markets, for example, are required by Commission regulation to have market participants consent to their jurisdiction.[13] It stands to reason that if market participants must consent to a designated contract market's jurisdiction and be subject to its rules (including disciplinary proceedings), the participants should be given the opportunity to comment on material rules before they are certified to the Commission and become binding on the market participants' trading practices. Moreover, post-Dodd-Frank, significantly more products have been moved into the mandatory clearing and trade execution space, and thus are subject to the rules of registered entities. Many more market participants are impacted by registered entity rules and thus should be afforded the opportunity to comment on them, including with respect to "made available to trade" determinations, which basically have the consequence that market participants must trade through a SEF (or nowhere), which is not being given sufficient consideration due to SEFs' ability to self-certify the made available to trade determination.

In addition, we recommend that the Commission require that registered entity certifications include analysis of the effect of the submission on market participants, including the costs and burdens that may be imposed in complying with new material rules or rule amendments, and whether any less burdensome alternatives were considered and, if so, why they were rejected in favor of the course of action taken. This would facilitate review for compliance with core principles, for example, addressing antitrust considerations that are applicable to registered entities, which require that, unless necessary or appropriate to achieve the purposes of the Act, rules of registered entities not impose anticompetitive burdens or restraints on trade.[14] Requiring registered entities to explain the costs and benefits of their material rules and rule amendments generally should also enhance the quality of registered entity rulemaking.

We also believe that these procedures should apply on a registered entity by registered entity basis. It is often the case that, if a rule or rule amendment is self-certified without Commission objection, or approved by the Commission, that other registered entities will follow suit by self-certifying the same rule. But that does not take into account differences between markets and

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12 See, e.g., *Perez v. Mortgage Bankers Ass'n*, 135 S. Ct. 1199, 1203 (2015) ("An agency must consider and respond to significant comments received during the period for public comment."). See also 5 U.S.C. 553(c)(requiring concise general statement of basis and purpose).

13 See 17 CFR 38.151(a). A similar requirement exists for swap execution facilities, see 17 CFR 37.202(b).

14 See CEA Section 5(d)(19) (DCMs), 5h(f)(11) (SEFs), 5b(c)(2)(N) (DCOs), and 21(f)(1) (SDRs).

market participants. Thus, we believe that if a registered entity has filed a certification under the procedures described above and there is no Commission objection, or the registered entity has voluntarily obtained Commission approval of a rule or rule amendment, other registered entities should be required to go through the procedures we are recommending before self-certifying the same rule. We also recommend that registered entities be required to explain the cross-market effects of their rules or rule amendments in their certification filings in order to take into account that other registered entities may adopt and certify the same rule.

Another change we believe may enhance the Commission's review is to require by regulation adopted pursuant to Section 8a(5) that a registered entity would have to consult with the Commission or file a draft 30 days prior to filing a certification of a material rule or rule amendment. This 30-day period could be concurrent with the 30-day comment period for market participants described above. Such a requirement would facilitate Commission review to determine if a certification should be stayed and reviewed when it is filed.

III. The Commission Should Review All Material Rules and Rule Amendments

If the Commission decides not to adopt our recommendations above regarding the certification process, we recommend in the alternative that the Commission establish by regulation that any material rule or rule amendment, as defined above, will be deemed "novel or complex" within the meaning of Section 5c(c)(2) of the Act,[15] and therefore will automatically be subject to the stay of self-certification and be put out for public comment by the Commission pursuant to Section 5c(c)(3) of the Act.[16] The Commission has inherent authority to interpret the CEA, including the meaning of what is "novel or complex" along these lines, and should be accorded *Chevron* deference with respect to its interpretation.[17]

Our recommended regulation would mean a stay, Commission review, and opportunity for public comment with respect to all registered entity certifications of rules and rule changes that are material (i.e., not included in the regulation as not material), which is similar to the review of terms and conditions for contracts on enumerated agricultural commodities. Review of enumerated agricultural contract terms and conditions is mandated by Section 5c(c)(4)(B) of the CEA, which requires that a designated contract market submit to the Commission for prior approval each rule amendment that materially changes the terms and conditions of such contracts if it applies to already listed contracts that have open interest. However, the regulation we are recommending is not inconsistent with Section 5c(c)(4)(B), which requires prior Commission *approval* of all material rule changes. Rather, the recommended regulation would require that the Commission stay and review all material rules and rule amendments (other than those subject to prior approval under the CEA for rules involving agricultural commodities), as opposed to prior approval. And we believe such a requirement is a necessary modernization of Part 40 to reflect the vastly expanded set of markets the Commission oversees post-Dodd-Frank. In this regard, requiring that all material rules and rule

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15 7 U.S.C. 7a-2(c)(2).

16 7 U.S.C. 7a-2(c)(3).

17 See note 10, supra.

changes be stayed, reviewed, and subject to public comment will allow the Commission to draw upon and consider the expertise and resources of market participants, other interested parties, and the public, which can only serve to help the Commission focus its analysis and identify issues with rules and rule amendments before they are implemented.

Moreover, such a regulation is not inconsistent with the spirit of Section 5c(c) and the self-certification process it establishes. The regulation would simply be stating ahead of time that material rules and rule changes will be deemed novel and complex and subject to automatic stay, Commission review, and opportunity for public comment, which is consistent with Sections 5c(c)(2) and (3) of the Act. We are not suggesting and do not recommend that non-material rules or rule changes be subject to this requirement, and in that regard, the Commission can always add to the list of categories of rules or rule amendments deemed not to be material beyond those in Reg. 40.6(d) and 40.4(b) (but expanded to all commodities), and therefore not subject to the automatic stay and review, if the Commission believes that non-material rules become subject to review as a result of our suggested regulation.

In the alternative, if the above recommendation is not adopted, we recommend establishing by regulation that certain categories of rules or rule amendments are by definition, or will be, deemed to be "novel or complex." Such rules might include rules pertaining to position limits, new compliance obligations, and other significant topics. Under this alternative, the Commission would enumerate in the regulation what is material, and therefore novel or complex and subject to automatic review, as opposed to enumerating what is not material as suggested above with all other changes being deemed material and subject to review. We prefer the proposal above because when the problem we are addressing is inadequate review, it is better to be over-inclusive and define what is not subject to automatic review rather than define what is subject to review and potentially miss rule categories that should be reviewed. However, we stand ready to assist the Commission in enumerating material rule categories if it were to determine that this alternative is preferable.

IV. The Commission Should Expand Review Beyond Inconsistency with the CEA or Regulations

A further issue under current Part 40 practice is that the Commission only reviews rules and rule amendments to determine if there is an inconsistency with the CEA and regulations thereunder. We believe the scope of review should be expanded to include other statements of CFTC policy. Specifically, we recommend that the Commission adopt a rule that interprets Section 5c(c)(5) of the CEA to mean that the Commission will approve rules or rule amendments unless the Commission finds that the new rule or rule amendment is inconsistent with the CEA, or regulations, <u>orders, guidance, policy statements, or interpretations thereunder.</u> Similarly, we recommend that the Commission adopt a rule that interprets Section 5c(c)(3) of the CEA to allow the Commission to object to a certification, if there is an inconsistency between a rule and the CEA, or regulations, orders, guidance, policy statements, or interpretations thereunder.

Although these provisions of the Act state inconsistency with the "Act (including regulations under the Act)," we believe it is reasonable to interpret this language to include orders, guidance, policy statements, or interpretations thereunder that the Commission is authorized to make. Congress did not limit review of inconsistency to regulations, but by using the word "including"

meant that regulations were only representative of what should be reviewed for inconsistency. Moreover, the Commission is expressly authorized under Section 5c(c)(1) to issue interpretations regarding registered entity core principles. It would be incongruous if the Commission could not review rule submissions for inconsistency with such interpretations. We believe that Commission review of rules and rule amendments would be enhanced by considering these and the other alternative sources of Commission policy mentioned above in administering the Act, including considerations of compliance costs and customer protections that are impacted by the rules or contractual changes.[18]

V. Affirmative Approval of Self-Certifications

The Commission could also require by regulation that material rules or rule amendments that it reviews and puts out for comment, if it decides not to object to such rules or rule amendments, will be the subject of a formal public approval notice that addresses any comments received. While the statute provides that certifications that are subject to review and approval will become effective within 90 days if the Commission does not object, there is nothing in the statute that prohibits the Commission from approving such certifications. Such required approval may help to enhance Commission review by requiring that all rule changes not objected to be subject to written approval addressing any comments and not just be allowed to go into effect without any Commission statement. To be clear, we are not recommending a return to the process 20 years ago, prior to the Commodity Futures Modernization Act of 2000, where most exchange rules or rule amendments were required to be approved by the Commission before they could go into effect. We are only suggesting that, in the case where the Commission does receive public comments, it should address those comments in an approval notice issued within 90 days; if there are no comments, no approval notice would be required. If the Commission decides to object to a rule or rule amendment, while we think the Commission likely would memorialize in writing, the regulation could also state such objection notices be in writing and address any comments received.

VI. Summary of Recommendations

In summary, SIFMA AMG recommends the following amendments to Part 40:

(1) <u>Add Steps to Registered Entity Self-Certification Procedures to Increase Public Participation and Enhance Review.</u> SIFMA AMG recommends that additional steps be added to the registered entity rule self-certification procedures that would increase public participation in the adoption of registered entity rules or rule amendments that are material, as defined above, and generally enhance the quality of such rules and Commission review, including that registered entities:

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[18] Moreover, we note that the CFTC may stay a rule or rule amendment if there is a "potential" inconsistency with the Act; this does not require a finding of an inconsistency. If our recommendation is not adopted that all material rule changes or certain categories should be subject to review as novel and complex as we are proposing above, CFTC staff should be educated/trained regarding this distinction so that more rules and rule amendments will be subject to review.

- post proposed certifications of such rules or rule amendments on their websites 30 days prior to filing the applicable certifications with the Commission;
- request comments from members and market participants during that 30-day period;
- afford members and market participants the opportunity to comment on whether a rule or rule amendment is "novel or complex" requiring a stay and further review by the Commission under Section 5c(c)(3) of the CEA;
- address any objections that were made and any comments that the rule or rule amendment is novel or complex requiring a stay and further Commission review in their certification filings;
- include an analysis in their certification filings of the effect of the submission on market participants, including the costs and burdens that may be imposed in complying with new material rules or rule amendments, and whether any less burdensome alternatives were considered and, if so, why they were rejected in favor of the course of action taken;
- explain the cross-market effects of their rules or rule amendments in their certification filings in order to take into account that other registered entities may adopt and certify the same rule; and
- consult or file a draft of their certification filings with the Commission 30 days prior to filing the certification.

Each registered entity should be required to follow the procedures outlined above for material rules and rule amendments (irrespective of whether another registered entity has self-certified or received approval for the same rule).

(2) Require in the Alternative Commission Review of All Material Rules. If our recommendation in (1) above is not adopted, we recommend in the alternative that the Commission either (a) establish by regulation that any material rule or rule amendment (again, per proposed standard set forth above) will be deemed novel or complex and therefore automatically be subject to the stay of self-certification and be put out for public comment; or (b) establish by regulation that certain categories of rules or rule amendments are by definition, or will be deemed to be, novel or complex.

(3) Expand the Scope of Commission Review. We recommend the scope of the Commission's review under the current Part 40 to determine whether a new rule or rule amendment is inconsistent with the CEA, or regulations, should be expanded to evaluate whether the rule or rule amendment is consistent with other statements of CFTC policy including orders, guidance, policy statements, or interpretations thereunder.

(4) Provide for Commission Approval of Registered Entity Rules Where There is Comment. Finally, we recommend the Commission also require by regulation that material rules or rule amendments that it puts out for comment, if the Commission decides not to object to such rules or rule amendments, will be the subject of a formal, public approval notice that addresses any comments received and issued within the 90-day review period, and similarly, if the Commission objects to a rule or rule amendment, such objection should be public, in writing, and address any comments.

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AMG looks forward to participating in future discussions on our proposed recommendations to amend Part 40. We are available to discuss these recommendations at your convenience. Should you have any questions or would like to discuss further, please contact Tim Cameron at 202-962-7447 or tcameron@sifma.org, or Laura Martin at 212-313-1176 or lmartin@sifma.org, or Julian Hammar, Morrison & Foerster LLP, at 202-887-1679 or jhammar@mofo.com.

Respectfully submitted,

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