Commodity Futures Trading Commission
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Q & A – Governance Requirements for DCOs, DCMSs and SEFs

What is the goal of the proposed rulemaking?

The notice of rulemaking 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") pursuant to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The proposed rules complement those voted on by the Commission on October 1, 2010.[1] In addition, the Commission is proposing rules to implement the core principles concerning governance fitness standards and the composition of governing bodies for DCMs and DCOs, and the core principle on diversity of Boards of Directors for publicly-traded DCMs.

What potential conflicts were identified by the Commission in proposing these rules?

As further discussed in the Conflicts of Interest NPRM, the Commission recognized that a DCO may confront potential conflicts of interest in, among other things, determining (i) whether a swap contract is capable of being cleared, (ii) the minimum criteria that an entity must meet in order to become a swap clearing member, and (iii) whether a particular entity satisfies such criteria.

The Commission identified that a DCM or SEF may confront potential conflicts of interest in, among other things, balancing the advancement of commercial interests and the fulfillment of self-regulatory responsibilities, including with respect to determinations on access.

In addition, the Commission recognizes that conflicts will evolve over time and in proposing these rules and those in the Conflicts of Interest NPRM, the Commission aims to establish a structure that will mitigate unidentified conflicts as well.

How do the proposed rules address the identified conflicts of interest and further implement the conflicts of interest core principles?

The rules proposed in this NPRM would mandate that each DCO report to the Commission when its Board of Directors rejects a recommendation from, or supersedes an action of, the Risk Management Committee (the "RMC"), or a subcommittee of the RMC. Each DCM or SEF would be required to report to the Commission when its Board of Directors rejects a recommendation from, or supersedes an action of, the Regulatory Oversight Committee ("ROC") or the Membership or Participation Committee. Each DCO, DCM, or SEF would also be required to submit certain governance information to the Commission within 30 days after each election of its Board of Directors.

In addition, the rules propose that each DCO, DCM, or SEF 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.

Further, the rules propose limitations on the use or disclosure of non-public information.

Finally, to increase transparency, the rules propose that each DCO, DCM, or SEF be required to make certain information on governance arrangements available to the public and relevant authorities, including summaries of significant decisions.

[1] 75 FR 63732 (Oct. 18, 2010). This NPRM shall hereinafter be referred to as the "Conflicts of Interest NPRM."

What types of significant decisions would be required to be disclosed? Would this include confidential information or meeting minutes?

With respect to a DCO, significant decisions would relate to open access, membership, or the determination of whether a product would be acceptable for clearing. With respect to a DCM or SEF, significant decisions would relate to access, membership, or disciplinary procedures. The Commission does not intend to require a DCM, SEF, or DCO to disclose any "non-public information" (as defined in proposed §1.3(ggg)) including, without limitation, meeting minutes.

What types of limits are proposed to prevent misuse of non-public information?

The proposed rules 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 (except as required, e.g., by a regulatory authority).

How is "non-public information" defined?

The proposed rules 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 (i) such registered entity or (ii) 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."

What are the requirements of the proposed "regulatory program?"

The rules propose to require each DCO, DCM, or SEF to establish, maintain, and enforce written procedures to identify existing and potential conflicts of interest and make decisions in the event of a conflict. Such rules would leave significant flexibility to the DCO, DCM, or SEF to determine how best to implement the regulatory program.

Will a registered entity be permitted to contract with a third-party regulatory service provider to fulfill its regulatory program requirement?

Yes. 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.

What fitness standards are proposed for directors or members of certain panels or committees?

To implement DCO Core Principle O and DCM Core Principle 15 pertaining to governance fitness standards, the proposed rules would require each DCO and DCM to specify and enforce fitness standards for directors, members of any Disciplinary Panel, and members of the Disciplinary Committee.

These standards shall include, at a minimum, those bases for refusal to register a person under Section 8a(2) of the CEA, and the absence of a significant history of serious disciplinary offenses, such as those that would be disqualifying under Section 1.63 of the Commission's regulations.

The proposed rules also require each DCM or DCO to specify and enforce fitness standards for (i) its members and affiliates 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 of equity interest in a DCM or DCO, and (iv) parties affiliated with directors, members of any Disciplinary Panel, and members of the Disciplinary Committee. At a minimum, such standards shall include those bases for refusal to register a person under Section 8a(2) of the CEA.

How will the proposed rules implement the transparency requirements in DCO Core Principle O that are not included in DCM Core Principle 15?

DCO Core Principle O provides that each DCO shall establish governance arrangements that are transparent to fulfill public interest requirements and 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 is unique to DCOs. Hence, the proposed rules set 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; and
- 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.

How do the proposed rules implement the core principles related to the composition of governing boards of DCMs and DCOs?

DCM Core Principle 17 provides that the governance arrangements of a DCM shall be designed to permit consideration of the views of market participants. To implement this core principle, the proposed rules 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 allow DCMs 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 the Core Principle is to have market participants on its board (or other governing bodies).

DCO Core Principle Q provides that each DCO shall ensure that the composition of the governing board or committee of the DCO includes market participants. To implement this core principle, the proposed rules require that each DCO have 10 percent customer representation on its board, in lieu of having such representation on the Risk Management Committee (or the Risk Management Subcommittee). Alternatively, the proposed rules require that each DCO have 10 percent customer representation on the Risk Management Committee (or the Risk Management Subcommittee), in lieu of having such representation on its board. Preliminarily, the Commission is anticipating only adopting one requirement on customer representation. Given the two alternatives, the Commission does not anticipate making a final determination on the customer representation question until it finishes reviewing comments on this rulemaking.

How do the proposed rules implement the core principle on diversity for publicly-traded DCMs?

DCM Core Principle 22 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 proposed rules would require 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 proposed rules would also require 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. Further, the proposed rules would require 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 proposed rules would require 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.