



October 10, 2022

Via Electronic Submission

Mr. Christopher J. Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Comment Letter on Proposed Rulemaking Relating to Governance Requirements for
Derivatives Clearing Organizations
RIN 3038-AF15, 87 FE 49559 (August 11, 2022)

Dear Mr. Kirkpatrick:

Cboe Clear Digital, LLC (“Cboe Clear Digital” or the “Clearinghouse”) appreciates the opportunity to provide its comments to the Commodity Futures Trading Commission (“CFTC” or “Commission”) regarding the CFTC’s proposal on governance requirements for derivatives clearing organizations (“Proposal”). Cboe Clear Digital is a registered derivatives clearing organization (“DCO”). Cboe Clear Digital currently has in place a Risk Management Committee (“RiskCo”) of the Board of Directors of Cboe Clear Digital (“Board”) that aids the Board in managing risks associated with operations of the Clearinghouse.

I. Proposal to Establish and Consult a Risk Management Committee

The Proposal seeks to require each DCO to establish and consult with one or more risk management committees (“RMCs”), comprised of clearing members and customers of clearing members, prior to making decisions that could materially affect the risk profile of the DCO. Cboe Clear Digital agrees with the Commission that it is important for DCOs to establish an RMC(s) that furthers the purpose of Core Principle O (Governance Fitness Standards) and CFTC Regulation §39.24¹ by establishing governance arrangements that explicitly support the stability of the broader financial system and relevant public interest considerations, and by making certain that a DCO’s design, rules, overall strategy, and major decisions appropriately reflect the legitimate interests of all relevant stakeholders. As such, Cboe Clear Digital believes that any governance standards that the Commission establishes in this area should be principles-based and not prescriptive. Establishing or requiring rigid or one-size-fits-all risk governance standards does

¹ 17 CFR §39.24

not allow for DCOs to appropriately tailor their risk management programs and processes to their own unique size, services, systems, and infrastructures, and places an undue burden on DCOs by establishing governance requirements merely for the sake of requirements that may be unnecessary, redundant and ill-suited for the specific risk management needs of a DCO.

i. Composition of RMC(s)

The Proposal would require that an RMC include representatives—that is, more than one—from both clearing members and customers of clearing members. Cboe Clear Digital does not agree with the requirement that an RMC must be comprised of customers of clearing members, nor does it agree that an RMC must be comprised of more than one clearing member.

First, Cboe Clear Digital does not believe that requiring an RMC to include representatives from customers is necessary to ensure that a DCO's governance arrangements are consistent with Core Principle O and § 39.24. Within the framework of DCO risk management, the legitimate interests of clearing members, customers of clearing members, and other relevant stakeholders are met by ensuring that the members that comprise the board committee dedicated to managing risks associated with the DCO possess the appropriate expertise in risk management. While there may undoubtedly be customers of clearing members that are highly knowledgeable in clearing risk management and day-to-day risk operations as they relate to a clearing firm, the expertise, business purposes, and operational structure of a clearing firm customer are generally not centered around clearing operations or risk-management related to clearing operations, and can vary widely from customer to customer. As such, clearing members are much better suited than their customers to inform DCO risk management frameworks.

A customer that clears their transactions on a DCO through a clearing member of the DCO is, by definition, a non-clearing member of that DCO. On the other hand, a clearing member has clearing privileges such that it can process, clear and settle trades through a DCO. Therefore, by its nature, a clearing member's expertise, business purposes, and operational structure must center around clearing risk and operations. Clearing members are also subject to various risk management and other risk-based requirements, as well as various obligations and duties to its customers, under the CFTC Rules and rules of the DCO. As a result, clearing members are best suited to lend clearing risk management expertise and to represent the interests of their varied customers, and the market as a whole, to a DCO. Moreover, establishing an RMC comprised of clearing member customers, whose expertise, business purposes, and operational structures are not required to focus on clearing risk and, instead, vary widely, may dilute the ability of an RMC to effectively identify and manage risk on behalf of the DCO in a collective manner. Cboe Clear Digital believes that an RMC comprised of one or more clearing members (as appropriate and as further described below) would ensure that the committee functions as an efficient mechanism for providing risk-based

input, placing a high priority on the safety and efficiency of the DCO while also representing the best interests of the broader market in accordance with § 39.24.

Second, Cboe Clear Digital believes the requirement to include more than one clearing member on an RMC is prescriptive, rather than principles-based, given the differences in size and offerings between different DCOs. A smaller DCO naturally has fewer clearing members and tends to have a smaller number of directors and board committee members than that of larger DCOs. Some DCOs may offer homogenous products or a smaller range of diverse products than that of other DCOs with a wide range of product types. As such, one clearing member representative on an RMC of a smaller DCO or a DCO with a more homogenous product offering may be sufficient to represent clearing member and customer interests across all areas of the DCO; more than one clearing member would be unnecessary and likely inefficient for an RMC of such a DCO. Cboe Clear Digital believes that an RMC should be required to have at least one clearing member representative and that a DCO may establish a policy that additional clearing member RMC representatives should proportionately represent the number of clearing members of (or products offered, if applicable) by the DCO.

ii. RMC Members as Independent Experts

The Commission seeks comment on whether requiring RMC members to act as independent experts, neither beholden to their employers' commercial interests nor acting as fiduciaries of the DCO raises any potential legal issues for those members. Cboe Clear Digital does not believe that ensuring such a level of independence is feasible nor necessary. While an RMC member must certainly be required to set aside commercial interest bias and provide only risk-based input, they likely possess a degree of implicit bias that cannot be untangled from the compensation paid by their employer. Notwithstanding that a level of commercial interest bias is inextricably linked to an employee's source of income, and without dissecting any and all potential legal issues that could arise in attempting to do so, Cboe Clear Digital expects that if legal issues were to arise, they would arise on a case-by-case basis depending on the position of the clearing member representative within their firm. Different clearing member representatives may have different levels of access to data, confidential information, planned initiatives, books of business, and so on within their firm, as well as different responsibilities and obligations to and agreements with their firm, depending on their position, title and the firm itself. As such, if independence as defined by the Proposal was at all possible, ensuring that the independence of each clearing member would not raise any legal issues for those members would prove an onerous, resource consuming exercise for the DCO with little, if any, enhancement of risk governance. A DCO's risk committee members are chosen for their risk management background and experience, are subject to a DCO's rules designed minimize conflicts of interest in the decision-making process of the DCO established pursuant to § 39.25, must meet a DCO's fitness standards established pursuant to § 39.24(c), and must carry out their duties and responsibilities as prescribed by a committee's

governing documents by applying their professional expertise through a risk-based lens. Risk committees (or any board of directors or committee of the board) are comprised of members that serve as a check and balance to offset any views potentially proffered through an individual, biased lens.

Additionally, whether the decision-making authority regarding all matters that may materially affect the risk profile of a DCO ultimately lies with the board of directors or decision-making for some material risk matters may be delegated to an RMC, as Cboe Clear Digital proposes below (Section I.v), this level of practically unachievable independency for RMC members would be decidedly unnecessary. In either case, consideration of input from the board of directors would be mandatory (whether or not the ultimate decision-making authority rests with the board of directors) thereby providing another, separate level of check and balance to the risk management decision-making process.

iii. Requirement to Establish a Risk Working Group

The Proposal would require a DCO to establish one or more risk advisory working groups (“RWGs”) from which the DCO may seek risk-based input. Cboe Clear Digital disagrees with uniformly imposing this requirement for each DCO as such a requirement is prescriptive, rather than principles-based. To impose a requirement that all DCOs establish a RWG does not at all consider the size and product variances between DCOs. While a RWG may be beneficial for a larger DCO or a DCO with a range of diverse products, the employment of a RWG for a smaller DCO or DCO with homogenous product offering would be arbitrary, burdensome and superfluous of the functions of the DCO’s RMC. As such, Cboe Clear Digital believes the implementation of a RWG should be left to individual DCOs based on need.

iv. List of Material Matters Affecting Risk Profile

The Proposal would codify a non-exhaustive list of matters that could materially affect the risk profile of a DCO, including any material change to margin model, default procedures, participation requirements, and risk monitoring practices, as well as the clearing of new products. These matters, as listed, are broad and undefined, and the Proposal calls for *any* material change to such a matter to go through the input, consideration and response process between the board and the RMC. Cboe Clear Digital believes that the Proposal’s partial prescribed list of matters that must be categorically treated as affecting the risk profile of a DCO would create uncertainty for DCOs implementing the proposed governance requirements. For example, it is unclear whether a material change to one of the prescribed matters that is not risk-based must still go through the input, consideration and response process between the board and the RMC. Moreover, if the Commission goes so far as to prescribe a partial list of categorically treated material matters affecting risk, what additional matters does the Commission expect to be treated categorically, if

not all? Rather than provide a partial, explicit list of broad matters² that should be categorically treated as a matter to which any material change could materially affect a DCO's risk profile, the Proposal would better-serve DCO risk management if it either: 1) put forth a complete list of clearly and more narrowly defined matters that a DCO must categorically treat as materially affecting its risk profile; or 2) require a DCO to establish in its policies and procedures a process for determining whether a material change could affect the DCO's risk profile and must go before the RMC, including certain factors that must be considered. Cboe Clear Digital believes the second alternative would be more effective.

If the Commission chooses to establish and maintain a list of matters that a DCO must categorically treat as affecting its risk profile, Cboe Clear Digital does not believe that the clearing of a new product should be included. Each new product or each change to a new product does not automatically introduce material impact to the risk profile of a DCO. A new product or material change to a product may have de minimis impact to the DCO's risk profile if, for example, the DCO already clears a substantially similar product and therefore has the operational, financial, legal, and other necessary capacities in place to readily accommodate the new or updated product without experiencing any issues. A DCO is well-suited to assess its current infrastructure and capacities in determining whether any potential impact may arise in clearing a new or updated product and, if necessary, the appropriate governance arrangements under which such product should be considered. Therefore, Cboe Clear Digital believes that, instead of categorical treatment, a DCO should be required to establish policies and procedures to determine if a new product or material change to a product could materially impact risk and therefore be considered under the appropriate governance arrangements. Alternatively, if the Commission ultimately drives its rulemaking to include the clearing of a new product as a matter that must be categorically treated as materially affecting a DCO's risk profile, Cboe Clear Digital suggests that the Commission seek to harmonize the definition of a new product with the relevant definitions under Part 40 of the Commodity Exchange Act to create a clear framework.

v. Board of Directors' Response to RMC input

The Proposal would require a DCO's board of directors to consult with, and consider and respond to input from, an RMC(s) on all matters that could materially affect the risk profile of the DCO. That is, the board of directors must respond to the substance of the input it receives rather than merely acknowledging that the input was received. The Proposal, however, does not prescribe exactly how a board of directors should respond to RMC input. Cboe Clear Digital expects that an RMC will provide input on matters that materially impact the risk profile of the DCO in the form of recommendations to the board of directors, rather than merely providing information, for the

² Including the clearing of new products. The Commission seeks comment on whether a DCO's proposal to clear a new product should be categorically treated as a matter that could materially affect the DCO's risk profile for purposes of the proposed RMC consultation requirement.

board's ultimate consideration and approval. If the board of directors approves a recommendation without modification, then the board's approval would suffice as a response. If the board of directors approves a recommendation with a modification(s) or otherwise disagrees with a recommendation, then Cboe Clear Digital expects that the board of directors would provide substantive reasoning regarding their decision to adopt a modified recommendation or decision not to adopt a recommendation.

The Proposal states that, while codifying an RMC consultation requirement will significantly enhance overall DCO risk management, a DCO's board of directors has the ultimate responsibility to make major decisions with respect to the DCO. Cboe Clear Digital requests that the Commission consider implementing a framework that could allow the board of directors to delegate decision-making authority on certain matters that could materially affect the risk profile of the DCO to an RMC, including whether and to what extent the board of directors would be required to provide consultation and a response on such matters that have been delegated to the RMC and the RMC's role in keeping the board of directors informed of all decisions on such matters. Particularly, some matters that could materially affect DCO risk may be risk decisions for which a board of directors may assign responsibility and accountability pursuant to § 39.24(b)(9). Indeed, governance arrangements between a board of directors and board committees regarding approval authority for certain matters and responsibilities vary across DCOs according to their governing documents and powers of delegation. Cboe Clear Digital understands that it is customary for a board of directors to delegate certain risk-based matters to a risk committee, and that a board of directors may set certain risk-appetite parameters for its risk committee within which the risk committee may take certain risk-based actions and have decision-making authority. Cboe Clear Digital believes that it is consistent with best practices for a board to delegate matters to a risk committee in this manner.

vi. Minimum Rotation Frequency for RMC Members

The Commission seeks comments on whether there should be a minimum frequency for the rotation of RMC members and what that frequency should be. Cboe Clear Digital agrees that there should be a minimum frequency for the rotation of RMC members. In line with a principles-based approach, Cboe Clear Digital believes that a DCO should be required to establish policies and procedures that define its RMC member cycle and rotation process. Cboe Clear Digital envisions that its own policies and procedures would require that an RMC member be cycled off of the RMC every three years as this would ensure that clearing member representatives have ample time to become fluent in Cboe Clear Digital's structure and risk-profile and effectively apply expertise in all areas of risk management. Additionally, given the finite number of a DCO's clearing members eligible and willing to serve on an RMC, Cboe Clear Digital expects that clearing members that have previously served on an RMC would be eligible to serve on the RMC again after a certain amount of time has lapsed since they last served on the RMC.

II. Future Proposed Rulemaking

i. Requirement to Consult Market Participants before Rule Changes

The Commission seeks comment on whether a DCO should be required to consult with a broad spectrum of market participants prior to submitting any rule change. Cboe Clear Digital strongly opposes any future rulemaking that may consider this requirement, be it in the form of risk-based consultation or consultation generally in connection with any rule changes pursuant to §§ 40.5, 40.6, or 40.10. Such a consultation requirement would be onerous, inefficient and unnecessary. The Commission's certification and approval procedures under the Part 40 Rules ensure that registered entities do not enact rules that, among other things, harm market participants or the public, result in unreasonable restraints of trade or material anticompetitive burdens on trading, or have other effects that are detrimental to the public interest.³ The rule filing framework under the Part 40 Rules is tailored to allow for an appropriate amount of time for stakeholder review and public comment depending on the materiality and nature of a rule change, and requires that a DCO that submits a rule change via the self-certification or voluntary rule approval process provide a brief explanation of any substantive opposing views expressed to the DCO by market participants that were not incorporated into the rule, thus ensuring that a DCO's rulemaking appropriately considers and reflects or addresses market participants' substantive opposing views. In addition to this, DCOs' governance arrangements are structured in a manner sufficient to consider and address a broad spectrum of substantive market participant views in the DCO's rulemaking process, including a board of directors that is statutorily required to make certain that a DCO's rules appropriately reflect the legitimate interests of clearing members, customers of clearing members, and other relevant stakeholders and to clearly disclose major decisions to clearing members, relevant stakeholders and the public, as well as an RMC comprised of members with risk-management expertise, including clearing member representatives that should proportionately represent the DCO's size and/or product offerings.

Cboe Clear Digital believes that a requirement to consult with a broad spectrum of market participants prior to submitting any rule change would diffuse the well-defined and tailored process and resulting efficiencies already in place under the current rule filing framework. Not all rule filings are the same; they each differ in impact, significance, and subject matter. As described above, the Commission's current rule filing framework appropriately accounts for this. To ensure the appropriate consultation for each rule filing is received before filing, as the Proposal envisions, a DCO would have to tailor the "broad spectrum" sample of market participants surveyed for consultation to each rule filing. Requiring that a DCO consult with a broad spectrum of market participants prior to submitting a rule change, or respond to every dissenting position, would place

³ See Derivatives Clearing Organization General Provisions and Core Principles, 85 FR 4800 (January 27, 2020) (Final Rule).

a significant burden on DCOs, both large and small, substantially increasing the workload of management and governing bodies and considerably hampering a DCO's ability to manage its business and risks efficiently and effectively. Importantly, as many rule changes are competitive in nature a DCO would, in addition to expending time and resources to ensure the appropriate spectrum of market participants are surveyed prior to filing, have to put in place non-disclosure mechanisms or otherwise risk disseminating competitive and strategic initiatives. Such processes prior to rule filing would prove onerous and inefficient, reducing operational and risk management efficiencies and diluting the purpose of the Commission's rule filing framework and DCOs' governance arrangements in place today, and as proposed.

Cboe Clear Digital further notes that, given the highly competitive marketplace, DCOs and other registered entities must create and amend rules in the interests and to the benefit of their market participants and stakeholders as a whole. If a DCO so chooses not to consider some or all market participant and stakeholder interests in their rulemaking, those participants can freely and easily choose to participate on another, competing DCO.

ii. Requirement to Enable Information Sharing between RMC Member and its Firm

Finally, the Commission seeks comment on whether a DCOs should be required to maintain policies and procedures designed to enable an RMC member to share certain types of information it learns in its capacity as an RMC member with fellow employees in order to obtain additional expert opinion. Cboe Clear Digital strongly opposes any future rulemaking that may consider this requirement. This level of information sharing is neither necessary nor feasible. DCO matters that go before a risk committee entail non-public, confidential and/or proprietary information of the DCO. A DCO of any size would be required to expend a great number of resources to identify all potential risks that could arise in connection with information sharing on a member-by-member and firm-by-firm basis and to ensure that all necessary permissions, non-disclosure mechanisms, conflict of interest and other background checks were in place for potentially numerous outside individuals to enable an RMC member to share a DCO's sensitive information with fellow employees. Even then, because neither the RMC member nor its fellow employees would be employees of the DCO, the DCO would have virtually no way of knowing or controlling the share of information once it leaves the RMC member, including mitigating any information leaks. Such a high risk and extensive use of resources greatly outweighs the limited, if any, benefit of sharing such information. RMC members are required to possess requisite expertise to provide informed, risk-based input on all matters presented to the RMC for consideration and, as such, there should be a limited number of instances in which additional, outside expertise would be warranted. In such instances, the RMC or the board of directors should collectively decide to seek, examine, and approve a special expert; rather than allowing RMC members to unilaterally seek outside expertise.

III. Conclusion

Cboe Clear Digital believes that the implementation of an RMC(s) and related policies and procedures tailored to the unique offerings and risk needs of the DCO will enhance the effectiveness of a DCO's risk management program and ensure its risk governance arrangements support the stability of the broader financial system and meet the needs of the market and investors as a whole. We are hopeful that after further thought and consideration, the Commission will reconsider the Proposal's provisions (as described above) that may be unnecessarily prescriptive, redundant or burdensome with limited benefit to overall market resilience. We encourage the Commission to consider principles-based risk governance standards that do allow for DCOs to appropriately tailor their risk management programs and processes to their own unique size, services, systems, and infrastructures to better serve the broader marketplace.

Cboe Clear Digital is available to provide any further input desired by the Commission regarding the issues discussed in the Proposal and to work cooperatively with the Commission to address them. Please contact (646) 459-4218 or jpalmer@cboe.com if you have any questions regarding our comments.

Sincerely,

/s/

John Palmer

President, Cboe Digital