COMMODITY FUTURES TRADING COMMISSION

17 CFR PARTS 1 AND 23

RIN 3038-AE59

Risk Management Program Regulations for Swap Dealers, Major Swap Participants, and Futures Commission Merchants

AGENCY: Commodity Futures Trading Commission.

ACTION: Advance notice of proposed rulemaking; request for comments.

SUMMARY: The Commodity Futures Trading Commission (CFTC or Commission) is issuing this Advance Notice of Proposed Rulemaking (ANPRM or Notice) and seeking public comment regarding potential regulatory amendments under the Commodity Exchange Act governing the risk management programs of swap dealers, major swap participants, and futures commission merchants. In particular, the Commission is seeking information and public comment on several issues stemming from the adoption of certain risk management programs, including the governance and structure of such programs, the enumerated risks these programs must monitor and manage, and the specific risk considerations they must take into account; the Commission further seeks comment on how the related periodic risk reporting regime could be altered or improved. The Commission intends to use the information and comments received from this Notice to inform potential future agency action, such as a rulemaking, with respect to risk management.

DATES: Comments must be in writing and received by **[60 days post-publication in the Federal Register]**.

ADDRESSES: You may submit comments, identified by RIN 3038-AE59, by any of the following methods:

- CFTC Comments Portal: https://comments.cftc.gov. Select the "Submit Comments" link for this rulemaking and follow the instructions on the Public Comment Form.
- Mail: Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.
- Hand Delivery/Courier: Follow the same instruction as for Mail, above.

Please submit your comments using only one of these methods. Submissions through the CFTC Comments Portal are encouraged. All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to https://comments.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 (FOIA), 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. The Commission reserves the right, but shall have no obligation, to review, prescreen, filter, redact, refuse, or remove any or all of your submission from https://comments.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 (APA) and other applicable laws and may be accessible under the FOIA.

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I. Background

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] (Dodd-Frank Act) amended the Commodity Exchange Act (CEA)[2] to establish a comprehensive regulatory framework to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things, providing for the registration and comprehensive

[1] See Dodd-Frank Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

[2] 7 U.S.C. 1 et seq.

regulation of swap dealers (SDs)[3] and major swap participants (MSPs),[4] and enhancing the rulemaking and enforcement authorities of the CFTC with respect to all registered entities and intermediaries subject to its oversight, including, among others, futures commission merchants (FCMs).[5] Added by the Dodd-Frank Act, CEA section 4s(j) outlines the duties with which SDs must comply.[6] Specifically, CEA section 4s(j)(2) requires SDs to "establish robust and professional risk management systems adequate for managing the day-to-day business of the [registrant]."[7] CEA section 4s(j)(7) directs the Commission to prescribe rules governing the duties of SDs, including the duty to establish risk management procedures.[8] In April 2012, the Commission adopted Regulation 23.600,[9] which established requirements for the development, approval, implementation, and operation of SD risk management programs (RMPs).[10]

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[3] An SD is an entity that holds itself out as a dealer in swaps; makes a market in swaps; regularly enters into swaps with counterparties as an ordinary course of business for its own account; or engages in any activity causing the entity to be commonly known in the trade as a dealer or market maker in swaps. See 7 U.S.C. 1a(49)(A); see also 17 CFR 1.3 (describing exceptions and limitations).

[4] An MSP is any person that is not an SD and maintains a substantial position in swaps for any of the major swap categories; whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or is a financial entity that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency and maintains a substantial position in outstanding swaps in any major swap category. See 7 U.S.C. 1a(33)(A); 17 CFR 1.3. There are currently no registered MSPs; the relevant regulatory requirements discussed in this ANPRM, however, apply to both SDs and MSPs. For ease of drafting, throughout this Notice, any reference to SDs should be construed to include both SDs and MSPs.

[5] An FCM is an entity that solicits or accepts orders to buy or sell futures contracts, options on futures, retail off-exchange forex contracts or swaps, and accepts money or other assets from customers to support such orders. See 7 U.S.C. 1a(28); 17 CFR 1.3.

[6] 7 U.S.C. 6s(j).

[7] 7 U.S.C. 6s(j)(2).

[8] 7 U.S.C. 6s(j)(7).

[9] 17 CFR 23.600.

[10] Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap

Following two FCM insolvencies involving the misuse of customer funds in 2011 and 2012, the Commission proposed and adopted a series of regulatory amendments designed to enhance the protection of customers and customer funds held by FCMs.[11] The Commission adopted Regulation 1.11 in 2013 to establish risk management requirements for those FCMs that accept customer funds. Regulation 1.11 is largely aligned with the SD risk management requirements in Regulation 23.600 (together with Regulation 1.11, the RMP Regulations).[12] The Commission concluded at that time that it could mitigate the risks of misconduct and an FCM's failure to maintain required funds in segregation[13] with more robust risk management systems and controls.[14]

The Commission is issuing this ANPRM for several reasons. After Regulation 23.600 was initially adopted in 2012, the Commission received a number of questions from SDs concerning compliance with these requirements, particularly those concerning governance (for example, questions regarding who is properly designated as "senior management," as well as issues relating to the reporting lines within the risk management unit).[15] The intervening decade

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Dealers, Major Swap Participants, and Futures Commission Merchants, 77 FR 20128 (Apr. 3, 2012) (2012 SD Risk Management Final Rule). For additional background, see the related notice of proposed rulemaking: Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, 75 FR 71397 (Nov. 23, 2010).

[11] Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 77 FR 67866 (Nov. 14, 2012) (FCM Customer Protection Proposed Rule); Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 FR 68506 (Nov. 14, 2013) (FCM Customer Protection Final Rule).

[12] 17 CFR 1.11; FCM Customer Protection Final Rule.

[13] The statutory requirement for FCMs to segregate customer funds from their own funds is a fundamental cornerstone of customer protection. FCM Customer Protection Final Rule, 78 FR at 68506 ("The protection of customers – and the safeguarding of money, securities or other property deposited by customers with an FCM – is a fundamental component of the Commission's disclosure and financial responsibility framework.").

[14] Id. at 68509.

[15] Some SDs expressed confusion to Commission staff regarding the reporting line requirements and the regulatory definitions of "governing body" and "senior management."

of examination findings and ongoing requests for staff guidance from SDs with respect to Regulation 23.600 warrant consideration of the Commission's rules and additional public discourse on this topic.

The Commission has further identified the enumerated areas of risk that RMPs are required to take into account, and the quarterly risk exposure reports (RERs), as other areas of potential confusion and inconsistency in the RMP Regulations for SDs and FCMs. Commission staff has observed significant variance among SD and FCM RERs with respect to how they define and report on the enumerated areas of risk (e.g., market risk, credit risk, liquidity risk, etc.), making it difficult for the Commission to gain a clear understanding of how specific risk exposures are being monitored and managed by individual SDs and FCMs over time, as well as across SDs and FCMs during a specified time period. Furthermore, the Commission's implementation experiences and certain market events over the last decade indicate that it may be appropriate to consider whether to include additional enumerated areas of risk in the RMP Regulations.

The Commission has observed inefficiencies with respect to the RER requirements in the RMP Regulations. Currently, Regulations 23.600(c)(2) and 1.11(e)(2)[16] prescribe neither the format of the RER nor its exact filing schedule.[17] As a result, the Commission frequently receives RERs in inconsistent formats containing stale information, in some cases data that is at least 90 days out-of-date. Furthermore, a number of SDs have indicated that the quarterly RERs

[16] 17 CFR 23.600(c)(2); 17 CFR 1.11(e)(2).

[17] The timeline for filing quarterly RERs with the Commission is tied to when such reports are given to SDs' and FCMs' senior management. Regulations 23.600(c)(2) and 1.11(e)(2) do not prescribe how soon after a quarter-end an SD or FCM must provide its RER to senior management or the format in which the SD or FCM must submit the information required in the RER to the Commission. Id.

are not relied upon for their internal risk management purposes, but rather, they are created solely to comply with Regulation 23.600, indicating to the Commission that additional consideration of the RER requirement is warranted.

Finally, the Commission also reminds SDs and FCMs that their RMPs may require periodic updates to reflect and keep pace with technological innovations that have developed or evolved since the Commission first promulgated the RMP Regulations.[18] The Commission is seeking information regarding any risk areas that may exist in the RMP Regulations that the Commission should consider with respect to notable product or technological developments.

Therefore, the Commission is issuing this Notice to seek industry and public comment on these aforementioned specific aspects of the existing RMP Regulations, as discussed further below.

II. Questions and Request for Comment

In responding to each of the following questions, please provide a detailed response, including the rationale for such response, cost and benefit considerations, and relevant supporting information. The Commission encourages commenters to include the subsection title and the assigned number of the specific request for information in their submitted responses to facilitate the review of public comments by Commission staff.

A. Risk Management Program Governance

Regulations 23.600(a) and (b) set out the parameters by which an SD must structure and govern its RMPs. Regulation 23.600(a) sets forth certain definitions, including "business trading

[18] Since the adoption of the RMP Regulations, some SDs and FCMs have engaged in novel product offerings, such as derivatives on certain digital assets, have increased their facilitation of electronic and automated trading, and have incorporated into their operations the use of recent technological developments, including cloud-based storage and computing, and possibly artificial intelligence and machine learning technologies.

unit,”[19] “governing body,”[20] and “senior management,”[21] whereas Regulation 23.600(b) requires an SD to memorialize its RMP through written policies and procedures, which the SD’s governing body must approve.[22] Regulation 23.600(b) further requires an SD to create a risk management unit (RMU) that: (1) is charged with carrying out the SD’s RMP; (2) has sufficient authority, qualified personnel, and resources to carry out the RMP; (3) reports directly to senior management; and (4) is independent from the business trading unit.[23]

Similar to Regulation 23.600, Regulation 1.11 contains specific requirements with respect to the risk governance structure.[24] Regulation 1.11(b) defines “business unit,”[25]

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[19] “Business trading unit” is defined as, “any department, division, group, or personnel of a swap dealer or major swap participant or any of its affiliates, whether or not identified as such, that performs, or personnel exercising direct supervisory authority over the performance of any pricing (excluding price verification for risk management purposes), trading, sales, marketing, advertising, solicitation, structuring, or brokerage activities on behalf of a registrant.” 17 CFR 23.600(a)(2).

[20] “Governing body” is defined as, “(1) A board of directors; (2) A body performing a function similar to a board of directors; (3) Any committee of a board or body; or (4) The chief executive officer of a registrant, or any such board, body, committee, or officer of a division of a registrant, provided that the registrant's swaps activities for which registration with the Commission is required are wholly contained in a separately identifiable division.” 17 CFR 23.600(a)(4).

[21] “Senior management” is defined as, “with respect to a registrant, any officer or officers specifically granted the authority and responsibility to fulfill the requirements of senior management by the registrant's governing body.” 17 CFR 23.600(a)(6).

[22] 17 CFR 23.600(b).

[23] 17 CFR 23.600(b)(5).

[24] 17 CFR 1.11.

[25] “Business unit” is defined as, “any department, division, group, or personnel of a futures commission merchant or any of its affiliates, whether or not identified as such that: (i) Engages in soliciting or in accepting orders for the purchase or sale of any commodity interest and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom; or (ii) Otherwise handles segregated funds, including managing, investing, and overseeing the custody of segregated funds, or any documentation in connection therewith, other than for risk management purposes; and (iii) Any personnel exercising direct supervisory authority of the performance of the activities described in paragraph (b)(1)(i) or (ii).” 17 CFR 1.11(b)(1)(i)-(iii).

"governing body,"[26] and "senior management,"[27] while Regulation 1.11(c) requires the FCM to establish the RMP through written policies and procedures, which the FCM's governing body must approve.[28] Regulation 1.11(d) requires that an FCM establish and maintain an RMU "with sufficient authority; qualified personnel; and financial, operational, and other resources to carry out the [RMP]," that is independent from the business unit and reports directly to senior management.[29]

The Commission seeks comment generally on the RMP structure and related governance requirements currently found in the RMP Regulations for SDs and FCMs. In addition, commenters should seek to address the following questions:

1. Do the definitions of "governing body" in the RMP Regulations encompass the variety of business structures and entities used by SDs and FCMs?
    a. Should the Commission consider expanding the definition of "governing body" in Regulation 23.600(a)(4) to include other officers in addition to an SD's CEO, or other bodies other than an SD's board of directors (or body performing a similar function)?
    b. Are there any other amendments to the "governing body" definition in Regulation 23.600(a)(4) that the Commission should consider?

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[26] "Governing body" is defined as, "the proprietor, if the futures commission merchant is a sole proprietorship; a general partner, if the futures commission merchant is a partnership; the board of directors if the futures commission merchant is a corporation; the chief executive officer, the chief financial officer, the manager, the managing member, or those members vested with the management authority if the futures commission merchant is a limited liability company or limited liability partnership." 17 CFR 1.11(b)(3).

[27] "Senior management" is defined as, "any officer or officers specifically granted the authority and responsibility to fulfill the requirements of senior management by the governing body." 17 CFR 1.11(b)(5).

[28] 17 CFR 1.11(c).

[29] 17 CFR 1.11(d).

c. Should similar amendments be considered for the "governing body" definition applicable to FCMs in Regulation 1.11(b)(3)?

2. Should the Commission consider amending the definitions of "senior management" in the RMP Regulations? Are there specific roles or functions within an SD or FCM that the Commission should consider including in the RMP Regulations' "senior management" definitions?
3. Should the RMP Regulations specifically address or discuss reporting lines within an SD's or FCM's RMU?
4. Should the Commission propose and adopt standards for the qualifications[30] of certain RMU personnel (e.g., model validators)?[31]
5. Should the RMP Regulations further clarify RMU independence and/or freedom from undue influence, other than the existing general requirement that the RMU be independent of the business unit or business trading unit?[32]
6. Are there other regulatory regimes the Commission should consider in a holistic review of the RMP Regulations? For instance, should the Commission consider harmonizing the RMP Regulations with the risk management regimes of prudential regulators?[33]

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[30] This could include, for example, prior risk management experience.

[31] Regulations 23.600(b)(5) and 1.11(d) require SDs and FCMs to establish and maintain RMUs with "qualified personnel." 17 CFR 23.600(b)(5); 17 CFR 1.11(d).

[32] See 17 CFR 23.600(b)(5). This concept relates to the fact that an RMU may be wholly "independent" from the business unit or business trading unit in terms of physical location and reporting lines, but that does not necessarily equate to freedom from undue influence. For example, during model validation activities, an SD's business trading unit, whose staff created the model, may try to improperly influence the RMU's model reviewer employees, who are undertaking an independent assessment of it.

[33] See 7 U.S.C. 1a(39) (defining the term "prudential regulator"). Non-U.S. SDs may also be subject to prudential supervision by regulatory authorities in their home jurisdiction.

7. Are there other portions of the RMP Regulations concerning governance that are not addressed above that the Commission should consider changing? Please explain.

B. Enumerated Risks in the Risk Management Program Regulations

The RMP Regulations specify certain enumerated risks that SDs' and FCMs' RMPs must consider. Specifically, Regulation 23.600(c)(1)(i) identifies specific areas of enumerated risk that an SD's RMP must take into account: market risk, credit risk, liquidity risk, foreign currency risk, legal risk, operational risk, and settlement risk.[34] Though not identical, Regulation 1.11(e)(1)(i) similarly lists specific areas of enumerated risk that an FCM's RMP must take into account: market risk, credit risk, liquidity risk, foreign currency risk, legal risk, operational risk, settlement risk, segregation risk, technological risk, and capital risk.[35]

Regulation 23.600(c)(4) requires that an SD's RMP include, but not be limited to, policies and procedures necessary to monitor and manage all of the risks enumerated in Regulation 23.600(c)(1)(i), as well as requiring that the policies and procedures for each such risk take into account specific risk management considerations.[36] In contrast, Regulation 1.11(e)(3) requires that an FCM's RMP include, but not be limited to, policies and procedures that monitor and manage segregation risk, operational risk, and capital risk, along with enumerating specific risk management considerations that are required to be included and/or addressed in the policies and procedures for these risks.[37] Unlike Regulation 23.600(c)(4), Regulation 1.11(e)(3) does not explicitly require policies and procedures, or enumerate attendant

[34] 17 CFR 23.600(c)(1).

[35] 17 CFR 1.11(e)(1)(i).

[36] 17 CFR 23.600(c)(4).

[37] 17 CFR 1.11(e)(3).

specific risk considerations, for all of the types of risk that must be taken into account by an FCM's RMP pursuant to Regulation 1.11(e)(1)(i), focusing instead on segregation, operational, and capital risks.

The Commission requests comment on SDs' and FCMs' enumerated risks generally, including: (a) whether specific risk considerations that must be taken into account with respect to certain enumerated risks should be amended; (b) whether definitions should be added for each enumerated risk; and finally, (c) whether the Commission should enumerate and define any additional types of risk in the RMP Regulations. In particular:

1. Should the Commission amend Regulation 1.11(e)(3) to require that FCMs' RMPs include, but not be limited to, policies and procedures necessary to monitor and manage all of the enumerated risks identified in Regulation 1.11(e)(1) that an FCM's RMP is required to take into account, not just segregation, operational, or capital risk (i.e., market risk, credit risk, liquidity risk, foreign currency risk, legal risk, settlement risk, and technological risk)? If so, should the Commission adopt specific risk management considerations for each enumerated risk, similar to those described in Regulation 23.600(c)(4)?
2. Regulation 23.600(c)(4)(i) requires SDs to establish policies and procedures necessary to monitor and manage market risk.[38] These policies and procedures must consider, among other things, "timely and reliable valuation data derived from, or verified by, sources that are independent of the business trading unit, and if derived from pricing models, that the

[38] 17 CFR 23.600(c)(4)(i).

models have been independently validated by qualified, independent external or internal persons."[39]

a. Does this validation requirement in Regulation 23.600(c)(4)(i)(B) warrant clarification?

b. Should validation, as it is currently required in Regulation 23.600(c)(4)(i)(B), align more closely with the validation of margin models discussed in Regulation 23.154(b)(5)?[40]

3. The policies and procedures mandated by Regulations 23.600(c)(4)(i) and (ii) to monitor and manage market risk and credit risk must take into account, among other considerations, "daily measurement of market exposure, including exposure due to unique product characteristics [and] volatility of prices," and "daily measurement of overall credit exposure to comply with counterparty credit limits."[41] To manage their risk exposures, SDs employ various financial risk management tools, including the exchange of initial margin for uncleared swaps. In that regard, the Commission has set forth minimum initial margin requirements for uncleared swaps,[42] which can be

[39] 17 CFR 23.600(c)(4)(i)(B).

[40] 17 CFR 23.154(b)(5) (outlining the process and requirements for the control, oversight, and validation mechanisms for initial margin models).

[41] 17 CFR 23.600(c)(4)(i)-(ii).

[42] 17 CFR 23.150-161. In adopting the margin requirements for uncleared swaps, the Commission noted that the initial margin amount required under the rules is a minimum requirement. See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636, 649 (Jan. 6, 2016). This is consistent with CEA section 4s(e), which directed the Commission to prescribe by rule or regulation minimum margin requirements for non-bank SDs. See 7 U.S.C. 6s(e)(2)(B).

calculated using either a standardized table or a proprietary risk-based model.[43] An SD's risk exposures to certain products and underlying asset classes may, however, warrant the collection and posting of initial margin above the minimum regulatory requirements set forth in the standardized table. Should the Commission expand the specific risk management considerations listed in Regulations 23.600(c)(4)(i)-(ii) to add that an SD's RMP policies and procedures designed to manage market risk and/or credit risk must also take into account whether the collection or posting of initial margin above the minimum regulatory requirements set forth in the standardized table is warranted?

4. The RMP Regulations enumerate, but do not define, the specific risks that SDs' and FCMs' RMPs must take into account. Should the Commission consider adding definitions for any or all of these enumerated risks? If so, should the enumerated risk definitions be identical for both SDs and FCMs?
5. The Federal Reserve and Basel III define "operational risk" as "the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events."[44] Would adding a definition of "operational risk" to the RMP Regulations that is closely aligned with this definition increase clarity and/or efficiencies for SD and FCM risk management practices, or otherwise be helpful? Should the Commission consider identifying specific sub-types of operational risk for purposes of the SD and FCM RMP requirements?

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[43] 17 CFR 23.154.

[44] 12 CFR 217.101(b); Basel Committee on Banking Supervision, "Calculation of RWA for Operational Risk" (Dec. 2019), available at https://www.bis.org/basel_framework/chapter/OPE/10.htm?inforce=20191215&published=20191215.

6. Technological risk is identified in Regulation 1.11(e)(1)(i) as a type of risk that an FCM's RMP must take into account; however, technological risk is not similarly included in Regulation 23.600(c)(1)(i) as an enumerated risk that an SD's RMP must address. Should the Commission amend Regulation 23.600(c)(1)(i) to add technological risk as a type of risk that SDs' RMPs must take into account?
   a. Should technological risk, if added for SDs, be identified as a specific risk consideration within operational risk, as described by Regulation 23.600(c)(4)(vi), or should it be a standalone, independently enumerated area of risk?
   b. If technological risk is added as its own enumerated area of risk, what risk considerations should an SD's RMP policies and procedures address, as required by Regulation 23.600(c)(4)?
   c. Relatedly, although technological risk is included in the various types of risk that an FCM's RMP must take into account, no specific risk considerations for technological risk are further outlined in Regulation 1.11(e)(3).[45] What, if any, specific risk considerations for technological risk should be added to Regulation 1.11(e)(3)? Should the Commission categorize any additional specific risk considerations for technological risk as a subset of the existing "operational risk" considerations in Regulation 1.11(e)(3)(ii), or should "technological risk" have its own independent category of specific risk considerations in Regulation 1.11(e)(3)?

[45] See 17 CFR 1.11(e)(1)(i); cf. 17 CFR 1.11(e)(3)(i)-(iii).

d. Should the Commission define "technological risk" in the RMP Regulations? For example, Canada's Office of the Superintendent of Financial Institutions (OSFI) defines "technology risk" as "the risk arising from the inadequacy, disruption, destruction, failure, damage from unauthorized access, modifications, or malicious use of information technology assets, people or processes that enable and support business needs and can result in financial loss and/or reputational damage."[46] If the Commission were to add a definition of "technological risk" to the RMP Regulations, should it be identical or similar to that recently finalized by OSFI?[47] If not, how should it otherwise be defined? Should the Commission consider different definitions of "technological risk" for SDs and FCMs? Should the Commission consider providing examples of "information technology assets" to incorporate risks that may arise from the use of certain emerging technologies, such as artificial intelligence and machine learning technology, distributed ledger technologies (e.g., blockchains), digital asset and smart contract-related applications, and algorithmic and other model-based technology applications?

7. Are there any other types of risk that the Commission should consider enumerating in the RMP Regulations as risks required to be monitored and managed by SDs' and FCMs'

[46] See OSFI Guideline B-13, Technology and Cyber Risk Management (July 2022), available at https://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/b13.aspx. The final Guideline B-13 will be effective as of January 1, 2024.

[47] The prudential regulators and the Securities and Exchange Commission (SEC) have not yet proposed or adopted definitions of "technological risk." Accordingly, Commission staff turned to non-U.S. financial regulators for potential definitions of this term. Canada's OSFI recently finalized its definition of "technology risk," following extensive engagement with industry and the public that included the September 2020 publication of its discussion paper and a consultation period from September to December 2020; the issuance of proposed guidance in November 2021; and further consultation on its proposed guidance from November 2021 to February 2022. See OSFI Releases New Guideline for Technology and Cyber Risk, Balancing Innovation with Risk Management (July 13, 2022), available at https://www.osfi-bsif.gc.ca/Eng/osfi-bsif/med/Pages/b13-nr.aspx.

RMPs? Geopolitical risk? Environmental, social and governance (ESG) risk? Climate-related financial risk, including physical risk and transition risk such as the energy transition? Reputational risk? Funding risk? Collateral risk? Concentration risk? Model risk? Cybersecurity risk? Regulatory and compliance risk arising from conduct in foreign jurisdictions? Contagion risk?

a. Should these potential new risks be defined in the RMP Regulations?

b. With respect to each newly suggested enumerated risk, what, if any, specific risk considerations should an SD's or FCM's RMP policies and procedures be required to include?

c. Are there international standards for risk management with which the Commission should consider aligning the RMP Regulations?

C. <u>Periodic Risk Exposure Reporting by Swap Dealers and Futures Commission Merchants</u>

In accordance with Regulation 23.600(c)(2), an SD must provide to its senior management and governing body a quarterly RER containing specific information on the SD's risk exposures and the current state of its RMP; the RER shall also be provided to the SD's senior management and governing body immediately upon the detection of any material change in the risk exposure of the SD.[48] SDs are required to furnish copies of all RERs to the Commission within five (5) business days of providing such RERs on a quarterly basis to their

[48] 17 CFR 23.600(c)(2). SD RERs shall "set[] forth the market, credit, liquidity, foreign currency, legal, operational, settlement, and any other applicable risk exposures of the [SD] …; any recommended or completed changes to the [RMP]; the recommended time frame for implementing recommended changes; and the status of any incomplete implementation of previously recommended changes to the [RMP]." <u>Id.</u>

senior management.[49] Likewise, Regulation 1.11(e)(2) has an identical RER requirement for FCMs.[50]

This Notice seeks comment generally on how the current RER regime for SDs and FCMs could be improved, as well as specific responses to the questions listed below:

1. At what frequency should the Commission require SDs and FCMs to furnish copies of their RERs to the Commission?
2. Should the Commission consider changing the RER filing requirements to require filing with the Commission by a certain day (e.g., a week, month, or other specific timeframe after the quarter-end), rather than tying the filing requirement to when the RER is furnished to senior management?
3. Should the Commission consider harmonizing or aligning, in whole or in part, the RER content requirements in the RMP Regulations with those of the National Futures Association (NFA)'s SD monthly risk data filings?[51]
    a. If so, should the Commission consider any changes or additions to the data metrics currently collected by NFA as could be required in the RMP Regulations?
    b. For FCMs who are not currently required to file monthly risk data filings with NFA, were the Commission to adopt a monthly risk exposure reporting

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[49] 17 CFR 23.600(c)(2)(ii).

[50] 17 CFR 1.11(e)(2).

[51] SDs must report certain metrics related to market and credit risk, including Value at Risk (VaR) for interest rates, credit, forex, equities, commodities, and total VaR; total stressed VaR; interest rate sensitivity by tenor bucket; credit spread sensitivity; forex market sensitivities; commodity market sensitivities; total swaps current exposure before collateral; total swaps current exposure net of collateral; total credit valuation adjustment or expected credit loss; and largest swaps counterparty current exposures. See NFA, Notice I-17-10: Monthly Risk Data Reporting Requirements for Swap Dealers (May 30, 2017), available at https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4817.

requirement, are there different risk data metrics for FCMs that it should consider including? If so, what are they?

4. Are there additional SD or FCM-specific data metrics or risk management issues that the Commission should consider adding to the content requirements of the RER?
5. Should the Commission consider prescribing the format of the RERs? For instance, should the Commission consider requiring the RER to be a template or form that SDs and FCMs fill out?
6. In furtherance of the RER filing requirement, should the Commission consider allowing SDs and FCMs to furnish to the Commission the internal risk reporting they already create, maintain, and/or use for their risk management program?
    a. If so, how often should these reports be required to be filed with the Commission?
    b. If the Commission allowed an SD or FCM to provide the Commission with its own risk reporting, should the Commission prescribe certain minimum content and/or format requirements?
7. Should the Commission consider prescribing the standard SDs and FCMs use when determining whether they have experienced a material change in risk exposure, pursuant to Regulations 23.600(c)(2)(i) and 1.11(e)(2)(i)? Alternatively, should the Commission continue to allow SDs and FCMs to use their own internally-developed standards for determining when such a material change in risk exposure has occurred?
8. Should the Commission clarify the requirements in Regulations 23.600(c)(2)(i) and 1.11(e)(2)(i) that RERs "shall be provided to the senior management and the governing body immediately upon detection of any material change in the risk exposure" of the SD or FCM?

9. Should the Commission consider setting a deadline for when an SD or FCM must notify the Commission of any material changes in risk exposure? If so, what should be the deadline?
10. Should the Commission consider additional governance requirements in connection with the provision of the quarterly RER to the senior management and the governing body of a SD, or of an FCM, respectively?
11. Should the Commission require the RERs to report on risk at the registrant level, the enterprise level (in cases where the registrant is a subsidiary of, affiliated with, or guaranteed by a corporate family), or both? What data metrics are relevant for each level?
12. Should the Commission require that RERs contain information related to any breach of risk tolerance limits described in Regulations 23.600(c)(1)(i) and 1.11(e)(1)(i)? Alternatively, should the Commission require prompt notice, outside of the RER requirement, of any breaches of the risk tolerance limits that were approved by an SD's or FCM's senior management and governing body? Should there be a materiality standard for inclusion of breaches in RERs or requiring notice to the Commission?
13. Should the Commission require that RERs contain information related to material violations of the RMP policies or procedures required in Regulations 23.600(b)(1) and 1.11(c)(1)?
14. Should the Commission require that RERs additionally discuss any known issues, defects, or gaps in the risk management controls that SDs and FCMs employ to monitor and manage the specific risk considerations under Regulations 23.600(c)(4) and

1.11(e)(3), as well as including a discussion of their progress toward mitigation and remediation?

D. Other Areas of Risk

Recent market, credit, operational, and geopolitical events have highlighted the critical importance of risk management and the need to periodically review risk management practices. Therefore, the Commission is interested in feedback and comment on other RMP-related topics, specifically: (1) the segregation of customer funds and safeguarding of counterparty collateral, and (2) risks posed by affiliates, lines of business, and other trading activity. The Commission continues to have confidence in its regulations governing the segregation of customer funds in traditional derivatives markets. The questions below are intended to assist the Commission in its ongoing evaluation of whether and how RMP regulations and practices at FCMs and SDs adequately and comprehensively address risks arising from new or evolving market structures, products, and registrants.

a. Potential Risks Related to the Segregation of Customer Funds and Safeguarding Counterparty Collateral

The segregation of customer funds and safeguarding of counterparty collateral are cornerstones of the Commission's FCM and SD regulatory regimes, respectively. Currently, the existing RMP Regulations address the management of segregation risk and the safeguarding of counterparty collateral in different ways, given the differing business models between FCMs and SDs. Regulation 1.11(e)(3)(i) requires an FCM's RMP to include written policies and procedures "reasonably designed to ensure segregated funds are separately accounted for and segregated or secured as belonging to customers."[52] This requirement further lists several

[52] 17 CFR 1.11(e)(3)(i).

subjects that must, "at a minimum," be addressed by an FCM's RMP policies and procedures, including the evaluation and monitoring process for approved depositories, the treatment of related residual interest, transfers, and withdrawals, and permissible investments.

Although Regulation 23.600(c)(6) of the SD RMP Regulations requires compliance with all capital and margin requirements, Regulation 23.600 does not explicitly require an SD's RMP to include written policies and procedures to safeguard counterparty collateral. Rather, the Commission chose to adopt Regulations 23.701 through 23.703 for the purpose of establishing a separate framework for the elected segregation of assets held as collateral in uncleared swap transactions.[53] Additionally, the Commission requires certain initial margin to be held through custodial arrangements in accordance with Regulation 23.157.[54]

The Commission seeks comment generally on the risks attendant to the segregation of customer funds and the safeguarding of counterparty collateral. In addition, commenters should seek to address the following questions:

1. Do the current RMP Regulations for FCMs adequately and comprehensively require them to identify, monitor, and manage the risks associated with the segregation of customer funds and the protection of customer property? Are there other Commission regulations that address these risks for FCMs?
2. Currently, the Commission understands that no FCM holds customer property in the form of virtual currencies or other digital assets such as stablecoins. To the extent that FCMs may consider engaging in this activity in the future, would the current RMP Regulations

[53] 17 CFR 23.701-23.703.

[54] 17 CFR 23.157.

for FCMs adequately and comprehensively require them to identify, monitor, and manage the risks associated with that activity, including custody with a third-party entity?

3. Do the current RMP Regulations for SDs adequately and comprehensively require them to identify, monitor, and manage all of the risks associated with the collection, posting, and custody of counterparty collateral and the protection of such assets? Are there any other risks that should be addressed by the RMP Regulations for SDs related to the collection, posting, and custody of counterparty collateral?
4. Do the Commission's RMP Regulations adequately address risks to customer funds or counterparty collateral that may be associated with SDs and FCMs that have multiple business lines and registrations? Although the Commission understands that SDs and FCMs currently engage in limited activities with respect to digital assets, should the Commission consider additional RMP requirements applicable to SDs and FCMs that are or may become involved in, or affiliated with, the provision of digital asset financial services or products (e.g., digital asset lending arrangements or derivatives)?

b. Potential Risks Posed by Affiliates, Lines of Business, and All Other Trading Activity

In light of increasing market volatility and recent market disruptions, as well as the growth of digital asset markets, the Commission generally seeks comment on the risks posed by SDs' and FCMs' affiliates and related trading activity. Generally, the RMP Regulations require SD and FCM RMPs to take into account risks posed by affiliates and related trading activity. Specifically, Regulation 23.600(c)(1)(ii) requires an SD's RMP to take into account "risks posed by affiliates" with the RMP integrated into risk management functions at the "consolidated entity

level."[55] Similarly, Regulation 1.11(e)(1)(ii) requires an FCM's RMP to take into account risks "posed by affiliates, all lines of business of the [FCM], and all other trading activity engaged in by the [FCM]."[56]

Some SDs and FCMs are subject to regulatory requirements designed to mitigate certain risks arising from certain affiliate activities. For example, SDs and FCMs that are affiliates or subsidiaries of a banking entity may have to comply with certain restrictions and requirements on inter-affiliate activities. Further, those SDs and FCMs that are subject to the Volcker Rule, codified and implemented in part 75 of the Commission's regulations, and incorporated into other requirements, such as Regulation 3.3, are subject to the Volcker Rule's risk management program and compliance program requirements.[57]

The Commission seeks comment generally on the requirements related to risks posed by affiliates and related trading activity found within the RMP Regulations for SDs and FCMs, including non-bank affiliated SDs or non-bank affiliated FCMs. In addition, commenters should seek to address the following questions:

1. What risks do affiliates (including, but not limited to, parents and subsidiaries) pose to SDs and FCMs? Are there risks posed by an affiliate trading in physical commodity markets, trading in digital asset markets, or relying on affiliated parties to meet regulatory requirements or obligations? Are there contagion risks posed by the credit exposures of affiliates? Are there risks posed by other lines of business of an SD, or of an FCM, respectively, that are not adequately or comprehensively addressed by the Commission's

[55] 17 CFR 23.600(c)(1)(ii).

[56] 17 CFR 1.11(e)(1)(ii).

[57] 17 CFR pt. 75; 17 CFR 3.3.

regulations, including, as applicable, the Volcker Rule regulations found in 17 CFR part 75?

2. Do the current RMP Regulations adequately and comprehensively address the risks associated with the activities of affiliates (whether such affiliates are unregulated, less regulated, or subject to alternative regulatory regimes), or of other lines of business, of an SD or of an FCM, respectively, that could affect SD or FCM operations? Alternatively, to what extent are the risks posed by affiliates discussed in this section adequately addressed through other regulatory requirements (for example, the Volcker Rule or other prudential regulations, or applicable non-U.S. laws, regulations, or standards)?
3. Should the Commission further expand on how SD and FCM RMPs should address risks posed by affiliates in the RMP Regulations, including any specific risks? Should the Commission consider enumerating any specific risks posed by affiliates or related trading activities within the RMP Regulations, either as a separate enumerated risk, or as a subset of an existing enumerated area of risk (e.g., operational risk, credit risk, etc.)?