



# Commodity Futures Trading Commission

## Office of Public Affairs

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## Proposed Rule on Governance Requirements for DCOs, DCMs and SEFs, & Additional Requirements Regarding the Mitigation of Conflict of Interest

The Commodity Futures Trading Commission (“Commission”) is proposing 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”). For DCOs and DCMs, the Commission is also proposing regulations to implement core principles concerning governance fitness standards and the composition of governing bodies. For publicly-traded DCMs, the Commission is proposing regulations to implement the core principle on diversity of Boards of Directors.

### Rulemaking Complements Conflicts of Interest Rulemaking Proposed October 1, 2010

On October 1, 2010, the Commission proposed<sup>1</sup> both (i) structural governance requirements and (ii) limits on voting equity and exercise of voting power to mitigate potential conflicts of interest pursuant to Section 726 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) and also the conflicts of interest core principles.<sup>2</sup> This proposed rulemaking aims to more fully implement the Conflict of Interest Core Principles by addressing reporting, transparency in decision-making, and limitations on use or disclosure of non-public information, among other things.

### Dodd-Frank Act

Sections 725(c), 735(b) and 733 of the Dodd-Frank Act establish new, or amend existing, Core Principles for DCOs, DCMs, and SEFs.

The Conflict of Interest Core Principles empower the Commission to develop standards for determining whether DCOs, DCMs, and SEFs have rules to minimize and resolve conflicts of interest in decision-making.

In addition, for DCMs and DCOs, the governance fitness core principles in Sections 725(c) and 735(b) of the Dodd-Frank Act empower the Commission to develop standards for determining whether the registered entity has appropriate fitness standards for directors, members, and others.

The governing board composition core principle in Section 735(b) requires that each DCM have a process for considering the range of opinions of market participants. The governing board or committee composition core principle in Section 725(c) requires that each DCO ensure that the composition of the governing board or committee includes market participants.

Finally, Section 735(b) provides that the Commission develop standards for implementing the core principle on diversity of boards for publicly-traded DCMs.

<sup>1</sup> 75 FR 63732 (Oct. 18, 2010) (“Conflicts of Interest NPRM”).

<sup>2</sup> The conflicts of interest core principles are DCO Core Principle P, DCM Core Principle 16, and SEF Core Principle 12 (“Conflicts of Interest Core Principles”).

## Summary of Proposed Requirements

The Conflicts of Interest Core Principles require each entity to (i) establish and enforce rules to minimize conflicts of interest in its decision-making process and (ii) establish a process for resolving such conflicts. The Commission is proposing the following requirements, which complement those requirements proposed in the Conflicts of Interest NRPM.

To further implement the Conflicts of Interest Core Principles, the Commission proposes the following regulations:

- Each DCO must report to the Commission when its board rejects a recommendation from or supersedes an action of the Risk Management Committee.
- Each DCM or SEF must report to the Commission when its board rejects a recommendation from or supersedes an action of the Regulatory Oversight Committee or the Membership or Participation Committee.
- Each DCO, DCM, or SEF must:
  - implement a regulatory program to identify, on an ongoing basis, existing and potential conflicts of interest, as well as a method for making fair and non-biased decisions in the event of such a conflict;
  - prescribe limits on the use or disclosure of non-public information by owners, members of the board, members of any committee, officers or other employees; and
  - make certain information on governance arrangements available to the public and relevant authorities, including summaries of significant decisions.<sup>3</sup>

To implement DCM Core Principle 15 and DCO Core Principle O on governance fitness standards, the Commission is proposing that each DCO or DCM specify and enforce minimum fitness standards for its members, directors, members of any Disciplinary Panel or Disciplinary Committee, and certain affiliates. To implement the additional language in Core Principle O requiring each DCO to establish governance arrangements that are transparent to permit, among other things, the consideration of the views of owners and participants, the Commission proposes certain transparency requirements.

To implement DCM Core Principle 17 on governing board composition, the Commission is proposing that each DCM 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 and (ii) new rules or rule amendments.

To implement DCO Core Principle Q on governing board or committee composition, the Commission is proposing 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 Commission is proposing 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.

To implement DCM Core Principle 22 regarding diversity, the Commission is proposing that each publicly-traded DCM evaluate the breadth and cultural diversity of its Board of Directors.

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<sup>3</sup> With respect to a DCM or SEF, significant decisions would relate to access, membership, and disciplinary procedures. With respect to a DCO, significant decisions would relate to open access, membership, and the determination of acceptability of products for clearing. The Commission does not intend the foregoing to require a DCM, SEF, or DCO to disclose any “non-public information” (as defined in this rulemaking in proposed §1.3(ggg)) including, without limitation, meeting minutes.