›nodalclear

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June 6, 2022

VIA CFTC PORTAL

Commodity Futures Trading Commission
Attention: Chris Kirkpatrick, Secretary
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: CFTC Regulation 40.6(a) Certification: Various Amendments to Nodal Clear Rules

Dear Mr. Kirkpatrick:

Pursuant to Commodity Futures Trading Commission ("Commission" or "CFTC") Regulation 40.6(a), Nodal Clear, LLC ("Nodal Clear" or the "Clearing House") hereby notifies the Commission that it is self-certifying amendments to the Nodal Clear Rulebook (collectively, the "Rule Amendments").[1] The Rule Amendments are attached hereto. The Rule Amendments document indicates the specific text that is being amended. The Rule Amendments shall become effective on June 21, 2022. The Rule Amendments were discussed at a meeting of Nodal Clear's Risk Advisory Committee ("RAC")[2] and Nodal Clear Clearing Members were given the opportunity to review and comment on the Rule Amendments prior to this filing.

Nodal Clear proposes to adopt Rule Amendments that:

(i) enhance Nodal Clear's management of defaults with the creation of Exchange Contract Segments that prioritize the use of default resources associated with the Exchange Contract Segment from which the loss originated;

(ii) revise Nodal Clear's methodology for calculating a Clearing Member's Guaranty Fund Deposit Requirement;

(iii) expressly provide for and describe the process for variation margin gains haircutting ("VMGH") and contract tear-up in the event funded resources and assessments are insufficient to manage a Clearing Member default; and

(iv) provide for various other clarifications and conforming changes.

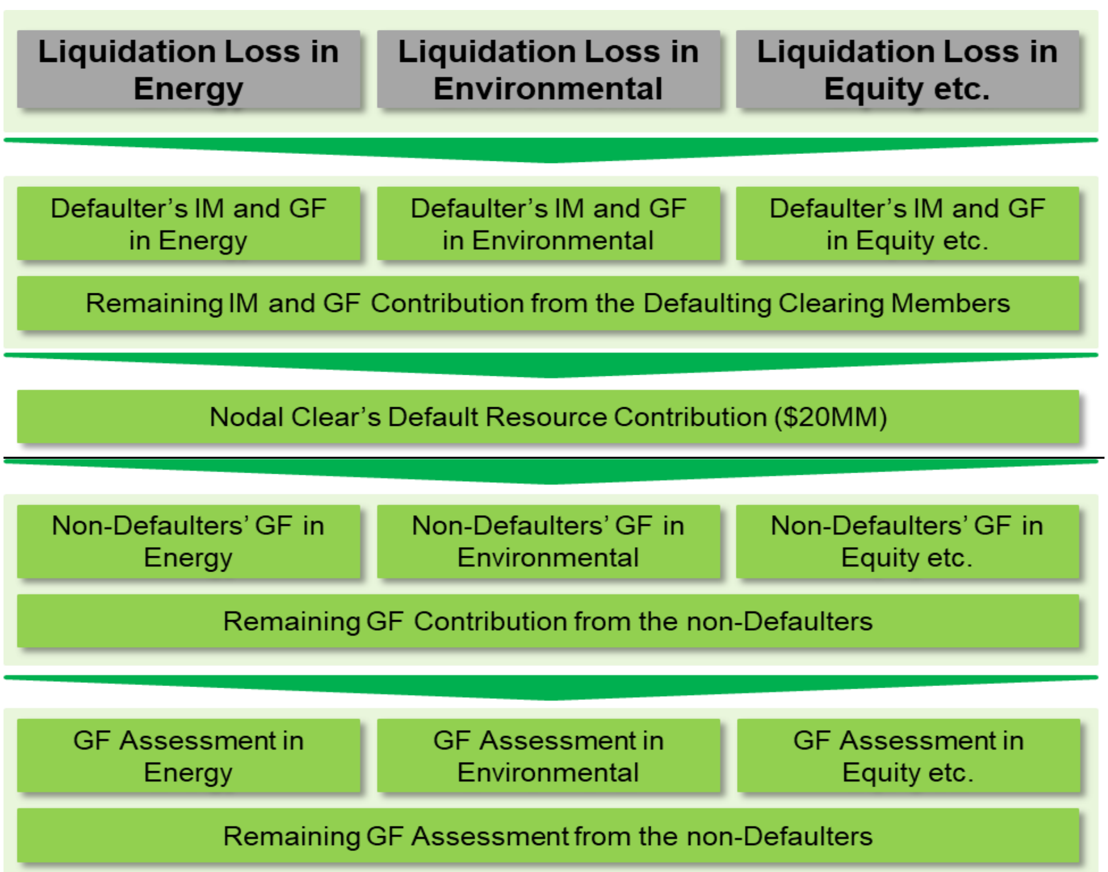
(i) Prioritization of Default Resources by Exchange Contract Segment

The Rule Amendments provide for, among other things, the creation of Exchange Contract Segments whereby each Exchange Contract is associated with an Exchange Contract Segment determined by Nodal Clear. For example, environmental contracts offered by Nodal Exchange could be placed in the environmental Exchange Contract

[1] Capitalized terms not defined herein have the meaning set forth in the Nodal Clear Rulebook.
[2] The RAC advises Nodal Clear in managing the risk associated with being the central counterparty to contracts cleared by Nodal Clear. The RAC is Chaired by Nodal Clear's Chief Risk Officer and membership consists of Nodal Clear Clearing Member representatives.

Segment while power contracts could be placed in an energy Exchange Contract Segment. This "Segmentation Approach" is intended to enhance risk segregation by reducing Guaranty Fund exposure due to a default in a product class that is not cleared by a non-defaulting Clearing Member (e.g., where a Clearing Member clears only energy contracts, but the default occurs in equity derivatives). While the Rule Amendments do not eliminate a non-defaulting Clearing Member's exposure to mutualized losses from the use of the Guaranty Fund, the prioritized use of the Guaranty Fund by Exchange Contract Segment reduces the likelihood of such loss. For example, if a non-defaulting Clearing Member supports only environmental contracts and there is a default in the energy Exchange Contract Segment that requires use of the Guaranty Fund, those Guaranty Funds associated with the energy Exchange Contract Segment would be used prior to the use of Guaranty Funds associated with other Exchange Contract Segments. Importantly, the full Guaranty Fund remains available to Nodal Clear for the management of a default. Each Clearing Member is able to control whether it falls under an Exchange Contract Segment via its trading activity and the activity of its Customers. As provided in the Rule Amendments, Nodal will provide advance notice to Clearing Members when making material changes to existing Exchange Contract Segments and will not make material changes to an Exchange Contract Segment when a Clearing Member is in default and the default is being actively managed.

In order to associate losses with the appropriate Exchange Contract Segment, Nodal Clear will track losses arising from the liquidation of the defaulting Clearing Member's and its Customers' positions and prioritize the use of the defaulting Clearing Member's initial margin and guaranty fund contribution by Exchange Contract Segment (as detailed in the below graphic).



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Rule Amendments - Prioritization of Default Resources by Exchange Contract Segment

- Rule 3.34.1(f) is amended to define the term "Exchange Contract Segment".
- Rule 3.34.2(c) is added to describe the Clearing House's authority to define and redefine the Exchange Contract Segments. However, the rule also provides that the Clearing House will provide advance notice to the Clearing Members when making material changes to the segments of the existing contracts and would not make segment changes during a default.
- Rule 3.35(v) is added to prioritize the use of default funds (i.e., initial margin and defaulting Clearing Members Guaranty Fund deposit) if the loss is associated with an Exchange Contract Segment. For example, if there are losses after liquidation of a defaulting Clearing Member's energy positions, the defaulting Clearing Member's Guaranty Fund deposit and margin associated with the energy Exchange Contract Segment would be applied first followed by the remainder of the defaulting Clearing Member's Guaranty Fund deposit and margin.
- Rule 3.35(b)(iv) is amended to provide for the prioritized use of that portion of the Guaranty Fund (on a pro rata basis) allocated to an Exchange Contract Segment where the Defaulted Obligation(s) originates. After the depletion of the Guaranty Funds allocated to the Exchange Contract Segment where the Default(s) originated, the remainder of the Guaranty Fund Deposits will be utilized on a pro-rata basis.
- Rule 3.35(l) is added to prioritize the use of Assessments collected from Clearing Members participating in the Exchange Contract Segment that gave rise to the defaulted obligation. Existing Assessment caps remain in place.
- Rule 3.40.1 is added to provide for VMGH (discussed further below) for the Exchange Contract Segment associated with the Defaulted Obligation.

(ii) <u>Guaranty Fund Deposit Requirements</u>

Nodal Clear's Rulebook has rules describing the calculation of the Guaranty Fund Deposit Requirement for each Clearing Member. The Rule Amendments revise Nodal Clear's methodology for calculating the Guaranty Fund Deposit Requirement by including uncovered stress loss and the volume of contracts cleared by the Clearing Member in the calculation. Prior to the Rule Amendment, the Guaranty Fund Deposit Requirement was based on the Clearing Member's share of Initial Margin and possibly a margin surcharge. Nodal Clear believes that Initial Margin provides a general view of the risks carried by a Clearing Member while uncovered stress loss provides a view as to Clearing Member risks under various extreme but plausible market conditions. During the consultation process, some Clearing Members suggested that a Clearing Member's trading volume also be included as a component in the calculation of the Guaranty Fund Deposit Requirement. The Clearing Members noted that a Clearing Member could have substantial intraday activity while carrying little open interest and such activity could bring risk (in the event of default during the trading day when the intraday positions are still open) to the clearing house that might not be reflected in initial margin or uncovered stress loss figures. Accordingly, the Rule Amendments include a Clearing Member's volume as a factor in the determination of the Clearing Member's Guaranty Fund Deposit Requirement. A Clearing Member's Guaranty Fund Deposit Requirement will be determined at the Exchange Contract Segment level and will consider the Clearing Member's Base Margin Amount, Base Uncovered Stress Loss Amount, Base Volume Amount, and Guaranty Fund Deposit Surcharge.

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Rule Amendments – Guaranty Fund Deposit Requirements

- Rule 3.34.1 is amended to include new terms Base Uncovered Stress Loss Amount, Base Volume Amount, and Guaranty Fund Deposit Surcharge.
- Rule 3.34.2 is amended to include Base Uncovered Stress Loss Amount, Base Volume Amount, and Guaranty Fund Deposit Surcharge in the description of the Guaranty Fund Deposit Requirement definition.

(iii) VMGH and Tear-up

Nodal Clear's Rulebook contains rules that explicitly address any losses that Nodal Clear may face as a result of a single or multiple Clearing Member default. Rule 3.35 of the Nodal Clear Rulebook contains the Nodal Clear default waterfall as well as rules for further assessments of Clearing Members.

Nodal Clear's default waterfall provides that the defaulting Clearing Member's resources are first used to cure the default. If the defaulting Clearing Member's resources are exhausted before the default has been cured, then Nodal Clear may next use any surpluses of Nodal Clear that the Board determines are available for such purpose, any lines of credit, and then the Clearing House Contribution of $20 million. Should these resources also be exhausted before the default has been cured, Nodal Clear will next apply the Guaranty Fund resources from non-defaulting Clearing Members. Should the resources of the Guaranty Fund be exhausted before the default has been cured, Nodal Clear will assess the surviving Clearing Members for additional contributions. Pursuant to the Nodal Clear Rulebook, in the unlikely event that the losses arising from the default of one or more Clearing Members on obligations to the Clearing House exceed the default waterfall resources and assessments, Nodal Clear may become subject to a bankruptcy proceeding and liquidation unless Nodal Clear implements temporary emergency procedures, such as changing the amount of money to be paid in connection with an Exchange Contract.[3] However, emergency rules and procedures are highly discretionary and therefore unpredictable making it difficult for Clearing Members to manage their exposure to such rules. Where possible, Nodal Clear believes it is better for all parties to have an *ex ante* understanding of the tools available to the Clearing House in the event a default losses exceed default waterfall resources and assessments. Accordingly, in order to facilitate the continuity of Nodal Clear's clearing services in a transparent and predictable manner, in the unlikely event that the losses arising from the default of one or more Clearing Members exceed the default waterfall resources and assessment, Nodal Clear presents rule changes to add i) VMGH and (ii) partial tear-up to its Rulebook.

Rule Amendments – VMGH and Tear-up

Variation Margin Gains Haircuts

- Rule 3.40 is added to establish a procedure for VMGH for only the Exchange Contract Segment associated with the Defaulted Obligation,[4] which permits Nodal Clear to not pay the full Variation Margin Gain owed to a Clearing Member in order to cover liquidation expenses from the defaulting Clearing Member. In order to enact a VMGH cycle, Nodal Clear must provide notice to Clearing Members of the VMGH settlement cycle. During the VMGH cycle, Nodal Clear will collect all Variation Margin Losses (payments from non-defaulting Clearing Members that hold Exchange Contracts in the Exchange Contract Segment associated with the Defaulted Obligation) and distribute Variation Margin Gains (payments to non-defaulting Clearing Members that hold Exchange Contracts in the Exchange Contract Segment associated with the Defaulted Obligation) pro rata to Variation Margin gainers to ensure cumulative cash flow to the Clearing House equals that from

[3] See Nodal Clear Rule 2.9.2.
[4] Unless otherwise determined by the Chief Risk Officer. See Nodal Clear Rule 3.40.1.

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the Clearing House during this cycle. During the VMGH cycle, Nodal Clear will maintain a running total of gains and losses for each Non-Defaulting Clearing Member to determine the haircut amount. Clearing Members are obligated to pay full collection amounts to the Clearing House during the haircutting cycle. Participation in the haircutting cycle is mandatory for all non-defaulting Clearing Members.

The VMGH cycle is three Business Days but the Nodal Clear Risk Management Committee ("RMC") may extend or reduce it by one to two Business Days, such that the maximum number of days with VMGH is five Business Days. In connection with such a decision, the RMC would likely consider: (i) the existing facts and circumstances; (ii) any recommendations made by the Nodal Clear RAC; (iii) whether such decision would be in furtherance of the integrity of the Clearing House and stability of the financial system; and (iv) the legitimate interests of Clearing Members and Customers of Clearing Members.

Voluntary Contributions

If the conditions in Nodal Clear Rules 3.40.1 – 3.40.2(d) are met, then pursuant to added Nodal Clear Rule 3.40.2(e)(i) the Clearing House shall provide Clearing Members and their Customers an opportunity to make voluntary contributions to assist in curing remaining losses. The incentive for Clearing Members and their Customers to provide voluntary contributions to the Clearing House is to avoid VMGH and enhance their likelihood of reimbursement in the event losses are recovered from the Defaulting Clearing Member.[5]

Tear-Up

- Rule 3.41 is added to provide for a partial tear-up process if House or Customer positions in Exchange Contracts of a Defaulting Clearing Member remain open following the last VMGH settlement cycle. This tool can be implemented during either the intra-day or end-of-day settlement cycles once a settlement price is determined per Nodal Clear Rule 3.41 and involved parties are notified, and is expected to be completed in that same settlement cycle. The RMC shall determine the appropriate scope of each Partial Tear-Up or shall determine that a Full Tear-Up is appropriate. In determining the scope of a Tear-Up, the RMC shall consider then existing known facts and circumstances, any recommendations made by the RAC, the furtherance of the integrity of the Clearing House and the stability of the financial system and the legitimate interests of Clearing Members and market participants.

Voluntary Partial Tear-Up

Pursuant to added Nodal Rule 3.41.1, at any time following the default of a Clearing Member, the Clearing House may notify Clearing Members and provide an opportunity for Clearing Members to voluntarily agree to have their House positions or, with a Customer's consent, to agree to have each such Customer's positions, extinguished by the Clearing House. Nodal Clear would quickly identify and approach Clearing Members whose positions, or whose Customers' positions, are on the opposite side of defaulting Clearing Members' or its Customers' positions that remain open. Such Clearing Members or their Customers, as applicable, could agree voluntarily to tear-up such positions in part or in full in a manner that would reestablish a matched book. The incentive for Clearing Members and their Customers to agree to take a loss and participate in a voluntary partial tear-up is to help Nodal Clear reestablish a matched book; avoid the consequences of VMGH, Partial Tear-Ups, and/or a Full Tear-Up; enhance their likelihood of reimbursement in the event losses are recovered from the Defaulting Clearing Member.[6]

[5] See Nodal Clear Rule 3.43.
[6] *Id*.

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(iv) <u>Clarifications and Conforming Changes</u>

- 3.35(e) is amended to clarify that the Guaranty Fund Deposit Requirement immediately prior to the occurrence of the Monetary Default is the value used to determine a non-defaulting Clearing Member's assessment liability in the case of a single Clearing Member default.
- 3.35(j) is added to make clear that VMGH and Tear-Ups are not Assessments and are therefore not subject to Assessment limits.
- Rule 3.42 is added to provide that no Clearing Member and no Customer of a Clearing Member shall institute against, or join any other person in instituting against, Nodal Clear any bankruptcy, reorganization or other similar proceedings under U.S. federal or state bankruptcy laws or other applicable law arising out of any claimed default by the Clearing House on an Exchange Contract as a result of the extinguishment, partial extinguishment, or VMGH of such Exchange Contract and related payments in accordance with these Rules. Rule 3.42 is intended to provide certainty and finality with respect to VMGH, Partial Tear-Up, and Full Tear-up and should enable Nodal Clear to avoid a Bankruptcy Event.
- 3.43 is added to provide for the reimbursement of non-defaulting Clearing Members for losses caused by a defaulting Clearing Member, to the extent such losses are recovered from the defaulting Clearing Member. Further, Rule 3.43 provides detail and clarity as to the prioritized allocation process for such recovered losses.

<u>Analysis of the Rule Amendments under DCO Core Principles</u>

Nodal Clear management has assessed the Rule Amendments and their compliance with applicable provisions of the Commodity Exchange Act ("CEA"), including the Commission's Regulations and DCO Core Principles. Nodal Clear has identified that the Rule Amendments may have some bearing on the following Core Principles:

Core Principle B – Financial Resources: The Rule Amendments will not impact Nodal Clear's ability to discharge its financial, operational, or managerial responsibilities as a DCO. Nodal Clear will continue to maintain a Guaranty Fund that consists of resources sufficient to cover the loss that would result from a default by the two Clearing Members creating the largest combined financial exposure to Nodal Clear in extreme but plausible market conditions ("Cover 2") and the full Guaranty Fund remains available to manage a default(s).

Core Principle C – Participant and Product Eligibility: The Rule Amendments will not impact product eligibility at Nodal Clear. Nodal Clear will continue to determine whether a product is suitable for clearing based on its existing processes. The Exchange Contract Segment assignment will then be evaluated after product eligibility is determined.

Core Principle E – Settlement Procedures: If the loss stemming from a Monetary Default is such that it exceeds assets available to cover the Clearing Member's Defaulted Obligation under Nodal Clear Rule 3.35, Nodal Clear can conduct up to three days of VMGH settlement cycles. Nodal Clear will collect from the Clearing Members with net portfolio losses, and will make payments to non-defaulting Clearing Members with net portfolio gains. Nodal Clear's payments to non-defaulting Clearing Members would be haircut to reflect the shortage of payments collected by the Clearing House during the settlement cycle. The RMC may instruct the Clearing House to extend or reduce the duration of VMGH settlement cycles by one or two Business Days, such that the maximum number of days with VMGH is five Business Days.

Core Principle G – Default Rules And Procedures: Consistent with CFTC Regulation 39.35, adding VMGH and voluntary contributions to the Rulebook specifically addresses how Nodal Clear would allocate losses that exceed the financial resources available to Nodal Clear under the Rulebook. The Rule Amendments are consistent with rules and procedures designed to allow for the efficient, fair, and safe management of a default as they enhance the allocation of losses, prioritizing losses among Clearing Members participating in the Exchange Contract Segment were the default occurred thereby allowing Clearing Members to mitigate their risk of exposure to mutualized losses.

Core Principle L – Public Information: As required by Core Principle L, Nodal Clear is publicly posting this self-certification letter on its website to ensure that market participants receive advance notice of the updated Nodal Clear Rules. On the effective date of the Rule Amendments, the updated Nodal Clear Rules will be posted on the Nodal Clear website.

Core Principle O – Governance Fitness Standards: The Rule Amendments provide that the RMC will determine whether to extend or reduce the duration of VMGH and the appropriate scope of tear-ups. The RAC may provide ad hoc recommendations to the Clearing House and the RMC.

Core Principle P – Conflicts of Interest: The Rule Amendments provide that the RMC will determine whether to extend or reduce the duration of VMGH and the appropriate scope of tear-ups. The RAC may provide ad hoc recommendations to the Clearing House and the RMC. Pursuant to the Rule Amendments, the RMC must consider then existing known facts and circumstances, any recommendations made by the RAC, the furtherance of the integrity of the Clearing House and the stability of the financial system and the legitimate interests of Clearing Members and market participants.

Pursuant to Section 5c(c)(1) of the CEA and the Commission's Regulation 40.6(a), Nodal Clear certifies that the Rule Amendments comply with the CEA and the Commission's Regulations thereunder. Nodal Clear is not aware of any opposing views expressed regarding the Rule Amendments. Nodal Clear certifies that this submission has been concurrently posted on the Nodal Clear website at www.nodalclear.com.

If you have any questions or need additional information regarding this submission, please contact me at 703-962-9864 or alvarez@nodalexchange.com.

Sincerely,

/s/Cody Alvarez

Cody Alvarez
Chief Compliance Officer
Corporate Counsel

Attachments:
Rule Amendments (Redline)