



asset management group

October 13, 2022

Christopher Kirkpatrick
Secretary
US Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: *Governance Requirements for Derivatives Clearing Organizations (RIN 3038-AF15) (the “Proposal”)*¹

Dear Mr. Kirkpatrick,

The Asset Management Group of the Securities Industry and Financial Markets Association (“**SIFMA AMG**”)² appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the “**Commission**” or “**CFTC**”) on the above-referenced Proposal to formalize and standardize governance practices for derivatives clearing organizations registered with the Commission (“**DCOs**”) to address potential conflicts between, and to promote the fair representation of, owners and participants; to establish requirements for the function and composition of DCO risk management committees (“**RMCs**”); and to increase transparency into DCO governance.

The CFTC Proposal springs from recommendations from the CFTC’s Market Risk Advisory Committee’s (“**MRAC**”) CCP Risk and Governance Subcommittee (“**MRAC CCP Governance Recommendations**”)³ which included representatives of DCOs, futures commission merchants (“**FCMs**”), and market participants including several SIFMA AMG members.

We note at the outset the parallel proposal by the Security and Exchange Commission (the “**SEC**”) to also address the governance of clearing agencies registered with the Commission (“**RCAs**”).⁴ Given the alignment of responsibilities of both DCOs and RCAs with respect to cleared products generally, and the fact that several are dually registered with both the CFTC and SEC, SIFMA AMG strongly believes the

¹ *Governance Requirements for Derivatives Clearing Organizations*, 87 Fed. Reg. 49559 (Aug. 11, 2022) (“**CFTC Proposal**”).

² SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG’s members represent U.S. and global asset management firms whose combined assets under management exceed \$45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

³ See CFTC Market Risk Advisory Committee, CCP Risk and Governance Subcommittee, *Recommendations on CCP Governance and Summary of Subcommittee Constituent Perspectives* (Feb. 23, 2021), available at https://www.cftc.gov/media/6201/MRAC_CCPRGS_RCCOG022321/download.

⁴ *Clearing Agency Governance and Conflicts of Interest*, Exchange Act Release No. 34-95431 (Aug. 8, 2022), 87 Fed. Reg. 51812 (Aug. 23, 2022).

applicable rule sets of each of the CFTC and SEC should be fully aligned to maximize the transparency offered by such governance practices; require the engagement of clearing participants (including asset managers) with respect to material risk issues and new product offerings; and require that the views of clearing participants are considered in decision making, with the rationale for decisions contrary to participant recommendations explained to the participants and reported to the agencies for review. Note that where appropriate, we have provided comments to the SEC on the SEC Proposal aligned with our comments to the CFTC herein.

While it is true that some of the practices identified for rulemaking by the Commission are present in the rulebooks of some DCOs, we do not believe the critical area of DCO governance should be left to voluntary practices specified in rulebooks that can be modified in the event of business exigencies.

Our comments have as their foundation the Core Principles applicable to DCOs including:

“(O) Governance fitness standards

(i) Governance arrangements

Each derivatives clearing organization shall establish governance arrangements that are transparent-

(I) to fulfill public interest requirements; and

(II) to permit the consideration of the views of owners and participants.

(Q) Composition of governing boards

Each derivatives clearing organization shall ensure that the composition of the governing board or committee of the derivatives clearing organization includes market participants.”⁵

The Core Principles make it clear that Congress intended that the views of clearing participants be included in the decision-making process and that the overall process is transparent to meet the public interest. We are especially gratified by the statement in the Proposal which identifies the rationale for participant involvement in clearing house decision making:

“Core Principle O ... require[s] DCOs to consider the views and legitimate interests of clearing members and customers of clearing members in their decision-making process. This principle is rooted in the need to ensure that these parties have an opportunity to express their concerns, and in recognition of the stake that clearing members and their customers have in the financial integrity of the DCO, as well as the fact that DCOs benefit from their unique perspective and expertise on risk management issues.”

SIFMA AMG therefore supports the CFTC’s efforts to enhance the regulatory framework for the governance of DCOs and our comments are meant to highlight areas of the Proposal with which we agree, while also identifying areas where we believe the Commission should consider certain improvements.

⁵ See Derivatives Clearing Organization General Provisions and Core Principles, 76 Fed. Reg. 69334, 69363 (Nov. 8, 2011) (the “**Core Principles**”).

I. Background

Overwhelmingly, SIFMA AMG members have embraced the transition of the over-the-counter market to clearing. Our members have been consistent, engaged supporters of the global mandates for the central clearing of standardized derivatives, and have worked closely with global regulators, with clearing members, and with DCOs to enhance the regulatory framework for central clearing so that it is a resilient structure to facilitate healthy, growing cleared markets. SIFMA AMG has long advocated for a globally harmonious, risk-appropriate, and efficient ruleset targeting improvements with respect to DCO transparency, governance, capital, and margin.⁶

SIFMA AMG members serve as fiduciaries for their investors and, as such, have due diligence responsibilities with respect to the risks presented by their trading counterparties. On behalf of their investors, AMG members enter into trades on both a voluntarily cleared and mandatorily cleared basis. As such, our investors are exposed in the performance of their cleared trades, the protection of their assets posted as margin for such trades, and the potential risk of having to participate in the mutualization of losses should a DCO fail. We therefore welcome the heightened focus on DCO risk and applaud the CFTC for addressing DCO governance issues in a manner that promotes transparency, requires engagement with participants, and mandates that participant feedback is considered by the DCO in its decision making.

We have sought to enhance DCO governance both as a means to contribute our perspectives and expertise to DCO decision making and to develop a more timely, consistent, and accurate understanding of DCO risk. Areas of risk with which our members feel particularly exposed include margin methodology,

⁶ See Letter from SIFMA AMG, to the Committee on Payments and Market Infrastructures and the Board of International Organization of Securities Commissions (October 23, 2015), *available at* <https://www.sifma.org/wp-content/uploads/2017/05/sifma-amg-submits-comments-to-cpmi-and-iosco-with-recommendations-on-financial-risk-management-of-central-counterparties.pdf>, Letter from SIFMA AMG, to the Committee on Payments and Market Infrastructures, the Board of International Organization of Securities Commissions, and the Financial Stability Board (October 17, 2016), *available at* <https://www.sifma.org/wp-content/uploads/2017/05/sifma-amg-submits-comments-to-cpmi-and-iosco-on-the-consultative-report-and-fsb-discussion-note-regarding-ccp-resiliency-recovery-and-resolution.pdf>, Letter from SIFMA AMG, to the Honorable J. Christopher Giancarlo, Chairman CFTC (June 5, 2017), *available at* <https://www.sifma.org/wp-content/uploads/2017/06/SIFMA-AMG-and-Other-Associations-Submit-Recommendations-on-Central-Counterparty-Standards-for-Derivatives.pdf>, Letter from SIFMA AMG, to the Committee on Payments and Market Infrastructures and the Board of International Organization of Securities Commissions (September 22, 2017), *available at* <https://www.sifma.org/wp-content/uploads/2017/09/SIFMA-AMG-Comments-on-the-CPMI-and-IOSCO-Consultation-Framework-for-Supervisory-Stress-Tests-of-CCPs.pdf>, Letter from SIFMA AMG, to Christopher Kirkpatrick, CFTC (September 13, 2019), *available at* https://www.sifma.org/wp-content/uploads/2019/09/CFTC-DCO-Proposal-Comment-Letter_SIFMA-AMG-Final-9.12.19.pdf, Letter from SIFMA AMG, to the Basel Committee on Banking Supervision, Committee on Payments and Market Infrastructures, and the Board of International Organization of Securities Commissions (January 26, 2022), *available at* <https://www.sifma.org/wp-content/uploads/2022/02/Consultative-Report-on-Review-of-Margin-Practices.pdf>, Letter from SIFMA AMG, to the Committee on Payments and Market Infrastructures and the Board of International Organization of Securities Commissions (February 7, 2022), *available at* <https://www.sifma.org/wp-content/uploads/2022/02/SIFMA-AMG-Discussion-Paper-Regarding-Client-Clearing-Access-and-Portability-for-CPMI-and-IOSCO.pdf>, and Letter from SIFMA AMG, to the Committee on Payments and Market Infrastructures and the Board of International Organization of Securities Commissions (October 3, 2022), *available at* <https://www.sifma.org/wp-content/uploads/2022/10/Response-to-CPMI-and-IOSCOs-Discussion-Paper-on-CCP-to-Address-Non-default-Losses.pdf>,

default fund management, non-default losses, product offerings, and the DCO's approach to recovery and resolution. Particularly as our members may be exposed to DCO default and non-default losses, we welcome the requirement to engage directly with DCOs to help advise on the mitigation of DCO risk.

II. Proposed Amendments to §39.24(b)

SIFMA AMG is gratified the Proposal would require each DCO to: (1) establish and consult with one or more risk management committees ("RMCs") on matters that could materially affect the risk profile of the DCO; (2) appoint clearing members and customers of clearing members to the RMC; (3) rotate RMC membership on a regular basis; (4) establish one or more risk working groups ("RWGs"); and (5) establish written policies and procedures regarding the RMC consultation process and the formation and role of each RWG. (collectively, the "RMC Proposals").

The RMC Proposals, collectively, represent a significant enhancement to existing practices where the present use of risk management committees is inconsistent, clearing member customers are not always consulted, committee member RMC members are frequently asked to sign NDAs and are required to focus on DCO interests rather than express independent views, there is generally no feedback loop to demonstrate how and why alternative views are considered, and opposing views are not always shared with the agencies. The clearing community (including both clearing members and clearing member customers) has a wealth of dedicated experts that should be deployed as a part of DCO ongoing transparency and governance. Experts in operational risk, business risk, investment and counterparty risk, custody risk, legal risk, cyber risk, etc., are examples of the pool available to support the governance of a DCO.

Our comments on specific components of the RMC Proposals are meant firstly to convey our strong support, and secondly to respond to the Commission's specific questions related to each component.

A. Establishment and Consultation of RMC - §39.24(b)(11)

SIFMA AMG fully agrees with the proposed requirement for a DCO to maintain governance arrangements that establish one or more RMCs and require a DCO's board of directors to consult with, and consider and respond to input from, its RMC(s) on all matters that could materially affect the risk profile of the DCO. We likewise agree with the proposed non-exhaustive list of matters that could materially affect the risk profile of the DCO, including any material change to the DCO's margin model, default procedures, participation requirements, and risk monitoring practices, as well as the clearing of new products that could significantly impact the DCO's risk profile.

RMC (and RWG) consideration of the risk presented by the launch of a new product that could significantly impact the DCO's risk profile is necessary as while the benefit of such a launch will accrue to the DCO, losses with respect to such new products may be mutualized among the clearing members and clearing member customers. And such risk is true even if a clearing member or clearing member customer does not engage in such new product. Of course, if a new product is conceived in a manner where the DCO assumes all of the risks, the need for the review of a proposed new product by the RMC and RWG would be mitigated. Otherwise, SIFMA AMG members firmly believe that those bearing the risks must have a say in the decision for the launch of a new product that could significantly impact the DCO's risk profile.

Given the areas of focus for the RMCs and RWGs, it will be critical for the CFTC to provide an explicit description of factors related to a new product launch which would qualify for treatment as

significantly impacting the DCO's risk profile. We agree with the CFTC's proposed list of factors to qualify a new product for RMC and RWG review including if a new product has different margining, liquidity, default management, pricing, or other risk characteristics from those applicable to products already cleared.

Consideration of these factors should not only be at launch, but also as the product matures over time as while the risk at launch may be minimal given the nascent size of the market, if the product is successful, it could present significant risk to the DCO and, by extension, to clearing members and clearing participants.

Such factors have also been identified by the European Securities and Markets Authority ("ESMA") in determining what constitutes a new product, including products:

“a. based on a new set of risk factors or indicators; and/or

b. involving the development or implementation of new: i) default fund; ii) stress scenarios; iii) pricing model, pricing histories, procedures detecting pricing uncertainties or ensuring reliable settlement prices, data used as input to risk models, or changes in the risk calculation or risk parameterization modules or operational or organizational developments linked to the change; iv) delivery/settlement procedures, including the settlement of a new currency.”⁷

To enable the RMC to perform its role effectively, we also recommend that the CFTC require DCOs to share relevant information with the RMC including, but not limited to, the results of stress tests and back-testing, sensitivity analysis, and other risk controls. To enhance the effectiveness of the RMC, its members, including clearing members and clearing member customers, must have insight not only into the proposals from the DCO, but also into its performance against risk-based benchmarks.

And as a related point, we recommend the CFTC apply rigorous governance requirements to a DCO's use of emergency powers and include a requirement for consultation with primary regulators. Rulebooks often provide the clearing house with broad and vaguely defined powers that can exacerbate market uncertainty in times of extreme volatility or market stress.

B. Policies and Procedures Governing RMC Consultation - §39.24(b)(11)(i)

SIFMA AMG likewise strongly supports the Commission's proposed requirement for DCOs to maintain written policies and procedures to make certain that the RMC consultation process is described in detail and includes requirements for the DCO to document the board's consideration of and response to RMC input.

The sequence, as we see it, is for rule changes which could materially impact a DCO's risk profile to be subject to the requirement for notification by the DCO to market participants generally, and specifically to the RMCs and RWGs, with an opportunity for comment. Feedback would be received from market participants for consideration by the RWGs and potential recommendation by the RWGs to the RMCs. A complete record of the diverse submissions would be gathered by the RWGs for consideration

⁷ ESMA Opinion on Article 15 and 49: Common indicators for new products and services under Article 15 and for significant changes under Article 49 of EMIR

by the RMCs on at least a quarterly basis and, ultimately by the board prior to submission of a risk-based rule change to the Commission.

And as a part of this process, the DCO's board would respond to the recommendation of the RMC, and market participants generally, including feedback as to why RMC recommendations may be accepted or rejected. It is important for the board's rationale to be shared with market participants to help inform their own decisions to continue to clear as the risk of such decisions is to be mutualized across clearing members and clearing member customers.

C. Representation of Clearing Members and Customers on RMC - §39.24(b)(11)(ii)

SIFMA AMG agrees with the Commission's proposal to require a DCO to maintain policies to make certain that an RMC (and RWG) includes representatives from clearing members and customers of clearing members. With respect to the members of both the RMCs and RWGs, SIFMA AMG fully supports that their contributions reflect a risk-based, independent, and informed opinion. The requirement should be explicit that the clearing members and clearing member customers are representing the perspectives of their employers. And while such perspectives may differ from perspectives of the representatives of the DCO, they can still meet the CFTC's objective for the perspectives to focus on the safety and efficiency of the DCO as well as stability of the broader financial system.

In considering the Proposals as a whole, and given the need to rotate members, we'd recommend no fewer than three RMC members from each of the clearing member and clearing member customer constituencies. That being said, in the event that the overall RMC membership is especially large, we'd recommend that clearing member and clearing member customer participation must represent a meaningful component of the RMC so that the perspectives are balanced as the group considers matters that could materially affect the risk profile of the DCO.

D. Rotation of RMC Membership - §39.24(b)(11)(iii)

SIFMA AMG supports the Commission's Proposal to require a DCO to maintain policies to make certain that membership of an RMC is rotated on a regular basis. It will be important that the requirement is principles-based, is subject to the Proposal's requirement for the inclusion of clearing members and clearing member customers, applies the Proposal's fitness standards, and requires a staggered rotation to ensure that there is a continuity of expertise across each constituency.

We recommend a three-year rotation which would therefore require that each constituency of members has at least three representatives with at least two continuing to serve in any given year. Such a rotation would be beneficial as it would enhance the diversity of views and allow for a broader range of candidates to participate over time. We believe that DCO decision-making will be stronger through the consideration of diverse, experienced, and independent views.

E. Establishment of Risk Working Group to Obtain Input - §39.24(b)(12)

We fully support the Commission's proposal to require a DCO to establish one or more RWGs, and to maintain policies and procedures regarding the formation and role of each RWG.

Given the relative infrequency of the board's meetings with the more senior members of the RMC (which we recommend to be at least quarterly), we agree with the Commission's call for DCOs to also establish RWGs including representatives from both clearing members and clearing member customers. The RWGs could be comprised of experts with knowledge of specific risk issues and be able to be deployed on an as-needed basis to assess the same issues assigned to RMCs, but on a deeper, timelier basis for the purpose of providing independent recommendations to the RMC for consideration.

We likewise recommend the CFTC clarify the matters required to be brought to the RWG to be the same scope of matters to be brought to the RMCs including all matters and proposed changes to the DCO's rules, procedures, or operations that could materially affect the risk profile of the DCO, including, but not limited to, any material change to the DCO's risk model, default procedures, participation requirements, and risk management practices, as well as the clearing of new products that could significantly impact the DCO's risk profile. It is important that the CFTC confirm that these matters must be presented to both the RMC and RWGs, not only to leverage the expertise of clearing members and clearing member customers, but also given the mutualization of risk to such participants.

RWG meetings should conform to the timing of the issues to be considered and for that reason it may not be appropriate to set a regularized cadence. What is most important is that the DCO must provide the opportunity for engagement on a DCO's rule changes and product launches that could materially impact a DCO's risk profile. Documentation of discussions is perhaps not advised, but documentation of recommendations – to be shared with the RMCs and ultimately with the DCO's board - makes sense to us. It is important that both the board, and the Commission, have insight into the views of market participants generally, and RMCs specifically as they deliberate on such issues.

II. Proposed Amendments to §39.24(c)

A. Fitness Standards for RMC Members - §39.24(c)(1)

We support the proposal for DCOs to set fitness standards for RMC members and also believe standards should be applied to RWG members as they will need to have expertise in the relevant area of DCO risk being considered. While fitness standards may vary across DCOs due to business models or otherwise, a foundational level of risk management expertise must be a consistent requirement.

B. Role of RMC Members as Independent Experts - §39.24(c)(3)

With respect to the members of both the RMCs and RWGs, SIFMA AMG fully supports that their contributions reflect a risk-based, independent, and informed opinion. The Commission should be explicit in requiring that the clearing members and clearing member customers are representing the perspectives of their employers. And while such perspectives may differ from perspectives of the representatives of the DCO, they can still meet the CFTC's objective for the perspectives to focus on the safety and efficiency of the DCO as well as on the stability of the broader financial system.

In addition, we would support the Commission requiring a principles-based approach whereby an DCO shall employ proportionate measures to mitigate the potential risk of a misuse of confidential information. Risk teams at both clearing members and clearing member customers are well-versed in establishing firewalls and maintaining confidentiality even while considering sensitive risk management issues, bringing experts over the wall on a controlled basis to weigh in as necessary.

III. Request for Comment

A. Market Participant Consultation Prior to Rule Change

SIFMA AMG strongly supports the MRAC CCP Governance Recommendation that DCO rule changes that could materially affect the DCO's risk profile be subject to public notice and comment prior to submission for agency consideration.

As noted in the MRAC CCP Governance Recommendations, there have been instances where material risk-based rule changes have been submitted to and approved by the CFTC without the awareness of clearing members, let alone clearing member customers. And although the risk of such an occurrence is mitigated by the enhanced usage of RMCs and RWGs, the insights provided by such groups can only be enriched through the solicitation of views from market participants through the notice and comment process.

As noted above, we believe it would enhance outcomes for potential rule changes with material DCO risk implications to be subject to the requirement for notification by the DCO to market participants generally, and specifically to the RMCs and RWGs. Especially as clearing member and clearing member customer participation in RMCs and RWGs is limited, and yet all are potentially exposed to DCO losses, public notice and comment is entirely appropriate.

And as a part of this process, the DCO, on behalf of its board, would respond to the recommendation of the RMC, and market participants generally, including feedback as to why RMC recommendations may be accepted or rejected. It is important for the board's rationale to be shared with market participants to help inform their own decisions to continue to clear as the risk of such decisions is to be mutualized across clearing members and clearing member customers.

While such an involved practice may slow the pace of potential risk-based material rule changes, the Commission would have confidence that market participants had full transparency into both the process and substance of such proposed changes, had a reasonable opportunity to comment on such proposed changes, that such comments had been fully considered by the DCO prior to submission of a risk-based rule proposal to the Commission, and the Commission had the benefit of the full diversity of market participant views on the proposed rule. The need for such transparency and opportunity for comment is fundamental given the mutualized risk.

B. RMC Member Information Sharing with Firm to Obtain Expert Opinions

As noted above, with respect to the members of both the RMCs and RWGs, SIFMA AMG fully supports that their contributions on issues that could materially impact the DCO's risk profile reflect a risk-based, independent, and informed opinion. The requirement should be explicit that the clearing members and clearing member customers are representing the perspectives of their employers. The objective is for RMC and RWG members to focus on the safety and efficiency of the registered clearing agency as well as the stability of the broader financial system.

Also as noted above, we believe it is entirely appropriate for the Commission to require a principles-based approach whereby an DCO shall employ proportionate measures to mitigate the potential risk of a misuse of confidential information. Risk teams at both clearing members and clearing member customers

are well-versed in establishing firewalls and maintaining confidentiality even while considering sensitive risk management issues, bringing experts over the wall on a controlled basis to weigh in as necessary.

IV. DCO Governance Reforms are a Component of Overall Clearing House Reforms needed to Enhance the Resiliency of Cleared Markets

SIFMA AMG members believe that more work is required on a comprehensive approach to enhance clearing house resiliency and to better prepare for clearing house recovery and resolution, including also addressing criteria for cleared products; capital contributions; default fund structure, sizing, and management; non-default loss responsibility; enhanced transparency; enhanced disclosure, back-testing, and stress-testing; limits on emergency powers; and a comprehensive and transparent resolution plan. While enhancements to clearing house governance practices will be a significant improvement, such changes must be supplemented with enhancements across transparency, margin, capital, and recovery and resolution planning to maximize the resiliency of cleared markets.

In sum, we fully support the Commission's Proposal to enhance DCO transparency and governance given the mutualized risk presented by clearing.

On behalf of SIFMA AMG, we appreciate the opportunity to respond to the Proposal and your consideration of our comments and recommendations. If you have any questions or require additional information, please do not hesitate to contact us by calling William Thum at (202) 962-7381.

Sincerely,



William C. Thum
Managing Director and Assistant General Counsel, SIFMA AMG

cc: Honorable Rostin Behnam, Chair, U.S. Commodity Futures Trading Commission
Honorable Kristin M. Johnson, Commissioner, U.S. Commodity Futures Trading Commission
Honorable Christy Goldsmith Romero, Commissioner, U.S. Commodity Futures Trading Commission
Honorable Summer K. Mersinger, Commissioner, U.S. Commodity Futures Trading Commission
Honorable Caroline D. Pham, Commissioner, U.S. Commodity Futures Trading Commission