



## asset management group

October 13, 2022

Vanessa A. Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

**Re:    *Clearing Agency Governance and Conflicts of Interest (File No. S7-21-22) (the “Proposal”)***<sup>1</sup>

Dear Ms. Countryman:

The Asset Management Group of the Securities Industry and Financial Markets Association (“**SIFMA AMG**”)<sup>2</sup> appreciates the opportunity to provide comments to the Securities and Exchange Commission (the “**Commission**” or “**SEC**”) on the above-referenced Proposal to formalize and standardize governance practices for clearing agencies registered with the Commission (“**RCAs**”) to address potential conflicts between, and to promote the fair representation of, owners and participants; to establish requirements for the function and composition of RCA risk management committees (“**RMCS**”); and to increase transparency into RCA governance.

We note at the outset the parallel proposal by the Commodity Futures Trading Commission (the “**CFTC**”) to also address derivatives clearing organization (“**DCO**”) governance.<sup>3</sup> 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**”)<sup>4</sup> which included representatives of DCOs, futures commission merchants (“**FCMs**”), and market participants including several SIFMA AMG members.

Given the alignment of responsibilities of both RCAs and DCOs with respect to cleared products generally, and the fact that several are dually registered with both the SEC and CFTC, SIFMA AMG strongly believes the applicable rule sets of each of the SEC and CFTC should be fully aligned to maximize the transparency offered by such governance practices; require the engagement of clearing participants

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<sup>1</sup>       *Clearing Agency Governance and Conflicts of Interest*, Exchange Act Release No. 34-95431 (Aug. 8, 2022), 87 Fed. Reg. 51812 (Aug. 23, 2022).

<sup>2</sup>       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.

<sup>3</sup>       *Governance Requirements for Derivatives Clearing Organizations*, 87 Fed. Reg. 49559 (Aug. 11, 2022) (“**CFTC Proposal**”).

<sup>4</sup>       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](https://www.cftc.gov/media/6201/MRAC_CCPRGS_RCCOG022321/download).

(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. While it is true that some of the practices identified for rulemaking by the Commission are present in the rulebooks of some RCAs, we do not believe the critical area of RCA 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.”<sup>5</sup>

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:

**“the risk mutualizing and trade guaranty features provided by covered clearing agencies provide for the shift of the consequences of one party’s actions to another, binding disparate interests together in certain circumstances, such as a participant default. These features both affect how different stakeholders maximize their own self-interest and also distinguish the governance of a clearing agency from other corporate structures, such as those of other financial services companies or, more generally, publicly traded companies, who are unable to legally bind their customers with financial obligations that are theoretically uncapped.”**

SIFMA AMG therefore supports the SEC’s efforts to enhance the regulatory framework for the governance of RCAs 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.

The need for enhancements to the regulatory framework for RCAs is also underlined by the increased scope of mandated clearing likely to result from the SEC’s recent proposed amendments to the standards applicable to clearing agencies that provide central counterparty services for transactions in U.S.

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

Treasury securities, and the broker-dealer customer protection rule, SEC Rule 15c3-3a, as it applies to margin posted for transactions in Treasury securities cleared by a Treasury CCP.<sup>6</sup>

## **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 RCAs 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 RCA transparency, governance, capital, and margin.<sup>7</sup>

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

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<sup>6</sup> *Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule With Respect to U.S. Treasury Securities*, Release No. 34-95763; File No. S7-23-22, (Sept. 14, 2022).

<sup>7</sup> *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 Jay Clayton, Chairman SEC (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](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>,

should an RCA fail. We therefore welcome the heightened focus on RCA risk and applaud the SEC for addressing RCA governance issues in a manner that promotes transparency, requires engagement with participants, and mandates that participant feedback is considered by the RCA in its decision making.

We have sought to enhance RCA governance both as a means to contribute our perspectives and expertise to RCA decision making and to develop a more timely, consistent, and accurate understanding of RCA risk. Areas of risk with which our members feel particularly exposed include margin methodology, default fund management, non-default losses, product offerings, and the RCA's approach to recovery and resolution. Particularly as our members may be exposed to RCA default and non-default losses, we welcome the requirement to engage directly with RCAs to help advise on the mitigation of RCA risk.

## **II. The Proposal**

### **A. Standards for Risk Management Committees Will Ensure Participant Views be Solicited, Considered, and Reported**

SIFMA AMG is gratified the Proposal would require each RCA to establish a risk management committee (or committees) ("**RMC**") to assist the board of directors in overseeing the risk management of the RCA. It would also require each RMC to reconstitute its membership on a regular basis and at all times include representatives from the owners and participants of the RCA. Finally, it would require that an RMC, in the performance of its duties, be able to provide a risk-based, independent, and informed opinion on all matters presented to it for consideration in a manner that supports the safety and efficiency of the registered clearing agency (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 members are frequently asked to sign NDAs and are required to focus on RCA interests rather 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 RCA 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 an RCA.

In terms of enhancements to the RMC Proposals, we recommend the following to more closely align with the DCO Core Principles, the CFTC Proposal, and the MRAC CCP Governance Recommendations:

- To enhance and clarify the role of the RMCs, the Commission should explicitly require the RCAs to establish one or more risk advisory working groups ("**RWGs**") which would have a larger membership than the RMCs and could meet as needed for specific issues to advise the RMCs. In addition, the Commission should explicitly require the RCA's board to consult with, consider, and respond to the RMC on at least a quarterly basis, and the RCA should document the board's consideration and response and provide such documentation to the SEC with respect to rule changes and product launches;
- To better clarify the requirement for "participant" membership, the Commission should explicitly require that RMCs and RWGs include the independent views of representatives of

- clearing members and clearing member customers, that membership is subject to fitness standards, and that membership within each constituency rotate on a three-year basis to welcome diverse views while preserving continuity of expertise;
- To better clarify the expected perspective to be applied by RMC and RWG members, the Commission should explicitly state that in addition to supporting the safety and efficiency of the RCA, RMC and RWG members should also support the stability of the broader financial system; and
  - To better clarify the matters to be brought to the RMC and RWG, the Commission should explicitly require that the RCA present to the RMC and RWG all matters and proposed changes to the RCA's rules, procedures, or operations that could materially affect the risk profile of the RCA, including, but not limited to, any material change to the RCA's risk model, default procedures, participation requirements, and risk management practices, as well as the clearing of new products that could significantly impact the RCA's risk profile.

We firmly believe the greater detail we have recommended is important to ensure the requirements are clear, that the views of clearing member customers are included, that the board must engage with the RMC, and that issues of material risk must be brought to the RMC and RWG for consideration. Absent these changes, it is possible a narrower interpretation could be applied which could serve to compromise the effectiveness of the RMC Proposals.

i. **Risk Working Groups:** Given the relative infrequency of the board's meetings with the more senior members of the RMC, we recommend the SEC adopt the requirement for RCAs to also establish RWGs in a manner similar to the CFTC Proposal 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 basis for the purpose of providing independent recommendations to the RMC for consideration.

We recommend the SEC require RCAs 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 RCA risk being considered. While fitness standards may vary across RCAs due to business models or otherwise, a foundational level of risk management expertise must be a consistent requirement

SIFMA AMG also recommends that the Commission require an RCA 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 requirement for the inclusion of clearing members and clearing member customers, applies the recommended 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. 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 RCA. A rotation of members 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 RCA decision-making will be stronger through the consideration of diverse, experienced, and independent views.

ii. **Include Independent Views of Participants:** 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 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 RCA, they can still meet the SEC's objective for the perspectives to focus on the safety and efficiency of the registered clearing agency – amended, as recommended, to include a focus on the stability of the broader financial system.

In addition, we would support the Commission requiring a principles-based approach whereby an RCA 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. **Stability of Financial System:** An expansion of the RMC's (and RWG's) purpose to include the stability of the broader financial system is necessary as otherwise a change could be viewed to be relatively safe and efficient for the RCA, while the change could increase overall risk to the financial system, including to clearing members and clearing member customers to whom losses may be mutualized. As the clearing model involves mutualized losses, the risk to those bearing those losses beyond the RCA itself must be considered. And therefore, it is entirely appropriate for the charge to the RMC and RWG to include consideration of the risk to the broader financial system.

iv. **Issues for RMCs and RWGs:** We likewise recommend the SEC clarify the matters required to be brought to the RMC and RWG to include all matters and proposed changes to the RCA's rules, procedures, or operations that could materially affect the risk profile of the RCA, including, but not limited to, any material change to the RCA's risk model, default procedures, participation requirements, and risk management practices, as well as the clearing of new products that could significantly impact the RCA's risk profile. It is important that the SEC confirm that these matters must be presented to the RMC and RWGs as the present drafting suggests a greater degree of discretion for the RCA to decide whether to present matters. Issues which materially impact the RCA's risk profile must be presented for consideration, not only to leverage the expertise of clearing members and clearing member customers, but also given the mutualization of risk to such participants.

To enable the RMC to perform its role effectively, we also recommend that the SEC require RCAs 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.

In a similar manner, RMC and RWG consideration of the risk presented by the launch of a new product that could significantly impact the RCA's risk profile is necessary as while the benefit of such a launch will accrue to the RCA, 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 RCA 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 RCA's risk profile.

Given the areas of focus for the RMCs and RWGs, it will be critical for the SEC to provide an explicit description of factors related to a new product launch which would qualify for treatment as significantly impacting the RCA's risk profile. We recommend the SEC adopt the list of factors specified in the CFTC Proposal including if a new product has different margining, liquidity, default management, pricing, or other risk characteristics from those applicable to products already cleared. The consideration should be not only at launch, but also as the product matures over time.

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."**<sup>8</sup>

We urge the SEC to adopt our recommended enhancements both to better achieve the Commission's goals for enhanced transparency and governance given the mutualized risk presented by clearing, as well as to better conform to the CFTC Proposal (and our recommendations for that) especially given the dual registrations of several RCAs.

**B. RCA Risk-based Rule Changes Must be subject to Notice and Comment Prior to Consideration by the Commission**

MRAC CCP Governance Recommendations addressed issues supported by clearing members and clearing member customers but rejected by the clearing houses. One such recommendation which we strongly support is that rule changes that could materially affect the clearing house'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 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.

The sequence, as we see it, is for rule changes that could materially affect the RCA's risk profile be subject to the requirement for notification by the RCA to market participants generally, and specifically to the RMCs and RWGs. 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 by the RMCs and, ultimately by the board prior to submission of a risk-based rule change to the Commission.

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<sup>8</sup> 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

And as a part of this process, the RCA'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.

While such an involved practice may slow the pace of potential risk-based 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 RCA 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. Such transparency and opportunity for comment is fundamental given the mutualized risk.

As a related point, we recommend the SEC apply rigorous governance arrangements to an RCA'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.

**C. An RCA Board of Directors must include Independent Directors including Clearing Member Customers.**

SIFMA AMG fully supports the requirement for an RCA's board to include independent directors with no material relationship to the RCA or to its affiliates. Not only would this mitigate potential conflicts involving a board with all directors related to the RCA, but it would also provide better board oversight of the RCA's risk management and other functions and contribute diverse views to decision making.

We also recommend that the SEC require that the RCA board include representation from clearing member customers. This makes sense for the reasons described above but is especially compelling given the noted practice of clearing member customers being bound to RCA financial obligations that are theoretically uncapped. Customer board participation would ensure that issues such as the protection of customer funds, and similar risk management concerns, are clearly represented in board discussions to better balance the RCA's commercial interests.

Customer participation on RCA boards is critical notwithstanding an RCA's ownership structure. Even if an RCA is majority owned by its clearing members, customers of such clearing members must be represented as they bear mutualized risk and have unique perspectives on critical risk management issues.

SIFMA AMG supports the SEC's efforts to diversify the representation on, and increase the independence of, RCA boards to better represent the views of clearing members and clearing member customers. However, we urge the SEC not to take an overly prescriptive approach that could result in underrepresentation on an RCA's board of the participants with critical expertise or that would bear substantially all of the losses associated with a failure of such RCA.



**III. RCA 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.

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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,



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

cc: Honorable Gary Gensler, Chair, U.S. Securities and Exchange Commission  
Honorable Caroline A. Crenshaw, Commissioner, U.S. Securities and Exchange Commission  
Honorable Jaime Lizárraga, Commissioner, U.S. Securities and Exchange Commission  
Honorable Hester M. Peirce, Commissioner, U.S. Securities and Exchange Commission  
Honorable Mark T. Uyeda, Commissioner, U.S. Securities and Exchange Commission