

Submitted Electronically

November 28, 2022

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

Re: Clearing Agency Governance and Conflicts of Interest (RIN 3235-0695, File No S7-21-22)

Dear Ms. Countryman:

The International Swaps and Derivatives Association, Inc. (“**ISDA**”)¹ appreciates the opportunity to submit these comments on the Security Exchange Commission’s (the “**Commission**”) notice of proposed rulemaking (the “**NPR**”).

We welcome the opportunity to provide our views on the NPR and are generally very supportive of the proposed rule changes. The efforts by the Commission to enhance the regulatory framework for the governance of clearing agencies should be an important priority for the Commission.

¹ Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 79 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association’s website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

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General Comments

In the proposal, the Commission states “*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*”². We believe this statement is very important, as it underlines that clearing agencies (also referred to as central counterparties or CCPs in this response) are different from other corporate structures, as they lack alternatives and are of significant systemic importance, which necessitate a bigger role for regulation. While appropriate regulation and supervision cannot be replaced by private negotiations, the unique structure and role of clearing agencies makes effective governance arrangements very important.

We therefore believe that the proposals should be considered as a starting point in enhancing the regulatory framework for CCPs. Governance is a building block to the resilience of a CCP, and should be designed to ensure that a CCP solicits, considers and addresses input from clearing members and end users in decisions that materially affect the risk profile of the CCP. There are several other important issues related to clearing agencies in which further regulatory action is warranted, including margin adequacy, transparency and CCP capital. There has been important work on international level, for instance the recent CPMI/IOSCO discussion paper on central counterparty practices to address non-default losses³ that recently closed and the BCBS/IOSCO/CPMI report “Review of margining practices”.⁴

We also believe the Commission should propose additional rules to apply rigorous governance arrangements to the use of emergency powers, including in consultation with primary regulators. Many CCP rulebooks provide the CCP with broad and vaguely defined powers that can exacerbate market uncertainty in times of extreme volatility or market stress.

We welcome that the Commission has liaised with the Commodity Futures Trading Commission and ask the two Commissions to make their approaches to CCP governance as consistent as possible.

This response covers the positions of our members on the buy-side and sell-side. The paper does not reflect the views of many CCPs, and many of the CCPs are in disagreement with the views.

² Page 41

³ <https://www.bis.org/cpmi/publ/d208.pdf>, ISDA response: <https://www.isda.org/2022/10/04/isda-fia-and-iff-respond-to-cpmi-iosco-ndl-discussion-paper/>

⁴ <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD714.pdf>

Please note that we have ordered our response by the importance we assign to each topic, with the topics most important for our members on top.

C. Risk Management Committee

We believe that Risk Management Committees (RMC) play a crucial role in a clearing agency's governance, as the RMC is the Committee that assembles a diverse group of risk management staff from clearing members, and in some cases also from clients, and can provide additional expertise to the clearing agency.

We understand that the RMC, as proposed by the NPR, is a subcommittee of the board. Members of the RMC, being board members, would therefore have the same independence requirements and fiduciary duty to the clearing agency. We, however, believe that RMC members should have specific skills and experience that may not be customary to the more general skills and experience required of board members.

Further, it is common practice in RMCs of CCPs across the globe that RMC members act not as representatives of their employer or as fiduciaries to the CCP, but as independent risk management experts prioritizing the stability of financial markets, and therefore acting in an advisory function to the CCP Board. We believe an advisory committee has advantages as its members can focus on providing risk management expertise to the CCP, without being bound or influenced by any duty to the commercial interests of the clearing agency as a board member may be.

We therefore believe that, consistent with this approach, the board of directors should be required to consult with, and consider and respond to input from, the RMC on all matters that could materially affect the risk profile of the clearing agency, including any material change to the clearing agency's margin model, default procedures, participation requirements, risk monitoring practices, as well as the clearing of new products.

Since it is clearing members' capital that underwrites CCP risk, clearing member representation should represent at least 50% of the external members of the RMC. In this context, clearing member representation does not include market participants unless they or an external participant such as an academic is nominated by a clearing member to represent them.

On reconstitution of the RMC, while rotation of RMC membership will in theory provide a wide variety of views to be represented in the RMC, there will be a few especially knowledgeable individuals that might be beneficial to have on the RMC and that the CCP might not want to see being rotated out. Also, a situation where the CCP spends a considerable part of RMC meetings on educating new RMC members should be avoided. Given the huge amount of information a new RMC member needs to process, and consequently the time required to get up to speed and to become a valuable resource for the CCP, we propose a minimum length of membership, which should not be less than 2 years.

We favor a staggered rotation system, which allows to have new members on while still retaining institutional knowledge. We think there is value in having knowledgeable members on for multiple years while recognizing that everyone should at some point get rotated. Perhaps there could be a cap that would prevent RMC members from staying on for more than 5 consecutive years.

Many CCPs' RMCs have members external to the CCP, but also representatives of management, for instance the Chief Risk Officer. We assume that the rotation of RMC membership affects only representatives external to the CCP.

It will be difficult to clearly specify in detail all matters that have to be presented to the RMC. We believe these should be any material changes to the risk management framework, new products and changes to operations that affect clearing participants (clearing members and clients). One proposal to make sure not only the board can decide what is being discussed is to give RMC members the right to propose matters to be discussed by the RMC. Overall, the rules can only be principle-based. There is also a role for supervision to play, to ensure that relevant topics are discussed by the RMC.

We believe that clearing agencies should be required to create and maintain minutes or other documentation of RMC meetings. This would improve accountability and transparency. As a minimum, these minutes should be made available to the Commission.

While some of our members believe the RMC meeting minutes should be public, we understand that this requirement could stifle some of the discussions at the RMC, or could contain sensitive information such that the minutes would have to be redacted.

We propose that the minutes of RMC meetings are made available to RMC members and shared with the CCP Board and available for review by the regulators. As the decisions made at the RMC meetings have an impact on a wide variety of market participants, it would be helpful if the CCP produced a summary that is made public and that does not include confidential information.

To the degree that the RMC expresses dissenting views with regard to the clearing agency's material risk decisions, or the clearing agency is not following advice of the RMC, those dissenting views should be documented and shared with regulators, including the CCP's rationale for not accommodating them.

Representatives in the RMC are unlikely to have expertise in all topics; they should therefore have the ability to consult internally on topics that the RMC discusses.

The RMC should meet on a regular basis and often enough to discuss all relevant topics. We also propose for the RMC to meet at least quarterly.

F. Obligation to Formally Consider Stakeholder Viewpoints

We welcome rule 17Ad-25(j) that “*would require each registered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to solicit, consider, and document its consideration of the views of participants and other relevant stakeholders of the registered clearing agency regarding material developments in its governance and operations on a recurring basis.*”

While we believe that Risk Working Groups (RWG) or similar fora are helpful (see below), we also believe that clearing agencies should widely consult on any material change to their risk profile. This includes requiring CCPs to document their consideration of such viewpoints to help ensure a record exists of the viewpoints provided and that the CCP has evaluated their merits. We agree this would help foster confidence in the process.

Such market consultation should also be required prior to a clearing agency filing rules with the Commission.

Notwithstanding the above, we welcome Risk Working Groups (RWG) or similar for a that allow clearing agencies to solicit and discuss views of the wider membership and their clients. As RMC members act in an advisory role as independent experts and do not represent their employer’s view, an RWG (or similar forum) allows the clearing agency to explicitly identify what the views of its clearing members and other clearing participants are. These groups should discuss all relevant topics to CCP risk management that impact on their participants’ own risk management, including, but not limited to:

- New products
- Operational changes
- Membership criteria
- Default management
- Risk framework, including margin models and stress testing scenarios
- Non-default loss mitigation and provisions
- recovery tools

As long as such fora exist and cover all relevant and significant topics, we are ambivalent as to the number of such fora. We believe that the clearing agency should not select the participants of these fora, but allow representatives of all clearing members and, depending on the topic, also clients and other stakeholders to freely join these fora.

There should be minutes of each meeting, which ideally could be made public, or at least be shared with all interested clearing members and clients.

As it is very difficult to define what material changes are, we support principle-based rules and see a strong role of supervision. The Commission could also define examples of what changes would be material to provide more guidance to the clearing agency.

To the degree that the RWG (or a similar forum) expresses dissenting views with regard to a clearing agency's material risk decisions, or the clearing agency is not following advice of the RWG, those dissenting views should be documented and shared with regulators, including the CCP's rationale for not accommodating them.

A. Board Composition and Requirements for Independent Directors

We are generally supportive of the pragmatic proposals of the Commission, especially that the rules accept that different market participants and owners have different objectives and understand the context to the resulting strategy to have boards of clearing agencies that cover a range of participants and therefore represent a wide range of views in the market. It is however also important to ensure that these representatives be able to present their views.

While we support the SEC's efforts to diversify the representation on, and increase the independence of, the boards of registered clearing agencies to better represent the views of owners, participants, and the range of customers and clients the participants serve, we urge the SEC not to take an overly prescriptive approach, for instance by including a large number of other stakeholders, which could result in under-representation on a clearing agency's board of the participants with critical expertise or that would bear substantially all of the losses associated with a failure of such clearing agency.

We also note that the CCP could avoid suitable representation of clearing participants by nominating completely independent directors (independent from owners and participants, for instance academics). This concern is however somewhat mitigated by the requirement that the nomination committee also needs to have a majority of independent directors.

These concerns can be somewhat mitigated by a strong nomination committee that also contains a majority of independent directors, with an independent chair.

Inclusion of directors truly independent from the clearing agency or its clearing members and their clients could help representation of a wider view of the market.

We also note that employees of participants acting as independents and then representing the interest of the clearing agency as board members (and thereby having fiduciary duties to the CCP) could raise conflicts of interest. These conflicts can potentially be addressed by requiring such participants to have due regard to market stability. We understand that this would fit with the Commission's proposal as these board members, while acting in the interest of the clearing

agency can still bring their unique view on the market into board discussion and therefore help the clearing agency by making more balanced and informed decisions.

E. Board Obligation to Oversee Service Providers for Critical Services

We believe the definition of a “service provider of critical services” is sufficiently clear and scoped.

We agree that outsourcing, especially the use of cloud computing could increase efficiency, but also pose additional risks that could be sizeable and therefore need to be carefully managed. Given this, it remains critical that the clearing agencies’ boards retain key responsibility for managing these risks. While we appreciate that this topic is so complex that clearing agencies need to also rely on well trained specialists for risk management of outsourcing, ultimate responsibility should remain with the clearing agency’s board. Furthermore, outsourcing arrangements involve data and assets pertaining to clearing participants (clearing members and their clients). As such, we would encourage transparency and consistency towards clearing participants in how these services are governed and managed. This is even more critical where the clearing agency itself relies on trained specialists to manage the risk of outsourcing.

Given that many reviews, assessments etc. are very confidential and are unlikely to be shared with clearing participants for their due diligence, we welcome a strong role of the Commission as supervisor. We encourage enhanced disclosure of these arrangements to provide clearing participants the comfort that the risk of such third party relationships are adequately managed by clearing agencies. This is even more important where a clearing agency faces concentration risk to a particular vendor.

We welcome the requirement for clearing agencies to ensure that risks associated with third party relationships are managed within the board-approved risk appetite and that clearing agencies should assess the impact of these arrangements periodically. We acknowledge that some of the relationships may be so critical that the clearing agencies could incur financial risks and may be required to provide financial support where the third party is in distress. However, to the extent that these arrangements could result in a financial risk, it is worth evaluating if a clearing agency’s capital framework should account for this and be sized accordingly.

* * *

ISDA appreciates the opportunity to submit these comments on the Commission's Consultation.

If ISDA can be of any help in this process, we hope that you will not hesitate to contact ISDA's Head of Clearing, Ulrich Karl, at telephone number +44 20 3808 9720 or at UKarl@isda.org.

Sincerely,



Ulrich Karl
Head of Clearing