

September 18, 2015

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CPMI Secretariat
Committee on Payments and Market Infrastructures
Bank for International Settlements
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Verinder Sharma
IOSCO General Secretariat
International Organization of Securities Commissions
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Re: Recommendations on Current CCP Risk Governance & Member Consultation Processes

Dear Mr. Lindley and Mr. Sharma:

The Clearing House Association L.L.C. (“TCH”)¹ appreciates the opportunity to provide you with our recommendations on enhancements to current central counterparty (“CCP”) risk governance practices and clearing member consultation processes. Over the past several years, TCH has been deeply engaged in policy discussions over how best to address and mitigate systemic risks presented by CCPs. While TCH supports the global mandate to clear standardized over-the-counter derivatives through CCPs, the shift to central clearing has the potential to concentrate systemic risks within the CCPs, as increasingly recognized by regulators, including, among others, the Bank of International Settlements (“BIS”), the Financial Stability Board (“FSB”), and members of the Board of Governors of the Federal Reserve System (“Board of Governors”), that have highlighted the importance of managing

¹ Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world’s largest commercial banks, which collectively hold more than half of all U.S. deposits and which employ over one million people in the United States and more than two million people worldwide. The Clearing House Association L.L.C. is a nonpartisan advocacy organization that represents the interests of its owner banks by developing and promoting policies to support a safe, sound and competitive banking system that serves customers and communities. Its affiliate, The Clearing House Payments Company L.L.C., which is regulated as a systemically important financial market utility, owns and operates payments technology infrastructure that provides safe and efficient payment, clearing and settlement services to financial institutions, and leads innovation and thought leadership activities for the next generation of payments. It clears almost \$2 trillion each day, representing nearly half of all automated clearing house, funds transfer and check-image payments made in the United States. See The Clearing House’s web page at www.theclearinghouse.org.

systemic risks arising from the increasing reliance upon CCPs within our financial markets,² and, in some cases, by regulatory actions in the United States to begin to address these risks.³ In this regard, we strongly support the recent announcement by CPMI-IOSCO that it is undertaking a review of stress testing by CCPs to determine (i) the manner in which CCPs are currently implementing the *Principles of Financial Market Infrastructures* (“PFMIs”)⁴ on stress testing, and (ii) whether additional guidance on stress testing is needed.⁵

² See, e.g., *Recovery of financial market infrastructures* (Oct. 15, 2014) issued by The Committee on Payments and Market Infrastructures of the BIS (“CPMI”) and the Board of the International Organization of Securities Commissions (“IOSCO”); *Key Attributes of Effective Resolution Regimes for Financial Institutions* (October 15, 2014) issued by the FSB; Remarks by Federal Reserve Board Governor Jerome H. Powell, “A Financial System Perspective on Central Clearing of Derivatives,” at “The New International Financial System: Analyzing the Cumulative Impact of Regulatory Reform,” 17th Annual International Banking Conference, Chicago, Illinois, November 6, 2014; Remarks by Federal Reserve Board Governor Daniel K. Tarullo, “Advancing Macroprudential Policy Objectives,” at the Office of Financial Research and Financial Stability Oversight Council’s 4th Annual Conference on Evaluating Macroprudential Tools: Complementarities and Conflicts, Arlington, Virginia, January 30, 2015; Remarks of CFTC Commissioner Mark P. Wetjen, “Ensuring the Promise of a Centrally Cleared, Global Swaps Market: Next Steps,” at FIA Asia Derivative Conference, Singapore, Dec. 4, 2014; CFTC Public Roundtable: Recovery and Orderly Wind-Down of Derivatives Clearing Organizations, Washington, D.C., March 19, 2015; Speech given by David Bailey, Director, Financial Market Infrastructure, Bank of England, “The Bank of England’s perspective on CCP risk management, recovery and resolution arrangements,” at “Deutsche Boerse Group and Eurex Exchange of Ideas” conference, London, Nov. 24, 2014.

³ In particular, pursuant to its authority under section 804 of the Dodd-Frank Act, the Financial Stability Oversight Council (“FSOC”) has designated eight financial market utilities, including certain CCPs, to be subject to enhanced risk management standards established by the Board of Governors or by the Securities and Exchange Commission (“SEC”) or the Commodity Futures Trading Commission (“CFTC”), each in consultation with the FSOC and the Board of Governors. Further, the CFTC and the SEC have proposed or established certain standards for both designated and non-designated CCPs within their respective jurisdictions. See *Enhanced Risk Management Standards for Systemically Important Derivative Clearing Organizations*, 78 Fed. Reg. 49663 (CFTC Final Rule, Aug. 15, 2013); *Derivative Clearing Organizations and International Standards*, 78 Fed. Reg. 72476 (CFTC Final Rule, Dec. 2, 2013). *Derivative Clearing Organization General Principles and Core Principles*, 76 Fed. Reg. 69334 (CFTC Final Rule, Nov. 8, 2011). See also *Standards for Covered Clearing Agencies*, 79 Fed. Reg. 29508 (SEC Proposed Rule, May 22, 2014); *Clearing Agency Standards*, 77 Fed. Reg. 66220 (SEC Final Rule, Nov. 2, 2012). Notwithstanding these regulatory actions, the respective standards applicable to designated and non-designated CCPs are inadequate to address the risks they pose.

⁴ Committee on Payment and Settlement Systems (“CPSS”) (currently known as the CPMI), BIS, and Technical Committee of IOSCO, *Principles for Financial Market Infrastructures*, April 2012, available at: <http://www.bis.org/cpmi/publ/d101.htm>.

⁵ See announcement by CPMI-IOSCO of March 11, 2015, available at: <https://www.iosco.org/news/pdf/IOSCONEWS372.pdf>

Given the potential systemic risks posed by CCPs, TCH has long voiced its support of enhanced regulatory oversight of CCPs. In 2012, TCH released a white paper, *Central Counterparties: Recommendations to Promote Financial Stability and Resilience*, which advocated for improved CCP risk management that built upon the G20 mandate and the PFMI and included recommendations to address key sources of systemic risks that could be posed by CCPs. Following the release of that white paper, TCH has continued to support regulatory efforts to develop heightened regulatory standards for CCPs through numerous comment letters to U.S. and international policymakers calling for greater and more effective management of the systemic risks that CCPs may pose. Most recently, TCH submitted a letter to the FSOC urging it to lead a coordinated effort of its member regulatory agencies to address and mitigate systemic risks arising from increased market reliance on central counterparties.⁶ In the letter, TCH detailed a set of concrete recommendations that would subject CCPs to more stringent standards and help ensure that their risks are more carefully managed and mitigated.

Despite the growing recognition by regulators and market participants of the risks that CCPs may present to financial stability, TCH continues to have concerns regarding the failure to establish minimum, global standards designed to mitigate CCP systemic risks. In particular, TCH is concerned that in making key risk management decisions, many CCPs do not seek or consider the input of independent risk experts, nor do all CCPs solicit or consider the input of other relevant stakeholders, such as clearing members and clients. Because of the possible systemic risks that CCPs may pose, it is critical that CCPs' management and boards of directors understand fully the potential risks associated with the CCP's activities. To gain this understanding, it is imperative that CCPs solicit and consider the perspectives of independent risk experts, as well as relevant stakeholders, including clearing members, who will ultimately bear the majority of any losses incurred as a result of risks taken by the CCP. To ensure that CCPs consider these views, TCH urges global regulators to require all CCPs to (i) establish CCP advisory risk committees ("**RC**") with mandatory composition requirements and clearly articulated mandates, (ii) solicit and consider the input of the advisory RC with respect to material risk matters ("**Material Risk Matters**")⁷ that could impact a CCP's risk profile or clearing member liability or exposure, (iii) establish a process by which clearing member input is sought and meaningfully considered by CCPs' management and boards of directors with respect to Material Risk Matters, and (iv) report to relevant regulatory

⁶ See letter from Paul Saltzman, President, The Clearing House Association L.L.C., to Jacob J. Lew, Chairman, Financial Stability Oversight Council (January 12, 2015), available at: <https://www.theclearinghouse.org/press-room/in-the-news/2015/01/20150109-press-release-tch-comments-to-fsoc-on-systemic-risk-posed-by-ccps>

⁷ Material Risk Matters would include any change to membership criteria, risk framework (e.g., initial margin, sizing of the guaranty fund), sizing of loss absorbency resources, default management framework, default waterfall, new products that introduce new, material risk into the system, and procedures for recovery and resolution of the CCP.

authorities those instances in which a CCP's decision on a Material Risk Matter conflicts with the recommendation of the RC or clearing members.

A. Executive Summary

To help mitigate the potential systemic risks posed by CCPs, it is critical that a mechanism is established to ensure that CCPs establish, consult with, and give meaningful consideration to the views of both the RC and the CCP's clearing members regarding Material Risk Matters. As described in further detail below, TCH recommends that global supervisory authorities require all CCPs to adopt the following enhancements to CCP risk governance and clearing member consultation processes:

- ***CCPs should establish risk committees with clearly-defined mandates, diverse memberships, and minimum member qualifications.*** CCPs should (i) establish RCs composed of clearing member, client, and independent representatives to advise CCPs' management and boards of directors on all Material Risk Matters, (ii) solicit and consider the input of the advisory RC with respect to all Material Risk Matters, (iii) set minimum standards for the qualifications of RC representatives, including that these representatives have significant experience in risk management related to the asset class that the risk committee is overseeing, and (iv) clarify that the role of RC representatives is to provide an independent, expert opinion on a CCP's risk management strategy and the impact of a CCP's actions on CCP and member stability, market integrity, and clients, rather than to act as a fiduciary on behalf of the CCP.
- ***CCPs should consider clearing member input on all Material Risk Matters.*** CCPs should establish mandatory "member consultation" processes by which a CCP's management or board of directors would be required to solicit and consider clearing member input on all Material Risk Matters.
- ***CCPs should maintain records of RC and clearing member recommendations on Material Risk Matters.*** To ensure that CCPs solicit and consider RC and clearing member input, CCPs should document and maintain an audit trail of RC and clearing member recommendations and report to the relevant regulators any instances in which a CCP's decision on a Material Risk Matter conflicts with the recommendation of either the RC or the clearing members, and the rationale for such decision.

These recommendations, together with a minimum “skin-in-the-game” requirement for CCPs,⁸ would help ensure that CCPs’ management and boards of directors consider the views of risk experts as well as those of clearing members, who will ultimately bear the majority of any losses incurred as a result of risks taken by the CCP. Thus, the adoption of these recommendations would help CCPs to achieve the appropriate alignment of interests among shareholders, members, clients, and other relevant stakeholders.

B. CCP Risk Committees

1. Inconsistency across CCPs

Because there are no minimum standards regarding the establishment, composition, or authority of advisory RCs, there are significant inconsistencies in the existence, as well as the structure, scope, composition, and mandate, of these RCs across CCPs. Although many CCPs have established RCs, there currently is no requirement that CCPs establish an advisory RC to provide independent, expert advice to a CCP’s management and board of directors. Further, TCH has a number of concerns with respect to existing CCP RC frameworks. First, there are no minimum global standards regarding the composition of these committees. For example, there is no requirement that these committees include clearing member or client representatives. The result is that some RCs do not benefit from the expert advice that RCs may provide, while others that may in fact have an RC, may not benefit from the diverse perspectives and expertise that clearing member and client representatives can provide. Moreover, in cases where CCPs are required to include such representatives on their RCs, such as CCPs that are governed by EMIR, there are generally no explicit minimum standards governing the depth and breadth of skills and experiences such representatives are required to possess. As a result, there are material differences in the effectiveness of, and quality of risk management guidance provided by, these committees among CCPs.⁹ In addition, current RC confidentiality agreements required by many CCPs do not allow RC representatives to discuss any RC topic with their own organization’s private-side risk teams. This restricts RC representatives’ ability to seek expert input on matters that may be beyond the representative’s area of expertise, which, in turn, ultimately limits the ability of the risk committee to provide the CCP with a complete picture of the risk considerations relevant to any particular matter under consideration.

⁸ See letter to the Honorable Jacob J. Lew, Chairman, Financial Stability Oversight Council, from Paul Saltzman, President, The Clearing House Association L.L.C., January 12, 2015, available at: <https://www.theclearinghouse.org/press-room/in-the-news/2015/01/20150109-press-release-tch-comments-to-fsoc-on-systemic-risk-posed-by-ccps>.

⁹ See Annex A for the requirements regarding risk committees under EMIR.

With respect to CCPs that have chosen to establish RCs, there is no minimum requirement prescribing the scope of risk matters that must be considered by a risk committee, resulting in significant inconsistencies in the matters considered by these committees across CCPs. Further, CCPs may make material risk-related decisions without the benefit of the expertise of the RC. For example, in some cases, material changes to eligible collateral requirements or the introduction of new products, which could materially alter the risk profile of the CCP, have not been considered by a CCP's RC.

Further, there is no consistency among CCPs regarding the duties of RC members. For example, in some cases, RC charters may impose a fiduciary duty to the CCP on RC members or a fiduciary duty to the CCP may be implied, while in other cases, the duties of RC members are not specified in the CCP's charter or otherwise. Finally, even in the case of CCPs that have risk committees that generally advise a CCP's management and board of directors on key risk-related matters, the CCP's board typically has no obligation to consider or act according to the recommendations of the RC. This is exacerbated by the fact that there is no requirement that a CCP demonstrate to regulators, the RC, clearing members, or other interested stakeholders that it has given due consideration to the recommendations of the RC or to explain any decisions that conflict with the advice of the RC. In those cases in which a CCP does report to the regulators a decision that is inconsistent with the recommendation of the RC, there are no consistent standards regarding the scope of what must be reported to the regulators.¹⁰ For example, there is great variation in the level of detail provided to regulators regarding the RC's consideration of a particular issue, the RC's recommendation, including any dissenting views, and the rationale for a conflicting decision by the CCP's management or board of directors. This lack of minimum standards regarding the establishment, as well as the composition, mandate, and accountability of risk committees fundamentally compromises the effective risk management of CCPs.

2. *Recommendations*

In light of the above concerns, TCH recommends that global regulators adopt the following minimum standards regarding the establishment of CCP RCs, as well as their mandate, duties, and structure:

- **Advisory RCs and Consultation.** All CCPs should be required to establish advisory RCs that must be consulted by a CCP's management and board of directors on all Material Risk Matters.¹¹

¹⁰ Under EMIR, a CCP must report instances where its board of directors does not follow the advice of its RC and any dissenting views expressed by its RC representatives. See Annex A for a full description of the requirements of EMIR with respect to risk committees.

¹¹ As noted previously, Material Risk Matters shall include, at a minimum, the establishment of or changes to membership criteria, the CCP's risk profile, including the methodology for establishing initial margin requirements,

These advisory RCs would be separate and apart from any board-level RC established by a particular CCP.

- **CCP Accountability.** A CCP's management and board of directors should be required to consider the input of the RC on all Material Risk Matters. To ensure that a CCP's management and board give due consideration to the recommendations of the RC, a detailed record and audit trail must be maintained by the CCP regarding the consultation of the RC by management or the board on any Material Risk Matter. This record should include, at a minimum (i) evidence demonstrating that the RC was consulted with respect to a particular Material Risk Matter, (ii) the RC's recommendation and any dissenting views, (iii) evidence demonstrating that the CCP's management and board were aware of and considered the RC's recommendations, and (iv) the final decision of the CCP's management or board and the rationale for such decision. CCPs also should be required to report to relevant regulatory authorities those instances in which a CCP's decision on a material matter conflicts with the recommendation of the RC, and the rationale for the CCP's decision.
- **Role and Duties of RC Representatives.** The role of an advisory RC representative should be that of an expert that provides an independent and impartial opinion regarding the impact of risk management decisions on CCP and member stability, market integrity, and end-users. RC representatives should not owe a fiduciary duty to the CCP, either implicitly or explicitly.
- **RC Structure.** In addition to independent representatives, CCPs should be required to include clearing member and client representatives on the RC. Moreover, an independent representative should serve as the chair of the RC. Further, CCPs should ensure that clearing members of all sizes and a diverse set of clients are represented on the RC.
- **Minimum Eligibility Criteria.** CCPs should be required to prescribe explicit minimum background and expertise requirements (e.g., risk, trading, operational), as well as seniority requirements, for RC representatives to ensure that the RC benefits from diverse perspectives and a sufficient level of expertise. These minimum standards should include a requirement that risk committee representatives have significant expertise in risk management related to the

the sizing of loss absorbency resources, the default management framework, the default waterfall, the acceptance of new products that may introduce new or unmanageable risk into the system, and procedures for recovery and resolution of the CCP. Material Risk Matters may exclude certain specific risk management decisions (e.g., the decision to increase margin on a specific member for idiosyncratic reasons) that would not affect the risk profile of the CCP or clearing member liability or exposure to the CCP.

asset class that the risk committee oversees. RC representatives should be nominated by their respective institutions based on these criteria.

- **RC Confidentiality Agreements.** CCPs should be required to permit RC representatives to share materials, on a confidential basis, with private-side experts within their respective organizations to obtain needed input to effectively perform their duties as RC representatives, thereby maximizing the risk expertise the RC may provide to the CCP's management and boards of directors.

C. Forum to Obtain Member Input

1. Current Framework for Considering Clearing Member Views

CCPs' management and boards of directors make key risk management decisions that materially affect the risk profile of the CCP, including those pertaining to membership criteria, product offerings, margin methodology, collateral eligibility, stress tests, default management, and recovery and resolution procedures. In making these decisions, CCPs' management and boards must balance a number of potentially competing objectives, including: shareholder profitability, financial stability, end-user costs and protection, and clearing member profitability and protection. However, there currently are no minimum requirements that CCPs solicit input from, or consider the views of, clearing members with respect to decisions that could alter the risk profile of the CCP or increase clearing member liability or exposure to the CCP. As a result, in some cases, clearing member views may not be considered with respect to key risk management decisions, even though clearing members will ultimately bear the majority of any losses incurred as a result of decisions impacting the CCP's risk profile.

Because of the systemic risks posed by CCPs, it is critically important that a CCP's management and board of directors consider *both* independent expert advice *and* clearing member views. While advisory RCs consisting of risk experts are the appropriate vehicle through which CCP management and boards of directors should solicit and consider the views of independent risk experts, as described previously, RCs are not, and should not be, the vehicle through which clearing member interests are considered by a CCP's management and board of directors. Therefore, in addition to advisory RCs consisting of risk experts, CCPs should also be required to establish a clearing member forum, separate from the RC, to ensure that clearing members' institutional views are considered by the RC, CCP management, and the CCP's board of directors in connection with Material Risk Matters.

2. Recommendations

Because it is critical for CCPs to consider not only the expert advice of the RC, but to consider the input of clearing members with respect to Material Risk Matters, TCH recommends that regulators

adopt the following minimum standards requiring CCPs to consult with and consider the views of clearing members:

- **Member Consultation Requirements.** Global regulators should require all CCPs to establish mechanisms that would give all clearing members the opportunity to express their institution's views on any Material Risk Matter presented to or considered by the RC, CCP management, or the board of directors prior to the CCP's final decision on such matter. This consultation would enable clearing members to express their own institutional views. In particular, to ensure that CCPs do not clear more risk than members can assume in a time of stress, on account of complex or less liquid products, CCPs should be required to solicit input from each member individually (on a strictly confidential, non-binding basis) as to the amount of a particular risk such member could expect to have the capacity to absorb in the event of a member default.¹² In consultation with the appropriate regulatory authority, CCPs should consider a sub-limit or sub-proportion of the aggregate amounts provided by their members (net of cover assumptions) in determining the amount of risk the CCP could clear, factoring in the number of CCPs clearing the product, in addition to the CCP's own assessment of observed market liquidity during periods of stress, and more current market information.¹³
- **CCP Accountability.** A CCP's management and board of directors should be required to not only solicit clearing member input, but to give due consideration to the input of clearing members on any Material Risk Matter. To ensure that a CCP's management and board give due consideration to the recommendations of clearing members, a detailed record and audit trail must be maintained by the CCP regarding the consultation of clearing members by management or the board of directors on any Material Risk Matter. This record should include, at a minimum: (i) evidence demonstrating that clearing members were consulted with respect to a particular Material Risk Matter, (ii) the clearing members' recommendations, (iii) evidence demonstrating that the CCP's management and board were aware of and considered the clearing members' recommendations, and (iv) the final decision of the CCP's management or board and the rationale for such decision. CCPs also should be required to report to relevant regulatory authorities those instances in which a

¹² Such guidance should be sourced prior to introducing new products, and could be refreshed at least quarterly to ensure the guidance properly reflected the then current market conditions.

¹³ Positions exceeding these levels could trigger exponential increases in initial margin so that participants are incentivized to reduce their positions until cleared risk is re-established within these levels.

CCP's decision with respect to a material matter conflicts with the recommendation of the majority of clearing members, and the rationale for the CCP's decision.

- **The Structure of Clearing Member Forums.** The particular form of consultation with clearing members by a CCP's management or board of directors and the ultimate report to management or the board of clearing member views could vary based on the nature of the matter being discussed. For example, in some cases, written consultation and reporting may be appropriate, while in others, verbal consultation and reporting may be proper. In still other cases, a ballot soliciting member views may be the most suitable method for collecting, evaluating, and communicating member input.
- **Eligibility Criteria.** As noted, all clearing members should be given the opportunity to express their institution's views on Material Risk Matters. Clearing members should identify those employees who should serve as the liaison between the member and the CCP for consultation purposes.

D. Conclusion

These issues are fundamentally important to TCH and to financial stability overall. In light of the current lack of standards requiring CCPs to appropriately balance the interests of all relevant stakeholders, TCH urges global regulators to adopt standards that would require CCPs to (i) establish CCP advisory RCs with mandatory composition requirements and clearly articulated mandates, (ii) solicit and consider the input of the advisory RC with respect to Material Risk Matters; (iii) establish a process by which clearing member input is sought with respect to Material Risk Matters and meaningfully considered by CCPs' management and boards of directors, and (iv) report to relevant regulatory authorities those instances in which a CCP's decision with respect to a Material Risk Matter conflicts with the recommendation of the RC or the CCP's clearing members and the rationale for the conflicting decision. TCH remains committed to helping both policymakers and financial market participants better understand the systemic risks that CCPs pose to help ensure a sound, stable, and competitive financial system that supports the health and growth of the economy.

* * * * *

We would welcome the opportunity to provide you with any assistance or input that you might find helpful. Should you have any questions or need further information about any of the matters discussed in this letter, please do not hesitate to contact me at (202) 649-4619 or paige.pidano@theclearinghouse.org.

Respectfully submitted,

A handwritten signature in black ink that reads "Paige E. Pidano". The signature is written in a cursive, flowing style.

Paige E. Pidano
Managing Director, Senior Associate General
Counsel
The Clearing House Association L.L.C.

cc: Robert Wasserman
Commodity Futures Trading Commission

Daniela Russo
European Central Bank

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Annex A

U.S. and E.U. Regulatory Requirements on Stakeholder Input/Representation with Respect to CCP Risk Processes

Annex A - U.S. and E.U. Regulatory Requirements on Stakeholder Input/Representation with Respect to CCP Risk Processes

➤ **Dodd-Frank Act**

- The Dodd-Frank Act requires the CFTC to promulgate rules to mitigate conflicts of interest in the operation of certain DCOs, DCMs, and SEFs.
 - Section 726(a) of the Dodd-Frank Act directs the Commission to determine the manner in which its rules may be deemed necessary or appropriate to improve the governance of certain DCOs, DCMs, or SEFs or to mitigate systemic risk, promote competition, or mitigate conflicts of interest in connection with the interaction between swap dealers and major swap participants, on the one hand, and such DCOs, DCMs, and SEFs.
 - Section 726(c) of the Dodd-Frank Act directs the Commission to consider the manner in which its rules address conflicts of interest in the abovementioned interaction arising from equity ownership, voting structure, or other governance arrangements of the relevant DCOs, DCMs, and SEFs.

➤ **CFTC Regulations.**

Risk Committee Requirement/Structure.

- Neither the establishment of a risk committee nor the inclusion of clearing members or clients on a risk committee is currently required by CFTC rules.
- However, the CFTC previously proposed a rule (“2010 Proposal”)¹⁴ pursuant to section 726 of the DFA that, among other things, would require DCOs to:
 - Establish a Risk Management Committee, with the following composition requirements:
 - 35 percent public directors, with sufficient expertise in, among other things, clearing services;
 - 10 percent customers of clearing members, who also routinely execute swap contracts (as well as commodity futures and options) and who have experience in using pricing models for such contracts (if only to ensure that they receive a fair price from the enumerated entities).
- The 2010 Proposal also would permit a DCO Risk Management Committee to delegate to a Risk Management Subcommittee the responsibility to:

¹⁴ 75 Fed. Reg. 63732 (October 18, 2010). Available at: <http://www.cftc.gov/ucm/groups/public/@Irfederalregister/documents/file/2010-26220a.pdf>. One CFTC commissioner has urged the CFTC to adopt final rules on CCP governance by year-end 2015. (Commissioner Bowen testimony on May 5, 2015 - <http://www.cftc.gov/PressRoom/SpeechesTestimony/opabowen-4>).

- (i) Determine the standards and requirements for initial and continuing clearing membership eligibility;
- (ii) approve or deny (or review approvals or denials of) clearing membership applications; and (iii) determine products eligible for clearing. If the Risk Management Committee effects such a delegation, then it would free itself of the composition requirements.
- The decisions of the Risk Management Subcommittee would be subject to review by the Risk Management Committee, and could be overruled by the Risk Management Committee.
- To prevent evasion of the composition requirements through internal reorganization, the Proposal would prohibit:
 - A decision of the Risk Management Subcommittee from being subject to the approval of, or otherwise restricted or limited by, a body other than the DCO Board of Directors or the DCO Risk Management Committee, including, without limitation, any advisory committee; and
 - Certain decisions of the Risk Management Committee from being subject to the approval of, or otherwise restricted or limited by, a body other than the DCO Board of Directors, including, without limitation, any advisory committee.

Accountability/Reporting Dissenting Views to Regulators.

- The 2010 Proposal noted that the CFTC was contemplating requiring the DCO to report to the Commission whenever the Risk Management Committee overrules the Risk Management Subcommittee, or whenever the Board of Directors overrules the Risk Management Committee.
- CFTC Rule 39.5, which requires DCOs to submit information to the CFTC to determine the DCO’s eligibility to clear a product it does not already clear, provides that as part of such submission, the DCO must provide:
 - “A description of the manner in which the DCO has provided notice of the submission to its members and a summary of any views on the submission expressed by the members (a copy of the notice to members shall be included with the submission).”
 - However, there does not appear to be a requirement that the DCO solicit the views of the clearing members prior to submitting the swap for a mandatory clearing determination.
- In addition, CFTC Rule 40.6(a)(7)(vi) requires DCOs submitting proposed rules for self-certification to the CFTC to also provide “a brief explanation of any substantive opposing views expressed to the registered entity by governing board or committee members, members of the entity or market participants, that were not incorporated into the rule, or a statement that no such opposing views were expressed.”¹⁵

¹⁵ 17 CFR 40.6(a)(7).

- However, there does not appear to be an explicit requirement that the DCO solicit input from any committee members, members of the entity or market participants.
- Further, the definition of “substantive opposing views” is open to interpretation raising concerns that individual RC representative’s views may not be reported.
- Similarly, CFTC Rule 40.10 requires a systemically important DCO (“SIDCO”) to notify the CFTC not less than 60 days in advance of any proposed change to its rules or procedures that could materially affect the level of risk presented by the SIDCO.¹⁶ In making such submission, the SIDCO must provide all of the information required by Rule 40.6(a)(7), including the information noted above.
 - However, as noted, there does not appear to be an explicit requirement that the DCO solicit input from any committee members, members of the entity or market participants, and the definition of “substantive opposing views” is open to interpretation raising concerns that individual RC representative’s views may not be reported.

➤ **European Market Infrastructure Regulation (“EMIR”) Risk Committee and Clearing Member Consultation Requirements.**

- EMIR requires establishment of RCs comprised of representatives of clearing members, independent members of the board and representatives of clients (such that neither clients nor clearing members have a majority). Employees and external independent experts attend the risk-committee meetings in a non-voting capacity.
- EMIR requires governance arrangements that ensure independence of the RC. The RC itself is required to “advise” the board on any arrangement that may impact the risk management of the CCP.
- However, RC representatives are bound by confidentiality and are not allowed to vote if a member has an actual or potential conflict of interest on a particular matter. The CCP is only obliged to notify competent authority of any decision in which the board decides not to follow the advice of the risk committee.
- EMIR additionally requires CCPs to consult with affected clearing members before proposing rule changes although it is not explicit on how to deal with dissenting views.

EMIR Risk Committee Provisions.¹⁷

- A CCP shall establish a risk committee, which shall be composed of representatives of its clearing members, independent members of the board and representatives of its clients. The

¹⁶ 17 CFR 40.10.

¹⁷ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, Article 28.

risk committee may invite employees of the CCP and external independent experts to attend risk-committee meetings in a non-voting capacity. Competent authorities may request to attend risk-committee meetings in a non-voting capacity and to be duly informed of the activities and decisions of the risk committee. The advice of the risk committee shall be independent of any direct influence by the management of the CCP. None of the groups of representatives shall have a majority in the risk committee.

- A CCP shall clearly determine the mandate, the governance arrangements to ensure its independence, the operational procedures, the admission criteria, and the election mechanism for risk-committee members. The governance arrangements shall be publicly available and shall, at least, determine that the risk committee is chaired by an independent member of the board, reports directly to the board and holds regular meetings.
- The risk committee shall advise the board on any arrangements that may impact the risk management of the CCP:
 - a. such as a significant change in its risk model;
 - b. the default procedures;
 - c. the criteria for accepting clearing members;
 - d. the clearing of new classes of instruments; or
 - e. the outsourcing of functions.
- The advice of the risk committee is not required for the daily operations of the CCP. Reasonable efforts shall be made to consult the risk committee on developments impacting the risk management of the CCP in emergency situations.
- Without prejudice to the right of competent authorities to be duly informed, the members of the risk committee shall be bound by confidentiality. Where the chairman of the risk committee determines that a member has an actual or potential conflict of interest on a particular matter, that member shall not be allowed to vote on that matter.
- A CCP shall promptly inform the competent authority of any decision in which the board decides not to follow the advice of the risk committee.

EMIR Clearing Member Consultation Provision.¹⁸

The CCP shall have a process for proposing and implementing changes to its rules and procedures and prior to implementing any material changes to consult with all affected clearing members and submit the proposed changes to the competent authority.

¹⁸ Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on requirements for central counterparties, Article 5(2).

Annex B

Committee on Payment and Settlement Systems at the Bank for International Settlements, and
Technical Committee of the International Organization of Securities Commissions

Relevant Provisions from *Principles for Financial Market Infrastructures* (April 2012)
Principle 2: Governance

Annex B: Relevant Provisions from PFMI Principle 2: Governance

Risk-Management Governance

3.2.14. In addition, the governance of the risk-management function is particularly important. It is essential that an FMI's risk-management personnel have sufficient independence, authority, resources, and access to the board to ensure that the operations of the FMI are consistent with the risk-management framework set by the board. The reporting lines for risk management should be clear and separate from those for other operations of the FMI, and there should be an additional direct reporting line to a non-executive director on the board via a chief risk officer (or equivalent). To help the board discharge its risk-related responsibilities, an FMI should consider the case for a risk committee, responsible for advising the board on the FMI's overall current and future risk tolerance and strategy. A CCP, however, should have such a risk committee or its equivalent. An FMI's risk committee should be chaired by a sufficiently knowledgeable individual who is independent of the FMI's executive management and be composed of a majority of members who are non-executive members. The committee should have a clear and public mandate and operating procedures and, where appropriate, have access to external expert advice.

Stakeholder Input

3.2.18. An FMI's board should consider all relevant stakeholders' interests, including those of its direct and indirect participants, in making major decisions, including those relating to the system's design, rules, and overall business strategy. An FMI with cross-border operations, in particular, should ensure that the full range of views across the jurisdictions in which it operates is appropriately considered in the decision-making process. Mechanisms for involving stakeholders in the board's decision-making process may include stakeholder representation on the board (including direct and indirect participants), user committees, and public consultation processes. As opinions among interested parties are likely to differ, the FMI should have clear processes for identifying and appropriately managing the diversity of stakeholder views and any conflicts of interest between stakeholders and the FMI. Without prejudice to local requirements on confidentiality and disclosure, the FMI should clearly and promptly inform its owners, participants, other users, and, where appropriate, the broader public, of the outcome of major decisions, and consider providing summary explanations for decisions to enhance transparency where it would not endanger candid board debate or commercial confidentiality.