August 2024

RECOMMENDATIONS ON DERIVATIVES CLEARING ORGANIZATIONS RECOVERY AND ORDERLY WIND-DOWN PLANS; INFORMATION FOR RESOLUTION PLANNING

Report of the Central Counterparty (“CCP”) Risk and Governance Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission (the “MRAC”)

Commissioner Kristin N. Johnson, Sponsor of the MRAC

Alicia Crighton, Chair of the MRAC

This report was approved on April 2, 2024 by the CCP Risk and Governance Subcommittee of the MRAC. On April 9, 2024, the MRAC voted to approve distribution of this report to the U.S. Commodity Futures Trading Commission (“Commission” or “CFTC”). The views, analyses, and conclusions expressed herein reflect the work of the CCP Risk and Governance Subcommittee of the MRAC, and do not necessarily reflect the views of the MRAC, the Commission or its staff, the Federal Reserve Bank of Chicago, the Federal Reserve System, or the U.S. government. Reference to any products, services, websites, organizations, or enterprises, or the use of any organization, trade, firm, or corporation name is for informational purposes only and does not constitute endorsement, recommendation, or favoring by the U.S. government.

I. Background and Introduction

This Report, of the MRAC CCP Risk and Governance Subcommittee (the "Subcommittee"), focuses on CCP resilience, recovery, and wind down (the "Report"). It provides recommendations and comments to support the staff of the CFTC in drafting the final rules on "Derivatives Clearing Organizations Recovery and Orderly Wind-Down Plans; Information for Resolution Planning."[1] This Report is the collective work of the Subcommittee, whose members are representatives from derivatives clearing organizations ("DCOs"), clearing members, end-users, the public sector and academia.

CCPs are fundamental market structures in derivatives markets and have gained further prominence following the 2008 financial crisis reforms. The G-20 nations committed to have all standardized over-the-counter ("OTC") derivatives, where appropriate, cleared through CCPs by 2012.[2] In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") reformed the legislative framework for CCPs.[3] Title VII of the Dodd-Frank Act sets core principles for DCOs.[4] Lawmakers addressed CCP resilience by requiring CCPs to have adequate financial, operational, and managerial resources to discharge their responsibilities and to have in place appropriate risk management tools and procedures. The Dodd-Frank Act also created a novel type of regulated entity, a systemically important DCO. Title VIII of the Dodd-Frank Act gave the Financial Stability Oversight Council ("FSOC") the authority to designate as systemically important those clearing entities (*e.g.*, DCOs) that "are or are likely to become, systemically important."[5] Systemically important DCOs ("SIDCOs") are subject to enhanced prudential and risk management standards and procedures.[6] In addition, Title VIII introduced an enhanced supervisory regime for SIDCOs that imposed on the CFTC the obligation to conduct annual examinations of these firms.[7]

In addition to the domestic reforms adopted under the Dodd-Frank Act, since 2010, international standard-setting bodies have been very active in adopting principles, guidance, and standards to support and inform national policymakers in the regulation of CCPs. The Committee on Payments and Market Infrastructures ("CPMI") and the International Organization of Securities Commissions ("IOSCO" and together with CPMI, "CPMI-IOSCO"), and the Financial Stability Board (the "FSB") have published extensive reports on CCP resilience, recovery, and resolution. In 2012, CPMI-IOSCO published the Principles for Financial Market Infrastructures ("PFMI"),[8] a set of 24

[1] *See* CFTC, Derivatives Clearing Organizations Recovery and Orderly Wind-Down Plans; Information for Resolution Planning, 88 Fed. Reg. 48968 (proposed July 28, 2023) (to be codified at 17 C.F.R. pts. 39 and 190) ("Proposed Rule").
[2] G-20, Leaders' Statement, The Pittsburgh Summit, September 24-25, 2009, https://www.oecd.org/g20/summits/pittsburgh/G20-Pittsburgh-Leaders-Declaration.pdf.
[3] *See* The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010) (codified, as amended, in scattered sections of 7, 12, and 15 U.S.C.).
[4] *See* Dodd-Frank Act § 725(c); 7 U.S.C. § 7a-1(c)(2).
[5] *See* Dodd-Frank Act § 804; 12 U.S.C. § 5463.
[6] *See* Dodd-Frank Act § 805; 12 U.S.C. § 5464.
[7] *See* Dodd-Frank Act § 807; 12 U.S.C. § 5466.
[8] CPMI-IOSCO, Principles for Financial Market Infrastructures (April 16, 2012), https://www.bis.org/cpmi/publ/d101.htm; *see also* CPMI-IOSCO, Resilience and Recovery of Central Counterparties (CCPs): Further Guidance on the PFMI – Consultative Report (August 16, 2016), https://www.bis.org/cpmi/publ/d149.htm; CPMI-IOSCO, Implementation Monitoring of PFMI: Level 3 Assessment – Report on the Financial Risk Management and Recovery Practices of 10 Derivatives CCPs (August 16, 2016), https://www.bis.org/cpmi/publ/d148.htm.

principles that should apply to financial market infrastructures, including CCPs, with the ultimate goal of enhancing their safety and efficiency.

Many of the PFMIs address the resilience of CCPs and their capacity to manage financial risk. The PFMI approach to CCP resilience builds on four aspects, developed in an *ad hoc* additional guidance report:[9] (1) governance arrangements of CCPs;[10] (2) comprehensive risk management frameworks;[11] (3) financial resources allocated to loss absorption;[12] and (4) stress testing for both credit and liquidity exposures.[13] CPMI-IOSCO acknowledges that it is vital for CCPs to have sufficient resilience to withstand clearing member failures and other stress events – and this is even more critical in the current market landscape, characterized by the mandatory central clearing of certain standardized OTC derivatives. To complement the resilience guidelines, CPMI-IOSCO also published a report on the recovery of CCPs.[14] The recommendations on recovery focus on CCPs' adoption of transparent and effective recovery plans, where the interests of all affected stakeholders are considered, and that contain different recovery tools appropriate to meet different recovery objectives.[15]

At the international level, the FSB has been quite active as well. In 2017, the FSB published guidelines for CCP resolution and resolution planning.[16] In March 2022, in the aftermath of the Covid-19 pandemic, the FSB, together with CPMI and IOSCO, assessed CCP financial resources in the context of recovery and resolution.[17] The FSB acknowledged the increased systemic importance of CCPs in markets that embraced central clearing and evaluated the operation of recovery mechanisms. However, the FSB concluded by admitting the necessity of additional input from stakeholders on the sufficiency of the existing toolkit for CCP resolution, in particular on non-default loss ("NDL") scenarios. The FSB further noted the need for potential alternative financial resources and tools for CCP resolution, along with an analysis of the costs and benefits (including effectiveness and impact on incentives) of such alternatives. In September 2023, the FSB launched a public consultation on financial resources and tools for CCPs.[18] The consultation, that ended in November 2023, proposed a regulatory toolbox approach as a global standard for CCP resolution. "In this approach, home resolution authorities for systemically important CCPs should have access to a set of resolution-specific resources and tools to meet the objectives for financial

---

[9] CPMI-IOSCO, Resilience of Central Counterparties (CCPs): Further Guidance on the PFMI – Final Report (July 5, 2017), https://www.bis.org/cpmi/publ/d163.htm.
[10] Principle 2.
[11] Principles 3, 4, 7, 13, 14, 15, and 17.
[12] Principles 5 and 6.
[13] Principles 4 and 7.
[14] CPMI-IOSCO, Recovery of Financial Market Infrastructures – Revised Report (July 5, 2017), https://www.bis.org/cpmi/publ/d162.htm.
[15] Bank for International Settlements ("BIS"), Report on Current Central Counterparty Practices to Address Non-Default Losses (August 23, 2023), https://www.bis.org/cpmi/publ/d162.htm.
[16] FSB, Guidance on Central Counterparty Resolution and Resolution Planning (July 5, 2017) https://www.fsb.org/2017/07/guidance-on-central-counterparty-resolution-and-resolution-planning-2/; FSB, Guidance on Financial Resources to Support CCP Resolution and on the Treatment of CCP Equity in Resolution (November 16, 2020), https://www.fsb.org/2020/11/guidance-on-financial-resources-to-support-ccp-resolution-and-on-the-treatment-of-ccp-equity-in-resolution/.
[17] FSB, Central Counterparty Financial Resources for Recovery and Resolution (March 10, 2022), https://www.fsb.org/2022/03/central-counterparty-financial-resources-for-recovery-and-resolution/.
[18] FSB, Financial Resources and Tools for Central Counterparty Resolution: Consultation Report (September 19, 2023), https://www.fsb.org/2023/09/financial-resources-and-tools-for-central-counterparty-resolution-consultation-report/.

resources to support resolution, in addition to the use of recovery resources and tools where these are available to the resolution authority ('resolution toolbox')."[19]

The FSB is working on finalizing its report, taking into account comments received during the consultation period. As discussed above, since 2008, domestic lawmakers and international standard-setting bodies have established regulations and standards that have substantially enhanced the resilience of CCPs. Such resilience has been demonstrated by the successful performance of CCPs during extreme stress events, including a historic global pandemic. Attention has more recently turned toward CCP recovery and wind down as international standard-setting bodies issue various forms of guidance.

Under the CFTC's regime, since 2013, SIDCOs and Subpart C DCOs have been subject to the requirement to develop and submit recovery and resolution plans. In July 2016, the staff of the CFTC's Division of Clearing and Risk ("DCR") issued an advisory letter ("Guidance") regarding the content of a SIDCO's and Subpart C DCO's recovery and orderly wind-down plans.[20] In response to CFTC regulations and such Guidance, SIDCOs and Subpart C DCOs spent considerable time, in collaboration with DCR, analyzing scenarios that could prevent a DCO from being able to meet its obligations and to provide its critical operations and services; developing and implementing recovery tools, wind-down scenarios and options; analyzing interconnections and interdependencies; evaluating agreements to be maintained during recovery and wind down; reviewing financial resources, governance arrangements, and notification policies; establishing a framework for regular policy updates; and conducting testing. This analysis resulted in significant revisions to DCO policies and practices to address recovery and wind down.

SIDCOs and Subpart C DCOs have spent considerable time responding to the Guidance and have taken material steps to reduce systemic risk within the financial system. The Commission is proposing to codify some of that Guidance in a proposed rule ("Proposed Rule"). The Commission believes that most, if not all, of the proposals are already incorporated into the plans submitted by SIDCOs and Subpart C DCOs. But the proposed requirements will be new for other DCOs. Informal guidance and rules do not have the same weight, as Guidance is non-binding, nor is guidance subject to public consultation. Moreover, the rule applies to all DCOs, whereas the Guidance applies to SIDCOs and Subpart C DCOs.

Pursuant to Title VII and VIII of the Dodd-Frank Act, and taking into account the international standards set by CPMI-IOSCO and the FSB, the CFTC published the Proposed Rule. The CFTC is "proposing, among other things: (1) for SIDCOs and Subpart C DCOs, that they should incorporate certain subjects and analyses in their viable plans for recovery and orderly wind down; and (2) for all other DCOs, that they should maintain viable plans for orderly wind down that incorporate substantially similar subjects and analyses as the proposed requirements for SIDCOs and Subpart C DCOs."[21]

This Report is intended to support the CFTC staff in its final rulemaking effort by offering recommendations and comments on four main areas: (1) supervisory stress testing of recovery and wind-down plans; (2) conducting recovery scenarios and analysis; (3) inclusion of NDL in

---

[19] *Id.* at iii.

[20] DCR, CFTC Letter No. 16-61, Recovery Plans and Wind-down Plans Maintained by DCOs and Tools for the Recovery and Orderly Wind-down of DCOs (July 21, 2016), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/16-61.pdf.

[21] Proposed Rule, 88 Fed. Reg. at 48969.

recovery and wind-down plans; and (4) porting of customer position and collateral during a CCP resolution and clearing member default.

II. Recommendations

A. Implement Supervisory Stress Tests

Recommendations:

- Commission staff should adopt and implement supervisory stress testing of credit and liquidity risks for all DCOs.
- Commission staff should adopt and implement supervisory stress testing of operational and other non-default risks for all DCOs, leveraging industry exercises covering these risks, where appropriate.
- Commission staff should include reverse stress tests in their supervisory stress tests.
- The results of the supervisory stress tests should be made available to the public, in a level of detail determined to be appropriate by Commission staff, within a reasonable time after the stress tests have been concluded.
- Subcommittee members representing end-users, FCMs and academia believe these stress tests should be required to take place at least annually. Subcommittee members representing DCOs do not believe that the frequency of reverse stress tests should be annual but rather that the frequency of reverse stress tests should be determined by Commission staff.

Proposed CFTC Regulation 39.39(c)(8) requires that the recovery plan and orderly wind-down plan of each SIDCO and Subpart C DCO include procedures for testing the viability of the plans. This includes testing the DCO's ability to implement the tools that each plan relies upon. The Proposed Rule provides specificity around the testing requirement in the recovery plan and orderly wind-down plan, including the frequency of the test. The Proposed Rule requires testing to occur after any material change to the recovery plan or orderly wind-down plan, but in any event, not less than once annually. A similar requirement applies to DCOs that are not SIDCOs or Subpart C DCOs. Subcommittee members representing DCOs expressed some concerns with the proposed text as drafted in the Proposed Rule and believe a certain level of flexibility for DCOs in designing these tests is paramount for conducting effective tests that not only yield useful information but also avoid overburdening the industry.

While it is important to have a roadmap for a potential recovery, wind down, or resolution, Subcommittee members note that resilience measures, if properly implemented, will materially decrease the likelihood of CCP failure and the need for recovery, wind down, or resolution. Supervisory stress testing of CCPs is designed to assess the resilience of CCPs and to complement the daily stress tests that DCOs must perform as a part of their risk management regime. Supervisory stress testing of CCPs, including in connection with recovery and orderly wind down, should also complement DCO stress testing for that purpose.

The Subcommittee believes that *supervisory* stress tests that relate to recovery and orderly wind down complement those run by DCOs, and the CFTC should perform reverse stress tests on a regular basis for all DCOs and SIDCOs together. The supervisory stress tests would assess the validity of the DCO's plans and enable the CFTC to better understand the resources needed by DCOs in recovery or wind down.

The results of a new supervisory test conducted by DCR staff was published on July 1, 2024.[22] The Subcommittee strongly believes that stress tests are designed to communicate information about the resilience of the entity tested and thus favors publication of the results of these tests, both for DCOs collectively and for individual DCOs.

In addition, some Subcommittee members recommend conducting such supervisory stress tests on a yearly basis. Other Subcommittee members do not believe that the frequency of reverse stress tests should be annual but rather that the frequency of reverse stress tests should be determined by Commission staff.

DCOs and other market participants conduct a number of industry tests related to operational and other non-default risks. Subcommittee members encourage the Commission and its staff to take those tests into account where possible.[23]

Supervisory stress tests of CCPs consist of stress test exercises carried out by supervisory agencies with respect to one or more CCPs. They are designed to assess the potential impact of a set of stress scenarios across CCPs and their clearing members with respect to one or more components, such as:

- **credit stress testing**, which would measure the ability of the DCO to absorb losses under a combination of market stresses and clearing member defaults;

[22] CFTC, CFTC Announces Supervisory Stress Test Results (July 1, 2024), https://www.cftc.gov/PressRoom/PressReleases/8929-24.
[23] Here are some examples of industry tests related to operational and other non-default risks:

- **The Hamilton Exercises**: These are sector-wide tabletops that reflect scenarios that have a systemic impact, such as communication exercises, critical third-party outages, and cross-sector outages. Attendees include Financial Service Sector Coordinating Council members (private sector) and Financial and Banking Information Infrastructure Committee members (government/regulators, etc.).
- **Analysis and Resilience Center ("ARC")**: ARC runs exercises based on the systemic risks that industry faces. Attendees are section 9 firms (critical infrastructure firms vulnerable to cybersecurity incidents), and government partners are kept apprised of the work.
- **Financial Services Information Sharing and Analysis Center ("FS-ISAC")**: FS-ISAC holds regional exercises (APAC, Americas, EMEA) and sector-wide exercises that focus on various cyber and resilience scenarios. The FS-ISAC also participates in exercises with the U.S. military from a financial sector perspective.
- **Securities Industry and Financial Markets Association ("SIFMA")**: SIFMA runs exercises that are focused on resilience and impact. Last year they held their annual quantum dawn cybersecurity exercise which was focused on a critical third-party payment outage which was hosted in the cloud. They include the international private sector and regulators in their exercises.
- **Futures Industry Association ("FIA")**: FIA runs similar exercises to SIFMA but will also often partner with the Hamilton Exercises. The FIA and SIFMA also hold their annual disaster recovery ("DR") exercise where customers participate by connecting into exchanges' DR environments.

- **liquidity stress testing**, which would test the ability of the DCO to convert, in a timely manner, non-cash resources to cash resources to meet its obligations resulting from the default of one or more of its clearing members and the simultaneous default of the DCO's private sector liquidity providers;

- **reverse stress testing**, which would identify scenarios that are extreme enough to exhaust the prefunded resources of a DCO;[24] and

- **operational and non-default risk stress testing**, which would identify risks stemming from operational factors (such as cyber risk) or CCP investment risk.

Some CCP supervisory stress tests also assess the ability of a CCP to absorb financial losses resulting from climate change risk and losses resulting from market illiquidity as a result of concentrated positions.[25] These scenarios can also be included in credit, liquidity, and reverse stress testing.

These supervisory stress tests do not substitute stress tests carried out by CCPs as required by applicable regulations, such as Part 39 of the CFTC regulations.[26]

Framework: In 2018, CPMI-IOSCO published a framework (the "CPMI-IOSCO Framework") for supervisory stress testing of CCPs.[27] The CPMI-IOSCO Framework builds on the PFMIs. The PFMIs set international standards for financial market infrastructures, including standards for stress testing by CCPs.[28]

---

[24] CFTC, CCP Supervisory Stress Tests: Reverse Stress Test and Liquidation Stress Test, A Report by Staff of the Commission (April 2019), https://www.cftc.gov/system/files?file=2019/05/02/cftcstresstest042019.pdf.

[25] ESMA launched its 2024 stress test for CCPs in May 2023. The results are expected during H2 2024, https://www.esma.europa.eu/press-news/esma-news/esma-launches-fifth-stress-test-exercise-central-counterparties. The results of the previous ESMA stress test were published in July 2022, https://www.esma.europa.eu/press-news/esma-news/esma-stress-test-central-counterparties-finds-clearing-system-resilient. ESMA included in its stress test framework climate risk, which "assesses the degree to which the CCP's business model is affected by the transition to a carbon-neutral economy, the consequences of the transition on the collateral posted by clearing members, and explores the impact of physical risk on CCPs" and concentration risk, which is defined as the "impact of liquidation costs derived from concentrated positions." ESMA, Final Report: Framework for the 5th ESMA Stress Test Exercise for Central Counterparties (May 31, 2023), https://www.esma.europa.eu/sites/default/files/2023-05/ESMA91-372-2557_Framework_for_the_5th_CCP_ST_exercise.pdf.

[26] *See* 17 C.F.R. §§ 39.13(h)(3) (stress tests for all DCOs) and 39.36(a) (stress tests of financial resources of SIDCOs and Subpart C DCOs).

[27] CPMI-IOSCO, Framework for Supervisory Stress Testing of Central Counterparties (CCPs) (April 2018), https://www.bis.org/cpmi/publ/d176.pdf.

[28] *See* CPSS-IOSCO, Principles for Financial Market Infrastructures (April 2012), https://www.bis.org/cpmi/publ/d101a.pdf. In Principle 4, Key Considerations 5 and 6 of the PFMI set a general framework for CCP stress tests (not supervisory stress tests). Consideration 5 sets out the following: "A CCP should determine the amount and regularly test the sufficiency of its total financial resources available in the event of a default or multiple defaults in extreme but plausible market conditions through rigorous stress testing. A CCP should have clear procedures to report the results of its stress tests to appropriate decision makers at the CCP and to use these results to evaluate the adequacy of and adjust its total financial resources. Stress tests should be performed daily using standard and predetermined parameters and assumptions. On at least a monthly basis, a CCP should perform a comprehensive and thorough analysis of stress testing scenarios, models, and underlying parameters

Examples of recent supervisory stress testing of CCPs: Following the publication of the CPMI-IOSCO Framework, the CFTC, ESMA and the Bank of England have further elaborated on the framework for supervisory stress testing of CCPs and have conducted CCP stress testing in recent years.[29]

B. Require DCOs to Determine Recovery and Wind-Down Scenarios and Analyses

Recommendations:

- In the final rule, the text of CFTC Regulation 39.39(c)(2) should be amended to require that DCOs conduct scenario analyses that include *extreme but plausible* scenarios that could trigger recovery or wind down.
- The final rule should retain the requirement that SIDCOs include in their plans an assessment of (1) the financial resources and tools available in the event of recovery and wind down, and (2) how they would address the scenarios identified that could trigger recovery and wind down.

The Proposed Rule, in CFTC Regulation 39.39(c)(2), specifies that DCOs include several scenarios as part of their recovery or wind-down plans. The purpose of including the DCO scenario analysis as part of the recovery and wind-down plans that DCOs must submit to the Commission is to calibrate and identify recovery or wind-down scenarios triggered by:

- uncovered credit losses and liquidity shortfalls; or
- general business risk, operational risk, or any other risk that threatens the DCO's viability as a going concern or NDLs.

---

and assumptions used to ensure they are appropriate for determining the CCP's required level of default protection in light of current and evolving market conditions. A CCP should perform this analysis of stress testing more frequently when the products cleared or markets served display high volatility, become less liquid, or when the size or concentration of positions held by a CCP's participants increases significantly. A full validation of a CCP's risk-management model should be performed at least annually."
Consideration 6 sets out the following: "In conducting stress testing, a CCP should consider the effect of a wide range of relevant stress scenarios in terms of both defaulters' positions and possible price changes in liquidation periods. Scenarios should include relevant peak historic price volatilities, shifts in other market factors such as price determinants and yield curves, multiple defaults over various time horizons, simultaneous pressures in funding and asset markets, and a spectrum of forward-looking stress scenarios in a variety of extreme but plausible market conditions." Each consideration has been in some form implemented domestically in 17 C.F.R. §§ 39.11(c), 39.13(h)(3) (stress tests for all DCOs), and 39.36(a) (stress tests of financial resources of SIDCOs and Subpart C DCOs).

[29] *See, e.g.*, Bank of England, 2023 CCP Supervisory Street Test: Results Report (November 8, 2023), https://www.bankofengland.co.uk/stress-testing/2023/2023-ccp-supervisory-stress-test-results-report#:~:text=As%20part%20of%20the%20Bank%27s%20ongoing%20supervision%20of%20UK%20CCPs,(the%202023%20CCP%20SST).

The Subcommittee wishes to take the opportunity to discuss those DCO scenarios as part of a holistic approach to such recovery and wind-down plans. Commenters on the Proposed Rule suggest that this requirement is overly prescriptive and may miss scenarios that could trigger recovery or wind down. The Subcommittee is sympathetic to that observation and proposes instead a process more aligned with the goals of the Proposed Rule and the PFMI, namely that DCOs run a scenario analysis that includes extreme but plausible scenarios that could trigger recovery or wind down. This would give DCOs the flexibility to specify those circumstances that represent the greatest threat to their business as a going concern. It would also give the Commission a better understanding of the factors that could threaten the operation of a DCO and trigger recovery or orderly wind down. The Subcommittee strongly believes that scenario analysis and stress tests are necessary but not sufficient alone to calibrate such triggers; they inform the judgment that is required to decide whether to act. But a DCO must explain in its plans the triggers and decision-making related to entering recovery and wind down.

The Subcommittee also believes that SIDCOs should include in their plans an assessment of (1) the financial resources and tools available in the event of recovery and wind down, and (2) how they would address the scenarios identified that could trigger recovery and wind down.

C. Support Inclusion of NDLs in Recovery and Resolution Planning for All DCOs

Recommendations:

- The Commission should retain the proposal to require a DCO that is neither a SIDCO nor a Subpart C DCO to maintain and submit to the Commission viable plans for orderly wind down necessitated by default losses as well as NDLs.
- The Commission should retain the proposed definition of NDL as applicable to all DCOs.

The Proposed Rule requires DCOs to consider default and NDLs in their planning process. The definitions in CFTC Regulation 39.2 will now apply to all DCOs. The definition of NDL is proposed to explicitly include, though not be limited to, losses arising from risks often referred to as these five categories: (1) general business risk, (2) custody risk, (3) investment risk, (4) legal risk, and (5) operational risk.

The Subcommittee supports the Commission's proposal to require a DCO that is neither a SIDCO nor a Subpart C DCO to maintain and submit to the Commission viable plans for orderly wind down necessitated by both default losses and NDLs.[30]

The Subcommittee is also supportive of the Commission's proposal to define NDLs to mean losses from any cause, other than default losses, that may threaten the DCO's viability as a going concern. This definition currently applies to SIDCOs and Subpart C DCOs, and it would benefit the market to have the same definition and expectations apply to non-SIDCOs and non-Subpart C DCOs.

[30] *See also* CPMI-IOSCO, Report on Current CCP Practices to Address Non-Default Losses (August 2023) https://www.bis.org/cpmi/publ/d217.pdf.

Examples of NDLs under this definition include investment losses (including those due to failures of repo counterparties and defaults or downgrades in credit ratings of sovereigns), losses arising from failures of securities custodians or settlement banks, losses caused by the negligence or malfeasance of employees and/or third parties, losses resulting from cyberattacks, and losses from operational or systems failure.

Given the potential disruptive impact of cyberattacks, the Subcommittee proposes to explore in greater detail the potential impact of NDLs resulting from a cyberattack.

D. Support the Provision of Data to the CFTC for Resolution Planning

Recommendation: Subcommittee members representing end-users, FCMs and academia believe that the Commission and FDIC should develop an inter-agency task force to discuss the sharing of information for resolution planning purposes for DCOs. However, Subcommittee members representing DCOs believe that coordination already occurs between the FDIC and the CFTC with respect to SIDCOs, an inter-agency task force is not necessary, and coordination can and will continue to occur through existing channels.

The Commission is proposing a new CFTC Regulation 39.39(f) to clarify that the requirement that a DCO have procedures in place to provide information directly to the Commission and FDIC for resolution planning purposes means that the DCO must provide such information to the Commission. The Commission would no longer be requiring DCOs to provide information related to resolution planning directly to the FDIC. The Commission provides such information related to resolution planning to the FDIC under a memorandum of understanding ("MOU").

In a comment on the Proposed Rule, the FDIC requested that the final rule retain the existing requirement in CFTC Regulation 39.39(c)(2) that covered DCOs have procedures in place to provide information needed for resolution planning directly to the FDIC.

The FDIC indicated in its comments that:

> it is critical for the FDIC to have the ability to obtain information for the purposes of resolution planning directly from the covered DCOs, and not to have to rely on the re-transmission of information provided by the DCOs to the CFTC. Given that resolution planning is the sole focus of the FDIC with respect to the DCOs, and the many complexities of planning for and executing a successful resolution, we believe it is most effective and efficient if the DCOs have the ability and processes in place to provide information directly to the FDIC in connection with resolution planning.[31]

The Subcommittee thinks it would be constructive for the Commission and FDIC to develop an inter-agency task force to discuss the sharing of information for resolution planning purposes. However, Subcommittee members representing DCOs believe that coordination already occurs between the FDIC and CFTC with respect to SIDCOs, that an inter-agency task force is not necessary, and that coordination can and will continue to occur through existing channels.

[31] FDIC, Comment Letter on Derivatives Clearing Organizations Recovery and Orderly Wind-Down Plans (September 21, 2023), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=35090.

E. Set up an Inter-agency Task Force to Address Challenges to Porting of Customer Positions and Collateral During Recovery and Wind Down

Recommendation: The Commission should develop an inter-agency task force, which should include the National Futures Association ("NFA"), to discuss and address impediments to the porting of customer positions and collateral in the context of a DCO resolution and clearing member default.

A robust porting regime is important to DCO resilience, since the failure to successfully port the positions of customers of a large futures commission merchant ("FCM") and the resulting fire-sale liquidation of those customers' positions and collateral could increase the risk of contagion to other FCMs, DCOs, and the broader financial system. While Part 190 of the Commission's regulations establishes a sound and well-designed legal framework to support porting, certain other CFTC and other U.S. regulatory requirements could present practical impediments to porting. One of the core concepts of Part 190, as set forth in CFTC Regulation 190.00(c)(4), is that customers should be ported where possible. CFTC Regulation 190.07(c) and (d) require that the trustee use their best efforts to transfer the customer accounts.

The Subcommittee suggests the following steps to improve the likelihood of successful porting in the event of the bankruptcy of a large FCM.

- **Customer Identification Program Rules (31 C.F.R. § 1026.220)**: Another potential challenge to successful porting is the requirement, set out in the Customer Identification Program ("CIP") rules jointly adopted by the Commission and the U.S. Department of the Treasury (the "Treasury"), that an FCM complete anti-money laundering ("AML") and know your customer ("KYC") verifications on a customer prior to opening an account for it. Compliance with this requirement would not be feasible in the case of an FCM taking on customers of an FCM that is bankrupt (or whose ultimate parent is bankrupt) at the time they are ported since those customers could number in the hundreds or possibly thousands. In the final adopting release for the Part 190 amendments in 2021, the Commission took the position that customer accounts ported to another FCM are not subject to CIP requirements because the term "account" is defined in the CIP rules to exclude any account that an FCM "acquires through any acquisition, merger, purchase of assets, or assumption of liabilities." The Commission and Treasury should discuss amending the definition of "account" in the CIP rules so that it expressly excludes any account transferred pursuant to Part 190.

- **Customer Due Diligence Rules (31 C.F.R. § 1026.210)**: Rules jointly adopted by the Commission and Treasury require an FCM to implement and maintain an AML program that includes appropriate risk-based procedures for conducting ongoing customer due diligence. In the Part 190 final adopting release, the Commission took the view that what would constitute "appropriate" risk-based procedures in the exigent context of an FCM accepting accounts transferred pursuant to Part 190 would be informed by CFTC Regulation 190.07(b)(3), which permits a transferee FCM to accept open contracts and property, and open accounts on its records for customers prior to completing diligence on

them so long as account opening diligence required by law (including provision of risk disclosures referred to in CFTC Regulation 1.65(a)(3)) is performed, and records/information required by law are obtained, as soon as practicable, but in any event within 6 months of the transfer. The Commission and Treasury should discuss amending the Customer Due Diligence rules to provide express relief that tracks CFTC Regulation 190.07(b)(3).

- **Other Customer Due Diligence and Record-keeping Requirements**: The Commission should consider whether any of its rules relating to record-keeping (*e.g.*, CFTC Regulation 1.37) should be amended to incorporate express provisions that make it clear that errors in a transferee FCM's record-keeping resulting from errors in or lack of data received by the transferee from the transferring FCM do not constitute a violation of such record-keeping rules so long as the transferee takes reasonable steps to detect and correct such errors. The Commission should work with the NFA and DCOs/exchanges to identify and amend their rules relating to customer due diligence and record-keeping (*e.g.*, NFA Rule 2-30) to incorporate express provisions that would provide relief to a transferee FCM.

- **Account Statements and Risk Disclosures**: The Commission should consider modifying the requirement under CFTC Regulation 1.33 to provide account statements and the requirement under CFTC Regulation 1.65(a)(3) to provide the risk disclosures it refers to would be satisfied in the case of transferred customers that are investment funds by a transferee FCM's delivery of such statements and disclosures to the funds' investment advisors during the 6 months following transfer. The Commission should work with the NFA, DCOs and exchanges to identify and amend any rules they may have regarding customer disclosures to parallel the relief provided by CFTC Regulation 190.07(b)(3).

- **Margin, Capital Charges and Residual Interest Requirements:** The Commission should re-consider its decision, stated in the Part 190 final adopting release, to decline to extend the time for a transferee to comply with capital and residual interest requirements (including the requirement to take undermargined account capital charges in the event the bankruptcy trustee transfers accounts without adequate margin and the transferee reasonably expects the trustee to promptly transfer such margin.

The Subcommittee thinks it would be constructive for the Commission to develop an inter-agency task force (that would include the NFA), to discuss and address impediments to the porting of customer positions and collateral in the context of a DCO resolution and clearing member default. The Subcommittee believes that an accommodation for KYC would further facilitate one of the goals set forth in the Commission's own regulations. We also think this recommendation aligns with CFTC Regulation 190.10.

Additionally, as part of such inter-agency task force, the Commission should consider requiring regular tests of porting, along the clearing chain, following a clearing member default scenario. This type of testing would help with all participants' readiness, and highlight pain points and areas requiring further focus and improvement, as well as assist participants in creating and enhancing their playbooks and decision-making preparedness in this regard. Results of such drills will also help the Commission to identify areas that may require further guidance and rulemaking.

F. Additional Considerations from Subcommittee Members Representing DCOs

Some Subcommittee members representing DCOs expressed the concern that the continued focus on recovery and wind down diverts efforts and resources and could result in CCPs reallocating resources away from preventing/managing a default in favor of focusing on extreme tail events. Subcommittee participants representing DCOs believe that attending to the management of existing risks is of greater value to the financial system than planning to recover from risk management failures.[32]

G. Conclusion

Subcommittee members support the efforts of the Commission to continue strengthening the stability of the U.S. financial system by implementing principles-based regulation that addresses the resilience, recovery, and wind down of DCOs.

[32] It is the opinion of Subcommittee members representing some DCOs that the most important outstanding resilience/prevention issues are inter-agency issues, and that there are valuable steps that can be taken to improve CCP resilience. For example, Federal Reserve deposit account access would eliminate liquidity risk from a CCP's list of concerns and strengthen the broader financial system. Additionally, CCP resilience could be improved through advocacy efforts with other U.S. regulators to address regulatory requirements that could potentially impede the successful porting of customers of a defaulting FCM, as illustrated in greater detail above.

Members of the MRAC CCP Risk and Governance Subcommittee

Alessandro Cocco (Chair)	Federal Reserve Bank of Chicago, on detail at the Department of the Treasury	Senior Policy Advisor
Alicia Crighton	Futures Industry Association	Global Co-Head of Futures and Head of OTC and Prime Clearing Businesses, Goldman Sachs
Ruth Arnould	Bank of America	Managing Director and Associate General Counsel
Richard Berner	New York University	Clinical Professor of Management Practice in the Department of Finance and Co-Director of the Stern Volatility and Risk Institute
Lee Betsill	CME Group	Managing Director and Chief Risk Officer
Juan Blackwell	Ontario Teachers' Pension Plan	Head of Credit & Counterparty Risk Management
Joseph Garelick	BlackRock	Vice President of Risk & Quantitative Analysis Group
Reginald Griffith	Louis Dreyfus Company	Global Head of Regulatory Compliance
Graham Harper	Futures Industry Association - Principal Traders Group	Head of Public Policy and Market Structure at DRW
David Horner	London Stock Exchange Group	Chief Risk Officer
Demetri Karousos	Nodal Exchange, LLC	President and COO
Elizabeth King	Intercontinental Exchange	Global Head of Clearing and Chief Risk Officer
Tim McHenry	National Futures Association	Senior Vice President
Rajalakshmi Ramanath	J.P. Morgan	Executive Director, CCP Credit and Risk Strategy
Paolo Saguato	George Mason University	Associate Professor of Law, Antonin Scalia Law School
Dmitrij Senko	Eurex Clearing AG	Chief Risk Officer
Viktor Vadasz	Morgan Stanley	Executive Director, Bank Resource Management