

RECOMMENDATIONS ON CCP GOVERNANCE AND SUMMARY OF SUBCOMMITTEE CONSTITUENT PERSPECTIVES

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

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MRAC: Subcommittee on CCP Risk and Governance: Summary of Clearing Member & End-user Recommendations, CCP Responses and Areas of Agreement

Representatives on the MRAC Subcommittee on CCP Risk and Governance (the “Subcommittee”) from DCOs, clearing members, and end-users held several meetings to discuss their perspectives on CCP Risk Governance. The Subcommittee’s discussions focused on the CFTC’s DCO rule filing process under the Part 40 Rules, DCO forums and processes to solicit participant feedback, and standards governing DCOs’ risk committees (“RCs”). Recommendations for improving DCOs’ governance arrangements were initially drafted by a subset of MRAC members representing clearing members and end-users (collectively referred to herein as “market participants”^{1,2}). The market participants’ recommendations seek to further enhance the effectiveness of CFTC governance standards by ensuring that DCOs’ management and their boards of directors have a formalized process to solicit, consider, and address input from varied clearing members and end-users before making decisions that could materially affect the risk profile of the DCO’s activity³. The DCOs’ responses to the recommendations reflect a shared objective to solicit and consider market participants’ risk-based (non-commercial) feedback through DCO forums and codify standards governing DCOs’ RCs.

As an output of the Subcommittee’s exercise, recommendations for DCOs’ governance arrangements from the clearing members and end-users of the Subcommittee⁴ and the related responses from the DCOs of the Subcommittee are included in Section I. The statutory authority of the CFTC related to governance and existing CFTC regulations are summarized in Section II.

The specific recommendations where areas of agreement were reached by the Subcommittee⁵ are summarized as follows with additional details on these recommendations, in the table further below.

- **Risk Forum to Obtain Input:** A DCO should establish various channels (such as risk advisory working groups) to solicit and obtain risk-based views of market participants in the early stages of proposing changes that could materially affect the risk profile of the DCO’s activity and choose the appropriate means of soliciting views depending on the issue to be addressed. The Subcommittee agreed to support a CFTC rule amendment as follows:

¹ For the purpose of governance arrangements, “market participants” should be formally defined to include **at a minimum** clearing members and end users whose margin and positions are at risk in a tail event.

² See [The ClearingHouse Recommendations on Current CCP Risk Governance & Member Consultation Processes](#), [FIA Global CCP Risk Position Paper](#), [ISDA CCP Best Practices](#), [Joint Trade response to CPMI-IOSCO Consultative report Resilience and recovery of central counterparties \(CCPs\): Further guidance on the PFMI](#). Many of these recommendations are also reflected in [A Path Forward for CCP Resilience, Recovery, and Resolution](#) published by 20 firms representing clearing members and end-users.

³ The International Monetary Fund recommended in its August, 2020 [United States : Financial Sector Assessment Program-Technical Note-Supervision of Financial Market Infrastructures, Resilience of Central Counterparties and Innovative Technologies](#) (see Table 1 on pg. 8 and para 22 on pg. 16) that the CFTC strengthen the rule approval process for systemically important CCPs from a “no-objection” approach to an affirmative approval process to be in line with the systemic profile of CCPs and recommended adding a public consultation phase into CFR 40.10 to allow stakeholders to formally express their opinion.

⁴ Independent members of the sub-committee, Richard Berner, Clinical Professor of Management Practice in Finance and Co-Director of the Stern Volatility and Risk Institute, NYU Stern School of Business, and Marcus Stanley, Policy Director, Americans for Financial Reform, expressed views generally supportive of the Clearing Member and End-User perspectives as laid out in the remainder of this paper.

⁵ Specific language of the proposed rule changes would not align with Nodal’s or MGEX’s governance structure but Nodal and MGEX believe their existing structures achieve the goals/outcomes of the proposed changes and are therefore generally supportive of the intent/ objective of the recommendation.

- Amend Rule 39.26 or Rule 39.13 to require establishment and regular scheduling of one or more market participant risk advisory working groups as a forum to seek risk-based views from a broad array of market participants; and
- For purposes of DCO risk forums or risk advisory working groups, define market participants within Rule 39.26 (or Rule 39.13) to include at least representatives from clearing members and end-users.
- **Risk Management Committees:** RC members must have clearly defined roles and obligations regarding the interests they represent and must have the ability and expertise to perform their role effectively. Therefore, the Subcommittee agreed to support a codification of best practices for RCs with amendments to CFTC Rule 39.24 as follows:
 - Adding a new Rule 39.24(b)(4) (and re-numbering accordingly) that states:
(b) A derivatives clearing organization shall have governance arrangements that: (4) Establish one or more risk management committees and require the board of directors to consult with and consider feedback from the risk management committee(s) on all matters and proposed changes to the derivatives clearing organization’s rules, procedures, or operations that could materially affect the risk profile of the derivatives clearing organization, including any material change to the derivatives clearing organization’s risk model, default procedures, participation requirements, and risk monitoring practices, as well as the clearing of new products that could significantly impact the derivatives clearing organization’s risk profile;
 - Adding a new Rule 39.24(c)(1)(iii) (and re-numbering accordingly) that states:
(c)(1) A derivatives clearing organization shall establish and enforce appropriate fitness standards for: (iii) Members of each risk management committee;
 - Adding a new Rule 39.24(c)(2)(iv)(A)-(B) that states:
(2) A derivatives clearing organization shall maintain policies to make certain that: (iv) Members of each risk management committee: (A) Are able to provide a risk-based independent, informed opinion on all matters presented to the risk management committee for consideration and perform their duties in a manner that support the safety and efficiency of the derivatives clearing organization and the stability of the broader financial system; and (B) Include representatives from market participants.
 - Adding a new Rule 39.24(c)(2)(v) that states:
(2) A derivatives clearing organization shall maintain policies to make certain that: (v) Membership of each risk management committee is reconstituted on a regular basis.

I. Clearing Member & End-user Recommendations and CCP Responses

| General Views | | |
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| Topic | Clearing Members & End-Users Perspective | DCO Perspective |
| General | A. Regulatory requirements on CCP governance standards must be enhanced to ensure that CCP management and their boards of directors have a formalized process to solicit, consider, and address risk-based input from varied clearing members and end-users (collectively referred to herein as “market participants”) before | Pursuant to the DCO Core Principles ⁷ and CFTC rules, a DCO’s governance arrangements are required to prioritize the stability of the broader financial system. In addition to its regulatory obligations, a DCO is inherently incentivized to effectively manage the risks of its market participants and in a manner that supports financial stability, since the |

⁷ 7 U.S.C. 7a-1.

making decisions that could materially affect the risk profile of the CCP's activity. In particular, greater risk-based input should be solicited from any market participants or segments of the industry which the CCP believes may be disproportionately or directly impacted by such decisions from a membership/user risk perspective. CFTC Rule 39.26 does not require DCOs to solicit, consider, and address the independent risk-based views of different segments or categories of market participants.

- B. Where risk-based input received by a CCP through such a formalized process is not fully reflected in the outcome of the CCP's action, the CCP should be required to explain the decision making to market participants and provide feedback to its regulators on the various risk-based viewpoints considered (and not just summarized substantive viewpoints as is now required), and rationale for adopting a specific approach (and not incorporating input received).
- C. These recommendations are not in any way intended to advance participant commercial interests and are being put forth to solely enhance CCP risk governance processes and ensure relevant and appropriate participant risk concerns are voiced and considered.

Below are the gaps within the applicable CFTC rules identified by the clearing members and end-users of the Subcommittee relative to their recommendations:

The CFTC has adopted regulations setting explicit minimum requirements in Rule 40.5, Rule 40.6, Rule 40.10 and Rule 39.26 to achieve the statutory objectives set forth in the Core Principles. However, there is no explicit rule that requires DCOs to solicit, consider, and address views of all participants on all issues being considered by the DCO that could materially affect the risk profile of the DCO's activity or to establish a forum to solicit such views.

- Rule 40.5 (Rule approval) and Rule 40.6 (Self-Certification) require DCOs to post notices on their website, but these rules do not require DCOs to solicit the views of market participants or to solicit

franchise value of a DCO is dependent on the integrity of its markets, which is predicated on its success as a risk manager. A significant risk management failure by a DCO directly results in the owners of the DCO and/or its parent company experiencing a degradation of the value of their ownership stake. In contrast, market participants generally accrue commercial benefits from their directional positions, whereas a DCO and its owners are solely focused on the integrity of the markets it clears.

A DCO's market participants form an important part of their governance arrangements, including as represented on the board of directors. However, given that market participants' decision-making can be motivated by their commercial interests, a DCO must ensure that only market participants' risk-based input informs a DCO's risk management decisions under its governance arrangements. This requires a carefully calibrated feedback mechanism that excludes commercially driven views, while allowing for the risk management expertise of clearing members and their customers to inform the DCO's risk management decisions. One example of this framework is through a DCO's RC or similar forum, where clearing members, customers, and other stakeholders (e.g., service providers) have the opportunity to provide risk-based feedback to the DCO, but are required to act in the best interests of financial market stability, rather than in the interests of their employers. A duty of RC members to prioritize the stability of the markets for which a DCO clears is appropriate and prevents commercially driven views from influencing the input a DCO receives via such committee.

The regulatory requirements imposed by the DCO Core Principles and related CFTC rules for DCOs set appropriate requirements for governance arrangements, including seeking market participant feedback and ensuring that the arrangements reflect the public interest considerations of the DCO's stakeholders. These regulatory requirements are reflected in the governance arrangements described above, including in relation to the RC or similar forum.

views across different segments or categories of market participants.

- Rule 40.5 and Rule 40.6 require DCOs to report substantive opposing views to the extent they are provided by market participants, but it is unclear what the “substantive” standard means and if minority views would be reported.
- Rule 40.6 allows the Commission to issue a stay and provide for a public comment period, but does not require DCOs to conduct a consultation with market participants prior to filing (when CCPs would have greater ability to consider and address such comments). Rule 40.5 does not allow the Commission to issue a stay or provide for a public comment period.
- Rule 40.10 requires SIDCOs to provide 60-day notice to the CFTC and Federal Reserve Board of any “proposed change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the systemically important derivatives clearing organization⁶”, but does not require SIDCOs to solicit the views of market participants or to solicit views across different segments or categories of market participants.
- Rule 39.26 (adopted in January 2020) requires that a DCO include market participants and individuals who are not executives, officers, or employees of the DCO or an affiliate thereof on the DCO’s governing board or board-level committee with the ultimate decision-making authority for the DCO, but does not require DCOs to solicit, consider, and address the independent views of different segments or categories of market participants as would be provided by the abovementioned methods. The term “market participant” is not defined for purposes of Rule 39.26 and, as such, it is unclear if it includes representatives from end-users.

It is also noted that DCOs are required to provide feedback to regulators on the substantive opposing views expressed in response to their rule filings. The DCOs on the Subcommittee understand that it has been suggested that such a requirement is not sufficient and must be expanded. The DCOs on the Subcommittee take a different view. The requirement to only provide feedback on substantive opposing views is sensible and one which ensures that non-substantive and commercially driven views are not subject to unnecessary and/or inappropriate disclosure and review. Such views are not relevant to risk management decisions, thus they are rightfully excluded from the regulatory review process.

While the CFTC regulatory framework is sufficient to elicit and consider input from market stakeholders, the DCOs on the Subcommittee are open to the creation of additional avenues for market stakeholders to express their risk management views to DCOs. For example, the utilization of a “Risk Advisory” committee, which some DCOs already have in place, would be an appropriate mechanism to provide additional avenues for clearing members and customers to provide risk-based input. We look forward to working with our market stakeholders to expand on this framework.

Below the CFTC’s current regulatory framework for a DCO’s governance arrangements is summarized, as well as its benefits.

DCO Regulatory Framework

Pursuant to DCO Core Principle O, a DCO must have governance arrangements that are transparent in order to fulfil public interests requirements and consider the views of owners and participants. In addition, DCO Core Principle Q requires that a DCO’s board must include market participants. CFTC Rule 39.26 further promulgates that a DCO’s board is required to include “market participants and individuals who are not executives, officers, or employees of the derivatives clearing

organization or an affiliate thereof.” Market participants form an important part of a DCO’s governance arrangements by providing their expertise.

CFTC Rule 39.24(a)(1)(iv) goes on to require that a DCO’s governance arrangements must prioritize supporting the stability of the broader financial system and other public interests, while placing a high priority on the safety and efficiency of the DCO itself. This includes the public interests of clearing members, end-users, and other relevant stakeholders. As such, pursuant to CFTC Rule 39.24(a)(2), major decisions of a DCO must appropriately reflect the legitimate interests of clearing members, end-users, and other relevant stakeholders. In order to comply with such requirements a DCO appropriately designs its governance arrangements to ensure that the board, typically through the DCO’s management, receives risk-based input from market stakeholders. DCOs have multiple forums for seeking the views of these stakeholders, as described below, which are appropriately tailored to the unique characteristics of a given DCO.

CFTC regulations under the Part 40 Rules set out a framework for a DCO to file changes to its rulebook and risk management practices – rule filings follow a standardized format and are publicly available. Such regulations provide that market participants substantive opposing views are appropriately reflected in a DCO’s rule filings, while also differentiating between material changes and less impactful changes, in order to allow for appropriate time for review and challenge.

Consistent with DCO Core Principle O, CFTC Rule 39.24(a)(1)(i)-(ii) requires that a DCO’s governance arrangements should be written, clear, and transparent. This would include relative to the RC, which should have written charters and other documentation, as necessary, that clearly lay out the duties of members and responsibilities of such committee. Further, in line with CFTC Rule 39.13(b), a DCO’s board must adopt the DCO’s risk management framework and be responsible for making major decisions, while its management is responsible for the actual

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| | | implementation of this framework. The framework should clearly identify and document the range of risks to which the DCO is exposed and address the monitoring and management of the entirety of those risks. |
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| Specific Recommendations | | |
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| Topic | Clearing Members & End-Users Recommendations | DCO Response |
| Risk Forum to Obtain Input | Agreed to amend Rule 39.26 or Rule 39.13 | |
| | <p>Clearing members contribute to a CCP’s mutualized default fund and end-users’ margin and positions are at risk in a tail event impacting a CCP; as such, CCP governance arrangements should consider risk-based input from market participants.</p> <p>CCPs should establish various channels (such as risk advisory working groups, member ballots) to solicit and obtain risk-based views of market participants in the early stages of proposing changes that could materially affect the risk profile of the CCP’s activity and choose the appropriate means of soliciting views depending on the issue to be addressed. This would allow all market participants to freely represent the risk-based views of their firms and other similarly situated market participants. Irrespective of the forum used, CCPs should be required to demonstrate that broad market participant risk-based input has been sought and considered from a variety of market participants across different segments of the industry.</p> <p>A. Amend Rule 39.26 or Rule 39.13 to require establishment and regular scheduling of (a) one or more market participant risk advisory working groups as a forum to seek risk-based views from a broad array of market participants, and (b) a mechanism to conduct a poll of clearing members and use the results to inform (though not necessarily instruct) CCP decisions.</p> <p>B. Define market participants within Rule 39.26 (or Rule 39.13) to include representatives from clearing members and end-users.</p> <p>We acknowledge that some CCPs have risk advisory or working groups but others only have operational and/or product advisory working groups. Further, even in case of CCPs that have risk advisory groups, there have been instances when specific rule changes increasing member liability have</p> | <p>A DCO provides multiple forums to obtain input from market stakeholders that are appropriately tailored to the DCO’s governance arrangements, as well as the topic at hand. The forums that a DCO leverages to obtain input must recognize that only risk-based input from market participants should be considered relative to risk management decisions. Forums to obtain input may include RCs, working groups, coordination through industry associations, one-on-one discussions, and rule filings. This is in addition to market participants being included on a DCO’s board, as required under DCO Core Principle Q and CFTC Rule 39.26. Of note:</p> <ul style="list-style-type: none"> - RC: RCs act as forum for DCOs to garner the risk management expertise of their market participants, where they act in a manner that prioritizes the safety and efficiency of the DCO and the stability of the broader financial markets. Although, the views solicited through an RC are those of its represented market stakeholders, the composition of the RC and the responsibilities thereof, are designed to represent the best interests of the market as a whole. As such, RCs provide DCOs an effective vehicle for soliciting risk-based input from market participants. - Rule Filings: Rule filings follow a standardized format established under the CFTC’s Part 40 Rules, which is intended to allow for rule filings to be easily digestible to market participants and provide a venue that is suitable for market participants to provide their commentary to a DCO and other key market stakeholders over a given period of time. The period of time for review varies by the filing type, with the filing type determined based on the type of |

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| | <p>been filed with regulators without discussion in these forums. Ideally, all CCPs would be required to institute risk advisory or working groups with meetings at a regular frequency (at least quarterly) and ensure all material risk matters are in scope for discussion.</p> | <p>change and in the case of SIDCOs, its materiality. The length of time is designed to provide market stakeholders the necessary time to review the change, while being appropriately efficient. Further, pursuant to CFTC Rules 40.6(c) and 40.10(f), the ruling filing process also provides the CFTC time to issue a stay of the certification or extend the review period, respectively. This provides the CFTC additional time to analyze the filing and for interested parties to provide feedback and in turn, for such feedback to be considered.</p> <p>Many DCO members on the Subcommittee currently have “Risk Advisory” committees or other similar forums, however believe that participant ballots would be an unacceptable method for seeking risk management feedback due to the negative implications for efficiency, difficulty in ensuring that all the participants in such a large forum avoid letting their commercial interests impact their feedback, and the fact that material risk management decisions by DCOs are already subject to robust review as described below. Notwithstanding the foregoing, the use of a “Risk Advisory” committee sidesteps these potential problems. As such, generally, the DCO members find the recommendation in A(a) to amend Rules 39.26 or 39.13 from the market participant members on the Subcommittee to be acceptable. It must be clear, however, that while a DCO must provide forums for seeking input and legitimate risk-based input should be appropriately considered by the DCO, a DCO’s board must ultimately maintain the responsibility for making major decisions consistent with well-established corporate law principles and requirements.</p> |
| <p>Consultation Prior to Rule Filing</p> | <p>No Agreement between DCOs and Clearing Members & End-Users</p> | |
| | <p>CCPs should conduct such a consultation with market participants⁸ before filing any rule submission with the CFTC that could materially affect the risk profile of the CCP’s activity. Such consultation is separate and distinct from existing RCs because not all participants are represented in RCs and those</p> | <p>Consistent with CFTC rules, a DCO designs its governance arrangements to ensure that market participants are appropriately consulted and have the opportunity to provide risk-based input as appropriate. As discussed immediately above, DCOs provide a number of forums for consultation</p> |

⁸ There are many clearing members and even more end users, and a CCP cannot be expected to obtain input from all constituents. There needs to be a mechanism for ensuring that a “sufficient quorum” of participants is consulted.

committees' members often have duties that preclude them from representing their employers. In addition, RC members are often precluded from consulting relevant experts within their organizations, which can impede the value of the consultation. We note that EU regulation requires that "[t]he CCP shall have a process ... prior to implementing any material changes to consult with all affected clearing members and submit the proposed changes to the competent authority."⁹

The consultation should include whether the proposed rule change "presents novel or complex issues" as that term is used in Rule 40.6, and therefore, should be identified as such in the rule filing with the CFTC.

- C. Amend Rule 40.5 (a) (6), Rule 40.6(a)(2) and Rule 40.10 (a) (1) to add the following section to require consultation with market participants allowing them to provide formal feedback prior to any rule filing that could materially affect the risk profile of the CCP's activity: For submissions by a derivatives clearing organization, such derivatives clearing organization shall also provide a certification that it has notified and consulted with a variety of market participants representing different segments of the industry and the relevant risk management committees, and a description of the manner in which the notification and consultation was conducted.

We note several examples of rule filings pertaining to material changes to recovery rules increasing membership liability without consulting members and these were filed either via CFTC Rules 40.10 or 40.6. A CCP amended its end of waterfall recovery rules through the 40.6 self-certification process without prior consultation with market participants, and such amendments introduced variation margin gains haircutting and partial tear-ups. Another CCP increased membership liabilities through a 40.10 rule filing, introducing allocation of non-default losses to members without prior notice or consultation with members. A CCP had product expansion to Bitcoin contracts without consultation which exposed members to new/novel risk

and the forum used is selected based on the type of change and of course, the DCO's specific governance arrangements. Given the number of clearing members and even greater number of end-users that engage in a DCO's clearing services, a DCO cannot and should not be expected to engage every participant. Such an approach would be unwieldy, reduce operational and risk management efficiency, and have limited benefit to overall market resilience. However, DCOs design their governance arrangements to require consultation with market participants prior to rule filings that modify clearing rules – e.g., rule filings under CFTC Rules 40.6, 40.5, and 40.10.

In addition, the rule filing process, in conjunction with a DCO's governance arrangements, is designed to ensure that only risk-based input is considered prior to and during the rule filing process. This is critical. As detailed above, commercially driven views cannot and should not influence a DCO's risk management decisions. Considering this, the DCO members of the Subcommittee believe that the commentary from the market participant members of the Subcommittee on the launch of Bitcoin contracts was driven predominantly by commercial interests. For example, in the case of CME, its Bitcoin contract did not present new or novel risk. In fact, the contract is a simple cash-settled index future, which has similar risk characteristics to other contracts CME clears. CME's risk analyses, prior to clearing the contract, affirmed this and in particular, that the price risks associated with the contract could be readily managed through CME's current risk management tools and protocols. In addition, the expected and actual open interest for the CME's Bitcoin contract represents an immaterial risk in the scope of the broader clearing house risk universe.

Notwithstanding the foregoing, as described above, the different rule filing types are designed to take into account the significance of the rule change and the DCO's standing, or lack thereof, as systemically important

⁹ See Article 5: *Compliance Policy and Procedures* of [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](#)

through the mutualized default fund. Following a rule filing under 40.6 without sufficient input from members and end-users, the CFTC staff issued [Advisory with respect to Virtual Currency Derivative Product Listings](#). The Advisory recommends consultation with members and other relevant stakeholders prior to any rule filing. It is unclear how a DCO's board of directors can make certain that legitimate interests of market participants are reflected and demonstrated in cases where no consultation occurs prior to rule submission.

Given the Commission's recognition that market participants can provide valuable input prior to a rule filing under 40.10, 40.6 or 40.5, this process should be formalized by the Commission for at least novel and complex product filings and rule changes that could materially affect the risk profile of the CCP's activity. In the case of 40.6, this enhancement would keep self-certification in place while ensuring necessary input by impacted firms.

in the U.S. It is inappropriate to create a "one size fits all" framework for the rule filing process, including their review and solicitation of feedback. While all rule filings are subject to the appropriate level of review by the CFTC in light of the type of change filed, filings pursuant to CFTC Rule 40.10 are subject to particularly rigorous review by the CFTC and also the Board of Governors of the Federal Reserve System. The significant review time for these filings is embedded into the regulation and allows ample opportunity for market stakeholders to provide feedback to the given DCO and CFTC.

The DCO members of the Subcommittee appreciate the focus of market stakeholders on risk management in their feedback through this exercise, but it is unclear why the current level of risk management review of initiatives is insufficient. In particular, in the case of material changes, including those related to major decisions (regardless of a DCO being systemically important or not), review is concluded internally by the DCOs' boards and/or board-level committees and externally by RCs (or similar forums) and the CFTC, as well as the Board of Governors of the Federal Reserve System in certain cases. All of these parties have significant expertise in derivatives markets and risk management. Additionally, in many cases, an expanded set of market stakeholders is engaged for risk management input prior to filing a rule. Notably, all parties involved in the formalized review process have obligations to prioritize the stability of the broader financial system, in order to ensure that they have appropriate incentives in conducting their reviews.

Notwithstanding this, CFTC Rule 39.24(a)(2) explicitly requires that the DCO's board makes certain that "major decisions appropriately reflect the legitimate interests of clearing members, customers of clearing members, and other relevant stakeholders". As stated in the section on "Forum to Obtain Input", it's critical that only risk-based input from market participants inform risk management decisions. Major decisions are also clearly disclosed to the relevant stakeholders. While a DCO must appropriately define within its governance arrangements how to determine if a decision is a "major decision" relative to its structure and

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| | | <p>offering, a major decision is typically one that has a significant impact on a DCO's risk management practices or resources.</p> |
| <p>Feedback Loop</p> | <p style="text-align: center;">No Agreement between DCOs and Clearing Members & End-Users</p> <p>There must be a clearly defined process for CCPs to factor in risk-based feedback received (through the forum and consultation processes per above) prior to submitting a rule filing. While there could be some dynamic tension across the viewpoints expressed by market participants and CCPs, to the extent that specific risk-based feedback from any constituent has not been incorporated (even if this is the exception), CCPs should be required to revert back to market participants informing them of the decision and outlining the rationale behind their action. There is no CFTC requirement currently for CCPs to provide direct feedback to participants on decisions made and reflected in rule filings.</p> <ul style="list-style-type: none"> Amend Rules 40.5, 40.6 and 40.10 as follows to require a response to market participants on feedback provided prior to rule filing: In the event a market participant provides risk-based input on a proposal and such proposal could materially affect the risk profile of the derivatives clearing organization's activity, if the rule proceeds without adopting the market participant's feedback, the derivatives clearing organization shall provide the market participant with a brief explanation for its action. <p>This rule amendment would promote an open dialogue and greater understanding between the CCPs and market participants.</p> | <p>DCOs have clearly defined processes for considering risk-based feedback from market participants, as supported by the CFTC regulatory framework and in particular, the rule filing process. As noted above, additional mechanisms for feedback, beyond Risk Advisory committees and other forums a DCO currently uses, risk allowing commercially driven feedback to be provided in the context of making risk management decisions, unless strict limitations are in place to eliminate such feedback.</p> <p>In particular, rule filings are published publicly on the CFTC website, which is a practice not followed in many jurisdictions and rule filings under CFTC Rules 40.6, 40.5, and 40.10 require:</p> <p style="text-align: center;"><i>"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."</i></p> <p>Including such explanation, in addition to receiving feedback in the first place and subjecting the rule filing to review under the DCO's defined governance arrangements, provides for appropriate transparency to market participants and scrutiny. While a DCO must fairly consider legitimate risk-based input from market participants, it would be unduly burdensome with unclear benefits for a DCO to address every piece of received feedback. Market participants benefit from transparency, which is provided by the current rule filing process and DCOs benefit from market participant feedback, which is provided as described in the section "Consultation Prior to Rule Filing".</p> <p>In addition, in order to comply with CFTC Rule 39.24(a)(2), in the case of major decisions, it is required that when a DCO receives feedback from</p> |

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| | | market participants such feedback must be appropriately disclosed to a DCO's board of directors. |
| Reporting | No Agreement between DCOs and Clearing Members & End-Users | |
| | <p>While implementing changes that alter the risk profile of a CCP's activity, there should be clear documentation provided to regulators as to the feedback received, CCP response/action, and rationale for accepting, incorporating, or rejecting the feedback. While the CFTC rules require substantive opposing views to be explained, minority risk-based views and/or those deemed by the CCPs to be not substantive, are not generally reported.</p> <ul style="list-style-type: none"> • Amend Rule 40.5 (a) (8), Rule 40.6 (a) (7) (vi) as follows and add this new language to 40.10 (a) (1): to require all (not just substantive) opposing views, including minority risk-based views, to be reported to regulators as part of a rule filing: <ul style="list-style-type: none"> ○ Provide a brief explanation of all opposing risk-based views expressed to the registered entity by governing board or committee members, members of the entity or through its consultation process with market participants that were not incorporated into the rule, or a statement that no such opposing risk-based views were expressed. | <p>Current CFTC rules set-out an appropriate framework for requiring a DCO to notify the CFTC of changes to its practices. In particular, as noted above, Part 40 Rules establish a standardized format for filing rule changes with the CFTC – the specific filing type (e.g., contents of the filing and length of review) is determined by the type of change and in the case of SIDCOs, its materiality. As noted above, rule filings under CFTC Rules 40.6, 40.5, and 40.10 require:</p> <p style="text-align: center;"><i>“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.”</i></p> <p>As detailed further above, the substantive standard is appropriate to ensuring that only legitimate risk-based feedback is provided as part of the rule filing process. In addition, CFTC Rules 39.19(c)(4)(xxi) and 39.24(a)(3)(i) also require that the CFTC be notified of any major decision of the DCO's board of directors.</p> |
| Risk Management Committee Standards | Agreed to amend Rule 39.24 | |
| | <p>RC members must have clarity on the role they play/interest they represent and must have the ability and expertise to perform their role effectively.</p> <p>We have observed the best practices outlined below:</p> <ul style="list-style-type: none"> - Duty of RC members: RC members provide an independent, informed opinion on a CCP's risk management strategy and the impact of a CCP's actions on CCP stability, market participant stability, and market resilience, rather than act as fiduciaries of the CCP. | <p>The following standards generally apply to a DCO's RC or similar forum:</p> <ul style="list-style-type: none"> - Duty of RC members: RC members provide an independent, informed opinion on a CCP's risk management strategy and the impact of a CCP's actions on CCP stability, market participant stability, and market integrity – this could be achieved through being required to act, not a as fiduciary, but with a duty of care that prioritizes the safety and efficiency of the DCO and the stability of the broader financial markets. - Scope of the RC: The minimum requirements or scope of risk matters that must be considered by an RC should be clearly articulated in the RC's charter (or similar documentation) to |

- **Scope of the RC:** CCPs prescribe the minimum requirements or scope of risk matters that must be considered by an RC to ensure that material risk matters are considered and addressed. At minimum, these should include a significant change in the CCP's risk model, default procedures, membership criteria and surveillance practices as well as to the clearing of new products.
- **Ability to consult internally:** RC members are permitted to consult with experts internally at their employer firms subject to certain guidelines (and bound by appropriate terms of confidentiality) to enhance the effectiveness of the RCs.
- **Tenure of participation:** Committees should be established on a term-basis with rotation of members at the end of the term to ensure diversity of perspective across participants.

In order to codify these best practices, we recommend amending CFTC Rule 39.24 as follows:

- Adding a new 39.24(b)(4) (and re-numbering accordingly) that states: "(4) Establish one or more risk management committees and require the board of directors to consult with the risk management committees on all matters to be considered by the board of directors and all proposed changes to the derivatives clearing organization's rules, procedures, or processes that could materially affect the risk profile of the derivatives clearing organization's activities, including a material change to the risk model, default procedures, membership criteria, surveillance practices, new product definitions or criteria, or services of the derivatives clearing organization;"
- Adding a new 39.24(c)(1)(iii) (and re-numbering accordingly) that states: "(iii) Members of each risk management committee;"
- Adding a new 39.24(c)(2)(iv) that states: "(iv) Members of each risk management committee provide an independent, expert opinion on all matters presented to the risk management committee for consideration,"

ensure that material risk matters are considered and addressed. To support this, the charter should be subject to regular review. At minimum, the RC's review should include any significant changes in the DCO's risk model, default procedures, membership criteria, and surveillance practices, as well as to the clearing of new products that could have a significant impact on the risk profile of the DCO.

- **Ability to consult internally:** RC members are permitted to consult with experts internally at their employer firms to enhance the effectiveness of the RCs, where permitted pursuant to the governance arrangements of the RC (e.g., approval of RC's chairman).
- **Tenure of participation:** Committees should be established on a term-basis with rotation of participants at the end of the term, as appropriate. In selecting participants, diversity of representation (e.g., type of market participant, products, etc.) should be prioritized and as such, to ensure ongoing diversity, participation by a person in an RC may be for one-term or extended for multiple terms. Selection of participants should be conducted pursuant to clearly defined governance arrangements and RCs should be re-constituted on a regular basis (e.g., annual).

In order to codify these standards, we recommend amending CFTC Rule 39.24 as follows*:

- Adding a new Rule 39.24(b)(4) (and re-numbering accordingly) that states:
*"(b) A derivatives clearing organization shall have governance arrangements that: **(4) Establish one or more risk management committees and require the board of directors to consult and consider feedback from the risk management committee(s) on all matters and proposed changes to the derivatives clearing organization's rules, procedures, or operations that could materially affect the risk profile of the derivatives clearing organization, including any significant change to the derivatives***

| | | |
|--|---|---|
| | <ul style="list-style-type: none"> - Adding a new 39.24(c)(2)(v) that states: “(v) Membership of each risk management committee is reconstituted on a regular basis; and” - Adding a new 39.24(c)(2)(vi) that states: “(vi) Each risk management committee includes representatives from clearing members and customers of clearing members.” | <p><u>clearing organization’s risk model, default procedures, participation requirements, and risk monitoring practices, as well as the clearing of new products that could significantly impact the derivatives clearing organization’s risk profile;”</u></p> <ul style="list-style-type: none"> - Adding a new Rule 39.24(c)(1)(iii) (and re-numbering accordingly) that states: “(c)(1) A derivatives clearing organization shall establish and enforce appropriate fitness standards for: <u>(iii) Members of each risk management committee;”</u> - Adding a new Rule 39.24(c)(2)(iv)(A)-(B) that states: “(2) A derivatives clearing organization shall maintain policies to make certain that: <u>(iv) Members of each risk management committee: (A) Provide a risk-based independent, expert opinion on all matters presented to the risk management committee for consideration and perform their duties in a manner that support the safety and efficiency of the derivatives clearing organization and the stability of the broader financial system; and (B) Include representatives from market participants.”</u> - Adding a new Rule 39.24(c)(2)(v) that states: “(2) A derivatives clearing organization shall maintain policies to make certain that: <u>(v) Membership of each risk management committee is reconstituted on a regular basis.”</u> <p><i>*Proposed additions are reflected as <u>follows</u>.</i></p> |
|--|---|---|

II. Background on regulatory authority related to governance

The regulatory regime applicable to DCOs is guided by the CFTC’s long-standing principles-based approach to regulation, supported by the core principles for DCOs under the Commodity Exchange Act (or the “DCO Core Principles”). The DCO Core Principles pertaining to governance are specifically dealt with in DCO Core Principle Q and DCO Core Principle O.

1. DCO Core Principle Q requires a DCO to ensure that the composition of its governing board or committee includes “market participants.”
2. DCO Core Principle O requires a DCO:
 - i. To establish governance arrangements that are transparent to fulfil public interest requirements and to permit the consideration of the views of owners and participants; and,
 - ii. To establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the DCO, any other individual or entity with direct access to the settlement or clearing activities of the DCO, and any other party affiliated with any of the foregoing individuals or entities.

Part 39 of the CFTC's regulations implement the DCO Core Principles, including in particular Rules 39.24 (Governance), 39.25 (Conflicts of interest), and 39.26 (Composition of governing boards). In addition, the CFTC's Part 40 Rules set-out the requirements for DCO's rules filings.

Members of the MRAC Central Counterparty Risk and Governance Subcommittee

| | <u>Name</u> | <u>Entity Representing</u> | <u>Title</u> |
|-----|----------------------------|--|---|
| 1. | Lee Betsill (Co-Chair) | CME Group | Managing Director and Chief Risk Officer |
| 2. | Alicia Crighton (Co-Chair) | Futures Industry Association | Global Co-Head of Futures and Head of OTC and Prime Clearing Businesses, Goldman Sachs |
| 3. | Richard Berner | | Clinical Professor of Management Practice in Finance and Co-Director of the Stern Volatility and Risk Institute, NYU Stern School of Business |
| 4. | Peter Borish | Quad Group | Chief Strategist |
| 5. | Chris Dickens | HSBC | Managing Director, Chief Operating Officer, Global Markets, EMEA |
| 6. | Matthias Graulich | Eurex Clearing AG | Member of the Executive Board and Chief Strategy Officer |
| 7. | Graham Harper | Futures Industry Association – Principal Traders Group | Head of Public Policy and Market Structure at DRW |
| 8. | Lindsay Hopkins | Minneapolis Grain Exchange | Clearing House Counsel |
| 9. | Demetri Karousos | Nodal Exchange, LLC | Chief Risk Officer, Nodal Clear, LLC, and Managing Director, Market Administration and Surveillance, Nodal Exchange, LLC |
| 10. | Eileen Kiely | BlackRock | Managing Director, Deputy Head of Counterparty Risk |
| 11. | Kevin McClear | Intercontinental Exchange, Inc. | Corporate Risk Officer |
| 12. | Dennis McLaughlin | LCH Group | Group Chief Risk Officer |
| 13. | Dale Michaels | The Options Clearing Corporation | Executive Vice President, Financial Risk Management |
| 14. | John Murphy | Commodity Markets Council | Managing Director and Global Head of the Futures Division, Mizuho Americas |
| 15. | Marnie Rosenberg | JP Morgan | Managing Director and Global Head of Clearinghouse Risk & Strategy |
| 16. | Dr. Marcus Stanley | Americans for Financial Reform | Policy Director |
| 17. | Robert Steigerwald* | Federal Reserve Bank of Chicago | Senior Policy Advisor, Financial Markets |
| 18. | William Thum | Vanguard | Principal and Global Head of Capital Markets Legal and Regulatory |
| 19. | Nadia Zakir** | Pacific Investment Management Company LLC (PIMCO) | Executive Vice President and Deputy General Counsel |

*-Mr. Steigerwald, in representing the Federal Reserve Bank of Chicago, is a non-voting member. In this capacity, he did not provide advice and recommendations on this report

**-denotes MRAC Chair

CONCURRING STATEMENTS



February 12, 2021

BlackRock Statement on CFTC MRAC CCP Risk and Governance Subcommittee Papers

BlackRock commends Acting Chair Behnam for establishing the CFTC's CCP Risk & Governance Subcommittee to provide reports and recommendations regarding issues impacting clearinghouse risk management and governance. BlackRock believes that stable and secure financial markets are paramount to the protection of end-users' investment activity and as such, we support the recommendations made in the Subcommittee's papers as they would serve to enhance CCP risk management and governance.

The papers contain specific recommendations on CCP Margin Methodologies and CCP Risk Governance, many of which are also highlighted in [A Path Forward for CCP Resilience, Recovery, and Resolution](#), a paper that BlackRock co-authored with a group of a buy-side and sell-side firms, released in 2019.^[1] The paper proposed twenty recommendations to enhance CCPs' resilience, recovery and resolution.

The Subcommittee papers represent an important part of a broader endeavor to enhance financial stability that is supported by CCPs, clearing members and end-users alike, and BlackRock encourages the CFTC and other relevant regulatory authorities to pursue rulemaking to implement these recommendations. While there were some areas of disagreement between CCPs and the clearing members and end-users, we believe the work presented by the Subcommittee as a meaningful first step and look forward to working through the Subcommittee in the months to come to address other key issues, such as transparency, disclosure, capital and stress testing.

Recommendations Regarding CCP Margin Methodologies

We support the recommendations on margin methodologies as we feel they will provide the CFTC with guidance on the market's expectations for how the CFTC's principles-based approach on CCPs' margin should be interpreted. We encourage the CFTC staff to apply this guidance when considering the adequacy of a particular margin practice.

Recommendations Regarding CCP Risk Governance

BlackRock supports the governance recommendations presented by the Subcommittee, as they would require CCPs to establish appropriate information channels with end-user participation that would allow the exchange of risk-based market views (to the extent a CCP does not already have such a channel).

^[1] The paper was originally published in October 2019 and was re-released in March 2020 with nineteen signatories.

JPMORGAN CHASE & CO.

JPMorgan Chase Statement on CFTC MRAC CCP Risk and Governance Subcommittee Papers

JPMorgan commends Acting Chair Behnam for establishing the CFTC's CCP Risk & Governance Subcommittee (Subcommittee) last year and supporting the development of actionable recommendations to enhance CCP risk management and governance. The two papers prepared by the Subcommittee, with specific recommendations on CCP Margin Methodologies and CCP Risk Governance, are an important step forward. Notably, they seek to address several of the issues highlighted in [A Path Forward for CCP Resilience, Recovery, and Resolution](#), a white paper that JPMorgan, together with a group of a buy-side and sell-side firms, released in 2019.¹ This white paper proposes twenty recommendations to enhance CCPs' resilience recovery and resolution, for consideration by relevant policymakers and regulators.

Overall, we support the recommendations in the Subcommittee's papers and encourage the CFTC and other relevant regulatory authorities to pursue rulemaking to implement them. We also endorse ongoing work by the Subcommittee, with support from Acting Chair Behnam, to continue the development of recommendations pertaining to issues of CCP transparency and disclosures, CCP capital, and CCP stress testing which were also raised in the 2019 industry white paper on CCP resilience, recovery and resolution referenced above.

Recommendations Regarding CCP Margin Methodologies

We support the six recommendations on margin methodologies which are intended to ensure that CCPs' margin models are robust, including those which require margin frameworks to address procyclicality, include concentration and liquidity add-ons, and align the margin period of risk with the liquidity of products. We also support the overarching requirement for greater transparency around margin models to enhance their predictability and support market participants' liquidity planning and risk management. While these recommendations represent a good starting point on these issues, we would welcome further examination on the topics of margin procyclicality, margin add-ons, and related disclosures by regulators. As stated in the paper itself, Subcommittee members representing FCMs, buy-side firms and one CCP along with the independent voting members thought procyclicality measures similar to those detailed in FIA's October, 2020 paper, [Revisiting Procyclicality: The Impact of the COVID Crisis on CCP Margin Requirements](#) should be included as recommendations along with expansion of CCP public disclosure requirements to include product level breach disclosures for significant products and setting the minimum margin period of risk assumption at two days to align with the time needed to hedge, port, or liquidate a defaulted portfolio.

Recommendations Regarding CCP Risk Governance

We support the recommendation to require CCPs to solicit, consider, and address market participants' views in the early stages of proposing changes that could materially affect a CCP's risk profile, for example through risk advisory working groups comprised of clearing members and end-users. Similarly, we support the recommendation to codify best practices related to CCPs' risk management committees. However, we would like to highlight that the independent voting member, clearing member and end-user perspective that CCPs should be required to formally consult with market participants before filing any rule submission with the CFTC that could materially affect the risk profile of the CCP's activity was not agreed upon by the full Subcommittee. We hope that this perspective can be revisited in future forums.

¹ The paper was originally published in October 2019 and now has twenty signatories.



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February 12, 2021

Submitted electronically

Alicia Lewis
CFTC MRAC Designated Federal Officer
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: ***CFTC MRAC CCP Risk and Governance Subcommittee: Vanguard Statement with respect to recommendations related to CCP Governance and CCP Margin Methodologies***

Dear Ms. Lewis:

Vanguard¹ appreciates the opportunity to serve on the Central Counterparty (“**CCP**”) Risk and Governance Subcommittee (the “**Subcommittee**”) of the Commodity Futures Trading Commission’s (“**CFTC**”) Market Risk Advisory Committee (“**MRAC**”). We commend Acting Chair Rostin Behnam for establishing the Subcommittee to develop actionable recommendations to address CCP risk issues.²

In multiple forums in recent years, Vanguard has consistently called on global regulators to address risks related to CCPs. In 2019, Vanguard joined with a group of concerned asset managers and futures commission merchants (“**FCMs**”), to publish “**A Path Forward for CCP Resilience, Recovery, and Resolution**” which sets forth twenty recommendations to improve CCP incentives, transparency and governance.

While our support for clearing is resolute, we see compelling opportunities to enhance the resiliency of CCPs, and to better prepare for their recovery and resolution. Especially as non-defaulting market participants are required to backstop CCP failures, it is imperative for market participants to have an effective voice in CCP governance and a clear window into CCP risks. The global ruleset must also be enhanced to strengthen the incentives for CCPs to offer products they can effectively risk manage, as the downside of a CCP’s risk management failure is presently disproportionately borne by non-defaulting market participants, including, potentially, our mutual funds.

¹ Vanguard is a global asset manager that offers more than 420 funds with aggregate assets of approximately \$7 trillion. Our core purpose is to take a stand for all investors, treat them fairly, and give them the best chance for investment success

² As a part of prudent management, Vanguard funds enter into derivatives contracts, including swaps and futures, to achieve a number of benefits for our investors, including hedging portfolio risk, lowering transaction costs, managing cash, and achieving more favorable execution compared with traditional investments. Vanguard has been fully supportive of global derivatives regulatory reform to bring much-needed transparency and regulation to the derivatives markets.

CFTC MRAC CCP Risk and Governance Subcommittee

February 12, 2021

Page 2

Vanguard supports the recommendations in the papers addressing CCP Governance and CCP Margin Methodologies presented for consideration by the MRAC as being directionally appropriate improvements to existing practices in these areas. The progress to be achieved from the implementation of the recommendations should be further expanded through committed efforts on matters highlighted in the papers which did not receive full Subcommittee support. For example, margin anti-procyclicality measures noted in the paper should be further considered to mitigate risks so clearly demonstrated in 2020. Likewise, additional work is required to advance the discussions aimed at ensuring that market participants have notice of, and the opportunity to comment on, matters that materially impact the risk profile of a CCP.

We also recommend that the work of the Subcommittee continue to develop actionable recommendations in the areas of CCP transparency, incentives, stress testing and liquidity, and default management. Vanguard is committed to productively engage in this meaningful effort to enhance the overall foundational resiliency of CCPs and thereby mitigate the potential systemic risk presented by this now critical market infrastructure.

* * * * *

We appreciate the opportunity to serve on the CFTC's MRAC Subcommittee on CCP Risk and Governance. If you have any questions about Vanguard's comments or would like any additional information, please contact William C. Thum, Principal, at (610) 669-9823 or william_thum@vanguard.com.

Sincerely,

DocuSigned by:



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/s/ William C. Thum, Principal

Global Head of Capital Markets Legal and Regulatory Practice Group
Vanguard