

MEMO# 34252

August 15, 2022

SEC Proposes New Rules for Clearing Agency Governance and Conflicts of Interest

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TO: Derivatives Markets Advisory Committee
Equity Markets Advisory Committee RE: SEC Proposes New Rules for Clearing Agency Governance and Conflicts of Interest

On August 8, the SEC proposed new rules to enhance the governance of SEC-registered clearing agencies, including requirements to reduce conflicts of interest among directors on clearing agencies' governing boards.[\[1\]](#) In light of this proposal, the SEC withdrew two prior related proposals that were narrower in scope.[\[2\]](#) According to the SEC, this proposal would establish more prescriptive governance requirements for all registered clearing agencies than existing rules.[\[3\]](#)

The SEC states that these new rules would help to ensure that clearing agencies "make more effective risk management decisions that account for relevant stakeholder perspectives and concerns" and that clearing agency governance is "transparent, objective, and addresses conflicts of interest" in times of market stress. It notes that participants have identified specific concerns about clearing agency governance, including the size and timing of margin requirements and the process for loss allocation in the event of participant default or a non-default loss. Accordingly, the SEC is concerned that current clearing agency decision-making related to such issues may be negatively affected by conflicting incentives among the agencies and their participants.[\[4\]](#)

Comments to the SEC's proposal are due the later of 30 days after publication in the Federal Register or October 7. ICI will host a member call via Zoom to discuss both this proposal and the CFTC's recent DCO governance proposal[\[5\]](#) on Thursday, August 18 at 1:00 p.m. (ET). A summary of the proposed rules follows below.

Board Composition and Requirements for Independent Directors

The proposed rules would establish certain requirements for clearing agencies relating to "independent directors," i.e., a director that has no "material relationship"[\[6\]](#) with the clearing agency or affiliate thereof:

- Majority of Independent Directors. A majority of a registered clearing agency's board must consist of a majority of independent directors and the clearing agency must consider "all relevant facts and circumstances" on an ongoing basis to determine whether a director remains independent. The majority requirement, however, would become one-third (34%) if a majority of voting interests are directly or indirectly owned by participants.^[7]
- Nominating Committee. A registered clearing agency must have a designated nominating committee that acts as the exclusive body for evaluating nominees for director. The committee must have a majority of independent directors, including an independent director as committee chair, and a written nominee evaluation process. Among other criteria, this committee must show that it (1) has considered whether a nominee would enable the board to reflect a range of differing business strategies, models, and participant sizes, as well as a range of participants' customers or clients; and (2) has considered the views of other stakeholders that may be impacted by the clearing agency's decisions, including institutional investors.^[8] According to the SEC, the committee would have discretion in deciding how to consider those views.
- Risk Management Committee. A registered clearing agency must establish a risk management committee (or committees) (RMC) to assist the board in overseeing risk management. The RMC must reconstitute its membership regularly and always include owner and participant representatives.^[9] Further, the RMC must be able to provide a risk-based, independent, and informed opinion on all matters presented before it in a way that supports safety and efficiency of the agency.
- Conflicts of Interest. A registered clearing agency must have written policies and procedures reasonably designed to identify and document existing or potential conflicts of interest in its decision-making processes, and mitigate or eliminate those conflicts.
- Consideration of Stakeholder Viewpoints. A registered clearing agency must have policies and procedures to solicit, consider, and document its consideration of the views of participants and other stakeholders regarding material developments in its governance and operations.
- Oversight of Critical Service Providers. A registered clearing agency must have written policies and procedures reasonably designed to enable the board to confirm and document that risks related to critical service provider relationships are managed in a manner consistent with the agency's risk management framework, including monitoring the agency management's monitoring efforts.

Nhan Nguyen
Assistant General Counsel, Securities Regulation

endnotes

^[1] Clearing Agency Governance and Conflicts of Interest, Exchange Act Release No. 34-85431 (Aug. 8, 2022) ("Proposal"), <https://www.sec.gov/rules/proposed/2022/34-95431.pdf>. The SEC notes that currently there

are seven active registered clearing agencies, all of which are "covered clearing agencies" because they provide a central counterparty (NSCC, FICC, ICC, ICEEU, LCH SA, OCC) or act as a depository for handling securities (DTC). Three of these agencies currently are also registered with the CFTC as DCOs (ICC, ICEEU, LCH SA).

[2] Exchange Act Release No. 63107 (Oct. 14, 2010), 75 Fed. Reg. 65882 (Oct. 26, 2010) (applying to security-based swap clearing agencies); Exchange Act Release No. 64017 (Mar. 3, 2011), 76 Fed. Reg. 14471 (Mar. 16, 2011) (applying various clearing agency standards relating to confidentiality of information and conflicts of interest, among other areas).

[3] Exchange Act Release No. 68080 (Oct. 22, 2012), 77 Fed. Reg. 66219 (Nov. 2, 2012) (adopting governance requirements for registered clearing agencies that are not covered clearing agencies under Rule 17Ad-22(d)(8)). "Covered clearing agencies" are registered clearing agencies that provide the services of a central counterparty or a central securities depository and, therefore, are subject to heightened requirements. Exchange Act Release No. 78961 (Sept. 28, 2016), 81 Fed. Reg. 70786 (Oct. 13, 2016).

[4] Based on its supervisory experience, the SEC believes that clearing agency decision-making may be negatively affected by (1) different incentives between clearing agency owners and participants, i.e., clearing members that affect risk management; (2) different views about risk management practices between small and large participants; and (3) access criteria and risk management standards imposed by clearing agencies on participants that create disproportionate costs. Proposal at 16-18.

[5] The CFTC recently proposed rules to require DCOs to establish RMCs. ICI Memorandum No. 34241 (Aug. 4, 2022), available at <https://www.ici.org/memo34241>.

[6] The proposed rules define "material relationship" as a relationship, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the director and includes relationships during a one-year lookback period.

[7] This exception also applies to where participants are owners as well. The SEC believes that the presence of participant-owners mitigates conflicts of interest because the interests of owners and participants will be more aligned with respect to ensuring more effective risk management. Proposal at 55-56.

[8] Proposal at 70.

[9] Under the CFTC's proposal, a DCO must ensure that its RMC(s) includes representatives from both clearing members and customers of clearing members. CFTC Proposed Rule 39.24(b)(11)(ii).