

MEMO# 35342

June 12, 2023

SEC and CFTC Propose Rules for Clearinghouse Resiliency and Recovery and Wind-Down Plans

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TO: Derivatives Markets Advisory Committee
Equity Markets Advisory Committee
Fixed-Income Advisory Committee RE: SEC and CFTC Propose Rules for Clearinghouse Resiliency and Recovery and Wind-Down Plans

The SEC and the CFTC have proposed amendments to the rules for covered clearing agencies (CCAs) and derivatives clearing organization (DCOs), respectively, related to resiliency, recovery, and wind-down plans. On May 17, the SEC proposed amendments that are intended to (1) strengthen CCA standards with respect to intraday margin requirements and requirements related to inputs in a CCA's risk-based margin system, and (2) specify the content of a CCA's recovery and wind-down plan.[\[1\]](#) On June 7, the CFTC also proposed similar amendments to DCO recovery and wind-down plan requirements, among other changes.[\[2\]](#) A summary of the relevant aspects is provided below.

Comments on the SEC proposal are due on July 17 and comments on the CFTC proposal are due 60 days after publication in the Federal Register. ICI will hold a member call to discuss both proposals and potential comments on Wednesday, June 14 from 2:00–3:00 p.m. ET.

SEC Proposed Amendments on CCA Intraday Margin

The SEC's proposal would enhance the CCA[\[3\]](#) standards for intraday margin under SEC Rule 17Ad-22(e). SEC rules currently require CCAs to have the authority and operational capacity to make intraday margin calls in "defined circumstances." The SEC is proposing to enhance this requirement by (1) requiring that a CCA's written rules and procedures reasonably ensure that monitoring of intraday exposure occurs on an "ongoing basis;"[\[4\]](#) and (2) specifying that a CCA should have the capacity to make intraday margin calls "as frequently as circumstances warrant," including when specified thresholds are breached or when there the relevant products or markets show "elevated volatility."[\[5\]](#) The SEC states that this should ensure that the CCA develops policies and procedures to determine when there is elevated volatility, which would then provide participants with notice as to when they may be subject to additional margin calls.

The SEC's proposal would also enhance existing requirements for substantive inputs in a CCA's risk-based margin model. SEC rules currently require a CCA to establish a margin model that uses "reliable sources of timely price data" and otherwise use "sound valuation models" where such price data isn't available or reliable. The SEC proposes to (1) expand the scope of inputs beyond price data to also include "substantive inputs"[\[6\]](#) and (2) establish procedures to address situations where such price data or substantive inputs are not available or reliable. Such procedures must include the use of alternative sources or an alternative margin model that doesn't rely on that unavailable or unreliable data.

The SEC requests comment on all aspects of the proposed amendments, including (1) whether it should prescribe particular risk thresholds for intraday margin calls, including what they should be and the basis for them, as well as whether they should be determined jointly or separately across different asset classes; (2) whether it should identify additional circumstances beyond "elevated volatility" that would warrant an intraday margin call; (3) whether it should specify that a CCA must use certain substantive inputs; and (4) whether certain participants of CCAs (e.g., those with less capital or using smaller settlement banks) may be challenged in meeting more frequent margin calls.

SEC and CFTC Proposed Amendments on Recovery and Orderly Wind-Down Plans

The SEC's and the CFTC's proposals detail the elements to be included in a CCA or DCO's recovery and "orderly wind-down" plan,[\[7\]](#) respectively. While SEC and CFTC regulations respectively require a CCA or DCO[\[8\]](#) to maintain and submit a recovery and wind-down plan for regulatory review and approval, the proposals would prescribe the content of those plans in greater detail.[\[9\]](#) The CFTC explains that its proposed amendments are intended in part to align with international standards and guidance issued since 2013, including from CPMI-IOSCO, as well as to codify relevant guidance from CFTC Letter No. 16-61.[\[10\]](#)

While both the SEC and CFTC propose similar requirements, the CFTC's proposal is generally more prescriptive, while the SEC's proposal sets forth broad-based rules that are supplemented with preamble guidance.[\[11\]](#) Across both sets, however, a CCA or DCO plan would generally need identify and describe:

- The CCA's or DCO's critical services provided to participants,[\[12\]](#) including how these services would continue to be provided in recovery or wind-down (through service providers and necessary supporting staff).[\[13\]](#)
- Scenarios that would prevent the CCA or DCO from being able to provide those critical services.[\[14\]](#)
- The criteria for triggering implementation of a recovery and/or wind-down plan and the process for monitoring such triggers.[\[15\]](#)
- The tools used in a recovery or orderly wind-down.[\[16\]](#) Both the SEC and CFTC, however, explicitly decline to prescribe that a CCA or DCO adopt and use specific types of tools, e.g., tear-ups, hair-cutting, skin-in-the game.[\[17\]](#)
- The procedures for notifying the SEC or CFTC as soon as practicable when the CCA or DCO is considering initiating a recovery or wind-down.[\[18\]](#)
- The procedures for testing a CCA's or DCO's ability implement the recovery or wind-down plan at least every twelve months, including a requirement that participants and other stakeholders (where practicable) participate in the testing, and procedures for reporting and addressing the test results with the board and senior management as well as for amending the plan based on the results.[\[19\]](#)
- The procedures for the CCA or DCO's board to review and approve the plans at least

every twelve months.^[20] The CFTC's proposal would also require the DCO's plans to describe the applicable governance structure and the processes that the DCO will use to guide its discretionary decision-making relevant to each plan. Further, the plans must describe the DCO's process for identifying and managing the diversity of stakeholder views and any conflict of interest between stakeholders and the derivatives clearing organization.^[21]

The SEC and CFTC seek comments on all aspects of their proposed rules on recovery and wind-down plans. Among its requests for comment, the SEC asks (1) whether it should also codify any elements of the CFTC's Letter No. 16-61, which provides guidance on the contents of a DCO's plans; and (2) whether it should adopt an explicit requirement for a CCA's plan to account for its unique characteristics and circumstances, including the effect on direct and indirect participants.

The CFTC's proposal also includes (1) amendments to the information that a DCO must provide regarding its recovery and orderly wind-down plans to assist with resolution planning by the FDIC, and the information systems and controls that it must maintain to provide that information;^[22] and (2) conforming amendments to the CFTC's bankruptcy provisions under part 190.

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Notes

^[1] Covered Clearing Agency Resilience and Recovery and Wind-Down Plans, Exchange Act Release No. 34-97516 (May 17, 2023), 88 Fed. Reg. 34708 (May 30, 2023) ("SEC Proposal").

^[2] Derivatives Clearing Organization: Recovery and Orderly Wind-Down Plans; Information for Resolution Planning, June 7, 2023), available at https://www.cftc.gov/media/8711/votingdraft060723_17CFRPart39b/download ("CFTC Proposal").

^[3] A CCA is a SEC-registered clearing agency that provides the services central counterparty or a central securities depository. All registered clearing agencies are currently designated as CCAs and include DTC, NSCC, FICC, OCC, ICE Clear Credit, ICE Clear Europe, and LCH SA.

^[4] SEC Proposed Rule 240.17ad-22(e)(6)(ii). The amended rule as proposed does not prescribe a specific time period or frequency, but rather allows the CCA to set these parameters based on the products cleared and market served.

^[5] SEC Proposed Rule 240.17ad-22(e)(6)(ii).

^[6] The SEC specifies that such additional inputs may include, for example, portfolio size, volatility, sensitivity to various risk factors that are likely to influence security prices, or duration and convexity, as well as results of margin models from third parties. The SEC emphasizes, however, that the rule would not mandate the use of specific substantive inputs.

[7] The SEC and CFTC propose similar definitions of "recovery" and "orderly wind-down," albeit with minor differences. See Exchange Act Proposed Rule 17ad-26(b) and CFTC Proposed Rule 39.2.

[8] References to "DCO" in this memo generally refer to DCOs deemed to be systemically important ("SIDCOs") or otherwise have elected to become a Subpart C DCO ("Subpart C DCO"). While existing CFTC recovery and orderly wind-down plan requirements currently do not apply to DCOs that do not fall into either category, the CFTC is proposing to extend many of the requirements applicable to the submission of orderly wind-down plans (but not recovery plans) to them as well. See CFTC Proposed Rule 39.13(k)(1)(a).

[9] The CFTC also proposes that currently registered DCOs must complete and submit recovery and orderly wind-down plans and supporting information within six months from the effective date of a final rule. CFTC Proposed Rule 39.19(c)(4)(xxiv).

[10] In 2016, CFTC staff issued Letter No. 16-61 as guidance as to what should be included in a DCO's recovery and wind-down plan. CFTC Letter No. 16-61 (July 16, 2016), available at <https://www.cftc.gov/csl/16-61/download>.

[11] The CFTC's proposal also delineates in its regulatory text separate but similar requirements for a DCO's recovery plan, see CFTC Proposed Rule 39.39(c)(2) and (4) and its wind-down plan, see CFTC Proposed Rule 39.39(c)(5), with respect to the applicable scenarios and tools to be described.

[12] The SEC refers to "critical payment, clearing, and settlement services," including those offered by service providers. SEC Proposed Rule 17ad-26(a)(1)-(2). The CFTC refers to "critical operations and services." CFTC Proposed Rule 39.39(c)(1). The CFTC's proposed rule text also provides greater specificity as to some of the details that a DCO must provide, such risks that the failure of each critical operation and service poses to the DCO, and a description of how such failures would be addressed, the DCO's financial and operational interconnections and interdependencies, the costs associated with recovery or orderly-winddown, and the impact of the multiple roles and relationships that a single financial entity may have with respect to the DCO, including affiliated entities and external entities.

[13] The CFTC's proposal additionally would require a DCO to determine which of its contract, arrangements, agreements, and licenses associated with critical operations and services would be altered or terminated when implementing a plan, and how it will continue those operations and services despite an alteration or termination. CFTC Proposed Rule 39.39(c)(6).

[14] The SEC specifies three broad types of scenarios: uncovered credit losses, uncovered credit shortfalls, and general business losses. SEC Proposed Rule 17ad-26(a)(3). While the SEC describes various specific examples of these scenarios in its proposal, see SEC Proposal at 34720-21, the CFTC proposes to codify specific scenarios, including a set of "commonly applicable scenarios," such as settlement bank failure, custodian bank failure, scenarios arising from investment risk, and poor business results. While these types of losses may constitute "non-default losses," as proposed to be defined under CFTC Rule 39.2, it also would require a description of default loss scenarios. Specifically, DCOs would need to describe 1) credit losses or liquidity shortfalls created by single and multiple clearing member defaults in excess of prefunded resources required by law; (2) liquidity shortfall created by a combination of clearing member default and a failure of a liquidity

provider to perform; (3) depository bank failure; and (4) losses resulting from interconnections and interdependencies with other CCPs (whether or not those CCPs are registered with the Commission as DCOs). CFTC Proposed Rule 39.39(c)(2).

[15] The CFTC proposes different required information for triggering a recovery plan versus a wind-down plan. A DCO's recovery plan would need to describe the criteria that may trigger both implementation and consideration of implementation of the recovery plan. With respect to the orderly wind-down plan, the DCO must only discuss the criteria that may trigger consideration of implementation of the plan. CFTC Proposed Rule 39.39(c)(3)(i).

[16] The SEC also specifies "rules, policies and procedures" that a CCA would use in a recovery or wind-down plan. SEC Proposed Rule 17ad-26(a)(5). Both the SEC (in preamble guidance) and CFTC (in regulatory text) specify that the plan contain details of the following: (1) a description of the tool to be used in each scenario; (2) the order in which each tool would be expected to be used; (3) the timeframe within which each such tool would be expected to be used; (4) the governance and approval processes for the use of each tool, including the exercise of discretion; (5) the processes to obtain external approvals to use each of the tools, and the steps that might be taken if such approval is not obtained; (6) the steps necessary to implement each tool; (7) the roles and responsibilities of all parties, including non-defaulting participants; (8) whether the tool is mandatory or voluntary; (9) an assessment of the likelihood the tools would result in recovery; and (10) an assessment of the associated risks from the use of each such tool to non-defaulting clearing members and their customers, linked financial market infrastructures, and the financial system more broadly. SEC Proposed Rule 17ad-26(a)(5); CFTC Proposed Rule 39.39(c)(4). The SEC's proposal further requires a CCA to include details on how it would its rules, policies procedures and any other tools or resources used for recovery or orderly wind-down would be used to ensure timely implementation. SEC Proposed Rule 17ad-26(a)(6).

[17] The SEC explains that each DCO is different and should have the discretion to decide which tools to include, as long as the tools "meets standards designed to protect indirect participants (e.g., clients, end users), direct participants (i.e., clearing members), the DCO itself, and other relevant stakeholders (including, in the case of SIDCOs, the financial system more broadly): 1) the set of tools should comprehensively address how the DCO would continue to provide critical operations and services in all relevant scenarios; (2) each tool should be reliable, timely, and have a strong legal basis; (3) the tools should be transparent and designed to allow those who would bear losses and liquidity shortfalls to measure, manage and control their exposure to losses and liquidity shortfalls; (4) the tools should create appropriate incentives for the DCO's owners, direct and indirect participants, and other relevant stakeholders; and (5) the tools should be designed to minimize the negative impact on direct and indirect participants and the financial system more broadly. CFTC Proposal at 44-45. The SEC provides similar guidance. SEC Proposal at 34722.

[18] The CFTC already requires DCOs to have procedures to notify the Commission as soon as practicable that a recovery plan is initiated or that an orderly wind-down is pending and is now proposing, among other things, that DCOs provide notice to both the CFTC and to clearing members. CFTC Propose Rule 39.39(b)(2).

[19] The CFTC's proposal also requires testing upon any material change to the recovery plan or orderly wind-down plan, but in any event not less than once annually. CFTC Proposed Rule 39.39(c)(8).

[20] The SEC's proposal would also require board review and approval of plans following material changes to the system or environment in which the CCA operates that would significantly affect the viability or execution of the plans. SEC Proposed Rule 17ad-26(a)(9).

[21] CFTC Proposed Rule 39.39(c)(7).

[22] According to the CFTC, these amendments are updates that are intended to align its current rules with additional standards and guidance applicable to resolution planning that have been adopted under the 2017 FSB resolution guidance. The required information includes (1) the DCO's structure and activities; (2) information about clearing members; (3) arrangements with other clearing entities; (4) the DCO's financial schedules and supporting details; (5) interconnections and interdependences with internal and external service providers; (6) information about critical personnel; and (7) other required information. CFTC Proposed Rule 39.39(f)(1)-(7).

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