

MEMO# 35679

April 16, 2024

SEC Adopts Final Rules for Clearing Agency Governance and Conflicts of Interest

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

Late last year, the Securities and Exchange Commission (SEC or "Commission") adopted final rules under the Securities Exchange Act of 1934 ("Exchange Act") to improve the governance of clearing agencies registered with the Commission ("registered clearing agencies") by reducing the likelihood of that conflicts of interest may influence the board of directors or equivalent governing body ("board") of a registered clearing agency.[\[1\]](#) The Final Rules identify certain responsibilities of the board, increase transparency into board governance, and, according to the Commission, improve the alignment of incentives among owners and participants of a registered clearing agency. In addition, the Final Rules establish new requirements for board and committee composition, independent directors, management of conflicts of interest, and board oversight.

The Final Rules were largely adopted as proposed[\[2\]](#) with a few technical modifications and clarifications in response to concerns from some commenters.[\[3\]](#) The Final Rules, and any modifications from the proposed rules, are summarized below.[\[4\]](#)

- **Board Composition and Requirements for Independent Directors.** A majority of the members of the board of a registered clearing agency must be independent directors, unless a majority of the voting interests issued as of the immediately prior record date are directly or indirectly held by participants, in which case at least 34% of the members of the board must be independent directors.[\[5\]](#) In addition, each registered clearing agency must consider all of the facts and circumstances on an ongoing basis to determine whether a director remains independent.[\[6\]](#) In making such determination, a registered clearing agency must (i) identify the relationships between a director and the registered clearing agency (or any affiliate thereof); (ii) evaluate whether any relationship is likely to impair the independence of the director; and (iii) document the evaluation and determination in writing.[\[7\]](#)
- **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 (i) 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 (ii) has considered the views of other stakeholders that may be impacted by the clearing agency's decisions, including institutional investors.[\[8\]](#) According to the Commission, the committee would have discretion in deciding how to consider those views.[\[9\]](#)

- Risk Management Committee. Each registered clearing agency must establish a risk management committee ("RMC") of the board to assist the board in overseeing the risk management of the registered clearing agency. The membership of each RMC must be reevaluated annually and at all times include representatives from the owners and participants of the registered clearing agency.[\[10\]](#) Additionally, the RMC must be able to provide a risk-based, independent, and informed opinion on all matters presented before it in a manner that supports the overall risk management, safety and efficiency of the registered clearing agency.[\[11\]](#)
- Conflicts of Interest. Each registered clearing agency must establish, implement, maintain, and enforce written policies and procedures designed to (i) identify and document existing or potential conflicts of interest in the decision-making process of the clearing agency involving directors or senior managers and (ii) mitigate or eliminate and document the mitigation or elimination of such conflicts of interest.[\[12\]](#)
- Management of Risks from Relationships with Service Providers for Core Services. Each registered clearing agency must establish, implement, maintain, and enforce written policies and procedures reasonably designed to require senior management to:

- (1) evaluate and document the risks related to an agreement with a service provider for core services,[\[13\]](#) including under changes to circumstances and potential disruptions, and whether risks can be managed in a manner consistent with the clearing agency's risk management framework;
- (2) submit to board for review and approval any agreement that would establish a relationship with a service provider for core services, along with the required risk evaluation;
- (3) be responsible for establishing the policies and procedures that govern relationships and manage risks related to such agreements with service providers for core services and require the board to be responsible for reviewing and approving such policies and procedures; and
- (4) perform ongoing monitoring of the relationship, and report to the board for its evaluation of any action taken by senior management to remedy significant deterioration in performance or address changing risks or material issues identified through such monitoring or if the risks or issues cannot be remedied, require senior management to assess and document weaknesses or deficiencies in the relationship with the service provider for submission to the board.[\[14\]](#)

- Obligation of Board of Directors to Solicit and Consider Viewpoints of Participants and Other Relevant Stakeholders. Each registered clearing agency must establish, implement, maintain, and enforce written policies and procedures reasonably

designed to require the board to solicit, consider, and document its consideration of the views of participants and other relevant stakeholders of the registered clearing agency regarding material developments in its risk management and operations on a recurring basis.^[15]

Compliance Dates

The compliance date for the Final Rules is 12 months ^[16] after publication in the Federal Register (i.e., December 5, 2024), except that the compliance date for Rules 17ad-25(b)(1), (c)(2) and (e) is 24 months after publication in the Federal Register (i.e., December 5, 2025).

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Notes

^[1] Clearing Agency Governance and Conflicts of Interest, 88 Fed. Reg. 84,454 (Dec. 5, 2023) ("Final Rules"), available at <https://www.govinfo.gov/content/pkg/FR-2023-12-05/pdf/2023-25807.pdf>.

^[2] For a summary of the proposed rules, please see ICI Memorandum No. 34252 (Aug. 15, 2022) available at <https://www.ici.org/memo34252>.

^[3] ICI submitted a joint comment letter to the CFTC and SEC on the proposed rules and analogous rules proposed by the CFTC for DCOs. See Letter to Mr. Christopher Kirkpatrick, Secretary, CFTC, and Ms. Vanessa Countryman, Secretary, SEC, from Sarah A. Bessin, Associate General Counsel, and Nhan Nguyen, Assistant General Counsel, ICI (Oct. 7, 2022) available at <https://www.ici.org/system/files/2022-10/34306a.pdf>.

^[4] The Final Rules promote similar outcomes as the CFTC's final rules related to DCOs, such as ensuring robust board oversight of senior management, and informing the board of stakeholder views, though in some cases the Commission has taken a different approach as to specific requirements because the Final Rules also address additional topics including board composition, director independence, and conflicts of interest. For a summary of the CFTC's final rules, please see ICI Memorandum No. 35364 (June 30, 2023) available at <https://www.ici.org/memo35364>.

^[5] See Rule 17ad-25(b)(1); Final Rules at 84,509. In a technical change from the proposed rule, the Commission replaced the term "voting rights" with "voting interests" consistent with the terms used elsewhere in the rule text.

^[6] See Rule 17ad-25(b)(2); Final Rules at 84,509. The Final Rules require the registered clearing agency to affirmatively determine that a director does not have a "material relationship" with the registered clearing agency or an affiliate thereof. A "material relationship" means a relationship, whether compensatory or otherwise, that exists or existed during a lookback period of one year from the initial determination in 17ad-25(b)(2) and that reasonably could affect the independent judgment or decision-making of a director. A minor, technical change was included in the final definition to clarify that the lookback period is part of the overall reference material relationships. Final Rules at 84,456.

[7] Final Rules at 84,456. In a minor, technical change to the rule text, the Commission clarified that the documentation requirement applies to both the registered clearing agency's evaluation of director independence and its ultimate determination of whether a director qualifies as an independent director. Final Rules at 84,456.

[8] See Rule 17ad-25(c); Final Rules at 84,510. Certain minor, technical changes to the rule text clarified that the nominating committee is responsible for evaluating the independence of nominees and directors in addition to evaluating nominees to serve as directors and specified that the evaluation process applies to nominees as well as directors. Final Rules at 84,466.

[9] Final Rules at 84,467.

[10] See Rule 17ad-25(d)(1); Final Rules at 84,510. The Commission adopted this requirement as proposed with minor modifications to reflect that the RMC is "of the board" of the registered clearing agency and that the RMC's membership must be "reevaluated annually" instead of "reconstituted annually." The Commission agreed with commenters that a "required reconstitution of the RMC on a regular basis could lead to the undesired outcome of turnover in the committee membership before members are able to contribute optimally, with a loss of continuity and expertise." The Commission further stated that the modification "leaves the frequency and type of reconstitution to the discretion of the registered clearing agency, while at the same time requiring a reevaluation to be conducted annually." Final Rules at 84,470.

[11] See Rule 17ad-25(d)(2); Final Rules at 84,510.

[12] See Rule 17ad-25(g); Final Rules at 84,510.

[13] "Service provider for core services" means any person that, through a written services provider agreement for services provided to or on behalf of the registered clearing agency, on an ongoing basis, directly supports the delivery of clearance or settlement functionality or any other purposes material to the business of the registered clearing agency. This definition was modified from the proposed rules to specify the intended scope of the rule, which the Commission stated generally should include cloud services, pricing services, model services, matching services, any services related to straight-through processing, and collateral management services. Final Rules at 84,477.

[14] See Rule 17ad-25(i); Final Rules at 84,510. The Commission modified the rule to more clearly delineate the roles of senior management and the board. Final Rules at 84,477.

[15] See Rule 17ad-25(j); Final Rules at 84,511. Minor, technical changes to the rule text replaced "governance and operations" with "risk management and operations." The Commission stated that although commenters recommended that it replace both terms "governance and operations" with "risk management," it was appropriate to retain "operations" because not all operational functions that directly affect participants and other stakeholders clearly fall within the concept of "risk management." Final Rules at 84,484.

[16] As proposed, the compliance date would have been 180 days after publication in the Federal Register. The Commission modified the compliance date in response to commenter concerns that registered clearing agencies have enough time to consider and develop changes to rules, policies, and procedures to ensure compliance with the Final Rules and to submit those changes to the Commission for review when required by Section 19 of the

Exchange Act and Rule 19b-4 thereunder. Final Rules at 84,490.

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