ISDA Safe, Efficient Markets

October 11, 2022

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st St. N.W.
Washington, DC 20581

Re: Governance Requirements for Derivatives Clearing Organizations (RIN 3038–AF15)

Dear Mr. Kirkpatrick:

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] appreciates the opportunity to submit these comments on the Commodity Futures Trading Commission's (the "**Commission**") notice of proposed rulemaking (the "**NPR**").

We welcome the opportunity to provide our views on DCO governance. With the central role governance plays in a DCO's risk management, we believe this NPR is very timely and will improve governance and risk management of DCOs.

We however believe that this NPR is only the beginning and would welcome further improvements in DCO governance.

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1000 member institutions from 78 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube..

General Comments

We are generally very supportive of this NPR. Risk Management Committees ("**RMC**"), Risk Working Groups ("**RWG**") and wider consultation will promote transparency, accountability, and predictability, and facilitate effective oversight by the Commission.

RMC are good practice in many CCPs[2] and already required by regulation in many other jurisdictions. We therefore welcome codification of such governance bodies as proposed by this NPR.

ISDA welcomes the consultation on additional topics, namely "Market Participant Consultation Prior to a Rule Change" and "RMC Member Information Sharing with Firm to Obtain Expert Opinions". We believe both proposals would significantly improve DCO governance.

We note that the Securities Exchange Commission is also consulting on CCP governance and welcome that the two Commissions are liaising with each other.

There are existing rules in other jurisdictions in relation to CCP governance. We propose that in case of conflicting rules between home jurisdiction of a CCP and other jurisdiction where the CCP might be registered, recognised or have a similar status, the rules of the home regulator will prevail if the CCP cannot comply with both.

ISDA also requests that the Commission issue Regulation 39.24(b)(11) as follows [black text was proposed by CFTC in the proposed rule; red underlined text is ISDA's requested addition]:

(11) Establish one or more risk management committees and require the board of directors to consult with, and consider and respond to input from, the risk management committee(s) on all matters that could materially affect the risk profile of the derivatives clearing organization, including any material change to the derivatives clearing organization's margin model, default procedures, participation requirements, rule enforcement policy, public information policy, and risk monitoring practices, as well as the clearing of new products…"

ISDA believes that a DCO's rule enforcement policy and public information policy are of similar significance to the other topics that the Commission has proposed a new RMC should address. Like the topics that the Commission already proposed (margin models, default procedures, participation requirements, and risk monitoring practices), a DCO's rule enforcement and public information policies are subject to DCO Core Principles set forth in the Commodity Exchange Act (in these cases, Core Principles H (Rule Enforcement) and L (Public Information) and CFTC Regulations (in these cases, Regulations 39.17 and 39.21)). Analogously, margin models and risk monitoring practices are subject to Core Principle D (Risk Management) and CFTC Regulation

[2] In this letter, we use the terms "CCP" and "DCO" interchangeably.

39.13, default procedures are subject to Core Principle G (Default Procedures) and CFTC Regulation 39.16, and participation requirements are subject to Core Principle C (Participant and Product Eligibility) and CFTC Regulation 39.12.

This response covers the positions of our members on the buy-side and sell-side. The paper does not reflect the views of many CCPs, and many of the CCPs are in disagreement with the views.

* * *

ISDA appreciates the opportunity to submit these comments on the Commission's Consultation.

If ISDA can be of any help in this process, we hope that you will not hesitate to contact ISDA's Head of Clearing, Ulrich Karl, at telephone number +44 20 3808 9720 or at UKarl@isda.org.

Sincerely,

Ulrich Karl
Head of Clearing

Appendix: Response to the Commission's questions

II. Proposed Amendments to § 39.24(b)

A. Establishment and Consultation of RMC – § 39.24(b)(11)

The Commission requests comment on whether a DCO's proposal to clear a new product should be categorically treated as a matter that could materially affect the DCO's risk profile for purposes of the proposed RMC consultation requirement given the heightened potential for novel and complex risks associated with clearing new products. If so, should the Commission define what constitutes a new product for this purpose, and how should it do so?

Not all new products will add risk to a CCP. For instance, adding another underlying equity to a CCP that already clears equity options usually would not cause concern and would not count as a new product. We agree with the proposal in the NPR that a "new product" could be defined to "*include those that have margining, liquidity, default management, pricing, or other risk characteristics that differ from those currently cleared by the DCO*".

Nevertheless, we propose that all proposals of new products should be introduced to the RMC. The RMC can determine which products require RMC consultation for approval. This approach would make sure that the RMC can opine on all products, even boundary cases which the DCO does not see as a "new product".

B. Policies and Procedures Governing RMC Consultation – § 39.24(b)(11)(i)

The Commission requests comment on whether DCOs should be required to create and maintain minutes or other documentation of RMC meetings.

We believe that DCOs should be required to create and maintain minutes or other documentation of RMC meetings. This would improve accountability and transparency. As a minimum, these minutes should be made available to the Commission.

While some of our members believe the RMC meeting minutes should be public, we understand that this requirement could stifle discussions at the RMC, or the minutes would be so redacted as to be unreadable.

We propose that the minutes of RMC members are made available to RMC members and shared with the CCP Board and available for review by the regulators. As the decisions made at the RMC

meetings have an impact on a wide variety of market participants, it would be helpful if the CCP produced a summary that is made public and that does not include confidential information.

C. Representation of Clearing Members and Customers on RMC – § 39.24(b)(11)(ii)

The Commission requests comment on whether it should adopt additional specific composition requirements, and if so, what those requirements should be.

We wonder whether the minimum requirement of more than one clearing member and more than one customer of a clearing member ensures a minimum level of market participant participation on RMCs. The required minimum - four external members of the RMC - might not provide a sufficient level of industry input and challenge, even for very small CCPs.

Since clearing members' capital underwrites CCP risk, clearing member representation should probably represent at least 50% of the external members of the RMC. In this context, clearing member representation does not include market participants unless they, or an external participant such as an academic, are nominated by a clearing member to represent them.

Because market participants will interact with the clearing ecosystem in different ways, it is important to have a wide range of representation to ensure that as many views are represented as possible. We therefore agree that a CCP should aim to have a wide variety of RMC members on the Committee – with different roles in their organization and from different types and sizes of organization. This is difficult to specify, and we therefore propose a principle-based rule requiring the CCP to have RMC members that cover a wide variety of organizations and roles within this organization, subject to good knowledge of CCPs.

To be able to represent a wide range of market participant, both on the clearing member and on the client side, we believe there should be at least 8 external members.

D. Rotation of RMC Membership – § 39.24(b)(11)(iii)

The Commission requests comment on whether it should set a minimum frequency for RMC membership rotation, what are the advantages and disadvantages of doing so, and, if it does, what that frequency should be.

While rotation of RMC membership will in theory provide a wide variety of views to be represented in the RMC, there will be a few especially knowledgeable individuals that might be beneficial to have on the RMC and that the DCO might not want to see being rotated out. Also, a

situation where the CCP spends a considerable part of RMC meetings on educating new RMC members should be avoided. Given the huge amount of information a new RMC member needs to process, and consequently the time required to get up to speed and to become a valuable resource for the CCP, we propose a minimum length of membership, which should not be less than 2 years.

We favor a staggered rotation system, which allows for new members, while still retaining institutional knowledge. We think there is value to having knowledgeable members on for multiple years while recognizing that everyone should at some point get rotated. Perhaps there could be a cap that would prevent RMC members from staying on for more than 5 consecutive years.

Many DCOs' RMCs have members external to the DCO, but also representatives of management, for instance the Chief Risk Officer. We assume that the rotation of RMC membership affects only representatives external to the DCO.

E. Establishment of RWG to Obtain Input – § 39.24(b)(12)

The Commission requests comment on whether the proposed requirement that each RWG convene quarterly is the appropriate frequency. The Commission also requests comment on whether it should require DCOs to document the proceedings of RWG meetings, considering both the transparency and accountability benefits of such a requirement and the potential impact of a documentation requirement on free and open dialogue.

We believe quarterly is the right frequency, at least as a minimum. We would hope DCOs embrace the benefits a RWG would bring and have more frequent meetings if required.

In the past, CCPs that were setting up new (OTC derivatives) clearing segments had RWGs almost weekly for some time.

We believe that it is helpful if the DCO documents each meeting because of the transparency and accountability benefits and also to allow members of the group that miss a meeting to efficiently participate in the next meeting. A solution for the impact on free and open dialogue could be that the meeting minutes contain discussion topics, points that were made by participants, but not who made these points. The minutes should also contain areas of disagreement and document any agreement or decision made (if any) on the discussed topics.

III. Proposed Amendments to § 39.24(c)

B. Role of RMC Members as Independent Experts – § 39.24(c)(3)

> The Commission requests comment on whether requiring RMC members to act as independent experts, neither beholden to their employers' commercial interests nor acting as fiduciaries of the DCO raises any potential legal issues for those members. Specifically, as a matter of corporate law, would RMC members be forced to contend with competing duties or obligations to the DCO and their employer, including any duties or obligations that would foreclose RMC participation? If so, how may the goal of receiving independent, expert opinions be achieved? Should DCOs be required to have policies for managing conflicts of interest specific to RMC members?

We believe that it is common practice in RMCs of CCPs across the globe that RMC members act not as representatives of their employer, but as independent experts. We are not aware that this practice has led to issues anywhere.

Against the background that RMC members are independent experts and do not represent their employer, we especially welcome the requirement to establish RWGs, as this would be a forum to provide any views, including views that reflect the house position of clearing participants.

IV. Request for Comment

A. Market Participant Consultation Prior to a Rule Change

> The Commission requests comment on whether it should also require a DCO to consult with a broad spectrum of market participants prior to submitting any rule change pursuant to §§ 40.5, 40.6, or 40.10. If so, what constitutes a sufficiently broad spectrum of market participants, and how should the DCO engage that group? Should a DCO be required to consult only on those rule changes that could materially affect the DCO's risk profile?

One could argue that if the DCO establishes RWGs and membership in the RWG is open to all clearing participants, consultations with RMCs and RWGs could replace a consultation requirement. We however believe that not all clearing participants will have the bandwidth to join RWGs, but some might want to opine on certain topics in the DCO's risk management framework. Given that large banks and FCMs usually have resources to participate in RWGs etc., but smaller firms do not, a consultation requirement will also enable smaller firms to have a voice and therefore could increase the range and variety of views provided to the DCO.

We believe that the best and easiest way to engage with clearing participants would be to publish consultations on the CCP's website (including an email notification service). This would enable the broadest range of participants to provide feedback, assuming the consultation deadlines are reasonable.

We believe that a DCO should consult on changes that have a material impact on the DCO's risk profile, and on those changes that would have a material impact on the internal operations of the FCMs. For example, this could include changes to margin transfer timings. We would hope that DCOs receive valuable feedback from the RMC, the RWG and through the consultation process, and that over time DCOs will actively seek the opportunity to receive this feedback.

In accomplishing effective consultation, is there value to requiring a DCO to respond to market participant feedback? Specifically, where specific risk-based feedback from market participants has not been incorporated in the DCO's decision, should the DCO be required to respond to market participants informing them of the decision and outlining the rationale behind their action? How could such a requirement be tailored to avoid forcing a DCO to respond to excessively detailed or irrelevant comments?

We believe it will add value to the DCO's decision process if the DCO responds to market participant feedback. This is important, in particular when the DCO does not incorporate the feedback into its decision. In this case the DCO should explain the rationale behind its decision.

We do not see any danger that the DCO would have to respond to "excessively detailed or irrelevant comments". Most parties engaged in clearing or interested in DCO risk management will not have the bandwidth to make "excessively detailed or irrelevant comments".

We do not believe that the DCO should be required to respond to each consultation response separately. The DCO could provide a summary of consultation responses received, which one were taken into account and which ones were not, together with the reason for the DCO's decision.

As noted above, Commission regulations currently require a DCO to provide to the Commission a "brief explanation of any substantive opposing views." Should the Commission further clarify the meaning of "substantive" in the context of this requirement? Should a DCO be required to provide the Commission with a report of all opposing views expressed to the DCO? Rather than expecting the DCO to accurately describe opposing views, should the Commission only require a DCO to pass on to the Commission any opposing views expressed to the DCO in writing? Should a DCO be required in its submission to the Commission to respond to opposing views expressed to the DCO? Finally, should the Commission consider additional rules to address a DCO's failure to comply with the full submission requirements of Part 40, such as the imposition of an automatic stay?

We believe that it is difficult to define what "substantive comments" are and would propose that the DCO shares with the Commission the same document it uses to respond to consultation feedback (please see our response to the previous question). We also would not disagree with a requirement that the DCO passes to the Commission all consultation responses. This could be done as a supplement to the summary report described above. Sharing this document would have the advantage that the Commission sees all the responses that the DCO gave to clearing participants.

We support the Commission to consider additional rules to address a DCO's failure to comply with the full submission requirements of Part 40, such as the imposition of an automatic stay.

B. RMC Member Information Sharing with Firm to Obtain Expert Opinions

The Commission requests comment on whether DCOs should be required to maintain policies and procedures designed to enable an RMC member to share certain types of information it learns in its capacity as an RMC member with fellow employees in order to obtain additional expert opinion. If so, what types of information should be eligible to be shared? What measures should be taken to ensure that confidential information is appropriately protected?

We believe that RMC members could do a better job and provide better advice and feedback to the DCO if they were allowed to consult with internal experts. Confidentiality arrangement should ensure that allowing to consult experts in a RMC member's organization does not result in an unfair benefit for these firms.

We believe that the involvement of other experts by a RMC member should only be allowed for questions that involve the DCO risk management framework, but not for RMC discussions that

affect other members or clients of members of the DCO. The DCO could identify such topics in their meeting agendas.

D. Antitrust Considerations

The Commission requests comment on whether the proposed amendments implicate any other specific public interest to be protected by the antitrust laws. The Commission has considered the proposed rulemaking to determine whether it is anticompetitive and has identified no anticompetitive effects. The Commission requests comment on whether the proposed rulemaking is anticompetitive and, if it is, what the anticompetitive effects are.

We agree with the Commission's preliminary determination that the proposed rule amendments are not anticompetitive and have no anticompetitive effects.