IDTA

October 7, 2022

Submitted Electronically via SEC.gov

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-21-22: Clearing Agency Governance and Conflicts of Interest

Dear Ms. Countryman:

The Independent Dealer and Trader Association[1] (the "IDTA") appreciates the opportunity to provide comments to the rulemakings proposed (the "Proposed Rule") by the Securities and Exchange Commission ("Commission"). The IDTA supports the efforts of the Commission to advance the goals of reviewing and enhancing standards of governance for registered clearing agencies. More specifically, the IDTA applauds the Commission's view that part of the goals of governance should be to ensure that smaller participants, who provide diverse perspectives and expertise that aid in improving the resilience of the clearing agency, have meaningful representation in the governance of these critically important entities.[2]

I. INTRODUCTION AND SUMMARY

The Commission in the Proposed Rule increases the representation of "independent directors" on the Boards of Directors of clearinghouses.[3] The IDTA agrees with this goal, but believes that the language in the proposal defining the "material relationship" should be expanded to ensure that an employee or other representative of an organization that is a member or clearing participant of a clearinghouse would represent a material relationship.

Also, the Commission notes in the Proposed Rule that based on its supervisory experience, it "believes that smaller participants and clients of participants should be represented on clearing agency boards and board committee, such that their views and perspectives are formally

[1] The IDTA was formed to create a forum for independent dealers and traders to discuss and consider the impact of market operations issues on their industry sector and to advocate for constructive solutions that promote the liquidity, efficiency and competition in the capital markets. The objective of the IDTA is to form an interactive line of communication with regulators and other relevant policy makers, with particular emphasis on the Securities and Exchange Commission, the Treasury Department, the Federal Reserve Board of Governors and the Federal Reserve Bank of New York.

[2] Clearing Agency Governance and Conflicts of Interest, 87 FR 51812, 51829 (Aug. 23, 2022), *available at* https://www.govinfo.gov/content/pkg/FR-2022-08-23/pdf/2022-17316.pdf (hereinafter "Proposed Rule")

[3] *Id*. at 51820.

considered in board decisions that may impact them."[4] The IDTA agrees with the concerns reflected in the proposed rule as it relates to both limiting conflicts of interest in clearinghouses and ensuring more diverse representation on the clearinghouses Boards of Directors. However, it is important that the focus not only be about balancing between directors with a material relationship, affiliation or ownership interest in the clearinghouse and independent directors with no such connections to the clearinghouse. It is critically important that there also be a balance between different types of directors with ownership interests, particularly on the boards of clearinghouses that operate as a cooperative among member participants. This would ensure that institutions of different types, sizes and location are represented on these Boards of Directors. Furthermore, such diversity will ensure that there is a meaningful number of affiliated (non-independent) Board members who are not designated by the Financial Stability Oversight Council ("FSOC") as systemically important institutions ("SIFIs").

The Proposed Rule attempts to address three sets of conflicts of interest: (1) different perspectives of various stakeholders involved in clearing agencies; (2) the diverging interests of larger clearing agency participants versus smaller clearing agency participants; and (3) the undue influence exerted by certain participants, which can result in limited access to the clearing agency based on their own interest. As the Commission acknowledges, the differing views between small and large clearing members or between direct and indirect participants may manifest themselves in a clearing agency's decision-making by benefiting one category of stakeholders at the expense of another.[5] The IDTA understands the Commission's observations that owners and participants may have "structural incentives" which leads to different views on certain risk management tools.[6] As the Commission also noted, the differing views of owners and participants impacts the nature of financial resource requirements that are imposed as part of the clearing agency's risk management framework. [7] But, simply put, both owners *and* participants in a clearinghouse have various perspectives based on their size and market activities.

It is important that various perspectives are given adequate consideration when decisions or policies are being formed. Doing so will not only mitigate conflicts of interest, but will facilitate transparency by ensuring there is a level playing field among market participants. The Commission observes in the proposal that the interests of owners and participants can be at odds; for instance, owners are interested in protecting the equity and operations of the clearing agency while participants are interested in avoiding loss allocations from a defaulting participant.[8] The IDTA applauds the Commission for its commitment to promoting fair and adequate representation of "independent directors" (properly defined) in the governance of the clearing agency.

Also, the priorities and interests of the largest financial institutions often differ greatly from non-SIFI firms. The IDTA agrees with the Commission's concern that when there is a small number of dominant participants exerting control over the services and participation rules of a clearing agency, the dominant participants may promote margin or other requirements that are not commensurate with the risks of each participant's specific products, portfolio market, business

[4] *Id*.
[5] *Id*. at 51815.
[6] *Id*. at 51816.
[7] *Id*.
[8] *Id*.

model and size.[9] Not only does this restrict competition, but also increases the dominant participants' ability to maintain and even grow market share, potentially adding concentration risk to the clearinghouse.[10]

II. IDTA COMMENTS ON PROPOSED RULES

A. Board Composition and Requirements for Independent Directors

The IDTA applauds the proposal to increase the number of independent members of the Board of Directors of clearing agencies. Such views, not encumbered by direct economic interests, are critical to the proper functioning of any board of directors, perhaps particularly critical for systemically important financial market clearinghouses. However, to ensure the goal of minimizing conflicts of interests and ensuring diversity of perspectives and views on the Boards of clearing agencies is not met solely by increasing the number of "independent" directors. To achieve such diversity, it is critical that these rules provide a requirement that there be diverse representation among clearinghouse participants, and most particularly among the counterparties who are members of the clearinghouse. This is most important if a clearing agency is organized as a cooperative among the clearinghouse members where ownership share is defined by some measure of market share. Failure to ensure such diverse board membership will result in perpetual and institutional representation by the largest firms and more episodic and nominal representation by smaller and more specialized firms. Such lopsided representation on a governing body ultimately results in policies that enhance the market strength of the largest firms at the expense of a more competitive and diverse market environment. This ultimately leads to greater concentration of risk among the largest players, which seem in direct contradiction to the goals of sound governance of clearing agencies.

As it relates to "independent directors," proposed Rules 17Ad-25(b), (e), and (f) would establish requirements related to independent directors, including requiring that a majority of the directors of a registered clearing agency be independent directors, unless a majority of the voting rights distributed to shareholders of record are directly or indirectly held by participants of the registered clearing agency. In such case, at least 34 percent of the board must be independent directors. The Proposed Rule would define "independence" as having no material relationship with the registered clearing agency or an affiliate.[11]

The Proposed Rule identifies the circumstances where a director is precluded from being an independent director due to their employment relationships, familial relationships, or if the director has received payment from the clearing agency or its affiliates, whether directly or indirectly.[12] Imposing specific limitations on ownership of the clearing agency, along with minimum independence requirements for members of the board of directors, is an effective way to address conflicts of interest. The IDTA generally supports the provisions of the Proposed Rule that would require more independent directors that have "no material relationships with the registered clearing

[9] *Id*.
[10] *Id*.
[11] *Id*. at 51820.
[12] *Id*. at 51825.

agency, or any affiliate thereof."[13] However, the IDTA believes strongly that in defining material relationships, it should be clear that an employee or director of an entity or company that is a member or clearing participant of a registered clearing agency, or an entity that has an ownership interest in the clearing agency, would be deemed to have a material relationship and not qualified to be an independent director.

Also, as stated above, the IDTA believes it is equally important to ensure that representation of affiliated (non-independent) directors is required to be more diverse. Such board diversity ensures sufficient and meaningful representation of large, middle market, small, bank affiliated, independent broker-dealer directors. Diverse perspectives will help ensure that policies enhance, and do not inhibit, competition. Further, diversity ensures that policies do not contribute to increased concentration risk amongst the largest systemically important institutions. If diversity among directors who have an affiliation or ownership interest in the clearing agency is improved and the definition of material interest expanded, the majority of the board should be composed of independent directors.

B. Nominating Committee and Risk Committee

The IDTA supports the establishment of a nominating committee and a risk management committee.[14] Nevertheless, the IDTA believes the Commission should be more prescriptive in requiring that certain types of stakeholders, such as more institutions that are not FSOC designated SIFIs, be afforded a right of participation on the board and those committees of a clearing agency. Proposed Rule 17Ad-25(c) would require the clearing agency to establish a nominating committee and a written evaluation process, or such committee to evaluate the individual nominees to serve as directors.[15] While the requirements for the composition of the nominating committee and the fitness standards for serving on the board are well-received, the IDTA believes that there should be requirements to ensure that the nominating committee considers nominees that represent the views of smaller and middle-market participants. The Commission puts forth helpful requirements with regard to the process the nominating committee would need to abide by, such as demonstrating that the nominating committee considered the views of other stakeholders who may be impacted by the decisions of the clearing agency.[16] Despite this, the Proposed Rule does not require a registered clearing agency to include other types of stakeholders in the selection of directors.[17] In order to maintain independence and improve the quality of nominees, the IDTA believes all members of the nominating committee should be independent directors, as opposed to the committee being composed of majority affiliated directors.

Proposed Rule 17Ad-25(d) would require each registered clearing agency to establish a risk management committee (or committees) to assist the board of directors in overseeing the risk management of the clearing agency and would require the committee to reconstitute its membership on a regular basis.[18] The IDTA agrees with the Commission's observation that

[13] *Id*. at 51820.
[14] *See* proposed rule 17Ad-25(c)(1), requiring each registered clearing agency to establish a nominating committee and a written evaluation.
[15] Proposed Rule at 51828.
[16] *Id*. 51828.
[17] *Id*. at 51830.
[18] *Id*. at 51830.

requiring representatives from a clearing agency's owners and participants to serve on the risk management committee helps ensure that the committee understands the clearing agency's operations.[19] Multiple representatives from the owners and participants of the clearing agency helps ensure the minimum standard for the inclusion of market participants on the risk management committees, but this composition does not create a diverse enough perspective with regards to risk management. The IDTA recommends that the rule include a requirement to ensure sufficient representation on the risk committees of non-SIFI entities (smaller and middle-market firms). The IDTA also believes that the requirements for the function, composition, and reconstitution should specifically include considerations of concentration of risk in the markets, competitiveness of the markets, and the impact of policies on competitiveness.

C. Conflicts of Interest

Requiring clearing agencies to adopt policies and procedures with respect to the management of conflicts is instrumental to maintaining a sound regulatory framework. Proposed Rule 17Ad-25(g) would require each clearing agency to establish, implement, maintain, and enforce written policies and procedures designed to identify and document existing or potential conflicts of interest in the decision-making process of the clearing agency involving directors or senior managers. Further, the Proposed Rule requires the clearing agency to mitigate or eliminate and document the mitigation or elimination of the conflicts of interest. To ensure all voices are heard, the policies and procedures should mandate that the reviewing and mitigation of conflicts are conducted by a diverse group, and, most particularly, not only large institutions.

The IDTA maintains that there should be board adopted policies and procedures to solicit, consider, and document the clearing agency's consideration of the views of its participants, as well as other relevant stakeholders, regarding its governance and operations. Such policies should include a review by a group or committee that includes representation from small and middle-market participants. Moreover, in considering the adoption of new policies, the IDTA recommends the consideration of the impact on institutions that are not FSOC designated SIFIs. Small and middle-market participants would be able to provide ongoing feedback on how policies are impacting the markets in order to minimize conflicts of interest and ensure competition among institutions of all sizes.

III. ECONOMIC ANALYSIS

The IDTA's recommendations aim to ensure meaningful representation in the governance of registered clearing agencies by non-SIFI small and middle-market clearinghouse members. Failure to do so could result in the market share of the largest banks continuing to grow – both increasing concentration of risk in the market and reducing competitiveness by increase barriers for smaller and middle market firms. As discussed above, it is imperative that various perspectives are considered when policies are formed in order to mitigate conflicts of interest. In addition to considering the views of its participants, the IDTA urges the Commission to review and analyze the effect of policies and procedures on competitiveness in the U.S. securities market. Not doing so would be inconsistent with President Biden's Executive Order on Competition ("Executive Order"), which requires regulators to ensure that current and proposed rules enhance, not hinder

[19] *Id*. at 51832.

competition in the markets they oversee.[20] The Executive Order calls for a "whole-of-government approach" to address excessive concentration, abuses of market power, unfair competition, and the effects of monopoly.[21] The Executive Order specifically identified the SEC as one of the agencies whose rules must seek to resist consolidation and promote competition, "including the market entry of new competitors."[22]

While the Proposed Rule takes steps to mitigate conflicts of interest in clearing agency governance, the IDTA remains concerned about the impact that future policies could have on smaller independent broker-dealers, particularly in the U.S. government securities market, and urges the Commission to review the mandate in the Executive Order and consider the impact on middle-market firms.

The IDTA appreciates the considerations provided in the Commission's analysis of economic considerations for the Proposed Rule and the impact of clearing agency policies on competition among participants. Institutions that are not SIFIs need assurance that their voices will be heard within the clearing agency regulatory framework. The Proposed Rule recognizes the divergent incentives among participants, e.g., large direct participants have incentives to influence the clearing agency to adopt policies that would inhibit smaller dealers from participating directly in the clearing agency.[23]

The IDTA welcomes the Commission's attempt to address the divergent incentives of large and small participants by reducing a large participant's ability to obtain or maintain a competitive advantage through activities such as providing lower quality collateral or promoting margin requirements that are not commensurate with the risks and particular attributes of each participant's specific products, portfolio, and market.[24] However, we also urge the Commission to assess the correlation between policies and the amount of risk that institutions take on. For example, clearinghouse directors appropriately review policies to protect against the material effect that the failure of a clearinghouse member may have on the clearinghouse itself and its members. Before advancing solutions that are applied on a "one-size-fits-all" basis, it should be determined, based on concentration risk data among clearinghouse members, how the failure of any particular clearing member would impact the clearinghouse. With such information, solutions can be appropriately fashioned in a manner consistent with that risk analysis. Failure to do such analysis has, in the past, resulted in "one-size-fits-all" solutions that ultimately result in significant and disproportional burdens on smaller clearing members. Moreover, such solutions will only lead to increased concentration risk and reduced competition in the market.

IV. CONCLUSION

Without sufficient representation and involvement of small and middle-market participants, the goals of the proposed rules to ensure that fair, efficient and effective governance of clearinghouses will not be met. If the economic interests of the largest financial institutions remain

[20] Exec. Order No. 14036, 86 Fed. Reg. 36987 (July 14, 2021).
[21] *Id*.
[22] *Id*. at 36989.
[23] Proposed Rule at 51842.
[24] *Id*. at 51843.

at the forefront of policymaking, the larger will only get larger, increasing the concentration risks in the markets and the markets will be less competitive.

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The IDTA thanks the Commission for the opportunity to comment on the Proposed Rule. Please feel free to contact me at [redacted] or at [redacted] with any questions you may have on our comments.

Sincerely,

James Tabacchi
Chairman
Independent Dealer and Trader Association

cc: Honorable Gary Gensler, Chairman
Honorable Hester M. Peirce, Commissioner
Honorable Caroline A. Crenshaw, Commissioner
Honorable Mark T. Uyeda, Commissioner
Honorable Jaime Lizárraga, Commissioner

Conformed to Federal Register version

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 242

[Release No. 34-95431; File No. S7-21-22]

RIN 3235-0695

Clearing Agency Governance and Conflicts of Interest

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule; partial withdrawal of proposed rule; withdrawal of applicability of proposed rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is proposing rules under the Securities Exchange Act of 1934 ("Exchange Act") to help improve the governance of clearing agencies registered with the Commission ("registered clearing agencies") by reducing the likelihood that conflicts of interest may influence the board of directors or equivalent governing body ("board") of a registered clearing agency. The proposed rules would identify certain responsibilities of the board, increase transparency into board governance, and, more generally, improve the alignment of incentives among owners and participants of a registered clearing agency. In support of these objectives, the proposed rules would establish new requirements for board and committee composition, independent directors, management of conflicts of interest, and board oversight.

DATES: As of August 23, 2022, SEC withdraws amendatory instructions # 7 and 8 (§§ 240.17Ad-25 and 240.17Ad-26 in Release No. 34-64017), published at 76 FR 14472 on March 16, 2011. Also as of August 23, 2022, SEC withdraws the applicability of the proposed rule

published at 75 FR 65881 on October 26, 2010 (Release No. 34-63107) as it pertained to clearing agencies.

Comments on this proposal should be received on or before October 7, 2022.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (https://www.sec.gov/rules/submitcomments.htm); or
- Send an email to rule-comments@sec.gov. Please include File Number S7-21-22 on the subject line.

Paper Comments:

- Send paper comments to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-21-22. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's website (https://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Operating conditions may limit access to the Commission's public reference room. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by email.

FOR FURTHER INFORMATION CONTACT: Matthew Lee, Assistant Director, Stephanie Park, Senior Special Counsel, Claire Noakes, Special Counsel, or Tanin Kazemi, Attorney-Adviser, Office of Clearance and Settlement at (202) 551-5710, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION: The Commission is withdrawing the following proposed rules under the Exchange Act: Regulation MC as proposed for security-based swap clearing agencies,[1] and rules proposed for clearing agencies at 17 CFR 240.17Ad-25 ("Rule 17Ad-25") and 240.17Ad-26 ("Rule 17Ad-26").[2] In their place, the Commission is proposing a new Rule 17Ad-25 to mitigate conflicts of interest, promote the fair representation of owners and participants in the governance of a clearing agency, identify responsibilities of the board, and increase transparency into clearing agency governance.

The Commission is also mindful of the differing perspectives that exist at registered clearing agencies among stakeholders, including owners and participants (some of whom also are clearing agency owners), small and large participants, and direct participants (who are

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[1] Exchange Act Release No. 63107 (Oct. 14, 2010), 75 FR 65882 (Oct. 26, 2010) ("Regulation MC Proposing Release").

[2] Exchange Act Release No. 64017 (Mar. 3, 2011), 76 FR 14471 (Mar. 16, 2011) ("Clearing Agency Standards Proposing Release") (proposing Rules 17Ad-25 and 17Ad-26).

clearing members) and indirect participants. [3] Proposed Rule 17Ad-25 would establish new requirements for clearing agency boards to address and mitigate conflicts of interest and to help ensure more effective oversight of the clearing agency by the board. The Commission believes these requirements would help ensure that a clearing agency's governance arrangements can more effectively manage these different perspectives so that the clearing agency can, among other things, help ensure that the design and implementation of risk management decisions are effective. Specifically, the proposed rule would: (i) define independence in the context of a director serving on the board of a registered clearing agency and require that a majority of directors on the board be independent, unless a majority of the voting rights distributed to shareholders of record are directly or indirectly held by participants of the registered clearing agency, in which case at least 34 percent of the board must be independent directors; (ii) establish requirements for a nominating committee, including with respect to the composition of the nominating committee, fitness standards for serving on the board, and documenting the process for evaluating board nominees; (iii) establish requirements for the function, composition, and reconstitution of the risk management committee; (iv) require policies and procedures that identify, mitigate or eliminate, and document the identification and mitigation or elimination of conflicts of interest; (v) require policies and procedures that obligate directors to report potential conflicts promptly; (vi) require policies and procedures for the board to oversee relationships with service providers for critical services; and (vii) require policies and procedures to solicit, consider, and document the registered clearing agency's consideration of the views of its participants and other relevant stakeholders regarding its governance and operations.

[3] Examples of indirect participants might be entities such as customers or clients of direct participants or clearing members since they rely on services provided by a direct participant to access the services of the clearing agency.

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I. Introduction

Clearing agencies registered with the Commission play an important role in the securities markets. They help ensure the prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership and the safeguarding of securities and related funds, which has the effect of protecting investors and persons facilitating transactions by and acting on behalf of investors.[4] As such, Section 17A of the Exchange Act requires that, before an entity provides clearing agency services, it must register with the Commission.[5] Under the Commission's supervision, registered clearing agencies, as self-regulatory organizations

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[4] *See* 15 U.S.C. 78q-1(a)(1)(A); *see, e.g.*, Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions, Principles for financial market infrastructures (Apr. 16, 2012), at 5 ("PFMI"), http://www.bis.org/publ/cpss101a.pdf (stating that financial market infrastructures ("FMIs"), which include clearing agencies like central counterparties ("CCPs") and central securities depositories ("CSDs"), "[w]hile safe and efficient . . . contribute to maintaining and promoting financial stability and economic growth, FMIs also concentrate risk. If not property managed, FMIs can be sources of financial shocks, such as liquidity dislocations and credit losses, or a major channel through which these shocks are transmitted across domestic and international financial markets").

[5] *See* 15 U.S.C. 78q-1(a)(2); *see also* 17 CFR 240.17Ab2-1.

("SROs") under Section 19 of the Exchange Act,[6] must submit to the Commission changes to their rules for review and approval or to be deemed immediately effective upon filing.[7]

Given the important role of clearing agencies in the U.S. financial system, the governance framework of each clearing agency is an integral part in helping to ensure that the clearing agency is resilient and strong. A transparent and reliable governance framework has a positive and lasting cascading effect: through the decision-making of the clearing agency and to its effective and efficient supervision. From the outset, an ideal governance framework that establishes a clear and deliberative process would have the clearing agency consider a range of stakeholder views as part of its rules and risk management practices, resulting in more thorough and robust SRO rule proposals for the Commission to consider in supervising the clearing agency. In essence, improved governance would help promote optimum practices for all registered clearing agencies to follow to help ensure that their processes and decisions are clear, transparent, and reliable, that risks are appropriately monitored, addressed, and managed, and that their leadership is competent and accountable. When these fundamental guiding principles on governance influence and permeate a clearing agency's culture and operations, the clearing agency will instill confidence in its participants, the markets, and the investing public, thereby

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6 Upon registration, registered clearing agencies are SROs under Section 3(a)(26) of the Exchange Act. *See* 15 U.S.C. 78c(a)(26).

7 Except for certain rule changes that do not need approval, set forth in 17 CFR 240.19b-4(f), an SRO must submit proposed rule changes to the Commission for review and approval pursuant to Rule 19b-4 under the Exchange Act. A stated policy, practice, or interpretation of an SRO, such as its written policies and procedures, would generally be deemed to be a proposed rule change. *See* 15 U.S.C. 78s(b)(1); 17 CFR 240.19b-4.

meeting and promoting the policy objectives in Section 17A of the Exchange Act regarding the prompt and accurate clearance and settlement of securities transactions, among other objectives.[8]

The Commission has previously stated that clear and transparent governance arrangements help promote accountability and reliability in the decisions, rules and procedures of the clearing agency because they provide interested parties (such as owners, direct and indirect participants, and general members of the public) with information about how such decisions are made and what the rules and procedures are designed to accomplish.[9] In turn, clear and transparent governance arrangements help optimize the clearing agency's decisions, rules and procedures that the Commission considers in the SRO rule filing process because clearing

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[8] *See* 15 U.S.C. 78q-1(a)(1)(A)-(D); *see also* Exchange Act Release No. 68080 (Oct. 22, 2012), 77 FR 66219, 66252 (Nov. 2, 2012) ("Clearing Agency Standards Adopting Release") (noting that "[g]overnance arrangements have the potential to play an important role in making sure that clearing agencies fulfill the Exchange Act requirements that the rules of a clearing agency be designed to protect investors and the public interest and to support the objectives of owners and participants. Similarly, governance arrangements may promote the effectiveness of a clearing agency's risk management procedures by creating an oversight framework that fosters a focus on the critical role that risk management plays in promoting prompt and accurate clearance and settlement").

[9] *See* Clearing Agency Standards Proposing Release, *supra* note 2, at 14488 ("Clear and transparent governance arrangements promote accountability and reliability in the decisions, rules and procedures of the clearing agency because they provide interested parties (such as owners, participants, and general members of the public) with information about how such decisions are made and what the rules and procedures are designed to accomplish. The key components of a clearing agency's governance arrangements include the clearing agency's ownership structure, the composition and role of its board, the structure and role of board committees, reporting lines between management and the board, and the processes that ensure management is held accountable for the clearing agency's performance. Governance arrangements have the potential to play an important role in making sure that clearing agencies fulfill the Exchange Act requirements that the rules of a clearing agency be designed to protect investors and the public interest and to support the objectives of owners and participants. Similarly, governance arrangements may promote the effectiveness of a clearing agency's risk management procedures by creating an oversight framework that fosters a focus on the critical role that risk management plays in promoting prompt and accurate clearance and settlement.").

agency transparency improves the quality of the information shared with stakeholders, which in turn improves the public comments submitted in response to rule filings. While the business models of clearing agencies vary and include entities that are affiliates of publicly traded companies and entities that function as participant-owned utilities, the key components of a clearing agency's governance arrangements include the clearing agency's ownership structure, the composition and role of its board, the structure and role of board committees, reporting lines between management and the board, and the processes that help ensure management is held accountable for the clearing agency's performance.[10] Regardless of the business model, the clearing agency is more effective when it has governance arrangements that accomplish the following: (1) help ensure that the clearing agency satisfies the Exchange Act requirements and Commission rules that are designed to protect investors and the public interest; and (2) support the objectives of the clearing agency's owners, direct participants, and indirect participants.[11]

In recognizing the implications that a robust governance framework has on the operations of clearing agencies, the Commission adopted a series of clearing agency governance requirements. In 2012, the Commission adopted a general governance rule for all registered clearing agencies (that are not covered clearing agencies) under Rule 17Ad-22(d).[12] In 2016, the Commission adopted a governance rule under Rule 17Ad-22(e) as part of its heightened

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10 *See id.* at 66269.

11 *See id.* at 66252.

12 *See* 17 CFR 240.17Ad-22(d)(8) (requiring that all registered clearing agencies aside from covered clearing agencies establish, implement, maintain and enforce written policies and procedures reasonably designed to have governance arrangements that are clear and transparent to fulfill the public interest requirements in Section 17A of the Exchange Act, to support the objectives of owners and participants, and to promote the effectiveness of the clearing agency's risk management procedures).

standards for covered clearing agencies, defined as a registered clearing agency that provides the services of a central counterparty or central securities depository.[13] The Commission took a broad, principles-based approach in the design of both rules, and emphasized that governance remains an area of continued consideration and interest, with the goal of establishing an evolving regulatory framework for clearing agencies.[14]

During the ensuing years since the adoption of the 2016 covered clearing agency governance rule, the Commission has observed and learned from recurring tensions among incentive structures in the area of clearing agency governance. The Commission understands that differing views among clearing agency stakeholders can have a ripple effect on the decisions that clearing agencies make, including risk management decisions that, in turn, affect clearing members and the larger financial community. Accordingly and for the reasons described throughout this release, the Commission is proposing rules that would build upon and strengthen the existing governance requirements adopted by the Commission in the Clearing Agency

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[13] *See* 17 CFR 240.17Ad-22(e)(2) (requiring a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent, clearly prioritize the safety and efficiency of the covered clearing agency, support the public interest requirements in Section 17A of the Exchange Act and the objectives of owners and participants, establish that the board of directors and senior management have appropriate experience and skills to discharge their duties and responsibilities, specify clear and direct lines of responsibility, and consider the interests of participants' customers, securities issuers and holders, and other relevant stakeholders of the covered clearing agency); *see also* Exchange Act Release No. 78961 (Sept. 28, 2016), 81 FR 70786 (Oct. 13, 2016) ("CCA Standards Adopting Release").

[14] *See* Clearing Agency Standards Adopting Release, *supra* note 8, at 66252 (stating that "[w]e continue to perform a careful review and evaluation of the comments that the Commission received on proposed Rules 17Ad–25, 17Ad–26 and Regulation MC, which commenters rightly observed represent separate, and in some cases more prescriptive, proposed requirements related to clearing agency governance and mitigation of conflicts of interest . . . .We believe it is more appropriate to consider those issues in connection with the Commission's ongoing consideration of those rules").

Standards Adopting Release in 2012 and the CCA Standards Adopting Release in 2016.[15] Specifically, the Commission believes that the existing clearing agency governance rules should be enhanced to help balance the differing incentives of the registered clearing agencies, clearing members, and other key stakeholders. While the governance requirements adopted by the Commission at that time are broad and principles-based, the rules proposed today would set more specific and defined parameters and requirements for governance for all registered clearing agencies—both covered clearing agencies under Rule 17Ad-22(e) under the Exchange Act and all registered clearing agencies other than covered clearing agencies that are subject to Rule 17Ad-22(d) under the Exchange Act. Because all clearing agencies would face these tensions, the Commission believes it is appropriate to have this governance proposal apply to all registered clearing agencies. In this regard, the rules would establish new governance requirements on board composition for independent directors, nominating committees, risk management committees, conflicts of interest, board obligations to oversee service providers for critical services, and an obligation to formally consider stakeholder viewpoints. The proposed rules are designed to address governance issues specific to registered clearing agencies, due to their distinct ownership structures and organizational forms. Moreover, the rules are designed to take a multi-layered approach to governance in that one rule alone would not necessarily capture and address an issue relating to governance; each of the different rules proposed today would provide one additional mitigation layer to help ensure that registered clearing agencies are designed, managed, and operated under a robust governance framework to protect investors and the public interest and help promote the prompt and accurate clearance and settlement of securities

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15 *See* 17 CFR 240.17Ad-22; *see also* Clearing Agency Standards Adopting Release, *supra* note 8; CCA Standards Adopting Release, *supra* note 13.

transactions. Each mitigation layer improves the robustness of the governance framework by itself, with each additional mitigation layer having a cumulative effect on robustness.

In Part II below, the Commission provides context for the rule proposal by (i) discussing the different perspectives that exist among various stakeholders at registered clearing agencies, (ii) briefly summarizing changes to the regulatory framework for registered clearing agencies following passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"),[16] and (iii) describing recent events that have increased focus among market participants on the governance arrangements that direct risk management policies and procedures at registered clearing agencies.

II. Background

Rule 17Ad-22 under the Exchange Act provides for two categories of registered clearing agencies and contains a set of rules that apply to each category. The first category is covered clearing agencies, which are registered clearing agencies that provide CCP[17] or CSD[18]

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16 Pub. L. No. 111-203, 124 Stat. 1376 (2010).

17 A CCP is a type of registered clearing agency that acts as the buyer to every seller and the seller to every buyer, providing a trade guaranty with respect to transactions submitted for clearing by the CCP's participants. *See* 17 CFR 240.17Ad-22(a)(2); Exchange Act Release No. 88616 (Apr. 9, 2020), 85 FR 28853, 28855 (May 14, 2020) ("CCA Definition Adopting Release"). A CCP may perform a variety of risk management functions to manage the market, credit, and liquidity risks associated with transactions submitted for clearing. For example, CCPs help manage the effects of a participant default by closing out the defaulting participant's open positions and using financial resources available to the CCP to absorb any losses. In this way, the CCP can prevent the onward transmission of financial risk. *See, e.g.*, Exchange Act Release No. 94196 (Feb. 9, 2022), 87 FR 10436, 10448 (Feb. 24, 2022) ("T+1 Proposing Release"). If a CCP is unable to perform its risk management functions effectively, however, it can transmit risk throughout the financial system.

18 A CSD is a type of registered clearing agency that acts as a depository for handling securities, whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible. Through use of a CSD, securities may be transferred, loaned, or pledged by bookkeeping entry without the physical delivery of certificates. A CSD also may

services.[19] Rule 17Ad-22(e) applies to covered clearing agencies and includes requirements intended to address the activity and risks that their size, operation, and importance pose to the U.S. securities markets, the risks inherent in the products they clear, and the goals of both the Exchange Act and the Dodd-Frank Act.[20] The second category includes registered clearing agencies other than covered clearing agencies; such clearing agencies must comply with Rule 17Ad-22(d).[21] Rule 17Ad-22(d) establishes a regulatory regime to govern registered clearing agencies that do not provide CCP or CSD services.[22] Currently, all clearing agencies registered with the Commission that are actively providing clearance and settlement services are covered clearing agencies.[23] Although all currently registered and active clearing agencies meet the

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permit or facilitate the settlement of securities transactions more generally. *See* 15 U.S.C. 78c(a)(23)(A); 17 CFR 240.17Ad-22(a)(3); CCA Definition Adopting Release, *supra* note 17, at 28856. If a CSD is unable to perform these functions, market participants may be unable to settle their transactions, transmitting risk through the financial system.

19 *See* 17 CFR 240.17Ad-22(a)(5).

20 *See* CCA Standards Adopting Release, *supra* note 13, at 70793. The Financial Stability Oversight Council ("FSOC") has designated certain financial market utilities ("FMUs")—which include clearing agencies that manage or operate a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the FMU—as systemically important or likely to become systemically important ("SIFMUs"). *See* 12 U.S.C. 5463. An FMU is systemically important if the failure of or a disruption to the functioning of such FMU could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system. *See* 12 U.S.C. 5462(9).

21 *See* 17 CFR 240.17Ad-22(d).

22 *See* CCA Standards Adopting Release, *supra* note 13, at 70793.

23 They are The Depository Trust Company ("DTC"), FICC, NSCC, ICE Clear Credit ("ICC"), ICE Clear Europe ("ICEEU"), The Options Clearing Corporation ("OCC"), and LCH SA.

definition of a covered clearing agency, thereby making Rule 17Ad-22(d) not applicable to any registered and active clearing agencies at present, clearing agencies that are not covered clearing agencies may register with the Commission in the future and would be subject to Rule 17Ad-22(d).[24]

In establishing these regimes under Rule 17Ad-22 under the Exchange Act, the Commission stated that the approach under Rules 17Ad-22(d) and (e) takes into account clearing agency activities and the risks they pose, while promoting robust risk management practices and the general safety and soundness of registered clearing agencies and addressing concerns relating to the level of concentration in the provision of clearing agency services.[25] The Commission recognized that Rule 17Ad-22(d) would allow new entrants to more firmly establish themselves as clearing agencies, which is important for the deconsolidation and diffusion of risk across the market.[26] Notwithstanding their different risk profiles, all registered clearing agencies—whether covered clearing agencies under Rule 17Ad-22(e) or registered clearing agencies under Rule 17Ad-22(d)—are important to the U.S. financial system, as evident in their obligations under Section 17A of the Exchange Act. Effective governance—the primary way by which a clearing agency develops and oversees the provision of its clearance and settlement services—is the lynchpin to ensuring a well-functioning and resilient clearing agency that can withstand periods

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24 The Boston Stock Exchange Clearing Corporation ("BSECC") and Stock Clearing Corporation of Philadelphia ("SCCP") are currently registered with the Commission as clearing agencies but conduct no clearance or settlement operations; both inactive clearing agencies are subject to Rule 17Ad-22(d). *See* Exchange Act Release No. 63629 (Jan. 3, 2011), 76 FR 1473, 1474 (Jan. 10, 2011) ("BSECC Notice"); Exchange Act Release No. 63268 (Nov. 8, 2010), 75 FR 69730, 69731 (Nov. 15, 2010) ("SCCP Notice").

25 *See* CCA Standards Adopting Release, *supra* note 13, at 70793.

26 *See id.*

of market stress.[27] In this regard, the Commission believes that the governance requirements in proposed Rule 17Ad-25 should apply to all registered clearing agencies. The Commission's intent with respect to proposed Rule 17Ad-25 is, in part, to take another incremental step to help ensure that risks posed by registered clearing agencies are appropriately managed consistent with the purposes of the Exchange Act.

A. Differing Perspectives at Registered Clearing Agencies

The Exchange Act requires each registered clearing agency to be so organized and have the capacity to facilitate prompt and accurate clearance and settlement.[28] It also requires each registered clearing agency to have rules that assure the fair representation of shareholders and participants in the selection of directors and the administration of its affairs.[29] These

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27 *See* SEC Division of Trading and Markets and Office of Compliance Inspections and Examinations, Staff Report on the Regulation of Clearing Agencies (Oct. 1, 2020) ("Staff Report on Clearing Agencies"), https://www.sec.gov/files/regulation-clearing-agencies-100120.pdf.

28 15 U.S.C. 78q-1(b)(3)(A).

29 15 U.S.C. 78q-1(b)(3)(C). The Exchange Act specifically states the "fair representation of . . . shareholders (or members) and participants" in the selection of directors and the administration of affairs, reflecting the fact that a clearing agency could be either a for-profit or not-for-profit entity. *See* Regulation of Clearing Agencies, Exchange Act Release No. 16900, 20 SEC Docket 415, 420 n.15 (June 17, 1980) (explaining that "[t]he fair representation requirement was adopted verbatim from S. 249, the Senate bill that preceded the Securities Acts Amendments of 1975. The report of the Senate Committee on Banking, Housing and Urban Affairs to accompany S. 249 states: 'The rules of the clearing agency must assure fair representation of its shareholders (or members) and participants in the decision making process of the clearing agency . . . . The reference to shareholders of [sic] members makes it clear that the bill establishes no norm as to whether clearing agencies should or should not be operated for profit. The bill makes no attempt to set up particular standards of representation or participation. Rather, it provides that the Commission must assure itself that the rules of the clearing agency regarding the manner in which decisions are made give fair voice to participants as well as to shareholders or members. Fair representation of participants may be found if they are afforded an opportunity to acquire voting stock of the clearing agency in proportion to their use of its facilities"). "Members," however, is a term often used to describe the participants of a clearing agency. This release refers to "shareholders (or members)" collectively as "owners" of the registered clearing agency. In some instances, owners and shareholders may differ in certain respects, such as the

requirements highlight the importance of a clearing agency's organization in facilitating prompt and accurate clearance and settlement, and of the need for a clearing agency to have rules that help ensure that both owners and participants participate in the selection of directors and the administration of its affairs, including board governance. Moreover, the Commission's recent experience has revealed that differing perspectives among other categories of stakeholders may influence the ways risk management decisions and practices develop and are implemented by the registered clearing agency. These differing views—whether between small and large clearing members or between direct and indirect participants of the clearing agency—warrant attention as they may manifest themselves in a clearing agency's decision-making to benefit one category of stakeholders at the expense of another category of stakeholders.

First, based on its supervisory experiences, the Commission has observed that owners and participants may have structural incentives that differ from one another, leading to differing views as to the efficacy of certain risk management tools and the potential for divergent interests in the risk management of the clearing agency. For example, owners and participants may have differing views as to the scope of products cleared by the clearing agency, the minimum standards required for participation in the clearing agency, and the size, timing, and nature of financial resource requirements applied as part of the risk management framework. Fundamentally, an owner's interest in protecting the equity and continued operation of the clearing agency diverges from a participant's interest in avoiding the allocation of losses from a defaulting participant. Diverging interests and incentives among owners and participants with respect to loss allocation or scope of products—such as in the event that some participants may

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nature and extent of their voting rights on the board. To avoid confusion, in this release the Commission uses only "participants" to refer to the direct users of a clearing agency, which have met the standards for participation and have executed a participation agreement.

want to limit access to a market by limiting access to clearing, while owners would like to expand the scope of products to collect fees–could limit the benefits of a clearing agency, and even potentially cause harm to the market it serves as well as the broader financial system to the extent that they might undermine the risk mitigating purpose of the clearing agency by failing to achieve the right balance among competing interests.[30]

When a clearing agency chooses to mutualize the risk it faces among its owners and participants, it may find a closer alignment of incentives among owners and participants because both owners and participants would bear losses associated with a failure of the clearing agency.[31] In considering how to mutualize the risk it faces, a clearing agency may choose from a number of different approaches. For example, a clearing agency may be organized so that the participants are owners of the clearing agency,[32] which may eliminate diverging incentives between owners and participants. Regardless of the approach, as stated above, the Exchange Act requires that a clearing agency be so organized and have the capacity to facilitate prompt and accurate clearance and settlement. In addition, the Exchange Act requires that the rules of the clearing

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30 For a discussion of the importance of aligning clearing agency governance with the interests of those who bear the financial risk, *see infra* note 167 and accompanying text.

31 *See* Jorge Cruz Lopez & Mark Manning, Who Pays? CCP Resource Provision in the Post-Pittsburgh World (Dec. 2017), https://www.bankofcanada.ca/wp-content/uploads/2017/12/sdp2017-17.pdf.

32 *See, e.g.*, Exchange Act Release No. 52922 (Dec. 7, 2005), 70 FR 74070 (Dec. 14, 2005) (explaining that participants of DTC, FICC, and NSCC that make full use of the services of one or more of these clearing agency subsidiaries of DTCC are required to purchase DTCC common shares).

agency assure a fair representation of its shareholders (or members) and participants in the selection of its directors and administration of its affairs.[33]

Second, the Commission has observed differing views between large and small participants in a registered clearing agency about risk management practices. Consolidation among market participants in recent years has resulted in the increased concentration of clearance and settlement activity among a smaller set of firms. For example, over 90 percent of the total notional amount of the U.S. market in credit derivatives is concentrated in four U.S. commercial banks.[34] Large clearing agency participants, especially participant-owners, often have different incentives from smaller participants. When a small number of dominant participants exercise control or influence over a registered clearing agency with respect to the services provided by the registered clearing agency or the rules applicable to its participants, these participants may promote margin requirements that are not commensurate with the risks and particular attributes of each participant's specific products, portfolio, and market, thereby indirectly limiting competition and increasing their ability to maintain higher profit margins. Given such incentives, a registered clearing agency that is dominated by a small number of large participants might make decisions that are designed to provide them with a competitive advantage.

Third, the Commission's proposal is informed, in part, by its experience overseeing registered clearing agencies with regard to the concerns raised by certain participants that access

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33 *See* 15 U.S.C. 78q-1(b)(3)(C).

34 *See* Staff Report on Clearing Agencies, *supra* note 27, at 21 (citing the Office of the Comptroller of the Currency, Quarterly Report on Bank Trading and Derivatives Activities, Third Quarter 2019, graph 4 (Dec. 2019), https://www.occ.gov/publications-andresources/publications/quarterly-report-on-bank-trading-and-derivatives-activities/files/pub-derivativesquarterly-qtr3-2019.pdf).

criteria and risk management standards may impose disproportionate costs relative to the value of access to clearing agencies. In addition, when the Commission proposed Regulation MC, the Commission identified a potential area where a conflict of interest of participants that exercise undue control or influence over a security-based swap clearing agency could adversely affect the central clearing of security-based swaps by limiting access to the security-based swap clearing agency, either by restricting direct participation in the security-based swap clearing agency or restricting indirect access by controlling the ability of non-participants to enter into correspondent clearing arrangements.[35] The resulting conflicts of interest could limit the benefits of a registered security-based swap clearing agency in the securities market to indirect participants. As a result, the Commission believes it should continue to implement measures that help ensure the decisions of a registered clearing agency reflect the interests and perspectives of the broadest cross-section of stakeholders as possible.

This proposal is intended to help ensure that a registered clearing agency's governance arrangements can manage these differing perspectives and interests more effectively. As discussed in detail below, the Commission believes that the proposed rules would help ensure that a registered clearing agency's governance arrangements can more effectively manage the divergent interests between and among clearing agency owners and participants, small and large participants, and direct and indirect participants of a clearing agency, which, in turn, would improve a clearing agency's risk management practices to be fair and more effective. Imposing these requirements on all registered clearing agencies would have the effect of building upon existing governance requirements with consistent, more defined and robust governance standards across all registered clearing agencies.

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35 *See* Regulation MC Proposing Release, *supra* note 1, at 65885.

B. Regulatory Framework for Registered Clearing Agencies

The regulatory framework for registered clearing agencies has evolved over the last decade. Existing elements of the regulatory framework establish policies and procedures requirements for minimum standards to help promote participation in registered clearing agencies.[36] Other rules require that certain clearing agencies have policies and procedures for governance arrangements that support the objectives of owners and participants and consider the interests of participants' customers, securities issuers and holders, and other relevant stakeholders.[37]

Following the enactment of the Dodd-Frank Act, the Commission has taken multiple steps to strengthen its regulatory framework for clearing agencies by: (i) establishing minimum requirements for governance, operations, and risk management practices of registered clearing agencies;[38] (ii) enhancing the Commission's oversight and enforcement of the technology and systems infrastructure that supports clearing agencies;[39] (iii) establishing an enhanced regulatory framework for systemically important clearing agencies and clearing agencies for security-based swaps;[40] and (iv) expanding the enhanced regulatory framework from systemically important clearing agencies to all registered clearing agencies that provide CCP or CSD services so that the

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36 *See, e.g.*, 17 CFR 240.17Ad-22(b)(5)–(7).

37 *See, e.g.*, 17 CFR 240.17Ad-22(e)(2)(iii), (vi).

38 *See* 17 CFR 240.17Ad-22; *see also* Clearing Agency Standards Adopting Release, *supra* note 8; CCA Standards Adopting Release, *supra* note 13; CCA Definition Adopting Release, *supra* note 17.

39 *See* 17 CFR 242.1000 *et seq.*; *see also* Exchange Act Release No. 73639 (Nov. 19, 2014), 79 FR 72251 (Dec. 5, 2014) ("Regulation SCI Adopting Release").

40 *See* 17 CFR 240.17Ad-22(e); CCA Standards Adopting Release, *supra* note 13.

set of covered clearing agencies includes the seven active clearing agencies registered with the Commission.[41] In addition, the Commission has adopted rules to help promote access to registered clearing agencies, including rules that require a registered clearing agency that performs CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to: (i) provide the opportunity for a person that does not perform any dealer or security-based swap dealer services to obtain membership on fair and reasonable terms at the clearing agency to clear securities for itself or on behalf of other persons; (ii) have membership standards that do not require that participants maintain a minimum portfolio size or minimum transaction volume; and (iii) provide that a person maintaining net capital equal to or greater than $50 million may obtain membership at the clearing agency, provided that such person is able to comply with other reasonable membership standards.[42]

1. Current Requirements and Past Proposals on Clearing Agency Governance

In the recent past, the Commission addressed clearing agency governance with the adoption of two rules. In 2016, the Commission adopted a rule that requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent, clearly prioritize the safety and efficiency of the covered clearing agency, support the public interest requirements in Section 17A of the Exchange Act, and the objectives of owners and participants, establish that the board of directors and senior management have appropriate experience and skills to discharge their duties and responsibilities, specify clear and direct lines of responsibility, and

41 *See* CCA Definition Adopting Release, *supra* note 17.

42 17 CFR 240.17Ad-22(b)(5)–(7).

consider the interests of participants' customers, securities issuers and holders, and other relevant stakeholders of the covered clearing agency.[43] In 2012, the Commission adopted a rule that requires all registered clearing agencies aside from covered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to have governance arrangements that are clear and transparent to fulfill the public interest requirements in Section 17A of the Exchange Act, to support the objectives of owners and participants, and to help promote the effectiveness of the clearing agency's risk management procedures.[44] The Commission took a broad, principles-based approach to these governance rules to give a clearing agency the discretion to consider its unique characteristics and circumstances, including ownership and governance structures, effect on direct and indirect participants, membership base, markets served, and the risks inherent in products cleared, while at the same time, largely being subject to the requirements of the SRO rule filing process, which requires public notice and comment and consideration by the Commission.[45]

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[43] *See* 17 CFR 240.17Ad-22(e)(2); *see also* CCA Standards Adopting Release, *supra* note 13, at 70802. The Commission also issued guidance on Rule 17Ad-22(e)(2) "because . . . [as] there may be a number of ways to address compliance with Rule 17Ad-22(e)(2), the Commission . . . provid[ed] the following guidance that a covered clearing agency generally should consider in establishing and maintaining its policies and procedures: . . . whether the roles and responsibilities of its board of directors are clearly specified, and whether there are documented procedures for the functioning of the board of directors, such as procedures for identifying, addressing, and managing member conflicts of interest, and for reviewing the board's overall performance and the performance of its individual members regularly." CCA Standards Adopting Release, *supra* note 13, at 70806–07.

[44] *See* 17 CFR 240.17Ad-22(d)(8); *see also* Clearing Agency Standards Adopting Release, *supra* note 8, at 66251–52.

[45] *See generally* CCA Standards Adopting Release, *supra* note 13, at 70800 ("With a number of exceptions, Rule 17Ad-22(e) does not prescribe a specific tool or arrangement to achieve its requirements. The Commission believes that when determining the content of its policies and procedures, each covered clearing agency must have the ability to consider its unique characteristics and circumstances, including ownership and governance structures, effect

The Commission also proposed, but did not adopt, other rules directed to clearing agency governance: proposed Regulation MC, which contemplated limitations on ownership and minimum requirements for independent directors intended to satisfy a requirement for Commission rulemaking set forth in Section 765 of the Dodd-Frank Act ("Section 765");[46] proposed Rule 17Ad-25, which included additional requirements for a clearing agency to mitigate conflicts of interest;[47] and proposed Rule 17Ad-26, which included requirements for a clearing agency to establish standards for directors on the board and committees thereof.[48] The Commission did not adopt those proposals, which were issued in 2010 and 2011, and is now withdrawing them because of the multiple changes that the Commission has made to its regulatory framework for clearing agencies as stated above.

As part of the incremental evolution of the Commission's clearing agency regulatory framework that has occurred over the past decade, the Commission now believes that updated

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on direct and indirect participants, membership base, markets served, and the risks inherent in products cleared. This ability, however, is subject to the requirements of the SRO rule filing and advance notice processes, which provide some opportunities for the public and participants to comment on the covered clearing agency's rules, policies, and procedures. The Commission does not believe that a granular or prescriptive approach to its regulation of covered clearing agencies would be appropriate, nor would such an approach ensure that a covered clearing agency does not become a transmission mechanism for systemic risk. Moreover, the Commission believes that the primarily principles-based approach reflected in Rule 17Ad-22(e) will help a covered clearing agency continue to develop policies and procedures that can effectively meet the evolving risks and challenges in the markets that the covered clearing agency serves."); Clearing Agency Standards Adopting Release, *supra* note 8, at 66252 ("We appreciate the perspective of commenters who prefer the more general policies and procedures design of Rule 17Ad-22(d)(8) to any more prescriptive rulemaking by the Commission in the area of clearing agency governance.").

46 *See* Regulation MC Proposing Release, *supra* note 1, at 65893–904.

47 *See* Clearing Agency Standards Proposing Release, *supra* note 2, at 14497–98.

48 *See id.* at 14498–99.

rules are warranted to build upon and strengthen the existing clearing agency governance framework, given the trends the Commission has observed in the securities markets and during its supervisory processes.[49] Specifically, the Commission believes that addressing the composition of a board and its committees will help ensure effective governance, help promote transparency into decision-making processes, facilitate fair representation of owners and participants, and mitigate the potential effects of conflicts of interest between owners and participants, large and small participants, and direct and indirect participants. For these reasons, proposed Rule 17Ad-25 includes provisions directed to all registered clearing agencies.

2. Commodity Futures Trading Commission's Governance Framework for Derivatives Clearing Organizations

Three clearing agencies registered with the Commission are also registered as derivatives clearing organizations ("DCOs") with the Commodity Futures Trading Commission ("CFTC"). The Commission acknowledges that, while other agency rules and regulations on governance may apply to a clearing agency registered with the Commission that are similar in scope or purpose to proposed Rule 17Ad-25, the Commission remains obligated to ensure that risk in the U.S. securities markets is appropriately managed—including through promulgation of its own rules and regulations—consistent with the purposes of the Exchange Act. Additionally, because Rule 17Ad-22(e) under the Exchange Act and other comparable regulations—including DCO

[49] As discussed further below, the Commission believes that the targeted set of proposed rules for governance included in this release can help ensure that the framework effectively addresses the considerations set forth in Section 765 with respect to clearing of security-based swaps. Although Section 765 directed the Commission to focus on conflicts of interest specifically with respect to security-based swap clearing agencies, the Commission believes that conflicts of interest concerns can arise across all registered clearing agencies regardless of the asset classes served.

governance rules adopted by the CFTC in January 2020[50]—are based on the same international standards, namely the PFMI, the potential for inconsistent regulation is low. In this regard, the Commission believes its existing governance rules for covered clearing agencies and registered clearing agencies other than covered clearing agencies are consistent with the CFTC's governance rule for DCOs.[51] Certain proposed requirements in this rulemaking are also consistent with the requirements in the CFTC's DCO regime, which provides conflicts of interest and board composition rules.[52] Further, in developing these rules, Commission staff has consulted with the CFTC and the Board of Governors of the Federal Reserve System ("FRB").

C. Risks Associated with Clearance and Settlement

The Commission also believes that the proposed governance rules would help ensure that registered clearing agencies make more effective risk management decisions that take into

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50 *See* DCO General Provisions and Core Principles, 85 FR 4800 (Jan. 27, 2020), https://www.cftc.gov/sites/default/files/2020/01/2020-01065a.pdf.

51 *See* 17 CFR 39.24 (requiring DCOs to, among other things, have governance arrangements that are written, clear and transparent, place a high priority on the safety and efficiency of the derivatives clearing organization, and explicitly support the stability of the broader financial system and other relevant public interest considerations of clearing members, customers of clearing members, and other relevant stakeholders; the board of directors shall make certain that the DCO's design, rules, overall strategy, and major decisions appropriately reflect the legitimate interests of clearing members, customers of clearing members, and other relevant stakeholders).

52 *See* 17 CFR 39.25 (requiring DCOs to establish and enforce rules to minimize conflicts of interest in the decision-making process of the derivatives clearing organization, establish a process for resolving such conflicts of interest, and describe procedures for identifying, addressing, and managing conflicts of interest involving members of the board of directors); 17 CFR 39.26 (requiring DCOs to ensure that the composition of the governing board or board-level committee of the DCO includes market participants and individuals who are not executives, officers, or employees of the derivatives clearing organization or an affiliate thereof). We note that the CFTC recently proposed amendments to its DCO governance framework relating to risk management committee requirements. *See* Governance Requirements for Derivatives Clearing Organizations, Release Number 8565-22 (July 27, 2022), https://www.cftc.gov/PressRoom/PressReleases/8565-22.

account relevant stakeholder perspectives and concerns. Recent episodes of increased market volatility—in March 2020 following the outbreak of the COVID-19 pandemic, and in January 2021 following heightened interest in certain "meme" stocks—have revealed potential vulnerabilities in the U.S. securities market and highlight the essential role of registered clearing agencies in managing the risk that securities transactions may fail to clear or settle.[53] These events underscore the importance of a strong regulatory framework to oversee registered clearing agencies that clear or settle securities transactions and provide transparency to the markets.

Among other things, the rules of a registered clearing agency generally require its participants to transfer collateral to the clearing agency, which may include different types of collateral, such as margin payments, funds, or other assets, and the requirements associated with these rules may change in response to changes in market volatility. The terms of these rules, and the related policies and procedures of the registered clearing agency that implement them, are generally approved by the board as part of the clearing agency's governance arrangements. These rules, policies, and procedures are also subject to Commission review as proposed rule changes under Section 19 of the Exchange Act and Rule 19b-4 thereunder.[54] The potential for sudden and large increases in the margin required by a registered clearing agency of its participants, as evidenced in the March 2020 and January 2021 events stated above, have

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53 *See, e.g.*, SEC, Staff Report on Equity and Options Market Structure Conditions in Early 2021 (Oct. 14, 2021) ("2021 Staff Report"), https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf. Staff reports, Investor Bulletins, and other staff documents (including those cited herein) represent the views of Commission staff and are not a rule, regulation, or statement of the Commission. The Commission has neither approved nor disapproved the content of these staff documents and, like all staff statements, they have no legal force or effect, do not alter or amend applicable law, and create no new or additional obligations for any person.

54 15 U.S.C. 78s; 17 CFR 240.19b-4.

increased scrutiny by a wide variety of market participants into the way a registered clearing agency establishes, implements, maintains, and enforces its rules that impose margin requirements.[55] Some market participants have suggested that such margin requirements are too conservative;[56] others have suggested that margin requirements do not sufficiently consider the range of participants in a clearing agency and the downstream effect such requirements may have on other types of investors.[57] In response to this increased attention, the Basel Committee on Banking Supervision ("BCBS"), the Committee on Payments and Market Infrastructure ("CPMI"), and the International Organization of Securities Commissions ("IOSCO") jointly released a consultative paper on CCP margin practices, focused on, among other things, recent market volatility and the apparent drivers of the size and composition of margin calls.[58]

Concerns about the size and timing of margin requirements are only one example of an area in which direct and indirect participants that rely on the clearance and settlement process have expressed concerns about clearing agency governance and, in particular, the way that such governance would oversee or employ risk management tools under stressed market conditions. Two other areas of heightened attention concern a clearing agency's process for loss allocation in

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55 *See, e.g.*, Fitch Ratings, Margin Call Disparity, Breaches Could Drive Clearinghouse Scrutiny (July 20, 2020), https://www.fitchratings.com/research/non-bank-financial-institutions/margin-call-disparity-breaches-could-drive-clearinghouse-scrutiny-20-07-2020.

56 *See* Alexander Campbell, CCP Margin Buffers Too Big, Research Suggests (July 9, 2019), https://www.risk.net/risk-management/6783941/ccp-margin-buffers-too-big-research-suggests.

57 *See* Glenn Hubbard et al., Report of the Task Force on Financial Stability, Brookings Institution (June 2021), https://www.brookings.edu/wp-content/uploads/2021/06/financial-stability_report.pdf.

58 *See* BCBS-CPMI-IOSCO, Consultative Report, Review of Margining Practices (Oct. 2021), https://www.bis.org/bcbs/publ/d526.pdf.

the event of a participant default and an event other than a participant default (hereinafter a "non-default loss"), such as an operational failure, cyber-attack, or theft. For example, participants and others have expressed concerns about the extent to which existing governance structures at registered clearing agencies would function during a potential recovery or resolution scenario, which would occur in the event that a clearing agency's prefunded financial resources available to absorb any loss—sometimes referred to as the "clearing fund" or "guaranty fund"—are insufficient to close out a defaulting participant's portfolio without allocating losses among the non-defaulting participants of the clearing agency.[59] Based on its supervisory experience, the Commission believes that this loss allocation process could thus have significant implications for the risk management of its non-defaulting participants.

Further, although concerns about the size and timing of margin requirements are, at one level, concerns about the risk management practices of a clearing agency, they also implicate clearing agency governance because the governance arrangements of a registered clearing agency will determine the process for developing and approving policies and procedures for imposing margin requirements, and the governance and management of the registered clearing agency will also implement these policies and procedures, whether during normal market conditions or periods of increased market volatility.

In this regard, proposed Rule 17Ad-25 is intended to help ensure that in periods of market stress or stress on the registered clearing agency, the governance process of all registered clearing agencies is transparent, objective, and addresses conflicts of interest. Trust among

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[59] In 2018, a default at a European CCP increased scrutiny of the auction process through which a CCP may choose to close out a defaulted portfolio. CPMI-IOSCO issued a report on issues for consideration in 2020. *See* Bank for International Settlements, Central Counterparty Default Management Auctions – Issues for Consideration (June 2020), https://www.bis.org/cpmi/publ/d192.pdf.

market participants in the national system for clearance and settlement, particularly in times of market stress, necessarily depends on trust in the ability of registered clearing agencies to more effectively manage the risk flowing from that market stress and, when necessary, transparently and objectively impose increased margin requirements or employ loss allocation mechanisms.

III. Proposed Rules

The Commission is proposing rules under the Exchange Act and to address the considerations set forth in Section 765 of the Dodd-Frank Act. Section 17(a) of the Exchange Act directs registered clearing agencies to make and keep for prescribed periods such records, furnish such copies, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or in furtherance of the Exchange Act.[60] Section 17A of the Exchange Act directs the Commission to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions and provides the Commission with the authority to regulate those entities critical to the clearance and settlement process.[61] Section 23(a) of the Exchange Act authorizes the Commission to make rules and regulations as necessary or appropriate to implement the provisions of the Exchange Act.[62] The enactment of the Payment, Clearing, and Settlement Supervision Act ("Clearing Supervision Act") in 2010 (Title VIII of the Dodd-Frank Act) reaffirmed the importance of the national system for clearance and settlement.[63]

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60 *See* 15 U.S.C. 78q(a).

61 *See* 15 U.S.C. 78q-1(a)(2)(A).

62 *See* 15 U.S.C. 78w(a).

63 *See* 12 U.S.C. 5461−5472.

Specifically, Congress found that the "proper functioning of the financial markets is dependent upon safe and efficient arrangements for the clearing and settlement of payments, securities, and other financial transactions."[64] In addition, Section 765 of the Dodd-Frank Act specifically directs the Commission to adopt rules to mitigate conflicts of interest for security-based swap clearing agencies.[65] Accordingly, the Commission is proposing these rules pursuant to overlapping statutory authorities, because although the Commission is able to propose these rules pursuant to Section 17A of the Exchange Act, the Commission is also meeting the mandatory rulemaking requirements of Section 765. The Commission preliminarily has determined that these proposed rules are necessary and appropriate to improve the governance of a clearing agency that clears security-based swaps and in which a major security-based swap participant has a material debt or equity investment.

The Commission had previously reviewed the potential for conflicts of interest at security-based swap clearing agencies in accordance with Section 765 of the Dodd-Frank Act when it proposed Regulation MC, and had identified those conflicts that could affect access to clearing agency services, products eligible for clearing, and risk management practices of the clearing agencies.[66] The Commission had identified three key areas where it believed a conflict of interest of participants who exercise undue control or influence over a security-based swap clearing agency could adversely affect the central clearing of security-based swaps.[67] First, participants could limit access to the security-based swap clearing agency, either by restricting

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64 12 U.S.C. 5461(a)(1).

65 *See* 15 U.S.C. 8343.

66 *See* Regulation MC Proposing Release, *supra* note 1, at 65885.

67 *See id.*

direct participation in the security-based swap clearing agency or restricting indirect access by controlling the ability of non-participants to enter into correspondent clearing arrangements. Second, participants could limit the scope of products eligible for clearing at the security-based swap clearing agency, particularly if there is a strong economic incentive to keep a product traded in the over-the-counter ("OTC") market for security-based swaps. Third, participants could use their influence to reduce the amount of collateral they would be required to contribute and liquidity resources they would have to expend as margin or guaranty fund to the security-based swap clearing agency. Although the Commission does not believe that the participants of security-based swap clearing agencies are engaged in these types of activities, the Commission recognizes that these three potential conflicts of interest could limit the benefits of a security-based swap clearing agency in the security-based swaps market, and even potentially cause substantial harm to that market and the broader financial markets.

Nevertheless, there are benefits to having participant incentives known and reflected in the decision making activity of a board of directors. Employees of participants—in particular, chief risk officers or their equivalent—are likely to bring technical expertise to a board of directors. Participants are often exposed to enormous financial liability in the event of a default, and so they have strong incentives to have sound risk management at the clearing agencies. In order to promote the utility of having directors who are familiar with participant operations, the proposed rule does not prohibit directors who, among other things, receive compensation from participants from meeting the definition of independent director (provided all other requirements of the proposed rules are met).[68]

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[68] Other jurisdictions have chosen a different approach, as discussed below. *See infra* Part IV.B.2.

For the reasons discussed throughout this release, the Commission is proposing rules for all registered clearing agencies to establish requirements for governance, including requirements for the composition of the board of directors, to mitigate conflicts of interest, to establish certain obligations of the board to oversee service provider relationships, and to establish an obligation of the board to consider the views of participants and other relevant stakeholders. Each of these proposed rules are discussed further below.

A. Board Composition and Requirements for Independent Directors

1. Proposed Rules 17Ad-25(b), (e) and (f)

Proposed Rules 17Ad-25(b), (e), and (f) would establish requirements related to independent directors. First, proposed Rule 17Ad-25(b)(1) would require that a majority of the directors of a registered clearing agency must be independent directors, as defined in proposed Rule 17Ad-25(a). The proposed rule would also provide that, if a majority of the voting interests issued as of the immediately prior record date are directly or indirectly held by participants, then at least 34 percent of the members of the board of directors must be independent directors. Proposed Rule 17Ad-25(a) would define an "independent director" to mean a director that has no material relationship with the registered clearing agency, or any affiliate thereof. Proposed Rule 17Ad-25(a) also would define "material relationship" to mean a relationship, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the director, and includes relationships during a lookback period of one year counting back from making the initial determination in proposed Rule 17Ad-25(b)(2). In addition, proposed Rule 17Ad-25(a) would define "affiliate" to mean a person that directly or indirectly controls, is controlled by, or is under common control with the registered clearing agency. Proposed Rule 17Ad-25(b)(2) would require each registered clearing agency to broadly consider all the relevant facts and circumstances, including under proposed Rule 17Ad-25(g), on an

ongoing basis, to affirmatively determine that a director does not have a material relationship with the registered clearing agency or an affiliate of the registered clearing agency to qualify as an independent director. In making such determination, a registered clearing agency must (i) identify the relationships between a director, the registered clearing agency, any affiliate thereof, along with the circumstances set forth in proposed Rule 17Ad-25(f); (ii) evaluate whether any relationship is likely to impair the independence of the director in performing the duties of director; and (iii) document this determination in writing. Such documentation requirements would be subject to the recordkeeping and retention requirements that apply to all SROs under Section 17(a)(2) of the Exchange Act.[69]

The Commission believes that proposed Rules 17Ad-25(a) and 17Ad-25(b)(2) could provide registered clearing agencies with a broad pool of potential candidates to serve as independent directors. For example, an employee of a participant of the registered clearing agency, a professional in the securities or financial services industries, an academic, and other such qualified persons would be eligible for consideration as an independent director as long as the candidate meets the other criteria under the definition of material relationship and proposed Rule 17Ad-25(f).

Proposed Rule 17Ad-25(e) would require that, if any committee has the authority to act on behalf of the board of directors, the composition of that committee must have at least the same percentage of independent directors as is required under these rules for the board of directors, as set forth in proposed paragraph (b)(1).

Proposed Rule 17Ad-25(f) would describe certain circumstances that would always exclude a director from being an independent director. These circumstances would include: (1)

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69 *See* 15 U.S.C. 78q(a)(2).

the director is subject to rules, policies, and procedures by the registered clearing agency that may undermine the director's ability to operate unimpeded, such as removal by less than a majority vote of shares that are entitled to vote in such director's election; (2) the director, or a family member, has an employment relationship with or otherwise receives compensation, other than as a director, from the registered clearing agency or any affiliate thereof, or the holder of a controlling voting interest of the registered clearing agency; (3) the director, or a family member, is receiving payments from the registered clearing agency, or any affiliate thereof, or the holder of a controlling voting interest of the registered clearing agency that reasonably could affect the independent judgment or decision-making of the director, other than the following: (i) compensation for services as a director to the board of directors or a committee thereof; or (ii) pension and other forms of deferred compensation for prior services not contingent on continued service; (4) the director, or a family member, is a partner in, or controlling shareholder of, any organization to or from which the registered clearing agency, or any affiliate thereof, or the holder of a controlling voting interest of the registered clearing agency, is making or receiving payments for property or service, other than the following: (i) payments arising solely from investments in the securities of the registered clearing agency, or affiliate thereof; or (ii) payments under non-discretionary charitable contribution matching programs; (5) the director, or a family member is employed as an executive officer of another entity where any executive officers of the registered clearing agency serve on that entity's compensation committee; or (6) the director, or a family member, is a partner of the outside auditor of the registered clearing agency, or an employee of the outside auditor who is working on the audit of the registered clearing agency, or any affiliate thereof. Proposed Rules 17Ad-25(f)(2)-(6) would be subject to a lookback period of one year (counting back from making the initial determination in proposed

Rule 17Ad-25(b)(2)). Family member would be defined to include any child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, niece, nephew, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, including adoptive relationships, any person (other than a tenant or employee) sharing a household with the director or a nominee for director, a trust in which these persons (or the director or a nominee for director) have more than fifty percent of the beneficial interest, a foundation in which these persons (or the director or a nominee for director) control the management of assets, and any other entity in which these persons (or the director or a nominee for director) own more than fifty percent of the voting interests.

At the time of the 2016 CCA Standards Adopting Release, the Commission declined to incorporate more prescriptive governance elements into the rule as urged by commenters, including specific requirements on independent representation on the board or risk committee or governance relating to business relationships and affiliates,[70] based on the premise that the requirements in Section 17A of the Exchange Act relating to fair representation and the public interest provided sufficient grounds to hold covered clearing agencies accountable to these concerns.[71] Similarly, with regard to the 2012 governance rule for all registered clearing agencies

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70 *See* CCA Standards Adopting Release, *supra* note 13, at 70804 (stating that "[a]fter careful consideration of the comments, the Commission has determined not to modify Rule 17Ad-22(e)(2) to include specific requirements related to public or independent representation on the covered clearing agency's board or risk committee . . . . The Commission is declining to modify Rule 17Ad-22(e)(2) to further specify that a particular director represent the interests of buy-side or sell-side market participants . . . . In addition, and for the same reasons, the Commission is declining to modify Rule 17Ad-22(e)(2) to provide further specification regarding business relationships and affiliates because these topics, like the above, are already addressed by the fair representation requirement in Section 17A(b)(3)(C) and the public interest requirements of Section 17A of the Exchange Act").

71 *See* 15 U.S.C. 78q-1(b)(3)(C).

that are not covered clearing agencies, the Commission declined to adopt more prescriptive elements to its approach on governance with regard to board composition.[72] However, given the growing concentration of clearing and settlement participants among a small number of firms[73] and the concentration of differing perspectives into distinct groups of clearing agency stakeholders, the Commission believes it is appropriate to propose requirements on independent representation to facilitate the consideration and management of diverse stakeholder interests in the decision-making of the clearing agency.

2. Discussion

a) Board of Director Oversight of Management

Several current requirements under the Exchange Act and regulations are applicable to a clearing agency's board of directors. Section 17A of the Exchange Act requires that the rules of a clearing agency assure the fair representation of owners and participants in the selection of

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72 *See* Clearing Agency Standards Adopting Release, *supra* note 8, at 66251 (adopting the rule largely as proposed and declining to incorporate prescriptive requirements as suggested by commenters, including "[o]ne commenter [who] urged the Commission to ensure that Rule 17Ad-22(d)(8) as well as any requirements adopted from the Commission's proposed Regulation MC pertaining to the mitigation of conflicts of interest are designed to ensure that buy-side market participants have a meaningful voice in the operating committees of clearing agencies because that representation is critical to promoting robust governance arrangements at clearing agencies and serving the best interests of the U.S. financial system. Another commenter stated that proposed Rules 17Ad-22(d)(8), 17Ad-25, and 17Ad-26 reflect a better approach to governance, conflicts of interest, and board and committee composition than the Commission's proposed requirements for clearing agencies under Regulation MC. One commenter urged the Commission to consider complementing proposed Rule 17Ad-22(d)(8) with a minimum board independence requirement so that at least two-thirds of all board directors would be required to be independent").

73 *See* Staff Report on Clearing Agencies, *supra* note 27, at 21.

directors and the administration of the clearing agency's affairs.[74] Rule 17Ad-22(e)(2)[75] under the Exchange Act requires a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to provide for governance arrangements that, in relevant part, (i) support the public interest requirements in Section 17A of the Exchange Act applicable to clearing agencies, and the objectives of owners and participants; (ii) establish that the board of directors and senior management have appropriate experience and skills to discharge their duties and responsibilities; and (iii) consider the interests of participants' customers, securities issuers and holders, and other relevant stakeholders of the covered clearing agency.

Given the importance of the board oversight function,[76] CPMI-IOSCO has issued guidance regarding the board's obligations with respect to oversight of management.[77] This guidance provides several examples of effective oversight of management by clearing agency boards. For example, the guidance highlights the board's responsibility for: (i) carefully

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74 *See* 15 U.S.C. 78q-1(b)(3)(C).

75 *See* 17 CFR 240.17Ad-22(e)(2)(iii)–(iv), (vi).

76 As a foundational principle of U.S. state corporate law, a board of directors of a corporation has ultimate responsibility for the oversight of management, consistent with a director's fiduciary duties of loyalty and care to a company. *See*, *e.g.*, Del. Code tit. 8, sec. 141 (2022) (establishing that the board is ultimately responsible for the corporation's management). In the context of a registered clearing agency incorporated under such principles, this means that the board has ultimate responsibility for ensuring an effective framework for the management of risk by the registered clearing agency, so that the clearing agency can facilitate the prompt and accurate clearance and settlement of securities transactions. To discharge this duty effectively, the board must necessarily work closely with management, but also effectively oversee it.

77 *See* CPMI-IOSCO, Final Report, Resilience of central counterparties (CCPs): Further guidance on the PFMI (July 2017) ("CCP Resilience Guidance"), https://www.bis.org/cpmi/publ/d163.pdf.

overseeing, monitoring and evaluating management's implementation of the risk-management framework; (ii) taking appropriate steps to help ensure that management is performing risk-management tasks properly and effectively; (iii) ensuring that processes are in place for effective and timely communication, reporting and information flow between management and the board; (iv) communicating with management about risk management processes; and (v) when assessing the risk-management framework, appropriately challenging management to demonstrate the effectiveness of risk-management processes.[78] Likewise, the report stated that while a board may not delegate its ultimate responsibilities regarding risk management, it may assign certain tasks, so long as the board clearly defines the assigned tasks and retains ultimate responsibility over such tasks.[79]

b) Requirement for Independent Directors

Corporate governance tools exist to help ensure that the board performs more effective oversight of the management of the company. One such tool is the independent director, which could bolster the board's ability to perform effectively by reducing the potential for financial or other relationships between directors and those persons who are overseen by directors, such as management.[80] The Commission is proposing a definition of "independent director" that retains

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78 *See id.* at 5.

79 *See id*.

80 *See, e.g.*, Bruce Dravis, Director Independence and the Governance Process (Aug. 14, 2018), https://www.americanbar.org/groups/business_law/publications/blt/2018/08/05_dravis/. In the United States, independent directors traditionally are not selected from among management and are not intended to serve as representatives of management, and therefore they do not carry the same financial or other relationships that might create a conflict of interest between the director's interests and the director's duties to the company.

elements of the definition used in Regulation MC, but with modifications.[81] The Commission continues to believe that as part of the definition, the key operating elements are the concepts of material relationships and affiliates, so those elements would be retained. However, at the same time, the Commission proposes using a modified definition of "independent directors" because of changes in scope of this proposed rulemaking. Regulation MC resulted from a public roundtable discussion and meetings held with interested persons, in part, to gain further insight into the sources of conflicts of interest at security-based swap clearing agencies.[82] Regulation MC had proposed a narrower definition of independent director, which would have excluded directors who had material relationships with participants and their affiliates as well,[83] and the proposal would have covered only one class of registered clearing agencies: security-based swap clearing agencies. Pursuant to Section 765, Regulation MC was designed to address anticipated governance concerns relating to participant activity[84] that existed in the OTC derivatives market.

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81 *See* Regulation MC Proposing Release, *supra* note 1, at 65897.

82 *See id.* at 65885.

83 *See id.* at 65928 (defining independent director as "(1) A director who has no material relationship with: (i) The security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable; (ii) Any affiliate of the security-based swap execution facility or national securities exchange or facility thereof that posts or makes available for trading security-based swaps, or security-based swap clearing agency, as applicable; (iii) A security-based swap execution facility participant, a member of a national securities exchange that posts or makes available for trading security-based swaps, or a participant in the security-based swap clearing agency, as applicable; or (iv) Any affiliate of a security-based swap execution facility participant, a member of a national securities exchange that posts or makes available for trading security-based swaps, or a participant in the security-based swap clearing agency, as applicable.").

84 *See id.* at 65885 ("These [security-based swap] entities are not wholly-owned by participants or exchanges and may have different governance related issues than the securities clearing agencies currently registered with the Commission.").

At the time of the proposal, the Commission also proposed Rules 17Ad-25 and 17Ad-26 for registered clearing agencies that took a broad, principles-based approach to clearing agency governance. Because some registered clearing agencies that would be subject to this proposal have participants who are also owners, the Commission's current proposal, under proposed Rule 17Ad-25(b)(1), creates a carve-out from the majority independence requirement when a majority of voting interests are owned by participant-owners, as set forth below.

The Commission believes that requiring a registered clearing agency to include independent directors on the board can improve the board's ability to conduct more effective oversight of management, which is a critical component of the effectiveness of a registered clearing agency. Independent directors constitute a set of directors that do not have potential conflicts of interest resulting from their relationships with management. This helps the board manage conflicts of interest among directors because independent directors do not have the existing relationships or accompanying incentives that might, for example, discourage or dis-incentivize the board to review management's decisions in a thorough, transparent, and consistent way. The appearance of conflicts of interest can reduce confidence among direct and indirect participants, other stakeholders, and the public in the functioning of the clearing agency, particularly during periods of market stress when general confidence in market resilience may be low.

The practice of employing independent directors is common across the financial industry and across public companies more generally.[85] Although Commission rules do not currently

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[85] *See, e.g.*, Quoc Trung Tran, Independent Directors and Corporate Investment: Evidence from an Emerging Market, 21 J. Econ. & Dev. 30 (2019), https://www.emerald.com/insight/content/doi/10.1108/JED-06-2019-0008/full/html (noting that "independent directors have become a common approach of corporate governance" in recent

require the boards of registered clearing agencies to include independent directors, each of the registered clearing agencies already require directors with some independence characteristics (such as "nonexecutive," or "public" directors).[86]

In that vein, in addition to the above dynamic that exists between the board and management, registered clearing agencies must also manage the competing and sometimes divergent interests of owners and participants, as previously discussed in Part II.A.[87] The structure of a registered clearing agency, and the risk management tools that it employs, affect how the interests of owners, participants, and other types of stakeholders align. For example, the risk mutualizing and trade guaranty features provided by covered clearing agencies provide for the shift of the consequences of one party's actions to another, binding disparate interests

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years). For example, the NYSE listing standards require that a majority of the board of directors of a listed company be independent, and they preclude managers or employees of the company from meeting the independence standard, among other criteria. *See*, *e.g.*, Weil, Gotshal & Manges LLP, Requirements for Public Company Boards (Jan. 3, 2022), https://www.weil.com/-/media/files/pdfs/2022/january/requirements_for_public_company_boards_including_ipo_transition_rules.pdf.

86 *See* DTCC, Board Mission Statement and Charter (Oct. 2021), at 5, https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/DTCC-BOD-Mission-and-Charter.pdf; ICC, Regulation and Governance Fact Sheet (Sept. 2021), at 2, https://www.theice.com/publicdocs/clear_credit/ICE_Clear_Credit_Regulation_and_Governance.pdf; ICEEU, Disclosure Framework (Jan. 31, 2021), at 20, https://www.theice.com/publicdocs/clear_europe/ICE_Clear_Europe_Disclosure_Framework.pdf; OCC, Board of Directors Charter and Corporate Governance Principles (Sept. 22, 2021), at 4–5, https://www.theocc.com/getmedia/99ed48a4-aa44-45ac-8dee-9399b479a1c8/board_of_directors_charter.pdf; LCH SA, Board of Directors (2022), https://www.lch.com/about-us/structure-and-governance/board-directors-0.

87 *See, e.g.*, Securities Industry Study, Report of the Subcommittee on Commerce and Finance, H.R. Rep. No. 92-1519, at 84 (1972) ("1972 House Report") (stating generally about SROs such as clearing agencies, "[s]elf-regulators may be parochial in adjustment and accommodating competing aims and policies. Furthermore, since self-regulatory bodies are composed of disparate subsidiary groups, the legitimate interests of a particular group may be overridden, or the tugging and pulling may result in inaction or impasse").

together in certain circumstances, such as a participant default. These features both affect how different stakeholders maximize their own self-interest and also distinguish the governance of a clearing agency from other corporate structures, such as those of other financial services companies or, more generally, publicly traded companies, who are unable to legally bind their customers with financial obligations that are theoretically uncapped. In particular, the owners of a clearing agency may seek to shift risks to the participants of the clearing agency to decrease the level of exposure that the owners face by capitalizing the clearing agency. Meanwhile, participants in the registered clearing agency may seek to raise the cost of participation to exclude competitors from the benefits of the clearing agency's risk mutualizing and mitigating tools, or they may seek to reduce their exposure to the clearing agency by not making certain assets available for use by the clearing agency during loss allocation. As described below, there can be countervailing benefits to having the interests of a director and the interests of an owner aligned, so as to increase the likelihood that decisions made will benefit shareholders. Likewise, there are benefits to having the interests of a director and the interests of a participant aligned, in order to increase the likelihood that decisions will take into account the long-term needs of participants. The requirement in Section 17A for fair representation recognizes that clearing agencies may serve competing stakeholders, such as owners and participants, both in the selection of directors and administration of their affairs.[88] Directors may carry these perspectives when they serve on the board, and these perspectives may influence the ultimate decision-making of the board. For example, one set of stakeholders could use the board to shift costs and risk exposure to others (*e.g.*, owners shifting them to participants), in ways that could undermine

[88] *See* 15 U.S.C. 78q-1(b)(3)(C).

the risk mutualizing and mitigating purpose of the clearing agency.[89] The Commission is also mindful that ultimately, owners (as holders of voting interests) are generally in the position of electing directors (subject to any restrictions on ownership, classes of shares, *etc*.), meaning that any director who has a material relationship with a participant and who has been nominated as a potential independent director must nonetheless be voted onto the board of directors by the owners; so ultimate approval of a director would remain in the hands of owners, creating an incentive for even a director who is employed by a participant to take into account the views of owners. Nonetheless, the criteria for independent directors under the proposed rules would help ensure that independent directors retain those features that distinguish their interests from those of other directors because, for example, an independent director cannot have an employment relationship with or otherwise receive compensation (other than as a director) from the registered clearing agency or any affiliate thereof, or the holder of a controlling voting interest of the registered clearing agency. In addition, although independent directors may be elected, in part, by owners, the views of owners would not be the only stakeholders' views that independent directors would consider.

Given the above dynamics between owners and participants, the Commission believes that registered clearing agency processes involving risk management or director nominations are also implicated in managing the dynamics between owners and participants. Therefore, the relationships affecting the independence of a director in the context of a registered clearing

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89 *See, e.g.*, PFMI, *supra* note 4, at 11 ("FMIs and their participants do not necessarily bear all the risks and costs associated with their payment, clearing, settlement, and recording activities. Moreover, the institutional structure of an FMI may not provide strong incentives or mechanisms for safe and efficient design and operation, fair and open access, or the protection of participant and customer assets. In addition, participants may not consider the full impact of their actions on other participants, such as the potential costs of delaying payments or settlements.").

agency also include those between the director and the registered clearing agency itself or its affiliates.[90] The ability of a registered clearing agency to help ensure effective risk management and loss allocation in the event of a default or non-default loss is linked to the interests of the owners of the clearing agency, who may also have financial relationships with the participants (or be the participants) of such registered clearing agency.[91] For example, The Options Clearing Corporation ("OCC") is owned by certain options exchanges, whose customers may also be participants of OCC.[92] Similarly, participants in the registered clearing agencies that are subsidiaries of The Depository Trust & Clearing Corporation ("DTCC") are required to purchase common shares of DTCC as part of periodic efforts to keep ownership proportionate to such owners' use of clearing agency services.[93] Such provisions that require common shares to be periodically re-allocated to reflect levels of use of the clearing agency services create financial and other relationships between a registered clearing agency, its participants, its affiliates, and its owners. In this sense, registered clearing agencies are not organized in a way that reflects the

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90 Affiliate is proposed to mean a person that directly or indirectly controls, is controlled by, or is under common control with the registered clearing agency. A director would, of course, have a relationship with the clearing agency that arises from service as a director, and the accompanying duties to the company such as the fiduciary duties of the duty of care or the duty of loyalty. These relationships and duties, however, do not create a potential conflict of interest that might impair the independent judgment of the director.

91 In Part III.A.2.f) below, the Commission discusses how participant-owners may have interests that are well-aligned with the risk management function of the clearing agency, supporting a lower threshold of independent directors when a majority of owners are participant-owners.

92 *See* OCC, Annual Report (2019), https://annualreport.theocc.com/About-OCC.

93 *See* DTCC, NSCC Important Notice No. A8986 (Apr. 5, 2021) (regarding the period common stock reallocation process), https://www.dtcc.com/-/media/Files/pdf/2021/4/5/A8986.pdf.

corporate ownership of the typical publicly traded company, where the shareholder base is a dispersed population that may have coordination problems, and therefore the scope of inquiry cannot end simply at whether a director is independent from management alone.[94] Rather, the owners of a registered clearing agency reflect a few key groups, who may be owners or participants of the clearing agency, and board composition will thus necessarily reflect these different stakeholder groups and their views on risk management.

In the context of a registered clearing agency, the Commission believes that requiring independent directors helps promote the ability of the board to perform its oversight of management function and to support a plurality of viewpoints voiced at the board level. Independent directors would help ensure that, when the interests between owners and participants diverge, the impact of such divergence is more manageable because the board would not be composed entirely of directors who have material relationships either to management (such as under a situation where managers approve compensation or other payments from the registered clearing agency to such director), owners, or participants. Balance between stakeholders with divergent views could help the board to adequately consider the respective needs of all stakeholders, and help promote the integrity of the clearing agency's risk management function. With respect to independent directors serving on the boards of public companies, some studies have questioned whether independent directors succeed in improving

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94 *See, e.g.*, Donald C. Clarke, Three Concepts of the Independent Director, 32 Del. J. Corp. L. 73 (2007), https://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=1045&context=faculty_publications .

shareholder value.[95] For registered clearing agencies, the Commission is proposing a requirement for independent directors for reasons unrelated to improving shareholder value. Rather, registered clearing agencies are subject to an expansive regulatory framework in which they operate as critical and often systemically important financial market utilities.[96] They are subject to requirements under the Exchange Act to facilitate prompt and accurate clearance and settlement, promote the public interest,[97] and help ensure the fair representation of owners and participants (regardless of whether these owners and participants are the controlling owner or the clearing agency's largest participant). As long as a majority of directors are not solely motivated by the needs of one category of stakeholders, this structure can help ensure that the board addresses the full set of owners and participants, even smaller participants,[98] in fulfilling these statutory objectives. In this way, a requirement for independent directors is well-suited to help promote more effective governance of a registered clearing agency and meet the purposes of the Exchange Act.[99]

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95 *See, e.g.*, *id.* at 75–77.

96 *See, e.g.*, 12 U.S.C. 5461; *see also* Board of Governors of the Federal Reserve System, Designated Financial Market Utilities, https://www.federalreserve.gov/paymentsystems/designated_fmu_about.htm (providing the list of designated financial market utilities, including five SEC-regulated registered clearing agencies).

97 *See* 15 U.S.C. 78q-1(b)(3)(C). *See also* Clarke, *supra* note 94, at 82–83 (noting that although there are situations where an independent director may not make an appreciable difference in outcomes, that provided there is a mechanism for accountability, "[a] director serving the 'public interest' should arguably be independent of *everyone* [such that a director is able to]… follow only the dictates of her conscience").

98 *See id.* at 80 (stating that non-management directors are viewed as potentially protecting small shareholders from big shareholders).

99 *See infra* Part IV.C.1 (discussing proposed Rules 17Ad-25(b), (e), and (f)).

c) Definition of "Material Relationship"

To be an independent director consistent with the proposed rules, a director must have no material relationships with a registered clearing agency or its affiliate. As defined in proposed Rule 17Ad-25(a), which was carried forward from the Commission's previous proposal in Regulation MC,[100] a "material relationship" means a relationship, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the director. The scope covers relationships during a lookback period of one year counting back from making the initial determination in proposed Rule 17Ad-25(b)(2). The proposed definition is identical to the definition proposed in Regulation MC, except for the addition of a one-year look back period, which is intended to address recently terminated business or personal relationships to prevent evasion of the purposes of this provision, as discussed further below. The Commission is retaining its prior proposed definition of material relationship because the definition of material relationship is not impacted by the type of security cleared (*i.e.*, expanding this proposal to cover all registered clearing agencies rather than security-based swap clearing agencies does not alter the rationale provided under the Regulation MC). Establishing a materiality and reasonableness threshold for such relationships provides a registered clearing agency with discretion to apply this requirement across a range of fact patterns while ensuring that they ultimately facilitate the fair representation of owners and participants.

The proposed rule includes relationships both compensatory and otherwise to help ensure that the evaluation of a director's independence is thorough. Such scope of relationships would include not only pecuniary transactions but other types of quid pro quo arrangements, biases, or obligations between persons. Under the Commission's proposed rule, however, such non-

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100 *See* Regulation MC Proposing Release, *supra* note 1, at 65897.

compensatory relationships must reach the level of materiality to affect a director's status as an independent director. In addition, the proposed rule would carve out any past relationships that have terminated at least one year prior because the Commission believes such past relationships are unlikely to have a material effect on a director's future decision-making. The proposed definition includes a lookback period, which is meant to cover recently terminated relationships as a method to avoid circumvention of the proposed independent director requirements. As discussed below, the Commission has experience with a one-year lookback period applied to employment relationships between auditors and former audit clients, and the Commission believes that the same objectives underpinning that lookback period would apply here.[101]

Finally, the definition would require consideration of material relationships between a director and any affiliate that directly or indirectly controls, is controlled by, or is under common control with the registered clearing agency. The purpose of this provision is to address potential conflicts of interest that would arise when a director is serving in a management or director role for an affiliate, such as a parent company, of the registered clearing agency,[102] or when a director

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101 *See generally* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, sec. 206, 116 Stat. 745, 774 (2002) ("SOX").

102 The potential implications of a director of a registered clearing agency having a material relationship with an affiliated company have been discussed in the context of European Union-based CCPs under the 2012 Regulatory Technical Standards ("RTS"), adopted by the European Commission as part of the European Market Infrastructure Regulation ("EMIR"). Chapter III, Article 3 of the RTS states, "[a] CCP that is part of a group shall take into account any implications of the group for its own governance arrangements including whether it has the necessary level of independence to meet its regulatory obligations as a distinct legal person and whether its independence could be compromised by the group structure or by any board member also being a member of the board of other entities of the same group. In particular, such a CCP shall consider specific procedures for preventing and managing conflicts of interest including with respect to outsourcing arrangements." *See* 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

has a material level of investment in a registered clearing agency or its affiliate. The Commission is not including a bright-line test as to what is a material level of investment because such an investment could be either material to the director, such as a financial investment that is a material percentage of an individual's wealth, or material to the registered clearing agency or its affiliate, such as a material percentage of ownership of a company. For example, if a director held ownership in an affiliated company of a registered clearing agency, this investor relationship should be evaluated for materiality and whether it could affect the independent judgment or decision-making of the director, even if such investment did not amount to such director being a controlling shareholder of such affiliate (which is specifically prohibited for independent directors under proposed rule 17Ad-25(f)(4), as discussed further below). If such relationships were not considered, then a director who serves on the management of the parent company and therefore indirectly manages the registered clearing agency itself through the holding structure could nonetheless be considered independent. The proposed definition would help mitigate evasion of the spirit of the independent director requirement through the use of multi-tier holding company structures that place management responsibility at multiple levels of the organizational structure. If the functional role of managing a clearing agency was housed in a parent company, thereby allowing a manager to claim to be an independent director by virtue of not being an employee of the registered clearing agency itself but instead of the parent company, then the Commission's intent in this proposed rule could be easily circumvented.

central counterparties, 2013 O.J. (L 52), at art. 3(4), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0153&from=EN.

d) Process for Assessing Relationships

Proposed Rule 17Ad-25(b)(2) establishes a process by which a registered clearing agency must identify, evaluate, and document its determinations regarding director independence. These requirements have been included in the rule because achieving director independence necessarily requires an assessment of a director's relationships. The provisions of Rule 17Ad-25(b)(2) include requirements to establish a process to identify and evaluate any such relationships and to document that process to help ensure that a registered clearing agency has considered a wide range of potential relationships, and applied its analysis transparently and consistently over time.

The proposed rule also requires a registered clearing agency to affirmatively determine that no material relationships exist, broadly considering all the relevant facts and circumstances. The Commission believes that establishing a process helps ensure more effective identification and evaluation of any material relationships. The Commission also believes that affirmatively determining that a director is independent helps promote a thorough review of the director's relationships and helps promote confidence in the governance arrangements of the clearing agency because each such director's independence status will have been evaluated by the registered clearing agency. The Commission has not specified in the rule the particular sources of information to be reviewed or the particular approach to inquiring about relationships because the facts and circumstances of each director or candidate's relationships are likely to differ. The Commission is not specifying a checklist of sources to consult and searches to perform, in order to avoid inadvertently leaving off such checklist a source that cannot be foreseen.

e) Excluded Relationships

The process set forth under Rule 17Ad-25(b)(2) would also require analysis of certain circumstances pursuant to which a director would be precluded from being an independent director, regardless of any determinations otherwise made pursuant to Rule 17Ad-25(b)(2).

These scenarios are intended to address cases where, in the Commission's view, the circumstances clearly prevent a director from exercising independent judgment or decision-making.

Currently, owners of registered clearing agencies are predominantly non-natural persons such as participants, exchanges, or a parent company. The Commission does not expect that a natural person serving as a director would typically be a controlling shareholder of such registered clearing agency, although there may be future registered clearing agencies with this organizational structure. However, due to the fact that directors are natural persons, but owners of registered clearing agencies currently tend to be non-natural persons, many of the circumstances described below seek to address the connection between the natural person director and the non-natural person owner.

Proposed Rule 17Ad-25(f)(1) limits the ability for a registered clearing agency to undercut the authority of independent directors, such as through provisions established by a registered clearing agency in the bylaws or other organizational documents. For example, if one director who happened to be associated with management was authorized to remove independent directors him or herself, rather than through the normal channels of removing a director via a majority vote of the shareholders, then any independent directors might be beholden to such director. Likewise, if some directors – such as those with relationships to management – could conduct closed meetings that exclude independent directors to discuss matters before the board, the ability of independent directors to perform their duties could be undercut. This provision would not limit the ability of a registered clearing agency to manage or mitigate conflicts of interests among its directors, such as by implementing through policies and procedures a requirement that conflicted directors recuse themselves from a matter pursuant to a conflicts of

interest policy, if such recusal would be necessary for that director to operate more effectively. Rather, the provision addresses whether independent directors would be limited, restricted, or chilled in expressing their views because they were subject to removal by a management director or denied information relevant to the decision-making process.

Proposed Rules 17Ad-25(f)(2) through (5) identify circumstances where a director is precluded from being an independent director because the director has an employment relationship or has received a payment from the clearing agency, its affiliates, or its holders of controlling voting interests, either directly or through indirect channels. Several of the provisions reference a family member, which the Commission is proposing to define broadly, to include natural persons who are related by blood, marriage, or household, including living antecedents and descendants, as well an non-natural persons (trusts and other legal entities) that are controlled by such natural persons. The Commission is intending for the prohibition to be comprehensive as to the relationship in order to cover potentially meaningful relationships. Although the list includes non-natural persons controlled by an extensive list of natural persons, a director would not necessarily need to compile a list of trusts or companies controlled by various in-laws and relatives. Instead, if the director compiled the list of natural persons referenced in the definition, a registered clearing agency could determine whether those persons (or legal entities under their control) were doing business with the registered clearing agency, any of its affiliates, the holder of a controlling voting interest of the registered clearing agency, the outside auditor, or an entity where an executive officer of the registered clearing agency serves on such entity's compensation committee, in a manner that would exclude a person from being considered an independent director under proposed Rule 17Ad-25(f), as described below.

A registered clearing agency is likely already determining who it is conducting business with as part of evaluating whether to enter into contracts with those companies.

Proposed Rule 17Ad-25(f)(2) precludes a director from being an independent director when the director is also an employee of the registered clearing agency or its affiliates, a requirement intended to reflect the traditional concept of director independence from management, discussed above. Proposed Rule 17Ad-25(f)(3) and (4) preclude a director from being an independent director when receiving certain types of payments, such as in a scenario where the director is a partner or a controlling shareholder of a consulting firm that contracts with the registered clearing agency, or where the director's spouse is a partner or controlling shareholder of a service provider that is hired by the registered clearing agency. These proposed rules address circumstances where payments would create a conflict of interest and undermine the ability of the director to maintain independent judgment. The proposed rules would carve out certain types of payments, such as payments from pensions or deferred compensation for prior services. The Commission believes that such payments are generally made in response to past, rather than future, activity and therefore do not have the potential to create conflicts of interest by affecting future decision-making by the director.

The list of payments for property or services in proposed Rule 17Ad-25(f)(4) scopes in participant clearing fees as well. The Commission is restricting the ability of a director to be independent if he or she is a partner or controlling shareholder of a participant because he or she could directly profit from reducing the size of the clearing fees even if that impairs the quality of the risk management of the clearing agency.

Proposed Rule 17Ad-25(f)(5) would preclude independence if a director, or a family member, is employed the as an executive officer of another entity where any executive officers

of the registered clearing agency serve on that entity's compensation committee. The intent of this provision would prevent circular arrangements whereby compensation could be elevated among a chain of interested persons.

Proposed Rule 17Ad-25(f)(6) would preclude a director from being an independent director when the director is a partner of an outside auditor or is an employee working on an audit of the registered clearing agency. As above, these limitations are designed to reduce the potential for conflicts of interest that would impair an independent director's independent judgment.

Finally, proposed Rule 17Ad-25(f) would subject paragraphs (f)(2)-(6) to a one-year lookback period, which is intended to capture conflicts of interest that may arise from relationships that have recently terminated (such as departure from a job). As with the lookback period in the "material relationship" definition, the purpose of this lookback period is the same for all provisions, as well as in the material relationship definition, which is to cover relationships that have recently terminated, while not reaching back so far in time as to impede the registered clearing agency's ability to select from a large pool of skilled and experienced candidates for independent director. The Commission believes that a one-year lookback period is consistent with similar requirements in other statutes and Commission rules.[103]

f) Majority of Independent Directors

In assessing the appropriate quantum of independent directors to be required under the proposed rule, the Commission has considered the potential impact of divergent interests between owners and participants, or the potential in which the interests of owners and participants might diverge. The Commission believes that requiring a majority of independent

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103 *See* SOX, *supra* note 101.

directors is most likely to result in the board acting from a position where the interests of all the stakeholders of the clearing agency are considered, rather than the interests of a particular subset of owners or participants. Having a majority of independent directors reduces the potential misalignment of interests among directors and management, and among owners and participants, helping to ensure that a majority of directors are unattached to these dynamics. In other words, an unattached or "disinterested" majority helps promote consideration of the risk management purposes of the clearing agency, and helps decrease the likelihood that other interests that may arise from a potential conflict of interest are the determinative factor in board decisions. If a majority of directors are non-independent directors, then a majority of directors influenced by potential or perceived conflicts of interest could sway the outcome of board decisions.

The Commission recognizes, however, that the interests of an owner and a participant can overlap in some cases, such as when a participant also owns a portion of its equity. For example, the Exchange Act provides that the Commission may determine that the representation of participants is fair if they are afforded a reasonable opportunity to acquire voting stock of the clearing agency, directly or indirectly, in reasonable proportion to their use of such clearing agency.[104] The opportunity for a participant to become such an owner of a clearing agency is one method to mitigate the potential for conflicts of interest among these two groups, by more closely aligning the interests of a participant with those of a voting interest holder (*i.e.*, owner).

In this structure, owners and participants would be one and the same, and the dynamic where diverging interests between owners and participants undermine the risk management function of the clearing agency is less likely because participant-owners would necessarily internalize and synthesize the divergent interests resulting from ownership and participation. In

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104 *See* 15 U.S.C. 78q-1(b)(3)(C).

other words, participant-owners are less likely to use their equity share to shift the burdens of risk management to the participants of the clearing agency because they are themselves participants. When a majority of voting shares are held by participant-owners, the Commission believes that the interests of the board will be more closely aligned with ensuring more effective risk management. In this circumstance, the Commission believes it is appropriate to reduce the number of independent directors required under the rule to promote the selection of directors by participant-owners because directors voted by a majority of persons intended to represent the clearing agency's participant-owners would mitigate against the possibility of a divergence of interests. Accordingly, the Commission is proposing a lower requirement for independent directors of at least 34 percent of directors when the registered clearing agency has a majority of its voting interests directly or indirectly held by participants; indirectly held by participants refers to participant ownership of a parent company. For example, if a registered clearing agency is wholly-owned by a holding company, and the holding company is majority owned by the participants of the registered clearing agency, then a 34 percent threshold would apply. Alternatively, if a registered clearing agency was 51 percent owned by a holding company, and that holding company was 100 percent owned by the participants of the registered clearing agency, then that would also amount to a majority ownerships of participants, which would cause the 34 percent independent director provision to apply. The Commission proposes to require 34 percent, or greater than one-third of directors, to encourage a significant portion of directors to meet the independence requirement but to provide a comparatively higher level of discretion to the clearing agency to select non-independent directors. A requirement for greater than one-third independent directors would align with the requirement for independence in other jurisdictions

for clearing agencies.[105] In addition, if 34 percent of directors are independent directors, and participants and owners of the registered clearing agency are predominantly the same entity (*i.e.,* participant-owners), then it remains less likely that any one of the three distinct groups seeking to influence the registered clearing agency—owners, management, and participants—will establish an outsized influence over the remaining non-independent directors.

Finally, the proposed rule defines the 34 percent requirement using the term "holders of voting interests" rather than simply "owners" so that the lower threshold only applies when participant-owners are entitled to vote to elect a director, irrespective of whether someone is otherwise entitled to the financial attributes of such ownership. The Commission is not using the term owner as the equivalent concept of holder of a voting interest, because the financial attributes of a security can be separated from the voting rights of a security. The Commission is focused on who has the ability to influence who is voted onto the board – which accompanies voting rights, not financial attributes – as the relevant factor in deciding whether participants can enjoy that benefit of ownership as participant-owners.

g) Other Committees of the Board Generally

Proposed Rule 17Ad-25(e) would impose the independent director requirement as applied to the full board of directors under Rule 17Ad-25(b)(1) to any board committee that has the authority to act on behalf of the board. For example, if 34 percent of the board must be composed

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105 *See* EMIR at art. 27(2), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0648&from=EN (stating that "[a] CCP shall have a board. At least one third, but no less than two, of the members of that board shall be independent"); *see also id.* at art. 2(28) (defining independent member of the board to mean a member of the board who has no business, family or other relationship that raises a conflict of interests regarding the CCP concerned or its controlling shareholders, its management or its clearing members, and who has had no such relationship during the five years preceding his membership of the board).

of independent directors, any committee that is taking action based on a board delegation also should have at least 34 percent of its members be independent directors, unless otherwise required to meet a higher standard under the rules.[106] The purpose of the proposed rule is to prevent a registered clearing agency from circumventing the proposed requirement for independent directors by delegating key decisions of the board to a committee with fewer independent directors than those required of the full board under Rule 17Ad-25(b)(1).

3. Request for Comment

The Commission requests comment on all aspects of proposed Rules 17Ad-25(b), (e), and (f). In particular, the Commission requests comment on the following specific topics:

1. Is requiring that the boards of registered clearing agencies have a majority of independent directors an effective tool for ensuring a transparent and objective governance process that balances the potentially competing or divergent interests of owners and participants? Has the Commission accurately described the benefits of independent directors, as defined in this release, to the board of a registered clearing agency? Why or why not?
2. Are there other ways to define "independent director" or "material relationship" that would achieve the Commission's goals? If so, what are they? Should the Commission establish a numerical threshold, such as $100,000 annually, for compensatory relationships in order for them to be considered material under this rule? If so, what should that numerical threshold be? Please be specific. Should the Commission create a list of the types of relationships that should be considered either material or that could

[106] For example, to help ensure that evaluations of director nominees made by the nominating committee reflect independent judgment, proposed Rule 17Ad-25(c)(2) would require that the nominating committee be composed of a majority of independent directors in all cases. *See infra* Part III.B.1 (discussing the proposed rule).

affect the independent judgment or decision-making of a director under this rule, and should that list distinguish between compensatory and non-compensatory relationships? Why or why not?

3. Should the Commission define the term "control" in the proposed rules? If so, would it be appropriate to adopt a definition similar to the one in 17 CFR 246.2, which states that control means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise?
4. What is the appropriate percentage of independent directors on the board of a registered clearing agency? Does the requirement for a majority of directors to be independent directors support the goals discussed in this proposal? Would another threshold be more effective at addressing diverging views among owners, participants, and other relevant stakeholders in the registered clearing agency? For example, would a requirement that one-third of the directors be independent (which has been adopted by European jurisdictions) provide the benefits of independent directors without any of the potential drawbacks? Please explain.
5. Is the application of director independence requirements appropriate for all registered clearing agencies, or should there be distinctions made among registered clearing agencies based on certain factors, such as organizational structure or products cleared? If so, what factors are relevant and why? Would these proposed rules apply to all types of organizational structures in a consistent manner, or would they impede a registered clearing agency from changing its organizational structure into a more innovative or efficient structure?

6. Is a one-year lookback period adequate for purposes of the "material relationship" definition and proposed Rules 17Ad-25(f)(2)-(6)? For example, is a one-year time period for the receipt of certain payments by clearing agencies the appropriate length of time to determine that a director is precluded from being considered independent? How will this impact the ability of clearing agencies to recruit experienced persons to serve as directors? More generally, how large is the pool of potential directors that could serve as independent directors, as defined in this release, on the boards of registered clearing agencies? Are there particular elements of the independent director definition that limit the pool of potential independent directors? Should those elements be modified to expand the pool?

7. Is it appropriate to include affiliates of registered clearing agencies as relevant to the consideration of material relationships of independent directors, as well as certain scenarios that preclude independence?

8. Is the scope of the scenario in proposed Rule 17Ad-25(f)(4) overly broad or overly narrow in covering all partners, regardless of relative holdings, and controlling shareholders? Should this provision cover all shareholders, or non-managing partners, instead? Why or why not?

9. The Commission is proposing in Rule 17Ad-25(f)(3) to carve out directors who are serving as directors on other boards from the list of scenarios that explicitly preclude independence. Is this carve-out appropriate in order to permit a director of a registered clearing agency who also serves as a director of another legal entity to qualify as independent (provided all other requirements are met), or should there be some

restrictions, such as restrictions on serving as a director of an affiliate, or participant? Why or why not?

10. The Commission requests comment on whether the proposal to require independent directors raises any potential legal issues for those directors or clearing agency governance committee members. Specifically, as a matter of corporate law, would independent directors or committee members be forced to contend with competing duties or obligations to the clearing agency such as under laws of another jurisdiction, including any duties or obligations that would foreclose participation in the board or the committees? If so, how may the goal of receiving independent, diverse opinions be achieved?
11. The Commission requests comment on whether the proposed approach to board composition and board member independence may raise compliance issues with respect to being registered with the Commission and the CFTC or a non-U.S. regulatory authority. If so, what steps should the Commission take to continue to facilitate dually-registered clearing agencies?
12. The Commission requests comment on whether the requirement to undergo a broad consideration of facts and circumstances when determining whether a board member is independent is sufficiently clear. Is there additional guidance needed on what sources could be consulted or what types of relationships could be considered?
13. The Commission is applying the lowered threshold applicable to registered clearing agencies whose voting interests are majority-held by participants, or whose parent company's voting interests are majority-held by the registered clearing agency's participants. Does this scope strike the right balance between permitting flexibility in

ownership structures versus providing the lowered threshold of 34 percent independent directors only when warranted (*i.e.,* when the interests of participants and owners are less likely to diverge when participant-owners are the holders of voting interests)? Why or why not?

14. Should the Commission permit directors who have material relationships with participants (such as being an employee of a participant), other than those relationships that are explicitly precluded in Rule 17Ad-25(f), to meet the definition of independent director, or should these relationships be precluded as well? Should the Commission be more restrictive, as is proposed in paragraph (f)(2), with respect to compensation and payments received from the registered clearing agency or its affiliates, rather than participants? Why or why not?
15. The Commission is soliciting comment on how to view participant clearing fees or other payments from participants that generate revenue for the clearing agency as a potential scenario that precludes director independence. Is it sufficiently clear in the text of proposed Rule 17Ad-22(f)(4) that revenues from participants are covered under the scope of this prohibition? Should the Commission treat revenues from participants differently from other sources of revenues or expenditures? Should the Commission create a carve out for lower levels of revenues in order to promote the opportunity for partners or controlling shareholders of small participants to be able to qualify as an independent director, such as by creating a minimum threshold of payments covered by this provision? Why or why not?
16. The Commission is proposing an extensive list of natural persons who fall within the definition of family member for this rulemaking, along with legal entities under their

control. Has the Commission chosen an appropriate scope for the definition of family member, or is the definition unworkable, either because it is overbroad, or because it misses an important category of persons?

17. Should the Commission define "family member" to refer to "spouse or spousal equivalent"? Why or why not? Is adding "spousal equivalent" unnecessary because such person would be covered as "any person (other than a tenant or employee) sharing a household," which is already part of the definition? Please explain.
18. The Commission is not specifying particular roles for several aspects of this rulemaking, such as who makes the determination that a director is an independent director. Should the Commission be more prescriptive and specify whose responsibility it is to make such a determination? Why or why not?

B. Nominating Committee

1. Proposed Rule 17Ad-25(c)

Proposed Rule 17Ad-25(c)(1) would require each registered clearing agency to establish a nominating committee and a written evaluation process whereby such nominating committee shall evaluate individual nominees to serve as directors. Proposed Rule 17Ad-25(c)(2) would require that (i) independent directors comprise a majority of the nominating committee, and (ii) an independent director chair the nominating committee. Proposed Rule 17Ad-25(c)(3) would require the nominating committee to specify and document fitness standards approved by the board. Such fitness standards for serving as a director would need to be consistent with all the requirements of proposed Rule 17Ad-25, and also would include that the individual nominee is not subject to any statutory disqualification as defined under Section 3(a)(39) of the Exchange

Act.[107] Proposed Rule 17Ad-25(c)(4) would require the nominating committee to document the outcome of the clearing agency's written evaluation process in a manner that is consistent with the nominating committee's written fitness standards required under proposed Rule 17Ad-25(c)(3). The process would require the nominating committee to: (i) take into account each nominee's expertise, availability, and integrity, and demonstrate that the board, taken as a whole, has a diversity of skills, knowledge, experience, and perspectives; (ii) demonstrate that the nominating committee has considered whether a particular nominee would complement the other board members, such that, if elected, the board of directors, taken as a whole, would represent the views of the owners and participants, including a selection of directors that reflects the range of different business strategies, models, and sizes across participants, as well as the range of customers and clients the participants serve; (iii) demonstrate that the nominating committee considered the views of other stakeholders who may be impacted by the decisions of the registered clearing agency, including transfer agents, settlement banks, nostro agents, liquidity providers, technology or other service providers; and (iv) identify whether each selected nominee would meet the definition of independent director in proposed Rules 17Ad-25(a) and (f), and whether each selected nominee has a known material relationship with the registered clearing agency or any affiliate thereof, an owner, a participant, or a representative of another type of stakeholder of the registered clearing agency described in (iii) above.

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[107] Section 3(a)(39) of the Exchange Act lists the particular events that would subject a person to "statutory disqualification" with respect to membership or participation in, or association with a member of, a self-regulatory organization, such as a registered clearing agency. 15 U.S.C. 78q-1(a)(3)(C).

2. Discussion

In Part III.A.2, the Commission discussed the importance of requiring independent directors on the board of a registered clearing agency to help manage the dynamics that exist between owners and participants. To help ensure that the nomination process for the selection of independent directors is thoughtful and transparent, promote the integrity of determinations that a nominee is independent and is qualified to serve, and also promote more effective governance, the Commission is proposing to require a nominating committee that is composed of a majority of independent directors and chaired by an independent director. The Commission is proposing to require that the nominating committee be composed of a majority of independent directors in all cases, even where a clearing agency is majority-owned by participants, to help ensure that the evaluation of director nominees by the nominating committee reflects independent judgment.[108]

a) Requirement for Nominating Committee

Many registered clearing agencies already have a designated nominating committee.[109] However, these nominating committees may not serve as the exclusive governing body for evaluating director nominees. To create a record that would help to ensure the integrity of the nominating committee's consideration of each potential nominee's qualifications, including whether such nominee would qualify as an independent director under proposed Rules 17Ad-25(b), (e), and (f), the Commission believes that requiring the nominating committee to be the exclusive governing body for evaluating director nominees helps ensure that director selections

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108 *See supra* note 106 and accompanying text (explaining that, despite the composition requirements for certain board committees under proposed Rule 17Ad-25(e), the lower independence threshold under proposed Rule 17Ad-25(b)(1) will not apply to the nominating committee).

109 *See infra* Part IV.B.4.a)(2) (discussing the current baseline for the proposed rule).

are made consistent with the proposed requirements and without influence from potential conflicts of interest. Some registered clearing agencies currently allow other governing bodies and/or constituents of their organizational structure to select certain directors.[110] While the proposed rule would not prohibit such approaches, it would require that any such nominees be submitted first to the nominating committee for evaluation—before being considered by the board—pursuant to a written evaluation process established by the registered clearing agency. This proposed requirement would help ensure that nominees are evaluated in a manner consistent with the requirements for independent directors and other qualifications to serve.

b) Role of Independent Directors

Not all registered clearing agencies require that the nominating committee be chaired by an independent director or composed of a majority of independent directors. As discussed above, however, independent directors are well-suited to help manage the divergent interests that exist among management, owners, and participants,[111] and are also best incentivized to help ensure that nominees do not have conflicts of interest that would preclude independent decision-making

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110 For example, OCC currently allows certain participant exchanges to select Exchange Director nominees for election to OCC's board. *See* OCC, By-Laws (rev. Apr. 11, 2022), at 39, https://www.theocc.com/getmedia/3309eceb-56cf-48fc-b3b3-498669a24572/occ_bylaws.pdf ("An individual may be nominated by, elected by, and serve as an Exchange Director for more than one Equity Exchange."); *see also* OCC, Board of Directors Charter and Corporate Governance Principles (rev. Sept. 22, 2021), at 4, 6, https://www.theocc.com/getmedia/99ed48a4-aa44-45ac-8dee-9399b479a1c8/board_of_directors_charter.pdf (providing that Public Director and Member Director nominees are selected by OCC's Governance and Nominating Committee, but Exchange Director nominees are instead selected by OCC's Equity Exchanges).

111 *See supra* Part III.A.2 (discussing independent directors as a governance tool to address such divergent interests).

or otherwise undermine the decisions of the board.[112] Because a majority of independent directors can help provide perspectives broader than owners and participants, constituting the nominating committee with a majority of independent directors would help promote the fair representation of owners and participants in the selection of directors. In addition, independent directors would facilitate a fair evaluation of a nominee's qualifications, including whether such individual would meet the Commission's proposed criteria for being an independent director, as such an evaluation would be conducted by a body that is free from influence in the performance of its duties and whose majority would itself satisfy the proposed criteria for being independent directors. By contrast, when evaluating nominees, directors serving on the nominating committee who are not independent directors may be more likely to favor board candidates whose views align with those persons with whom the director has a material relationship, reducing the likelihood that the nominating committee will consider a set of director nominees that represent the different stakeholders in a clearing agency. Thus, having a nominating committee that is composed of majority independent directors should help to address and facilitate both the selection of independent directors, as well as the selection of a broad range of directors that reflect the different stakeholder groups in a fair and more representative way.

c) Fitness Standards

Fitness standards for directors help ensure that directors have the necessary qualifications and experience to contribute more effectively to board governance, and most clearing agencies already have documented fitness standards for serving as director. The Commission believes that codifying this practice by requiring documented fitness standards will help ensure that directors

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112 *See supra* Part III.A.2 (discussing independent directors as a governance tool to address such conflicts).

are subject to consistent standards, fairly applied over time by the nominating committee and the board. Because the Commission is proposing rules to require independent directors, the Commission also believes requiring documented fitness standards will help ensure that a nominee's qualifications and relationships are reviewed pursuant to a consistent set of standards before the nomination is voted on by the board. In addition, the Commission is establishing that the nominating committee is responsible for maintaining the fitness standards because the composition of the nominating committee, in which a majority of directors must be independent directors, helps ensure that the standards are objective and evenly applied across nominees and over time because they will be maintained by a majority of directors from among the objective and disinterested group of independent directors.

Although many registered clearing agencies already have documented fitness standards for selecting nominees to serve as directors generally, not all registered clearing agencies have an existing requirement to forbid directors who have been subject to a statutory disqualification. Because such individuals have been found in violation of applicable laws or suspended from membership or participation in an SRO, the Commission does not believe such an individual should serve in the capacity of a director, where functionally the individual would be in a position to advise and direct the decisions of a registered clearing agency. The Commission believes that adding such a requirement helps ensure a nominee's fitness to serve on the board.

d) Selection Criteria for Directors

Based on its supervisory experience, the Commission believes that enhancements to clearing agency governance practices would facilitate the ability of clearing agencies to obtain and address input from a broader array of market participants, especially on risk management issues, to improve resilience. Additionally, based on its supervisory experience, the Commission believes that clearing agencies should consider the views of relevant stakeholders, such as

clearing members and clients, in their decision-making, as these groups will ultimately bear the majority of any losses incurred as a result of decisions affecting the clearing agency's risk profile. Further, based on its supervisory experience, the Commission believes that smaller participants and clients of participants should be represented on clearing agency boards and board committees, including the risk management committee, such that their views and perspectives are formally considered in board decisions that may impact them. In the Commission's view, the diverse perspectives and expertise that smaller participants and clients of participants can provide will help inform a clearing agency's operations and thereby improve the resilience of the registered clearing agency. Therefore, the Commission believes that board governance of the risk management function of the clearing agency will be enhanced when it has the benefit of more diverse perspectives on relevant risk management issues from across the range of stakeholders—owners, direct participants, and indirect participants—in a registered clearing agency. Accordingly, proposed Rules 17Ad-25(c)(4)(i), (ii), and (iii) would require that clearing agencies take steps to facilitate diverse perspectives and expertise on the board of directors, as well as greater involvement by these stakeholders.

In the Commission's view, the proposed rules would complement the Exchange Act requirements for fair representation of owners and participants in the clearing agency's selection of directors and the administration of the clearing agency's affairs.[113] Proposed Rule 17Ad-25(c)(4)(ii) would help ensure that, when evaluating director nominees, the nominating committee considers nominees that represent the views of a broad range of participants with different business strategies, models, and sizes—such as smaller participants and clients of participants—for director positions. The Commission believes that it is useful for the nominating

113 *See* 15 U.S.C. 78q-1(b)(3)(C).

committee to also consider nominees who are representatives from participants and their clients for director positions because directors representative of a diverse cross-section of the clearing agency's participants and clients of participants are more likely to identify and understand the disparate impacts of different risks and risk management practices across the full set of participants and their clients.

While proposed Rule 17Ad-25(c)(4)(iii) does not require a registered clearing agency to include other types of stakeholders in the selection of directors, the Commission understands that other stakeholders—including transfer agents, settlement banks, nostro agents, liquidity providers, technology or other service providers—may be impacted by board decisions concerning risk management and other significant operational issues. Therefore, the Commission believes that board governance may benefit in some instances from considering such stakeholders' perspectives in the evaluation process for director nominees. Accordingly, proposed Rule 17Ad-25(c)(4)(iii) would help ensure that the nominating committee considers the views of other stakeholders who may be impacted by the decisions of the clearing agency into the evaluation process for director nominees. In this regard, the Commission believes that proposed Rule 17Ad-25(c)(4)(iii) would facilitate a process that considers the wide variety of perspectives that may have an interest in the risk management purpose of the clearing agency.

Proposed Rule 17Ad-25(c)(4)(iii) would give the nominating committee discretion to determine how to consider the views of other stakeholders, in part based on the markets served by the clearing agency and the relevant interested stakeholders. In the Commission's view, relevant stakeholders generally would include persons and entities that access the national system for clearance and settlement indirectly (*e.g.,* institutional and retail investors), entities that rely on the national system for clearance and settlement to more effectively provide services to

investors and market participants, and other market infrastructures.[114] The Commission believes that considering the views of such persons and entities in particular would support the Exchange Act requirements that clearing agencies be able to facilitate prompt and accurate clearance and settlement, protect investors and the public interest, and ensure the safeguarding of securities and funds in the custody or control of the clearing agency or for which the clearing agency is responsible.[115] The Commission understands that the scope of relevant stakeholders who may be impacted by the decisions of the registered clearing agency will vary for each registered clearing agency and could include direct participants, indirect participants, and other stakeholders described in proposed Rule 17Ad-25(c)(4)(iii).

Finally, proposed Rule 17Ad-25(c)(4)(iv) would require the nominating committee's process to identify whether each selected nominee would meet the independent director definition in proposed Rules 17Ad-25(a) and (f), and whether each selected nominee has a known material relationship with the registered clearing agency or any affiliate thereof, an owner, a participant, or a representative of another stakeholder of the registered clearing agency described in proposed Rule 17Ad-25(c)(4)(iii). Such record would help to ensure and verify the integrity and consistency of the nominating committee's process and adherence to the clearing agency's standards for independent directors, consistent with proposed Rules 17Ad-25(b), (e), and (f).

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114 *See* CCA Standards Adopting Release, *supra* note 13, at 70803 ("Other relevant stakeholders currently include, for example, transfer agents, liquidity providers, and other linked market infrastructures, including exchanges, matching service providers, and payment systems.").

115 *See supra* Part I and Part II.A; *see also* 15 U.S.C 78q-1(b)(3)(A).

3. Request for Comment

The Commission requests comment on all aspects of proposed Rule 17Ad-25(c). In particular, the Commission requests comment on the following specific topics:

19. Is it appropriate for the Commission to require that the nominating committee be the exclusive venue for evaluating nominees for director to the board of directors? What alternative arrangements or processes might also be appropriate for evaluating director nominees? Should the rules incorporate such arrangements? Why or why not? Please explain.
20. Should the Commission be more prescriptive in requiring that certain types of stakeholders, such as smaller participants and customers, be afforded a right of participation in the board of a clearing agency? Why or why not? If so, which types of stakeholders? Please explain with specific information.
21. Do commenters agree with the Commission's assessment that requiring a majority of independent directors on the nominating committee will improve the quality of nominees? Please explain.
22. Do commenters believe that the proposed rule will help ensure that the nominating committee considers nominees that represent the views of smaller participants and clients of participants? Please explain. Should the Commission consider additional specific composition requirements? Why or why not? If so, what should those requirements be?
23. Has the Commission provided sufficient specificity regarding the scope and content of the evaluation process for director nominees? Please identify and explain other types of criteria, if any, that should be included in the evaluation process for director nominees. Please identify and explain any proposed criteria that should be excluded from the evaluation process for director nominees.

C. Risk Management Committee

1. Proposed Rule 17Ad-25(d)

Proposed Rule 17Ad-25(d)(1) would require each registered clearing agency to establish a risk management committee (or committees) to assist the board of directors in overseeing the risk management of the registered clearing agency. Proposed Rule 17Ad-25(d)(1) would also require each risk management committee to reconstitute its membership on a regular basis and at all times include representatives from the owners and participants of the registered clearing agency. Proposed Rule 17Ad-25(d)(2) would require that a risk management committee, in the performance of its duties, be able to provide a risk-based, independent, and informed opinion on all matters presented to it for consideration in a manner that supports the safety and efficiency of the registered clearing agency.

2. Discussion

a) Purpose and Experience of the Risk Management Committee

Covered clearing agencies are subject to the requirements of Rule 17Ad-22(e) under the Exchange Act, while all registered clearing agencies other than covered clearing agencies are subject to the requirements of Rule 17Ad-22(d) under the Exchange Act.[116] Currently, all registered clearing agencies are covered clearing agencies and, as such, they are required to have risk management committees as a part of their governance arrangements under Rule 17Ad-22(e)(3)(iv).[117] While Rule 17Ad-22(e)(3)(iv) requires covered clearing agencies to have a risk

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116 *See supra* notes 17–23 and accompanying text (explaining that there are two categories of clearing agencies: covered clearing agencies and all registered clearing agencies other than covered clearing agencies).

117 *See* 17 CFR 240.17Ad-22(e)(3)(iv); *see also* CCA Standards Adopting Release, *supra* note 13, at 70807–09 (discussing that, under Rule 17Ad-22(e)(3)(iv), a registered clearing

management committee, no parallel requirement exists for registered clearing agencies that are subject to Rule 17Ad-22(d). The Commission recognizes that there may be future registered clearing agencies that are not covered clearing agencies and, as a result, would be subject to Rule 17Ad-22(d). The Commission believes that clearing agencies subject to Rule 17Ad-22(d) will also likely face risk management issues related to their activities and, therefore, that any clearing agency subject to Rule 17Ad-22(d) will likely benefit from having a risk management committee. Accordingly, the Commission is proposing Rule 17Ad-25(d) so that clearing agencies subject to Rule 17Ad-22(d) will also be required to have risk management committees as a part of their governance arrangements.[118] Additionally, because the general requirement for a risk management committee under Rule 17Ad-22(e)(3)(iv) does not outline minimum requirements for such committee, proposed Rule 17Ad-25(d) establishes more defined requirements related to the purpose and function of risk management committees. The specific requirements imposed by proposed Rule 17Ad-25(d) will help enhance risk management governance across all registered clearing agencies.

As discussed above, each registered clearing agency is also a covered clearing agency and, therefore, has established some form of risk management committee to consider risk issues generally.[119] Critical to the effective functioning of a clearing agency is the board's ability to understand and engage with the risks that a registered clearing agency faces and the risk

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agency's risk management framework must provide risk management personnel with a direct reporting line to, and oversight by, a risk management committee of the board of directors).

118 *See supra* Part III.C.1 (discussing proposed Rule 17Ad-25(d)(1), which requires a risk management committee to assist the board in overseeing the risk management of a registered clearing agency); *infra* Part VIII (providing the proposed rule text).

119 *See infra* Part IV.B.4.a)(3).

management practices it employs to mitigate those risks. The Commission recognizes that while the board has ultimate responsibility over risk management matters, it may assign certain tasks to a board committee to assist the board in discharging its ultimate responsibility.[120] Therefore, the Commission believes that a risk management committee of the board is a more effective way to help ensure that the board is engaged with and informed of the ongoing risk management of the clearing agency, and that a dedicated committee of the board remains focused exclusively on matters related to risk management. The Commission believes that requiring registered clearing agencies to establish a risk management committee of the board would help ensure that the board can more effectively oversee management's decisions concerning matters that implicate the clearing agency's risk management, including its policies, procedures, and tools for mitigating risk.

In addition, for the risk management committee itself to be effective, it must have a clearly defined purpose and obligations to the board. Accordingly, proposed Rule 17Ad-25(d)(2) would require that a risk management committee, in the performance of its duties, be able to provide a risk-based, independent, and informed opinion on all matters presented to it for consideration in a manner that supports the safety and efficiency of the registered clearing agency. The proposed rule is intended to specify the role of the risk management committee by stating the committee's purpose—namely, to provide a risk-based, independent, and informed opinion on all matters presented to it in a way that supports the safety and efficiency of the registered clearing agency. The Commission believes the proposed rule helps ensure that the committee has a clear scope and sufficient direction to more effectively address risk management

120 *See* CCP Resilience Guidance, *supra* note 77, at 5.

related matters, regardless of the participants, markets, and products that a clearing agency serves.

First, with respect to its purpose, the risk management committee's opinions must be risk-based, meaning that its opinions are focused on both the risks that the clearing agency faces and the tools at its disposal to mitigate and address such risks. To facilitate such an approach, the proposed rule provides that the risk management committee must be able to provide an opinion that supports the safety and efficiency of the clearing agency itself. As a result, the Commission believes that when the risk management committee makes recommendations to the board, its opinions should reflect how the decisions support the safety and efficiency of the clearing agency. In the Commission's view, the stated objective of supporting the safety and efficiency of the clearing agency helps ensure that the risk management committee's recommendations represent the best interests of the clearing agency. Second, the risk management committee's opinions must be independent. That is, when making recommendations to the board, the risk management committee's decisions or opinions must be its own, mindful of the objective discussed above, and not merely a rubber stamp for the recommendations presented to the committee by management. The Commission believes that, by requiring the risk management committee to provide an independent opinion, irrespective of its composition, the proposed rule helps ensure that the committee is free from influence in the performance of its duties.

Finally, the risk management committee's opinions must be informed. That is, when making recommendations to the board, the risk management committee's opinions should demonstrate that the committee was able to engage thoughtfully and knowledgeably with the matters presented to it. In this regard, for the risk management committee to provide an informed opinion, its members should have a clear understanding of the clearing agency's operations and

risk management procedures, including the risks that it faces and its methods of addressing such risks. Accordingly, the Commission believes that, in complying with this proposed requirement, the risk management committee generally should include directors with specific risk management expertise and experience related to the risks that the clearing agency faces.[121] Because the risks a clearing agency faces will vary depending on the products it clears and the markets it serves, the Commission believes that a clearing agency should have discretion to determine the appropriate qualifications and expertise needed for the risk management committee to provide an informed opinion. The Commission also believes that, by requiring the risk management committee to provide an informed opinion, the proposed rule helps ensure that the committee's recommendations are more reliable and effective. In the Commission's view, the risk management committee's ability to provide risk-based, independent, and informed opinions is critical to the proper functioning and effectiveness of the committee.

b) Representation of Owners and Participants

Commission rules do not currently require a registered clearing agency to include representatives from the clearing agency's owners and participants on the risk management committee. Based on its supervisory experience, the Commission believes that clearing agencies will benefit from the diverse perspectives and expertise that representatives from owners and participants can provide, which enhances the effectiveness of their risk management practices. With this in mind, the Commission is proposing that the risk management committee at all times

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[121] The Commission has previously recognized that, because clearing and settlement is a highly specialized area, specific risk management expertise and experience are needed to serve on the risk management committee and make informed decisions. *See* Regulation MC Proposing Release, *supra* note 1, at 65899, 65921 (discussing the "highly specialized risk management expertise required of directors serving on [the risk management] committee").

include representatives from the owners and participants of the registered clearing agency.[122] In the Commission's view, these representatives would be persons who have a relationship with the clearing agency's owners and participants, such as employees of the owners and participants or those who have an ownership interest in the owners and participants. Based on its supervisory experience, the Commission believes that representatives from a clearing agency's owners and participants will likely have an understanding of the clearing agency's operations and procedures, as well as the complex risk management issues that the clearing agency's board must consider. In this regard, requiring the risk management committee to include representatives from the clearing agency's owners and participants helps ensure that the risk management committee's recommendations to the board reflect these stakeholders' unique perspectives and expertise on risk management issues.

Proposed Rule 17Ad-25(d)(1) requires that the risk management committee at all times include multiple representatives from the owners and participants of the registered clearing agency. By requiring the risk management committee to include representatives from the clearing agency's owners and participants, the Commission believes that the committee will likely include representation from a broad range of participants with different business strategies, models, and sizes. The committee generally should include both small and large participants. The Commission recognizes that, other than requiring that multiple representatives from the clearing agency's owners and participants serve on the committee at all times, the proposed rule does not require that a certain percentage or number of such representatives serve on the committee. Accordingly, the Commission believes that the proposed rule provides a registered clearing

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122 *See supra* Part III.C.1 (discussing proposed Rule 17Ad-25(d)(1)); *infra* Part VIII (providing the proposed rule text).

agency with some discretion to determine the appropriate composition for the risk management committee with respect to representation from its owners and participants. By requiring that the risk management committee include multiple representatives from the owners and participants of the clearing agency, the proposed rule helps ensure a minimum standard for the inclusion of market participants on risk management committees while providing sufficient flexibility to registered clearing agencies given the range of different sizes, business models, and governance structures across clearing agencies.

c) Requirement to Reconstitute Membership

Many registered clearing agencies have established policies and procedures for governance arrangements that help promote participation from a broader array of owners and participants on the risk management committee through the use of regular reconstitution.[123] The Commission believes that codifying this practice will set a minimum standard for the reconstitution of the risk management committee's membership. Therefore, the Commission is proposing that the risk management committee reconstitute its membership on a regular basis.[124] Requiring the risk management committee to regularly reconstitute its membership helps ensure that a broad range of owners and participants will be able to provide their risk management expertise and participate in the decision-making of the risk management committee over time. In the Commission's view, the proposed reconstitution requirement achieves the above objective of

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123 *See, e.g.*, ICC, ICE Clear Credit Regulation and Governance Fact Sheet, at 3 (April 2022), https://www.theice.com/publicdocs/clear_credit/ICE_Clear_Credit_Regulation_and_Governance.pdf; OCC, Risk Committee Charter, at 1 (rev. Sept. 22, 2021), https://www.theocc.com/getmedia/e71a4c1d-52dc-4c95-aeb1-98dab9159f41/risk_committee_charter.pdf.

124 *See supra* Part III.C.1 (discussing proposed Rule 17Ad-25(d)(1)); *infra* Part VIII (providing the proposed rule text).

ensuring a broad range of participation on the risk management committee without imposing specific obligations related to owners, participants, or independent directors that may be suitable in some, but not necessarily all, cases.

Because the risk management committee is broadly responsible for providing recommendations to the board on all risk management related matters, it is important that the committee's membership reflects a wide range of owners and participants with relevant experience and expertise on a variety of risk management issues. By requiring the risk management committee to regularly reconstitute its membership, proposed Rule 17Ad-25(d)(1) helps ensure ongoing diversity of perspectives across owners and participants and expertise on the risk management committee. The Commission believes the proposed reconstitution requirement helps ensure that the risk management committee is well-positioned to provide more effective recommendations to the board on all risk management matters. The Commission also believes the proposed reconstitution requirement helps ensure that the committee is able to provide fresh perspectives on risk management matters, which, in turn, helps promote more effective and reliable risk management practices at a registered clearing agency.

The Commission acknowledges that proposed Rule 17Ad-25(d)(1) only requires the risk management committee to reconstitute its membership "on a regular basis." In this regard, the proposed rule provides a registered clearing agency with discretion to determine the appropriate timing for reconstitution. For example, the charter for a registered clearing agency's risk management committee could establish that the committee will conduct a review of its members on an annual basis, or other specified length of time, to assess whether the committee continues to be an accurate reflection of the clearing agency's owners and participants. The charter could also establish that members of the committee serve for a specified term, or that the committee

would rotate or replace directors on the committee at certain intervals absent a specified turnover threshold among directors. Additionally, registered clearing agencies could stagger terms in order to have regular turnover of participants and other members of the risk management committee.

3. Request for Comment

The Commission generally requests comments on all aspects of proposed Rule 17Ad-25(d). In addition, the Commission requests comments on the following specific issues:

24. The Commission is not proposing to carve out the risk management committee from the director independence requirements under proposed Rule 17Ad-25(e). Should the Commission include such a carve-out for the risk management committee so that a registered clearing agency would not be required to include independent directors on the committee? Why or why not? If not, should there be separate director independence requirements applicable only to the risk management committee that reflect the highly specialized risk management expertise needed to serve on the committee? Why or why not?
25. Is the proposed requirement that the registered clearing agency's risk management committee be a committee of the board a more effective way to structure the risk management committee than requiring that the risk management committee be an external committee, such as a management committee or an advisory committee? Why or why not? If not, should the risk management committee be structured to represent more participants, regardless of whether those participants are represented on a clearing agency's board? Why or why not?
26. The Commission is not specifying whose responsibility it is to determine the matters presented to the risk management committee for consideration. Should the Commission

be more prescriptive and specify whose responsibility it is to make such determinations? If so, should the Commission require the risk management committee to designate thresholds or identify the types of risk management related matters that warrant consideration by the committee? Why or why not? Please explain.

27. Is the proposed requirement that the risk management committee include at all times representatives from the registered clearing agency's owners and participants sufficient to help ensure that the directors serving on the committee will have the specific risk management expertise and relevant experience needed to make effective risk management decisions? Why or why not? In requiring that the risk management committee include such representatives at all times, should the Commission require that a specific percentage or number of representatives from the clearing agency's owners and participants serve on the risk management committee? Why or why not? If so, what percentage or number? Please explain with specific information.
28. Should the Commission require the risk management committee to include at all times a specific percentage or number of representatives from small participants of the clearing agency in addition to representatives from the owners and participants more generally, as proposed? Why or why not? If so, what percentage or number? Please explain with specific information.
29. The Commission is not specifying whose responsibility it is to determine the appropriate qualifications and expertise needed for a director to serve on the risk management committee. Should the Commission be more prescriptive and specify whose responsibility it is to make this determination, such as the nominating committee, or

should this determination remain up to the discretion of the registered clearing agency? Why or why not? Please explain.

30. The Commission requests comment on whether the requirement that a risk management committee "reconstitute" its membership on a regular basis is sufficiently clear. Is there additional guidance needed on what "reconstitute" means? Is it sufficiently clear that the term "reconstitute" refers to the membership of the risk management committee and not to the form of the committee? Why or why not? Should the Commission instead require that the membership be "rotated"?[125] Please explain.

31. Has the Commission provided a sufficient explanation for what constitutes "on a regular basis" with respect to how often a risk management committee is required to reconstitute its membership? Why or why not? Would a more specific reconstitution requirement be appropriate? For example, should this requirement specify a frequency for the risk management committee's reconstitution (*e.g.*, annually)? Why or why not? If so, please explain what the appropriate frequency should be.

D. Conflicts of Interest

1. Proposed Rules 17Ad-25(g) and (h)

Proposed Rule 17Ad-25(g) would require each registered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to identify and document existing or potential conflicts of interest in the decision-making process of the clearing agency involving directors or senior managers of the registered clearing agency; and mitigate or eliminate and document the mitigation or elimination of such conflicts of interest.

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[125] The CFTC's proposal would require a risk management committee to "rotate" its membership on a regular basis. *See supra* note 52 and accompanying text.

Additionally, proposed Rule 17Ad-25(h) would require registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures reasonably designed to require a director to document and inform the registered clearing agency promptly of the existence of any relationship or interest that reasonably could affect the independent judgment or decision-making of the director.

2. Discussion

At the time of the 2016 CCA Standards Adopting Release, the Commission declined to incorporate more prescriptive governance elements into the rule as urged by commenters, including specific requirements on conflicts of interest,[126] based on the premise that the requirements in Section 17A of the Exchange Act relating to fair representation and the public interest provided sufficient grounds to hold covered clearing agencies accountable to these concerns.[127] At the time, the Commission also observed that as a general matter, the market for clearing agency services demonstrates evidence of a significant volume of activity being concentrated in a small number of large financial institutions.[128] The concentration of clearing

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126 *See* CCA Standards Adopting Release, *supra* note 13, at 70804 (stating that "[o]ne commenter stated that proposed Rule 17Ad-22(e)(2) does not require covered clearing agencies to resolve conflicts of interests among board members and management and urged the Commission explicitly to require covered clearing agencies to document and maintain policies and procedures governing the resolution of conflicts of interests that may impact certain decisions by the board of directors. The Commission notes . . . that the commenter's concern is addressed by Section 17A(b)(3)(F) of the Exchange Act, which requires that the rules of a clearing agency be designed, in general, to protect investors and the public interest").

127 *See* 15 U.S.C. 78q-1(b)(3)(C).

128 *See* CCA Standards Adopting Release, *supra* note 13, at 70793 (stating that "the Commission has considered the level of concentration in the provision of clearing agency services" and acknowledging concerns "that at present the clearance and settlement industry, like much of the financial sector, can be described as highly concentrated, and . . . that it is

and settlement services within a handful of entities continues, suggesting that additional interventions may be appropriate.[129] The Commission is concerned that this characteristic could impede the continued development of open, transparent, and competitive markets and, therefore, believes it is appropriate to propose requirements on registered clearing agencies on mitigating or eliminating conflicts of interest so that such conflicts do not undermine the integrity of decisions made in the governance of the clearing agency. The proposed rules are intended to address concerns that the institutions that currently dominate the securities markets would have conflicts of interest that influence their participation in the development of centralized trading and clearance and settlement systems for securities. As they relate to clearing agencies that clear security-based swaps, the proposed rules would also advance the policy objectives set forth in Section 765 by establishing new requirements for policies and procedures that require such clearing agencies to identify, mitigate or eliminate, and document the identification and mitigation or elimination of conflicts of interest.

With the above in mind, requirements on registered clearing agencies to address conflicts of interest would strengthen the integrity of a registered clearing agency's governance arrangements, including those regarding director independence, the fitness standards applied and nominations made by the nominating committee, and the independent opinions and recommendations made by the risk management committee previously discussed. Proposed Rules 17Ad-25(g) and (h) help promote the integrity of these governance arrangements by

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paramount . . . [to] promote the proliferation of viable new clearing agencies, given that existing clearing agencies typically serve as intermediaries for trillions of dollars in trading volumes").

129 *See* Staff Report on Clearing Agencies, *supra* note 27, at 21.

helping ensure that a registered clearing agency is capable of both identifying potential conflicts when they arise and subjecting conflicts to a transparent and uniform process of review, mitigation or elimination, and documentation. Specifically, the proposed rules would help ensure that potential conflicts of interest are identified and documented, that policies and procedures for their management have been established ex ante to help ensure a consistent approach over time, and that cases are subject to established processes for review and mitigation or elimination. In some cases, for example, a conflicts of interest policy may simply require that a director or senior manager recuse herself from a particular decision to mitigate or eliminate the conflict of interest. At the same time, the Commission believes that disclosure, while an effective tool for the clearing agency to identify and recognize a conflict of interest, is insufficient by itself to reduce the potential harm a conflict of interest may have on the clearing agency. Instead, the Commission believes that as the clearing agency is best positioned to identify and address conflicts of interest that may arise in its operations and risk management and decision-making, the clearing agency is best positioned through reasonable policies and procedures to mitigate—namely, reduce—or eliminate these conflicts of interest so that such conflicts do not undermine the integrity of decisions made in the governance of the clearing agency. In addition, the policies and procedures approach helps ensure the documentation of conflicts of interest and their mitigation or elimination, helping the Commission to assess and compare the types of conflicts that arise across clearing agencies to help promote more effective oversight and regulation of clearing agencies.

In the absence of policies and procedures to address conflicts of interest, directors and senior managers of a registered clearing agency could undermine the purpose of requiring independent directors and centralizing the nominating process for new directors in a nominating

committee composed of a majority of independent directors. More broadly, the proposed rules help to ensure that when directors and senior managers develop relationships that create potential conflicts of interest, the clearing agency has a process to manage those relationships to mitigate or eliminate conflicts so that they do not undermine the integrity of decisions made in the governance of the clearing agency.

a) Potential Conflicts

Under proposed Rule 17Ad-25(g), the registered clearing agency must be able to identify and document both existing and potential conflicts of interest involving directors or senior managers of the registered clearing agency. The rule is intended to address the conflicts of interests of directors and senior managers that could undermine the decision-making process within a registered clearing agency or interfere with fair representation and equitable treatment of clearing members or other market participants by a registered clearing agency. Being able to identify potential conflicts of interest is critical to ensuring the effective identification and management of actual conflicts of interest. In other words, a clearing agency must be able to spot close cases, where another director, manager, employee, or observer might perceive a conflict of interest, in order to more effectively manage actual conflicts and help ensure the integrity of decisions made in the governance of the clearing agency.

As previously discussed in Part II.A, it is important for the registered clearing agency to consider the differing incentives and interests of individual directors, once they are on the board, when they are governing the registered clearing agency. The board as a whole is ultimately responsible for overseeing the clearing agency's compliance with the regulatory obligations under the Dodd-Frank Act and the Exchange Act, including the open and fair access

requirements.[130] Yet, depending on their affiliation with owners, large participants, small participants, or indirect participants, individual directors may be subject to different perspectives and motivations when fulfilling these duties and roles. Like participants themselves, direct participant directors may on balance be more likely to favor reducing or minimizing the risk exposure of the clearing agency, potentially at the expense of more open access; in contrast, indirect participant directors may be inclined to favor expanded access to products and services, which may increase the amount of risk that the clearing agency must successfully manage.[131]

The Commission believes that because interests and incentives may vary among directors and over time for a range of reasons, it is not possible to predict how any individual director will address particular matters. For this reason, the approach taken in proposed Rule 17Ad-25(g)—as well as proposed Rule 17Ad-25(h)—is intended to achieve an appropriate balance among these various considerations by taking a principles-based approach to addressing conflicts of interest. While the proposed rule provides the registered clearing agency with a certain level of discretion to address specific facts and circumstances it faces in light of its governance structure, the product it clears, and the market it serves, it is designed to complement other applicable, more prescriptive requirements in this proposal, which the registered clearing agency may also separately apply where relevant. Additionally, the proposed rule is intended to limit the clearing agency's discretion through more prescriptive procedural requirements the clearing agency must undertake to establish, implement, maintain, and enforce written policies and procedures reasonably designed to document the identification, mitigation or elimination of conflicts of interest under proposed Rule 17Ad-25(g).

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130 *See* Regulation MC Proposing Release, *supra* note 1, at 65888.

131 *See id.*

b) Obligation of Directors to Report

Because a registered clearing agency may not have access to information necessary to identify a potential conflict of interest, proposed Rule 17Ad-25(h) would also require a registered clearing agency to have policies and procedures that require a director to document and inform the registered clearing agency promptly of the existence of any relationship or interest that reasonably could affect the independent judgment or decision-making of the director. The proposed rule takes elements from the "material relationship" definition, which was carried forward from the Commission's previous proposal in Regulation MC,[132] without incorporating the definition into the proposed rule itself. Specifically, the Commission is requiring policies and procedures that focus on any relationship or interest that reasonably could affect the independent judgment or decision-making of the director, rather than material relationships or interests, so that the registered clearing agency—not the party with a reporting obligation—can determine whether a relationship or interest is subject to mitigation or elimination under the conflicts of interest policy. This approach helps ensure that the registered clearing agency has sufficient information to investigate, identify and address potential conflicts.

c) Policies and Procedures Approach

Because organizational structures vary across clearing agencies, as do the products, markets, and market participants served by the clearing agency, the Commission has taken a policies and procedures approach in the proposed rule to manage conflicts. This provides registered clearing agencies with discretion to design policies that fit their particular structure and circumstances, and help ensure that policies and procedures remain effective over time as circumstances change. While the Commission has identified some specific circumstances in

132 *See id.* at 65896–97.

proposed Rules 17Ad-25(f) that preclude a director from being an independent director because they present a clear conflict of interest, as a general matter the Commission believes that a clearing agency should have discretion to assess conflicts and determine how to mitigate or eliminate them.

3. Request for Comment

The Commission generally requests comments on all aspects of proposed Rules 17Ad-25(g) and (h). In addition, the Commission requests comments on the following specific issues:

32. Are proposed Rules 17Ad-25(g) and (h) sufficient to have registered clearing agencies address conflicts of interest within their governance arrangements? Why or why not? Please provide specific examples to illustrate your points, if possible.
33. Do commenters agree with the potential conflict concerns that the Commission has identified? What effect would the identified conflicts of interest likely have? Should the Commission focus on any of these conflicts more than others? Are there other existing conflicts concerns that commenters believe warrant scrutiny? If so, what are they and how are they likely to affect registered clearing agencies? Which conflicts of interest could potentially cause the greatest harm to a registered clearing agency? Please explain.
34. What potential new conflicts of interest could arise that the Commission should consider? What other parties may have conflicts of interest that would affect whether they should control or participate in the governance of a registered clearing agency? In what circumstances do these conflicts of interest arise?
35. Are there any additional requirements and/or guidance that the Commission could provide to help registered clearing agencies evaluate the relationships of their directors and senior managers to identify potential sources of conflicts? Please explain with specifics in terms of processes that would help identify both existing and potential

conflicts of interest involving directors or senior managers of the registered clearing agency.

36. In requiring registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures reasonably designed to require a director to document and inform the registered clearing agency promptly of the existence of any relationship or interest that reasonably could affect the independent judgment or decision-making of the director, does proposed Rule 17Ad-25(h) provide sufficient requirements to have directors document and inform the registered clearing agency promptly of potential conflicts of interest? Why or why not?

37. Is the "reasonably could affect" standard proposed in Rule 17Ad-25(h) sufficient? Why or why not?

E. Board Obligation to Oversee Service Providers for Critical Services

1. Proposed Rule 17Ad-25(i)

Proposed Rule 17Ad-25(a) would define the term "service provider for critical services" to mean any person that is contractually obligated to the registered clearing agency for the purpose of supporting clearance and settlement functionality or any other purposes material to the business of the registered clearing agency.[133] Proposed Rule 17Ad-25(i)(1) would require

[133] The proposed rule would not apply to utility companies, such as a power company providing general power services for the registered clearing agency, although general power services are necessary to allow a registered clearing agency to function and operate, as a general matter. The Commission believes that such services neither support the core clearance and settlement functionality of the registered clearing agency nor are material to the clearing agency's business, in that the power company does not perform the core clearance and settlement functionality or material clearing agency business functions itself. At the same time, the registered clearing agency should be aware of how issues relating to such services may impact its obligations under the Exchange Act. This is consistent with Commission staff's views. *See*, *e.g.*, Division of Trading and Markets: Responses to Frequently Asked Questions Concerning Regulation SCI (rev. Aug. 21, 2019), https://www.sec.gov/divisions/marketreg/regulation-sci-

each registered clearing agency to establish, implement, maintain, and enforce 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 registered clearing agency's risk management framework, and to review senior management's monitoring of relationships with service providers for critical services. Proposed Rule 17Ad-25(i)(2) would require each registered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to enable the board to approve policies and procedures that govern the relationship with service providers for critical services. Proposed Rule 17Ad-25(i)(3) would require each registered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to enable the board to review and approve plans for entering into third-party relationships where the engagement entails being a service provider for critical services to the registered clearing agency. Proposed Rule 17Ad-25(i)(4) would require each registered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to enable the board to, through regular reporting to the board by senior management, confirm that senior management takes appropriate actions to remedy significant deterioration in performance or address changing risks or material issues identified through ongoing monitoring.

2. Discussion

Under existing requirements, the Commission requires registered clearing agencies to manage operational risk, which can include risks associated with relationships with service providers for critical services. Rule 17Ad-22(d)(4) under the Exchange Act requires a registered

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faq.shtml (stating that "an issue at a power utility may interrupt the electric power supplied to an SCI entity's SCI systems. Even if the outage at the power utility's system would not itself be an SCI event, there is a significant likelihood that an SCI entity would nonetheless experience an SCI event following such an outage").

clearing agency that is not a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to identify sources of operational risk and minimize them through the development of appropriate systems, controls, and procedures; implement systems that are reliable, resilient and secure, and have adequate, scalable capacity; and have business continuity plans that allow for timely recovery of operations and fulfillment of a clearing agency's obligations.[134] Rule 17Ad-22(e)(17) under the Exchange Act requires a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to manage the covered clearing agency's operational risks by, among other things, identifying the plausible sources of operational risk, both internal and external, and mitigating their impact through the use of appropriate systems, policies, procedures, and controls.[135] Additionally, under Regulation SCI, the Commission requires registered clearing agencies as SCI entities to conduct risk assessments of SCI systems at least once per year and report the findings to senior management and the board of directors.[136]

Based on its supervisory experience, the Commission has observed that clearing agencies have used service providers to help ensure the prompt and accurate clearance and settlement of securities transactions, and that in some cases, service providers are affiliates or a parent company within the same holding company structure as the registered clearing agency itself. Service providers may also be third party entities, such as technology providers, data providers, or providers of other services. Because of the range of relationships and needs of a registered

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134 *See* 17 CFR 240.17Ad-22(d)(4).

135 *See* 17 CFR 240.17Ad-22(e)(17).

136 *See* 17 CFR 242.1000-1007.

clearing agency, service providers can perform a wide variety of functions. For example, a clearing agency may contract with its parent company to staff the registered clearing agency.[137] A clearing agency may contract with one or more investment advisers to help facilitate the closing out of a defaulting participant's portfolio.[138] A clearing agency may use one or more data service providers to help calculate pricing information for securities.[139] A clearing agency may also purchase technology services from service providers that may help to facilitate clearance and settlement in a number of ways. In each of the cases described above, failure of the service provider to perform its obligations would pose significant operational risks and have critical effects on the ability of the registered clearing agency to perform its risk management function and facilitate prompt and accurate clearance and settlement. In this regard, under existing requirements, including Regulation SCI, outsourcing a clearance and settlement functionality to

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137 *See, e.g.*, DTCC, Businesses and Subsidiaries, https://www.dtcc.com/about/businesses-and-subsidiaries; *see also* Part IV.B.1 (explaining that DTC, FICC, and NSCC are clearing agency subsidiaries of DTCC).

138 *See, e.g.*, NSCC, Disclosure Framework for Covered Clearing Agencies and Financial Market Infrastructures (Dec. 2021), at 84, https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/NSCC_Disclosure_Framework.pdf ("NSCC utilizes the services of investment advisors and executing brokers to facilitate such [close-out purchase and sale] transactions [for open Continuous Net Settlement (CNS) positions] promptly following its determination to cease to act. NSCC may engage in hedging transactions or otherwise take action to minimize market disruption as a result of such purchases and sales.").

139 *See, e.g.*, FICC, Disclosure Framework for Covered Clearing Agencies and Financial Market Infrastructures (Dec. 2021), at 58, 65, https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/FICC_Disclosure_Framework.pdf ("Collateral securities are re-priced every night, from pricing sources utilized by FRM's [Financial Risk Management's] Securities Valuation unit . . . . FICC utilizes multiple third-party vendors to price its eligible securities and uses a pricing hierarchy to determine a price for each security.").

a service provider for critical services does not relieve the registered clearing agency of its statutory and regulatory obligations, which remain with the registered clearing agency.[140]

As firms explore new technologies that can facilitate prompt and accurate clearance and settlement in new and innovative ways, clearing agencies may increasingly determine that service providers will offer the most effective technology to perform key functions.[141] Reliance on service providers will require careful oversight of these relationships because service provider relationships are a key source of operational risk to a registered clearing agency, risk which can result in service outages that, due to the centralizing nature of registered clearing agencies, could have implications for the national system for clearance and settlement.

Ultimately, it is the responsibility of the board to oversee the relationships that management establishes with service providers to help ensure that management is performing its function more effectively and that the clearing agency can facilitate prompt and accurate clearance and settlement. Accordingly, the Commission believes it is appropriate to propose certain requirements relating to the board oversight of service providers for critical services.

a) Definition of Service Providers for Critical Services

Registered clearing agencies perform some oversight of certain service provider relationships, pursuant to existing Commission requirements with respect to these relationships.[142] Against this backdrop and as part of the evolution of the registered clearing

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140 *See* Regulation SCI Adopting Release, *supra* note 39, at 77276 (expressing that an "SCI entity should be responsible for managing its relationship with third parties operating systems on behalf of the SCI entity through due diligence, contract terms, and monitoring of third party performance").

141 *See id.* at 72252–53.

142 *See* 17 CFR 240.17Ad-22(d)(4) and (e)(17); 17 CFR 242.1000-1007.

agency regulatory framework, the Commission proposes a companion governance requirement to these existing rules that makes explicit the registered clearing agency's board obligation to oversee the range of its service providers for critical services. In this regard, proposed Rule 17Ad-25(a) would define the scope of "service provider for critical services" to mean any person that is contractually obligated to the registered clearing agency for the purpose of supporting clearance and settlement functionality or any other purposes material to the business of the registered clearing agency. Absent regular monitoring and oversight, these relationships could endanger the operational resilience of a registered clearing agency and call into question the registered clearing agency's ability to meet its obligations under the Exchange Act.

b) Obligations of the Board

In addition, proposed Rule 17Ad-25(i) would explicitly obligate the registered clearing agency to have policies and procedures that require its board to oversee a registered clearing agency's relationships with service providers for critical services. Proposed Rule 17Ad-25(i) includes a policies and procedures approach because, the Commission believes that, given the range of potential service provider relationships, the risks that they pose, and the different ways in which they might interact with different types of products, markets, and market participants, a registered clearing agency will need to exercise its discretion and judgment in managing these risks and reviewing steps taken by management.

Accordingly, under paragraphs (1) and (2), the board would be charged with reviewing senior management's monitoring of each relationship with a service provider for critical services, confirming and documenting that the risks related to such relationships have been considered and addressed consistent with the clearing agency's risk management framework, and, more generally, approving policies and procedures that govern such relationships. One method of

confirming and documenting the risks posed by a service provider for critical services to the registered clearing agency would be for the board to complete a self-assessment based on the format and substance of Annex F in the PFMI[143] that highlights oversight expectations applicable to critical service providers. Annex F, in its form as of the date of this publication, provides a comprehensive basis for the board of a registered clearing agency to use to assess a service provider's risk identification and management, information security management, reliability and resilience, technology planning, and the strength of communications with users. Completing such a self-assessment is not mandatory but may be helpful for the registered clearing agency to demonstrate compliance with this element of proposed Rule 17Ad-25(i)(1).

Paragraph (1) would also require review of senior management's oversight of a service provider relationship. The Commission believes that the board should be aware of the risks flowing into the registered clearing agency, including through its relationships with service providers for critical services, and maintain awareness of those risks over time by monitoring management's oversight of the relationship. In its traditional function as a check on management, the board can help ensure that, for example, management assesses and addresses performance issues by the provider under any agreement with the provider and helps to ensure that product or other deliverables are provided timely and consistent with the terms of the agreement.

Under paragraph (3), the board should review and approve plans for entering into third-party relationships where the engagement entails being a service provider for critical services to the registered clearing agency. The Commission believes the board's participation in this regard is required as part of sound risk management when the clearing agency enters into contractual

143 *See* PFMI, *supra* note 4, at 170–71.

relationships with third parties. Board involvement would help ensure that the terms of performance for the service provider are sufficient to support the needs of the registered clearing agency and any increased level of risk to the registered clearing agency is evaluated, assessed, and accounted for. If renewal of third-party contracts or performance issues are called into question, the Commission believes that the Board should generally review such matters as part of its oversight responsibilities in existing governance arrangements and requirements.[144]

Finally, under paragraph (4), the board would have responsibility for overseeing the extent to which senior management remedies performance issues under a service provider contract. A key source of risk in any service provider relationship to a registered clearing agency is the operational risks that may arise if a service provider is not performing pursuant to the agreed terms of the contractual relationship. Without the board's effective ongoing monitoring of such risks and oversight of management's remedial actions to control such risks, the registered clearing agency may be faced with increasing levels of risk that undermine sound risk management and operational resilience. Accordingly, the Commission believes that policies and procedures should specifically provide for regular reporting to the board by senior management to ascertain whether senior management is taking appropriate remedial actions to mitigate or eliminate the risks of a critical service provider's significant performance deterioration or other material changes in the relationship that would result in an unacceptable increase in risk to the registered clearing agency if not remedied in a timely manner.

144 *See generally* 17 CFR 240.17Ad-22(d)(8), (e)(2). Existing Rules 17Ad-22(d)(8) and (e)(2) impose obligations on a governance arrangements of the clearing agency to promote the effectiveness of the clearing agency's risk management procedures. Proposed Rule 17Ad-25(i)(3) would impose obligations on the Board when initiating a third-party relationship.

3. Request for Comment

The Commission generally requests comments on all aspects of proposed Rule 17Ad-25(i). In addition, the Commission requests comments on the following specific issues:

38. Is the definition of "service provider for critical services" sufficiently clear and properly scoped? Why or why not? Please explain and include alternative definitions, if possible.
39. In requiring registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures reasonably designed to enable the board to oversee relationships with service providers of critical services, should the Commission provide specific guidance regarding the means and measures by which the board performs such oversight responsibilities? Why or why not?
40. In requiring registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures reasonably designed to confirm and document that risks related to relationships with service providers for critical services are managed in a manner consistent with its risk management framework, should the Commission require—rather than provide as guidance, as currently formulated—that the board confirm and document the risks through a self-assessment as discussed above? Why or why not?

F. Obligation to Formally Consider Stakeholder Viewpoints

1. Proposed Rule 17Ad-25(j)

Proposed Rule 17Ad-25(j) would require each registered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed 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 governance and operations on a recurring basis.

2. Discussion

Currently, all registered clearing agencies are covered clearing agencies and, as such, they are subject to requirements for their governance arrangements to include policies and procedures that support the public interest and the objectives of owners and participants, as well as that consider the interests of participants' customers, securities issuers and holders, and other relevant stakeholders.[145] However, no parallel requirement exists for registered clearing agencies that are subject to Rule 17Ad-22(d). Based on its supervisory experience, the Commission believes that enhancing clearing agency governance practices will facilitate the ability of clearing agencies subject to Rule 17Ad-22(d) to obtain and consider the views of a diverse cross-section of their participants and stakeholders, who will likely bear any of the losses incurred as a result of the clearing agency's decisions with respect to its governance and operations. Accordingly, the proposed rule would supplement existing Commission requirements by also requiring that a registered clearing agency have policies and procedures to solicit, consider, and document its consideration of the views of participants and other relevant stakeholders regarding material developments in the clearing agency's governance and operations. The Commission believes that other relevant stakeholders generally would include investors, customers of participants, as well as securities issuers.

The Commission understands that many registered clearing agencies already have established committees, working groups, and other fora of varying size, scope, and formality to share and solicit information with participants, the customers of their participants, and other stakeholders regarding changes to risk management and other services offered by the clearing agency. These groups and fora are useful tools for information sharing and gathering, and help

145 *See* 17 CFR 240.17Ad-22(e)(2)(iii) and (vi).

promote an open dialogue between the clearing agency, its participants, and other relevant stakeholders. Accordingly, the Commission is proposing Rule 17Ad-25(j) to help promote the formalization of these processes and structures to help ensure their ongoing use, both for the existing set of registered clearing agencies and for potential future registrants. The Commission believes that the proposed rule would help ensure that these types of groups have a clear purpose and scope by requiring that registered clearing agencies solicit views from relevant stakeholders in addition to their participants and document their consideration of views expressed, and that the views solicited concern topics related to material developments in a clearing agency's governance and operations. Soliciting and considering viewpoints from participants and other relevant stakeholders helps ensure that the board of a registered clearing agency is informed of the full range of views across its participants and stakeholders while making decisions related to material developments in the clearing agency's governance and operations.

In addition, the Commission believes that requiring registered clearing agencies to document their consideration of such viewpoints would help ensure that a record exists of the viewpoints provided by participants and other relevant stakeholders regarding material developments in a clearing agency's governance and operations, ensuring that the clearing agency indicated that it had received such viewpoints and evaluated their merits. Such a requirement also helps promote confidence in the use of such fora and other structures because records will help demonstrate the ways in which registered clearing agencies consider and engage with stakeholder viewpoints. Building a record of such engagements also would help the Commission itself evaluate the ways in which clearing agencies consider stakeholder viewpoints and balance potentially competing viewpoints, facilitating the Commission's monitoring and oversight of registered clearing agencies and their impact on the U.S. securities market.

3. Request for Comment

The Commission generally requests comments on all aspects of proposed Rule 17Ad-25 (j). In addition, the Commission requests comments on the following specific issues:

41. The Commission understands that some registered clearing agencies have established multiple groups or fora to target specific topics or types of participants when sharing and soliciting information. What should a registered clearing agency consider when determining to establish one versus multiple fora for soliciting viewpoints? Why? How should it select the types of stakeholders or market participants from whom it solicits information? Are there particular topics for which a group or fora should be required under the rule? Are there any merits in limiting the number of different groups or fora to avoid overly fragmenting the discussion of topics and solicitation of viewpoints? Please explain with specific examples, if possible.
42. Should the rule include specific requirements applicable to committees, working groups, or other fora when established by a clearing agency? Please explain.
43. The proposed rule would require that a registered clearing agency solicit viewpoints regarding material developments in its governance and operations. Does limiting the topics for soliciting viewpoints to "material" aspects of a clearing agency's governance and operations provide for the appropriate scope of topics for which a clearing agency should solicit viewpoints? Why or why not? Should the rule limit the topics for soliciting viewpoints only to risk management? Why or why not? Conversely, should the set of topics be expanded to include topics such as participation requirements, products cleared, fees, new technologies, services, or other topics relevant to participants and other stakeholders? Please explain with specific examples, if possible.

44. The proposed rule would require that the registered clearing agency solicit viewpoints on a recurring basis. How frequently should a registered clearing agency solicit viewpoints? Should the requirement apply on an annual basis, a quarterly basis, or some other frequency? How should a clearing agency balance the frequency of its outreach against the obligation to document its consideration of viewpoints received?
45. Does the proposed rule interact with the board's fiduciary duty to the clearing agency? If so, how? Please explain with specific information.

G. Considerations Related to Implementation and Compliance

The Commission believes it is important to establish governance requirements for registered clearing agencies given the potentially significant risks posed by their size, systemic importance, and/or the risks inherent in the products they clear, and therefore believes that implementation of any of the requirements in proposed Rule 17Ad-25, if adopted, should be prompt. However, the Commission also recognizes that additional time may be warranted to address any new requirements, if adopted, by both clearing agencies currently registered with the Commission and those entities that intend to register as clearing agencies with the Commission while the rules are being finalized.

The Commission intends to review any application for registration as a clearing agency pursuant to the requirements of Section 17A of the Exchange Act and the rules and regulations thereunder, including Rule 17Ad-22 and any amendments thereto, and notes that the compliance date would apply to all clearing agencies, including an applicant for registration as a clearing agency whose application is pending upon the compliance date. In reviewing such an application, Section 17A(b)(3) of the Exchange Act requires that a clearing agency shall not be registered unless the Commission determines that an applicant's rules and operations satisfy each

of the requirements set forth in Section 17A(b)(3).[146] Following registration, any registered clearing agency would need to address compliance with any of the requirements in proposed Rule 17Ad-25, if adopted.

The Commission is also mindful of the time and costs that may be incurred by registered clearing agencies to implement aspects of proposed Rule 17Ad-25, if adopted, namely the independence requirements for the board and board committees. Implementation of these proposed requirements could require changes to policies and procedures currently utilized to comply with the Commission's clearing agency rules. These burdens could be exacerbated if affected clearing agencies must begin complying with any proposed Rule 17Ad-25, if adopted, in their existing policies and procedures at or near the same time that they are making changes to their board and board committee composition by undertaking the steps to identify and select candidates to accommodate these proposed requirements. The Commission believes that implementation of the proposed rules, if adopted, can and should be done in a manner that carries out the fundamental policy goals of the rules while minimizing burdens and disruptions as much as practicable, including minimizing the prospect of current directors having to resign before their terms expire. The Commission believes that this should be done pursuant to a phased-in compliance schedule whereby the proposed rules, if adopted, would have a compliance date that is 180 days from publication of the final rules in the Federal Register for all the provisions other than proposed Rule 17Ad-25(b)(1), (c)(2), and (e), and 24 months from publication of the final rules in the Federal Register for the independence requirement for the board and board committees under proposed Rule 17Ad-25(b)(1), (c)(2), and (e).

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146 *See* 15 U.S.C. 78q-1(b)(3).

1. Request for Comment

46. Are the 180-day and 24-month compliance periods appropriate? Why or why not? Please be specific.

47. Does the phased-in compliance date envisioned by the Commission adequately address the time and resources needed for clearing agencies to comply with proposed Rule 17Ad-25 if adopted? Please explain. Should specific requirements be phased in over time, such as to allow current directors to serve their complete term rather than needing to resign early in order to adjust the number of independent directors on a board? If so, what is the appropriate number of days that would allow current directors to serve their complete terms?

H. General Request for Comment

The Commission generally requests comments on all aspects of proposed Rule 17Ad-25.

IV. Economic Analysis

A. Introduction

The Commission is sensitive to the economic consequences and effects of the proposed rules, including their benefits and costs.[147] The Commission acknowledges that, since many of these proposals could require a clearing agency to adopt new policies and procedures, the economic effects and consequences of these rules include those flowing from the substantive

[147] Under Section 3(f) of the Exchange Act, whenever the Commission engages in rulemaking under the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, it must consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f). In addition, Section 23(a)(2) of the Exchange Act prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. *See* 15 U.S.C. 78w(a)(2).

results of those new policies and procedures. Further, as stated above, Section 17A of the Exchange Act directs the Commission to have due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents when using its authority to facilitate the establishment of a national system for clearance and settlement of transactions in securities.[148]

This section addresses the likely economic effects of the proposed rules, including their anticipated and estimated benefits and costs and their likely effects on efficiency, competition, and capital formation. Many of the benefits and costs are difficult to quantify. For example, the issue of misaligned incentives is a core economic matter that is persistent across many different types of economic interactions among clearing agency stakeholders. Incentives affect the economic outcome of a transaction but there is little data about how decision-making processes directly affect monetary gains and losses. In addition, quantification of these incentive effects is particularly challenging due to the number of assumptions that would be needed to forecast how clearing agencies would respond to the proposed rules, and how those responses would, in turn, affect the broader market for cleared securities products. While the Commission has attempted to quantify economic effects where possible, much of the discussion of economic effects is qualitative in nature. The Commission also discusses the potential economic effects of certain alternatives to the approaches recommended in this proposal.

B. Economic Baseline

To consider the effect of the proposed rules, the Commission first explains the current state of affairs in the market (the economic baseline). All the potential benefits and costs from

148 *See* 15 U.S.C. 78q-1(a)(2)(A).

adopting the proposed rules are changes relative to the economic baseline. The economic baseline in this proposal considers (1) the current market for registered clearing agency activities, including the number of registered clearing agencies, the distribution of participants across these clearing agencies, and the volume of transactions these clearing agencies process, (2) the current regulatory framework for registered clearing agencies, and (3) the current practices of registered clearing agencies that relate to the proposed rules.

1. Description of Market

Of the nine registered clearing agencies, there are currently seven operating businesses.[149] Six provide CCP services and one provides CSD services.[150] NSCC, FICC, and DTC are all registered clearing agencies that are DTCC subsidiaries. Together they offer clearance and settlement services for equities, corporate and municipal bonds, government and mortgage-backed securities, derivatives, money market instruments, syndicated loans, mutual funds, and alternative investment products in the United States. ICC and ICEEU are both registered clearing agencies for credit default swaps ("CDS"), and are both subsidiaries of

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[149] There are two registered but inactive clearing agencies: BSECC and SCCP. Neither has provided clearing services in well over a decade. *See* Exchange Act Release No. 63629 (Jan. 3, 2011) (BSECC "returned all clearing funds to its members by September 30, 2010, and [] no longer maintains clearing members or has any other clearing operations as of that date. [] BSECC [] maintain[s] its registration as a clearing agency with the Commission for possible active operations in the future."); Exchange Act Release No. 63268 (Nov. 8, 2010) ("SCCP "returned all clearing fund deposits by September 30, 2009; [and] as of that date SCCP no longer maintains clearing members or has any other clearing operations. [] SCCP [] maintain[s] its registration as a clearing agency for possible active operations in the future."). Because they do not provide clearing services, BSECC and SCCP are not included in the economic baseline or the consideration of benefits and costs. They are included in the PRA for purposes of the PRA estimate, *see infra* at Section V.

[150] *See supra* note 17 (summarizing typical CCP services) and note 18 (summarizing typical CSD services).

Intercontinental Exchange, Inc. ("ICE"). LCH SA, a France-based subsidiary of LCH Group Holdings Ltd, is a registered clearing agency that also offers clearing for CDS. The seventh registered clearing agency, OCC, offers clearing services for exchange-traded U.S. equity options.

Registered clearing agencies broadly operate under one of two models. Specifically, the clearing agency may be organized so that the participants are owners of the clearing agency,[151] or so that participants are not owners of the clearing agency.[152]

Registered clearing agencies currently feature specialization and limited competition. For example, there is only one registered clearing agency serving as a central counterparty for each of the following asset classes: exchange-traded equity options (OCC), government securities (FICC), mortgage-backed securities (FICC), and equity securities (NSCC). There is also only one registered clearing agency providing central securities depository services (DTC). Registered clearing agency activities exhibit high barriers to entry and economies of scale. These features of the existing market, and the resulting concentration of clearing and settlement services within a handful of entities, informs the Commission's examination of the effects of the proposed rules on competition, efficiency, and capital formation, as discussed below. Table 1 summarizes the most recent data on the number of participants at each registered clearing agency.[153]

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151 *See supra* note 32 (explaining the ownership structure of DTCC and its subsidiary clearing agencies).

152 OCC is owned by certain options exchanges. ICC and ICEEU are both subsidiaries of ICE, which is listed on the New York Stock Exchange. LCH SA is a subsidiary of LCH Group Holdings, Ltd., which is majority-owned by London Stock Exchange Group plc (a publicly traded company).

153 Participant statistics are taken from the websites of each of the listed clearing agencies as of August 2021, September 2021, or October 2021. *See* DTCC, NSCC Member Directories, http://www.dtcc.com/client-center/nscc-directories; DTCC, DTC Member Directories,

Table 1. Number of participants at registered clearing agencies.

Registered Clearing Agency	Number of Participants
Subsidiaries of The Depository Trust & Clearing Corporation	
National Securities Clearing Corporation	3,532
The Depository Trust Company	841
Fixed Income Clearing Corporation (Government Securities Division)	204
Fixed Income Clearing Corporation (Mortgage Backed Securities Division)	140
Subsidiaries of Intercontinental Exchange	
ICE Clear Credit	29
ICE Clear Europe (CDS Participants Only)	30
Subsidiaries of LCH	
LCH SA (CDSClear Participants Only)	25
The Options Clearing Corporation	184

Registered clearing agencies have become an essential part of the infrastructure of the U.S. securities markets due to their role as intermediaries.[154] Many securities transactions are centrally cleared by clearing agencies. For example, in 2021 approximately $1.1 trillion (65%) of the notional amount of all single-name CDS transactions in the United States were centrally

http://www.dtcc.com/client-center/dtc-directories; DTCC, FICC-GOV Member Directories, http://www.dtcc.com/client-center/ficc-gov-directories; DTCC, FICC-MBS Member Directories, http://www.dtcc.com/client-center/ficc-mbs-directories; ICE, ICE Clear Credit Participants, https://www.theice.com/clear-credit/participants; ICE, ICE Clear Europe Membership, https://www.theice.com/clear-europe/membership; LCH, LCH SA Membership, https://www.lch.com/membership/member-search; OCC, Member Directory, http://www.theocc.com/Company-Information/Member-Directory.

154 *See supra* Part I.

cleared.[155] In addition, in 2021 DTCC processed $2.4 quadrillion in securities transactions, and OCC cleared 9.9 billion individual options contracts.[156]

Central clearing generally benefits the markets in which it is available through significantly reducing participants' counterparty risk and through more efficient netting of margin. Consequently, central clearing also benefits the financial system as a whole by increasing financial resilience and the ability to monitor and manage risk.[157] Notwithstanding the benefits, central clearing concentrates risk in the clearing agency.[158] Disruption to a clearing agency's operations, or failure on the part of a clearing agency to meet its obligations, could serve as a source of contagion, resulting in significant costs not only to the clearing agency itself

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155 Data from DTCC's Trade Information Warehouse, compiled by Commission staff.

156 *See* OCC, Annual Report (2021), https://annualreport.theocc.com; DTCC, Annual Report (2021), https://www.dtcc.com/~/media/files/downloads/about/annual-reports/DTCC-2021-Annual-Report. Within DTCC, NSCC cleared $2.0 trillion of equity trades every day on average, FICC cleared a total of $1.4 quadrillion of government securities transactions and $69 trillion of agency mortgage-backed securities transactions, and DTC settled a total of $152 trillion of securities.

157 *See* Darrell Duffie, Still the World's Safe Haven? Redesigning the U.S. Treasury Market After the COVID-19 Crisis, Hutchins Center Working Paper No. 62 (June 2020), at 15, https://www.brookings.edu/wp-content/uploads/2020/05/wp62_duffie_v2.pdf ("Central clearing increases the transparency of settlement risk to regulators and market participants, and in particular allows the CCP to identify concentrated positions and crowded trades, adjusting margin requirements accordingly. Central clearing also improves market safety by lowering exposure to settlement failures…. As depicted, settlement failures rose less in March [2020] for [U.S. Treasury] trades that were centrally cleared by FICC than for all trades involving primary dealers. A possible explanation is that central clearing reduces 'daisy-chain' failures, which occur when firm A fails to deliver a security to firm B, causing firm B to fail to firm C, and so on.").

158 *See generally* Albert J. Menkveld & Guillaume Vuillemey, The Economics of Central Clearing, 13 Ann. Rev. Fin. Econ. 153 (2021).

or its participants but also to other market participants and the broader U.S. financial system.[159] As a result, proper management of the risks associated with central clearing helps ensure the stability of the U.S. securities markets and the broader U.S. financial system.[160]

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[159] *See generally* Dietrich Domanski, Leonardo Gambacorta & Cristina Picillo, Central Clearing: Trends and Current Issues, BIS Q. Rev. (Dec. 2015), https://www.bis.org/publ/qtrpdf/r_qt1512g.pdf (describing links between CCP financial risk management and systemic risk); Darrell Duffie, Ada Li & Theo Lubke, Policy Perspectives on OTC Derivatives Market Infrastructure, Fed. Res. Bank N.Y. Staff Rep. No. 424, at 9 (Mar. 2010), http://www.newyorkfed.org/research/staff_reports/sr424.pdf ("If a CCP is successful in clearing a large quantity of derivatives trades, the CCP is itself a systemically important financial institution. The failure of a CCP could suddenly expose many major market participants to losses. Any such failure, moreover, is likely to have been triggered by the failure of one or more large clearing agency participants, and therefore to occur during a period of extreme market fragility."); Craig Pirrong, The Inefficiency of Clearing Mandates, Policy Analysis No. 655, at 11–14, 16–17, 24–26 (July 2010), http://www.cato.org/pubs/pas/PA665.pdf (stating, among other things, that "CCPs are concentrated points of potential failure that can create their own systemic risks," that "[a]t most, creation of CCPs changes the topology of the network of connections among firms, but it does not eliminate these connections," that clearing may lead speculators and hedgers to take larger positions, that a CCP's failure to effectively price counterparty risks may lead to moral hazard and adverse selection problems, that the main effect of clearing would be to "redistribute losses consequent to a bankruptcy or run," and that clearing entities have failed or come under stress in the past, including in connection with the 1987 market break); Hubbard *supra* note 57, at 96 ("In short, the systemic consequences from a failure of a major CCP, or worse, multiple CCPs, would be severe. Pervasive reforms of derivatives markets following 2008 are, in effect, unfinished business; the systemic risk of CCPs has been exacerbated and left unaddressed."); Froukelien Wendt, Central Counterparties: Addressing their Too Important to Fail Nature, IMF Working Paper No. 15/21 (Jan. 2015), http://papers.ssrn.com/sol3/Delivery.cfm/wp1521.pdf (assessing the potential channels for contagion arising from CCP interconnectedness); Manmohan Singh, Making OTC Derivatives Safe—A Fresh Look, IMF Working Paper No. 11/66 (Mar. 2011), at 5–11, http://www.imf.org/external/pubs/ft/wp/2011/wp1166.pdf (addressing factors that could lead central counterparties to be "risk nodes" that may threaten systemic disruption).

[160] *See* Paolo Saguato, Financial Regulation, Corporate Governance, and the Hidden Costs of Clearinghouses, 82 Ohio St. L.J. 1071, 1074–75 (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3269060 ("[T]he decision to centralize risk in clearinghouses made them critical for the stability of the financial system, to the point that they are considered not only too-big-to-fail, but also too-important-to-fail institutions.").

2. Overview of the Existing Regulatory Framework

The existing regulatory framework for clearing agencies registered with the Commission includes Section 17A of the Exchange Act and the Dodd-Frank Act, and the related rules adopted by the Commission. The current regulatory system is discussed in Parts I, II and III of this proposal.

The Commission is aware that clearing agencies registered in the U.S. may also be subject to other domestic or foreign regulators. Specifically, clearing agencies operating in the U.S. may also be subject to regulation by the CFTC (as clearing agencies for futures or swaps) and the Board of Governors of the Federal Reserve System (as systemically important financial market utilities or state member banks).[161] In addition, clearing agencies operating in the U.S. may be subject to foreign clearing agency regulators. For example, LCH SA is regulated by l'Autorité des marchés financiers, l'Autorité de Contrôle Prudentiel et de Résolution, and the Banque de France, and is subject to EMIR.[162] ICEEU is regulated by the Bank of England and is subject to EMIR.[163]

The Commission also considers relevant international standards when engaged in rulemaking for clearing agencies. For example, in 2012, the Committee on Payments and Market Infrastructure (CPMI) and the International Organization of Securities Commissions (IOSCO)

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161 Currently, ICC, ICEEU, LCH SA, and OCC are regulated by the CFTC. DTC, FICC, NSCC, ICC, and OCC have been designated systemically important financial market utilities. DTC is also a state member bank of the Federal Reserve System.

162 *See* LCH, Company Structure, https://www.lch.com/about-us/structure-and-governance/company-structure.

163 *See* ICE, ICEEU Regulation, https://www.theice.com/clear-europe/regulation.

issued the PFMI, a set of international standards for financial market infrastructures.[164] In connection with rulemaking required by Section 805(a)(2)(A) of the Clearing Supervision Act, 12 U.S.C. 5464(a)(2)(A), the Commission considered the principles and responsibilities in the PFMI when adopting Rule 17Ad-22(e).[165]

Table 2 summarizes the board composition and independent director requirements of the CFTC, the Board of Governors of the Federal Reserve System, and EMIR, as well as the related principle in the PFMI.

Table 2. Board Composition and Independent Director Requirements of CFTC, Board of Governors, EMIR, and CPMI-IOSCO (PFMI).

Organization	**Board Composition and Independence Requirements**
CFTC	"A derivatives clearing organization shall ensure that the composition of the governing board or board-level committee of the derivatives clearing organization includes market participants and individuals who are not executives, officers, or employees of the derivatives clearing organization or an affiliate thereof." (17 CFR § 39.26).
Board of Governors of the Federal Reserve System	"… the designated financial market utility has governance arrangements that are designed to ensure … [t]he board of directors includes a majority of individuals who are not executives, officers, or employees of the designated financial market utility or an affiliate of the designated financial market utility" (12 CFR § 234.3(a)(2)(iv)(D)).
European Market Infrastructure Regulation (EMIR)	"A CCP shall have a board. At least one third, but no less than two, of the members of that board shall be independent. Representatives of the clients of clearing members shall be invited to board meetings for matters relevant to

164 *See* PFMI, *supra* note 4.

165 CCA Standards Adopting Release, *supra* note 13, at 70789, 70796–97. A CPMI-IOSCO assessment report also has assessed that the Commission's rules are consistent with the PFMI principles. *See* CPMI-IOSCO, Implementation monitoring of PFMI: Assessment report for the United States – Payment systems, central securities depositories and securities settlement systems (May 31, 2019), at 2, https://www.bis.org/cpmi/publ/d184.pdf (presenting the conclusions drawn by the CPMI and IOSCO from a Level 2 assessment).

	Articles 38 and 39. The compensation of the independent and other non-executive members of the board shall not be linked to the business performance of the CCP" (Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012, Title IV, Article 27). "'independent member' of the board means a member of the board who has no business, family or other relationship that raises a conflict of interests regarding the CCP concerned or its controlling shareholders, its management or its clearing members, and who has had no such relationship during the five years preceding his membership of the board" (Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012, Title I, Article 2(28)).
CPMI-IOSCO	"[Board] members should be able to exercise objective and independent judgment. Independence from the views of management typically requires the inclusion of non-executive board members, including independent board members, as appropriate. Definitions of an independent board member vary and often are determined by local laws and regulations, but the key characteristic of independence is the ability to exercise objective, independent judgment after fair consideration of all relevant information and views and without undue influence from executives or from inappropriate external parties or interests. The precise definition of independence used by an F[inancial] M[arket] I[nfrastructure (FMI)] should be specified and publicly disclosed, and should exclude parties with significant business relationships with the FMI, cross-directorships, or controlling shareholdings, as well as employees of the organisation" (PFMI, § 3.2.10, footnotes omitted).

In addition to Federal regulation, as noted earlier, clearing agencies must also follow state laws applicable to their choice of organization, such as limited liability companies, corporations, or trusts.[166]

[166] For example, "The New York State Department of Financial Services supervises DTC as a New York State-chartered trust company." *See* Board of Governors of the Federal Reserve System, Designated Financial Market Utilities. https://www.federalreserve.gov/paymentsystems/designated_fmu_about.htm. The OCC is a Delaware corporation. *See* OCC, Certificate of Incorporation, https://www.theocc.com/Company-Information/Documents-and-Archives/OCC-Certificate-of-Incorporation.

3. Divergent Incentives of Clearing Agency Stakeholders

Several researchers have commented that the misalignment of interests between clearing agency stakeholders (owners and non-owner participants, for example) weakens the effectiveness of clearing agencies' risk management under the existing regulatory framework.[167] Less effective risk management, in turn, impedes the resilience of individual clearing agencies, the clearing services market, and the broader financial markets, as well as competition among participants. However, academic literature has not coalesced around a standard model describing clearing agency governance, leaving some uncertainty about the theoretically best way to mitigate divergent incentives.[168]

As discussed more fully below, the Commission is aware of divergent incentives at some clearing agencies between clearing agency owners and non-owner participants, and the importance of actively addressing these divergent incentives through proactive measures to achieve sound governance and resilience. In the 2020 Staff Report on the Regulation of Clearing

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[167] *See* Saguato, *supra* note 160, at 5, 13 (stating that "effective risk management in financial institutions can be achieved only if the final risk bearers have a voice in the governance of the firm" and that "the existing regulatory framework underestimates and does not address the misaligned incentives that spill from the agency costs of the separation of risk and control and from the member-shareholder divide . . ."); Hester Peirce, Derivatives Clearinghouses: Clearing the Way to Failure, 64 Clev. St. L. Rev. 589 (2016), https://engagedscholarship.csuohio.edu/cgi/viewcontent.cgi?article=3915&context=clevstlrev (arguing that clearing members must play a central role in risk management); Craig Pirrong, The Economics of Central Clearing: Theory and Practice, ISDA Discussion Papers Series No. 1 (May 2011), at 3, https://www.isda.org/a/yiEDE/isdadiscussion-ccp-pirrong.pdf ("CCPs should be organized so as to align the control of risks with those who bear the consequences of risk management decisions.").

[168] *See* Menkveld & Vuillemey, *supra* note 158, at 21 ("While the literature on central clearing has made significant progress over the past ten years, a number of important questions remain open. On the theoretical front, there is still no standard model of . . . [CCP] governance.").

Agencies, Commission staff emphasized that "robust written rules, policies, and procedures are important to clearing agency functioning, but represent only the first step in achieving resilience and compliance. To achieve real-life outcomes that help promote resilience and compliance, rules, policies, and procedures must be … subject to sound governance that ensures they will be executed promptly and effectively."[169]

a) Divergent Incentives of Owners vs. Non-Owner Participants

Because clearing agencies mutualize risk among participants but not all participants necessarily hold an equity interest in the clearing agencies,[170] the incentives of clearing agency owners can differ from the incentives of clearing agency participants.[171] For example, owners have an incentive to transfer as much risk of loss as possible to non-owner participants or to lower risk management standards.[172] In such cases, the owners benefit by receiving higher profits or tying up less capital in their investment while participants are left with greater potential losses in the event of a counterparty default or non-default loss and potentially higher margin and default fund requirements.

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169 Staff Report on Clearing Agencies, *supra* note 27, at 25.

170 For example, OCC, ICC, ICEEU, and LCH SA are not owned by participants.

171 *See* Saguato, *supra* note 160, at 1099 ("This new agency conflict that stems from the separation of risk and control and from the 'member-shareholder divide' misaligns the incentives of the clearinghouse from those of its members…"). This specific agency conflict is less of a concern in cases where clearing agency participants own shares of the clearing agency, because there is less separation of risk and control. For example, DTC, NSCC, and FICC operate under a utility model, where the participants own shares of the parent company, DTCC.

172 *See* Menkveld & Vuillemey, *supra* note 158, at 20 (noting that because participants are a "captive clientele," clearing agencies could be incentivized to relax risk management standards); Saguato, *supra* note 160, at 1099, 1102. However, it is possible that a captive clientele could also incentivize a clearing agency to increase its risk management standards if there is participant representation in the governance structure.

b) Divergent Incentives among Participants

In addition, different types of participants (direct vs indirect participants or large vs small participants, for example) have divergent incentives. For example, large direct participants have incentives to influence the clearing agency to adopt policies that would exclude smaller dealers from participating directly in the clearing agency.[173] Because there is only one registered clearing agency serving as a central counterparty for some asset classes, such policies could negatively affect competition among clearing agency participants. The diverging incentives of large direct participants compared to smaller indirect participants are mitigated by Rule 17Ad-22, which in part generally requires a clearing agency to admit participants who meet minimum standards.[174]

Large participants also have incentives to influence the clearing agency to adopt policies that could allocate a disproportionately large risk of loss to smaller participants by allowing the large participant to contribute lower quality collateral to satisfy margin or default fund requirements or by promoting margin requirements that are not commensurate with the risks and

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173 *See* Kristin N. Johnson, Commentary on the Abraham L. Pomerantz Lecture: Clearinghouse Governance: Moving Beyond Cosmetic Reform, 77 Brook. L. Rev. 2, 698 (2012), https://brooklynworks.brooklaw.edu/blr/vol77/iss2/5 ("Large dealers have incentives to limit smaller dealers' access to clearinghouse membership. When large dealers act as brokers for the smaller nonmember dealers, the larger dealers earn revenues for executing transactions for dealers who are nonmembers and ineligible for membership. If eligibility standards preclude smaller dealers from gaining the full benefits of membership, then small dealers who desire to execute transactions must seek the assistance of the larger dealers who are members. Thus, large dealers have commercial incentives to ensure that smaller dealers remain ineligible for membership."); Sean Griffith, Governing Systemic Risk: Towards a Governance Structure for Derivatives Clearinghouses, 61 Emory L. J. 1153, 1197 (2012), https://scholarlycommons.law.emory.edu/elj/vol61/iss5/3 ("The major dealers may also use their influence over clearinghouses to protect [their] trading profits, using the clearinghouse as a means of increasing their market share and excluding competitors.").

174 *See* 17 CFR 240.17Ad-22(b)(5)–(b)(7) and (e)(18).

particular attributes of each participant's specific products, portfolio, and market. The diverging incentives of large participants compared to smaller direct participants are also mitigated by Rule 17Ad-22, which in part generally requires a clearing agency to establish minimum margin and liquidity requirements.[175] By establishing minimum margin and liquidity requirements, Rule 17Ad-22 reduces a large participant's ability to obtain or maintain a competitive advantage through activities such as providing lower quality collateral or promoting margin requirements that are not commensurate with the risks and particular attributes of each participant's specific products, portfolio, and market.

c) Incentives of Clearing Agency Stakeholders Could Diverge from the Interest of the Broader Financial Markets

Clearing agency stakeholders, such as owners and direct and indirect participants, also have incentives that may not be in alignment with the interests of the broader financial markets.[176] Any such misalignment, if left unmitigated, could limit the benefits of central clearing and hinder the resilience of other financial market intermediaries and the broader financial market.[177] For example, in securities markets where all or part of a transaction may not be subject to a central clearing requirement, a single participant or a small group of participants

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175 *See* 17 CFR 240.17Ad-22(e)(5)–(e)(6).

176 *Cf.* Bank of England, The Bank of England's supervision of financial market infrastructures — Annual Report (Mar. 2015), at Chapter 2.1.4 ("Strong user and independent representation in [UK CCPs] governance structures should help ensure that UK CCPs focus not only on the management of microprudential risks to themselves but also on systemic risks.").

177 *See* Griffith, *supra* note 173, at 1210 ("[T]he containment of systemic risk [is] a public good . . . . Because no private party can enjoy the full benefit of eliminating systemic risk, no private party has an incentive to fully internalize the cost of doing so. As a result, no private party can simply be entrusted with the means of doing so because it is more likely to use those means to some other ends . . . . In other words, none of the commercial parties has the right incentives.").

may have a profit incentive to select bi-lateral clearing over central clearing[178] or seek to influence a clearing agency to not clear a security that would profit the participants more if the security were cleared bi-laterally. Not only could such incentives limit the benefits of central clearing, but they could also impede resilience in the broader financial market by increasing systemic risk.[179] In addition, indirect participants that are not permitted to directly access clearing services have incentives to "avoid clearing and seek higher-margin trading activity through faux customization."[180] This, too, could hinder resilience in the broader financial market by increasing systemic risk. Lastly, as pointed out in a BIS and IOSCO report, "…an FMI and its participants may generate significant negative externalities for the entire financial system and real economy if they do not adequately manage their risks."[181] To the extent these negative

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178 *Cf*. Treasury Market Practices Group (TMPG), Best Practice Guidance on Clearing and Settlement, at 3 (July 2019), https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/CS_BestPractices_071119.pdf (in commenting on the "potential role for expanded central clearing" in the secondary U.S. Treasuries market, the TMPG noted that "changes to market structure that have occurred have also resulted in a substantial increase, in both absolute and percentage terms, in the number of trades that clear bilaterally rather than through a central counterparty. This principally stems from the increased prevalence of P[rincipal] T[rading] F[irm] activity on I[nter]D[ealer]B[roker] platforms.").

179 *See* Griffith, *supra* note 173, at 1197 ("[D]ealers have a clear incentive to protect the profits they receive from the bilateral market…by keeping trades off of clearinghouses. Keeping trades off of clearinghouses has obvious systemic risk implications: a clearinghouse cannot contain the risk of trades that it does not clear."). Though bi-lateral clearing serves a well-defined function in eliminating basis risk and allowing for more precise hedging, its benefits in terms of systemic risk mitigation are more limited relative to centralized clearing.

180 *See* Griffith, *supra* note 173, at 1200.

181 *See* PFMI, *supra* note 4, at 11.

externalities are not adequately internalized by the clearing agency or otherwise mitigated, they could present systemic risks to the broader financial markets.[182]

4. Current Governance Practices

Registered clearing agencies must operate in compliance with Rule 17Ad-22, though they may vary in the particular ways they achieve such compliance. Some variation in practices across registered clearing agencies derives from the products they clear and the markets they serve.

An overview of current practices at the seven operating clearing agencies is set forth below and includes discussion of clearing agency boards' policies and procedures related to the composition of the board and board committees, conflicts of interests involving directors and senior managers, the obligations of the board regarding overseeing relationships with service providers for critical services, and consideration of stakeholders' views. This discussion is based on the Commission's general understanding of current practices as of the date of this proposal and reflects the Commission's experience supervising registered clearing agencies.

a) Current Practices Regarding Board Composition

Each registered clearing agency has a board that governs its operations and supervises senior management. Section 17A(b)(3)(C) of the Exchange Act prohibits a clearing agency from registering unless the Commission finds that "the rules of the clearing agency assure a fair representation of its shareholders (or members) and participants in the selection of its directors

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[182] *Cf. id.* at 128 (Noting that regulators have a role in addressing negative externalities. "[R]egulation, supervision, and oversight of an FMI are needed to … address negative externalities that can be associated with the FMI, and to foster financial stability generally."); Menkveld & Vuillemey, *supra* note 158, at 22 ("Network externalities create a role for regulators to coordinate investors on a socially desirable equilibrium.").

and administration of its affairs. (The Commission may determine that the representation of participants is fair if they are afforded a reasonable opportunity to acquire voting stock of the clearing agency, directly or indirectly, in reasonable proportion to their use of such clearing agency.)."[183] In addition, Rule 17Ad-22(e)(2) requires governance arrangements that support the objectives of owners and participants and consider the interests of other relevant stakeholders.

(1) Independent Directors

Clearing agencies currently use various definitions of independence and independent director. In addition, current practices vary widely regarding the board and board committee requirements for independent directors (as the term is currently used by clearing agencies). For example, clearing agencies' existing requirements for the minimum percentage of independent directors on the board ranges from 0% to 55%. Table 3 summarizes the general board composition and independent director requirements of each operating clearing agency.

Table 3. Board Composition and Independent Director Requirements of Operating Clearing Agencies

Clearing Agency	**Board Composition Requirements**	**Definition of Independent Director**
DTC, FICC, and NSCC (all use the same board as DTCC)	22 directors: 1 non-executive Chair, 1 DTCC executive (DTCC's Pres. & CEO), 14 participant-owner directors, 4 non-participant directors, 1 director designated by DTCC preferred stock shareholder ICE, 1 director designated by DTCC preferred stock shareholder FINRA. (*See* https://www.dtcc.com/about/leadership.)	Independent director is not defined. Independence is listed as one of a number of "characteristics essential for effectiveness as a Board member." (See DTCC Board Election Procedures.[a])
OCC	20 directors: 1 management director (Chair), 5 public directors, 9 participant directors, 5 exchange directors. (*See*	A public director "lacks material relationships to OCC, OCC's senior management, and other directors" and

183 15 U.S.C. 78q-1(b)(3)(C).

	https://www.theocc.com/Company-Information/Board-of-Directors; OCC Board Charter[b].)	is "not affiliated with any national securities exchange or national securities association or with any broker or dealer in securities" (OCC Board Charter at 4, 6). "A substantial portion of directors shall be 'independent' of OCC and OCC's management as defined by applicable regulatory requirements and the judgment of the Board" (OCC Board Charter at 4-5).
ICE Clear Credit	9 directors (a/k/a Board of Managers): at least 5 independent directors and 2 management directors. 5 directors elected by ICE US Holding Company L.P. (3 of 5 are independent and the remaining 2 are from ICE management). The Risk Committee designates four nominees (two must be independent and two may be non-independent). (*See* ICC Regulation and Governance Fact Sheet[c] at 2.)	An independent director must satisfy the independence requirements in the NYSE Listed Company Manual.[d] An independent director also may not (among other things): • "have any material relationships with the Company and its subsidiaries." • be affiliated with a Member Organization or, within the last year, (a) be employed by a Member Organization, (b) have an immediate family member who was an executive officer of a Member Organization, or (c) have received from any Member Organization more than $100,000 per year in direct compensation. (*See* ICC Independence Policy.[e])
ICE Clear Europe	6 to 12 directors (currently 10): at least 1/3 independent directors (excluding the Chair), 1 director approved by the Bank of England, and the president of ICEEU. (*See* ICEEU Organizational Structure Disclosure[f] at 1; ICEEU Articles of Association[g] at paragraph 26.)	Independent director "means a person who meets the independence criteria for a director, as defined under relevant applicable legislation and who is appointed as a non-executive director" (ICEEU Articles of Association at paragraph 3).
LCH SA	3 to 18 directors (currently 11 with 5 independent): "the board shall be composed of the	Independent director "means an independent director, who satisfies

	following categories of Directors:" an independent Chair, independent directors, executive directors, a director proposed by Euronext, user directors, and a director representing London Stock Exchange Group plc. (*See* https://www.lch.com/about-us/structure-and-governance/board-directors-0; LCH SA Terms of Reference of the Board[h] at 4-5.)	applicable Regulatory Requirements regarding independent directors and who is appointed in accordance with the Nomination Committee terms of reference" (LCH SA Terms of Reference of the Board at 2).

a. DTCC, Procedure for the Annual Nomination and Election of the Board of Directors (Feb. 11, 2021),) ("DTCC Nomination and Election Procedure"), https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/DTCC-BOD-Election-Procedure.pdf.

b. OCC, Board of Directors Charter and Corporate Governance Principles (Sept. 22, 2021), https://www.theocc.com/getmedia/99ed48a4-aa44-45ac-8dee-9399b479a1c8/board_of_directors_charter.pdf.

c. ICE, ICC Regulation and Governance Fact Sheet, https://www.theice.com/publicdocs/clear_credit/ICE_Clear_Credit_Regulation_and_Governance.pdf.

d. *See* Section 303.A.02 of the NYSE Listed Company Manual, https://nyseguide.srorules.com/listed-company-manual ("No director qualifies as 'independent' unless the board of directors affirmatively determines that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company)." The independence requirements also list five situations that would preclude a director from being considered independent).

e. ICE, Independence Policy of the Board of Directors of Intercontinental Exchange, Inc., https://s2.q4cdn.com/154085107/files/doc_downloads/governance_docs/ICE-Independence-Policy.pdf.

f. ICE, ICEEU Organizational Structure, Objectives and Strategy, https://www.theice.com/publicdocs/clear_europe/Organisational_Structure_Objectives_Strategy.pdf.

g. ICE, Articles of Association of ICEEU (Jan. 29, 2021), https://www.theice.com/publicdocs/regulatory_filings/ICEEU-2021-013.pdf.

h. LCH SA, Terms of Reference of the Board (Aug. 18, 2020), https://www.lch.com/system/files/media_root/LCHSA_Governance%20Arrangements_CFTC%20Self-Certif_18%20Aug%202020.pdf.

(2) Nominating Committee

Six of the seven operating clearing agency boards have a nominating committee or a committee that serves a similar function. Current practices regarding the minimum level of

independent directors on the nominating committee vary widely. For example, DTC, NSCC, and FICC require that the nominating committee be composed entirely of "non-management" directors; ICEEU requires that a majority of the nominating committee be independent directors (as defined by ICEEU); LCH SA requires that its nomination committee include an independent chair, at least two independent directors (as defined by LCH SA), and one user director; and OCC requires only that the chairman of the nominating committee be a "public director."[184] As stated previously, the definition of independent director varies across clearing agencies.[185]

All seven boards have fitness standards for directors and processes for identifying and selecting directors. The fitness standards and processes for identifying and selecting directors vary across clearing agencies. For example, OCC's nominating committee is required to "identify, screen and review individuals qualified to be elected or appointed [to the Board] after

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184 *See* DTCC Governance Committee Charter 1 (Feb. 2020), https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/DTCC-BOD-Governance-Committee-Charter.pdf ("All members of the Committee shall be members of the Board who are not employed by DTCC ('non-management' directors)."); ICEEU Compliance with PFMI 17 (Jan. 31, 2021), https://www.theice.com/publicdocs/clear_europe/ICE_Clear_Europe_Disclosure_Framework.pdf ("[T]he Nominations and Compensation Committee may consist of up to five Committee Members the majority of which must be [Independent Non-Executive Directors]."); LCH SA Terms of Reference of the Nomination Committee of the Board of Directors (Sept. 9, 2020), https://www.lch.com/system/files/media_root/LCH%20SA%20-%20NomCom%20ToRs.pdf ("[The] membership shall comprise the Chairman, at least two Independent Directors, one User Director and the LSEG Director. The size of the Committee . . . for the current time, will comprise four to six directors."); OCC Governance and Nominating Committee Charter 1 (Sept. 22, 2021), https://www.theocc.com/getmedia/483ac739-0d43-46d2-a1ca-7ed38094975c/governance_nominating_charter.pdf ("The Committee will be composed of at least one Public Director, one Exchange Director, and one Member Director. No Management Director will be a member of the Committee . . . . The Committee Chair will be designated by the Board from among the Public Director Committee members.").

185 *See supra* Table 3 and accompanying text.

consultation with the Chairman,"[186] whereas DTCC's governance committee, which serves as the nominating committee for DTC, NSCC, and FICC, is not required to consult with the chairman. Instead, DTCC's governance committee "considers possible nominations on its own initiative and invites suggestions from all participants of each of DTCC's clearing and depository subsidiaries . . . . The Governance Committee may also use a professional director search consultant to assist in identifying candidates for the non-participant Board positions."[187]

(3) Risk Management Committee

The Commission already requires that all seven operating clearing agencies have risk management committees, because they are covered clearing agencies.[188] All seven clearing agencies include representatives from participants on the risk management committee, though only four clearing agencies require it.[189] Six of the seven operating clearing agencies identify the risk management committee as a board committee.[190] Three of the seven operating clearing agencies require the risk management committee to be reconstituted on a regular basis.[191]

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186 OCC Governance and Nominating Committee Charter, *supra* note 184, at 3.

187 DTCC, Procedure for the Annual Nomination and Election of the Board of Directors (Feb. 11, 2021), at 2, https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/DTCC-BOD-Election-Procedure.pdf.

188 Covered clearing agencies are required to have risk management committees to comply with 17 CFR 240.17Ad-22(e)(3)(iv).

189 OCC, ICC, ICEEU, and LCH SA each require that the risk committee include representatives from participants. Article 28 of EMIR requires that a clearing agency have a risk committee that includes representatives of its clearing members. *See* EMIR, *supra* note 105, at art. 28(1).

190 DTC, NSC, FICC, OCC, ICEEU, and LCH SA.

191 OCC, ICC, and LCH SA require that the committee be reconstituted annually.

b) Current Practices Regarding Conflicts of Interest Involving Directors or Senior Managers

The boards of all seven operating clearing agencies have policies and procedures in place to identify and mitigate conflicts of interests involving directors or senior managers. All seven boards also require directors to notify the clearing agency if a conflict of interest arises.

c) Current Practices Regarding Board Oversight of Relationships with Service Providers for Critical Services

The Commission already requires registered clearing agencies to manage risks from operations,[192] which can include risks associated with relationships with service providers.[193] The Commission is aware that at least some clearing agencies periodically inform their boards regarding risk management associated with service providers for critical services.

The Commission also requires that SCI entities—including registered clearing agencies—conduct risk assessments of "SCI systems" at least once per year in accordance with Regulation SCI and report the findings to senior management and the board of directors.[194] Insofar as service providers for critical services are the providers of SCI systems, each registered clearing agency board likely already has written policies and procedures reasonably designed to

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192 *See* 17 CFR 240.17Ad-22(d)(4), (e)(17).

193 In addition, DTC, as a state member bank of the Federal Reserve System, has received guidance from the Board of Governors of the Federal Reserve System regarding managing service provider risks. *See* SR Letter 13-19 / CA Letter 13-21, Guidance on Managing Outsourcing Risk (Dec. 5, 2013, rev. Feb. 26, 2021). The Board of Governors of the Federal Reserve System, jointly with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, proposed updated guidance for banking organizations in 2021 regarding the management of risks arising from third-party relationships. *See* Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Proposed Interagency Guidance on Third-Party Relationships: Risk Management, 86 FR 38182, 38193 (July 19, 2021). The proposed guidance is not yet final.

194 *See* 17 CFR 242.1000–1007.

enable the board of directors to oversee service providers for critical services, including confirming that the risks related to service provider relationships are managed in a manner consistent with its risk management framework, reviewing senior management's monitoring of relationships with service providers for critical services, and confirming that senior management takes appropriate actions to remedy significant deterioration in performance or address changing risks or material issues identified through ongoing monitoring of service providers for critical services.[195]

d) Current Practices Regarding Board Consideration of Stakeholder Viewpoints

Currently, each covered clearing agency is required to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide governance arrangements that consider the interests of participants' customers, securities issuers and holders, and other relevant stakeholders of the covered clearing agency.[196] The Commission understands that clearing agency boards currently use both formal and informal channels to solicit, receive, and consider the viewpoints of participants and other relevant stakeholders.[197] Clearing agency

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195 *See* Regulation SCI Adopting Release, *supra* note 39, at 77276 (noting that "The Commission agrees with the comment that an SCI entity should be responsible for managing its relationship with third parties operating systems on behalf of the SCI entity through due diligence, contract terms, and monitoring of third party performance. […] The Commission believes that it would be appropriate for an SCI entity to evaluate the challenges associated with oversight of third-party vendors that provide or support its applicable systems subject to Regulation SCI. If an SCI entity is uncertain of its ability to manage a third-party relationship (whether through due diligence, contract terms, monitoring, or other methods) to satisfy the requirements of Regulation SCI, then it would need to reassess its decision to outsource the applicable system to such third party.").

196 *See* 17 CFR 240.17Ad-22(e)(2)(vi).

197 *See, e.g.*, OCC, Order Approving Proposed Rule Change, Exchange Act Release No. 88029 (Jan. 24, 2020), 85 FR 5500, 5508 (Jan. 30, 2020) ("OCC also describes the formal and informal mechanisms that OCC employs to solicit feedback from Clearing Members and other

participants acknowledge that their ability to offer viewpoints has yielded positive but mixed results.[198]

C. Consideration of Benefits and Costs

The discussion below sets forth the potential economic effects stemming from adopting the proposed rules, including the effects on efficiency, competition, and capital formation.

The benefits and costs discussed in this section are relative to the economic baseline discussed earlier, which includes clearing agencies' current practices. In some instances, the proposed rules reflect what we believe to be current practices at many registered clearing agencies. To the extent that a clearing agency's current practices could reasonably be considered to be in compliance with a proposed rule, the clearing agency and broader market would have already absorbed the benefits of the proposed rule and so might not experience any direct benefits if the Commission adopts the rule.[199] In these cases, the Commission believes that

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interested stakeholders, including its Financial Risk Advisory Committee, Operations Roundtable, multiple letters and open calls with Clearing Members and other interested stakeholders, and routine in-person meetings with trade groups and individual firms."); *Cf.* J.P. Morgan et al., A Path Forward for CCP Resilience, Recovery and Resolution (Mar. 10, 2020), https://www.jpmorgan.com/content/dam/jpm/cib/complex/content/news/a-path-forward-for-ccp-resilience-recovery-and-resolution/pdf-0.pdf ("[C]learing participants have provided diverse perspectives and detailed feedback to CCPs and regulators through individual firm and industry association position papers, targeted comment letters, and participation in regulatory and industry-sponsored forums on a global scale.").

[198] *See, e.g.*, J.P. Morgan et al., *supra* note 197, at 1 (explaining that "[w]hile CCPs and the regulatory community have taken significant steps to address the feedback received, there remain outstanding issues that require additional attention" and recommending "[e]nhancing governance practices to obtain and address input from a broader array of market participants on relevant risk issues" to enhance CCP resilience).

[199] However, a clearing agency whose current practices could reasonably be considered to be in compliance with the proposed rules might still be required to expend resources if the Commission adopted the rule, because the clearing agency would likely need to review its policies and procedures in response to the adoption.

imposing these requirements on all registered clearing agencies would have the effect of imposing consistent governance standards across all registered clearing agencies.

If adopted, many of the proposed rules could result in a clearing agency needing to amend its bylaws, rulebook, or other governance documents. Because clearing agencies are SROs, any such amendments that constitute rule changes would be subject to Commission review pursuant to Rule 19b-4. Adopting the proposed rules could also cause a clearing agency to make different business decisions, such as capital expenditure decisions, which would not be subject to the same Commission review process.

It is uncertain to what extent the costs discussed in this section would be borne by clearing agencies, as opposed to participants. For clearing agencies owned by participants, all of the costs will ultimately be passed on to participants because they are residual beneficiaries of the clearing agency. For clearing agencies not owned by participants, the level of pass through would depend upon a number of factors, including the lack of competition among clearing agencies.

1. Economic Considerations for Rule Proposals Regarding Board Composition

As discussed in more detail above, proposed Rules 17Ad-25(b), (e), and (f) would (1) require that a majority of the board (or 34 percent, if a majority of the voting rights are directly or indirectly held by participants) be independent directors (as determined by the clearing agency and precluding certain circumstances that impact independence), (2) establish minimum independent director requirements for the composition of certain board committees, and (3) identify circumstances that would exclude a director from being an independent director.[200]

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200 *See supra* Part III.A.1 (discussing proposed Rules 17Ad-25(b), (e), and (f)).

To the extent an operating clearing agency could determine that its current board meets the proposed minimum requirements for independent directors on the board and board committees, adopting the proposed rule will not directly affect the effectiveness of the clearing agency's governance or directly affect the management of divergent interests between owners and participants, among various types of participants, and between clearing agency stakeholders and the broader financial markets.

To the extent operating clearing agencies would need to change the composition of their boards or board committees to meet the proposed minimum requirements, the proposed rule could help promote more effective governance by providing impartial perspectives and helping mitigate the impact of the divergent interests between owners and participants, among various types of participants, and between clearing agency stakeholders and the broader financial markets. The Commission believes that more effective governance will improve the effectiveness of a clearing agency's risk management practices, which will promote resilience at individual clearing agencies and in the broader financial markets.[201] For example, more effectively managing divergent interests could help the clearing agency better internalize the costs of participant defaults and non-default losses, which could mitigate a clearing agency's incentive to underinvest in risk management services such as liquidity arrangements and risk modelling. The proposed rules could also help clearing agencies ensure that an appropriate risk-based margin system is in place.

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[201] See Paolo Saguato, The Unfinished Business of Regulating Clearinghouses, 2020 Colum. Bus. L. Rev. 449, 488 (2020), https://journals.library.columbia.edu/index.php/CBLR/article/view/7219/3838 ("The agency costs between clearinghouses' shareholders and members (the former participating in the profits of the business, and the latter bearing its final costs) increase the moral hazard of these institutions and threaten clearinghouses' systemic resilience."); Saguato, *supra* note 160.

The Commission also believes that better managing the divergent interests could improve the ability of indirect participants to compete with direct participants of the clearing agency. Given that the cleared derivatives market is an imperfect substitute for uncleared derivatives, some commentators argue that large dealers may have an incentive to protect economic rents and therefore may urge boards to adopt policies that restrict the classes or volume of transactions that may use clearinghouse platforms.[202]

Some academic literature on corporate governance could be interpreted to suggest that, under the proposed definition of independent director and the proposed minimum requirements for independent directors on the board and board committees, divergent interests between owners and participants, among various types of participants, and between clearing agency stakeholders and the broader financial markets may continue to adversely impact governance because independent directors in closely held companies will cede to the interests of controlling shareholders unless they are affirmatively incentivized to protect the interests of one or more stakeholder groups.[203] One author suggests that independent directors will be more effective if (1) their explicit purpose is to "prevent minority expropriation at the hands of the block-holders," (2) there is a strong regulation and enforcement regime, and (3) the nomination procedure and the design of incentives guarantee the independent director is accountable to a specific

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202 *See* Johnson, *supra* note 173, at 698–700.

203 *See*, *e.g.*, Clarke, *supra* note 94, at 85 ("The dominant view has been that directors who are responsible to many constituencies are in effect responsible to none . . . "); Lucian A. Bebchuk & Assaf Hamdani, Independent Directors and Controlling Shareholders, 165 Univ. Pa. L. Rev. 1271, 1274 (2017), https://scholarship.law.upenn.edu/penn_law_review/vol165/iss6/1/ (taking the position that the best way to help ensure an independent director does not capitulate to controlling shareholders' or management's interests is to help ensure the independent director is accountable to (*i.e.*, nominated by) another group of stakeholders).

constituency other than controlling shareholders.[204] Another author argues that including independent directors in the governance process provides a roadmap, but does not guarantee results in terms of favoritism and objectivity.[205] While studies on the benefits of independent directors offer mixed results and while independence alone is unlikely to be sufficient to motivate a director to act in the public interest,[206] director independence, particularly when complemented with other governance requirements, may help mitigate divergent incentives.

The Commission believes that the proposed independence rules will work in conjunction with (1) existing governance rules that emphasize the clearing agency's responsibility to owners, participants and other stakeholders,[207] (2) Commission enforcement of securities regulations, and (3) the adoption of other rules in this proposal (such as the proposed nominating committee requirements) to help independent directors mitigate the effects of divergent interests between

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204 *See* Maria Gutierrez & Maribel Saez, Deconstructing Independent Directors, 13 J. Corp. L. Stud. 63, 90 (2013).

205 *See* Dravis, *supra* note 80.

206 *See* Clarke, *supra* note 94, at 82-83 ("If one is to rely on NMDs [Non-Management Director's] to exercise their voting power in favor of compliance with external standards, then there needs to be some reason for believing that NMDs will be more likely to do so than non-NMDs. Both kinds of directors can be subject to sanctions for voting to violate clear legal obligations. If the purpose is to encourage corporations to act in accordance with principles that do not constitute legal obligations (for example, "maximize local employment"), then it is unlikely that NMDs elected by, and accountable to, profit-maximizing shareholders will produce this result. A director serving the "public interest" should arguably be independent of everyone--dominant shareholders, management, and indeed all those who have an interest in the company-and follow only the dictates of her conscience. Assuming accountability to be a good thing, however, it is hard to see how such a director could properly be made accountable. In the real world, of course, any director without security of tenure will, in the absence of counterincentives and assuming that the position is desirable, tend to be accountable to whoever was responsible for appointing her.").

207 *See*, *e.g.*, Rule 17Ad-22(e)(2).

owners and participants, among various types of participants, and between clearing agency stakeholders and the broader financial markets.

In addition, the Commission believes that standardizing the definition of independent director could improve efficiency by reducing economic frictions and search costs related to monitoring by stakeholders.

The Commission is aware of three primary costs associated with adopting the proposed rules regarding the composition of the board. First, adopting the proposed rules would cause clearing agency boards to immediately expend resources memorializing information that has been gathered for consideration in determining each director's independence, and then preserving the records of the determination. The Commission estimates that each registered, operating clearing agency would incur a one-time burden of approximately $20,353[208] to comply with proposed Rules 17Ad-25(b), (e), and (f) if the rules were adopted. Clearing agencies would also expend future resources to repeat the above process of memorializing information and documenting a determination, likely twice a year. The Commission estimates that each registered, operating clearing agency would incur an annual, recurring burden of approximately $40,706[209] to comply with proposed Rules 17Ad-25(b), (e), and (f) if the rules were adopted.

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208 This figure is calculated as follows: Chief Compliance Officer for 5 hours at $577 per hour + Compliance Attorney for 44 hours at $397 per hour = $2,885 + $17,468 = $20,353. No hours are allocated to proposed Rules 17Ad-25(e) or (f). *See infra* notes 236 and 237. The per-hour costs ($577 for a Chief Compliance Officer and $397 for a Compliance Attorney) are from SIFMA's Management and Professional Earnings in the Securities Industry – 2013, modified by Commission staff to account for an 1800-hour work-year and inflation, and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. *See* SIFMA, Management and Professional Earnings in the Securities Industry – 2013 (Oct. 7, 2013), https://www.sifma.org/resources/research/management-and-professional-earnings-in-the-securities-industry-2013/.

209 This figure is calculated as follows: Chief Compliance Officer for 10 hours at $577 per hour + Compliance Attorney for 88 hours at $397 per hour = $5,770 + $34,936 = $40,706. No

Second, clearing agencies may need to add independent directors to the board, either by replacing directors or increasing the board size.[210] As mentioned earlier, approaches to defining independence for directors vary across clearing agencies. Thus, if proposed Rules 17Ad-25(b), (e), and (f) were adopted, to the extent that a clearing agency's definition of an "independent director" conflicts with the proposed rules, including the prohibitions in proposed Rule 17Ad-25(f), a clearing agency currently reporting a majority of its directors as independent (or 34 percent, if a majority of the voting rights are directly or indirectly held by participants) on its board may need to replace directors to comply with the rule requirements.[211]

Adding independent directors would require a clearing agency to expend resources conducting a search for new directors. The costs incurred by the clearing agency may vary based on whether it conducts its own search or retains an outside consultant. The Commission estimates that retaining a recruitment specialist to secure an independent director could cost approximately $90,000 per director.[212]

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hours are allocated to proposed Rules 17Ad-25(e) or (f). *See infra* note 239. The per-hour costs ($577 for a Chief Compliance Officer and $397 for a Compliance Attorney) are from SIFMA's Management and Professional Earnings in the Securities Industry – 2013, *supra* note 208.

210 Alternatively, clearing agencies might achieve compliance by reducing the board size and eliminating a sufficient number of non-independent directors.

211 On the other hand, a clearing agency that does not require a minimum percentage of independent directors could determine that its current slate of directors already satisfies the independence requirements in the proposed rules.

212 The Commission is basing this estimate on a report by The Good Search noting that the retainer fee for outside directors is on average $90,000. *See* The Good Search, Retained Search Fees, https://tgsus.com/executive-search-blog/retained-search-fees/. The Commission believes that this amount could serve as a proxy for the amount of any fee to be charged by a recruitment firm that would conduct a national search for an independent director.

Third, to the extent that non-independent directors tend to have more relevant knowledge and experience than independent directors do, requiring that a majority of directors (or 34 percent, if a majority of the voting rights are directly or indirectly held by participants) be independent could reduce the depth or breadth of relevant expertise that can be brought to clearing agency boards. A reduced level of combined experience on a clearing agency board might impair clearing agency efficiency in the near term. However, the Commission believes that any such effect would be short-lived, as new independent directors gain more experience and prospective director nominees to the board that may not meet existing experience criteria would qualify under the proposed new independence requirements and fitness standards.

The Commission believes that the expected costs to implement proposed Rules 17Ad-25(b), (e), and (f) are sufficiently small that they would not have a material effect on (1) competition among the existing clearing agencies or on a new entrant's ability to enter the market; (2) capital formation, including clearing agencies' ability to raise capital; and (3) the efficiency of clearing agencies or their participants. For example, the Commission estimates that a clearing agency would spend approximately $20,353 plus whatever director search costs were necessary in the first year if the rules were adopted (which the Commission estimates to be up to $90,000 per director), and $40,706 in each year thereafter.

2. Economic Considerations for Rule Proposals Regarding the Nominating Committee

As discussed in more detail above, proposed Rule 17Ad-25(c) would establish minimum requirements for nominating committees, including a minimum composition requirement, fitness

standards for serving on the board, and a documented process for evaluating board nominees, including those who would meet the Commission's proposed independence criteria.[213]

Given that six of the seven operating clearing agencies already have nominating committees (or a committee that serves a similar function), the primary benefit of adopting proposed Rule 17Ad-25(c) would be to increase the number of independent directors on existing nominating committees. Insofar as a lack of independent directors on a clearing agency's nominating committee has prevented the clearing agency from having a fairer representation of their shareholders and participants in the selection of their directors and the administration of their affairs, proposed Rule 17Ad-25(c) would help the clearing agency better meet Section 17A's fair representation requirements.

Adopting proposed Rule 17Ad-25(c) would cause clearing agency boards to immediately expend resources reviewing, revising, and possibly creating governance documents and related policies and procedures. The Commission estimates that each registered, operating clearing agency would incur a one-time burden of approximately $35,060[214] to comply with proposed Rule 17Ad-25(c) if the rule was adopted. Clearing agencies would also need to expend future resources for monitoring, compliance, and documentation activities related to the new or revised policies and procedures. The Commission estimates that each registered, operating clearing

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213 *See supra* Part III.B (discussing proposed Rule 17Ad-25(c)); *infra* Part VIII (providing the proposed rule text).

214 This figure is calculated as follows: Assistant General Counsel for 30 hours at $507 per hour + Compliance Attorney for 50 hours at $397 per hour = $15,210 + $19,850 = $35,060. *See infra* note 242. The per-hour costs ($507 for an Assistant General Counsel, and $397 for a Compliance Attorney) are from SIFMA's Management and Professional Earnings in the Securities Industry – 2013, *supra* note 208.

agency would incur an annual, recurring burden of approximately $11,910[215] to comply with proposed Rule 17Ad-25(c) if the rule were adopted.

The Commission believes that the expected costs to implement proposed Rule 17Ad-25(c) are sufficiently small that they would not have a material effect on (1) competition among the existing clearing agencies or on a new entrant's ability to enter the market; (2) capital formation, including clearing agencies' ability to raise capital; and (3) the efficiency of clearing agencies or their participants.

3. Economic Considerations for Rule Proposals Regarding the Risk Management Committee

As discussed in more detail above, proposed Rule 17Ad-25(d) would require each registered clearing agency to establish a risk management committee (or committees) and establish minimum requirements for the composition, reconstitution, and function of such risk management committees. Based on the Commission staff's review of relevant governance documents, the Commission understands that many registered clearing agencies currently have written governance arrangements that largely conform to the requirements for risk management committees in proposed Rule 17Ad-25(d). The Commission believes that each clearing agency's governance documents and related policies and procedures would need minimal modifications if proposed Rule 17Ad-25(d) were adopted. To the extent that a clearing agency's existing governance documents and related policies and procedures could reasonably be considered to be in compliance with the proposed rules, the benefits of the proposed rule would already be incorporated by market participants.

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215 This figure is calculated as follows: Compliance Attorney for 30 hours at $397 per hour = $11,910. *See infra* note 244. The $577 per hour cost for a Chief Compliance Officer is from SIFMA's Management and Professional Earnings in the Securities Industry – 2013, *supra* note 208.

Adopting proposed Rule 17Ad-25(d) would cause clearing agency boards to immediately expend resources reviewing, revising, and possibly creating governance documents and related policies and procedures. The Commission estimates that each registered, operating clearing agency would incur a one-time burden of approximately $3,506[216] to comply with proposed Rule 17Ad-25(d) if the rule was adopted. Clearing agencies would also need to expend future resources for monitoring, compliance, and documentation activities related to the new or revised governance documents and related policies and procedures. The Commission estimates that each registered, operating clearing agency would incur an annual, recurring burden of approximately $1,191[217] to comply with proposed Rule 17Ad-25(d) if the rule was adopted.

The Commission believes that the expected costs to implement proposed Rule 17Ad-25(d) are sufficiently small that they would not have a material effect on (1) competition among the existing clearing agencies or on a new entrant's ability to enter the market; (2) capital formation, including clearing agencies' ability to raise capital; and (3) the efficiency of clearing agencies or their participants.

4. Economic Considerations for Rule Proposals Regarding Conflicts of Interest Involving Directors or Senior Managers

As discussed in more detail above, proposed Rules 17Ad-25(g) and (h) would (1) require policies and procedures that identify and document existing or potential conflicts of interest,

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216 This figure is calculated as follows: Assistant General Counsel for 3 hours at $507 per hour + Compliance Attorney for 5 hours at $397 per hour = $1,521 + $1,985 = $3,506. *See infra* note 248. The per-hour costs ($507 for an Assistant General Counsel, and $397 for a Compliance Attorney) are from SIFMA's Management and Professional Earnings in the Securities Industry – 2013, *supra* note 208.

217 This figure is calculated as follows: Compliance Attorney for 3 hours at $397 per hour = $1,191. *See infra* note 250. The per-hour cost is from SIFMA's Management and Professional Earnings in the Securities Industry – 2013, *supra* note 208.

mitigate or eliminate the conflicts of interest and document the actions taken,[218] and (2) require policies and procedures that obligate directors to report potential conflicts.[219]

The Commission believes that each clearing agency's existing policies and procedures for identifying, reporting, and mitigating conflicts of interest by directors or senior managers would need minimal modifications if the proposed rules were adopted. To the extent a clearing agency's existing policies and procedures could reasonably be considered to be in compliance with the proposed rules, the benefits discussed below would already be incorporated by market participants.

The Commission believes that adopting the proposed rules regarding conflicts of interest would help clearing agencies continue to identify and mitigate conflicts of interest by directors and senior managers as circumstances change. For example, by codifying current best practices, the proposed rules would reduce the future ability of clearing agencies to change a clearing agency's conflict of interest disclosure requirements to the detriment of participants and the economic efficiency of the clearing market.

In addition, to the extent that adopting the proposed rule would require clearing agencies to strengthen policies and procedures that deal with identifying, reporting, mitigating or eliminating, and documenting conflicts of interest, strengthening those policies and procedures could reduce the monitoring costs borne by clearing agency stakeholders.

Finally, to the extent a previously undisclosed conflict of interest resulted in less favorable outcomes for the clearing agency—such as higher expenses with service providers or the loss of business from smaller participants—adopting the proposed rule would improve the

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218 *See supra* Part III.D.1 (discussing proposed Rule 17Ad-25(g)).

219 *See supra* Part III.D.1 (discussing proposed Rule 17Ad-25(h)).

clearing agency's profitability (operating efficiency) and the economic efficiency of the clearing market.

Adopting the proposed rules regarding conflicts of interest would cause clearing agency boards to immediately expend resources reviewing, revising, and possibly creating governance documents and related policies and procedures. The Commission estimates that each registered, operating clearing agency would incur a one-time burden of approximately $6,945[220] to comply with proposed Rules 17Ad-25(g) and (h) if the rules were adopted. Clearing agencies would also need to expend future resources for monitoring, compliance, and documentation activities related to the new or revised policies and procedures. The Commission estimates that each registered, operating clearing agency would incur an annual, recurring burden of approximately $2,382[221] to comply with proposed Rules 17Ad-25(g) and (h) if the rules were adopted.

The Commission believes that the expected costs to implement proposed Rules 17Ad-25(g) and (h) are sufficiently small that they would not have a material effect on (1) competition among the existing clearing agencies or on a new entrant's ability to enter the market; (2) capital

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220 This figure is calculated as follows: Assistant General Counsel for 9 hours at $507 per hour + Compliance Attorney for 6 hours at $397 per hour = $4,563 + $2,382 = $6,945. The Assistant General Counsel's 9 hours are allocated among the proposed rules: 8 hours for proposed Rule 17Ad-25(g) and 1 hour for proposed Rule 17Ad-25(h). The Compliance Attorney's 6 hours are allocated among the proposed rules: 5 hours for proposed Rule 17Ad-25(g) and 1 hour for proposed Rule 17Ad-25(h). *See infra* notes 251, 253, and 255. The per-hour costs ($507 for an Assistant General Counsel and $397 for a Compliance Attorney) are from SIFMA's Management and Professional Earnings in the Securities Industry – 2013, *supra* note 208.

221 This figure is calculated as follows: Compliance Attorney for 6 hours at $397 per hour = $2,382. The Compliance Attorney's 6 hours are allocated among the proposed rules: 5 hours for proposed Rule 17Ad-25(g) and 1 hour for proposed Rule 17Ad-25(h). *See infra* notes 252, 254, and 256. The per-hour cost is from SIFMA's Management and Professional Earnings in the Securities Industry – 2013, *supra* note 208.

formation, including clearing agencies' ability to raise capital; and (3) the efficiency of clearing agencies or their participants.

5. Economic Considerations for Rule Proposals Regarding Oversight of Service Providers for Critical Services

As discussed in more detail above, proposed Rule 17Ad-25(i) would require policies and procedures enabling the board to oversee relationships with service providers for critical services.

The Commission believes that, to the extent a clearing agency's risk management framework does not already consider how reliance on an affiliated or third-party service provider might affect clearing agency's risks, adopting the proposed rule would enhance the effectiveness of a clearing agency's risk management framework. A more effective risk management framework would reduce the probability of clearing agency failure or financial distress. The reduced probability of these outcomes directly and positively affects the stability of the broader financial system.

Adopting the proposed rules regarding the board's ultimate responsibility for the oversight of relationships with service providers for critical services would cause clearing agency boards to immediately expend resources reviewing, revising, and possibly creating governance documents and related policies and procedures. For example, boards might need to create or revise policies for overseeing relationships with service providers for critical services. The Commission estimates that each registered, operating clearing agency would incur a one-time burden of approximately $35,060[222] to comply with proposed Rule 17Ad-25(i) if the rule was

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222 This figure is calculated as follows: Assistant General Counsel for 30 hours at $507 per hour + Compliance Attorney for 50 hours at $397 per hour = $15,210 + $19,850 = $35,060. *See infra* note 261. The per-hour costs ($507 for an Assistant General Counsel and $397 for a

adopted. Clearing agency boards would also need to expend future resources for monitoring, compliance, and documentation activities related to the new or revised policies and procedures. The Commission estimates that each registered, operating clearing agency would incur an annual, recurring burden of approximately $11,910[223] to comply with proposed Rule 17Ad-25(i) if the rule was adopted.

The Commission believes that the expected costs to implement proposed Rule 17Ad-25(i) are sufficiently small that they would not have a material effect on (1) competition among the existing clearing agencies or on a new entrant's ability to enter the market; (2) capital formation, including clearing agencies' ability to raise capital; and (3) the efficiency of clearing agencies or their participants.

6. Economic Considerations for Rule Proposals Regarding Formalized Solicitation, Consideration, and Documentation of Stakeholders' Viewpoints

As discussed in more detail above, proposed Rule 17Ad-25(j) would require policies and procedures to solicit, consider, and document the registered clearing agency's consideration of the views of its participants and other relevant stakeholders regarding material developments in its governance and operations.

The Commission believes that, to the extent clearing agency boards' inadequate solicitation of stakeholder viewpoints has caused some stakeholder views not to be considered, adopting the proposed rules regarding the solicitation, consideration, and documentation of stakeholders' views would improve boards' consideration of different stakeholder views. The

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Compliance Attorney) are from SIFMA's Management and Professional Earnings in the Securities Industry – 2013, *supra* note 208.

223 This figure is calculated as follows: Compliance Attorney for 30 hour at $397 per hour = $11,910. *See infra* note 263. The per-hour cost is from SIFMA's Management and Professional Earnings in the Securities Industry – 2013, *supra* note 208.

Commission believes the improved consideration of different views would help persuade stakeholders with divergent interests to assert their needs more vigorously, which would encourage debate amongst actors with different goals. More informed debates would, in turn, help to foster consensus agreements with mandates and other decisions that are supported by a broader spectrum of stakeholders. Consequently, clearing agencies would identify and develop rule proposals that (to the extent the Commission considers them) would be more likely to meet the public interest requirements under Section 17A of the Exchange Act.[224]

Adopting the proposed rules regarding obligations of the board would cause clearing agency boards to immediately expend resources reviewing, revising, and possibly creating governance documents and related policies and procedures. For example, boards might need to create policies for soliciting, considering, and documenting the consideration of stakeholders' views. The Commission estimates that each registered, operating clearing agency would incur a one-time burden of approximately $6,438[225] to comply with proposed Rule 17Ad-25(j) if the rule was adopted. Clearing agency boards would also need to expend future resources for monitoring, compliance, and documentation activities related to the new or revised policies and procedures. The Commission estimates that each registered, operating clearing agency would incur an

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224 *See* 15 U.S.C. 78q-1(b)(3)(F).

225 This figure is calculated as follows: Assistant General Counsel for 8 hours at $507 per hour + Compliance Attorney for 6 hours at $397 per hour = $4,056 + $2,382 = $6,438. *See infra* note 267. The per-hour costs ($507 for an Assistant General Counsel and $397 for a Compliance Attorney) are from SIFMA's Management and Professional Earnings in the Securities Industry – 2013, *supra* note 208.

annual, recurring burden of approximately $1,588[226] to comply with proposed Rule 17Ad-25(j) if the rule was adopted.

The Commission believes that the expected costs to implement proposed Rule 17Ad-25(j) are sufficiently small that they would not have a material effect on (1) competition among the existing clearing agencies or on a new entrant's ability to enter the market; (2) capital formation, including clearing agencies' ability to raise capital; and (3) the efficiency of clearing agencies or their participants.

D. Reasonable Alternatives to the Proposed Rule

1. More Flexibility in Governance, Operations, and Risk Management

The Commission believes that when determining the content of its policies and procedures, each clearing agency must have the ability to consider the effects of its unique characteristics and circumstances, including ownership and governance structures, on direct and indirect participants, markets served, and the risks inherent in products cleared.[227]

It has been the Commission's experience that particular securities markets (*e.g.*, equities, fixed income, and options) have unique conventions, characteristics, and structures that are best addressed on a market-by-market basis. The Commission recognizes that a less prescriptive approach can help promote efficient and effective practices and encourage regulated entities to

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226 This figure is calculated as follows: Compliance Attorney for 4 hours at $397 per hour = $1,588. *See infra* note 269. The per-hour cost is from SIFMA's Management and Professional Earnings in the Securities Industry – 2013, *supra* note 208.

227 *See* CCA Standards Adopting Release, *supra* note 13, at 70806 ("The Commission believes it is appropriate to provide covered clearing agencies with flexibility, subject to their obligations and responsibilities as SROs under the Exchange Act, to structure their default management processes to take into account the particulars of their financial resources, ownership structures, and risk management frameworks.").

consider how to manage their regulatory obligations and risk management practices in a way that complies with Commission rules, while considering the particular characteristics of their business.[228]

Even where current practices at clearing agencies do not significantly differ from the proposed rules, clearing agencies could still potentially face costs associated with the limitations on discretion that would result from the rules, including costs related to limiting a clearing agency's flexibility to respond to changing economic environments. For example, to the extent that clearing agencies having boards with a majority of independent directors value the ability to sometimes have less than a majority of independent directors on the board of directors, they may incur additional costs because, if proposed rules were adopted, they would lose the option to do so.

Although there may be costs to limiting the degree of discretion clearing agencies have over governance, operations, and risk management, the Commission believes there are also potential benefits. For example, clearing agencies may not fully internalize the social costs of differing incentives between owners and participants, among various types of participants, and between clearing agency stakeholders and the broader financial markets and thus, without more granular regulations, may not appropriately address the needs and incentives of the direct or indirect participants or the broader financial market.

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228 *See* CCA Standards Adopting Release, *supra* note 13, at 70801; *see also* Randall S. Kroszner, Central Counterparty Clearing: History, Innovation, and Regulation, 30 Econ. Persp. 37, 39 (2006) ("[37, 39 (2006) ("[M]ore intense government regulation of CCPs may prove counterproductive if it creates moral hazard or impedes the ability of CCPs to develop new approaches to risk management.").

2. Ownership Limits

In 2010, the Commission proposed Regulation MC, which was "designed to mitigate potential conflicts of interest … through conditions and structures related to ownership, voting, and governance."[229] Regulation MC proposed mitigating divergent incentives, especially between larger and smaller owners, by imposing maximum ownership limits. Specifically, Regulation MC proposed that security-based swap clearing agencies be required to choose one of two governance alternatives. The Voting Interest Alternative in part prevented any single participant from having more than 20 percent ownership or voting interest in a clearing agency, and limited total participant ownership or voting rights to no more than 40 percent. The Voting Interest Alternative also required that at least 35 percent of the board be independent directors.

The Governance Interest Alternative in part limited any participant to no more than 5 percent ownership or voting rights in the clearing agency, and required that at least 51 percent of the board be independent directors.

The Commission has not proposed ownership limits in the current proposal because (1) rules during the intervening time have significantly altered how clearing agencies must treat smaller participants[230] and (2) bright-line ownership limits are easy to manipulate, for example by obfuscating beneficial ownership or by getting extremely close to the limit.

3. Increase Shareholders' At-Risk Capital ("Skin in the Game")

The proposed rules are intended, in part, to better manage divergent incentives of clearing agency owners and non-owner participants. One suggested cause of the incentive misalignment

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229 *See* Regulation MC Proposing Release, *supra* note 1, at 65882.

230 *See supra* Part II.B. (discussing, in part, how the Commission has adopted rules to promote access to registered clearing agencies, including access for smaller participants).

is owners' lack of at-risk capital ("skin in the game").[231] Under the existing regulatory structure, for-profit clearing agencies can bifurcate risk from reward, sending the reward (*e.g.*, profits) to owners and requiring participants to hold disproportionate risks (*e.g.*, responsibility for non-default losses or participants' defaulted positions). Thus, it is reasonable to consider using skin in the game to correct the incentive alignment.[232]

The Commission is not currently proposing skin-in-the-game requirements. Instead, the Commission is proposing using governance requirements to help manage the divergent incentives of clearing agency shareholders and participants. The Commission believes that the improved management of misaligned incentives will help facilitate clearing agencies' ability to adopt policies, such as skin-in-the-game requirements, that can further ameliorate the divergent incentives of shareholders and participants.

4. Increase Public Disclosure

One of the purposes of the proposed rules is to increase transparency into board governance. Increased transparency could also be achieved by requiring clearing agencies to enhance their governance disclosures. For example, the Commission could require clearing agencies to publicly disclose, for each director, the existence of any relationship or interest that reasonably could affect the independent judgment or decision-making of the director. This

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231 *See, e.g.*, Saguato, *supra* note 201, at 488 ("[There is] significant imbalance of the economic exposure of clearing members vis-à-vis clearinghouses and their holding groups. This imbalance … results in the misaligned incentives of members and share-holders, which creates agency costs between the firms' primary stakeholders that threaten clearinghouses' systemic resilience.").

232 *See* OCC, Order Approving Proposed Rule Change to Establish OCC's Persistent Minimum Skin-In-The-Game, Exchange Act Release No. 92038 (May 27, 2021), 86 FR 29861, 29863 (June 3, 2021) ("The Commission continues to regard skin-in-the-game as a potential tool to align the various incentives of a covered clearing agency's stakeholders, including management and clearing members.").

requirement could include each director's affiliation with clearing agency participants. The Commission could require these disclosures to be submitted in a structured (*i.e.*, machine-readable) data language, which could augment any transparency benefits resulting from the disclosures by increasing the efficiency with which they are processed.

E. Request for Comment

The Commission requests comment on all aspects of this initial economic analysis, including the potential benefits and costs, all effects on efficiency, competition (including any effects on barriers to entry), and capital formation, and reasonable alternatives to the proposed rules. We request and encourage any interested person to submit comments regarding the proposed rules, our analysis of the potential effects of the proposed rules, and other matters that may have an effect on the proposed rules. We request that commenters identify sources of data and information as well as provide data and information to assist us in analyzing the economic consequences of the proposed rules and each reasonable alternative. We also are interested in comments on the qualitative benefits and costs we have identified and any benefits and costs we may have overlooked, including those associated with each reasonable alternative. In addition, we are interested in comments on any other reasonable alternative, including any alternative that would distinguish registered clearing agencies based on certain factors, such as organizational structure or products cleared.

V. Paperwork Reduction Act

Certain provisions of the proposed rules contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[233] We are submitting the

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233 44 U.S.C 3502.

proposed collections of information to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[234] The title for the collection of information is: "Clearing Agency Standards for Operation and Governance" (OMB Control No. 3235-0695).[235] An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

As discussed further below, proposed Rules 17Ad-25(b) through (d) and ((g) through (j) each contain collections of information. The collections in proposed Rules 17Ad-25(b) through (d) and (g) through (j) are mandatory. Respondents under these rules are registered clearing agencies, of which there are currently nine. The Commission estimates for purposes of the PRA that one additional entity may seek to register as a clearing agency in the next three years, and so for purposes of this proposal the Commission has assumed ten respondents.

A. Rule 17Ad-25(b)

The elements of proposed Rule 17Ad-25(b) are discussed in Part III.A.1. The purpose of the rule is to require either a majority or 34 percent of independent directors, depending on the circumstances set forth in the rule. Proposed Rule 17Ad-25(b)(2) would impose a collection of information requirement.

The Commission estimates that proposed Rule 17Ad-25(b)(2) would require respondent clearing agencies to incur a one-time burden of 44 hours[236] to memorialize information that has been gathered for the person(s) making the determination to consider prior to making it, as well

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234 44 U.S.C 3507.

235 *Id*.

236 This figure is calculated as follows: ((Chief Compliance Officer for 4 hours) + (Compliance Attorney for 40 hours)) = 44 hours.

as 5 hours[237] to document and preserve the records of the determination. The Commission estimates that the initial activities required by Rule 17Ad-25(b)(2) would impose an aggregate initial burden on respondent clearing agencies of 490 hours.[238] Due to the fact that board composition changes on occasion after elections or due to unexpected events such as restructuring, resignations, or deaths, the Commission estimates that respondent clearing agencies would incur an ongoing annual burden of 98 hours to repeat the above process of memorializing information and documenting a determination twice a year.[239] The Commission estimates that the ongoing activities required by Rule 17Ad-25(b)(2) would impose an aggregate ongoing burden on respondent clearing agencies of 980 hours.[240]

B. Rule 17Ad-25(c)

As discussed in Part III.B above, the Commission is proposing certain composition and process requirements for nominating committees of registered clearing agencies. As proposed, Rule 17Ad-25(c)(1) through (4) would add governance requirements regarding the nominating committee of the Board that do not appear in the existing requirements for governance arrangements in Rules 17Ad-22(d)(8) and 17Ad-22(e)(2).[241] Based on the Commission staff's review of relevant governance documents, the Commission understands that many registered

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237 This figure is calculated as follows: ((Chief Compliance Officer for 1 hours) + (Compliance Attorney for 4 hours)) = 5 hours.

238 This figure is calculated as follows: 49 hours x 10 respondent clearing agencies = 490 hours.

239 This figure is calculated as follows: ((Chief Compliance Officer for 10 hours) + (Compliance Attorney for 88 hours)) = 98 hours.

240 This figure is calculated as follows: 98 hours x 10 respondent clearing agencies = 980 hours.

241 17 CFR 240.17Ad-22(d)(8), (e)(2).

clearing agencies currently have written governance arrangements broadly similar to the requirements for nominating committees in proposed Rule 17Ad-25(c)(1) through (4). Therefore, the Commission would expect that the PRA burden for a respondent clearing agency includes the incremental burdens of reviewing and revising existing governance documents and related policies and procedures, and creating new governance documents and related policies and procedures, as necessary, pursuant to the proposed rule. Accordingly, the Commission estimates that respondent clearing agencies would incur an aggregate one-time burden of approximately 800 hours to review and revise existing governance documents and related policies and procedures and to create new governance documents and related policies and procedures, as necessary.[242]

Proposed Rule 17Ad-25(c)(1) through (4) would also impose ongoing burdens on a respondent clearing agency. The proposed rule would require ongoing monitoring and compliance activities with respect to governance documents and related policies and procedures created in response to the proposed rule. The proposed rule would also require ongoing documentation activities with respect to the implementation of a written process for a nominating committee to evaluate board nominees, including those who would meet the definition of an independent director, pursuant to the proposed rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,[243] the Commission estimates that the ongoing activities required by proposed Rule 17Ad-25(c)(1)

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242 This figure is calculated as follows: ((Assistant General Counsel for 30 hours) + (Compliance Attorney for 50 hours)) = 80 hours x 10 respondent clearing agencies = 800 hours.

243 *See* Clearing Agency Standards Adopting Release, *supra* note 8, at 66260–63; CCA Standards Adopting Release, *supra* note 13, at 70891–99.

through (4) would impose an aggregate annual burden on respondent clearing agencies of 300 hours.[244]

C. Rule 17Ad-25(d)

Proposed Rule 17Ad-25(d)(1) would require a registered clearing agency to establish a risk management committee (or committees) to assist the board of directors in overseeing the risk management of the registered clearing agency. Under proposed Rule 17Ad-25(d)(1), each risk management committee would be required to reconstitute its membership on a regular basis and at all times include representatives from shareholders (or members) and participants of the registered clearing agency. Proposed Rule 17Ad-25(d)(2) would require each risk management committee, in the performance of its duties, to be able to provide a risk-based, independent, and informed opinion on all matters presented to it for consideration in a manner that supports the safety and efficiency of the registered clearing agency.[245]

The purpose of this collection of information is to promote sound risk management and governance arrangements at registered clearing agencies, to help ensure diversity of perspective across shareholders (or members) and participants in the oversight of registered clearing agencies' risk management practices, and to mitigate potential or existing conflicts of interest that could undermine the recommendations of risk management committees.

Proposed Rule 17Ad-25(d)(1) through (2) would add governance requirements regarding the risk management committee (or committees) of a registered clearing agency's board of

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244 This figure is calculated as follows: (Compliance Attorney for 30 hours) x 10 respondent clearing agencies = 300 hours.

245 *See supra* Part III.C.1 (discussing proposed Rule 17Ad-25(d)); *infra* Part VIII (providing the proposed rule text).

directors that do not appear in the existing requirements for governance arrangements in Rules 17Ad-22(d)(8) and 17Ad-22(e)(2).[246] Based on the Commission staff's review of relevant governance documents, the Commission understands that many registered clearing agencies currently have written governance arrangements that largely conform to the requirements for risk management committees in proposed Rule 17Ad-25(d)(1) through (2). Therefore, the Commission would expect that the PRA burden for a respondent clearing agency includes the incremental burdens of reviewing and revising its existing governance documents and related policies and procedures and creating new governance documents and related policies and procedures, as necessary, pursuant to the proposed rule.[247] Accordingly, the Commission estimates that respondent clearing agencies would incur an aggregate one-time burden of approximately 80 hours to review and revise existing governance documents and related policies and procedures and to create new governance documents and related policies and procedures, as necessary.[248]

Proposed Rule 17Ad-25(d)(1) through (2) would also impose ongoing burdens on a respondent clearing agency. The proposed rule would require ongoing monitoring and compliance activities with respect to the governance documents and related policies and procedures created in response to the proposed rule. The proposed rule would also require

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246 *See* 17 CFR 240.17Ad-22(d)(8), (e)(2).

247 Because the written governance arrangements at many registered clearing agencies already largely conform to the proposed requirements for risk management committees, the Commission believes that registered clearing agencies may need to make only limited changes to update their governing documents and related policies and procedures to help ensure compliance with proposed Rule 17Ad-25(d)(1) through (2).

248 This figure is calculated as follows: ((Assistant General Counsel for 3 hours) + (Compliance Attorney for 5 hours)) = 8 hours x 10 respondent clearing agencies = 80 hours.

ongoing documentation activities with respect to the establishment of a risk management committee (or committees) pursuant to the proposed rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,[249] the Commission estimates that the ongoing activities required by proposed Rule 17Ad-25(d)(1) through (2) would impose an aggregate annual burden on respondent clearing agencies of 30 hours.[250]

D. Rule 17Ad-25(g)

Proposed Rule 17Ad-25(g)(1) would contain similar provisions to Rules 17Ad-22(d)(8) and 17Ad-22(e)(2) in that they reference clear and transparent governance arrangements, but also adds additional requirements that do not appear in those rules. The Commission therefore would expect that a respondent clearing agency may have written rules, policies, and procedures similar to the requirements in the rule, and the PRA burden includes the incremental burdens of reviewing and revising current policies and procedures and creating new policies and procedures, as necessary, pursuant to the rule. Accordingly, based on the similar provisions and the corresponding burden estimates previously made by the Commission for Rules 17Ad-22(d)(8) and 17Ad-22(e)(2), the Commission estimates that respondent clearing agencies would incur an aggregate one-time burden of approximately 80 hours to review and revise existing policies and

249 *See* Clearing Agency Standards Adopting Release, *supra* note 8, at 66260–63; CCA Standards Adopting Release, *supra* note 13, at 70891–99.

250 This figure is calculated as follows: (Compliance Attorney for 3 hours) x 10 respondent clearing agencies = 30 hours.

procedures and to create new policies and procedures as necessary to help ensure compliance with proposed Rule 17Ad-25(g)(1).[251]

Rule 17Ad-25(g)(1) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rules 17Ad-22(d)(8) and 17Ad-22(e)(2) and because the modifications to Rule 17Ad-25(g)(1) will require updating current policies and procedures or establishing new policies and procedures to help ensure compliance, the Commission estimates that the ongoing activities required by Rule 17Ad-25(g)(1) would impose an aggregate annual burden on respondent clearing agencies of 30 hours.[252]

Proposed Rule 17Ad-25(g)(2) would contain similar provisions to Rules 17Ad-22(d)(8) and 17Ad-22(e)(2) in that they reference clear and transparent governance arrangements, but also adds additional requirements that do not appear in those rules. The Commission therefore would expect that a respondent clearing agency may have written rules, policies, and procedures similar to the requirements in the rule and that the PRA burden includes the incremental burdens of reviewing and revising current policies and procedures and creating new policies and procedures, as necessary, pursuant to the rule. The Commission recognizes that while registered clearing agencies may have existing policies and procedures to comply with proposed Rule 17Ad-25(g)(1), they may not have current policies and procedures designed specifically to mitigate and document the how the conflict of interest was mitigated, as required by Rule 17Ad-25(g)(2).

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[251] This figure is calculated as follows: ((Assistant General Counsel for 5 hours) + (Compliance Attorney for 3 hours)) = 8 hours x 10 respondent clearing agencies = 80 hours.

[252] This figure is calculated as follows: (Compliance Attorney for 3 hours) x 10 respondent clearing agencies = 30 hours.

Accordingly, based on the similar provisions and the corresponding burden estimates previously made by the Commission for Rules 17Ad-22(d)(8) and 17Ad-22(e)(2), the Commission estimates that respondent clearing agencies would incur an aggregate one-time burden of approximately 50 hours to review and revise existing policies and procedures and to create new policies and procedures as necessary to help ensure compliance with proposed Rule 17Ad-25(g)(2).[253]

Rule 17Ad-25(g)(2) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rules 17Ad-22(d)(8) and 17Ad-22(e)(2) and because the modifications to Rule 17Ad-25(g)(2) will require updating current policies and procedures or establishing new policies and procedures to help ensure compliance, the Commission estimates that the ongoing activities required by Rule 17Ad-25(g)(2) would impose an aggregate annual burden on respondent clearing agencies of 20 hours.[254]

E. Rule 17Ad-25(h)

Proposed Rule 17Ad-25(h) would contain similar provisions to Rules 17Ad-22(d)(8) and 17Ad-22(e)(2) in that they reference clear and transparent governance arrangements, but also adds additional requirements that do not appear in those rules. The Commission therefore would expect that a respondent clearing agency may have written rules, policies, and procedures similar to the requirements in the rule and that the PRA burden includes the incremental burdens of

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253 This figure is calculated as follows: ((Assistant General Counsel for 3 hours) + (Compliance Attorney for 2 hours)) = 5 hours x 10 respondent clearing agencies = 50 hours.

254 This figure is calculated as follows: (Compliance Attorney for 2 hours) x 10 respondent clearing agencies = 20 hours.

reviewing and revising current policies and procedures and creating new policies and procedures, as necessary, pursuant to the rule. Accordingly, based on the similar provisions and the corresponding burden estimates previously made by the Commission for Rules 17Ad-22(d)(8) and 17Ad-22(e)(2), the Commission estimates that respondent clearing agencies would incur an aggregate one-time burden of approximately 20 hours to review and revise existing policies and procedures and to create new policies and procedures as necessary to help ensure compliance with proposed Rule 17Ad-25(h).[255]

Rule 17Ad-25(h) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rules 17Ad-22(d)(8) and 17Ad-22(e)(2) and because the modifications to Rule 17Ad-25(h) will require updating current policies and procedures or establishing new policies and procedures to help ensure compliance, the Commission estimates that the ongoing activities required by Rule 17Ad-25(h) would impose an aggregate annual burden on respondent clearing agencies of 10 hours.[256]

F. Rule 17Ad-25(i)

As discussed in Section III.F above, the Commission is proposing certain obligations of the board to oversee service providers for critical services to a registered clearing agency under proposed Rule 17Ad-25(i). Such obligation does not appear in the existing requirements for

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[255] This figure is calculated as follows: ((Assistant General Counsel for 1 hours) + (Compliance Attorney for 1 hours)) = 2 hours x 10 respondent clearing agencies = 20 hours.

[256] This figure is calculated as follows: (Compliance Attorney for 1 hours) x 10 respondent clearing agencies = 10 hours.

governance arrangements in Rules 17Ad-22(d)(8) and 17Ad-22(e)(2),[257] but certain aspects of the proposed rule may be addressed in existing requirements. For example, proposed rule 17Ad-25(i)(1) references the existence of a risk management framework but does not itself require the creation of such framework. Instead, maintenance of a risk management framework is already required for all currently registered clearing agencies under Rule 17Ad-22(e)(3)(i).[258] Additionally, as discussed above, there are existing requirements for managing operational risk under Rule 17Ad-22(d)(4)[259] and Rule 17Ad-22(e)(17).[260] Therefore, the Commission would expect that the PRA burden for a respondent clearing agency includes the incremental burdens of reviewing and revising its existing governance documents and related policies and procedures and creating new governance documents and related policies and procedures, as necessary, pursuant to the proposed rule. Accordingly, the Commission estimates that respondent clearing agencies would incur an aggregate one-time burden of approximately 800 hours to review and revise existing governance documents and related policies and procedures and to create new governance documents and related policies and procedures, as necessary.[261]

Proposed Rule 17Ad-25(i) would also impose ongoing burdens on a respondent clearing agency. The proposed rule would require ongoing documentation, monitoring, and compliance activities with respect to the governance documents and related policies and procedures created

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257 17 CFR 240.17Ad-22(d)(8), (e)(2).

258 17 CFR 240.17Ad-22(e)(3)(i).

259 17 CFR 240.17Ad-22(d)(4).

260 17 CFR 240.17Ad-22(e)(17).

261 This figure is calculated as follows: ((Assistant General Counsel for 30 hours) + (Compliance Attorney for 50 hours)) = 80 hours x 10 respondent clearing agencies = 800 hours.

in response to the proposed rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,[262] the Commission estimates that the ongoing activities required by Rule 17Ad-25(i) would impose an aggregate annual burden on respondent clearing agencies of 300 hours.[263]

G. Rule 17Ad-25(j)

Proposed Rule 17Ad-25(j) would require a registered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed 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 the clearing agency's governance and operations on a recurring basis.[264]

Proposed Rule 17Ad-25(j) contains similar provisions to Rules 17Ad-22(d)(8) and 17Ad-22(e)(2) but would also impose additional governance obligations that do not appear in the existing requirements for governance arrangements in Rule 17Ad-22.[265] Therefore, the Commission would expect that a respondent clearing agency may have written rules, policies, and procedures similar to some of the requirements in the proposed rule and that the PRA burden includes the incremental burdens of reviewing and revising existing policies and procedures and creating new policies and procedures, as necessary, pursuant to the proposed rule. Accordingly,

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262 *See* Clearing Agency Standards Adopting Release, *supra* note 38, at 66260-63; CCA Standards Adopting Release, *supra* note 38, at 70891-99.

263 This figure is calculated as follows: (Compliance Attorney for 30 hours) x 10 respondent clearing agencies = 300 hours.

264 *See supra* Part III.F.2 (discussing proposed Rule 17Ad-25(j)); *infra* Part VIII (providing the proposed rule text).

265 *See* 17 CFR 240.17Ad-22(d)(8), (e)(2).

based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rules 17Ad-22(d)(8) and 17Ad-22(e)(2),[266] the Commission estimates that respondent clearing agencies would incur an aggregate one-time burden of approximately 140 hours to review and revise existing policies and procedures and to create new policies and procedures, as necessary.[267]

Rule 17Ad-25(j) also imposes ongoing burdens on a respondent clearing agency. The proposed rule would require ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the proposed rule. The proposed rule would also require ongoing documentation activities with respect to the board's consideration of participants' and relevant stakeholders' views pursuant to the proposed rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,[268] the Commission estimates that the ongoing activities required by proposed Rule 17Ad-25(j) would impose an aggregate annual burden on respondent clearing agencies of 40 hours.[269]

H. Chart of Total PRA Burdens

Name of Information Collection	Type of Burden	Number of Respondents	Initial Burden Per Entity	Ongoing Burden Per Entity	Total Annual Burden Per Entity	Total Industry Burden
17Ad-25(b)	Recordkeeping	10	49 hours	98 hours	147 hours	1,470 hours

266 *See* Clearing Agency Standards Adopting Release, *supra* note 8, at 66260; CCA Standards Adopting Release, *supra* note 13, at 70891–92.

267 This figure was calculated as follows: ((Assistant General Counsel for 8 hours) + (Compliance Attorney for 6 hours)) = 14 hours x 10 respondent clearing agencies = 140 hours.

268 *See* Clearing Agency Standards Adopting Release, *supra* note 8, at 66260–63; CCA Standards Adopting Release, *supra* note 13, at 70891–99.

269 This figure was calculated as follows: (Compliance Attorney for 4 hours) x 10 respondent clearing agencies = 40 hours.

Name of Information Collection	Type of Burden	Number of Respondents	Initial Burden Per Entity	Ongoing Burden Per Entity	Total Annual Burden Per Entity	Total Industry Burden
17Ad-25(c)	Recordkeeping	10	80 hours	30 hours	110 hours	1,100 hours
17Ad-25(d)	Recordkeeping	10	8 hours	3 hours	11 hours	110 hours
17Ad-25(g)	Recordkeeping	10	13 hours	5 hours	18 hours	180 hours
17Ad-25(h)	Recordkeeping	10	2 hours	1 hour	3 hours	30 hours
17Ad-25(i)	Recordkeeping	10	80 hours	30 hours	110 hours	1,100 hours
17Ad-25(j)	Recordkeeping	10	14 hours	4 hours	18 hours	180 hours

I. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to:

1. Evaluate whether the proposed collection of information is necessary for the proper performance of the Commission's functions, including whether the information shall have practical utility;

2. Evaluate the accuracy of the Commission's estimates of the burden of the proposed collection of information;

3. Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected;

4. Evaluate whether there are ways to minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology; and

5. Evaluate whether the proposed rules would have any effects on any other collection of information not previously identified in this section.

Persons wishing to submit comments on the collection of information requirements should direct them to the OMB Desk Officer for the Securities and Exchange Commission,

MBX.OMB.OIRA.SEC_desk_officer@omb.eop.gov, and should also send a copy of their comments to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090, with reference to File Number S7-21-22. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File Number S7-21-22 and be submitted to the Securities and Exchange Commission, Office of FOIA/PA Services, 100 F Street NE, Washington, DC 20549-2736. As OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

VI. Small Business Regulatory Enforcement Fairness Act

Under the Small Business Regulatory Enforcement Fairness Act of 1996, a rule is considered "major" where, if adopted, it results or is likely to result in (i) an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease); (ii) a major increase in costs or prices for consumers or individual industries; or (iii) significant adverse effect on competition, investment, or innovation.[270] The Commission requests comment on the potential impact of proposed Rule 17Ad-25 on the economy on an annual basis, any potential increase in costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

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[270] Pub. L. 104-121, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

VII. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act ("RFA") requires the Commission, in promulgating rules, to consider the impact of those rules on small entities.[271] Section 603(a) of the Administrative Procedure Act,[272] as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules to determine the impact of such rulemaking on "small entities."[273] Section 605(b) of the RFA states that this requirement shall not apply to any proposed rule which, if adopted, would not have a significant impact on a substantial number of small entities.[274]

A. Registered Clearing Agencies

Proposed Rule 17Ad-25 would apply to all registered clearing agencies. For the purposes of Commission rulemaking and as applicable to proposed Rule 17Ad-25, a small entity includes, when used with reference to a clearing agency, a clearing agency that (i) compared, cleared, and settled less than $500 million in securities transactions during the preceding fiscal year, (ii) had less than $200 million of funds and securities in its custody or control at all times during the preceding fiscal year (or at any time that it has been in business, if shorter), and (iii) is not

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271 *See* 5 U.S.C. 601 *et seq.*

272 5 U.S.C. 603(a).

273 Section 601(b) of the RFA permits agencies to formulate their own definitions of "small entities." *See* 5 U.S.C. 601(b). The Commission has adopted definitions for the term "small entity" for the purposes of rulemaking in accordance with the RFA. These definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10.

274 *See* 5 U.S.C. 605(b).

affiliated with any person (other than a natural person) that is not a small business or small organization.[275]

Based on the Commission's existing information about the clearing agencies currently registered with the Commission,[276] the Commission believes that all such registered clearing agencies exceed the thresholds defining "small entities" set out above. While other clearing agencies may emerge and seek to register as clearing agencies with the Commission, the Commission believes that no such entities would be "small entities" as defined in Exchange Act Rule 0-10.[277]

B. Certification

For the reasons described above, the Commission certifies that proposed Rule 17Ad-25 would not have a significant economic impact on a substantial number of small entities for purposes of the RFA. The Commission requests comment regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities and

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275 *See* 17 CFR 240.0-10(d).

276 In 2021, DTCC processed $2.37 quadrillion in financial transactions. Within DTCC, DTC settled $152 trillion of securities and held securities valued at $87.1 trillion, NSCC processed an average daily value of $2.029 trillion in equity securities, and FICC cleared $1.4 quadrillion of transactions in government securities and $69 trillion of transactions in agency mortgage-backed securities. *See* DTCC, 2021 Annual Report, https://www.dtcc.com/annuals/2021/. ICE averaged daily trade volume of 5.97 million contracts and total revenues of $7.1 billion in 2021. *See* ICE, 2021 Annual Report, https://s2.q4cdn.com/154085107/files/doc_financials/2021/ar/250217_009_Web_BMK-(1).pdf. In addition, OCC cleared more than 7.5 billion contracts and held margin of $180 billion at the end of 2020. *See* OCC, 2020 Annual Report, https://annualreport.theocc.com/. These trade volumes exceed the $500 million threshold for small entities.

277 *See* 17 CFR 240.0-10(d). The Commission based this determination on its review of public sources of financial information about registered clearing agencies.

provide empirical data to support the extent of the impact. Persons wishing to submit written comments should refer to the instructions for submitting comments in the front of this release.

VIII. Statutory Authority and Text of Proposed Rule

The Commission is proposing Rule 17Ad-25 under the Commission's rulemaking authority in the Exchange Act, particularly Section 17(a), 15 U.S.C. 78q(a), Section 17A, 15 U.S.C. 78q-1, Section 23(a), 15 U.S.C. 78w(a), Section 765 of the Dodd-Frank Act, and 805 of the Clearing Supervision Act, 15 U.S.C. 8343 and 15 U.S.C. 5464 respectively.

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

Text of Amendment

In accordance with the foregoing, title 17, chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78dd, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; Pub. L. 111-203, 939A, 124 Stat. 1376 (2010); and Pub. L. 112-106, sec. 503 and 602, 126 Stat. 326 (2012), unless otherwise noted.

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2. Section 240.17Ad-25 is added to read as follows:

§ 240.17Ad-25 Clearing agency boards of directors and conflicts of interest.

(a) *Definitions*. All terms used in this section have the same meaning as in the Securities Exchange Act of 1934, and unless the context otherwise requires, the following definitions apply for purposes of this section:

Affiliate means a person that directly or indirectly controls, is controlled by, or is under common control with the registered clearing agency.

Board of directors means the board of directors or equivalent governing body of the registered clearing agency.

Director means a member of the board of directors or equivalent governing body of the registered clearing agency.

Family member means any child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, niece, nephew, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, including adoptive relationships, any person (other than a tenant or employee) sharing a household with the director or a nominee for director, a trust in which these persons (or the director or a nominee for director) have more than fifty percent of the beneficial interest, a foundation in which these persons (or the director or a nominee for director) control the management of assets, and any other entity in which these persons (or the director or a nominee for director) own more than fifty percent of the voting interests.

Independent director means a director of the registered clearing agency who has no material relationship with the registered clearing agency or any affiliate thereof.

Material relationship means a relationship, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the director. A material

relationship also includes a relationship that existed during a lookback period of one year counting back from making the initial determination in paragraph (b)(2) of this section.

Service provider for critical services means any person that is contractually obligated to the registered clearing agency for the purpose of supporting clearance and settlement functionality or any other purposes material to the business of the registered clearing agency.

(b) *Composition of the board of directors*. (1) A majority of the members of the board of directors of a registered clearing agency must be independent directors, unless a majority of the voting rights issued as of the immediately prior record date are directly or indirectly held by participants, in which case at least 34 percent of the members of the board of directors must be independent directors.

(2) Each registered clearing agency shall broadly consider all the relevant facts and circumstances, including under paragraph (g) of this section, on an ongoing basis, to affirmatively determine that a director does not have a material relationship with the registered clearing agency or an affiliate of the registered clearing agency, and is not precluded from being an independent director under paragraph (f) of this section, in order to qualify as an independent director. In making such determination, a registered clearing agency must:

(i) Identify the relationships between a director, the registered clearing agency, and any affiliate thereof and any circumstances under paragraph (f) of this section;

(ii) Evaluate whether any relationship is likely to impair the independence of the director in performing the duties of director; and

(iii) Document this determination in writing.

(c) *Nominating committee*. (1) Each registered clearing agency must establish a nominating committee and a written evaluation process whereby such nominating committee shall evaluate nominees for serving as directors.

(2) A majority of the directors serving on the nominating committee must be independent directors, and the chair of the nominating committee must be an independent director.

(3) The fitness standards for serving as a director shall be specified by the nominating committee, documented in writing, and approved by the board of directors. Such fitness standards must be consistent with the requirements of this section and include that the individual is not subject to any statutory disqualification as defined under Section 3(a)(39) of the Act.

(4) The nominating committee must document the outcome of the written evaluation process consistent with the fitness standards required under paragraph (c)(3) of this section. Such process shall:

(i) Take into account each nominee's expertise, availability, and integrity, and demonstrate that the board of directors, taken as a whole, has a diversity of skills, knowledge, experience, and perspectives;

(ii) Demonstrate that the nominating committee has considered whether a particular nominee would complement the other board members, such that, if elected, the board of directors, taken as a whole, would represent the views of the owners and participants, including a selection of directors that reflects the range of different business strategies, models, and sizes across participants, as well as the range of customers and clients the participants serve;

(iii) Demonstrate that the nominating committee considered the views of other stakeholders who may be impacted by the decisions of the registered clearing agency, including

transfer agents, settlement banks, nostro agents, liquidity providers, technology or other service providers; and

(iv) Identify whether each selected nominee would meet the definition of independent director in paragraphs (a) and (f) of this section, and whether each selected nominee has a known material relationship with the registered clearing agency or any affiliate thereof, an owner, a participant, or a representative of another stakeholder of the registered clearing agency described in paragraph (c)(4)(iii) of this section.

(d) *Risk management committee*. (1) Each registered clearing agency must establish a risk management committee (or committees) to assist the board of directors in overseeing the risk management of the registered clearing agency. The membership of each risk management committee must be reconstituted on a regular basis and at all times include representatives from the owners and participants of the registered clearing agency.

(2) In the performance of its duties, the risk management committee must be able to provide a risk-based, independent, and informed opinion on all matters presented to the committee for consideration in a manner that supports the safety and efficiency of the registered clearing agency.

(e) *Committees generally*. If any committee has the authority to act on behalf of the board of directors, the composition of that committee must have at least the same percentage of independent directors as is required for the board of directors, as set forth in paragraph (b)(1) of this section.

(f) *Circumstances that preclude directors from being independent directors*. In addition to how the definition of independent director set forth in this section is applied by a registered clearing agency, the following circumstances preclude a director from being an independent

director, subject to a lookback period of one year (counting back from making the initial determination in paragraph (b)(2) of this section) applying to paragraphs (f)(2) through (6) of this section:

(1) The director is subject to rules, policies, or procedures by the registered clearing agency that may undermine the director's ability to operate unimpeded, such as removal by less than a majority vote of shares that are entitled to vote in such director's election;

(2) The director, or a family member, has an employment relationship with or otherwise receives compensation other than as a director from the registered clearing agency or any affiliate thereof, or the holder of a controlling voting interest of the registered clearing agency;

(3) The director, or a family member, is receiving payments from the registered clearing agency, or any affiliate thereof, or the holder of a controlling voting interest of the registered clearing agency, that reasonably could affect the independent judgment or decision-making of the director, other than the following:

(i) Compensation for services as a director on the board of directors or a committee thereof; or

(ii) Pension and other forms of deferred compensation for prior services not contingent on continued service;

(4) The director, or a family member, is a partner in, or controlling shareholder of, any organization to or from which the registered clearing agency, or any affiliate thereof, or the holder of a controlling voting interest of the registered clearing agency, is making or receiving payments for property or services, other than the following:

(i) Payments arising solely from investments in the securities of the registered clearing agency, or affiliate thereof; or

(ii) Payments under non-discretionary charitable contribution matching programs;

(5) The director, or a family member, is employed as an executive officer of another entity where any executive officers of the registered clearing agency serve on that entity's compensation committee; or

(6) The director, or a family member, is a partner of the outside auditor of the registered clearing agency, or any affiliate thereof, or an employee of the outside auditor who is working on the audit of the registered clearing agency, or any affiliate thereof.

(g) *Conflicts of interest*. Each registered clearing agency must establish, implement, maintain and enforce written policies and procedures reasonably designed to:

(1) Identify and document existing or potential conflicts of interest in the decision-making process of the clearing agency involving directors or senior managers of the registered clearing agency; and

(2) Mitigate or eliminate and document the mitigation or elimination of such conflicts of interest.

(h) *Obligation of directors to report conflicts*. Each registered clearing agency must establish, implement, maintain, and enforce written policies and procedures reasonably designed to require a director to document and inform the registered clearing agency promptly of the existence of any relationship or interest that reasonably could affect the independent judgment or decision-making of the director.

(i) *Obligation of board of directors to oversee relationships with service providers for critical services*. Each registered clearing agency must establish, implement, maintain, and enforce written policies and procedures reasonably designed to enable the board of directors to:

(1) Confirm and document that risks related to relationships with service providers for critical services are managed in a manner consistent with its risk management framework, and review senior management's monitoring of relationships with service providers for critical services;

(2) Approve policies and procedures that govern the relationship with service providers for critical services;

(3) Review and approve plans for entering into third-party relationships where the engagement entails being a service provider for critical services to the registered clearing agency; and

(4) Through regular reporting to the board of directors by senior management, confirm that senior management takes appropriate actions to remedy significant deterioration in performance or address changing risks or material issues identified through ongoing monitoring.

(j) *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 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 governance and operations on a recurring basis.

By the Commission.

Dated: August 8, 2022.

Vanessa A. Countryman,
Secretary.