September 13, 2019

Via Electronic Submission and Email

Christopher Kirkpatrick
Secretary of the Commission
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Derivatives Clearing Organization General Provisions and Core Principles (RIN 3038-AE66)

Dear Mr. Kirkpatrick:

The Futures Industry Association ("**FIA**") and the International Swaps and Derivatives Association ("**ISDA**") (collectively, the "**Associations**") appreciate the opportunity to comment on the Commodity Futures Trading Commission's ("**Commission**" or "**CFTC**") notice of proposed rulemaking entitled "Derivatives Clearing Organization General Provisions and Core Principles" (the "**DCO Proposed Rule**").[1] The Associations support the Commission's effort to enhance the rules governing various aspects of the Core Principles applicable to derivatives clearing organizations ("**DCOs**"). Because clearing members act as integral intermediaries and risk managers in the framework for clearing listed and over-the-counter derivatives, the Associations' clearing members have a significant interest in a regulatory and governance framework that promotes the resiliency of DCOs.

As detailed further below, the Associations support many of the Commission's proposed clarifications of and amendments to the regulations applicable to DCOs. However, the

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[1] 84 Fed. Reg. 22226 (May 16, 2019). The Futures Industry Association is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members play a critical role in the reduction of systemic risk in global financial markets. Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 71 countries. ISDA's members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearinghouses and repositories, as well as law firms, accounting firms and other service providers.

Associations recommend that the Commission amend or reissue certain proposed rule changes after further consultation with clearing members and DCOs in order to ensure that the regulatory framework supports the transparent, efficient and safe clearing of derivatives.

I. Summary of the Associations' Comments

The Associations focus their comments primarily on the aspects of the proposed rule that would directly or indirectly affect the obligations and responsibilities of clearing members. For the convenience of the Commission and Staff, the Associations summarize below their specific comments, recommendations and requests:

- The Associations support the proposed amendment clarifying the requirement to obtain written acknowledgments from DCO depositories;
- The Commission should consider and propose a requirement that a DCO's financial resources include a reasonable minimum of its own capital that aligns its default risk management interests with those of clearing members;
- A DCO should be allowed to include in its financial resource calculation excess collateral that cannot be voluntarily withdrawn;
- A DCO should not be allowed to rely upon assessments to meet its financial resources requirement;
- The Associations support treating a committed line of credit as a permitted default resource to cover credit losses;
- The Commission should retain the existing requirement that a DCO "ensure" that its operations would not be disrupted and that non-defaulting clearing members would not be exposed to unanticipated or uncontrollable losses in the event of a member default;
- The Commission should define "concentration risk" and specify additional risk factors that a DCO must consider in establishing initial margin requirements;
- The Associations support annual validation of a DCO's systems for generating initial margin requirements;
- Employees of an affiliate of a DCO should not be eligible to conduct a validation of a DCO's initial margin model;
- A DCO should be required to consult with its risk committee as part of its initial margin model validation;
- A DCO should share the findings of its initial margin model validation with clearing members;
- A DCO should not require risk committee members to sign overly broad non-disclosure agreements;

- The Commission should not require the collection and/or reporting of gross customer margin on an intraday basis;
- The proposed changes to customer initial margin requirements may impose an operationally impractical regime for clearing members to collect initial margin from customers;
- The Commission should codify no-action relief which clarifies that the initial margin requirements in Rule 39.13(g)(8)(ii) do not apply to security futures positions;
- The Commission should address in a re-proposed rule the initial margin issues for separate accounts raised in Staff Letter No. 19-17;
- The Associations support the Commission's proposal to require that a DCO evaluate on a monthly basis the appropriateness of haircuts applicable to assets accepted for initial margin;
- Prior to requiring that a DCO impose hard risk limits on a clearing member for positions that may be difficult to liquidate, the Commission should consult with clearing members;
- The Commission should not require a DCO to take action to address concerns resulting from a review of a clearing member's risk management policies and procedures;
- The Associations support the proposed codification of the Commission's evaluation of cross-margining arrangements, and recommend additional factors for review;
- The Associations support the proposed clarification regarding when customer positions and related funds must be transferred because it reflects current market practice;
- The proposed requirement that a DCO include clearing members in a test of its default management plan should also include "Participants";
- The proposed DCO default committee should convene in the event of a "material" default;
- The Commission should provide a DCO with flexibility concerning how and when it provides notice of a declaration of default;
- The Commission should propose an amended process for liquidating or allocating a defaulting clearing member's positions;
    - A DCO should utilize an auction format to close out a defaulting clearing member's positions only when liquidation via a central limit order book is not practical;
    - A DCO should be required to consult with clearing members in designing auction procedures;

  - If closing out a defaulting clearing member's positions via a central limit order book or auction fails, the DCO should not be authorized to forcibly allocate positions to non-defaulting clearing members;

- The Commission should confirm that its proposed amendments to a DCO's rule enforcement obligations are non-substantive;
- The Commission should consult further with DCOs and clearing members prior to imposing the proposed daily reporting requirements based upon ownership of an account;
- The proposed requirement that a DCO notify the Commission of a margin model issue also should require notice to clearing members and should include inaccurate margin calls;
- The Commission should clarify when a DCO must submit recovery and wind-down plans;
- The proposed requirement that a DCO provide the Commission with advance notice of a new product accepted for clearing should apply to novel and complex products, and should include notice to, and require consultation with, clearing members;
- The Associations support the proposed requirement that a DCO make certain information available on its website as opposed to its rulebook;
- The Commission should propose and adopt the following additional enhancements to DCO risk governance. In particular, the Commission should:
  - Propose a public comment process, similar to the process required in current Rule 40.6(c), for systemically important DCO rule changes that raise novel or complex issues;
  - Require a DCO to consult with clearing members in advance of proposing non-emergency material rule changes;
  - Require a DCO to seek clearing member and end-user input in advance of making key risk decisions;
  - Require a DCO to disclose in any rule change filed with the Commission whether the DCO did not implement feedback from clearing members and/or end-users;
  - Require a DCO to consult with clearing members prior to approving new categories and types of acceptable collateral;
- The Associations support codification of no-action relief related to fully collateralized positions; and
- The Commission's rules should ensure that clearing members are not responsible for a DCO's non-default losses and require that a DCO maintain adequate capital to address those types of losses.

II. The Associations Support the Proposed Amendment Clarifying the Requirement to Obtain Written Acknowledgments from DCO Depositories – Rule 1.20

Under current Rule 1.20(d)(1), a futures commission merchant ("FCM") must obtain a written acknowledgement from each depository with which the FCM deposits futures customer funds. However, an FCM is not required to obtain a written acknowledgement from a DCO that has adopted rules providing for the segregation of customer funds in accordance with the Commodity Exchange Act, as amended ("**CEA**"), and CFTC rules. The Commission proposes to clarify that, if a DCO has adopted rules that provide for the segregation of customer funds, then the information-sharing requirements specified in Rules 1.20(d)(3) through (6) do not apply.[2] According to the Commission, "[t]he proposed changes are not intended to be substantive, but rather reflect the Commission's intent when [Rule] 1.20 was last amended."[3]

The Associations support the proposed clarification, and agree that it is a non-substantive change. This clarification would ensure that the Commission's rules would be interpreted in a manner that avoids redundant information-sharing arrangements. As noted in the DCO Proposed Rule, the Commission already has extensive oversight authority over DCOs, and thus has "ample means of obtaining information regarding accounts held at a DCO under [Rule] 1.20 by virtue of its ongoing oversight and supervision of DCOs."[4]

III. DCO Financial Resources – Rule 39.11

A. The Commission Should Consider and Re-Propose a Requirement that a DCO's Financial Resources Include a Reasonable Minimum of Its Own Capital

Proposed Rule 39.11(c)(1) would add minimum requirements that a DCO would have to satisfy in determining its financial resources requirement. The additional minimum requirements focus on clearing member contributions to the DCO. The Associations believe that the Commission should consider and re-propose additional mechanisms to enhance a DCO's financial resources beyond those in proposed Rule 39.11(c).

In particular, as the Associations have commented in the past, the financial resources requirement that the Commission imposes on a DCO should ensure that a DCO's own capital contribution is set at an appropriate level (so-called "skin in the game") to align the interests of a DCO with those of its clearing members.[5] The Associations believe that a central counterparty

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[2] Similarly, the Commission proposes to amend Rules 1.20(d)(7) and (8) related to an FCM's obligation to file copies of the written acknowledgments to account for FCMs that are not required to obtain written acknowledgements as a result of the proposed amendments to Rule 1.20(d)(1).

[3] DCO Proposed Rule at 22227.

[4] *Id.*

[5] *See* Letter from Walt L. Lukken, President and CEO, FIA, to Christopher Kirkpatrick, Secretary, CFTC, in response to Project Kiss (Sept. 28, 2017) *available at* https://fia.org/file/5996/download?token=8HAKRUY0. *See also* ISDA CCP Best Practices Whitepaper (January 2019) *available at* https://www.isda.org/a/cigME/CCP-Best-Practice.pdf.

("**CCP**") should be required to contribute an amount to the default waterfall that is material to, and commensurate with the amount of risk cleared by, the CCP. Having sufficient skin in the game relative to the aggregate default fund would incentivize the CCP and its shareholders to engage in prudent risk management prior to and during a stress event because they would share in any resulting losses. Furthermore, setting a DCO's minimum financial resources based, in part, upon a DCO's capital contribution would help to ensure the DCO's resiliency in variable market conditions.

B. The Commission Should Clarify that a DCO's Financial Resource Calculation May Include Excess Collateral that Cannot be Voluntarily Withdrawn – Rule 39.11(c)(2)(i)(A)

The Commission proposes to add Rule 39.11(c)(2)(i)(A) specifying that a DCO may not take into account excess collateral on deposit or initial margin required, but not yet received, when calculating its required financial resources. The Commission noted that the proposed clarifications were consistent with the Committee on Payments and Market Infrastructures ("**CPMI**") and the Board of the International Organization of Securities Commissions ("**IOSCO**") July 2017 Report on the Resilience of Central Counterparties: Further Guidance on the PFMI ("**CPMI-IOSCO July 2017 Report**").[6]

The Associations support proposed Rule 39.11(c)(2)(i)(A), but recommend that the Commission clarify what is meant by "excess collateral on deposit." The CPMI-IOSCO July 2017 Report, which the Commission cites as support for the new rule, states that a "CCP should ignore any voluntary, excess contributions from participants. Since the Contributions are voluntary, a participant may withdraw or decrease any excess deposits during times of stress."[7] The Associations agree that a DCO should not take into account a voluntary contribution when calculating its financial resources. If, on the other hand, a clearing member's excess contribution cannot be voluntarily withdrawn, the Commission should permit a DCO to take the excess contribution into account as part of its financial resource calculation. The Associations ask that the Commission amend the DCO Proposed Rule accordingly.

C. The Commission Should Not Allow A DCO to Rely Upon Assessments to Meet Its Financial Resources Requirement – Rule 39.11(d)(2)

The Commission proposes to clarify one condition in Rule 39.11(d)(2) that applies to a DCO's use of assessments for additional guaranty fund contributions in calculating the financial resources available to meet its obligations under Rule 39.11(a)(1). Rather than clarifying one such condition, the Associations request that the Commission amend Rule 39.11(d)(2) to prohibit the use of assessments because assessments are unfunded resources. When calculating its financial resources, a DCO should only be allowed to include resources that are fully funded. The Associations' recommendation is consistent with European regulations applicable to central

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6 DCO Proposed Rule at 22233.

7 CPMI-IOSCO July 2017 Report at 4.2.5.

counterparties.[8] The Associations believe that the Commission should harmonize Rule 39.11(d)(2) with the European regulations to enhance risk management.

D. The Associations Support Treating a Committed Line of Credit as a Permitted Default Resource – Rule 39.11(e)(3)

The Commission proposes to clarify that a committed line of credit or similar facility is a permitted default resource up to the amount allowed under Rule 39.11(e)(1)(ii), provided that it is not counted twice to meet the requirements of Rules 39.11(e)(1)(ii) and (e)(2). The Associations support the proposed clarification because it makes express the Commission's intention for a DCO to utilize a committed line of credit or similar facility under these circumstances.

IV. DCO Risk Management – Rule 39.13

A. The Commission Should Retain the Existing Requirement that a DCO "Ensure" that Its Operations Would Not Be Disrupted and that Non-Defaulting Clearing Members Would Not Be Exposed to Unanticipated or Uncontrollable Losses – Rule 39.13(f)

Rule 39.13(f) currently requires a DCO to limit its exposure to potential losses from clearing member defaults to "ensure" that the DCO's operations would not be disrupted and that non-defaulting clearing members would not be exposed to unanticipated or uncontrollable losses. In the DCO Proposed Rule, the Commission stated that it "recognizes that a DCO cannot ensure protection from that which it cannot anticipate."[9] Therefore, the Commission proposes "to replace 'ensure' with 'minimize the risk' and make conforming changes to paragraphs (f)(1) and (2) of Rule 39.13."[10]

The Associations request that the Commission retain the original language requiring a DCO to limit its exposure to potential losses from clearing member defaults to "ensure" that its operations would not be disrupted and that non-defaulting clearing members would not be exposed to unanticipated or uncontrollable losses. The Associations are concerned that the proposed change from "ensure" to "minimize the risk" would increase the potential for non-defaulting clearing members to be exposed to uncapped liability. "Minimizing the risk" suggests that members could be subject to uncontrollable and unquantifiable liability; exposure that is contrary to the sound risk management principles to which members are subject. To address the Commission's observation about the ability of a DCO to "ensure" against unanticipated losses, it could revise the language in current Rule 39.13(f) as follows: "A derivatives clearing organization shall limit its exposure to potential losses from defaults by clearing members

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8 Regulation (EU) No 648/2012 of the European Parliament and the Council, Article 43.3 (4 July 2012).

9 DCO Proposed Rule at 22235.

10 *Id.*

through margin requirements and other risk control mechanisms reasonably designed to ensure that. . . ."

If the Commission nevertheless decides to adopt the proposed change, the Associations request that the Commission explain that the proposed change clarifies, but does not alter, a DCO's existing obligations. In particular, the proposed change should not permit a DCO to be any less stringent in managing the risk of disruption to its operations or increase the potential exposure for clearing members.

B. The Commission Should Specify in a Re-Proposed Rule the Definition of "Concentration Risk" and Specify Additional Risk Factors that a DCO Must Consider in Establishing Initial Margin Requirements – Rule 39.13(g)(2)

The Commission proposes changes to Rule 39.13(g)(2)(i), which currently requires a DCO to establish initial margin requirements that "are commensurate with the risk of each product and portfolio, including any unusual characteristics, or risk associated with particular products or portfolios." More specifically, current Rule 39.13(g)(2)(i) expressly requires a DCO to consider risk related to "jump-to-default risk or similar risk." The Commission's proposal would expressly require a DCO to consider "concentration of positions" risk.

The Associations agree that a DCO should consider "concentration risk" when establishing initial margin requirements. However, the Associations request that the Commission define "concentration risk" in a re-proposed rule. For example, concentration risk could be defined to include positions that cannot be closed in a two-day period. Alternatively, concentration risk could be more broadly defined. The Associations recommend that initial margin should cover concentration risk over the period that it would take to liquidate a defaulting participant's positions. In addition, the Associations recommend that initial margin requirements consider the "concentration risk" of open positions relative to product liquidity and percentage of open interest. The Associations also recommend that a DCO's initial margin requirements evaluate concentration risk at an account level. To accomplish this, the Commission should specify in a re-proposal that a DCO must provide sufficient reports to clearing members to enable them to collect the requisite margin at an account level. Finally, the Associations request that the Commission require in a re-proposal that a DCO consider other risk factors, such as correlation and pro-cyclicality, when determining its initial margin requirements.

C. The Associations Recommend Enhancements to the Proposed Initial Margin Model Validation Process – Rule 39.13(g)(3)

The Commission proposes to amend Rule 39.13(g)(3) regarding the review and validation of initial margin models. At present, the rule requires that the initial margin models be reviewed and validated by a qualified and independent party on a regular basis. The validation may be conducted by independent contractors or employees of the DCO, as long as they are not responsible for the development or operation of the systems and models being tested. The

Commission proposes to amend this provision to replace "on a regular basis" with "on an annual basis," and also to permit employees of an affiliate of the DCO to conduct the validations.[11]

1. The Associations Support Annual Validation

The Associations support the Commission's proposal to replace the requirement to review and validate margin models on a "regular basis" with a requirement to do so "on an annual" basis. An annual review is sufficient to ensure that a DCO's systems and models for generating initial margin requirements are working reasonably well and adequately protect the DCO and clearing members from the risk of a default.[12]

2. The Commission Should Specify in a Re-Proposed Rule that Employees of an Affiliate of a DCO Are Not Eligible to Conduct a Validation of a DCO's Initial Margin Model

The Associations request that the Commission withdraw its proposed rule allowing employees of an affiliate of a DCO to conduct an initial margin model validation and, instead, require in a re-proposed rule that a qualified and independent third party must conduct the initial margin model validation. Although the employees of a DCO (or an affiliate of the DCO) technically may be qualified to conduct a validation, the Associations are concerned that these employees may not be independent evaluators of the initial margin models. For example, if the employees validate the same initial margin models used by more than one affiliated DCO, they may not independently analyze whether the same model is appropriate for different products cleared by the affiliated DCOs.

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[11] DCO Proposed Rule at 22235.

[12] The Associations support allowing a DCO to exercise discretion concerning the extent of the annual validation process depending, for example, on whether material changes have been made to the margin model since the prior validation. If not, it may be appropriate for a DCO to review and affirm an earlier validation as part of the annual validation process. *See, e.g., Board of Governors of the Federal Reserve System, Division of Supervision of Regulation, Bank Holding Company Supervision Manual – Model Risk Management*, Section 2126.0.5 (Feb. 2019), *available at* https://www.federalreserve.gov/publications/files/bhc.pdf. ("Banks should conduct a periodic review—at least annually but more frequently if warranted—of each model to determine whether it is working as intended and if the existing validation activities are sufficient. Such a determination could simply affirm previous validation work, suggest updates to previous validation activities, or call for additional validation activities. Material changes to models should also be subject to validation. It is generally good practice for banks to ensure that all models undergo the full validation process . . . at some fixed interval, including updated documentation of all activities.").

3. The Commission Should Re-Propose Several Adjustments to a DCO's Initial Margin Model Validation Process to Increase Transparency

a. A DCO Must Consult with Its Risk Committee as Part of Initial Margin Model Validation

The Commission should require that a DCO provide transparency to clearing members about the validation of its initial margin models. Prior to validating its initial margin models, a DCO should be required to consult with the DCO's Risk Committee and permit Committee members to consult with their own internal experts about the validity of the DCO's margin models. For example, a DCO should be required to inform Committee members about how the models are calibrated. Requiring the involvement of the DCO's Risk Committee (as informed by member internal experts) would help to ensure that a sufficiently representative number of stakeholders are involved in the model validation process.

b. A DCO Should Share the Findings of an Initial Margin Model Validation with Clearing Members

The Commission also should require that a DCO make available to clearing members any findings that result from the review and validation of its initial margin model. Because a DCO's initial margin models place the financial resources of clearing members at risk, clearing members have a strong interest in the review and validation of the models. Consequently, clearing members should have access to any findings related to the review and validation of the DCO's initial margin model.

c. A DCO Should Not Be Permitted to Require Risk Committee Members to Sign Overly Broad Non-Disclosure Agreements

Some DCOs require that clearing member representatives on a DCO's Risk Committee sign a non-disclosure agreement ("**NDA**") that prevents the representative from consulting with his/her own in-house experts at the clearing member. Although some form of NDA may be appropriate to limit the disclosure of confidential information to third parties, the Commission should not permit the use of broad NDAs that prevent representatives of the DCO's Risk Committee from consulting with in-house experts. Such overly broad NDAs may impede prudent risk-management. NDAs should be narrowly tailored to prevent the inappropriate use and disclosure of confidential information, but also should enable clearing member representatives to consult with experienced in-house risk managers.

D. The Commission Should Not Require the Collection and/or Reporting of Gross Customer Margin on an Intraday Basis – Rule 39.13(g)(8)(i)

The Commission proposes to amend Rule 39.13(g)(8)(i) to require a DCO to collect customer initial margin from its clearing members on a gross basis only during its end-of-day settlement cycle, in light of the operational issues that may arise intraday. However, the

Commission strongly encourages a DCO to collect customer initial margin from its clearing members on a gross basis during any intraday settlement cycle in which the DCO collects customer initial margin, if it is able to calculate the margin accurately. The Commission requests comment as to whether this is the correct approach or whether there are other alternatives that would address the collection of intraday gross margin.[13]

The Commission should not encourage a DCO to collect gross customer margin on an intraday settlement cycle because it would create significant operational problems. Similarly, reporting gross customer positions on an intraday settlement cycle also would be operationally challenging. For example, initial margin is a portfolio calculation and customers trade until end of day. Because trades might not settle into the ultimate account for which the margin calculation should be performed until the close of the DCO's clearing and allocation window, it would be difficult to calculate initial margin on an intraday basis while trading and clearing activity is ongoing. In addition, instructions to "give out" certain trades on an "execution only" basis would only be made available to clearing members by end of day, which would also make margin calculations before these instructions have been received and acted upon impractical and incomplete.

E. Clearing Members and the Collection of Customer Initial Margin – Rule 39.13(g)(8)(ii)

1. The Proposed Change to Customer Initial Margin Requirements May Impose an Operationally Impractical Regime for Clearing Members to Collect Initial Margin from Customers – Rule 39.13(g)(8)(ii)

Current Rule 39.13(g)(8)(ii) provides that a DCO must require its clearing members to collect initial margin from customers "for non-hedge positions, at a level that is greater than 100 percent of the [DCO's] initial margin requirements with respect to each product and swap portfolio." The Commission proposes to amend Rule 39.13(g)(8)(ii) by deleting the reference to "non-hedge" positions, changing the reference to "a level that is greater than 100 percent" to "a level that is not less than 100 percent," clarifying that the customer initial margin level is measured against "clearing" initial margin requirements, and explicitly stating that customer initial margin levels must be "commensurate with the risk presented by each customer account."[14]

The Associations are concerned that this approach would give DCOs too much discretion and encourage DCOs to apply differing measures to assess additional margin. Clearing members need to be able to rely on a common approach among DCOs. If there are different measures versus consistent speculative criteria, it might be difficult to manage different data points per DCO in determining and assessing incremental margin amounts. Moreover, currently there are

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[13] DCO Proposed Rule at 22236-37.

[14] DCO Proposed Rule at 22236.

two rates of margin; one that applies to hedging portfolios and one that applies to speculative portfolios. If the proposal leads to additional categories of margin being created, it would impose significant infrastructure and processing burdens for clearing members.

2. The Commission Should Codify No-Action Relief Which Clarifies that the Initial Margin Requirements in Rule 39.13(g)(8)(ii) Do Not Apply to Security Futures Positions

Regardless of whether the Commission adopts the proposed changes to Rule 39.13(g)(8)(ii), the Associations request that the Commission codify a prior Commission Staff interpretation that this rule "does not apply to customer initial margin collected as performance bond for customer security futures positions."[15] In particular, Rule 39.13(g)(8)(ii) should be amended by inserting after the word "product," the words "other than security futures contracts and options thereon" to clarify that different initial margin requirements apply to security futures products.

F. The Commission Should Address in a Re-Proposed Rule the Initial Margin Issues for Separate Accounts Raised in Staff Letter No. 19-17 – Rule 39.13(g)(8)(iii)

Rule 39.13(g)(8)(iii) obligates a DCO to require its clearing members to ensure that the clearing members' customers do not withdraw funds from their accounts unless the net liquidating value plus the margin deposits remaining in the customer's account would be sufficient to meet the customer's initial margin requirements. On July 10, 2019, Commission Staff issued no-action relief to address the application of Rule 39.13(g)(8)(iii) to separate accounts of the same customer.[16] The no-action relief, which expires at the end of the day on June 30, 2021, states that the Commission will consider "whether to conduct, and if so, to in fact conduct, a rulemaking to implement appropriate relief on a permanent basis."[17] Because the DCO Proposed Rule addresses the initial margin requirements in Part 39, the Associations request that the Commission re-propose amendments to Rule 39.13(g)(8)(iii) to incorporate appropriate relief with respect to separate accounts of the same customer.

G. The Associations Support the Proposed Requirement that a DCO Evaluate on a Monthly Basis the Appropriateness of Haircuts Applicable to Assets Accepted for Initial Margin – Rule 39.13(g)(12)

Rule 39.13(g)(12) currently requires a DCO to evaluate on a quarterly basis the appropriateness of haircuts that it applies to reflect credit, market and liquidity risk for initial

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[15] *See* CFTC Letter No. 12-08, Section IV (Sept. 14, 2012). *See also Customer Margin Rules Relating to Security Futures*, 84 Fed. Reg. 36434 (July 26, 2019) (proposed rule).

[16] *See* CFTC Letter No. 19-17 (July 10, 2019).

[17] *Id*. at 3.

margin obligations. The Commission proposes to amend Rule 39.13(g)(12) to require a DCO to evaluate the appropriateness of these haircuts on a monthly basis instead.

The Associations support the Commission's proposal. As the Commission notes in the release, given the frequent changes in the value of assets held for initial margin, it would be appropriate for a DCO to assess the value of the haircuts more frequently. In addition, the proposed change would align the requirement to review initial margin haircuts on a monthly basis with the DCO's requirement to review haircuts on a monthly basis for the DCO's financial resources obligations.

H. Prior to Requiring that a DCO Impose Hard Risk Limits on a Clearing Member for Positions that May Be Difficult to Liquidate, the Commission Should Consult with Clearing Members – Rule 39.13(h)(1)(i)

Rule 39.13(h)(1)(i) currently requires a DCO to impose risk limits on each clearing member, by house origin and by each customer origin, in order to prevent a clearing member from carrying positions for which the risk exposure exceeds a specified threshold relative to the clearing member's and/or the DCO's financial resources. The Commission proposes to add a requirement that the risk limits in Rule 39.13(h)(1)(i) also should address positions that may be difficult to liquidate.[18]

The proposed imposition of hard risk limits on positions that may be difficult to liquidate would be a significant departure from current risk management practices for clearing members. At present, clearing members typically require more margin when a position is riskier (referred to as "super margin"). If a DCO's discretion to impose hard limits inhibits the ability of clearing members to collect super margin, or to implement other prudent risk management practices, the Associations are concerned that this proposal may have the unintended consequence of inhibiting prudent risk-management. Furthermore, this aspect of the DCO Proposed Rule does not provide sufficient notice or detail about how a DCO might implement limits for positions that may be difficult to liquidate. Consequently, it is difficult for the Associations to provide meaningful comments to the Commission. Because this proposal would significantly change current market practices, the Associations request that the Commission withdraw this aspect of the DCO Proposed Rule. Instead, the Commission should consult with DCOs and clearing members about how best to risk-manage positions that are difficult to liquidate.

I. The Commission Should Not Require a DCO to Take Action to Address Concerns Resulting from a Review of a Clearing Member's Risk Management Policies and Procedures – Rule 39.13(h)(5)

Rule 39.13(h)(5)(ii) requires a DCO, on a periodic basis, to review the risk management policies, procedures, and practices of each of its clearing members that address the risks that clearing members may pose to the DCO, and to document such reviews. The DCO Proposed

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[18] DCO Proposed Rule at 22237.

Rule provides that after conducting a review, a DCO must "take appropriate actions to address concerns identified in such reviews, and document such reviews and the basis for determining what action was appropriate to take." According to the Commission, the reason for the additional requirement to take appropriate action is that "[a]bsent such follow-up, the reviews would lack purpose."[19]

The Associations believe that the proposed addition to Rule 39.13(h)(5)(ii) is unnecessary because the process that a DCO and clearing members follow under the current rule is sufficient to address any concerns about an FCM's risk management policies and procedures. Under the current rule, a DCO and clearing members work collaboratively to resolve concerns about risk management policies and procedures. The Associations are concerned that imposing a new requirement on a DCO to take affirmative action to address concerns about risk management policies and procedures would create an "enforcement mentality" that might impede the ability of a DCO and clearing members working collaboratively to resolve risk management issues. If, despite the concerns raised by the Associations, the Commission nevertheless adopts its proposed rule change, the Associations request that the Commission expressly state that any "action" taken by the DCOs should be implemented collaboratively and not inhibit the effective application of a clearing member's risk management policies and procedures.

J. The Associations Support the Proposed Codification of the Commission's Evaluation of Cross-Margining Arrangements, and Recommend Additional Factors for Review – Rule 39.13(i)

As proposed, new Rule 39.13(i) would codify the Commission's existing practices for evaluating cross-margining arrangements between DCOs. According to the Commission, when evaluating cross-margining arrangements, it reviews: "(1) The methodology to be used to calculate margin requirements for the positions subject to the cross-margining arrangement; (2) the correlation between the positions, including the stability of the relationship among the eligible products and the potential impact a change in the correlation could have on setting margin requirements; (3) the impact on the settlement process; and (4) the application of default procedures, including any loss-sharing arrangements, pursuant to the proposed arrangement."[20] If only one of the clearing organizations participating in the cross-margining arrangement is a registered DCO, the Commission analyzes additional factors, such as the other clearing organization's status with and oversight by other regulators. If one of the clearing organizations is organized outside of the United States, "the Commission evaluates the bankruptcy treatment in that clearing organization's jurisdiction."[21] In addition, the Commission considers the potential impact of the cross-margining arrangement "on the DCO's ability to comply with the DCO Core Principles, particularly those concerning financial resources and risk management."[22] The

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[19] DCO Proposed Rule at 22238.

[20] *Id*.

[21] *Id*.

[22] *Id*.

Commission requests comment concerning whether there are other factors that the Commission should consider and, if so, other information that it should request.[23]

The Associations generally support new proposed Rule 39.13(i). Codifying the practices that the Commission follows for evaluating cross-margining arrangements between DCOs would increase transparency and improve the ability of clearing members to manage the risks associated with positions subject to cross-margining.[24]

In response to the Commission's question about whether it should consider other factors when evaluating proposed cross-margining arrangements between DCOs, the Associations believe that the Commission should consider including in its evaluation the credit and liquidity risk management, settlement and default management-related principles identified in the CPMI-IOSCO Principles for Financial Market Infrastructures.[25] In addition, the Commission should require DCOs participating in a cross-margining arrangement to consult with their respective clearing members. Consultation with clearing members should help to improve the transparency and robustness of cross-margining risk management procedures.

K. The Associations Support the Proposed Clarification Regarding When Customer Positions and Related Funds Must be Transferred Because It Reflects Current Market Practice – Rule 39.15(d)

Rule 39.15(d) requires a DCO to have rules providing for the transfer of all or a portion of a customer's portfolio of positions and related funds at the same time from the carrying clearing member to another clearing member without requiring the closeout and rebooking of the positions prior to the requested transfer. The Commission proposes to amend Rule 39.15(d) to require the prompt, but not necessarily simultaneous, transfer of a customer's positions and related funds. The Associations support the proposed change because, under current market practice, clearing members first transfer positions and then transfer related collateral.

L. Default Rules and Procedures – Rule 39.16

As explained in more detail below, the Associations recommend several modifications to DCO default rules and procedures. The Associations also refer the Commission to the August 9, 2019 joint response of FIA and ISDA to the June 2019 CPMI-IOSCO discussion paper on

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[23] *Id*.

[24] It is particularly important to ensure that cross-margining arrangements include well-defined rules and procedures for managing a participant default. The Commission should have a full understanding of whether default management procedures would be implemented jointly or individually by DCOs that are parties to a cross-margining arrangement.

[25] https://www.bis.org/cpmi/publ/d101a.pdf, April 2012 (Credit and liquidity risk management, Settlement, and Default management), and https://www.bis.org/cpmi/publ/d163.pdf, July 2017 (5.2: Margin system design).

central counterparty default management auctions, a copy of which is attached hereto as Attachment A ("**DM Response**").[26]

1. The Proposed Requirement that a DCO Include Clearing Members in a Test of Its Default Management Plan Should Also include "Participants" – Rule 39.16(b)

The Commission proposes to amend Rule 39.16(b) to add a requirement that a DCO include clearing members in a test of its default management plan at least on an annual basis. The Commission explained that it does not believe that a default management plan can be tested "effectively without clearing members' participation."[27] Consequently, the Commission stated that a "DCO should ensure that a sufficient portion of its clearing membership participates in such testing and is therefore prepared to support the DCO's default management efforts."[28]

The Associations generally support this proposed rule change, but make a number of practical recommendations for the Commission's consideration. The rule text should refer to clearing members and "participants" so that, if a DCO's rules allow non-clearing member participants to participate in an auction of a defaulting clearing member's positions, then a sufficient portion of such participants should be required to participate in the testing of the DCO's default management plan.

DCOs should set clear expectations about when clearing members are expected to participate in the annual test of the DCO's default management plan. In addition, participation in testing should be tied to asset classes, so that only clearing members that carry positions, or participants that trade, in a particular asset class are required to participate in tests of a DCO's default management plan for that particular asset class. DCOs also should be required to coordinate the testing of their respective default management plans, so that the requirement to participate in testing of the plan does not place an undue burden on clearing members.

2. The Proposed DCO Default Committee Should Convene in the Event of a "Material" Default – Rule 39.16(c)(1)

The Commission proposes to amend Rule 39.16(c)(1) to require a DCO to have a default committee that would be convened in the event of a default involving substantial or complex positions to help identify market issues facing any action the DCO is considering. The default committee would be required to include clearing members and could include other participants to help the DCO efficiently manage the house or customer positions of the defaulting clearing member.

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[26] Available at https://www.isda.org/a/CNhME/FIA-ISDA-Response-to-IOSCO-Auction-DP-final.pdf.

[27] DCO Proposed Rule at 22239.

[28] *Id.*

The Associations generally support a requirement that a DCO have a standing default committee. They recommend, however, that absent exigent circumstances the default committee convene whenever a material default occurs, not just when a default involving substantial or complex positions occurs.[29] The Associations also support the proposed requirement that the default committee include clearing members. The Associations previously have recommended that clearing members be allowed to participate on default management committees, but such participation should be voluntary, not mandatory.[30] It is important for clearing members, whose mutualized resources are at risk in the event of a default, and customers, whose trades are cleared through and held by a DCO, to have a voice in a DCO's default management process. Customers often are the principal liquidity providers in a particular asset class and are well versed in managing the risk of positions in that class. Consequently, the Associations also support including other exchange participants on the default committee.[31]

As the Associations commented in their DM Response, a default committee can provide market advice and expertise that would help to promote the objectives of an efficient and successful default management process, including:

- Managing and closing out the defaulting participant's positions in a prudent and orderly manner;
- Minimizing the losses incurred by the CCP and non-defaulting participants;
- Limiting disruptions to the market; and
- Ensuring timely completion of settlements.[32]

The default committee also would support governance from the perspective of clearing members who contribute mutualized default resources. Because of the value that a default committee would add to the orderly resolution of a default, the Associations generally support the

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[29] For example, a DCO should have discretion in exigent circumstances to liquidate a defaulting clearing member's positions via a central limit order book ("CLOB") without convening the default committee if necessary to minimize the losses to non-defaulting clearing members.

[30] *See, e.g.*, DM Response at 4 ("[Clearing members] believe that there needs to be increasing levels of governance and oversight where results of auctions could result in losses that flow deeper through the waterfall – for instance, the CCP can take decisions if just the defaulters resources were to be used, whereas the Board may have to be involved if the SITG is used while participant participation may be justified if there is an expectation that the losses will result in the usage of the default fund (DF) and/or use of recovery tools. Therefore [clearing members] believe that a CCP should offer participation in the DMG in all asset classes and that depending on the particular situation, participants should have the flexibility to determine if they would want to participate in the DMG. In their view, the DMG's role, other than providing experts to the CCP, is to provide governance during default management and to give a voice to the [clearing member] firms whose mutualised default resources are at risk, especially if there is a possibility of these resources to be used.").

[31] DM Response at 3.

[32] DM Response at 3.

requirement that a DCO have a standing default committee that convenes in the event of any material default.

3. The Commission Should Provide Some Flexibility Concerning How and When a DCO Provides Notice of a Declaration of Default – Rule 39.16(c)(2)(ii)

The Commission proposes to amend Rule 39.16(c)(2)(ii) to require DCOs' default procedures to include "immediate public notice on the DCO's website of a declaration of default."[33] The Associations generally support immediate notice to the clearing members, clients and other DCOs of a default because it would enable them to better manage the risks associated with a default. However, as the Commission notes, the timing of the announcement of a default could potentially affect the market, and the ability of the DCO, clearing members and clients to manage the risks and consequences of the default.[34] The Associations recommend that the Commission allow a DCO reasonable flexibility concerning how and when the notice is disseminated. Furthermore, throughout the default management process, a DCO should provide clearing members and market participants with transparent and regular updates in substance and in a manner that is consistent with ensuring a fair and orderly resolution of the default whether by auction of the defaulting participant's open positions or otherwise.

4. The Commission Should Propose an Amended Process for Liquidating or Allocating a Defaulting Clearing Member's Positions – Rule 39.16(c)(2)(iii)(C)

The Commission proposes to amend Rule 39.16(c)(2)(iii)(C) to clarify that a DCO cannot require a clearing member to bid for a portion of, or accept an allocation of, the defaulting clearing member's positions that is not proportional to the size of the bidding or accepting clearing member's positions in the same product class at the DCO.[35] However, if a clearing member wishes voluntarily to bid or accept more than its proportional share, the clearing member would be allowed to do so, provided that it can manage the risk of any such new positions.[36] The Commission also is proposing to clarify that the clearing member's positions in the same product class should be measured by the clearing initial margin requirements for those positions.[37]

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33 DCO Proposed Rule at 22239.

34 DCO Proposed Rule at 22240.

35 *Id.*

36 *Id.*

37 *Id.* The Associations note that initial margin may not always be the most appropriate proxy for determining the maximum proportionate share of positions on which a clearing member or other market participant is permitted to bid. Other relevant considerations include a bidder's available capital and risk management capabilities.

The Associations believe the Commission should propose a new framework for liquidating or allocating a defaulting member's positions. The Associations' recommended framework is outlined below.

a. A DCO Should Utilize an Auction Format to Close Out a Defaulting Clearing Member's Positions Only When Liquidation Via a Central Limit Order Book is Not Practical

As explained in the Associations' DM Response, "[a]uctions require time and interactions between the CCP, Default Management Group, and participants. Ideally, where possible, closing out the defaulter's portfolio via a CLOB is preferable."[38] A DCO should utilize an auction format only when using a CLOB is not a practical method for closing out positions, for example, because trading in the relevant products is not sufficiently liquid, the relevant products are too complex to be closed out via a CLOB, or no CLOB exists.

b. A DCO Should Be Required to Consult with Clearing Members in Designing Auction Procedures

A DCO should be required to consult with clearing members in designing its rules concerning who is permitted to participate in an auction and how the auction will be conducted. The Associations refer the Commission to their DM Response for more detailed discussion of their views on auction participation and procedures.[39]

c. If Closing Out a Defaulting Clearing Member's Positions Via a CLOB or Auction Fails, the DCO Should Not Be Authorized to Forcibly Allocate Positions to Non-Defaulting Clearing Members

If liquidation via a CLOB or transfer via an auction does not cover all of a defaulting clearing member's positions, the Commission's rules should not authorize a DCO to forcibly allocate the positions to unwilling non-defaulting clearing members even up to a clearing member's proportional share of initial margin. There are many reasons why a non-defaulting clearing member may not wish to accept the positions of a defaulting clearing member. For example, a clearing member's customer base may be institutional rather than retail. In such circumstances, the DCO should not be authorized to forcibly allocate the positions of retail customers to a non-defaulting clearing member.

To the extent that liquidation via a CLOB or transfer via a voluntary auction process fails to cover all of a default clearing member's positions, a DCO could employ alternative tools such as the termination of some of the open positions (*i.e.*, partial tear-up) at a set price. However, as the Associations have commented in the past, a DCO should be required to agree with clearing members on how the partial termination process would be applied to each type of asset cleared

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38 DM Response *et seq*.

39 DM Response at 7.

by the DCO on an *ex-ante* basis (*i.e.*, before the auction) to help ensure that the process is more measurable and controllable.[40]

V. The Commission Should Confirm that the Proposed Amendments to a DCO's Rule Enforcement Obligations Are Non-Substantive – Rule 39.17

The Commission proposes to amend Rule 39.17(a)(1) to clarify the Commission's expectation that DCOs currently do, and would continue to, ensure that both the DCO and its members comply with the DCO's rules. It does this by adding the parenthetical ("by itself and its clearing members)" to the requirement that a DCO effectively monitor and enforce compliance with its rules. The Associations assume that the Commission does not seek by this clarification to impose any new obligations on clearing members. If the Associations' assumption is incorrect, they request that the Commission provide them with notice of, and an opportunity to comment on, any such new obligations.

VI. Reporting Requirements – Rule 39.19

A. The Commission Should Consult Further with DCOs and Clearing Members Prior to Imposing the Proposed Daily Reporting Requirements Based Upon Ownership of an Account – Rule 39.19(c)(1)(i)

Rule 39.13(c)(1)(i) currently requires a DCO to report, on a daily basis, margin, cash flow, and position information for each clearing member, by house origin and by each customer original. The Commission proposes to amend Rule 39.19(c)(1)(i) to require a DCO to additionally report margin, cash flow, and position information by individual customer account because "individual customers may have multiple accounts, which should be reported separately."[41] The Commission is also proposing to have DCOs provide any legal entity identifiers and internally generated identifiers within each customer origin for each clearing member. Finally, the Commission is also proposing to amend Rule 39.19(c)(1)(i)(D) to specify that with respect to end-of-day positions, DCOs must report the positions themselves (*i.e.*, the long and short positions) as well as risk sensitivities and valuation data for these positions.

The Associations are concerned about how the proposed information that a DCO must report relates to other reporting requirements applicable to clearing members. For example, the Commission's large trader position reporting requirements and ownership-and-control reporting requirements in Part 17 of the Commission's rules are generally based upon control of a relevant account. In contrast, the proposed reporting requirements in the DCO Proposed Rule appear to be based upon ownership of a particular account. If clearing members would be expected to provide new information to a DCO in order to allow the DCO to comply with the proposed

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[40] CPMI-IOSCO, Recovery Report, Recovery of financial market infrastructures, Section 4.5.17 (July 2017) *available at* https://www.bis.org/cpmi/publ/d162.pdf. *See also* CPMI-IOSCO, Recovery Report, Recovery of financial market infrastructures, Section 4.5.17 (October 2014) *available at* https://www.bis.org/cpmi/publ/d121.pdf.

[41] *Id.*

reporting requirements, the Commission should conduct a cost-benefit analysis of the new burdens imposed upon clearing members, so that clearing members have an opportunity to comment on the proposed rules.

B. The Proposed Requirement that a DCO Notify the Commission of a Margin Model Issue Also Should Require Notice to Clearing Members and Include Inaccurate Margin Calls – Rule 39.19(c)(4)(xxiv)

The Commission proposes to adopt new Rule 39.19(c)(4)(xxiv), which would require a DCO to report to the Commission no later than one business day after any issue occurs with a DCO's margin model (including cross-margined portfolios) that affects the DCO's ability to calculate or collect initial margin or variation margin. According to the Commission, DCOs have had unanticipated issues arise with the functioning of their margin models, and the CFTC would like to be informed of these issues.

The Associations supports the proposed requirement that a DCO report to the Commission issues with the DCO's margin model that affect its ability to calculate or collect initial margin or variation margin. The Commission should expand the notification requirement to include notice to clearing members of material issues with a DCO's margin model. Because clearing members' mutualized resources are at risk in the event of a default, they have a strong interest in the proper functioning of a DCO's margin model. Furthermore, the Associations request that a DCO be required to file similar notices with the Commission and clearing members when a DCO makes materially inaccurate margin calls. For example, the Commission and clearing members should be notified when a DCO incorrectly debits a clearing member's account. The DCO notice to clearing members should provide a high-level description, without revealing confidential information, of the approximate amount involved, the number of clearing members impacted, the reason for and the resolution of the error.

C. The Commission Should Clarify When a DCO Must Submit Recovery and Wind-Down Plans – Rule 39.19(c)(4)(xxv)

The Commission proposes to adopt new Rule 39.19(c)(4)(xxv), which would require a DCO that is required to maintain recovery and wind-down plans pursuant to Rule 39.39(b) to submit its plans to the Commission no later than the date on which it is required to have the plans. As proposed, it is difficult to discern from the regulatory text when a DCO must submit its recovery and wind-down plans. Therefore, the Associations recommend that the Commission replace the phrase "the date on which it is required to have the plans" with the actual date that a DCO is required to have plans.

D. The Proposed Requirement that a DCO Provide the Commission with Advance Notice of a New Product Accepted for Clearing Should Apply to Novel and Complex Products, and Should Include Notice to, and Require Consultation with, Clearing Members – Rule 39.19(c)(4)(xxvi)

The Commission proposes to adopt new Rule 39.19(c)(4)(xxvi), which would require a DCO to provide notice to the Commission no later than 30 calendar days prior to accepting a new product for clearing. According to the DCO Proposed Rule, receiving the notice 30 days before the DCO begins accepting the product for clearing would allow Commission Staff enough time to ask further questions of the DCO as necessary.[42] In addition to the proposed new requirement, the DCO Proposed Rule requested comment regarding how the Commission should define what constitutes a new "product" for purposes of when a DCO would be required to file a notice.

The Associations support a notice requirement for a DCO that plans to clear new products. They recommend that the Commission only require notice for new "novel and complex" products. Novel and complex products include, for example, products that display risk characteristics that are new to the DCO (optionality or non-linear), require the DCO to amend or introduce a new pricing model, or are physically deliverable and require either a new delivery process or amendments to existing delivery processes. This principles-based standard would provide the Commission Staff with advance notice to inquire about the clearing of new products that may necessitate additional discussion, but would avoid the need for a DCO to file advance notice for products that are similar to existing products that the DCO already clears.

In addition to providing Commission Staff with advance notice about novel and complex products that a DCO plans to clear, the Commission should also require that a DCO provide advance notice to, and consult with, clearing members prior to clearing new novel and complex products. Clearing members, like Commission staff, need advance notice, so they have an opportunity in advance to ask questions, identify any operational concerns, and prepare to clear a new novel and complex product. At a minimum, new novel and complex products should be subject to advance clearing member consultation and presented to the DCO's risk committee for formal approval. This process is consistent with the expectations of Commission Staff as set forth in a prior advisory notice related to new virtual currency derivative contracts.[43]

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[42] DCO Proposed Rule at 22242-43.

[43] *See* CFTC Staff Advisory No. 18-14 (May 21, 2018) (Section II.D) ("[T]he exchange should consider consulting with, and soliciting input from, members and other relevant stakeholders, beyond those market participants interested in trading the new contract. For example, clearing members and FCMs, including those who do not plan to offer clearing services for the new contract, can provide valuable insight into DCO risk management.").

VII. The Associations Support the Proposed Requirement that a DCO Make Certain Information Available on Its Website as Opposed to Its Rulebook – Rule 39.21(c)

The Commission proposes to amend the public reporting requirements of Rule 39.21 to require a DCO to make each specified type of information available separately on the DCO's website instead of just in the DCO's rulebook.[44] According to the Commission, this method of disclosure "will assist members of the public in locating the relevant information and may facilitate greater uniformity across DCO websites."[45] The Commission also proposes to clarify that information on the size and composition of a DCO's financial resource package should be updated as of the end of a DCO's most recent fiscal quarter.

The Associations support the Commission's proposed amendments to Rule 39.21(c). The proposed rule changes would help clearing members and market participants to access contract, fee, margin methodology, default procedure, financial and other important information on a DCO's website.

VIII. The Commission Should Propose and Adopt Additional Enhancements to DCO Risk Governance

The Commission proposes to remove Rule 39.32 and adopt new Rules 39.24, 39.25, and 39.26, that would incorporate all of the requirements of Rule 39.32 and move them to Subpart B, which would have the effect of making them applicable to all DCOs, not just SIDCOs and Subpart C DCOs. The Commission explained that these governance requirements are intended to enhance a DCO's risk management and controls "by promoting transparency of governance arrangements and making sure that the interests of a DCO's clearing members and, where relevant, their customers are taken into account."[46] The Commission also explained that it interprets the title of Core Principle Q, "Composition of Governing Boards," to refer to the governing body of a DCO, regardless of whether it is a "board" or a "committee."[47] Consequently, the Commission proposes to require market participant participation on the DCO's governing board or board-level committee, *i.e.*, the group with the ultimate decision-making authority.[48]

Strong governance is critical to all aspects of a DCO's compliance with the DCO Core Principles and the Commission's implementing regulations. Although the Associations support the Commission's effort to enhance DCO governance, they believe that the governance measures in the DCO Proposed Rule are not sufficient. Therefore, the Associations request that the Commission propose the additional measures discussed below to enhance DCO risk governance.

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44 DCO Proposed Rule at 22243.

45 *Id.*

46 *Id.* at 22244.

47 DCO Proposed Rule at 22244.

48 *Id.*

The following recommendations are consistent with the Associations' recommendations to CPMI-IOSCO.[49]

The Associations understand that some of their recommendations may need to be addressed in a separate rulemaking proposal focused on Part 40 of the Commission's rules. The Associations have supported, and continue to support, the Commission's self-certification process for DCO rule amendments. Nevertheless, the recommendations below are meant to increase the transparency of the existing rule approval process and to ensure that clearing members and end-users are consulted about important risk issues.

A. The Commission Should Propose a Public Comment Process, Similar to the Process Required in Current Rule 40.6(c), for Systemically Important DCO Rule Changes that Raise Novel or Complex Issues – Rule 40.10

Rule 40.6 sets forth the process for a DCO to self-certify that a new or amended rule complies with the CEA. If the Financial Stability Oversight Council designates a DCO as a systemically important DCO ("**SI-DCO**"), Rule 40.10 sets forth a special process for the SI-DCO to adopt a new or amended rule "that could materially affect the nature or level of risks presented by the [SI-DCO]."[50] The processes specified in Rules 40.6 and 40.10 establish a time period for the Commission to review a proposed rule change along with the ability for the Commission to stay its review period if the rule change raises "novel or complex issues."[51] However, if the Commission stays the certification of a proposed rule change on the grounds that it raises novel or complex issues, Rule 40.6(c)(2) requires the Commission to solicit public comment. In contrast, the certification procedures under Rule 40.10 do not require public comment in similar circumstances.

The Associations request that the Commission propose a requirement to solicit public comment for proposed rule changes involving novel or complex issues under Rule 40.10 that is similar to the requirement in Rule 40.6(c). The Commission's analysis of novel or complex issues raised in a SI-DCO's rule submission would benefit from public comment. The Associations are unaware of any policy rationale for not applying the same public comment requirement for rule changes involving novel or complex issues under both Rules 40.6 and 40.10.

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[49] *See, e.g.,* The Associations *et al.* letter to CPMI-IOSCO regarding the consultative report on the Resilience of Recovery and CCPs: Further Guidance on the PFMI (Oct. 18, 2016) *available at* https://www.isda.org/a/uTiDE/fia-gfma-iif-isda-tch-response-to-cpmi-iosco-consultative-report-resilience-and-recovery-of-ccps.pdf.

[50] Rule 40.10(a).

[51] Rule 40.6(c) and 40.10(f).

B. The Commission Should Require a DCO to Consult with Clearing Members in Advance of Proposing Non-Emergency Material Rule Changes

In order to ensure that a DCO receives and considers a range of perspectives from relevant stakeholders, the Commission's Part 40 rules should require that a DCO consult with clearing members prior to the submission of material rule changes. Consulting with clearing members in advance of a material rule change would enable a DCO to incorporate member feedback in a proposed rule regardless of whether it is self-certified or submitted to the Commission for its approval. The Associations' note that this recommendation is consistent with the July 2017 CPMI-IOSCO guidance on CCP resilience.[52]

C. The Commission Should Require a DCO to Seek Clearing Member and End-User Input in Advance of Making Key Risk Decisions

The Commission should enhance DCO risk governance by proposing to require a DCO to seek input from clearing members and end-users in advance of making key risk decisions. The Associations support providing a DCO with reasonable discretion concerning the most appropriate method for seeking input; for example, through a formal written submission process and/or an informal forum. Such a process would help to ensure that expert views of clearing members and end-users are considered by the DCO during the initial stages of key risk decisions. The Commission should clarify that the length and form of the consultation process should be directly related to the importance of the issue to the DCO, clearing members, and end-users. For example, if a proposed rule amendment would change the potential liability of clearing members, there should be a more thorough process to solicit clearing member input and approval (*e.g.*, the circulation of voting ballots).

D. The Commission Should Require a DCO to Disclose in Any Rule Change Filed with the Commission Any Recommendations that the DCO Received, but did not Implement

The Commission should enhance a DCO's disclosure obligations during the rule-filing process by requiring that a DCO identify any clearing member or end-user recommendations that the DCO did not implement regardless of whether they are characterized as "opposing" views. This obligation would supplement the existing requirement that a DCO following the self-certification or voluntary rule approval process provide a "brief explanation of any substantive opposing views expressed to the registered entity by governing board or committee members, members of the entity or market participants, that were not incorporated into the rule, or a statement that no such opposing views were expressed."[53] Furthermore, the disclosure should include the DCO's rationale for not implementing the recommendation. This disclosure obligation would help to ensure that the Commission is informed of all relevant recommendations when evaluating a DCO rule change.

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[52] *See* CPMI-IOSCO Guidance (July 2017), CCP Resilience Section 2.2.24.

[53] *See* Rule 40.6(a)(7)(vi). *See also* Rule 40.5(a)(8).

E. The Commission Should Require a DCO to Consult with Clearing Members Prior to Approving New Categories and Types of Acceptable Collateral

The Commission should enhance a DCO's risk governance framework by requiring that a DCO consult with clearing members prior to approving new categories and types of acceptable collateral. A collaborative process between the DCO and relevant stakeholders would help to ensure that a new proposed category and type of collateral is sufficiently liquid, robust and commercially practical to enhance DCO and clearing member risk management.

IX. The Associations Support the Codification of No-Action Relief Related to Fully Collateralized Positions – Rule 39.2

The Commission proposes to codify certain no-action relief from Part 39 requirements for DCOs that clear fully collateralized positions.[54] The Associations generally support this proposal. They note, however, that strong governance is required to ensure that the positions are fully collateralized, *i.e.*, that sufficient collateral is on deposit at all times to cover the maximum potential loss that could be incurred by the DCO in connection with a cleared position.

X. The Commission's Rules Should Ensure that Clearing Members Are Not Responsible for a DCO's Non-Default Losses

Although not addressed in the DCO Proposed Rule, the Associations request that the CFTC adopt rules to ensure that clearing members are not responsible for a DCO's non-default losses. In order to avoid a default, a DCO must have sufficient capital and/or insurance to cover all non-default losses. Non-default losses that are under the exclusive control and governance of the DCO, such as operational, legal, general business, cyber, credit, and liquidity risks, should not be borne by the clearing members. Because only the DCO is able to quantify and manage these risks, the CFTC's rules should clarify that clearing members are not responsible for such losses. To the extent that a DCO is able to pass through losses that are within the sole control of the DCO, there is an inherent conflict between the risk management practices of a DCO and a clearing member that are designed to prevent such losses. It is crucial that a DCO consider and stress-test each potential non-default loss scenario to ensure adequate capitalization to address non-default losses. The Commission should specify the appropriate capital framework to ensure that a DCO is adequately capitalized to cover non-default losses. In addition, in the event that funding is insufficient, the DCO's parent company and/or equity holders should be required to inject additional funding into the DCO.

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[54] *Id.* at 22245.

XI. Conclusion

The Associations appreciate the opportunity to comment on the DCO Proposed Rule. If the Commission or staff have any questions about this letter, please contact Allison Lurton, Senior Vice President and General Counsel of FIA, at 202-466-5460, or Ulrich Karl, Head of Clearing Services, ISDA, at +44 020 3808 970, ukarl@isda.org.

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