SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–98959; File No. S7–21–22]

RIN 3235–0695

Clearing Agency Governance and Conflicts of Interest

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') is adopting rules under the Securities Exchange Act of 1934 (''Exchange Act'') to improve the governance of clearing agencies registered with the Commission (''registered clearing agencies'') by reducing the likelihood that conflicts of interest may influence the board of directors or equivalent governing body (''board'') of a registered clearing agency. The rules 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 rules establish new requirements for board and committee composition, independent directors, management of conflicts of interest, and board oversight.

DATES:

Effective date: February 5, 2024.

Compliance date: The applicable compliance dates are discussed in Part III of this release.

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SUPPLEMENTARY INFORMATION: The Commission is adopting 17 CFR 240.17ad–25 (''Rule 17Ad–25'') under the Exchange Act to establish new requirements for the board governance of registered clearing agencies and for the management of conflicts of interest by registered clearing agencies.[1] Below is a table of citations to the rules being adopted in this release:

Commission reference	CFR citation (17 CFR)
Securities Exchange Act of 1934 (''Exchange Act''):	
Rule 17Ad–25	§ 240.17ad–25.
Rule 17Ad–25(a)	§ 240.17ad–25(a).
Rule 17Ad–25(b)	§ 240.17ad–25(b).
Rule 17Ad–25(b)(1)	§ 240.17ad–25(b)(1).
Rule 17Ad–25(b)(2)	§ 240.17ad–25(b)(2).
Rule 17Ad–25(b)(2)(i)	§ 240.17ad–25(b)(2)(i).
Rule 17Ad–25(b)(2)(ii)	§ 240.17ad–25(b)(2)(ii).
Rule 17Ad–25(b)(2)(iii)	§ 240.17ad–25(b)(2)(iii).
Rule 17Ad–25(c)	§ 240.17ad–25(c).
Rule 17Ad–25(c)(1)	§ 240.17ad–25(c)(1).
Rule 17Ad–25(c)(2)	§ 240.17ad–25(c)(2).
Rule 17Ad–25(c)(3)	§ 240.17ad–25(c)(3).
Rule 17Ad–25(c)(4)	§ 240.17ad–25(c)(4).
Rule 17Ad–25(c)(4)(i)	§ 240.17ad–25(c)(4)(i).
Rule 17Ad–25(c)(4)(ii)	§ 240.17ad–25(c)(4)(ii).
Rule 17Ad–25(c)(4)(iii)	§ 240.17ad–25(c)(4)(iii).
Rule 17Ad–25(c)(4)(iv)	§ 240.17ad–25(c)(4)(iv).
Rule 17Ad–25(d)	§ 240.17ad–25(d).
Rule 17Ad–25(d)(1)	§ 240.17ad–25(d)(1).
Rule 17Ad–25(d)(2)	§ 240.17ad–25(d)(2).
Rule 17Ad–25(e)	§ 240.17ad–25(e).
Rule 17Ad–25(f)	§ 240.17ad–25(f).
Rule 17Ad–25(f)(1)	§ 240.17ad–25(f)(1).
Rule 17Ad–25(f)(2)	§ 240.17ad–25(f)(2).
Rule 17Ad–25(f)(3)	§ 240.17ad–25(f)(3).
Rule 17Ad–25(f)(3)(i)	§ 240.17ad–25(f)(3)(i).
Rule 17Ad–25(f)(3)(ii)	§ 240.17ad–25(f)(3)(ii).
Rule 17Ad–25(f)(4)	§ 240.17ad–25(f)(4).
Rule 17Ad–25(f)(4)(i)	§ 240.17ad–25(f)(4)(i).
Rule 17Ad–25(f)(4)(ii)	§ 240.17ad–25(f)(4)(ii).
Rule 17Ad–25(f)(5)	§ 240.17ad–25(f)(5).
Rule 17Ad–25(f)(6)	§ 240.17Ad–2525(f)(6).
Rule 17Ad–25(g)	§ 240.17ad–25(g).
Rule 17Ad–2525(g)(1)	§ 240.17Ad–2525(g)(1).
Rule 17Ad–25(g)(2)	§ 240.17ad–25(g)(2).
Rule 17Ad–25(h)	§ 240.17ad–25(h).
Rule 17Ad–25(i)	§ 240.17ad–25(i).
Rule 17Ad–25(i)(1)	§ 240.17ad–25(i)(1).
Rule 17Ad–25(i)(2)	§ 240.17ad–25(i)(2).
Rule 17Ad–25(i)(3)	§ 240.17ad–25(i)(3).
Rule 17Ad–25(i)(4)	§ 240.17ad–25(i)(4).
Rule 17Ad–25(j)	§ 240.17ad–25(j).

With respect to board governance, Rules 17Ad–25(b), (e), and (f) establish requirements for board composition and independent directors, as discussed in Part II.A. Rules 17Ad–25(c) and (d) establish requirements for the nominating and risk management committees of the board, as discussed in Parts II.B and II.C respectively. With respect to conflicts of interest, Rules 17Ad–25(g) and (h) establish requirements for policies and procedures to identify, document, and mitigate or eliminate such conflicts of interest, as well as an obligation of directors to report such conflicts to the registered clearing agency, as discussed in Part II.D. In addition, Rules 17Ad–5(i) and (j) establish obligations of the board to oversee the management of risks from relationships with service providers for core services, as discussed in Part II.E, and to solicit, consider and document the views of stakeholders, as discussed in Part II.F.

As discussed further in Part III, the compliance date for Rule 17Ad–25 is December 5, 2024, except that the compliance date for the independence requirements of the board and board committees in Rules 17Ad–25(b)(1), (c)(2), and (e) is December 5, 2025.

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[1] This adopting release also modifies the proposed CFR designations to ensure the regulatory text conforms with section 2.13 of the Document Drafting Handbook. *See* 1 CFR 21.11; Office of the Federal Register, Document Drafting Handbook (Aug. 2018 Edition, Revision 2.1, dated Oct. 2023), *https://www.archives.gov/files/federal-register/write/handbook/ddh.pdf.* Because the Commission proposed the new rules to contain an uppercase letter in their CFR citations, the Commission is modifying the CFR section designations at adoption to replace each such uppercase letter with the corresponding lowercase letter. Accordingly, 17 CFR 240.17Ad–25 will be designated at adoption as 17 CFR 240.17ad–25.

I. Introduction

Clear and transparent governance arrangements are integral to ensuring that a clearing agency is resilient because, among other things, such arrangements promote accountability and reliability in decision-making.[2] Since the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (''Dodd-Frank Act'') in 2010,[3] the Commission has adopted a series of rules intended to promote the resilience of registered clearing agencies,[4] with the goal of establishing an evolving regulatory framework.[5] As discussed in greater detail in the Governance Proposing Release,[6] the Commission has continued to observe and learn from the recurring tensions that exist in the incentive structure of a clearing agency, including their potential effect on the participants of the clearing agency and the broader financial system.[7] Accordingly, the Governance Proposing Release included new rules designed to help ensure that a registered clearing agency can effectively balance the differing incentives that exist among the clearing agency, its participants, and other key stakeholders.[8] The proposed rules included more specific and defined parameters and requirements for governance intended to build upon and strengthen the existing requirements in Rule 17Ad–22 that have a broader and principles-based focus.[9]

The Commission received comments on the Governance Proposing Release from registered clearing agencies, participants of registered clearing agencies and their customers, industry groups representing clearing agencies, their participants, and other market participants, academics, individual investors, and other interested parties.[10] Many commenters were supportive of the proposed rules, though some commenters also expressed concerns regarding specific elements of certain rules. In Part II below, the Commission discusses these comments in detail and modifications made in response to the comments. In addition, the Commodity Futures Trading Commission (''CFTC'') recently adopted new requirements applicable to risk management committees (''RMCs'') and risk working groups (''RWGs'') of derivatives clearing organizations (''DCOs''),[11] topics which are also addressed in the context of registered clearing agencies by the Commission's final rules discussed below. The Commission's final rules promote similar outcomes as the CFTC's rules, such as ensuring robust board oversight of senior management, and informing the board of stakeholder views, though in some cases the Commission has taken a different approach as to specific requirements because Rule 17Ad–25 also addresses additional topics, including board composition, director independence, and conflicts of interest. The differing approaches are explained further in Parts II.C.4 and II.F.7. Finally, these rules are being adopted pursuant to section 765 of the Dodd-Frank Act with respect to clearing of security-based swaps,[12] which specifically directs the Commission to adopt rules to mitigate conflicts of interest for security-based swap clearing agencies.[13]

II. Discussion of Comments Received and Final Rules

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 serving on the board of a registered clearing agency. First, proposed Rule 17Ad–25(b)(1) would require that a majority of the directors 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 of the registered clearing agency, then at least 34 percent 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-

[2] Release No. 34–95431 (Aug. 8, 2022), 87 FR 51812, 51813 (Aug. 23, 2022) (''Governance Proposing Release'').

[3] Public Law 111–203, 124 Stat. 1376 (2010).

[4] *See, e.g.,* 17 CFR 240.17Ad–22 (''Rule 17Ad–22''); *see also* Release No. 34–88616 (Apr. 9, 2020), 85 FR 28853, 28855 (May 14, 2020) (''CCA Definition Adopting Release''); Release No. 34–78961 (Sept. 28, 2016), 81 FR 70786 (Oct. 13, 2016) (''CCA Standards Adopting Release''); Release No. 34–68080 (Oct. 22, 2012), 77 FR 66219 (Nov. 2, 2012) (''Clearing Agency Standards Adopting Release'').

[5] Governance Proposing Release, *supra* note 2, at 51814.

[6] *Id.* at 51814–51819.

[7] *Id.* at 51814 (describing the same as ''clearing members and the larger financial community'').

[8] *Id.*

[9] *Id.*

[10] The Commission voted to issue the Governance Proposing Release on August 8, 2022. The release was posted on the Commission website that day, and comment letters were received beginning the following day. The comment period closed on October 7, 2022. Comments received are available on the Commission's website at *https://www.sec.gov/comments/s7-21-22/s72122.htm.* The Commission has considered all comments received since August 8, 2022.

[11] *See* Governance Requirements for Derivatives Clearing Organizations, Final Rule, 88 FR 44675 (July 13, 2023).

[12] Public Law 111–203, 124 Stat. 1376 (2010).

[13] *See* Governance Proposing Release, *supra* note 2, at 51819 & n.49 (stating ''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.'').

making of the director, and includes relationships that existed during a lookback period of one year counting back from making the initial independence determination made in accordance with 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 that a registered clearing agency 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, and is not precluded from being an independent director under proposed Rule 17Ad–25(f), 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, 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 self-regulatory organizations (''SROs'') under Exchange Act section 17(a)(2) and rules thereunder.

Proposed Rule 17Ad–25(e) would require that, if any committee has the authority to act on behalf of the board, the composition of that committee must have at least the same percentage of independent directors as is required under these rules for the board, 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) 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 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 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. Proposed Rules 17Ad–25(f)(2) through (6) would be subject to a lookback period of one year, counting back from making the initial determination required by proposed Rule 17Ad–25(b)(2).

Proposed Rule 17Ad–25(a) would define ''family member'' 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.

The Commission is adopting Rules 17Ad–25(b), (e), and (f) generally as proposed but with technical changes to Rule 17Ad–25(a), Rule 17Ad–25(b)(1), Rule 17Ad–25(b)(2), Rule 17Ad–25(b)(2)(i), and Rule 17Ad–25(b)(2)(iii), for the reasons discussed below. In making the technical change to the definition of ''material relationship'' in Rule 17Ad–25(a), the Commission is embedding the reference to a lookback period that was proposed in a standalone sentence into the initial sentence relating to relationships that could affect the independent judgment or decision-making of a director, in order to clarify that the lookback period is part of the overall reference to these relationships. In making the technical change to Rule 17Ad–25(b)(1), the Commission is replacing the term ''voting rights'' with ''voting interests,'' which would be consistent with the terms used elsewhere in the rule text, and which remains consistent with the concept as proposed. In making the technical change to Rule 17Ad–25(b)(2), the Commission is deleting the last proviso that stated, ''in order to qualify as an independent director,'' because this reference is unnecessary and does not describe all of the requirements for qualifying as an independent director. In making the technical change to Rule 17Ad–25(b)(2)(i), the Commission is reordering the language requiring identification of the relationships between a director and a registered clearing agency, and a director and any affiliate of a registered clearing agency. The proposed rule text implied that there needed to be identification of relationships between the registered clearing agency and its affiliates, which is not intended. In making the technical change to Rule 17Ad–25(b)(2)(iii), the Commission is specifying that the documentation requirement applies to both the registered clearing agency's evaluation of director independence *and* its ultimate determination (*i.e.,* whether the director qualifies as an independent director or is not an independent director). Under the proposed text, the phrase ''this determination'' was intended to encompass broad consideration of all the relevant facts and circumstances on an ongoing basis. The Commission is modifying the text in adopted Rule 17Ad–25(b)(2)(iii) to be ''the evaluation and determination'' to specify that the documentation requirement applies to both the evaluation of independence and the ultimate determination regarding independence.

In the Governance Proposing Release, the Commission stated that an independent director can bolster a 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.[14] Even the appearance of conflicts of interest can reduce confidence in the functioning of the registered clearing agency among direct and indirect participants of the registered clearing agency, other stakeholders, and the public, particularly during periods of market stress when general confidence in market resilience may be low.[15] Indeed, as discussed in the Governance Proposing Release, each of the registered clearing agencies already requires a portion of their directors to have some characteristics of independence (establishing, for example, ''nonexecutive'' or ''public'' directors).[16] Further, 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, as discussed in the Governance Proposing Release, the risk mutualizing and trade guaranty features provided by many registered clearing agencies provide for the shift of the consequences of one party's actions to another in certain circumstances, such as after a participant default.[17] These features both affect how different stakeholders maximize their own self-interest and also distinguish the governance of a registered clearing agency from other corporate entities. The Commission stated its belief that registered clearing agency processes involving risk management or director nominations are also implicated in managing the dynamics between owners and participants.[18] 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. The Commission stated its belief that requiring a certain percentage of 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.[19] Independent directors would help ensure that, when the interests between owners and participants diverge, the balancing of interests 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 payments from the registered clearing agency to such director), owners, or participants of the registered clearing agency. Achieving balance between stakeholders with divergent views could help the board adequately consider the respective needs of all such stakeholders and help promote the integrity of, and public confidence in, the registered clearing agency's risk management function.

Comments on the proposed board composition requirements and requirements for independent directors are discussed below.

2. Overall Views

Of the comments received on the Governance Proposing Release, the majority were from individuals. Several expressed high-level views either in support or against the proposal,[20] referencing, for example, their concerns that retail investors are being cheated due to clearing agency greed or conflicts of interest, or requesting retail investor representation on the board. Several commenters were specifically concerned with incidents of failures to deliver with their transactions, but did not discuss the rule proposals in the Governance Proposing Release.[21] Many commenters were under the mistaken impression that the proposal would alter the status of certain entities as SROs.[22] However, the Exchange Act clearly defines registered clearing agencies as SROs,[23] and the proposed rule would have no impact on this status. As a general matter, the concerns expressed by these commenters regarding the perception of conflicts of interest at a registered clearing agency highlight the need to adopt Rule 17Ad–25, including the provisions for independent directors and to address conflicts of interest, to promote confidence in registered clearing agency governance through requirements intended to ensure transparency, fair representation, and effective decision-making at the board level.

Several comments from representatives of trade groups or registered clearing agencies expressed general support for having an independent director requirement as a ''good first step,'' [24] appropriately designed to reduce the risk of conflicts of interest [25] and provide diverse viewpoints [26] in a ''pragmatic'' [27] way. One commenter supported the independent director requirement because it was consistent with public company listing rules and would be particularly useful in capturing a range of perspectives when combined with the requirement of a nominating committee to consider a broad range of views.[28] Another commenter viewed the requirements as consistent with independent director requirements that were already incorporated into its

[14] *See* Governance Proposing Release, *supra* note 2, at 51821.

[15] *See id.* at 51819; *see also id.* at 51812 n.3 (explaining that examples of indirect participants are 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).

[16] See *id.* at 51844.

[17] *See id.* at 51822.

[18] *See id.*

[19] *See id.* at 51823.

[20] *See, e.g.,* Timothy Washington (Aug. 12, 2022) (''Washington''); Andres Loubriel (Aug. 12, 2022) (''Loubriel''); Gerald (Aug. 12, 2022) (''Gerald''); Dylan Crosby (Aug. 12, 2022) (''Crosby''); Anonymous (Aug. 12, 2022) (''Anonymous 1''); Josh Zimmerman (Aug. 12, 2022) (''Zimmerman''); Nathan Rohde (Aug. 13, 2022) (''Rohde''); Ian Marshall (Aug. 17, 2022) (''Marshall''); Anonymous (Aug. 26, 2022) (''Anonymous 4''); Harun Krishnan (Aug. 26, 2022) (''Krishnan''); Matthew Fry (Aug. 26, 2022) (''Fry''); the Delois Albert Brassell Estate (Sept. 3, 2022) (''Delois Albert Brassell Estate''); Kaleab Tesema (Sept. 7, 2022) (''Tesema''); Jamario (Oct. 6, 2022) (''Jamario''); Ben Passlow (May 11, 2023) (''Passlow'') (each expressing views in support); *see also* Val Ayrapetov (Aug. 9, 2022) (''Ayrapetov''); George (Aug. 12, 2022) (''George''); Anonymous (Aug. 12, 2022) (''Anonymous 2''); M.B. (Oct. 6, 2022) (''M.B.'') (requesting creation of a retail-specific board member) (each expressing views against).

[21] *See, e.g.,* Crosby, Loubriel; Zimmerman.

[22] *See* Anonymous 1; Christopher Hewitt (Aug. 12, 2022) (''Hewitt''); Mason Smith (Aug. 12, 2022) (''Smith''); Samuel Ryan (Aug. 12, 2022) (''Ryan''); Keith Clark (Aug. 12, 2022) (''Clark''); Dillon (Aug. 12, 2022) (''Dillon''); Evan (Aug. 12, 2022) (''Evan Letter''); John J. Kozubal (Oct. 6, 2022) (''Kozubal''); James Fox (Oct. 6, 2022) (''Fox''); Joe (Oct. 7, 2022) (''Joe''); Anonymous (Oct. 12, 2022) (''Anonymous 5''); Anonymous (Oct. 13, 2022) (''Anonymous 6''); Kens Bane (Jan. 16, 2023) (''Bane'').

[23] *See* 15 U.S.C. 78c(a)(23), (26).

[24] *See* Thomas Price, Managing Director, Operations/Technology, Robert Toomey, Managing Director, Associate General Counsel, Head of Capital Markets, Joseph Corcoran, Managing Director, Associate General Counsel, Securities Industry and Financial Markets Association (Oct. 28, 2022) (''SIFMA'') at 2.

[25] *See* Chris Barnard (Sept. 9, 2022) (''Barnard''); Stephen W. Hall, Legal Director and Securities Specialist, and Houston Shaner, Senior Counsel, Better Markets, Inc. (Oct. 7, 2022) (''Better Markets'') at 5; Murray Pozmanter, Managing Director, President, Clearing Agency Services & Head of Global Business Operations, Depository Trust & Clearing Corporation (Oct. 7, 2022) (''DTCC'') at 2.

[26] William C. Thum, Managing Director and Assistant General Counsel, SIFMA Asset Management Group (Oct. 13, 2022) (''SIFMA AMG'') at 8.

[27] Ulrich Karl, Head of Clearing, International Swaps and Derivatives Association, Inc. (Oct. 28, 2022) (''ISDA'') at 6.

[28] Paolo Saguato, Assistant Professor of Law, George Mason University Antonin Scalia Law School (Oct. 6, 2022) (''Saguato'') at 3.

governance structure.[29] Another group of commenters supported the independent director requirement because it was consistent with a whitepaper issued by the group in 2019 concerning the need for enhanced governance at clearing agencies to address their risk-related concerns.[30]

One commenter cautioned against ''completely'' independent directors (*i.e.,* independent from owners and participants, such as academics) creating a situation where clearing agency participants could be under-represented.[31] As discussed further below, the Exchange Act requires that the rules of the clearing agency assure a fair representation of its shareholders and participants in the selection of its directors and administration of its affairs. Another commenter that supported the proposed requirements cautioned against going any further than the proposal—such as by requiring certain types of stakeholders to be represented—stating that a board's effectiveness comes from the skills, personal attributes (including leadership and integrity), and relevant business and risk management experience of its directors, and not simply by drawing directors from various stakeholder groups.[32] As discussed further below, Rules 17Ad–25(b) and (e) address the composition of the board and board committees, and does not go further to address the composition of an advisory group (the constitution of which can serve a wider set of stakeholders because its members need not already be serving on the board to serve on such an advisory group). Exchange Act section 17A(b)(3)(c) directs the Commission to only register clearing agencies whose rules assure a fair representation of participants in, among other things, the selection of directors.[33] In terms of the skills and effectiveness of a board, other requirements of Rule 17Ad–25 help promote highly qualified and effective candidates serving as independent directors. For example, as discussed in Part II.B below, Rule 17Ad–25(c) as adopted requires policies and procedures for a registered clearing agency's nominating committee to have a written process for evaluating directors and nominees for director, including taking into account each nominee's expertise, availability, and integrity, and demonstrating that the board of directors, taken as a whole, has a diversity of skills, knowledge, experience, and perspectives.

Another commenter did not see the problem that the proposed rules would solve, indicating the group's belief that the approach to board composition and board independence was too prescriptive, which could prevent a registered clearing agency from having governance measures that are uniquely suited to manage risks particular to the registered clearing agency.[34] As stated in the Governance Proposing Release, the requirements regarding the representation of independent directors are appropriate to facilitate the consideration and management of diverse stakeholder interests by the board in the overall decision-making process of the registered clearing agency.[35] Regarding the level of prescriptiveness, Rule 17Ad–25(f) identifies situations that, in the Commission's judgment, create material relationships with the registered clearing agency that are incompatible with being an independent director but, other than these specific exclusions, registered clearing agencies would have discretion to evaluate whether a director's relationships to the registered clearing agency are material. Because Rule 17Ad–25 provides registered clearing agencies with such discretion, the Commission set forth the list of specific exclusions in Rule 17Ad–25(f) to ensure a consistent, minimum standard for independent directors across registered clearing agencies.[36] Therefore, the Commission disagrees that the rules are overly prescriptive because of the levels of discretion that are allowed, and disagrees that unique governance measures could not be adopted by registered clearing agencies.

3. Criteria for Independence

One commenter supported the requirement for establishing an overall level of independent directors at 34 percent for participant-owned registered clearing agencies as being sufficient and without the drawbacks of too many independent directors.[37] Another commenter disagreed with the proposal, stating that the Commission should not impose any percentage of independent directors given the differences in organizational structure, markets, and products cleared, among other things, across registered clearing agencies.[38] A separate commenter supported the requirement for independent directors because it would mitigate potential conflicts and also provide better board oversight of the registered clearing agency's risk management and other functions.[39] The proposed requirements for the percentage of independent directors strike a reasonable balance between the competing interests of management, owners, participants, and any parties falling into more than one of those categories. In the Governance Proposing Release, the Commission considered whether a clearing agency's particular organizational structures, markets served, or products cleared support differing minimum levels of independence, and stated that the percentage of participant ownership of the clearing agency is an important factor against which to set the minimum standard for director independence. Commenters have not identified another specific factor that would support modifying the proposed threshold. Further, Rule 17Ad–25 does not impede registered clearing agencies from considering a broad pool of potential candidates to serve as independent directors, to appropriately reflect their different organizational structures, markets served, and products cleared. Therefore, the Commission is adopting the percentages as proposed.

One commenter supported aspects of the ''independent director'' definition but stated that the proposed requirement that a majority of directors be independent is unlikely to resolve all conflicts of interest because registered clearing agency owners will still have ultimate approval of, and influence over, independent directors. The commenter also explained that independent directors still have fiduciary duties to the registered clearing agency and are constrained to act in service of shareholder value when reviewing risk priorities.[40] The value of a particular element of Rule 17Ad–25 is not diminished even though it does not address all potential conflicts of interest. Rule 17Ad–25 is intended to

[29] Kara Dutta, Assistant General Counsel, Intercontinental Exchange, Inc. (Nov. 11, 2022) (''ICE'') at 2.

[30] *See* Frank Baldi, Managing Director, Head of Financial Institutions and Emerging Markets Credit Risk, Barclays, et al. (Oct. 18, 2022) (''Barclays et al.'') at 1.

[31] ISDA at 6.

[32] ICE at 2–3.

[33] *See* 15 U.S.C. 78q–1(b)(3)(c).

[34] Global Association of Central Counterparties (Oct. 7, 2022) (''CCP12'') at 1; *see also* SIFMA at 3; ICE at 3.

[35] *See* Governance Proposing Release, *supra* note 2, at 51821.

[36] *See id.* at 51824 (''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.'').

[37] Joseph P. Kamnik, Senior Special Advisor and Regulatory Counsel, Options Clearing Corporation (Oct. 7, 2022) (''OCC'') at 23.

[38] CCP12 at 3.

[39] SIFMA AMG at 8.

[40] Better Markets at 13.

bolster the overall quality of governance (and therefore risk management) at a registered clearing agency. The same commenter also requested clarification that material relationship would include director compensation that is tied to registered clearing agency equity, revenue, volume, or scope of products.[41] While Rule 17Ad–25(f) identifies specific circumstances that establish a material relationship, the definition of ''material relationship'' in Rule 17Ad–25(a) is broad. Circumstances where director compensation includes elements that generate potential conflicts of interest, such as those tying monetary compensation to equity, revenue, volume of activity, or scope of products, generally could create a material relationship under Rule 17Ad–25(a).

The same commenter also suggested that the definition of ''material relationship'' be modified to include any interests that create a reasonable appearance of clouding the judgment of a director, on the basis that even the appearance of a bias erodes trust.[42] Trust is important, especially during times of market stress, but the proposed definition does not need to be modified to address this concern. The definition of ''material relationship'' already contains a ''reasonableness'' element, requiring that such relationships be assessed as they would be perceived by a reasonable person, which would allow a clearing agency to consider and address relationships that create the appearance of a conflict. This reasonableness requirement applies even to relationships or situations that are otherwise not among the exclusions in Rule 17Ad–25(f), because Rule 17Ad–25(f) applies in addition to how the definition of independent director is applied by a registered clearing agency. In this regard, clearing agencies generally should consider this reasonableness element in the context of participants, vendors, or non-controlling shareholders of the clearing agency or its affiliates. Employees of participants may be subject to disqualification under this reasonableness requirement, even if they are not subject to disqualification under Rule 17Ad–25(f). The reasonableness element would apply to an evaluation of the qualifications necessary for being an independent director, which will be contingent on the broad set of facts and circumstances under consideration. The definition also includes relationships that reasonably could affect the independent judgment or decision-making of the director, which seeks to address outcomes that reasonably could happen, even if they have not yet in fact happened. Therefore, the Commission is not modifying the rule in response to this comment.[43]

The commenter further suggested expanding the definition of ''family member'' to include first cousins.[44] The Commission considered this expansion, and also reviewed prior Commission rationales on the appropriate scope of ''family member'' definitions under other Commission rules.[45] In those prior rulemakings, the Commission concluded that the scope of family members included there (which is identical to the scope proposed in the Governance Proposing Release) provides adequate coverage to address regulatory interests because any close ties between a director and a relative that are not already within the definition of ''family member'' (such as cousins of various degrees) can be addressed by using the other provision that applies to all persons who share a household with the director, as a proxy for such close ties rather than serving as a generalized proxy for a particular category of relatives. Moreover, the exclusions that relate to family member activities in Rule 17Ad–25(f) are designed to be a floor, not a ceiling, meaning that other fact patterns may preclude a director from meeting the independence requirement pursuant to the general requirements in Rule 17Ad–25(b) instead of a specific exclusion in Rule 17Ad–25(f).

One commenter stated that many of the prohibitions in Rule 17Ad–25(f)(4) were ''overbroad'' and that not all payments from participants should preclude an independence determination; rather, in the commenter's view, Rule 17Ad–25(f)(4) should include a de minimis threshold and an exemption for the payment of clearing fees.[46] The commenter stated that, in the absence of a de minimis threshold, the rule could exclude registered clearing agency participants that are only receiving a nominal sum for a small service provided to the registered clearing agency. The commenter further stated that clearing fees are a relatively inconsequential component of market participants' cost of business, and it is unlikely that a director could reduce clearing fees without oversight because clearing fee changes must be filed with the Commission. In particular, the commenter stated that its fee refunds should not be covered by this exclusion (which the Commission understands to apply when accrued clearing fees exceed the registered clearing agency's targeted capital amount, so refunding an overpayment does not implicate the same potential conflict as does receiving a payment). Another commenter stated that, in the absence of a de minimis threshold, the rule could exclude candidates for independent director who are only receiving de minimis payments or remuneration or clearing fees.[47]

The exclusion in Rule 17Ad–25(f)(4) would apply to directors who are partners or controlling shareholders of a registered clearing agency participant.[48] The scope of this exclusion is narrow, however; employees, managers, and non-controlling shareholders of a participant could still qualify, allowing for a broad range of potential candidates who have experience with the participant's business. Additionally, although the payments received or made between, for example, a participant and a registered clearing agency may be inconsequentially small from the perspective of the registered clearing agency or the participant as a business entity, that same payment may be meaningful to an individual who is a director and who is a controlling shareholder of the participant. For example, that individual's equity stake in the participant may result in extra personal income for every dollar saved or earned. Due to the potential for personal enrichment, the Commission is not adopting a de minimis amount of payments that would allow a participant's controlling shareholder to serve as an independent director. Because the Commission is not incorporating any de minimis carve out,

[41] *Id.* at 12.

[42] *Id.* at 18–19.

[43] *See infra* Part II.D.2 (similarly addressing comments with respect to the ''reasonableness'' requirement in Rule 17Ad–25(g)).

[44] Better Markets at 20.

[45] *See, e.g.,* Disclosure of Certain Relationships and Transactions Involving Management, Securities Act Release No. 6441, Exchange Act Release No.19290, Investment Company Act No. 12865 (Dec. 2, 1982), 47 FR 55661, 55663 (Dec. 14, 1982) (discussing whether to apply a rule to a class of relatives that is broader than those who live in a household with a reporting person, because there is not complete overlap between the two categories. The Commission considered whether to apply the rule to relatives who could take advantage of financial transactions with a reporting person without living in that reporting person's household. As a corollary, some members of a household may not be relatives either, but both categories were contemplated as a proxy for the existence of close ties between two people).

[46] OCC at 6.

[47] CCP12 at 3.

[48] Specifically, Rule 17Ad–25(f)(4) applies to directors who are partners or controlling shareholders of any organization to or from which the registered clearing agency is making or receiving payments, which would include clearing fee payments made by a participant as a clearing member.

it is not addressing how to calculate such de minimis amount. Accordingly, the Commission also is not addressing whether fee refunds should be included in calculations to establish a de minimis amount of such payments. Nonetheless, and regardless of the circumstances, such controlling shareholder of a participant could still serve on the board as a non-independent director.

A commenter also suggested, as an alternative to explicitly carving out payments for clearing fees from the exclusion in Rule 17Ad–25(f)(4), that the Commission specify that the term ''partner'' therein only refers to someone who has an equity ownership stake in the organization.[49] The term ''partner,'' as used in Rule 17Ad–25(f)(4) as adopted, refers to those with an equity ownership stake in an organization such as an limited partnership or limited liability partnership and does not include any person who simply has the term ''partner'' in her job title without also holding an equity ownership stake in the organization that is sending or receiving payments to or from a registered clearing agency, an affiliate thereof, or a holder of a controlling voting interest of the registered clearing agency.

One commenter suggested that the Commission require board representation by customers of registered clearing agency participants because such customers are bound to registered clearing agency obligations that are theoretically uncapped, bear mutualized risk, and could provide unique perspectives on risk management issues.[50] Another commenter requested that the Commission add a requirement for registered clearing agency boards to have representatives from customers of registered clearing agency participants, such as buy-side market participants, due to their understanding of the risks and impacts of registered clearing agency decisions on a wide variety of such market participants and their clients.[51]

In considering the application of the rule, it is important to distinguish the contractual obligations and liabilities that exist between registered clearing agency participants and the registered clearing agency itself on the one hand, and between registered clearing agency participants and their own customers on the other. The Commission does not agree that customers of registered clearing agency participants are bound *to the clearing agency* for uncapped obligations. Customers of registered clearing agency participants do face contractual performance risk vis-à-vis their counterparty to a given transaction when they rely on a registered clearing agency participant to facilitate the clearing of such transaction on the customer's behalf, but the risk of non-performance in this case differs from the risk that parties to contracts generally assume. Notably, because the registered clearing agency may guarantee the transaction, the risk to the customer may be lower than other types of contractual relationships due to this extra layer of protection (notwithstanding the particular arrangements that may exist between the participant and its customer in the event of a default). The risk exposure between a participant and its customer is thus different in nature and scope than the risk exposure between a registered clearing agency and its participant. Consequently, the nature of these contractual obligations does not support extending by Commission rule representation on the board of a registered clearing agency to the customers of registered clearing agency participants. However, the Commission recognizes the importance of the board considering the views of stakeholders, including customers of registered clearing agency participants, and the Commission has provided opportunities for such views to be considered under Rule 17Ad–25(c) when nominating directors, and when soliciting viewpoints and feedback consistent with Rule 17Ad–25(j).[52]

One commenter agreed with the Commission's approach to allow registered clearing agencies (and in particular, nominating committees thereof) to exercise judgment to determine what constitutes materiality under the ''material relationship'' definition, rather than have it further defined, such as by numerical thresholds of financial compensation.[53] The commenter stated that such numerical thresholds would not be useful if established in advance. Likewise, the commenter stated that the concept of ''control'' should be left to the determination of the nominating committee of the registered clearing agency, as long as the analysis is documented and auditable.[54] The Commission agrees that numerical thresholds may not reflect the potential intersection of a director's personal finances and the ''material relationship'' definition, particularly when such thresholds have been formulated *ex ante,* and that, more generally, it is appropriate for the nominating committee to determine whether a director qualifies as an independent director, as further discussed in Part II.B.2 below.[55]

One commenter drew a comparison between the Commission's required levels of independent directors and the levels of a related category under the European Market Infrastructure Regulation (''EMIR'')[56] called Independent Non-Executive Directors (''INEDs'').[57] The commenter stated that currently EMIR requires at least one-third (and no fewer than two) of clearing agency board members to be INEDs. The commenter stated that requiring more INEDs would not result in greater transparency or objective governance, and that requiring a majority of the board to be INEDs would result in large boards that are ''functionally inefficient.''[58] The commenter also pointed out that the INED definition excluded representatives of clearing agency participants, regardless of whether those clearing agency participants were shareholders or not. Consequently, the commenter requested greater alignment between EMIR and the Commission's proposal. The Commission supports alignment where practicable and concludes that the two provisions are not in conflict with one another as currently structured based on the following: although the EMIR standard has a lower percentage requirement, it also defines independence more strictly than the Commission's proposal, and so the pool of eligible directors under EMIR is smaller than under Rule 17Ad–25. For example, if a clearing agency dually

[49] OCC at 7.

[50] SIFMA AMG at 8.

[51] Sarah A. Bessin, Associate General Counsel, and Nhan Nguyen, Assistant General Counsel, Investment Company Institute (Oct. 7, 2022) (''ICI'') at 7.

[52] *See infra* Parts II.B.3 (discussing the requirements in Rule 17Ad–25(c)(4)(ii) for the nominating committee to demonstrate that it has considered whether a particular nominee would complement the other board members, such that, if elected, the board, 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) and II.F (discussing the requirements in Rule 17Ad–25(j) to solicit, consider, and document stakeholder viewpoints).

[53] Claire O'Dea, Director, Government Relations and Regulatory Strategy, Americas, London Stock Exchange Group (Oct. 7, 2022) (''LSEG'') at 3–4.

[54] *Id.* at 4.

[55] *See infra* Part II.B.2 (further discussing the purview of the nominating committee and the comment regarding ''control'').

[56] *See* Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, as amended, *https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02012R0648-20200101.*

[57] LSEG at 3.

[58] *Id.*

registered under EMIR and with the Commission had a board with six persons, with two persons representing a controlling shareholder, two persons who were risk management professionals at two participants, and two persons who were independent academics, then that board could (with all other factors being met) comply with both the Commission's requirement of a majority of independent directors (four out of six), and the EMIR requirement of one-third INEDs (two out of six). Therefore, the requirements for INEDs under EMIR and for independent directors under the Commission's proposal do not conflict with each other.

The commenter also stated that operating under two definitions of ''independent director'' would require a dual registrant to undertake two sets of analyses because a director could qualify as independent under one standard but not the other, though the commenter also stated that the Commission's approach would not raise any compliance issues by itself.[59] The commenter encouraged alignment where possible. In this situation, the additional burden of conducting evaluations under these two standards is insignificant, because the evaluation process of a director's material relationships is highly fact-specific. The evaluation of whether a director meets the standard for independence generally should be broad and thorough, and it generally should turn on the specific facts of each director's individual circumstances. A broad inquiry that satisfies the requirement to determine whether material relationships exist will likely already reveal whether a candidate meets the criteria set forth in each respective jurisdiction, so it is unlikely that fully aligning the Commission's rules with the EMIR standard will result in cost or time savings.

In connection with the request for harmonization, the commenter stated that EMIR's limited INED requirement helps ensure that the board retains expertise sufficient to make decisions about budget, investments, and commercial strategy.[60] As discussed above, the Commission's definition of ''independent director'' would allow participants with experience on these strategic matters to also qualify as an independent director, so the concern from the commenter that a majority of the board being independent directors would result in inexperienced decision makers is misplaced, due to the differences in the scope of the respective definitions of INED and the Commission's proposal.

With respect to the inclusion of affiliates of the registered clearing agency in the definition of ''material relationship'' and in Rule 17Ad–25(f), the commenter expressed preference for consistency with how EMIR handles affiliates.[61] The commenter stated that under the EMIR regulatory framework, a clearing agency that is part of a group must evaluate 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. Therefore, under EMIR, if a clearing agency has the necessary level of independence to meet its regulatory requirements, a director could be considered independent even if she held a non-executive role at another clearing agency within the same group, which allows for consistency in risk management and cross-fertilization of ideas within a group.

The Commission used the term ''affiliates'' in the definition of ''independent director'' with respect to material relationships, and the exclusions in Rule 17Ad–25(f), to ensure an appropriate minimum standard across clearing agencies with respect to the board composition requirements in the rule. If affiliate relationships were excluded from the definition of ''independent director'' with respect to material relationships, a registered clearing agency could create an organizational structure where a majority of the board is aligned—such as through compensation—with an affiliate of the clearing agency. Benefits associated with the exchange of ideas can be obtained in other manners, such as information sharing agreements among affiliated companies. At the clearing agency, risk management should be tailored to the specific risks facing a particular registrant consistent with the statutory requirements for registration as a clearing agency, not with respect to its overall corporate group or affiliates. While affiliate relationships may, in some instances, enable a clearing agency to see risks outside of its own particular clearing agency function or services, consistency across affiliates is not per se an important risk management goal. A registered clearing agency generally should focus on identifying and managing the risks that it faces, rather than risks to its affiliates. Therefore, the Commission is adopting the definition of ''material relationship'' and the exclusions in Rule 17Ad–25(f) to include affiliates of a clearing agency as proposed.

As to the adequacy of the Commission's use of one-year lookback periods in Rule 17Ad–25(f), one commenter recommended a longer period of three to five years as an adequate lookback period.[62] The commenter stated that there is a five-year requirement under EMIR, and that a one-year requirement could be considered too short because some payments may not be received by a director for a while (*e.g.,* some payments may be deferred for up to four years), some projects to which a person has played a key role may not yet be delivered, and informal relationships may continue. The obligation not to have a material relationship applies in an ongoing manner, not simply to a moment in time. Although the lookback period that applies to the ''material relationship'' definition and to the list of exclusions in Rule 17Ad–25(f) covers the one-year period prior to the date that a determination of independence is made, delayed payments that a director might receive while serving as an independent director would be addressed due to the ongoing application of Rule 17Ad–25(f). For instance, if an independent director received payments in the third year of his or her term, such payments were related to relationships that existed two years prior to the start of that term, and such payments precluded a director from being independent under Rule 17Ad–25(f), then the director would cease to qualify as an independent director at the time of the payment—irrespective of the lookback period. Consequently, extending the lookback period is not necessary to address any delayed or deferred activity because a director must meet the standard for an ''independent director'' on an ongoing basis under the requirements of Rule 17Ad–25(b).

Several commenters stated that the possible inclusion of employees of clearing agency participants as independent directors on registered clearing agency boards would bring several benefits, including increasing the candidate pool, providing industry expertise, promoting a strong alignment between the risk management and operational integrity of the registered clearing agency, and bringing diverse

[59] *Id.* at 6.

[60] *Id.* at 4.

[61] *Id.* at 5.

[62] LSEG at 5.

perspectives.[63] One commenter disagreed, stating that the definition of ''material relationship'' should be expanded to ensure that employees or other representatives of participants be excluded from qualifying as independent,[64] while another commenter stated that the candidate pool from among employees of clearing agency participants would shrink under the proposed rules.[65] Having qualified, experienced persons serving in these director roles promotes sound risk management practices at the registered clearing agency because such persons bring necessary technical experience in clearing agency risk management. The Commission supports the inclusion of employees of participants in the potential pool of candidates for independent director in order to make such experienced personnel available for consideration as candidates, provided that such personnel do not have relationships that would preclude them from being independent directors. The Commission acknowledges that the candidate pool would shrink to the extent that experienced employees of participants also have material relationships that pose a conflict of interest (for example, if such employees' judgment or independent decision-making could be affected by their relationships with a participant), other than being an employee of a participant.

Additionally, a separate commenter requested that the independent director definition explicitly require independence from dominant market participants.[66] The commenter stated that the derivatives markets, within which the Commission regulates clearing agencies for security-based swaps, continue to be dominated by a few market participants, thereby concentrating risk and skewing incentives towards the largest clearing agency participants, at the expense of appropriate risk management and competition.[67] The commenter suggested that the lowering of the majority requirement to 34 percent of independent directors when participants are a majority of owners should have restrictions as to the size of the clearing agency participants that can qualify, to exclude dominant market participants.[68] The commenter disagreed with the Commission that existing regulations, such as Rule 17Ad–22, have adequately addressed market dominance by certain participants, and stated that anecdotal evidence from abroad suggests that clearing agencies hold such dominant participants to less scrutiny with respect to risk management requirements, while small and medium-sized entities struggle to maintain access to central clearing.[69]

The liability inherent to being a clearing agency participant, to which participants of all sizes subject themselves, aligns their interests with the goal of a well-managed registered clearing agency, even if incentives to free-ride, and thereby have the costs of managing the clearing agency borne by other participants, remain. Because Exchange Act section 17A(b)(3)(C) states 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,'' [70] it remains appropriate to not summarily restrict representation based on volume of use, which is what the commenter is requesting. Therefore, the Commission is not removing the ability of employees or other representatives of certain sizes of clearing agency participants to qualify as independent directors, provided all other requirements of Rule 17Ad–25 are met.

4. Incentive Structures

One commenter requested that the Commission undertake a comprehensive study of how various ownership models allocated incentives among owners and participants of registered clearing agencies, stating that different ownership models might each require a special regulatory approach to ensure a full alignment of incentives among stakeholders.[71] In particular, the commenter stated that conflicts of interest arise in the investor-owned model, where some participants are not owners but still face mutualized risk at the clearing agency, as compared to a participant-owned model. The rule already addresses the distinction between clearing agencies that are majority-owned by participants and other types of clearing agencies by applying a 34 percent independent director requirement to the former category. The commenter expressed the view that applying a different standard for independent directors between participant-owned and investor-owned clearing agencies is unnecessary, in part, because the commenter read the economic analysis in the Governance Proposing Release to state that all participant-owned clearing agencies already have boards with a majority of independent directors.[72] However, Table 3 in the Governance Proposing Release discussed different criteria that applied to certain directors,[73] and the Governance Proposing Release did not discuss the extent to which these criteria may differ from the proposed definition of and proposed requirements for independent directors. Importantly, although registered clearing agencies may currently label some directors as ''independent,'' such directors may not meet the requirements for an ''independent director'' under Rule 17Ad–25. Application of Rule 17Ad–25 to existing registered clearing agencies will impose composition standards that better serve the goals of Exchange Act section 17A than current practice. Additionally, Rule 17Ad–25 will apply to prospective applicants that may seek to be registered clearing agencies in the future—not only the current set—and so establishing a standard that existing registered clearing agencies may already satisfy can nonetheless still ensure a certain minimum standard across potential future applicants and registrants. Therefore, the Commission is not modifying the application of the 34 percent independent directors versus a majority of independent directors in the final rule.

The same commenter also stated that, if a requirement for a majority of independent directors leads to effective board oversight of management, then all registered clearing agencies—not just those that are investor-owned—should be subject to that standard.[74] However, the ''independent director'' requirement in Rule 17Ad–25 considers, in addition to a director's independence from management, a director's material relationships with a registered clearing agency's affiliates, owners, vendors, customers, and controlling interests of participants. Because the requirements in Rule 17Ad–25 preclude an individual from serving as an independent director when such material relationships reasonably could affect the independent judgment or decision-making of the director, a registered clearing agency that is majority-owned by participants

[63] *See* DTCC at 4; Saguato at 3 (supporting the inclusion of employees of participants because they have substantial financial exposure and a commitment to the resilience of the participant).

[64] James Tabacchi, Chairman, Independent Dealer and Trader Association (Oct. 7, 2022) (''IDTA'') at 1; *see also* Zimmerman (expressing general concerns about potential conflicts of interest among directors and senior managers).

[65] CCP12 at 3.

[66] Better Markets at 16.

[67] *Id.* at 10.

[68] *Id.* at 17.

[69] *Id.* at 16–17.

[70] 15 U.S.C. 78q–1(b)(3)(C).

[71] Saguato at 2.

[72] *Id.* at 3.

[73] *See* Governance Proposing Release, *supra* note 2, at 51844.

[74] Saguato at 3.

could determine that an employee of an owner-participant has relationships that preclude the employee from serving as an independent director—not on the basis of her employment relationship to the participant but rather other potential entanglements that may emerge from the employee's other material relationships with the clearing agency. For example, if an employee of an owner of a clearing agency received stock options as part of a compensation package, that employee has interests tied to the profits of the clearing agency distinct from an employee who receives stock options of a clearing agency participant that is not also an owner of a clearing agency. The existence of such interests tied to profit that carry through ownership structures back to the clearing agency poses a potential conflict of interest for a director of that clearing agency. In this way, a registered clearing agency may determine that employees of owners are less likely than employees of participants to satisfy the independent director requirement. Applying a 51 percent requirement to registered clearing agencies that are majority-owned by their participants could, in the view of a registered clearing agency evaluating the material relationships of its nominees for independent directors, result in minority representation of owners and participants. Therefore, the rule applies a lower threshold to participant-owned clearing agencies to provide the shareholders of such a registered clearing agency greater discretion to nominate, as independent directors, candidates from among, for example, the employees of participant-owners. Applying the higher standard to all clearing agencies, solely to insulate the board from influence by management, could restrict access to representatives of participant-owners in a way that may impair the board's ability to oversee the clearing agency's risk management function effectively.

One commenter agreed that the proposed requirements for independent directors address conflicts of interest, but the commenter also stated that the solution was incomplete to address the problem and so recommended that the Commission also adopt a ''skin-in-the-game'' requirement.[75] Specifically, this commenter stated its belief that it is necessary to align the incentives between a clearing agency and its participants by requiring the clearing agency to subject a meaningful amount of its own capital to potential loss after a default of a participant, in particular after the defaulting participant's margin and guaranty fund contributions are used to satisfy its obligations, but before any margin or guaranty fund contributions of other non-defaulting participants are used to satisfy the obligations of the defaulting participant. This idea seeks to encourage a clearing agency to manage risks well, to prevent its own capital from being lost during a default. This commenter's suggestion is beyond the scope of the present rulemaking.

One commenter expressed concern that employees of participants who are acting as independent directors and representing the interests of the clearing agency could have conflicts of interest between these two roles.[76] The commenter recommended that the Commission impose a requirement for such persons to have due regard to market stability in their role at the clearing agency. Directors do not need to have a specific obligation applied to them in their individual capacity to consider market stability. Rules 17Ad–22(e)(2)(ii) and (iii) require covered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for governance arrangements that clearly prioritize the safety and efficiency of the covered clearing agency and support the public interest requirements in Exchange Act section 17A.[77] These existing requirements are sufficient to ensure a registered clearing agency has due regard for financial stability.

One commenter agreed with the Commission's concerns that a small number of participants—if allowed to exercise control over a clearing agency—can promote margin or other requirements that are not commensurate with the risks of a participant's specific products, portfolio market, business model, and size, which could lead to a concentration of risk in a few dominant market participants who benefit.[78] The commenter suggested that the Commission adopt rules that would address non-independent directors and would require diversity among participant representation on the board, based on size and level of specialization by said participants. Otherwise, the commenter suggested, the representation among participants will be lopsided, leading to greater concentration of risk among the clearing agency's largest participants. The Commission agrees that the interests of participants are not always homogenous or aligned, and therefore, the interests of smaller participants can diverge from those of the largest. However, the Exchange Act requirement for fair representation allows for the consideration of proportionality as an element.[79] Although all participants are equally exposed to default risk, larger firms may be more impacted by policies that apply based on transaction volume. Thus, it can be appropriate to apportion representation according to use of the clearing agency, even if an effect of this approach is to be disproportionate as to the number of small, medium, or large participants represented on the board relative to the total number of small, medium, or large participants in a clearing agency's customer base at any particular time. Further, there could be arguments that reducing the degree of proportionality of representation relative to use of the clearing agency could lead to negative externalities that disproportionately impact larger participants. Accordingly, the Commission is declining to expand the scope of this rule to develop participant categories and to require certain level of participant representation on the board as non-independent directors among those categories.

5. Ownership Structures

One commenter stated that the largest clearing agency participants do not necessarily need personal influence over a director because they possess economic leverage over the clearing agency.[80] Additionally, the commenter requested that special attention be paid towards participants at registered clearing agencies that clear derivatives products because of the risk posed to effective governance by an ''oligopoly'' of market power exercised by certain derivatives dealers.[81] Instead of relying on independent directors as a bulwark against conflicts of interest, the commenter suggested restoration of the ownership limits that were previously proposed in Regulation MC to address market concentration.[82] The commenter further suggested that the Commission go beyond what was originally proposed in Regulation MC and add restrictions

[75] Better Markets at 5–6, 12–14.

[76] *See* ISDA at 6.

[77] *See* 17 CFR 240.17Ad–22(e)(2)(ii), (iii); *see also* 17 CFR 240.17Ad–22(d)(8) (requiring registered clearing agencies that are not covered clearing agencies to establish, implement, maintain and enforce governance arrangements that are clear and transparent to fulfill the public interest requirements in Exchange Act section 17A).

[78] IDTA at 2–3.

[79] *See* 15 U.S.C. 78q–1(b)(3)(C) (''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.'').

[80] Better Markets at 14.

[81] *Id.* at 10.

[82] *Id.* at 15; *see also* Exchange Act Release No. 63107 (Oct. 14, 2010), 75 FR 65882 (Oct. 26, 2010) (proposing Regulation MC).

on commercial arrangements for volume, such as volumetric discounts, rebates, or revenue sharing. This suggestion goes beyond the scope of this rulemaking because they concern restrictions on commercial arrangements rather than requirements for board composition and governance.

The commenter also suggested expanding the definition of ''affiliate'' to deem all owners and shareholders as affiliates, under the reasoning that a handful of dominant shareholders could ''collude'' among one another to exercise constructive control over a clearing agency, even if each individual shareholder did not meet the definition for control itself.[83] Many participants are also shareholders of a clearing agency, and so if the affiliate definition were to be expanded, it would restrict employees of many participants from meeting the independent director definition as a result of the exclusion in Rule 17Ad–25(f)(2). The Commission is concerned that such an expanded definition could interfere with the ability of a clearing agency to afford fair representation to participants, as contemplated by Exchange Act section 17A(b)(3)(C), which discusses the ability of participants to participate in board governance. In addition, Rule 17Ad–25 includes elements directed at the problems of ''collusion'' in multiple ways, and Rules 17Ad–25(g) and (h), and the associated requirements to address and disclose conflicts of interest, are better suited to address such potential ''collusion'' among certain shareholders because they are broad-based and not restricted to one potential source of conflicts (*i.e.,* affiliates).[84]

6. Circumvention

One commenter expressed concern that the proposal did not specify who at the clearing agency should determine whether a fact pattern meets the definition of ''material relationship,'' reasoning that if the board can make that determination, there could be an incentive on the board of directors to give each other a ''free pass'' as to their potentially objectionable relationships.[85] Instead, the commenter suggested an explicit requirement for disinterested compliance officers or qualified outside professionals to determine whether material relationships exist. The proposed rules did not specify who at the clearing agency should evaluate relationships under this definition, and the Commission has modified the final rules to specify that the nominating committee is required to evaluate all board members under the independent director standard, as discussed further in Part II.B.2.

Some commenters provided recommendations that went beyond the composition of the board and instead addressed the authority of a board more generally. Specifically, some commenters requested that the Commission apply more rigorous governance procedures to clearing agencies with respect to their emergency powers as set forth in their rulebooks, which the commenters stated were broad and vaguely defined.[86] But emergency powers exist at two levels for many clearing agencies: those provisions that impact the rights and obligations of the board, as set forth in the organizational documents of the legal entity itself (such as the ability of the board to act without a quorum in the event of an emergency, such as a terrorist attack),[87] and those provisions that impact the clearing agencies' rights and obligations with respect to the clearing members.[88] Although the Commission's rules do not directly impact the parameters around which emergency powers can be exercised, either at the board level or under the rules of the clearing agency, they do address who will make decisions when exercising such emergency powers. Ensuring that decision-making processes are clear, transparent, and fair, and that market participants have confidence in those processes in an emergency—including that neither clearing agency owners nor participants will dominate the decision-making process to achieve their own ends—can help reassure those who may be significantly impacted by such decisions. Rule 17Ad–25 meaningfully addresses such generalized concerns about the fair and even-handed use of emergency powers by establishing new standards for board governance applicable to registered clearing agencies.

Finally, one commenter suggested that the majority independent director requirement could be evaded by any supermajority requirement for voting or quorums of the board.[89] The Commission is aware that some registered clearing agencies currently apply supermajority requirements in certain scenarios, such as a requirement that three-fourths of an entire board shall constitute a quorum for purposes of electing the board chair.[90] Policies and procedures to identify, mitigate, or eliminate existing or potential conflicts of interest required under Rule 17Ad–25(g) generally should provide for the clearing agency to evaluate whether any supermajority requirements in any of the registered clearing agency's rules, policies, and procedures would allow directors with potential conflicts of interest to steer the clearing agency in service of those personal interests by avoiding any mechanisms that might require mitigation or elimination (*e.g.,* recusal by the director on the matter at hand) of the conflict of interest. A registered clearing agency generally should consider whether its policies and procedures under Rule 17Ad–25(g) are ''reasonably designed'' if provisions of its rules, policies or procedures would allow non-independent directors to exercise disproportionately greater control of certain board decisions beyond what their numbers would otherwise allow.[91]

[83] Better Markets at 19.

[84] *See infra* Part II.D (further discussing final Rules 17Ad–25(g) and (h)).

[85] Better Markets at 19.

[86] Barclays et al. at 3; *see also* SIFMA at 4 (stating that ''greater transparency and a more rigorous governance process, including consultation with primary regulators, regarding the use of emergency powers should help further confidence in the overall financial system and ensure that affected stakeholders are aware and have buy-in when such powers are used.''); ISDA at 2.

[87] *See, e.g.,* Bylaws, The Option Clearing Corporation, at Article II, Section 15 (stating, ''During any emergency which results, directly or indirectly, from an attack (including a terrorist attack) on the United States or on a locality in which the Corporation maintains an office or customarily holds meetings of the Board of Directors, or from a war, armed hostilities, insurrection or other calamity involving the United States or any such locality, or from any nuclear or atomic disaster, or from any other catastrophe, disaster, (including any environmental or natural disaster), communications systems failure, or other similar condition, in which a quorum (as specified in Article III of the By-Laws) of the Board of Directors or a standing committee thereof cannot readily be convened for action (an ''Emergency''), the following provisions of this Section 15 shall be operative notwithstanding any other provision in any of the sections (other than Section 110) of the Delaware Corporation Law or in the Certificate of Incorporation, By-Laws or Rules of the Corporation. The Chairman, Chief Executive Officer, Chief Operating Officer or, if it is not feasible for the Chairman, Chief Executive Officer, or Chief Operating Officer to take such action, then another officer who is a Designated Officer is authorized to declare the existence of such Emergency and to declare this By-Law to be in effect.''), *https://www.theocc.com/company-information/documents-and-archives/by-laws-and-rules.*

[88] *See, e.g.,* ''Rule 38: Market Disruption and Force Majeure,'' DTC Rulebook, *https://www.dtcc.com/-/media/Files/Downloads/legal/rules/dtc_rules.pdf.*

[89] Better Markets at 18.

[90] *See* Organizational Certificate of the Depository Trust Corporation, *https://www.dtcc.com/legal/rules-and-procedures.*

[91] *See infra* Part II.D.2 (further discussing the ''reasonably designed'' and ''reasonableness'' elements of Rules 17Ad–25(g) and (h)).

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 compose 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, which must be 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.[92] 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 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, 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 affected 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.

In the Governance Proposing Release, the Commission explained that some registered clearing agencies currently use governance arrangements other than a nominating committee to select certain directors.[93] It also explained that, 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 boardpursuant to a written evaluation process established by the registered clearing agency.[94]

With respect to proposed Rule 17Ad–25(c)(4)(iii), which would give the nominating committee discretion to determine how to consider the views of other stakeholders, the Commission stated that 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.[95]

Commenters generally supported the proposed rules addressing the nominating committee.[96] As discussed in more detail below, commenters sought clarity regarding discussion in the Governance Proposing Release stating that the nominating committee would be the ''exclusive venue'' for considering director nominees, as discussed further below. In addition, some commenters recommended modifying the proposed approach to participation by small and medium-sized firms on the board, and regarding the percent of directors that are independent directors serving on the nominating committees. The Commission addresses each of these topics in Parts II.B.2 through II.B.4.

2. As ''Exclusive Venue'' for Considering Nominees

Several commenters sought clarity regarding statements in the Governance Proposing Release that the nominating committee be the ''exclusive'' venue for considering nominees.[97] As discussed further below, the Commission is modifying the rule being adopted to address more clearly scenarios in which directors may be nominated or appointed directly by shareholders pursuant to the organizational documents of the registered clearing agency outside of the process established by the nominating committee.

First, one commenter recommended that the Commission modify the rule so that the nominating committee only conduct written evaluation of nominees and not appointees that may be selected via other mechanisms in the governance structure.[98] For example, OCC allows certain participant exchanges to select ''Exchange Director'' nominees for election to OCC's board. The proposed rule text does not address this specific type of selection process, but as discussed in the Governance Proposing Release,[99] proposed Rule 17Ad–25(c) would not prohibit the selection of such directors appointed pursuant to such a process. Nonetheless, as previously discussed in the Governance Proposing Release, 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.[100] 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.

Accordingly, as proposed, Rule 17Ad–25(c) was intended to ensure that, with respect to all nominees and appointed directors, the nominating committee would evaluate each nominee or appointee for director, no matter the source of her nomination or equivalent selection as director, against the standards for fitness and

[92] As explained in the Governance Proposing Release, *supra* note 2, at 51828 & n.107, 15 U.S.C. 78q–1(a)(3)(C) identifies the circumstances that 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.

[93] Governance Proposing Release, *supra* note 2, at 51829 (describing these arrangements other than a nominating committee as ''other governing bodies and/or constituents of their organizational structure'').

[94] *Id.*

[95] *Id.* at 51830.

[96] *See, e.g.,* Better Markets at 4; DTCC at 5; IDTA at 4; ISDA at 6; LSEG at 8; OCC at 3; Saguato at 3. *But see* ICE at 3 (describing the proposed approach as ''too prescriptive'').

[97] DTCC at 5; LSEG at 8; OCC at 7; Saguato at 4; *see also* Governance Proposing Release, *supra* note 2, at 51830 (requesting comment on the following: ''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?'').

[98] OCC at 7–8.

[99] *See* Governance Proposing Release, *supra* note 2, at 51829.

[100] *See id.*

independence established by Rule 17Ad–25.[101] This ensures that the board, the participants of the registered clearing agency, and ultimately other stakeholders and the public, have confidence in the fitness of directors generally and in the independence standard applied to directors to qualify as independent directors. The commenter's recommended approach would be inconsistent with the purpose and intent of proposed Rule 17Ad–25 because proposed Rule 17Ad–25(c) was intended to ensure that, with respect to all directors, the nominating committee would evaluate each nominee, no matter the source of their nomination, against the standards for fitness and independence established by Rule 17Ad–25. To the extent that any directors are ''appointed,'' it is appropriate to subject such ''appointees'' to the same standards as other nominees for director. Doing so would not slow or otherwise stymie the appointment of such directors because, regardless of how they are selected to serve on the board, all directors are subject to the same fitness standards and also would be subject to disclosure requirements regarding the reporting of potential conflicts of interest and material relationships.[102] Specifically, Rule 17Ad–25(c)(4)(ii) requires the nominating committee to demonstrate that it 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. Because this requirement is focused on board composition, excluding any directors from the requirement would undermine the purpose of the rule and the ability of the nominating committee to evaluate board composition as a whole.

Similarly, proposed Rule 17Ad–25(c)(4)(iv) requires the nominating committee to identify whether each 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. Because this requirement establishes a baseline against which the registered clearing agency will need to evaluate potential conflicts of interest, regardless of whether a director is intended to be independent, the nominating committee should evaluate appointed directors as well. Such requirement helps ensure that the clearing agency can evaluate potential conflicts of interest that may require a director to recuse as to certain matters before the board. The Commission therefore is not modifying the rule to exclude from evaluation by the nominating committee nominees or directors who are appointed by other means pursuant to the organizing documents of the registered clearing agency.

Notwithstanding the above, the Commission is modifying Rule 17Ad–25(c) in two ways: (a) the Commission is modifying paragraph (1) to add that the nominating committee shall also ''evaluate the independence of nominees and directors,'' in addition to evaluating nominees for serving as directors, and (b) the Commission is modifying paragraph (4)(iv) in two places to specify that the evaluation process applies to nominees as well as directors. Pursuant to the latter modification, the written evaluation process required by the rule shall identify whether each nominee ''or director'' would meet the definition of independent director and whether each ''such nominee or director'' has a known material relationship with the registered clearing agency (or an affiliate thereof).[103] These changes ensure that the final rule addresses the role of the nominating committee in evaluating directors which it did not itself nominate because their nominations came through different processes specified in the organizing documents of the registered clearing agency. Separately, the Commission is also modifying paragraph (4)(iii) to replace the term ''impacted'' with ''affected.'' This is a technical correction to avoid the use of informal language in the rule text.

Second, as previously discussed in Part II.A.3, one commenter stated that the concept of ''control'' as used in certain definitions in and requirements of Rule 17Ad–25, should be left to the determination of the nominating committee of the registered clearing agency, as long as the analysis is documented and auditable.[104] The Commission agrees and Rule 17Ad–25(c)(1) accordingly includes a requirement for a written evaluation process, so that the clearing agency has documentation as to its determinations of control.

Third, one commenter sought clarity as to whether the nominating committee can perform other functions.[105] Specifically, the commenter explained that a registered clearing agency might establish one committee that performs the entire function and role of the nominating committee but also consider other governance functions more broadly. Such an approach can be appropriate and consistent with the adopted rule. Rule 17Ad–25(c), as discussed above and modified, requires that the nominating committee evaluate each nominee for serving as a director and evaluate the independence of nominees and directors. A committee that performs these functions would satisfy the requirements of the rule, even if it also performed additional functions as specified in the organizing documents of the registered clearing agency. A registered clearing agency, however, generally should take account of the overall workload imposed on the nominating committee in the organizing documents and ensure that the nominating committee has sufficient time and resources to fulfill the functions required by Rule 17Ad–25(c), which include evaluating nominees and directors as explained above and establishing the fitness standards for serving on the board.

Fourth, one commenter asked whether the board could take on the functions of the nominating committee if it met all requirements applicable to the nominating committee.[106] Such an approach can be appropriate and consistent with the rule. Consistent with the requirements in Rule 17Ad–25(c)(2), such an approach would require that a majority of the directors serving on the board be independent directors—regardless of the ownership structure of the clearing agency—and that the chair of the board be an independent director.

3. Approach to Representation of Small and Medium-Sized Firms

In addition to comments discussed in Part II.A.4 regarding establishing a ''right of participation'' generally on the board by small and medium-sized participants of the registered clearing agency, commenters also expressed similar views specific to participation

[101] *See* Governance Proposing Release, *supra* note 2, at 51829 n.110 (providing the same example).

[102] *See infra* Part II.D (further discussing both a clearing agency's entity-wide obligations and a director's specific obligations relating to potential conflicts of interest and the evaluation of material relationships).

[103] *See* Rule 17Ad–25(b)(2) (requiring, among other things, that the registered clearing agency broadly consider all the relevant facts and circumstances 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).

[104] LSEG at 4.

[105] DTCC at 5.

[106] ICE at 3.

on the nominating committee. Two commenters recommended that the Commission specifically authorize such a right of participation on the nominating committee.[107]

Exchange Act section 17A(b)(3)(C) directs the Commission to ensure the fair representation of owners and participants in the selection of directors and the administration of affairs. As previously discussed in Part II.A.4, it can be appropriate to apportion representation according to use of the clearing agency, even if an effect of this approach is to be disproportionate as to the number of small, medium, or large participants represented on the board relative to the total number of small, medium, or large participants that use the clearing agency. In addition, reducing the degree of proportionality of representation relative to use of the clearing agency could lead to negative externalities. For these same reasons, the Commission is not modifying the proposed rule to require a ''right of participation'' on the nominating committee specific to small and medium-sized participants.[108] In proposing Rule 17Ad–25(c), the Commission stated its belief that smaller participants and clients of participants generally should be represented on clearing agency boards and board committees, such that their views and perspectives are formally considered in board decisions that may impact them.[109] In particular, the Commission explained that 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. Consistent with these views, board governance, and through it the risk management function of the clearing agency, benefits from diverse perspectives on 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) require that clearing agencies take steps to facilitate diverse perspectives and expertise on the board, including a requirement in Rule 17Ad–25(c)(4)(ii) for the nominating committee to demonstrate that it 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—among other things—the range of different business strategies, models, and sizes across participants, as well as the range of customers and clients the participants serve. These requirements ensure that the nominating committee considers a diverse set of backgrounds, experience, and skills in selecting and evaluating nominees for the board.[110] In this regard, a registered clearing agency generally should provide in its governance arrangements that the nominating committee explicitly consider some nominees that represent the views of medium and small participants, but, in the Commission's view, it is appropriate to leave discretion to the clearing agency and its board to evaluate and select the appropriate mix of nominees and directors mindful of its organizational documents, markets served, and products cleared.

For the above reasons, the Commission is not modifying Rule 17Ad–25(c) in response to these comments.

4. Percent of Directors That Are Independent Directors

Some commenters expressed support for the proposed approach to require that the chair of the nominating committee be an independent director and that a majority of the directors serving on the nominating committee be independent directors.[111] One commenter recommended that the Commission modify the proposal to require that all directors serving on the nominating committee be independent directors.[112] The commenter stated that such an approach would help maintain the standard for director independence and improve the overall quality of nominees.

The Commission is not requiring all directors serving on the nominating committee be independent directors for two reasons. First, as a general matter, the proposal sought to ensure an approach to board governance that facilitates fair representation of both owners and participants in the selection of directors and the administration of a clearing agency's affairs.[113] The proposed approach is consistent with this requirement in part because it enables any individual director, whether independent or not, to serve on the nominating committee. Second, and mindful of the concern raised by the commenter, the proposed rule would require that a majority of the directors serving on the nominating committee be independent directors regardless of the ownership structure of the registered clearing agency.[114] A majority of independent directors and a chair of the nominating committee that is also an independent director is sufficient to ensure the thoughtful consideration, evaluation, and selection of nominees, particularly for nominees to serve as independent directors on the board of a registered clearing agency. Given the definition of ''independent director'' used in Rule 17Ad–25, modifying the rule further to require that *only* independent directors can serve on the nominating committee would not clearly improve the functioning of the nominating committee. Independent directors would already be a majority of the nominating committee when making determinations, and as such, directors intended to represent owners of the clearing agency cannot comprise a majority of the nominating committee without also obtaining support from independent directors as to particular decisions. Because clearing agencies perform a unique and often systemically important function that facilitates effective risk management in the U.S. securities markets, enabling a wide range of stakeholders in the registered clearing agency to serve on the nominating committee, including directors who are not independent directors, can provide expertise,

[107] Better Markets at 20 (recommending that the Commission mandate participation from smaller clearing members to guard against a board that finds diversity within the ''oligopoly of large dealers''); IDTA at 4 (recommending that the Commission be more prescriptive in requiring that certain types of stakeholders, such as ''not FSOC designated SIFIs'' be afforded a right to participate).

[108] *See supra* notes 76–78 and accompanying text (not modifying the rule to designate certain seats on the board for specific types of clearing agency participants or their customers).

[109] Governance Proposing Release, *supra* note 2, at 51829.

[110] *See infra* Part II.F (further discussing Rule 17Ad–25(j), which imposes an obligation on the board to formally consider stakeholder viewpoints, also helps ensure that the board is actively soliciting the views of those stakeholders who do not participate in the board directly so that the views of such stakeholders can be considered and incorporated into the board's risk management and operations).

[111] DTCC at 5; ISDA at 6; LSEG at 9; Saguato at 3; *see also* ICE at 3 (observing that, in its view, requiring written evaluations of nominees is unnecessary if the committee is also composed of a majority of independent directors).

[112] IDTA at 4.

[113] Governance Proposing Release, *supra* note 2 at 51818 (''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.'').

[114] *See supra* Part II.A (further discussing Rule 17Ad–25(b), which sets the general requirement for the number of independent directors required to serve on the board based on the percentage of ownership held by participants in the registered clearing agency).

experience, and skills useful to the nominating committee's overall purpose.

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) (''RMC'') to assist the board in overseeing the risk management of the registered clearing agency. Proposed Rule 17Ad–25(d)(1) would also require each RMC 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 the RMC, 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.

In the Governance Proposing Release, the Commission explained that because all registered clearing agencies are currently covered clearing agencies and, as such, are required to have RMCs as a part of their governance arrangements under Rule 17Ad–22(e)(3)(iv),[115] no parallel requirement exists for registered clearing agencies that are subject to Rule 17Ad–22(d).[116] The Commission stated that because future registered clearing agencies that are not covered clearing agencies and, as a result, are subject to Rule 17Ad–22(d), will also likely face risk management issues related to their activities, any clearing agency subject to Rule 17Ad–22(d) will likely benefit from having a RMC.[117] Accordingly, the Commission proposed Rule 17Ad–25(d) so that clearing agencies subject to Rule 17Ad–22(d) will also be required to have RMCs as a part of their governance arrangements.[118] Additionally, the Commission stated that proposed Rule 17Ad–25(d) would establish more defined requirements related to the purpose and function of RMCs that Rule 17Ad–22(e)(3)(iv) does not and that specific requirements imposed by proposed Rule 17Ad–25(d) would help enhance risk management governance across all registered clearing agencies.[119]

In the Governance Proposing Release, the Commission also stated that it recognizes the importance of enabling the board to assign certain tasks to a board committee to assist the board in discharging its ultimate responsibility of ensuring the sound risk management of the clearing agency.[120] The Commission stated that for the RMC itself to be effective, it must have a clearly defined purpose and obligations to the board; therefore, the proposed rule would require the RMC 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.[121]

Commenters generally supported the proposed approach to Rule 17Ad–25(d).[122] However, some commenters requested clarifications [123] or modifications to the rule.[124] Other commenters disagreed with certain aspects of the rule.[125] Proposed Rule 17Ad–25(d) balances more defined requirements with principles-based requirements relating to a registered clearing agency's RMC. In keeping with this approach and to address requests for clarifications and revisions to the rule, the Commission adopts Rule 17Ad–25(d) as proposed, with certain modifications. Specifically, Rule 17Ad–25(d)(1) has been modified to reflect that: (1) the RMC is ''of the board'' of the registered clearing agency; and (2) the RMC's membership must be ''re-evaluated annually.'' Additionally, Rule 17Ad–25(d)(2) has been modified to reflect that the RMC's work must support the ''overall risk management, safety and efficiency of the registered clearing agency.'' Rule 17Ad–25(d) establishes specific requirements as a minimum bar for RMCs across all registered clearing agencies while also providing registered clearing agencies with discretion to consider when and how to re-evaluate the RMC membership annually and regarding the choice of the RMC chair.

2. RMC of the Board

Many commenters had understood the proposed rule to require a board-level RMC, as the Commission had intended the rule to require, and supported the Commission's approach.[126] A commenter requested that the Commission clarify in a final rule that the board-level RMC is ''not merely an advisory body that only develops opinions or recommendations for full board consideration and action.'' [127] Another commenter stated that because risk management should be a critical focus of the RMC, the RMC should have adequate representation by clearing agency participants, and the proposed requirement would help formalize such a structure and foster further consistency across clearing agencies.[128]

Two commenters, however, objected to the Commission's approach that would require the RMC to be a board-level committee.[129] For example, one commenter stated that registered clearing agencies should be given the discretion to structure their RMCs as they see fit, whether as a board committee or an advisory group with a broader membership than the board and

[115] *See* 17 CFR 240.17Ad–22(e)(3)(iv); *see also* CCA Standards Adopting Release, *supra* note 4, at 70807–09 (discussing that, under Rule 17Ad–22(e)(3)(iv), a registered clearing agency's risk management framework must provide risk management personnel with a direct reporting line to, and oversight by, a RMC of the board of directors).

[116] *See* Governance Proposing Release, *supra* note 2, at 51831.

[117] *See id.*

[118] *See id.*

[119] *See id.*

[120] *See id.*

[121] *See id.*

[122] *See, e.g.,* SIFMA at 3 (stating that it ''supports this part of the rule and urges the Commission to adopt it . . .''); Barclays *et al.* at 2 (stating that ''[w]hile it is reassuring that all seven of the current clearing agencies include participant representatives on their RMCs, we believe that the codification of this practice into a requirement will be beneficial''); DTCC at 5 (stating that ''DTCC generally supports the requirements set forth in proposed Rule 17Ad–25(d) regarding the establishment and function of a board risk committee . . .''); ICI at 2 (stating that ''[w]hile RMCs currently exist at some clearing entities, the proposed requirements would promote greater consistency and a defined role for these committees.'').

[123] *See, e.g.,* DTCC at 5–6; OCC at 8–9.

[124] *See, e.g.,* SIFMA AMG at 4–6; Barclays et al. at 2.

[125] *See, e.g.,* OCC at 8–9 (stating that ''[a] requirement that forces a registered clearing agency to replace well-informed risk management experts with directors relatively unfamiliar with a particular matter or the broader risk management framework would rob the registered clearing agency of critical risk management continuity.''); CCP12 at 4–5 (stating that ''[w]hile we agree that it can be beneficial for a risk management committee to be a board committee . . . we do not support making this a requirement . . .''); ICE at 4 (stating that ''ICE supports the Commission's proposal to require a SEC Registered CA to establish a risk management committee but disagrees with the requirement that a risk management committee be a committee of the board.'').

[126] *See, e.g.,* LSEG at 10 (stating that ''this would be an effective way to structure the committee. As a board sub-committee, the RMC can be formally delegated certain authorities and would be subject to the same corporate governance regime of the company.''); Saguato at 4 (stating that ''[a] [c]learing agency should have one or more risk committee to support the board in its operation.'').

[127] DTCC at 6.

[128] *See* SIFMA at 3 (stating that ''the Commission's specific proposal in this regard will help formalize this structure and further foster consistent practices across such clearing agencies.'').

[129] *See* ICE at 4 (stating that it ''supports the Commission's proposal to require a SEC Registered CA to establish a risk management committee but disagrees with the requirement that a risk management committee be a committee of the board.''); CCP12 at 4 (stating that ''we do not support making this a requirement for all clearing agencies, as there are other models that clearing agencies use that are also effective.'').

with requisite expertise in risk management matters, stating it does not view that ''a board level risk management committee . . . improve[s] the board's engagement with clearing agency risk management, nor is there any evidence that it makes a board's oversight of management's decisions more effective.'' [130]

In response to commenters, the Commission is modifying Rule 17Ad–25(d)(1) to specify that the RMC is ''of the board'' to make clear that the RMC is not merely an advisory board. The Commission is modifying Rule 17Ad–25(d)(2) to specify that the RMC's work supports the ''overall risk management, safety and efficiency of the clearing agency.'' [131] The Commission disagrees with the commenter's suggestion that requiring registered clearing agencies to structure their RMCs as board-level committees would not make a board's oversight of management's decisions more effective. As stated in the Governance Proposing Release, a RMC 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, because a dedicated committee of the board remains focused exclusively on matters related to risk management.[132] One reason that a board-level RMC is a more effective structure for the registered clearing agency's risk management decisions lies in the fact that such RMC is directly answerable to the board; requiring registered clearing agencies to establish a RMC 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.[133] As one commenter stated, board-level RMCs of registered clearing agencies ''do not function in such a passive manner, but instead act pursuant to delegated authority from the full board to evaluate and take risk management decisions directly . . . . allowing for this balancing of roles and responsibilities between the two bodies [of the RMC and the board] enhances the clearing agency's ability to evaluate and respond in a timely manner to evolving risks and other changes in the relevant cleared market.'' [134] While the board may or may not take the recommendations of an advisory group, RMCs generally have delegated authority from the board to conduct oversight and make decisions regarding risk management, as most commenters have observed,[135] pursuant to a charter or other governing document specifying its purpose and its delegation of authority from the board. Notwithstanding the above, the requirement for a board-level RMC in no way precludes the establishment or use of an advisory committee composed of non-board members, as the commenter has suggested.[136]

In addition, Rule 17Ad–25(d) specifies that, in the performance of its duties, the RMC must be able to provide a risk-based, independent, and informed opinion on all matters presented to it in a manner that supports the overall risk management, safety and efficiency of the registered clearing agency. As discussed in the Governance Proposing Release,[137] this requirement helps ensure that the RMC has a clear scope and sufficient direction to effectively address risk management-related matters and not merely serve as a ''rubber stamp'' for recommendations presented to it by management.[138] In this sense, it is neither advisory in its review of management's decisions nor advisory in its recommendations provided to the board. As a general matter, based on its supervisory experience, the Commission has observed that the boards of registered clearing agencies often give considerable deference to the recommendations, advice, and opinions of their RMCs. The Commission continues to believe that it is appropriate for the board, while retaining ultimate responsibility over risk management, to assign certain tasks to the RMC (and other committees) to assist the board in discharging its ultimate responsibility.[139]

3. Annual Requirement To Re-Evaluate RMC Membership

Several commenters disagreed with the Commission's approach to require RMC membership reconstitution on a regular basis, as proposed in Rule 17Ad–25(d)(1), because doing so could remove individuals with useful subject matter expertise and institutional knowledge required for the RMC to be effective.[140] One commenter suggested alternative language for a different approach, requesting that the Commission modify the proposed rule to require the registered clearing agency to ''reevaluate'' the composition of the RMC rather than ''reconstitute,'' as proposed.[141] Some commenters proposed a staggered rotation system with term limits, as well as fitness standards.[142] Another alternative suggested by a commenter is to have the clearing agency use an outcomes-based approach to review the work of the RMC and prevent it from becoming non-representative or entrenched.[143] Another commenter suggested annual review of the membership is sufficient and also requested that the Commission clarify whether membership refers to

[130] ICE at 4 (also stating that ''[a] risk committee that is not board level can benefit from the expertise of a wider range of individuals and thus better inform the board than a board level risk committee would.'').

[131] To address the concern that the board can also benefit from input and expertise reflecting a broader set of potential stakeholders in the registered clearing agency, the Commission is separately adopting Rule 17Ad–25(j), as discussed in Part II.F, which requires a registered clearing agency to seek input from other relevant stakeholders, such as the customers of clearing agency participants, regarding its risk management and operations.

[132] *See* Governance Proposing Release, *supra* note 2, at 51831.

[133] *See id.*

[134] DTCC at 6.

[135] *See* LSEG at 10 (stating that ''. . . this would be an effective way to structure the committee. As a board sub-committee, the RMC can be formally delegated certain authorities . . .''); CCP12 at 5 (stating that ''[o]ur view is that board-level RMCs may be delegated authority by the board to proactively address certain aspects of risk management. This is in line with generally accepted corporate governance principles.'').

[136] *See* ICE at 4.

[137] *See* Governance Proposing Release, *supra* note 2, at 51831.

[138] *See id.*

[139] *See id.*

[140] *See, e.g.,* OCC at 8 (stating that ''[w]e believe a forced reconstitution on a regular basis would frustrate the Commission's goal . . . as registered clearing agencies may be required to remove directors from the risk management committee(s) with deep industry and subject matter experience to meet this requirement.''); ISDA at 3–4 (stating that ''a situation where the CCP spends a considerable part of RMC meetings on educating new RMC members should be avoided.''); CCP12 at 6 (stating that ''RMC members often serve because they have specialized expertise or a familiarity with the intricacies of a clearing agency's risk management framework that would merit a longer term.''); ICE at 4–5 (stating that ''reconstitution requirements must consider the value an experienced and knowledgeable risk management committee member provides to a clearing agencies' risk management function.'').

[141] *See* DTCC at 6 (stating that ''[i]nstead, we would suggest that that the Commission consider alternative terms such as 'reevaluate' '').

[142] *See, e.g.,* ISDA at 3–4 (stating that ''staggered rotation system . . . allows to have new members on while still retaining institutional knowledge.''); SIFMA AMG at 5–6 (stating that ''[i]t will be important that the requirement is principles-based, is subject to the requirement for the inclusion of clearing members and clearing member customers, applies the recommended fitness standards, and requires a staggered rotation . . .'').

[143] *See* DTCC at 6 (requesting that the Commission consider registered clearing agencies to ''periodically evaluate whether the risk committee membership and structure continues to provide current, diverse and expert risk management oversight that supports the safety and efficiency of the clearing agency'').

participant firms or individuals representing them.[144]

The Commission is modifying Rule 17Ad–25(d)(1) to require an annual re-evaluation of the RMC. Having considered the comments received, the Commission agrees that a required reconstitution of the RMC on a regular basis could lead to the undesired outcome of turnover in the committee membership before members are able to contribute optimally, with a loss of continuity and expertise. In this way, the modification to Rule 17Ad–25(d)(1) reflects an outcomes-based approach. As registered clearing agencies may have different methods of term limits, including staggered rotation, the Commission leaves the frequency and type of reconstitution to the discretion of the registered clearing agency, while at the same time requiring a re-evaluation to be conducted annually. Rule 17Ad–25(d), as modified, will preserve the initial intent of the rule—to prevent stagnation of the RMC membership, while also allowing registered clearing agencies flexibility and discretion in the composition of the RMC. As stated in the Governance Proposing Release, 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 RMC through the use of RMC membership changes.[145] The Commission continues to believe that codifying this practice will set a minimum standard for re-evaluation of the RMC membership.[146] Requiring the registered clearing agency to re-evaluate the RMC membership annually 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 RMC over time.[147] As stated in the Governance Proposing Release, the Commission continues to believe that Rule 17Ad–25(d)(1) achieves the above objective of ensuring a broad range of participation on the RMC without imposing specific obligations related to owners, participants, or independent directors that may be suitable in some, but not necessarily all, cases, and because the RMC is broadly responsible for providing recommendations to the board on all risk management related matters, it is important that the RMC's membership reflects a wide range of owners and participants with relevant experience and expertise on a variety of risk management issues.[148] By requiring the RMC to re-evaluate its membership annually, Rule 17Ad–25(d)(1), as modified, helps ensure ongoing diversity of perspectives across owners and participants and expertise on the RMC, while better ensuring that the RMC is not subject to stagnation of views that neither serves the safety and efficiency of the registered clearing agency in its risk management decision-making nor promotes effective and reliable risk management practices at a registered clearing agency.[149] As stated in the Governance Proposing Release, the charter that defines the terms of the RMC could also establish that RMC members serve for a specified term, or that the RMC would rotate or replace directors on the RMC at certain intervals absent a specified turnover threshold among directors, or that their terms could be staggered to have regular turnover of participants and other RMC members.[150]

Although some commenters recommend against the Commission requiring a certain percentage or number of small participant representatives on the RMC,[151] a few commenters requested substantive modifications to the rule that would address RMC composition requirements.[152] One commenter suggested requiring directors serving on the RMC be individuals selected from smaller clearing agency participants,[153] although another commenter stated that obtaining a broad range of perspectives is not necessary.[154] This commenter suggested that the Commission go further and that the RMC of the board ''should be structured to represent more participants than the board . . . [and] neither clearing members or clients of clearing members should represent a majority.'' [155] One commenter suggested that ''a majority of the [RMC] should be composed of independent directors,'' and that ''a dual-level [RMC] structure would be theoretically ideal.'' [156] With regard to this comment, requiring a board-level RMC pursuant to Rule 17Ad–25(d) in conjunction with requiring the registered clearing agency to solicit and document stakeholder viewpoints pursuant to Rule 17Ad–25(j) is fully consistent with the commenter's recommendation of a ''dual-level'' structure, in which the board-level RMC acts with delegated authority from the board on risk management issues while the registered clearing agency is required to solicit stakeholder views from representatives of clearing agency participants, their customers, other end users, and any other relevant stakeholders.[157] Another commenter requested clarification from the Commission on RMC composition requirements and the reference to ''independent'' opinion in Rule 17Ad–25(d)(2).[158]

With regard to other comments on specifying RMC membership composition, the Commission is not modifying Rule 17Ad–25(d) to require that the RMC be composed of majority independent directors because such requirement may exclude too many directors with specialized technical expertise from the pool of directors eligible to serve on the RMC, as previously considered and discussed in the Governance Proposing Release.[159] However, pursuant to the requirements

[144] *See* LSEG at 12 (stating that ''it should be sufficient for a clearing agency to regularly (*e.g.*, annually) review the membership of its RMC to ensure there is sufficient representation of its participants.'').

[145] *See* Governance Proposing Release, *supra* note 2, at 51832–33.

[146] *See id.*

[147] *See id.*

[148] *See id.*

[149] *See id.*

[150] *See* Governance Proposing Release, *supra* note 2, at 51833.

[151] *See, e.g.,* CCP12 at 5 (stating that ''additional requirements may make the governance of RMCs more burdensome and inefficient, which could potentially have a negative impact on the functioning of the committee.''); ICE at 5 (advising ''against mandating specific risk management committee composition requirements, such as a specific percentage or number of representatives from small participants.'').

[152] *See, e.g.,* Better Markets at 21 (stating that ''diversity needs to be genuine and can only be strengthened by guaranteeing enough representation for smaller entities to check the largest players.''); IDTA at 4–5 (recommending that ''that the rule include a requirement to ensure sufficient representation on the risk committees of non-SIFI entities (smaller and middle-market firms).'').

[153] *See* IDTA at 5.

[154] *See* LSEG at 11 (stating that ''[w]e do not believe that small participants should be systematically represented since very small participants may not have this expertise, nor the required involvement'').

[155] LSEG at 10.

[156] Saguato at 4 (stating that ''[i]n actuality a dual level risk committee structure would be theoretically ideal as it would better incorporate inputs from the many constituencies of a clearing agency'').

[157] *See infra* Part II.F (further discussing the requirements of Rule 17Ad–25(j)).

[158] *See* OCC at 9 (requesting the Commission ''clarify that one representative from each of the owners and the participants of the registered clearing agency would satisfy the requirement of Proposed Rule 17Ad–25(d)(1) . . . . [and] that a risk management committee(s) may provide such an independent opinion so long as a majority of participating directors on the committee(s) are themselves independent.'').

[159] *See, e.g.,* Governance Proposing Release, *supra* note 2, at 51831; *see also id.* at 58132 (''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.'').

of Rule 17Ad–25(e), if the RMC 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. The Commission continues to believe that, by requiring the RMC to provide an independent opinion, *irrespective of its composition,* Rule 17Ad–25(d) helps ensure that the RMC is free from influence in the performance of its duties.[160] In response to commenters' request to clarify the reference to ''independent'' opinion, ''independent'' here refers to the nature of the opinion and does not mean independent in the same context as the requirements discussed in Part II.A for ''independent'' directors; when making recommendations to the board, the RMC's decisions or opinions must be its own—not a rubber stamp of management's decisions or opinions—so that the RMC is free from influence in the performance of its duties to reflect how its decisions support the safety and efficiency of the clearing agency and represent the best interests of the clearing agency.[161] The requirement to include directors on the committee representative of both owners and participants, without also providing further specificity as to the size (or market power) of the participants so included, is consistent with the requirements set forth in Rule 17Ad–25(c)(4) regarding the nomination of directors by the nominating committee more generally. Specifically, those requirements establish that the nominating committee shall consider, when selecting nominees for director, representation on the board as a whole that reflects a range of participants with different business strategies, models, and sizes, as further discussed in Part II.B.3.

The Governance Proposing Release also stated 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, and so Rule 17Ad–25(d) requires that RMCs at all times include representatives from the owners and participants of the registered clearing agency.[162] As discussed in the Governance Proposing Release, 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.[163] Based on its supervisory experience, the Commission continues to believe that, because 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, requiring the RMC to include representatives from the clearing agency's owners and participants helps ensure that the RMC's recommendations to the board reflect these stakeholders' unique perspectives and expertise on risk management issues.[164]

Accordingly, the rule provides a registered clearing agency with some discretion to determine the appropriate composition for the RMC with respect to representation from its owners and participants. The RMC generally should include representation reflective of both small and large participants, and the affirmative Commission requirements reflected in the selection process for directors generally under Rule 17Ad–25(c) would better ensure appropriate representation of a diverse set of stakeholder viewpoints.[165] Therefore, the Commission is not modifying the proposed rule in response to these commenters.

4. Harmonization With CFTC and EMIR Requirements

Some commenters recommended that the Commission harmonize Rule 17Ad–25(d) with CFTC requirements for the RMCs of DCOs,[166] particularly for entities dually registered as DCOs with the CFTC and registered clearing agencies with the Commission.[167] Specifically, some commenters suggested the Commission clarify the expected perspective to be applied by RMC members to support not just the safety and efficiency of the clearing agency, as required in Rule 17Ad–25(d)(2), but also the stability of the broader financial system.[168]

The Commission is adopting the proposed rule without modification because the goal of safety and efficiency of the clearing agency is not mutually exclusive with that of overall financial stability. As stated in the Governance Proposing Release, in providing risk-based opinions, the RMC must focus on both the risks that the clearing agency faces and the tools at its disposal to mitigate and address such risks in its aim toward the goal of supporting the safety and efficiency of the clearing agency itself.[169] The stability of clearing agencies is an essential part of the stability of the overall financial system and the markets that clearing agencies serve.[170] Therefore, the Commission is not modifying Rule 17Ad–25(d)(2) as suggested by commenters.

Additionally, one commenter requested that the Commission adopt the list of factors specified in CFTC requirements for DCO RMCs by explicitly requiring a registered clearing

[160] *See id.* at 51831 (emphasis added).

[161] *See id.*

[162] *See id.*

[163] *See id.*

[164] *See id.*

[165] *See id.*

[166] *See* 17 CFR part 39; *see also* CFTC Final Rule: Governance Requirements for Derivatives Clearing Organizations, 88 FR 44675 (July 13, 2023) (CFTC adopting amendments to its rules to require DCOs to establish and consult with one or more RMCs composed of clearing members and customers of clearing members on matters that could materially affect the DCO's risk profile, minimum requirements for RMC composition and rotation, and requiring DCOs to establish and enforce fitness standards for RMC members; also adopting requirements for DCOs to maintain written policies and procedures governing the RMC consultation process and the role of RMC members; also adopting requirements for DCOs to establish one or more market participant risk advisory working groups (RWGs) that must convene at least two times per year, and adopt written policies and procedures related to the formation and role of the RWG).

[167] *See, e.g.,* ICI at 5 (stating that ''[h]armonization would promote consistency, certainty, and efficiency in how clearing entities—especially CFTC and SEC dual-registrants—manage risk by detailing the process by which the board consults and obtains an RMC's input.''); CCP12 at 6 (encouraging the Commission and the CFTC ''to coordinate . . . . [by] adopt[ing] a flexible outcomes-based approach in which the clearing agency would periodically evaluate whether the RMC membership is appropriately expert, diverse and current in terms of tenure.''); ICE at 5 (urging ''coordination and harmonization'').

[168] *See* Barclays et al. at 2 (recommending ''[o]ne approach to addressing this conflict would be to require RMC members to also consider the safety and efficiency of the broader financial markets, rather than solely the registered clearing agency.''); SIFMA AMG at 5 (recommending the Commission ''explicitly state that in addition to supporting the safety and efficiency of the RCA, RMC and RWG members should also support the stability of the broader financial system''); *see also* 17 CFR 39.24(c)(1)(iv)(3) (''A derivatives clearing organization shall maintain policies designed to enable members of risk management committee(s) to provide informed opinions in the form of risk-based input on all matters presented to the risk management committee for consideration, and perform their duties in a manner that supports the safety and efficiency of the derivatives clearing organization and the stability of the broader financial system.'').

[169] *See* Governance Proposing Release, *supra* note 2, at 51831.

[170] *See* Committee on Payment and Settlement Systems (''CPSS'') and Technical Committee of the International Organization of Securities Commissions (''IOSCO''), *Principles for financial market infrastructures* (Apr. 16, 2012), at 5, available at *http://www.bis.org/publ/cpss101a.pdf* (''PFMI'') (stating that ''[f]inancial market infrastructures that facilitate the clearing, settlement, and recording of monetary and other financial transactions can strengthen the markets they serve and play a critical role in fostering financial stability.''). In 2014, the CPSS became the Committee on Payments and Market Infrastructures (''CPMI'').

agency to present to the RMC and any advisory committee or RWG all matters regarding, and proposed changes to, the registered clearing agency's rules, procedures, or operations that could materially affect the risk profile of the registered clearing agency, including, but not limited to, any material change to the registered clearing agency's risk model, default procedures, participation requirements, and risk management practices, as well as the clearing of new products that could significantly impact the clearing agency's risk profile.[171] According to the commenter, ''the greater detail we have recommended is important to ensure the requirements are clear, that the views of clearing member customers are included, that the board must engage with the RMC, and that issues of material risk must be brought to the RMC and RWG for consideration.'' [172] Additionally, another commenter suggested 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.'' [173] However, one commenter stated that listing factors for RMC consideration would be overly prescriptive,[174] while another commenter stated that listing all matters for RMC consideration would be difficult.[175]

The Commission is not modifying the proposed rule by adopting the CFTC DCO list of factors for RMC consideration into Rule 17Ad–25(d). In the Governance Proposing Release, the Commission explained that the purpose of the RMC is to ''provide 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''—matters that implicate the clearing agency's risk management, including its policies, procedures, and tools for mitigating risk.[176] The Commission further stated that Rule 17Ad–25(d) ''helps ensure that the committee has a clear scope and sufficient direction to more effectively address risk management related matters, regardless of the participants, markets, and products that a clearing agency serves.'' [177] Explicitly enumerating the matters presented to the RMC, as suggested by commenters, would be unnecessarily prescriptive, and that the individual clearing agencies are best qualified to determine the matters presented to the board based on the specifics of their participants, markets and products. Additionally, whereas the CFTC considers DCO policies and procedures under a self-certification process, the SEC requires that registered clearing agencies submit to the Commission for approval, after a public comment period, certain policies and procedures—including policies and procedures related to the level of risks faced by the registered clearing agency—under the SRO rule filing process for registered clearing agencies, except for certain rule changes that are immediately effective upon filing as set forth in Exchange Act section 19(b)(3)(A) [178] and 17 CFR 240.19b–4(f).[179] Not only are the financial risk management matters referred to by the commenters subject to the SRO rule filing process, registered clearing agencies designated as systemically important financial market utilities (''SIFMUs'') are required to file 60-days advance notice of changes to rules, procedures, and operations that could materially affect the nature or level of risk presented by the SIFMU.

In a similar vein, a commenter suggested that the Commission assess how greater predictability and transparency can be provided to market participants regarding margin methodologies as part of a clearing agency's governance process to assist market participants in managing their liquidity needs and minimize the risk of market disruptions.[180] The Commission agrees that predictability and transparency of margin requirements can help clearing members better manage their liquidity and other market risks. The focus of this rulemaking regarding transparency is to ''increase transparency into board governance,'' rather than into the specific margin methodologies. In fact, improved governance could generally lead to more transparent margin methodologies. Accordingly, the Commission is not modifying the rule in response to this comment.[181]

One commenter urged the Commission to harmonize Rule 17Ad–25(d) with EMIR, which requires that an RMC be chaired by an independent director.[182] Another commenter requested clarification that a risk committee with some non-independent members can still provide overall independent opinions to the board.[183] The Commission is not modifying the rule as suggested by commenters. Rule 17Ad–25(d)(2) requires that the RMC ''be able to provide a risk-based, independent, and informed opinion on all matters presented to the committee for consideration.'' This opinion on risk matters brought before the RMC can be independent without an explicit prescriptive requirement that the RMC is chaired by an independent director.[184] The rule's focus is on RMC decisions and opinions being free of influence from management by virtue of being a board-level committee, not the chair's independence in the context of the requirements in Rule 17Ad–25(b), because at the heart of the rule is the safety and efficiency of the registered clearing agency, and critical to the effective functioning of a registered clearing agency is the board's ability to understand and engage with the risks that a registered clearing agency faces and the risk management practices it employs to mitigate those risks.[185] With respect to registered clearing agencies, it

[171] *See* SIFMA AMG at 5–7 (requesting the Commission ''explicitly require that the RCA [registered clearing agency] present to the RMC and RWG all matters and proposed changes to the RCA's rules, procedures, or operations that could materially affect the risk profile of the RCA, including, but not limited to, any material change to the RCA's risk model, default procedures, participation requirements, and risk management practices, as well as the clearing of new products that could significantly impact the RCA's risk profile'').

[172] *See id.*

[173] IDTA at 4–5.

[174] *See* LSEG at 11 (stating that ''[i]t is not necessary for the SEC to define the matters to be presented to the RMC and be overly prescriptive. Requiring that clearing agencies are explicit in the committee Terms of Reference ('TOR') would meet the SEC's objective . . .'').

[175] *See* ISDA at 4 (stating that ''[i]t will be difficult to clearly specify in detail all matters that have to be presented to the RMC.'').

[176] *See* Governance Proposing Release, *supra* note 2, at 51831 (stating that ''[t]he 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.'').

[177] *Id.*

[178] 15 U.S.C. 78s(b)(3)(A).

[179] *See* 15 U.S.C. 78s(b)(1); 17 CFR 240.19b–4.

[180] *See* Stephen John Berger, Managing Director, Global Head of Government & Regulatory Policy, Citadel (Oct. 7, 2022) (''Citadel'') at 1.

[181] *See* Governance Proposing Release, *supra* note 2, at 51812 (stating that ''[t]he 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'').

[182] *See* LSEG at 10 (stating that ''independent directors are required under EMIR, hence LCH SA does not rely solely on experts from the participants and owners of the clearing agency. The INEDs selected for the Risk Management Committee ('RMC') must have good risk knowledge, and we support the RMC being chaired by an INED.'').

[183] *See* OCC at 9 (requesting clarification that an RMC ''may provide such an independent opinion so long as a majority of participating directors on the committee(s) are themselves independent.'').

[184] *See* Governance Proposing Release, *supra* note 2, at 51831 (stating that ''the proposed rule helps ensure that the committee is free from influence in the performance of its duties.'').

[185] *See id.*

is critically important that the chair of the RMC, which generally sets the agenda for and prioritizes the work of the RMC, has a high level of expertise in, and familiarity with, the risk management topics likely to come before the RMC for its review and opinion. In this regard, the expertise required to chair the RMC of a registered clearing agency to ensure that the RMC provides risk-based, independent, and informed opinions for the proper functioning and effectiveness of the RMC is more important than requiring that the chair of the RMC be independent subject to the requirements of Rules 17Ad–25(b), (e), and (f) because clearing agencies perform a unique and often systemically important function that facilitates effective risk management in the U.S. securities markets.[186] As stated in the Governance Proposing Release, by requiring the RMC to provide an independent opinion, ''irrespective of its composition,'' the rule would help ensure that the RMC is free from influence in the performance of its duties.[187]

One commenter stated that the RMC composition requirements in Rule 17Ad–25(d) conflict with the composition requirements for the RMC set forth in EMIR.[188] Contrary to the commenter's view, Rule 17Ad–25(d) can be read consistently with EMIR. Article 28 of EMIR states, ''A CCP shall establish a risk committee, which shall be composed of representatives of its clearing members, independent members of the board and representatives of its clients.'' It further states that, ''The advice of the risk committee shall be independent of any direct influence by the management of the CCP.'' [189] By comparison, Rule 17Ad–25(d) requires that the RMC be a board-level committee and that it at all times include representatives from the owners and participants of the registered clearing agency. The commenter indicated that ''owners are not permitted to be on the RMC under EMIR,'' but Article 28 of EMIR as described here suggests that only management is barred from direct representation on the RMC.[190] Even if the commenter is correct that owners are not permitted to be on the RMC under EMIR, Rule 17Ad–25(d) does not require that management serve on the RMC; nor does it require that owners serve as directors on the RMC. Rather, Rule 17Ad–25(d) requires that the composition of the RMC include *representatives of* owners (and participants). A non-independent director may serve as a representative of owners without being part of management or an owner of the clearing agency; for example, such a director could be non-management and a non-owner who nonetheless maintains a material relationship with the registered clearing agency, or that falls within a specific exclusion set forth in Rule 17Ad–25(f). For this reason, the Commission is not modifying Rule 17Ad–25(d) to address the comment. Nonetheless, to the extent that a registered clearing agency identifies facts or circumstances that clearly demonstrate a requirement under Rule 17Ad–25 is in direct conflict with a requirement of EMIR, the Commission has previously provided guidance as to how such a registered clearing agency can request an exemption from said requirement.[191]

5. Other Comments

One commenter requested that Rule 17Ad–25(d) include an explicit provision that allows directors on the RMC to obtain feedback from experts within their ''member firms,'' to enhance the quality of input the registered clearing agencies receive from directors on the committee.[192] As a general matter, directors on the RMC should be fully qualified to serve without having to rely on expertise from others, such as other personnel at their employer firm (*i.e.,* a clearing agency participant), to provide input on risk management decisions before the RMC. The more appropriate venue for providing the input described by the commenter is via the structure established in Rule 17Ad–25(j), as discussed in Part II.F, pursuant to which a relevant stakeholder would provide such input in response to solicitations of stakeholder viewpoints by the registered clearing agency. Ultimately, the ability of directors to consult with their primary employers on risk management matters will be governed by the specific governing documents of the clearing agency, its board, and any obligations as to confidentiality or information sharing that the registered clearing agency imposes through those documents on directors. Accordingly, the Commission is not modifying Rule 17Ad–25(d) to specifically permit directors on the RMC to consult with a clearing agency participant.

Additionally, one commenter requested that Rule 17Ad–25(d) go further by detailing additional RMC requirements, including requirements that: (1) registered clearing agencies create and maintain minutes or other documentation of RMC meetings that should be made available to the Commission and a summary of which that is made public; (2) the RMC document and share with regulators any dissenting RMC views with regard to the clearing agency's material risk decisions or the clearing agency not following the advice of the RMC, as well as the accompanying rationale for not accommodating dissenting views; and (3) the RMC meet on a regular basis and at least quarterly.[193] The Commission is not modifying Rule 17Ad–25(d) as suggested by the commenter in recognition that each entity has particular policies and needs, and that there could be different ways to accomplish the rule's objectives. The Commission designed Rule 17Ad–25(d) to balance establishing a common set of minimum standards on RMCs across registered clearing agencies while still providing registered clearing agencies with discretion to design the RMC to be most effective at conducting its risk management function. The Commission believes that registered clearing agencies currently are capable of determining how to apply these factors for the operation of their respective RMCs, and will continue to consider whether the Commission's objectives are being met and whether further rulemaking in this area is appropriate.

[186] *Cf.* Governance Proposing Release, *supra* note 2, at 51830–31.

[187] *See id.* at 51831.

[188] *See* LSEG at 11 (stating that ''it is important that members of the RMC have necessary levels of expertise to make effective risk decisions and provide sound advice. Further, owners are not permitted to be on the RMC under EMIR, which will create a conflict for dually registered clearing agencies.'').

[189] *See* EMIR, *supra* note 56.

[190] EMIR Article 28(1) provides: ''A CCP shall establish a risk committee, which shall be composed of representatives of its clearing members, independent members of the board and representatives of its clients . . . The advice of the risk committee shall be independent of any direct influence by the management of the CCP. None of the groups of representatives shall have a majority in the risk committee.''

[191] *See* Release No. 34–90492 (Nov. 23, 2020), 85 FR 76635 (Nov. 30, 2020) (''CCP Statement''). In the CCP Statement, the Commission explained (i) that it would take substantially the same approach for other jurisdictions that have adopted a regulatory framework substantially similar to EMIR, and (ii) that the policy and guidance provided also would apply to CCPs for securities products other than security-based swaps. *See id.* at nn.1 & 23.

[192] *See* Barclays et al. at 3 (stating that ''[w]e believe that the proposed rules should include explicit provisions that allow RMC members to obtain feedback from experts within their member firms which will enhance the quality of input the registered clearing agencies receive from RMC members'').

[193] *See* ISDA at 4.

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. 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.

In the Governance Proposing Release, the Commission explained that proposed Rules 17Ad–25(g) and (h) help promote the integrity of governance arrangements of registered clearing agencies by 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.[194] 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.[195] By requiring the registered clearing agency to identify and document both existing and potential conflicts of interest involving directors or senior managers of the registered clearing agency, proposed Rule 17Ad–25(g) was 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.[196] The Commission stated that the ability to identify potential conflicts of interest is critical to ensuring the effective identification and management of actual conflicts of interest.[197] In the Governance Proposing Release, the Commission specifically explained that 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.[198]

With regard to proposed Rule 17Ad–25(h), the Commission explained in the Governance Proposing Release that because a registered clearing agency may not have access to information necessary to identify a potential conflict of interest, the proposed rule 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.[199] The Commission explained that it 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.[200] The Commission stated that this approach would help ensure that the registered clearing agency has sufficient information to investigate, identify and address potential conflicts.[201]

Commenters generally supported proposed Rules 17Ad–25(g) and (h),[202] notably the principles-based approach to the rules.[203] Two commenters urged the Commission to consider modifications to the rules.[204]

1. Mitigation or Elimination of Conflicts

While generally supportive of the proposed rules, one commenter urged the Commission to strengthen the rule, stating that proposed Rule 17Ad–25(g) is vague on exactly how a registered clearing agency should ''mitigate or eliminate'' conflicts.[205] The commenter suggested that the proposed rule should instead specify that agency policies should require recusal unless or until a conflict has been fully eliminated.[206]

The Commission is not modifying Rule 17Ad–25(g) in the ways suggested by the commenter. The Commission disagrees that ''mitigate or eliminate'' conflicts is vague and therefore, should be replaced by an outright requirement to recuse. As stated in the Governance Proposing Release, the registered clearing agency is best positioned to identify and address conflicts of interest that may arise in its operations and risk management and decision-making.[207] Specifically, given the array of potential conflicts of interest scenarios that a registered clearing agency may need to address, the registered clearing agency is best positioned through reasonable policies and procedures to mitigate—namely, reduce the harm—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.[208] This rule is principles-based to provide flexibility, for example, to dictate the disposition or resolution of private interests that may be unworkable or discourage qualified, experienced individuals from performing their duties to the registered clearing agency. Therefore, the rule focuses on the process to identify and

[194] Governance Proposing Release, *supra* note 2, at 51834.

[195] *Id.*

[196] *Id.*

[197] *Id.*

[198] *Id.*

[199] *Id.* at 51835.

[200] *Id.*

[201] *Id.*

[202] *See, e.g.,* Better Markets at 22 (stating that ''[w]e commend the Proposal for requiring written policies to identify, document, disclose, and mitigate conflicts of interest''); DTCC at 3–4 (stating that it ''generally finds that the requirements laid out in proposed Rules 17Ad–25(g) and (h) regarding conflicts of interest also are appropriately designed, and therefore recommends that they be adopted without further modification''); Chris Barnard at 2 (stating that ''[p]roposed Rule 17Ad–25(g) . . . I agree with this. . . . I also agree with proposed Rule 17Ad–25(h)''); ICE at 5 (stating that it ''welcomes such approach and believes it would provide SEC Registered CAs with the flexibility necessary for effective governance by allowing such clearing agencies the discretion to design policies that fit their particular structure and characteristics''); LSEG at 13 (stating that ''[t]he clearing agency should have policies and procedures in place to address conflicts of interest. . . . [and] should leverage the conflicts identified by the SEC to build its own policy''); IDTA at 5 (stating that ''[r]equiring clearing agencies to adopt policies and procedures with respect to the management of conflicts is instrumental to maintaining a sound regulatory framework'').

[203] *See* DTCC at 3–4; ICE at 5; LSEG at 13.

[204] *See, e.g.,* Better Markets at 22; IDTA at 5.

[205] *See* Better Markets at 22 (stating that ''[f]irst, the Proposal is vague on exactly how a clearing agency should 'mitigate or eliminate' conflicts. It should instead specify that agency policies should require recusal unless or until a conflict has been fully eliminated. Second, the . . . double layer of reasonableness review seems unnecessary and likely to be too generous towards clearing agencies and their boards. The Proposal should instead require clearing agencies to affirmatively oblige directors to disclose any material relationships'').

[206] *See id.*

[207] Governance Proposing Release, *supra* note 2, at 51834.

[208] *See id.*

document existing or potential conflicts of interest in the clearing agency decision-making involving directors or senior managers. Mitigation of the harm of such conflicts may include raising awareness of the circumstances in which conflicts can arise for the purpose of preventing conflicts of interest and providing training on how to identify and report such conflicts. In the Governance Proposing Release, the Commission explained that in some cases 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; [209] whether recusal is necessary depends on the conflict at hand. The Commission emphasizes that pursuant to the overarching obligation of this rule, elimination of conflicts of interest is one method of addressing the conflict. Depending on the circumstances, it may be appropriate to mitigate a conflict through other methods.[210]

Additionally, another commenter encouraged the Commission to have the rules consider the impact on institutions that are not designated systemically important financial institutions (''SIFIs'') by the Financial Stability Oversight Council (''FSOC''), as small and middle-market participants would be able to provide ongoing feedback on how policies are impacting the markets to minimize conflicts of interest and ensure competition among institutions of all sizes.[211]

The Commission is not modifying Rule 17Ad–25(d) in response to the comment. Because the types and sizes of participants vary significantly across different registered clearing agencies depending on the markets they serve, registered clearing agencies could determine the impact on non-SIFIs by requiring the consideration of viewpoints of small participants and a range of participants pursuant to Rule 17Ad–25(j). The Commission understands the overarching concerns that the commenter highlights about the need to have a process to include a wider array of stakeholder viewpoints in the registered clearing agency's decision-making. In this regard, Rules 17Ad–25(c) and (j) (rather than Rules 17Ad–25(g) and (h)) are designed to address concerns about a process to include stakeholder viewpoints in the registered clearing agency's decision-making, including the context that the commenter describes.[212]

2. Use of ''Reasonably Designed'' Policies and Procedures Approach

Some commenters supported the principles-based approach of proposed Rules 17Ad–25(g) and (h).[213] However, one commenter found the language of proposed Rule 17Ad–25(h) ''unnecessary and likely . . . too generous towards clearing agencies and their boards,'' specifically, the ''double layer of reasonableness review'' that the clearing agency must have policies ''reasonably designed'' to prompt disclosure of relationships that ''reasonably could affect the independent judgment of . . . the director.'' [214] The commenter suggests that the rule ''should instead require clearing agencies to affirmatively oblige directors to disclose any material relationships.'' [215]

The Commission agrees with the commenter that disclosure of material relationships is an important consideration, but the overall structure of the rule already requires evaluation of certain relationships of a director from an objective perspective, and that additional modifications to the rule are therefore not necessary. The Commission proposed rules in the context of the overlay of ''written policies and procedures reasonably designed.'' [216] The ''reasonably designed'' component, consistent with other Commission rules for clearing agencies, helps ensure that policies and procedures are thoughtfully tailored to the specific governance and organizational structure of each individual clearing agency. The commenter suggests that the construction of the proposed requirement for this policies and procedures rule is ''generous'' to the registered clearing agencies and the boards. Policies and procedures are subject to the SRO rule filing process for registered clearing agencies. Except for certain rule changes that do not need approval, set forth in Exchange Act section 19(b)(3)(A) [217] and 17 CFR 240.19b–4(f), an SRO must submit proposed rule changes to the Commission for review (after a public comment period) pursuant to Rule 19b–4 under the Exchange Act.[218] This established process, as required by statute and implemented through a regulatory framework, is not designed to be ''generous'' to the registered clearing agency and its board. An impact of having the rule as a policies and procedures requirement is to subject such policies and procedures to the rigorous SRO rule filing process.

Additionally, the ''reasonableness'' standard embedded in the policies and procedures requirement that is meant to be applied to the independent judgment of the director imposes an objective standard on what would otherwise be the subjective judgment of the director. Such a reasonableness standard helps ensure that analysis under the rule occurs from an objective, rather than subjective perspective. The reasonableness standard better ensures that the director and the registered clearing agency could not simply assume that the director's judgment would not be impaired by a relationship when it would be favorable for the director to avoid a conflict in a particular circumstance. Based on the requirements of the rule, registered clearing agencies generally should evaluate whether certain relationships might affect the judgment of a director.

E. Management of Risks From Relationships With Service Providers for Core 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. Proposed Rule 17Ad–25(i)(1) would require each registered clearing agency to establish, implement, maintain, and enforce

[209] *See id.*

[210] *See id.* (stating 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.'').

[211] *See* IDTA at 5 (stating that ''[t]o 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 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'').

[212] *See supra* Part II.B.3 (discussing the approach to participation by small and medium-sized participants); *infra* Part II.F (discussing requirements for considering stakeholder viewpoints, including the views of small and medium-sized participants).

[213] *See* DTCC at 3–4, ICE at 5, LSEG at 13.

[214] Better Markets at 22.

[215] *Id.*

[216] *See, e.g.,* 17 CFR 240.17Ad–22(d), (e); 17 CFR 240.17Ad–27; *see also* Exchange Act Release No. 96930 (Feb. 15, 2023), 88 FR 13872, 13905 (Mar. 6, 2023) (explaining that a ''reasonably designed'' requirement enables the clearing agency to tailor policies and procedures to accommodate its individualized internal operations, systems, business models and users as it determines how best to achieve compliance with the rule).

[217] 15 U.S.C. 78s(b)(3)(A).

[218] *See* 15 U.S.C. 78s(b)(1); 17 CFR 240.19b–4.

written policies and procedures reasonably designed to enable the board to confirm and document that risks related to relationships with service providers for critical services 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.

In the Governance Proposing Release, the Commission explained that it proposed a companion governance requirement to existing rules to make explicit the registered clearing agency's board obligation to oversee the range of its service providers for critical services, particularly as registered clearing agencies explore and use new technologies to facilitate prompt and accurate clearance and settlement in new and innovative ways and may increasingly determine that service providers will offer the most effective technology to perform key functions.[219] The Commission provided many examples of service provider relationships meant to be scoped into the proposal to capture the range of relationships and wide variety of functions that service providers perform on behalf of the registered clearing agency.[220] For example, a clearing agency may contract with its parent company to staff the registered clearing agency;[221] a clearing agency may contract with one or more investment advisers to help facilitate the closing out of a defaulting participant's portfolio;[222] a clearing agency may use one or more data service providers to help calculate pricing information for securities;[223] a clearing agency may also purchase technology services from service providers that may help to facilitate clearance and settlement in a number of ways.[224] As the Commission stated in the Governance Proposing Release, 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.[225] Additionally, 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.[226] In this regard, the Commission emphasized that outsourcing a clearance and settlement functionality to 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.[227] It was against this backdrop and as part of the evolution of the registered clearing agency regulatory framework that the Commission proposed these requirements.[228]

Commenters generally supported the proposed rule and the Commission's policy objectives.[229] However, some commenters objected to the definition of ''service provider for critical services'' as unclear and overbroad and to proposed Rule 17Ad–25(i) as confusing the roles of senior management and the board.[230] Some commenters also believed that the Commission underestimated the burdens and costs of proposed Rule 17Ad–25(i).[231]

The proposed definition and requirements on service provider oversight were: (i) meant to capture outsourced services[232] directly applicable to core clearance and settlement functionality; (ii) not meant to impose duplicative responsibility to manage service provider relationships on the board when these are already within the remit of senior management to manage service provider relationships,[233] and, so, in this regard, (iii) the proposed requirements would

[219] *See* Governance Proposing Release, *supra* note 2, at 51836–37.

[220] *See id.* at 51836.

[221] *See, e.g.,* DTCC, Businesses and Subsidiaries, *https://www.dtcc.com/about/businesses-and-subsidiaries; see also* Governance Proposing Release, *supra* note 2, at 51836 n.137 (providing the same example and also explaining that three registered clearing agencies, DTC, FICC, and NSCC, are subsidiaries of DTCC).

[222] *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.''); *see also* Governance Proposing Release, *supra* note 2, at 51836 n.138 (providing the same example).

[223] *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.''); *see also* Governance Proposing Release, *supra* note 2, at 51836 n.139 (providing the same example).

[224] *See* Governance Proposing Release, *supra* note 2, at 51836.

[225] *See id.*

[226] *See id.* at 51837.

[227] *See id.* at 51836.

[228] *See id.*

[229] *See* Barclays et al. at 3; ISDA at 6; DTCC at 7.

[230] *See* OCC at 10 (stating that the Commission approach is ''overbroad, unnecessarily prescriptive, and duplicative of long-standing director obligations extant in general corporate law and reinforced by current Commission regulation and OCC rules.''); DTCC at 3 (stating that ''[w]hile we support the Commission's overall policy objectives . . . the proposed requirements and definition are overly broad, could conflict with existing requirements and standards other regulators have applied in respect of CSPs, confuse the distinction between the roles of the board and management, and will deter otherwise qualified individuals from serving as registered clearing agency board directors'').

[231] *See* OCC at 10 (stating that ''though more time and clarity regarding the scope and application of the Proposed Rule 17Ad–25(i) are required to conduct a deeper analysis into the potential cumulative costs of compliance with it, we preliminarily believe such costs could be considerable''); DTCC at 3 (stating that ''[w]e also believe the Proposal significantly underestimates the burdens and costs of these requirements''); CCP12 at 7.

[232] *See* Governance Proposing Release, *supra* note 2, at 51836, 51846 n.195.

[233] *See id.* at 51837 (explaining that ''the board should be aware of the risks flowing into the registered clearing agency . . . 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.'').

not double or multiply the costs and burdens required of the registered clearing agencies. Nonetheless, as discussed below, to ensure the Commission has fully addressed the concerns raised by commenters, and to specify the intended scope of proposed Rule 17Ad–25(i) and the roles of the board and senior management in the oversight of service providers, the Commission is modifying at adoption (1) the definition of ''service provider for critical services'' [234] and (2) Rule 17Ad–25(i).

Specifically, the Commission is modifying the definition to refer to: (a) ''a written services provider agreement for services provided to or on behalf of the registered clearing agency, on an ongoing basis'' to replace the proposed definition's reference to ''contractually obligated to the registered clearing agency''; and (b) ''directly supports the delivery of clearance or settlement functionality'' to replace the proposed definition's reference to ''supporting clearance and settlement functionality.'' The Commission also provides guidance below that the scope of the definition of ''service providers for core services'' generally should include cloud services, pricing services, model services, matching services, any services related to straight-through processing, and collateral management services.

Additionally, the Commission is modifying Rule 17Ad–25(i) to more clearly delineate the roles of senior management and the board, in response to commenters. First, under Rule 17Ad–25(i)(1), the Commission is preserving the proposed Rule 17Ad–25(i)(1) policies and procedures requirement to document service provider risks but is modifying the final rule to make clear that senior management must evaluate and document risks related to the service provider agreement, including under changes to circumstances and potential disruptions, and whether the risks can be managed consistent with the clearing agency's risk management framework. Second, under Rule 17Ad–25(i)(2), the Commission is requiring a companion policies and procedures requirement found in Rule 17Ad–25(i)(1) by requiring in Rule 17Ad–25(i)(2) that senior management submit to the board for review and approval the service provider agreement and senior management's evaluation that is required in Rule 17Ad–25(i)(1). Third, the Commission is moving the policies and procedures requirement originally in proposed Rule 17Ad–25(i)(2) to Rule 17Ad–25(i)(3), now modified to make clear that senior management has the responsibility to establish policies and procedures that govern relationships and manage risks related to service provider agreements, while also making clear that the board is responsible for reviewing and approving such policies and procedures.

Fourth, under Rule 17Ad–25(i)(4), the Commission is preserving the proposed policies and procedures requirement originally contained in proposed Rule 17Ad–25(i)(4) to have ongoing monitoring to remedy significant deterioration in performance or address changing risks or material issues identified through ongoing monitoring. But the Commission is now modifying Rule 17Ad–25(i)(4) to clearly delineate the roles of senior management and the board. Specifically, Rule 17Ad–25(i)(4) is modified to require through policies and procedures that senior management performs the ongoing monitoring and report to the board any action senior management takes to remedy significant deterioration in performance or address changing risks or material issues identified. Rule 17Ad–25(i)(4) is also modified to have policies and procedures to require senior management to assess and document weaknesses or deficiencies in the relationship with the service provider in circumstances where the risks or issues cannot be remedied, which senior management must submit to the board. Rule 17Ad–25(i)(4) is also being modified to clearly delineate that the board is to evaluate any senior management action taken to remedy significant deterioration in performance or address changing risks or materials identified.

The modifications are meant to address commenters' concerns regarding the potential that the board is being required to undertake responsibilities reserved for senior management, as well as other elements of the proposed rule. In this regard, the modifications differentiate more clearly the roles of senior management and the board in the context of Rule 17Ad–25(i) while preserving the intended impact of the proposed rule. While the words and phrases in the proposed rule have changed and moved, the thematic elements in the requirements for the board and senior management remain unchanged.

2. Definition of Service Provider for Core Services

Although a commenter stated that the definition of ''service provider for critical services'' is sufficiently clear and scoped,[235] other commenters stated that it is unclear and overbroad.[236] One suggested amending the definition to: (1) cover any mutual understanding or agreement between a registered clearing agency and third-party entity by which the third-party entity is required or commits to provide ongoing goods or services to the registered clearing agency pursuant to a written contract; [237] (2) establish a clear definition of what makes a service provider ''critical,'' including providing a non-exhaustive list of relationships and service providers that registered clearing agencies should consider, as well as guidance on how to interpret materiality in this context; [238] and (3) to include only a service provider that ''directly supports the delivery of clearing and settlement functionality or any other purpose material to the business of the registered clearing agency.'' [239] Another commenter objected to the definition, stating that its scope is broader than the definition of ''SCI System'' under Regulation SCI [240] and also stated that the text ''supporting clearance and settlement functionality'' without modification could ''potentially capture virtually all non-trivial service providers to registered clearing agencies, particularly if clearance and settlement services is the only or primary service offering of the registered clearing agency.'' [241] Another commenter stated that this proposed requirement would potentially capture a large number of non-trivial service providers to registered clearing

[234] As discussed further below, Rule 17Ad–25(a) now uses the term ''service providers for core services,'' not ''critical services.''

[235] *See* ISDA at 7.

[236] *See, e.g.,* DTCC at 21; OCC at 10; ICE at 6; CCP12 at 6–7.

[237] *See* DTCC at 7 (''[T]he written contract would make clear that local police, fire, and other municipal services are explicitly out of scope. The proposed definition of service provider should also include an 'ongoing basis' element. Without this element, a one-off or single service may be included within the scope of the Proposal and trigger application of the full risk management lifecycle in the same way that a recurring arrangement does.'').

[238] *See id.* at 8 (stating that ''[w]ith respect to the question of clarifying which service providers are in fact 'critical' for the purposes of ensuring effective board oversight, we respectfully ask that the Commission first consider more fully how its approach to CSPs in the Proposal interacts, and potentially creates redundancy or misalignment, with existing similar concepts that apply to registered clearing agencies, whether under existing Commission requirements (such as Regulation Systems Compliance and Integrity or 'Regulation SCI') or under applicable international standards.'').

[239] *Id.* at 8.

[240] *See* OCC at 12–13 (stating that ''the proposed definition is significantly broader than the definition used to define SCI Systems.' . . . If the Commission adopts a rule regarding the oversight of relationships with service providers for critical services, OCC requests the Commission revise the definition of 'service providers for critical services' to align it with the definition of SCI Systems.'').

[241] *Id.* at 27.

agencies, particularly in cases where clearance and settlement services are the only or the primary service offering of the registered clearing agency, and therefore, suggested that the definition be changed to ''any person that is contractually obligated to the registered clearing agency for the purpose of providing critical services that directly support clearance and settlement functionality.'' [242]

To address the concerns raised above, the Commission is modifying the definition in Rule 17Ad–25(a) at adoption to contain three key elements to specify its scope: (i) ''a written services provider agreement for services provided to or on behalf of the registered clearing agency'' to replace the proposed definition's reference to ''contractually obligated to the registered clearing agency''; (ii) ''on an ongoing basis'' nature of the services provided; and (iii) ''directly supports the delivery of clearance or settlement functionality'' to replace the proposed definition's reference to ''supporting clearance and settlement functionality.'' The changes to the definition better ensure that the final definition of ''service providers for core services'' is clear and properly scoped. The Commission discusses each of these modifications in turn below.

First, the Commission is modifying the defined term at adoption to refer to ''core services,'' rather than ''critical services'' as proposed.[243] To provide further clarity and to address comments requesting a non-exhaustive list of service provider relationships under Rule 17Ad–25(i),[244] the Commission provides guidance that ''core services'' generally should include cloud services, pricing services, model services, matching services, any services related to straight-through processing, and collateral management services. This list is not meant to be an exhaustive list of ''core services'' but is being provided to give examples of the services that generally should be in scope of the definition while allowing clearing agencies some discretion to apply the definition to their specific markets and participants served and products cleared. The services in this list reflect services that registered clearing agencies are seeking from service providers, based on the Commission's supervisory experience. For example, a registered clearing agency may consider the use of cloud services to modernize and further develop the systems that underpin its core clearance and settlement functionality, facilitating, among other things, the calculation of its margin requirements, the modeling of financial risk, and communication with clearing agency participants. Similarly, pricing and model services directly support core clearance and settlement functionality when they are used by a registered clearing agency to calculate end-of-day settlement obligations and margin requirements for clearing agency participants. In addition, clearing agency technologies that facilitate matching services, straight-through processing, and collateral management are themselves the functions of a clearing agency and facilitate core clearance and settlement of securities transactions, and so such technologies generally should be within the scope of the modified ''core services'' definition.

Second, the Commission is modifying the definition of ''service provider for core services'' in adopting Rule 17Ad–25(a) to mean ''any person that, through a written services provider agreement for services provided to or on behalf of the registered clearing agency, on an ongoing basis, directly supports the delivery of clearance or settlement functionality or any other purposes material to the business of the registered clearing agency.'' Rule 17Ad–25(a) now uses the term ''service providers for core services,'' not ''critical services,'' as the Commission observes that some commenters requested that the Commission scope the definition of service providers to overlap with the definition of ''SCI system'' in Regulation SCI.[245] The Commission recognizes that the use of the word ''critical'' could evoke Regulation SCI considerations for some commenters. However, as explained in the Governance Proposing Release, the definition in proposed Rule 17Ad–25(a) is not the same as used in Regulation SCI—in scope or subject matter.[246] The Commission is not conforming the scope of the defined term to Regulation SCI because the definition of ''service provider for critical services'' in proposed Rule 17Ad–25(a) is, as suggested by a commenter, purposefully wider in scope than the definition of ''SCI system'' in Regulation SCI because the definition of ''service provider for critical services'' addresses relationships beyond those concerning only technology or systems, as explained in the Governance Proposing Release.[247]

The definition is modified to include the components of ''a written services agreement for services provided to or on behalf of the registered clearing agency, on an ongoing basis'' because in the Commission's view, core services supporting clearance or settlement functionality should be clearly memorialized in a written agreement that specifies the key elements of any core services being provided. Specifically, cloud services, pricing services, model services, matching services, any services related to straight-through processing, and collateral management services are examples of ongoing services often provided to a registered clearing agency that would be subject to a written services agreement and therefore within scope of the final rule. Such written services agreements may not necessarily be entered into by the registered clearing agency with a service provider for core services; rather, and consistent with the final rule, such written services agreement could be entered into by the parent or an affiliate of the registered clearing agency for services provided to or on behalf of the registered clearing agency. In modifying this element of the definition, the Commission recognizes that the written agreement provides the foundation upon which a registered clearing agency can assess, manage, and monitor the performance of a service provider, as well as assess, manage, and monitor the risks of the core service—and outsourced clearance or settlement functionality. In this regard, the Commission agrees with the commenter that the written agreement provides the registered clearing agency with the legal authority to direct the service provider to comply with the obligations in the agreement,[248] which is important as the registered clearing agency still bears the responsibility for compliance with any statutory or regulatory obligation when it chooses to rely on such a service provider.[249]

Additionally, the modifications to the definition are intended to make clearer that municipal service providers (which are not generally subject to written

[242] *See* CCP12 at 7.

[243] *See* Governance Proposing Release, *supra* note 2, at 51836.

[244] *See* DTCC at 8.

[245] *See* OCC at 12, 27; DTCC at 8.

[246] *See* Governance Proposing Release, *supra* note 2, at 51836 (providing examples of a wide variety of functions that service providers perform on behalf of the registered clearing agency, including its parent company providing staff, investment advisers facilitating the closing out of a defaulting participant's portfolio, data service providers helping calculate pricing information for securities, technology service providers facilitating clearance and settlement).

[247] *See id.*

[248] *See* DTCC at 7.

[249] *Cf.* Governance Proposing Release, *supra* note 2, at 51836 (stating that ''[u]ltimately, 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.'').

service agreements for ongoing services to the registered clearing agency) are not captured in the definition, as commenters have suggested.[250] The Commission previously addressed this scoping concern in the Governance Proposing Release,[251] and such services neither support the core clearance or 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 or settlement functionality or material clearing agency business functions itself.

In addition, the Commission is modifying the definition to capture service providers that provide services on an ongoing basis that directly support the delivery of clearance or settlement functionality or any other purposes material to the business of the registered clearing agency. The modifications change the scope of the proposed definition to capture ongoing services and not limit capture of services to a single instance. The defined term also captures those services that directly support the core functionality of a clearing agency. In this regard, service providers retained for administrative tasks or a limited, one-time provision of services would not be covered by this definition. These changes respond to commenters' concerns and also reflect current practices in which registered clearing agencies have cloud services, pricing services, model services, matching services, services related to straight-through processing, and collateral management services provided by service providers to directly support the registered clearing agency's clearance or settlement functionality on an ongoing basis. Finally, the Commission is modifying the definition to refer to ''clearance *or* settlement'' functionality (emphasis added), rather than ''clearance *and* settlement functionality'' as proposed, to ensure that the definition is consistent with the generalized way in which the Commission often refers to ''clearance and settlement.'' That is, the definition was intended to address both functions in an ''either/or'' sense, as not all registered clearing agencies provide both functions and the Commission often speaks to the collective set of functions without specifying whether one is ''clearance'' or ''settlement.''

3. Roles of Senior Management and the Board

While at least two commenters acknowledged the corporate governance principle that the board conducts oversight of management,[252] several commenters objected to the approach in proposed Rule 17Ad–25(i), stating that the rule confused the distinction between the roles of the board and management, thereby contravening this corporate governance principle and potentially deterring otherwise qualified individuals from serving as directors.[253] Specifically, some commenters understood the proposed rule to shift the responsibility for oversight of service providers from management to the board.[254] One commenter urged a more principles-based approach and also sought clarity as to the scope of proposed Rule 17Ad–25(i)(4), which in the commenter's view did not appear to be limited to ''service providers for critical services'' and so could apply to ''significant deterioration in performance,'' ''changing risks,'' or ''material issues'' regarding the business of the registered clearing agency. This commenter recommended adding a materiality threshold to proposed Rule 17Ad–25(i)(4) to focus the board on ensuring that management has appropriate processes in place to identify and elevate material changing risks.[255] One commenter recommended flexibility in allowing the board to determine ''the process and materiality'' of service providers of critical services.[256] Another commenter urged the Commission to take an alternative approach to differentiate the board and management roles in oversight of service provider relationships.[257]

Additionally, some commenters expressed concern regarding the proposed requirement for the board to ''confirm'' risks posed by a service provider. According to one commenter, because proposed Rule 17Ad–25(i)(4) includes a requirement for the board to ''confirm that senior management takes appropriate actions to remedy significant deterioration in performance or address changing risks or material issues,'' which is ''not consistent with a board's oversight role[,] [i]t is unclear how, in practice, a board could satisfy this 'confirmation' function without engaging in a management function, which would conflict with and distract from the board's oversight functions.'' [258] With regard to statements in the Governance Proposing Release that registered clearing agencies could confirm and document the risks posed by a service provider for critical services by completing a self-assessment based on the format and substance of Annex F to the PFMI,[259] two commenters expressed concern. One stated that ''the board itself should not conduct such an assessment, as such tasks should be performed by an internal corporate function such as third-party risk management, internal audit, or a similar function and then reported to the board (or board-level committee).'' [260] Another commenter stated that although it ''does not believe that the Commission should require that the board confirm and document through a self-assessment that risks related to relationships with service providers for critical services are managed in a manner consistent with its risk management framework. . . . [it] does believe that the Commission

[250] *See* DTCC at 7 (suggesting a modification to the definition to include a ''written contract [which] would make clear that local police, fire, and other municipal services are explicitly out of scope. The proposed definition of service provider should also include an 'ongoing basis' element. Without this element, a one-off or single service may be included within the scope of the Proposal and trigger application of the full risk management lifecycle in the same way that a recurring arrangement does.'').

[251] *See* Governance Proposing Release, *supra* note 2, at 51835, n.133 (explaining that 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).

[252] *See, e.g.,* CCP12 at 7; LSEG at 14 (''We agree that it is a specific responsibility of the board to have oversight.'').

[253] *See, e.g.,* CCP12 at 7 (stating that the ''enhanced board oversight would duplicate the work that is currently performed by staff and management at considerable additional cost, compromising the careful check and balance relationship of the board and management.''); OCC at 10–11 (stating that the proposed rule's oversight dynamic ''would impose responsibilities on the Board akin to those that are squarely within the purview of management by effectively requiring the Board to manage the relationship with service providers for critical services''); ICE at 6 (stating that the proposal ''would require the board to go beyond its oversight responsibilities and tasks the board with a role in managing such relationships.'').

[254] *See, e.g.,* DTCC at 8–10, 14 (stating that ''[w]e believe that such a shift in responsibility is inappropriate insofar as what the Proposal effectively requires is not board oversight of CSP relationships but instead direct board management of such relationships.''); OCC at 10–11; CCP12 at 7.

[255] *See* OCC at 13.

[256] *See* LSEG at 14 (''[T]here should be flexibility to allow the board to determine the process and materiality of service providers of critical services. For example, allowing the board to specifically delegate to a qualified sub-committee of the board, with appropriate escalation and reporting to the board.'').

[257] *See* DTCC at 8–10, 14 (stating that ''[a]s an alternative approach, we recommend that the Commission not impose the obligations set forth in sub-parts (1) and (3) of proposed Rule 17 Ad–25(i) directly on the board. . . . [and] follow the approach it and other global regulators have applied in similar contexts and with the positive outcome of helping ensure resiliency and management of CSP risk,'' citing to Rule 1003(b)(l) of Regulation SCI and Annex F of the PFMI as precedent).

[258] ICE at 6.

[259] *See* Governance Proposing Release, *supra* note 2, at 51837.

[260] CCP12 at 8.

should state explicitly that a properly executed self-assessment similar to the Annex F described in the Proposed Rule is evidence of compliance with Proposed Rule 17Ad–25(i).'' [261]

It was not the Commission's intent to merge, adjust, or duplicate management functions with those of the board in contravention of traditional corporate governance principles with the board directly managing the service provider relationships, as commenters have suggested.[262] In the Governance Proposing Release, the Commission acknowledged the differentiated roles and traditional functions [263] of senior management and the board.[264] To improve clarity in response to commenters concerns,[265] the Commission is modifying the rule at adoption to specify and differentiate the roles and responsibilities of the board and senior management of the registered clearing agency in the oversight of service providers. These changes in the final rule better ensure that risks posed by service providers for core services are properly monitored and managed and better delineate the board oversight function in line with corporate governance principles. Because the modifications are meant to more clearly differentiate the roles of senior management and the board in the context of Rule 17Ad–25(i) while preserving the intended impact of the proposed rule, the words and phrases in the proposed rule have changed and moved in Rule 17Ad–25(i), but the requirements for the board and senior management remain unchanged. Each requirement of Rule 17Ad–25(i) is further explained below.

First, under Rule 17Ad–25(i)(1) as adopted, a registered clearing agency must establish, implement, maintain, and enforce written policies and procedures reasonably designed to require senior management to evaluate and document the risks related to an agreement with a service provider for core services, including under changes to circumstances and potential disruptions, and whether the risks can be managed in a manner consistent with the clearing agency's risk management framework.[266] In the Governance Proposing Release, the Commission discussed the role of senior management to monitor 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.[267] The Commission agrees with the commenter's concern with regard to the term ''confirm.'' [268] Under Rule 17Ad–25(i)(1), while preserving proposed Rule 17Ad–25(i)(1)'s policies and procedures requirement to document service provider risks, the Commission is modifying the final rule to specify that senior management must evaluate—rather than requiring that the board must ''confirm''—and document risks related to the service provider agreement, including under changes to circumstances and potential disruptions, and whether the risks can be managed in a manner consistent with the clearing agency's risk management framework. If changes to circumstances (*e.g.,* a need to expand or scale up the scope or breadth of services of the service provider beyond what was initially agreed to or envisioned) and potential disruptions (*e.g.,* disruptions caused by natural disasters or systems outages) occur, senior management must evaluate and document risks related to such changes and disruptions. The added language of ''changes to circumstances and potential disruptions'' is meant to reflect the parallel elements in Rule 17Ad–25(i)(4) regarding ''changing risks or material issues identified.'' These modifications to Rule 17Ad–25(i)(1) require the policies and procedures to clearly delineate the role senior management must undertake to evaluate risks posed by service providers for core services to the registered clearing agency, as requested by commenters. For the same reason to address commenters' concerns [269] regarding a board self-assessment under Annex F of the PFMI, the Commission is not requiring the board to conduct a self-assessment of such risks.

Second, under Rule 17Ad–25(i)(2) as adopted, a registered clearing agency must establish, implement, maintain, and enforce written policies and procedures reasonably designed to require senior management to submit to the board for review and approval any agreement that would establish a relationship with a service provider for core services, along with the risk evaluation required in Rule 17Ad–25(i)(1). As a companion policies and procedures requirement to Rule 17Ad–25(i)(1), Rule 17Ad–25(i)(2) captures the intent of proposed Rule 17Ad–25(i)(3)'s requirement for policies and procedures to require the board to ''review and approve plans for entering into third-party relationships where the engagement entails being a service provider for critical services.''

Rule 17Ad–25(i)(1) requires policies and procedures to have senior management evaluate service provider relationship risks posed to the registered clearing agency, while Rule 17Ad–25(i)(2) requires policies and procedures to have senior management submit to the board its risk evaluation and any agreements for board review and approval. In response to commenters' concerns,[270] the modifications are designed to clearly differentiate the responsibilities the board and senior management have in this regard in line with corporate governance principles, which was the Commission's intent at proposal. In the Governance Proposing Release, the Commission explained that Proposed Rule 17Ad–25(i)(1) would also require review of senior management's oversight of a service provider relationship.[271] The Commission stated its belief 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

[261] OCC at 27.

[262] For this reason, the Commission also believes that the proposed costs and burdens for Rule 17Ad–25(i) were generally accurate, as further discussed in Part V.F.

[263] *See, e.g.,* Governance Proposing Release, *supra* note 2, at 51837 (stating that ''[i]n 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.'').

[264] *See, e.g.,* Governance Proposing Release, *supra* note 2, at 51836 (recognizing that ''the board . . . oversee[s] 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.'').

[265] *See* DTCC at 8–10, 14; CCP12 at 7; LSEG at 14; OCC at 10–11; ICE at 6.

[266] In the Governance Proposing Release, the Commission had suggested that 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, which highlights oversight expectations applicable to critical service providers. Given that commenters expressed concerns about duplicating management functions at the board level, the Commission is not adopting this guidance. *See* DTCC at 3; CCP12 at 7.

[267] *See* Governance Proposing Release, *supra* note 2, at 51837.

[268] *See* ICE at 6.

[269] CCP12 at 8; OCC at 27; DTCC at 8–10, 14 (stating that ''[a]s an alternative approach, we recommend that the Commission not impose the obligations set forth in sub-parts (1) and (3) of proposed Rule 17 Ad–25(i) directly on the board'').

[270] *See, e.g.,* DTCC at 8–10, 14; CCP12 at 7; LSEG at 14; OCC at 10–11; ICE at 6.

[271] *See* Governance Proposing Release, *supra* note 2, at 51837.

the relationship. In the Governance Proposing Release, the Commission explained that, under Proposed Rule 17Ad–25(i)(3), the board would 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.[272] The Commission stated its belief such board participation is necessary to ensure the maintenance of sound risk management principles as the clearing agency enters into contractual relationships with third parties.[273] Board involvement helps ensure that management has sufficiently established terms of performance by the service provider that can support the needs of the registered clearing agency and that management also has evaluated, assessed, and accounted for any increased level of risk to the registered clearing agency.[274] As stated in the Governance Proposing Release, the board generally should monitor such matters as part of its oversight responsibilities.[275] In this regard, Rule 17Ad–25(i)(2), modified as adopted, is substantively consistent with the discussion of this element of the proposed rule in the Governance Proposing Release.

Third, under Rule 17Ad–25(i)(3) as adopted, a registered clearing agency must establish, implement, maintain, and enforce written policies and procedures reasonably designed to require senior management to be responsible for establishing the policies and procedures that govern relationships and manage risks related to such agreements with service providers for core services and require the board to be responsible for reviewing and approving such policies and procedures. In modifying Rule 17Ad–25(i)(3), the Commission is moving the policies and procedures responsibility originally in proposed Rule 17Ad–25(i)(2) to Rule 17Ad–25(i)(3). These modifications are being made to address commenters' concerns about the rule not being clear about differentiated senior management and board responsibilities under corporate governance principles.[276] As a general matter, proposed changes to a registered clearing agency's policies and procedures must be approved by board action or under authority delegated by the board.[277] As adopted, Rule 17Ad–25(i)(3) is written to explicitly require that senior management—as the group responsible for evaluating the risks of service provider relationships pursuant to Rule 17Ad–25(i)(1)—establish policies and procedures to manage the risks posed by and relationships with the service providers for core services, and that such policies and procedures are reviewed and approved by the board. In this regard, Rule 17Ad–25(i)(3), as adopted, is substantively consistent with established practices of registered clearing agencies with regard to board review and approval of registered clearing agency policies and procedures.

Fourth, under Rule 17Ad–25(i)(4) as adopted, a registered clearing agency must establish, implement, maintain, and enforce written policies and procedures reasonably designed to require senior management to perform ongoing monitoring of the relationship, and report to the board for its evaluation of any action taken by senior management to remedy significant deterioration in performance or address changing risks or material issues identified through such monitoring; or if the risks or issues cannot be remedied, require senior management to assess and document weaknesses or deficiencies in the relationship with the service provider for submission to the board. Under Rule 17Ad–25(i)(4) at adoption, the Commission is preserving proposed Rule 17Ad–25(i)(4)'s policies and procedures requirement to have ongoing monitoring to remedy significant deterioration in performance or address changing risks or material issues identified through ongoing monitoring. But the Commission is now modifying Rule 17Ad–25(i)(4) to clearly delineate the roles of senior management and the board in this context, as a response to commenters' corporate governance concerns.[278] Specifically, Rule 17Ad–25(i)(4) is modified to require policies and procedures that senior management perform the ongoing monitoring and report to the board any action senior management takes to remedy significant deterioration in performance or address changing risks or material issues identified. Rule 17Ad–25(i)(4) is also modified to require policies and procedures that has senior management assess and document weaknesses or deficiencies in the relationship with the service provider in circumstances where the risks or issues cannot be remedied, which senior management must submit to the board. Elements of ''remedy significant deterioration in performance or address changing risks or material issues'' were contained in Proposed Rule 17Ad–25(i)(4). The modifications in the adopted rule are meant to frame the responsibilities more clearly to senior management, as requested by commenters. Rule 17Ad–25(i)(4) is also being modified to clearly delineate that the board is to evaluate any senior management action taken to remedy significant deterioration in performance or address changing risks or materials identified.

In its traditional function as a check on management based on corporate governance principles, the board can better ensure that products or other deliverables are provided timely and consistent with the terms of a service provider agreement, if the board evaluates senior management action to address service provider performance issues.[279] In the Governance Proposing Release, the Commission explained that under Proposed Rule 17Ad–25(i)(4), the board would have responsibility for overseeing the extent to which senior management remedies performance issues under a service provider contract.[280] The changes to Rule 17Ad–25(i)(4) make clear that while senior management is responsible for ongoing monitoring of the service provider relationship and its attendant risks, it is the board that is responsible for overseeing senior management's response to those risks. This layered oversight responsibility in the context of service providers is important because 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.[281] 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.[282] Accordingly, the Commission continues to believe that policies and procedures should specifically provide for reporting to the board by senior management regarding the service provider relationship and associated risks, as well as the board oversight and evaluation of senior management's ongoing monitoring of

[272] *See id.*

[273] *See id.*

[274] *See id.*

[275] *See id.*

[276] *See, e.g.,* DTCC at 8–10, 14; CCP12 at 7; LSEG at 14; OCC at 10–11; ICE at 6.

[277] *See* CCA Standards Adopting Release, *supra* note 4, at 70805.

[278] *See, e.g.,* DTCC at 8–10, 14; CCP12 at 7; LSEG at 14; OCC at 10–11; ICE at 6.

[279] *See* CCA Standards Adopting Release, *supra* note 4, at 70805.

[280] *See* Governance Proposing Release, *supra* note 2, at 51837.

[281] *See id.*

[282] *See id.*

and response to the service provider relationship and risks.[283]

The Commission is not modifying Rule 17Ad–25(i)(4) to be more flexible and principles-based, as two commenters requested.[284] Rule 17Ad–25(i)(4) provides the general parameters for registered clearing agencies to establish policies and procedures to meet the requirements of the rule without prescribing the manner and content of the ongoing monitoring of the service provider relationship and the manner and content of the board's evaluation of senior management action taken to remedy significant deterioration in performance or address changing risks or material issues identified through such monitoring. In response to one commenter's request to have the flexibility for the board to delegate its responsibilities under Rule 17Ad–25(i) to a qualified board sub-committee,[285] the board may choose to do so under Rule 17Ad–25(e), which provides that if any committee has the authority to act on behalf of the board, the composition of that committee must have at least the same percentage of independent directors as is required for the board of directors.

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.

In the Governance Proposing Release, the Commission explained that such ''other relevant stakeholders'' generally would include investors, customers of clearing agency participants, and securities issuers.[286] The Commission also explained 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 registered clearing agency's governance and operations by requiring the registered clearing agency to document that it had received such viewpoints and evaluated their merits.[287]

Many commenters supported the proposed approach to addressing stakeholder viewpoints.[288] Some commenters sought clarity regarding whether existing registered clearing agency rules are sufficient to comply with the proposed rule or whether they need to introduce or modify any existing processes.[289] Furthermore, some commenters recommended limiting the scope of the rule to material developments which affect clearing agencies' risk management or risk profile.[290] Other commenters sought clarity on the frequency of outreach with relevant stakeholders, as well as the design and approach to fora formation.[291] Finally, some commenters recommended that the Commission harmonize proposed Rule 17Ad–255(j) with CFTC regulations at 17 CFR 39.24(b)(12) requiring the establishment of an RWG to obtain input from stakeholders.[292] The Commission addresses each of these topics in Parts II.F.2 through II.F.7.

2. Concern Regarding Duplicative Requirements

Several commenters suggested that existing rules at the registered clearing agencies already consider views of clearing agency participants and other stakeholders, stating that Rule 17Ad–255(j) may be duplicative, redundant, or unnecessary.[293] As discussed further below, the Commission is adopting Rule 17Ad–255(j) to supplement existing Commission requirements and to help formalize processes and structures at the registered clearing agencies.

First, one registered clearing agency commenter explained that its existing governance framework, which includes the composition of its board and reliance on an advisory group it titles the ''Financial Risk Advisory Council'' (FRAC), affords relevant stakeholders the opportunity to provide their viewpoints on relevant risk management issues.[294] Another registered clearing agency commenter similarly stated that its existing governance framework captures clearing participant and other stakeholder views through its board composition as well as through its diverse array of clearing agency participant and stakeholder working groups.[295] Given its current structure, the commenter sought clarity on whether a covered clearing agency, subject to requirements in 17 CFR 240.17Ad–252(e)(2)(iii) and (vi) (''Rule 17Ad–252(e)(2)''),[296] is likely already observing the requirements set forth in proposed Rule 17Ad–255(j), or whether there is something more a covered clearing agency should do to satisfy the proposed requirements. If the latter, the commenter stated its belief that such an approach would be redundant, overly prescriptive, and likely reduce the ability of each unique covered clearing agency to develop the necessary stakeholder inputs.[297] If the former, the

[283] *See id.*

[284] *See* OCC at 13; LSEG at 14.

[285] *See* LSEG at 14 (''[T]here should be flexibility to allow the board to determine the process and materiality of service providers of critical services. For example, allowing the board to specifically delegate to a qualified sub-committee of the board, with appropriate escalation and reporting to the board.'').

[286] *See* Governance Proposing Release, *supra* note 2, at 51838 (''The Commission believes that other relevant stakeholders generally would include investors, customers of participants, as well as securities issuers.'').

[287] *See id.* (''[T]he 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.'').

[288] *See* ISDA at 5; SIFMA at 3; Citadel at 1; Barclays et al. at 2.

[289] *See* OCC at 14; DTCC at 12–13; CCP12 at 9.

[290] *See* OCC at 15, CCP12 at 9; DTCC at 13–14.

[291] *See* CCP12 at 8,10; ISDA at 5; SIFMA AMG at 5–7; Barclays et al. at 2; ICI at 5; Better Markets at21.

[292] *See* ICI at 4; SIFMA AMG at 5; SIFMA at 3–4.

[293] *See* OCC at 14; DTCC at 12–13; CCP12 at 9; ICE at 6.

[294] *See* OCC at 14–15 (explaining various initiatives as part of a ''multi-pronged'' governance framework that furthers ''the goal of considering the viewpoints of relevant stakeholders in corporate initiatives,'' including elements of its bylaws and committee structure, use of public directors on its board, and the FRAC).

[295] *See* DTCC at 12 (explaining its view that ''DTCC's participant-owned governance structure results in a board and board committee composition that is strongly aligned and widely diverse in representing the various participant types that benefit from the services of the registered clearing agencies'' and that the DTCC clearing agencies ''maintain a diverse array of participant and stakeholder working groups that are designed to solicit input from constituencies beyond those immediately represented on the boards of the registered clearing agencies'' including its ''Systemic Risk Roundtable, Risk Advisory Council, Clearing Agency Liquidity Council, Client Risk Forum, and FMI Forum'').

[296] *See* 17 CFR 240.17Ad–252(e)(2)(iii) (requiring a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to support the public interest requirements in Exchange Act section 17A, and the objectives of owners and participants); 17 CFR 240.17Ad–252(e)(2)(vi) (requiring a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to consider the interests of participants' customers, securities issuers and holders, and other relevant stakeholders of the covered clearing agency).

[297] *See* DTCC at 13 (stating that further prescribing and standardizing the current approach in existing Rules 17Ad–252(e)(2)(iii) and (vi) is redundant, overly prescriptive, and will likely reduce the ability of each unique covered clearing agency to develop the necessary stakeholder inputs unique to the cleared markets that they serve).

commenter recommended that the Commission clarify this point further.[298] The commenter also inquired whether the proposed rule was intended for covered clearing agencies to document how they currently comply with Rules 17Ad–252(e)(2)(iii) and (vi), recommending that the Commission modify the proposed rule to more specifically consider how it would apply to covered clearing agencies versus other registered clearing agencies.[299]

With respect to the first two comments stating that the registered clearing agencies' existing governance framework already captures clearing participant and other stakeholder views, the Governance Proposing Release explained that many 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 clearing agency participants, and other stakeholders regarding changes to risk management and other services offered by the registered clearing agency.[300] The Commission proposed Rule 17Ad–255(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.[301] Registered clearing agencies that have already established such structures generally should evaluate their own internal processes, including their approach to observing Rules 17Ad–252(e)(2)(iii) and (vi) if applicable, and determine to what extent any additional steps need to be defined, formalized, or otherwise undertaken to ensure compliance with Rule 17Ad–255(j). In contrast to existing rules for covered clearing agencies, Rule 17Ad–255(j) establishes new requirements for written policies and procedures reasonably designed to require the solicitation, consideration, and documentation of the consideration of the view of stakeholders regarding certain material developments. The specific requirements with respect to solicitation and documentation do not exist in Rule 17Ad–252(e)(2) and therefore the new requirements are not redundant. The requirements are also not overly prescriptive or likely to reduce the ability of each unique covered clearing agency to develop the necessary stakeholder inputs because the registered clearing agencies would have the discretion to determine the appropriate approach to solicitation and documentation relating to stakeholder views. Because Rule 17Ad–255(j) is not duplicative of requirements in Rule 17Ad–252(e)(2), the Commission is also not modifying Rule 17Ad–255(j) for covered clearing agencies in response to these comments.

In asserting that proposed Rule 17Ad–255(j) is duplicative of existing requirements, several commenters cited Exchange Act Rule 19b–4, which generally requires a registered clearing agency, as an SRO, to submit proposed changes to its rules, policies, and procedures to the Commission for review, a process which includes publication and a solicitation of public comments.[302] In addition, commenters also cited requirements under the Dodd-Frank Act for registered clearing agencies that are SIFMUs to file an advance notice of certain material changes, which are also subject to public comment.[303] Another commenter stated its belief that, with respect to the solicitation of risk-based viewpoints, these existing requirements for SROs and SIFMUs are sufficient.[304] Finally, one commenter explained that clearing agencies dually registered as DCOs with the CFTC are subject to requirements for CFTC approval under CFTC regulations at 17 CFR 40.5 and 17 CFR 40.6 that provide market participants with opportunities to review and comment on modifications to rules, procedures, or operations.[305] The commenters believe that, because the above-described filing processes for proposed changes already solicit feedback from the public regarding material issues that affect a registered clearing agency, Rule 17Ad–255(j) would be duplicative of these existing requirements.[306]

The Commission is not modifying Rule 17Ad–255(j) in response to the commenters because soliciting public comments relating to a registered clearing agency's rule filings and advance notices, and the clearing agencies' consideration of stakeholder views as proposed in Rule 17Ad–255(j), are two different processes with wholly separate and distinct purposes. The Commission explained in the Governance Proposing Release that clear and transparent governance arrangements help optimize the registered clearing agency's decisions, rules, and procedures because transparency in the registered clearing agency's internal governance process improves the quality of information shared with its participants and stakeholders, thereby improving the ability of public commenters to provide meaningful comments on proposed rule changes submitted to the Commission or CFTC in one of the above-described filing processes.[307] In particular, it is beneficial for registered clearing agencies to exchange information and consider stakeholder views at any appropriate time to enhance transparency and the quality of the proposed rule, and not only after the proposed rule has been published for public comments. Because these represent two distinct steps to enhance transparency, as well as two distinct processes with different objectives, soliciting and considering stakeholder viewpoints is not duplicative of existing requirements. For the reasons stated above, the Commission is not modifying Rule 17Ad–255(j) in response to these comments because the proposed requirements are not duplicative or redundant of the existing filing processes cited by commenters.

3. Proposed Scope of ''Governance and Operations''

Several commenters explained that the scope of the proposed rule should focus on material developments which may impact a registered clearing agency's risk profile or risk management, and not ''governance and operations.'' [308] First, one commenter stated that the reference to ''governance and operations'' is overly broad and vague.[309] Additionally, the commenter explained that it was unclear whether a registered clearing agency would be required to solicit, consider, and document views from participants and relevant stakeholders before executing

[298] *See id.*

[299] *See id.*

[300] *See* Governance Proposing Release, *supra* note 2, at 51838.

[301] *See id.*

[302] *See* OCC at 15; CCP12 at 9; ICE at 6–7. *See generally* 15 U.S.C. 78s; 17 CFR 240.19b–4 (setting forth requirements for the filing with the Commission of proposed changes to SRO rules).

[303] *See* ICE at 6–7; OCC at 15. *See generally* 12 U.S.C. 5465(e)(1)(A); 17 CFR 240.19b–4(n) (setting forth the requirement for a SIFMU to file advance notice of material changes with its designated supervisory authority under the Dodd-Frank Act).

[304] *See* CCP12 at 9 (also explaining that clearing agencies disclose extensive information in their public quantitative and qualitative disclosures under the PFMIs and operate under publicly available rulebooks).

[305] *See* ICE at 7.

[306] *See* ICE at 6; CCP12 at 9; OCC at 15.

[307] *See* Governance Proposing Release, *supra* note 2, at 51813 (''[C]lear 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 agency transparency improves the quality of the information shared with stakeholders, which in turn improves the public comments submitted in response to rule filings.'').

[308] *See* OCC at 15; CCP12 at 9; DTCC at 13–14.

[309] *See* OCC at 15.

on certain measures,[310] which according to the commenter represent core functions for which the board is required to exercise its considered discretion in the interests of the registered clearing agency.[311] Instead, the commenter explained that such a requirement should be tailored to address those changes that represent a risk to the registered clearing agency's core clearance and settlement operations, and the commenter recommended that the Commission accomplish that goal by modifying the language of the proposed rule to narrow the scope of changes from those that represent ''material developments'' in ''governance or operations'' to those that ''could materially affect the level or nature of risk presented by the registered clearing agency.'' [312] In the commenter's view, this would be consistent with existing requirements for registered clearing agencies that are SIFMUs to submit to the Commission for public notice and comment any changes to operations or procedures that could materially affect the level or nature of risk presented by the registered clearing agency.[313]

Second, another commenter recommended that the registered clearing agency focus on the solicitation of risk-based viewpoints on matters that would materially affect a registered clearing agency's risk profile and related risk management and to not solicit input on every topic on which stakeholders wish to have input (*e.g.,* participation requirements, fees, new technologies, and services).[314] The commenter further stated that governance of a registered clearing agency should be within the sole purview of the registered clearing agency itself, as long as the registered clearing agency complies with regulatory requirements and applicable laws and appropriately considers the interests of customers of clearing agency participants and objectives of owners and participants on matters that materially impact a registered clearing agency's risk profile.[315] Regarding governance, this commenter also stated that it is imperative to ensure that market participants' involvement in clearing agency governance, including through the RMC, is limited to risk-based viewpoints (as opposed to, for example, commercially-driven viewpoints), due to the differing objectives between a registered clearing agency and its participants in their respective day-to-day operations.[316]

The third commenter stated that whereas it is common practice for clearing agencies to solicit feedback on operational matters such as rule changes, prospective enhancement to services or risk management, and fee changes, the governance structure of the clearing agency, where they meet regulatory requirements, is a matter for the board, executives and majority shareholders where such clearing agency forms part of a wider group.[317] The fourth commenter stated that scoping the requirements to material changes in the ''governance and operations'' of a registered clearing agency is overly broad with the likely result that registered clearing agency governance will become less dynamic and responsive to changes and risks in the markets they serve.[318] Therefore, the commenter's recommendation is that the Commission modify the scope of the proposed requirements to ''risk management,'' instead of ''governance and operations.'' The commenter further elaborated that referencing ''risk management'' should be effective in capturing the broad swathe of issues and topics described by the Commission in the proposing release as being of interest to the broader universe of participants and stakeholders in a registered clearing agency.[319] Regarding whether gaps may persist in stakeholder input related to governance, this commenter also recommended that the Commission consider all of the various channels that currently exist for such input (citing, for example, the various filing processes for proposed rule changes previously described in Part II.F.2).[320] Finally, two commenters recommended modifying the rule to specifically require risk-based input via RWGs to ensure input from a broad range of market participants and other stakeholders.[321]

In proposing Rule 17Ad–255(j), the Commission described the scope of the rule as ''governance and operations'' because these categories would address, in a comprehensive way, the clearance and settlement operations of registered clearing agencies without being overly prescriptive. However, permitting input into governance matters may, for example, require the board to disclose to participants and other relevant stakeholders sensitive or non-public information that impacts only the registered clearing agency. The Commission also agrees that the broad scope of ''governance'' may burden the registered clearing agency unnecessarily with the consideration of proposals and concerns that impede the ability of the board or the registered clearing agency to prioritize effectively its risk management function.

Accordingly, in adopting Rule 17Ad–255(j), the Commission is modifying the rule to specify viewpoints as to ''risk management and operations'' rather than ''governance and operations.'' Although some commenters recommended that the Commission replace both terms ''governance and operations'' with ''risk management,'' it is appropriate to retain ''operations,'' because not all operational functions that directly affect participants and other stakeholders clearly fall within the concept of ''risk management.'' Specifically, although topics associated with operational risk management would fall within the scope of ''risk management'' more generally, the basic operations of the registered clearing agencies relating to functions of the clearing agency (*e.g.,* the design and functioning of the processes and technology systems that support the infrastructure of the registered clearing

[310] The commenter identified the following measures: hiring a new member of the senior management team, hiring a new management level committee with authority to make recommendations to the board, selecting a new director, selecting a new outside auditor, or determining the scope of its internal audit plan. *See id.*

[311] *See id.*

[312] *See id.*

[313] *See supra* Part II.F.2 and note 303 (also discussing the requirements in the Dodd-Frank Act for SIFMUs to submit advance notices to their designated supervisory authority).

[314] *See* CCP12 at 9.

[315] *See id.*

[316] *See* CCP12 at 9–10 (explaining that a ''clearing agency's first priority is to contribute to the stability of the broader financial markets, that ''a clearing agency is a risk-manager—not a risk-taker—and supports financial stability by effectively managing the risks of its market participants'' and that ''[m]arket participants, on the other hand, do not have the same regulatory objective of prioritizing financial stability in their day-to-day operations'').

[317] *See* LSEG at 15.

[318] *See* DTCC at 3.

[319] *See* DTCC at 14 (stating that ''risk management'' would also capture the broad swathe of issues and topics noted by the Commission in the Governance Proposing Release as being of interest to the broader universe of participants and stakeholders in a registered clearing agency, including financial risk management, cyber and operational resiliency, default management, and the potential introduction of new cleared products or services).

[320] *See* DTCC at 13 (stating that ''we also believe, in considering the question of what gaps persist in stakeholder input to governance, that the Commission should more purposefully consider all of the various existing channels that currently exist for such input: namely, the self-regulatory organization proposed rule change notice and SIFMU advance notice requirements.'').

[321] *See* Barclays et al. at 2 (recommending a requirement to establish risk working groups as a forum to seek risk-based input from a broad array of market participants); SIFMA at 3–4 (suggesting a requirement that registered clearing agencies formally establish one or more risk working groups to provide a forum for them to seek risk-based input from a broad array of market participants, including participant members and their clients).

agency itself, and the way that participants and other stakeholders connect to such systems) may not. It is appropriate to enable participants and other stakeholders to have input into matters that may be purely operational relating to functions of the clearing agency, including how to access systems.

One commenter stated that clearing agencies should widely consult on any material changes to their risk profile and, in addition, recommended that all relevant topics relating to clearing agency risk management be discussed with an RWG or similar fora.[322] Similarly, another commenter stated that all matters and proposed changes related to the registered clearing agency's rules, procedures, and operations that could materially affect the risk profile of the clearing agency including, but not limited to, any material changes to the risk model, default procedures, participation requirements, and risk management practices, as well as the clearing of new products that could significantly impact the clearing agency's risk profile, should be presented to the RWG for consideration.[323] Regarding these comments, the Commission is not limiting the scope of Rule 17Ad–25(j) to defined risk management categories such as default management, new products or margin methodologies. Rather, the clearing agencies should have the discretion to determine the appropriate topics within risk management and operations relating to the functions of the clearing agencies and determine whether these changes are material developments under the broader direction of soliciting feedback regarding ''operations and risk management.'' In the Commission's view, the topics identified by commenters generally should be the types of topics relating to the functions of the clearing agency on which a registered clearing agency solicits feedback.

Another commenter stated that, to better clarify the expected perspective to be applied by RMC and RWG members, the Commission should explicitly state that in addition to supporting the safety and efficiency of the registered clearing agency, RMC and RWG members should also support the stability of the broader financial system.[324] The Commission is not modifying, in connection with the comment, that the proposed rule on stakeholder viewpoints should include a provision which requires RWGs to consider the safety and efficiency of the registered clearing agency as well as the stability of the broader financial system. The purpose of the proposed rule, as stated above, is for registered clearing agencies to solicit, consider, and document their consideration of the views of participants and other relevant stakeholders regarding material developments in their risk management and operations. Given the varied composition of the fora or RWG, which may include clearing agency participants and other stakeholders including customers of clearing agency participants and other industry participants, the interests of each of these groups may not be perfectly aligned with the registered clearing agency relating to the safety and efficiency of the registered clearing agency or even with broader financial stability measures. In this sense, the commenter may be seeking to better align disparate interests between stakeholders and the registered clearing agencies in connection with supporting the safety and efficiency of the registered clearing agency as well as the stability of the broader financial system; however, pursuant to Commission rules, registered clearing agencies already have obligations to support safety and efficiency, as well as the public interest requirements in section 17A of the Act, throughout their governance processes and not only with respect to soliciting feedback.[325] Given their relatively wider view of market practices and market dynamics, registered clearing agencies may be better positioned to assess safety, soundness, and financial stability than their participants or other stakeholders, and so adding such a requirement applicable to stakeholder viewpoints as a whole may dampen interest in or participation in such stakeholder outreach, limiting the registered clearing agency's ability to continue to collect and consider the wide range of information that is uniquely available to it. Instead, registered clearing agencies should structure and design the fora to address the markets and products they serve so that they can gather useful information effectively. As a result, the Commission is not modifying the scope of the proposed rule to include more granular elements or a reference to the stability of the broader financial system.

One commenter sought clarity on ''material'' changes that require stakeholder viewpoints and recommended that the Commission provide more guidance on what changes would be material.[326] Given materiality may differ across clearing agencies as well as the products cleared, clearing agencies should have the discretion and responsibility to determine whether a development in their risk management and operations is material in the context of their own operations. Pursuant to Rule 17Ad–25(j), a registered clearing agency would be required to establish written policies and procedures in compliance with the rule, and those policies and procedures therefore would also need to clearly define material developments. Given this policies and procedures requirement, a registered clearing agency could make clear in any outreach to participants and other stakeholders how it has defined such material developments. The Commission is not modifying Rule 17Ad–255(j) to provide more specificity as to what constitutes materiality.

Finally, one commenter expressed the view that the board's fiduciary duty to the clearing agency would not conflict with the proposed requirements in Rule 17Ad–255(j) but that it may need to conduct further legal analysis on this point under the relevant local requirements in its jurisdiction.[327] In the Commission's view, soliciting and considering stakeholder views relating to operations and risk management helps the board to fulfill its fiduciary duty to the registered clearing agency because it helps the board to collect information from affected stakeholders regarding the clearing agency's core risk management function.

[322] *See* ISDA at 5 (''These groups should discuss all relevant topics to CCP risk management that impact on their participants' own risk management, including, but not limited to: New Products, Operational Changes, Membership criteria, Default Management, Risk Framework, including margin models and stress testing scenarios, non-default loss mitigation and provisions, and recovery.'').

[323] *See* SIFMA AMG at 6 (recommending that matters required to be brought to the RMC and RWG include all matters and proposed changes to rules, procedures, or operations that could materially affect the risk profile of the clearing agency, including, but not limited to, any material change to its risk model, default procedures, participation requirements, and risk management practices, as well as the clearing of new products that could significantly impact its risk profile).

[324] *See* SIFMA AMG at 5.

[325] *See, e.g.,* 17 CFR 240.17Ad–22(e)(2)(ii), (iii) (requiring a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for governance arrangements that clearly prioritize the safety and efficiency of the covered clearing agency and support the public interest requirements in section 17A of the Exchange Act, applicable to clearing agencies).

[326] *See* ISDA at 6 (''[A]s it is very difficult to define what material changes are, we support principle-based rules and see a strong role of supervision. The Commission could also define examples of what changes would be material to provide more guidance to the clearing agency.'').

[327] *See* LSEG at 15.

4. Frequency and Method of Outreach

Several commenters stated that the Commission should not specify the frequency with which clearing agencies solicit viewpoints from participants and other stakeholders.[328] One commenter specifically stated that the frequency should depend on the topic and its materiality to the clearing agency, clearing agency participants, and relevant stakeholders.[329] Another commenter stated that RWGs should be deployed only on an as-needed basis to assess the same issues as those considered by the RMC.[330] A third commenter stated that a more prescriptive requirement for the frequency of obtaining feedback could force registered clearing agencies to solicit stakeholder viewpoints even when there are no material matters to discuss, solely to satisfy a regulatory requirement.[331] From the commenter's perspective, the frequency of solicitation should be determined based on when topics arise that could have a material impact on the risk profile of the clearing agency, which will inherently vary across clearing agencies. This commenter also stated that not requiring a minimum frequency for soliciting viewpoints is more efficient and could lead to more active participation when viewpoints are solicited.[332]

The Commission agrees that clearing agencies should retain discretion when considering how frequently and via what mechanism to engage with participants and other stakeholders, as the most appropriate timing and mechanism are likely to vary by topic, informed in part by the markets served and products cleared. Therefore, the Commission is retaining in final Rule 17Ad–255(j) the reference to ''recurring,'' and is not modifying the proposed rule by specifying the frequency of any solicitations or outreach.

One commenter specifically recommended that consultation with market participants should be required prior to a clearing agency filing rules with the Commission.[333] Similarly, another commenter suggested that the Commission encourage registered clearing agencies to publicly consult on any proposals affecting their risk management practices before filing them as proposed rule changes with the Commission.[334] As an example, the commenter cited current practice at the Financial Industry Regulatory Authority (''FINRA'') to consult on significant changes to its own SRO rules when those rules would change the compliance obligations of its members, suggesting that the Commission and registered clearing agencies consider FINRA's model as a potentially workable approach.[335] Finally, one commenter also recommended that the clearing agencies consult with a ''broad spectrum'' of market participants prior to submitting a rule change.[336] Although the Commission recognizes the benefits of consulting with participants and other stakeholders *prior* to proposed changes that concern key elements of risk management functions or operations, registered clearing agencies are best positioned to assess when to conduct such outreach and accordingly, the rule should not mandate such consultations. Rather, clearing agencies would be required to consult with participants and other stakeholders regarding material developments in its risk management and operations on a *recurring* basis. Depending on the scope and materiality of the proposed rule change, the registered clearing agency can ultimately determine whether to consult with participants and other stakeholders. As a result, the Commission is not modifying the proposed rule to provide more specificity regarding the timing of the outreach with stakeholders in response to these comments.

One commenter asked the Commission to clarify expectations regarding the method of communication with participants and other stakeholders and, specifically, whether written consultation conducted pursuant to Rule 17Ad–255(j) would need to be disclosed pursuant to Form 19b–4.[337] If the latter, the commenter stated that this would adversely impact communications between the clearing agency and stakeholders and increase costs and burdens relating to the SRO rule filing process for registered clearing agencies.[338]

As previously discussed, proposed Rule 17Ad–255(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.[339] Therefore, registered clearing agencies would have discretion in the design and structure of stakeholder outreach including the method of communication (*e.g.,* use of an advisory group or council, other types of in-person meetings, and written correspondence). Additionally, although a clearing agency must establish, implement, maintain, and enforce written policies and procedures reasonably designed to require the board of directors to solicit and consider viewpoints of participants and other relevant stakeholders, nothing in the rule prohibits the board of directors from obtaining assistance in soliciting viewpoints of participants and other relevant stakeholders from staff of the registered clearing agencies. Although registered clearing agencies may determine the appropriate method of communication under Rule 17Ad–255(j), whether such discussions must ultimately be disclosed pursuant to Form 19b–4 would turn on the specific facts and circumstances of any such written correspondence. As previously discussed in Part II.F.2, Rule 17Ad–255(j) and the process for filing by SROs of proposed rule changes serve distinctly different purposes and so engagement under Rule 17Ad–255(j) may (or may not) implicate corresponding obligations regarding disclosure on Form 19b–4. Accordingly, Rule 17Ad–255(j) need not be modified at adoption to include more specific requirements on the method of communication with stakeholders.

5. Use of Fora To Satisfy the Rule

As stated in the Governance Proposing Release, the Commission recognized 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 clearing agency participants, the customers of clearing agency participants, and other stakeholders regarding changes to risk management

[328] *See, e.g.,* LSEG at 15 (''This should be determined on a case-by-case basis depending on the topic and materiality to the clearing agency and to its members/relevant stakeholders.''); CCP12 at 10 (stating that the rule should not specify how often the clearing agency needs to solicit viewpoints or how consideration of these viewpoints needs to be documented).

[329] *See* LSEG at 15.

[330] *See* SIFMA AMG at 5.

[331] *See* CCP12 at 10.

[332] *See id.*

[333] *See* ISDA at 5.

[334] *See* SIFMA at 4.

[335] *Id.*

[336] *See* ICI at 5.

[337] *See* DTCC at 13 (seeking to understand whether the Commission expects registered clearing agencies to treat stakeholder engagements under proposed Rule 17Ad–255(j) as ''any correspondence or other communications reduced to writing (including comment letters) to and from such [registered clearing agency] concerning the proposed rule change'' as required by the General Instructions to Form 19b–4 and expressing concern that applying such an interpretation ''would likely chill open and frank discussions between the clearing agency and the stakeholder groups,'' as well as ''increase the costs and burdens to the SRO rule filing process for registered clearing agencies'').

[338] *See id.*

[339] *See supra* Part II.F.1.

and other services offered by the registered clearing agency.[340] These fora are useful tools for information sharing and help to promote an open dialogue between various stakeholders.

The Commission received several comments relating to the formation of fora (or RWGs) in connection with stakeholder viewpoints. First, one commenter explained that registered clearing agencies must have the flexibility to determine the appropriate structure and use of these groups in a way that best serves their risk management needs and the markets that they serve.[341] From the commenter's perspective, prescribing granular requirements would reflect a shift away from principles-based rules and would be highly concerning given the diversity in number and types of fora that registered clearing agencies already use to solicit stakeholder input. The commenter stated that the Commission should defer to the registered clearing agency's discretion to determine how best to obtain and consider stakeholder input and not include in the rule granular requirements for the committees, working groups, and other fora.[342] The Commission agrees with the comment that clearing agencies should have the flexibility to determine the most appropriate structure for the use of fora or RWGs to ensure that these fora are effectively designed to address the risk management needs of the registered clearing agency, and therefore the Commission is not modifying the proposed rule to include specific requirements.

One commenter stated that the clearing agency should not select the participants of the fora, but allow representatives of the clearing agency participants and, depending on the topic, also customers of clearing agency participants and other stakeholders, to freely join these fora.[343] Some commenters indicated that these fora should include representatives from both clearing agency participants and their customers.[344] Another commenter recommended that the RWGs be composed of experts with knowledge of specific risk issues.[345] Finally, one commenter recommended that the Commission require the establishment of RWGs to seek input from a broad array of market participants so all market participants can freely represent the view of their firms and other similarly situated market participants.[346] In response to these comments, although stakeholders may include a wide range of clearing agency participants, customers of clearing agency participants, and other stakeholders, as discussed in the Governance Proposing Release, the proposed rule would require each registered clearing agency to establish and enforce written policies and procedures reasonably designed to solicit, consider, and document its consideration of the views of participants and other relevant stakeholders. Depending on the topic and issue or scope of issues under discussion, the registered clearing agency may occasionally need to reach out to a select group to obtain the appropriate amount of stakeholder input. As such, the Commission did not require specific fora participation in the proposed rule because the process for clearing agencies to effectively collect and consider stakeholder views could be adversely impacted. For those same reasons, the Commission is not modifying the rule to specify the composition of or qualifications for participation in such fora.

Several commenters expressed the view that the rule should specify the composition of fora to ensure participation by customers of clearing agency participants and other end users. One commenter recommended that the RWG's membership include a meaningful proportion of customers of clearing agency participants to promote broad and fair representation of end users' risk-based views and input vis-a-vis other market participants.[347] Specifically, to obtain a ''meaningful proportion,'' the commenter recommended that the Commission adopt selection parameters that would ensure a cross-section of customers representing a meaningful level of customer risks are included. As previously discussed,[348] the Commission's view is that other relevant stakeholders generally would include investors, customers of clearing agency participants, and securities issuers. However, registered clearing agencies should have the discretion to determine the appropriate design and structure of the fora to address any material developments relating to risk management and operations, including the appropriate proportion of customers of clearing agency participants, because not all topics relating to risk management and operations will necessarily impact customers of clearing agency participants and other types of stakeholders. The Commission therefore is not modifying the rule to provide additional specification that a meaningful proportion of customers of clearing agency participants be represented within stakeholder views. Nonetheless, a registered clearing agency generally should endeavor to solicit viewpoints from a representative cross-section of affected parties.

Another commenter stated that the proposed rule did not specify the consideration of views held by small participants, or even a certain range of participants, and that mere ''consideration'' requirements would be subject to influence by boards, which the commenter explained would be beholden to large broker-dealers that serve increasingly concentrated markets.[349] From this commenter's perspective, the requirement to consider stakeholder views does nothing to remedy potential vulnerabilities in the nomination process or the broader independence requirement. The commenter stated that only more prescriptive interventions can remedy the underlying problem of director independence.[350] Because the types of participants, as well as their comparative sizes, vary significantly across the markets served by the different registered clearing agencies, registered clearing agencies should have the discretion to determine the appropriate design and structure of the fora including the consideration of small participants and a range of participants. Therefore, the Commission is not modifying Rule 17Ad–255(j) in response to the comment regarding the inclusion of small participants and range of participants. As to the commenters' concerns regarding the role

[340] *See* Governance Proposing Release, *supra* note 2, at 51838.

[341] *See* CCP12 at 8.

[342] *See id.*

[343] *See* ISDA at 5.

[344] *See* SIFMA AMG at 5 (''To better clarify the requirement for 'participant' membership, the Commission should explicitly require that RMCs and RWGs include the independent views of representatives of clearing members and clearing member customers . . .''); Citadel at 1 (supporting the proposed requirement for registered clearing agencies to implement written policies and procedures to solicit and consider the views of participants (including customers of direct members) regarding material developments in governance and operations because there may be circumstances where the interests of the clearing agency, its direct members, and customers are not fully aligned, and explaining that such a requirement will result in fairer and more informed decision-making, and ultimately more confidence in the clearing infrastructure).

[345] *See* SIFMA AMG at 5.

[346] *See* Barclays et al. at 2 (recommending a requirement for risk working groups as a forum to seek risk-based input from a broad array of market participants to ensure that all market participants can freely represent the views of their firms and other similarly situated market participants).

[347] *See* ICI at 5.

[348] *See supra* Part II.F.1; *see also* Governance Proposing Release, *supra* note 2, at 51838.

[349] Better Markets at 21.

[350] *See id.*

of large and small participants in the context of board composition and the nominating committee, the Commission previously addressed these concerns in Part II.B.3.

One commenter stated its support for contributions by RWGs that reflect a risk-based, independent, and informed opinion; requested that the Commission be explicit that the clearing agency participants and customers of clearing agency participants are representing the perspectives of their employers; and expressed support for the Commission requiring a principles-based approach whereby a registered clearing agency shall employ proportionate measures to mitigate the potential risk of a misuse of confidential information.[351] Although the Commission generally agrees that contributions should be risk-based, independent, and informed, when providing such risk-based input, the Commission is not revising the rule to prescribe that fora be used or how such fora ought to be structured to give registered clearing agencies discretion in how they treat sensitive or confidential information to avoid hampering or discouraging participant or other stakeholder participation in such fora. As a result, the Commission is not modifying Rule 17Ad–255(j) to include more prescriptive requirements regarding how to participate in fora established to achieve compliance with the rule. By comparison, the Commission has considered, and in some cases included, such requirements in the context of the board RMC under Rule 17Ad–255(d), as discussed in Part II.C.

One commenter specified that the Commission should explicitly require registered clearing agencies to establish one or more risk advisory groups, which would have a larger membership than the RMCs and could meet as needed for specific issues to advise the RMCs.[352] Moreover, the commenter stated that the Commission should explicitly require RWG membership be subject to fitness standards and that the membership within each constituency rotate on a three-year basis to welcome diverse views while preserving continuity of expertise.[353] The commenter acknowledges that fitness standards may vary across the registered clearing agencies due to business models or otherwise, but stated that a foundational level of risk management expertise must be a consistent requirement. As stated above,[354] the design and structure of the fora including but not limited to composition, fora count, fora rotation, and fitness standards specifying the level of risk management expertise are best determined by the clearing agencies themselves because they have unique insight into how issues or emerging topics might impact their participants and other stakeholders. Therefore, the Commission is not modifying the proposed rule to add specific requirements with respect to fora formation.

6. Documentation of Stakeholder Views

One commenter stated that although a clearing agency generally should document its consideration of stakeholder viewpoints, each clearing agency should have the discretion to determine the appropriate level of documentation.[355] Two commenters also stated that requiring clearing agencies to document their consideration of participant viewpoints, and thereby ensure that a record of such viewpoints exists and has been evaluated as to their merits would be beneficial.[356] The Commission agrees that documenting the consideration of stakeholder viewpoints helps build a record of the reasons certain actions have been taken over time by the registered clearing agency and therefore helps promote thoughtful and consistent decision-making over time. While each registered clearing agency will be required to document its consideration of the views of participants and other relevant stakeholders, each registered clearing agency may determine the appropriate level of details relating to the documentation of its consideration of stakeholder viewpoints to ensure that the potential burdens associated with the documentation process, and the resulting time it adds to the decision-making process, do not undermine the benefits of soliciting viewpoints from relevant stakeholders.[357] As a result, no modifications are necessary to the proposed documentation requirement.

Another commenter stated that there should be minutes of each meeting relating to RWG or similar fora, which ideally could be made public, or at least be shared with all interested clearing agency participants and customers of clearing agency participants.[358] Furthermore, the commenter recommended that any dissenting views be documented and shared with regulators, including the clearing agency's rationale for not accommodating such views.[359] Similarly, another commenter recommended that clearing agency participants' and end users' feedback be disclosed to regulators.[360] Finally, another commenter recommended that registered clearing agencies be required to respond to market participant feedback, specifically in scenarios where the feedback has not been incorporated into the registered clearing agency's decision.[361]

Documenting the consideration of viewpoints from stakeholders (including minutes) ensures that a record exists of the viewpoints provided by relevant stakeholders. However, the requirement for the board to ''consider'' the views of participants and other relevant stakeholders may not in all cases result in action by the registered clearing agency. A registered clearing agency generally should endeavor to ensure that it has a complete and accurate record of input received, particularly when the registered clearing agency determines that the most appropriate action is action with which some participants or other key stakeholders disagree. However, in the context of soliciting viewpoints, each registered clearing agency should have discretion to determine, in its policies and procedures, the appropriate level of detail relating to documentation across the different mechanisms used to solicit viewpoints, whether through an advisory group or other fora, survey, or other written correspondence, while generally endeavoring to ensure that it has a complete and accurate record of input received. Documentation of stakeholder viewpoints under Rule 17Ad–255(j) would constitute records of

[351] *See* SIFMA AMG at 6.

[352] *See* SIFMA AMG at 4.

[353] *See id.* at 4–5.

[354] *See supra* notes 342–346 and accompanying text.

[355] *See* CCP12 at 10 (stating that a clearing agency should document its consideration of viewpoints received, but that each clearing agency should have the discretion to determine the appropriate level of documentation to balance the need for efficiency with the need to document and disseminate its consideration of these viewpoints, and that this is currently a standard practice).

[356] *See* ISDA at 5; Barclays et al. at 2.

[357] *See infra* Part IV.C.6 (discussing the economic effects of the rule) and V.G (discussing the PRA burdens estimated for the rule).

[358] *See* ISDA at 5.

[359] *See id.* at 6 (''To the degree that the RWG (or a similar forum) expresses dissenting views with regard to a clearing agency's material risk decisions, or the clearing agency is not following advice of the RWG, those dissenting views should be documented and shared with regulators, including the CCP's rationale for not accommodating them.'').

[360] *See* Barclays et al. at 2 (stating that ''as the proposal rightly observes, such a requirement would help promote confidence in the use of participant forums, promote an open dialogue and greater understanding between the clearing agencies and participants and also help the Commission evaluate the ways in which clearing agencies consider stakeholder viewpoints and balance potentially competing viewpoints'').

[361] *See* ICI at 5.

the registered clearing agency, and therefore be subject to review and examination by representatives of the Commission upon request.

With respect to meeting minutes, a registered clearing agency generally should endeavor to disclose their contents as fully as possible, though the Commission acknowledges that, due to the confidential nature of some of the topics discussed regarding risk management and operations, it may not always be appropriate to share such documents in full with the public. Furthermore, some stakeholders may not be as forthcoming in their feedback to registered clearing agencies if all such views would be shared automatically with the public, such as through posting on a public website.

With respect to responding to feedback not taken, it is inappropriate to require in Rule 17Ad–255(j) a response from the registered clearing agency to feedback in cases where the registered clearing agency has not incorporated the feedback into its final decision. The clearing agency may have declined to incorporate the feedback for a variety of reasons. As a general matter, clearing agencies generally should endeavor to provide timely feedback and explanation in response to stakeholder viewpoints, but also retain discretion in determining whether and when to respond to such views or feedback. The Commission therefore is not modifying the rule to require documentation relating to stakeholder views to be disseminated to all registered clearing agency participants or the general public.

7. Harmonization With CFTC Requirements for RWG

One commenter recommended that the Commission harmonize proposed Rule 17Ad–255(j) with the CFTC's more prescriptive approach relating to RMCs [362] and RWGs, including by adding a requirement to establish RWGs.[363] Another commenter also recommended that the Commission adopt requirements for registered clearing agencies to establish RWGs in a manner similar to CFTC requirements, with a corresponding requirement that the RWG include representatives from both clearing agency participants and customers of clearing agency participants.[364] The commenter also recommended that the Commission adopt the list of factors that were specified in CFTC requirements as significantly impacting the registered clearing agency's risk profile, including if a new product has different margining, liquidity, default management, pricing, or other risk characteristics from those applicable to products already cleared. Finally, one commenter, consistent with a recommendation by the CFTC's Market Risk Advisory Committee, suggested that the Commission include in any final rulemaking a requirement that registered clearing agencies formally establish one or more RWGs to provide a forum to seek risk-based input from a broad array of market participants, including clearing agency participants and the customers of clearing agency participants.[365]

In the Commission's view, the differences between the CFTC's final rules at 17 CFR 39.24(b)(12) requiring creation of an RWG and proposed Rule 17Ad–255(j) are appropriate within the context of the full set of requirements contained in Rule 17Ad–255 and considering the different products and markets served by registered clearing agencies. As a general matter, Rule 17Ad–255 imposes specific requirements onto the board-level RMC similar to those contemplated by the CFTC but does not specifically require creation of an RWG when soliciting stakeholder viewpoints.[366] Rule 17Ad–255(j) also does not require a minimum number of meetings or solicitations of feedback, though it does similarly require documentation of feedback and specify the range of parties from whom a registered clearing agency must solicit feedback, including participants, customers of participants, and other stakeholders such as securities issuers. Despite these differences, the objectives of Rule 17Ad–255(j) and the CFTC's rules are the same, and the approaches are consistent considering the discretion afforded in Rule 17Ad–255(j) for developing written policies and procedures. For example, in the Commission's view, a registered clearing agency generally could demonstrate compliance with Rule 17Ad–255(j) by codifying the creation of an RWG under CFTC requirements in its written policies and procedures, assuming that in so doing it addressed the requirements in Rule 17Ad–255(j) to solicit, consider, and document its consideration of stakeholder viewpoints consistent with the rule.

With respect to the list of factors specified in CFTC requirements, the approach in Rule 17Ad–255(j) is more general, focused on soliciting viewpoints regarding ''operations and risk management'' rather than identifying more specifically the discrete topics that should be considered. The two approaches are consistent and Rule 17Ad–255(j) is appropriately targeted given the range of clearing agency functions performed by registered clearing agencies, not all of which are central counterparties,[367] and therefore may not be able to meaningfully solicit feedback on topics like margin or liquidity.

In connection with the third commenter's request to include representatives from both clearing agency participants and customers of clearing agency participants as well as explicitly require that the clearing agencies establish one or more RWGs, as previously discussed in Part II.F.5 above,[368] the rule considers stakeholder feedback from a wide range of participants and other stakeholders, including customers. However, clearing agencies should have the discretion to determine the structure and design of the fora including the composition and the number of fora.

In consideration of the above, 17Ad–255(j) is broadly consistent with the CFTC requirements to establish an RWG and therefore the Commission believes it is unnecessary to modify Rule 17Ad–255(j) in adopting the rule to achieve harmonization with CFTC rules for RWGs.

III. Compliance Dates

As proposed, the compliance date for Rule 17Ad–255 would be 180 days after publication in the **Federal Register** except that the compliance date for proposed Rules 17Ad–255(b)(1), (c)(2),

[362] The Commission notes that Rule 17Ad–255(d), as discussed in Part II.C, would require the establishment of a board-level RMC, whereas CFTC regulations do not specifically require that the RMC be a board-level committee.

[363] *See* ICI at 4 (stating that ''First, we recommend that the SEC harmonize its proposal with the CFTC's more prescriptive approach to RMCs and RWGs.'').

[364] *See* SIFMA AMG at 5 (stating that, given the relative infrequency of the board's meetings with the more senior members of the RMC, the Commission should adopt the requirement to also establish RWGs in a manner similar to the CFTC, including representatives from both clearing members and clearing member customers, explaining that the RWGs could be composed of experts with knowledge of specific risk issues and be able to be deployed on an as-needed basis to assess the same issues assigned to RMCs, but on a deeper basis).

[365] *See* SIFMA at 3–4.

[366] In addressing the relationship between the CFTC's requirements for the RMC and the Commission's own Rule 17Ad–255, Part II.C discusses in more detail how Rule 17Ad–255 is intended to bolster the overall quality of governance (and therefore risk management) at a registered clearing agency to achieve substantially similar outcomes to the CFTC requirements.

[367] For example, registered clearing agencies may instead be central securities depositories, which perform different functions from CCPs and do not collect margin.

[368] *See supra* notes 342–346 and accompanying text.

and (e) would be 24 months after publication in the **Federal Register**. The Commission is modifying these compliance dates so that the compliance date for Rule 17Ad–255 is 12 months after publication in the *Federal* Register, except that the compliance date for Rules 17Ad–255(b)(1), (c)(2), and (e) is 24 months after publication in the **Federal Register,** for the reasons discussed below.

First, one commenter recommended that the Commission consider a later compliance date for Rules 17Ad–255(b)(1), (c)(2), and (e) to ensure that registered clearing agencies had sufficient time to replace any directors to meet requirements related to independence.[369] In particular, the commenter explained that some directors serve terms longer than two years, and so a later compliance date could help ensure an orderly transition.[370] An orderly transition of directors is important, but a later compliance date is unnecessary to achieve an orderly transition of directors, to the extent such transition is necessary. Even in a case where directors serve three-year terms, the implementation period need not accommodate the expiration of all terms of currently serving directors because the rules do not require the turnover of all directors. To the extent that a clearing agency determines that either its overall board composition or its current set of independent and non-independent directors must change to achieve compliance with the final rules, 24 months provides sufficient time to develop and apply new standards for independent directors in an orderly manner and, as a general matter, to conduct nominations, elections, and appointments of new directors within the clearing agency's established processes for nominations, elections, and appointments. As an example, most clearing agencies would complete two cycles of annual nominations, elections, and appointments before the compliance date. Even for a clearing agency that has directors serving longer terms that are not staggered, the governance arrangements would still provide mechanisms to replace directors in an orderly manner. Such mechanisms include, for example, those that a clearing agency would use to fill a vacancy that occurs when a director vacates her position prior to the end of her term. In addition, even for a clearing agency that does not conduct annual elections of directors, it would still conduct an annual meeting of shareholders, at which off-calendar director elections could be scheduled as needed. In the Commission's view, two years provides sufficient time to ensure an orderly transition of directors, to the extent a registered clearing agency determines that its current board composition should change to meet the requirements in Rule 17Ad–255 for independent directors.

Second, one commenter recommended more generally that the Commission consider a later compliance date because, in the commenter's view, the proposed rules are more burdensome than described by the Commission as proposed.[371] For the reasons discussed in Part II above, and particularly in Part II.E, the proposed rules are not more burdensome than originally described, and in the final rules the Commission has modified the text of the rules to ensure that the obligations under the rule are clear and consistent with the discussion in the Governance Proposing Release. Nevertheless, to ensure that registered clearing agencies have time to consider and develop changes to rules, policies, and procedures to ensure compliance with Rule 17Ad–255, and to submit those changes to the Commission for review when required by section 19 of the Exchange Act and Rule 19b-4, the Commission is adopting a compliance date of 12 months after publication in the **Federal Register** for Rule 17Ad–255, except that the compliance date for Rules 17Ad–255(b)(1), (c)(2), and (e) is 24 months after publication in the **Federal Register**.

IV. Economic Analysis

A. Introduction

The Commission is sensitive to the economic consequences and effects of the final rules, including their benefits and costs.[372] The Commission acknowledges that, since many of these rules could require a registered clearing agency to adopt new policies and procedures, the economic effects and consequences of these rules include those flowing from the substantive results of those new policies and procedures. Further, as stated above, Exchange Act section 17A 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.[373]

This economic analysis addresses the likely economic effects of the final 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 divergent incentives is a core economic matter that is persistent across many different types of economic interactions among registered clearing agency stakeholders. Incentives affect the economic outcome of a transaction, but there is no reliable or comparable data across different organizations 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 registered clearing agencies will respond to the final rules, and how those responses will, in turn, affect the broader market for cleared securities. While the Commission has attempted to quantify economic effects where possible, much of the discussion of economic effects is qualitative in nature. However, the inability to quantify benefits and costs does not mean that the benefits and costs of the final rules are any less significant. The Commission sought comment on all aspects of the economic analysis, especially any data or information that would enable a quantification of economic effects, and the analysis below takes into consideration relevant comments received. The Commission also discusses the potential economic effects of certain alternatives to the final rules.

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369 LSEG at 15.

370 *Id.* (explaining that its directors serve three-year terms, suggesting that a longer implementation period of three years would provide time for complete turnover of the board).

371 *See* DTCC at 22.

372 Under Exchange Act section 3(f), 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).

373 *See* 15 U.S.C. 78q–1(a)(2)(A).

B. Economic Baseline

To consider the effect of the final rules, the Commission first explains the current state of affairs in the market (*i.e.,* the economic baseline). All the benefits and costs from adopting the final rules are changes relative to the economic baseline. The economic baseline in this release 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 scope of trading activity 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 final rules.

1. Description of Market

Clearing agencies are financial markets infrastructures, which include central securities depositories and central counterparties, and each clearing agency plays an important role in the financial system. In the United States, there are currently six active registered clearing agencies (NSCC, DTC, FICC, ICC, LCH SA, and OCC), and two registered clearing agencies that are inactive (BSECC and SCCP).[374]

DTC provides central securities depository (CSD) services; the other five active registered clearing agencies provide central clearing counterparty (CCP) services. NSCC offers clearance services for equities, corporate and municipal bonds, derivatives, money market instruments, syndicated loans, mutual funds, and alternative investment products in the United States. FICC provides clearance services for government and mortgage-backed securities. ICC and LCH SA are both registered clearing agencies for credit default swaps (''CDS''). OCC offers clearing services for exchange-traded U.S. equity options.

Registered clearing agencies broadly operate under two organizational models. Specifically, the registered clearing agency may be organized so that the participants are owners of the clearing agency,[375] or so that participants are not owners of the clearing agency.[376]

Registered clearing agencies currently operate specialized clearing services and face limited competition in their markets. 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 agencies' participants include securities brokers and dealers, custodian and clearing banks, and certain other investment institutions. Table 1 summarizes the most recent data on the number of participants at each registered clearing agency.

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,[377] informs the Commission's examination of the effects of the final rules on competition, efficiency, and capital formation, as discussed below.

TABLE 1—ACTIVE REGISTERED CLEARING AGENCIES AND NUMBER OF PARTICIPANTS

Registered clearing agency	Abbreviated name	Function	Number of participants [a]
Subsidiaries of The Depository Trust & Clearing Corporation (DTCC):			
—National Securities Clearing Corporation [b]	NSCC	CCP	4,090
—The Depository Trust Company [c]	DTC	CSD	860
—Fixed Income Clearing Corporation (Government Securities Division) [d]	FICC	CCP	214
—Fixed Income Clearing Corporation (Mortgage Backed Securities Division) [e]	FICC	CCP	139
Subsidiaries of Intercontinental Exchange (ICE):			
—ICE Clear Credit [f]	ICC	CCP	30
Subsidiaries of LCH Group Holdings Ltd (LCH):			
—LCH SA (CDS Clear Participants Only) [g]	LCH SA	CCP	25
The Options Clearing Corporation [h]	OCC	CCP	187

[a] Participant statistics were taken from the websites of each of the listed clearing agencies in July 2023.
[b] *NSCC Member Directories, available at http://www.dtcc.com/client-center/nscc-directories.*
[c] *DTC Member Directories, available at http://www.dtcc.com/client-center/dtc-directories.*
[d] *FICC-GOV Member Directories, available at http://www.dtcc.com/client-center/ficc-gov-directories.*
[e] *FICC-MBS Member Directories, available at http://www.dtcc.com/client-center/ficc-mbs-directories.*
[f] *ICE Clear Credit Participants, available at https://www.theice.com/client-center/clear-credit/participants.*
[g] *LCH SA Membership, available at https://www.lch.com/membership/member-search.*
[h] *Member Directory, available at http://www.theocc.com/Company-Information/Member-Directory.*

Registered clearing agencies in the U.S. are an essential part of the infrastructure of the U.S. securities markets due to their role as intermediaries for clearing and settling securities transactions.[378] In the 12-month period from October 2021 to September 2022, approximately $1,270 billion (65 percent) of the notional

[374] Neither BSECC nor SCCP has provided clearing services in 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 Part V.

[375] For example, DTC, NSCC, and FICC are subsidiaries of DTCC. 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. *See, e.g.,* Exchange Act Release No. 52922 (Dec. 7, 2005), 70 FR 74070 (Dec. 14, 2005).

[376] For example, OCC is owned by certain options exchanges; ICC is a subsidiary of ICE, which is listed on the New York Stock Exchange; and LCH SA is a subsidiary of LCH Group Holdings, Ltd., which is majority-owned by London Stock Exchange Group plc (a publicly traded company).

[377] *See* DTCC at 4 (''it is true as the Proposing Release suggests that concentration of clearing and settlement services has occurred over time'').

[378] *See* Governance Proposing Release. *supra* note 2, at 51813.

amount of all single-name CDS transactions in the United States were centrally cleared.[379] In 2022, DTCC processed $2.5 quadrillion in securities transactions, and OCC cleared 10.38 billion individual options contracts.[380]

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.[381] Notwithstanding the benefits, central clearing concentrates risk in the registered clearing agency.[382] Disruption to a registered clearing agency's operations, or failure on the part of a registered clearing agency to meet its obligations, could serve as a source of contagion across U.S. securities markets, resulting in significant costs not only to the registered clearing agency itself or its participants but also to other market participants and the broader U.S. financial system.[383] 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.[384]

2. Overview of the Existing Regulatory Framework

The existing regulatory framework for clearing agencies registered with the Commission includes Exchange Act section 17A and the Dodd-Frank Act, and the related rules adopted by the Commission. The current regulatory system is discussed in the Governance Proposing Release.[385]

The Commission is aware that clearing agencies registered with the Commission may also be subject to other domestic or foreign regulators. Specifically, registered clearing agencies operating in the United States may also be subject to regulation by the CFTC (as derivatives clearing organizations for futures or swaps) and the Board of Governors of the Federal Reserve System (as systemically important financial market utilities or state member banks).[386] In addition, clearing agencies registered with the Commission may be subject to foreign clearing agency regulators. For example, LCH SA is subject to EMIR and is regulated by l'Autorité des marchés financiers, l'Autorité de Contrôle Prudentiel et de Résolution, and the Banque de France.[387]

The Commission also considers relevant international standards when engaging in rulemaking for registered clearing agencies. For example, in 2012, CPMI and IOSCO issued the PFMI, a set of international standards for financial market infrastructures.[388] 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).[389] Further, registered clearing agencies must follow state laws applicable to their choice of business structure, such as limited liability companies, corporations, or trusts.[390] 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.[391]

[379] Data from DTCC's Trade Information Warehouse, compiled by Commission staff.

[380] *See* OCC, Annual Report (2022), *available at https://annualreport.theocc.com;* DTCC, Annual Report (2022), *available at https://www.dtcc.com/about/annual-report.* Within DTCC, NSCC cleared $2.1 trillion of equity trades every day on average, FICC cleared a total of $1,512 trillion of government securities transactions and $61 trillion of agency mortgage-backed securities transactions, and DTC settled a total of $462 trillion of securities.

[381] *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, *available at 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.'').

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

[383] *See generally* Dietrich Domanski, Leonardo Gambacorta & Cristina Picillo, Central Clearing: Trends and Current Issues, BIS Q. Rev. (Dec. 2015), *available at 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), *available at 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), *available at 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); Glenn Hubbard et al., Report of the Task Force on Financial Stability, Brookings Institution (June 2021), *available athttps://www.brookings.edu/wp-content/uploads/2021/06/financial-stability_report.pdf,* 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), *available at 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, *available at 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).

[384] *See* Paolo Saguato, Financial Regulation, Corporate Governance, and the Hidden Costs of Clearinghouses, 82 Ohio St. L.J. 1071, 1074–75 (2022), *available at 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.'').

[385] Governance Proposing Release, *supra* note 2, at various places in Parts I, II, and III (51813–51839).

[386] Currently, ICC, 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.

[387] *See* LCH, Company Structure, *available at https://www.lch.com/about-us/structure-and-governance/company-structure.*

[388] *See* Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions, PFMI (Apr. 16, 2012), *available athttp://www.bis.org/publ/cpss101a.pdf.*

[389] CCA Standards Adopting Release, *supra* note 4, 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, *available at https://www.bis.org/cpmi/publ/d184.pdf* (presenting the conclusions drawn by the CPMI and IOSCO from a Level 2 assessment).

[390] For example, the OCC is a Delaware corporation. *See* OCC, Certificate of Incorporation, *available at https://www.theocc.com/Company-Information/Documents-and-Archives/OCC-Certificate-of-Incorporation.*

[391] PFMI is an international standard, and as such does not have the force of law.

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)).[a]
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 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). "'[I]ndependent 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).

[a] "The risk management standards [12 CFR 234] do not apply, however, to . . . a clearing agency registered with the Securities and Exchange Commission . . ." (12 CFR 234.1(b)).

3. Divergent Incentives of Registered Clearing Agency Stakeholders

Registered clearing agency stakeholders, such as owners and direct and indirect participants, have incentives that may not be in alignment with the interests of the broader financial markets.[392] 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.[393] 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 may have a profit incentive to select bilateral clearing over central clearing[394] or seek to influence a registered clearing agency to not clear a security that would profit the participants more if the security were cleared bilaterally. Not only could such incentives limit the benefits of central clearing, but they could also reduce resilience in the broader financial market by increasing overall counterparty risk.[395] 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."[396] This, too, could hinder resilience in the broader financial market by increasing overall counterparty 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."[397] To the extent these negative externalities are not adequately internalized by the registered clearing agency or otherwise mitigated, they could present systemic risks to the broader financial markets.[398] Multiple commenters agreed that the incentives of registered clearing

[392] *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.").

[393] *See* Sean Griffith, Governing Systemic Risk: Towards a Governance Structure for Derivatives Clearinghouses, 61 Emory L. J. 1153, 1197 (2012), *available at https://scholarlycommons.law.emory.edu/elj/vol61/iss5/3,* 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.").

[394] *Cf.* Treasury Market Practices Group (TMPG), Best Practice Guidance on Clearing and Settlement, at 3 (July 2019), *available at 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 stated 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.").

[395] *See* Griffith, *supra* note 393, 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 bilateral 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.

[396] *See* Griffith, *supra* note 393, at 1200.

[397] *See* PFMI, *supra* note 388, at 11.

[398] *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 382, at 22 ("Network externalities create a role for regulators to coordinate investors on a socially desirable equilibrium.").

agencies and their stakeholders can diverge from the interest of the broader financial markets.[399]

Several researchers have commented that the misalignment of interests between registered clearing agency stakeholders (owners and non-owner participants, for example) weakens the effectiveness of registered clearing agencies' risk management under the existing regulatory framework.[400] Less effective risk management, in turn, hinders the resilience of individual registered 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 theoretical best way to mitigate divergent incentives.[401]

As discussed more fully below, the Commission is aware of divergent incentives at some registered 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 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.'' [402]

(a) Divergent Incentives of Owners and Non-Owner Participants

Because registered clearing agencies mutualize risk among participants but not all participants necessarily hold an equity interest in the registered clearing agencies,[403] the incentives of clearing agency owners can differ from the incentives of clearing agency participants.[404] 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.[405] 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.

One commenter encouraged the Commission to further study ''how different clearing agencies ownership models and organizational arrangements allocate incentives among owners and participants'' and to go further in aligning the interests of owners and non-owner participants.[406] This adopting release incorporates a comprehensive review of academic, business, and regulatory studies on clearing agency ownership models and organizational arrangements. The Commission evaluated certain clearing agency ownership alternatives in the Part IV.D. The Commission will continue to monitor the incentives of registered clearing agency owners and participants and their effects on the agencies' decision-making processes.

(b) Divergent Incentives Among Participants

In addition, different types of participants (direct versus indirect participants or large versus small participants, for example) have divergent incentives. For example, large direct participants have incentives to influence the registered clearing agency to adopt policies that would exclude smaller dealers from participating directly in the registered clearing agency.[407] Because there is only one registered clearing agency serving as a central counterparty for some asset classes, such policies could negatively affect competition among registered clearing agency participants. The diverging incentives of large direct participants compared to smaller indirect participants are mitigated by Rule 17Ad–22, which in part requires a registered clearing agency to admit participants who meet minimum standards.[408]

Large participants also have incentives to influence the registered clearing agency to adopt policies that could disproportionately allocate a risk of loss to smaller participants, such as 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 particular attributes

[399] *See, e.g.,* comments by Ian Marshall (Aug. 17, 2022) (''. . . very rarely do individuals operate outside their own interests which in the case of powerful far reaching institutions such as clearing agencies, produces the potential to risk the well being of members, affiliated parties, and market stability. . . ''); Chris Barnard (Sept. 9, 2022) (''. . . conflicts of interest inherent in clearing agency relationships could substantially harm the security-based swaps or wider financial market.'').

[400] *See* Saguato, *supra* note 384, 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), *available at 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, *available at 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.'').

[401] *See* Menkveld & Vuillemey, *supra* note 382, 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.'').

[402] 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''), *available athttps://www.sec.gov/files/regulation-clearing-agencies-100120.pdf,* at 25.

[403] For example, OCC, ICC, and LCH SA are not owned by participants.

[404] *See* Saguato, *supra* note 384, 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.

[405] *See* Menkveld & Vuillemey, *supra* note 382, at 20 (noting that because participants are a ''captive clientele,'' clearing agencies could be incentivized to relax risk management standards); Saguato, *supra* note 384, 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.

[406] *See* Saguato at 2.

[407] *See* Kristin N. Johnson, Commentary on the Abraham L. Pomerantz Lecture: Clearinghouse Governance: Moving Beyond Cosmetic Reform, 77 Brook. L. Rev. 2, 698 (2012), *available at 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.''); Griffith, *supra* note 393, at 1197 (''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.''). Multiple commenters agreed that large participants stand to gain from anti-competitive conduct against smaller participants (*See* Better Markets at 9–10; IDTA at 3).

[408] *See* 17 CFR 240.17Ad–22(b)(5) through (b)(7), and (e)(18).

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 requires a registered clearing agency to establish minimum margin and liquidity requirements.[409] 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.

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 six operating registered clearing agencies is set forth below and includes discussion of registered 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 core 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 release 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. Exchange Act section 17A(b)(3)(C) 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 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.).'' [410] In addition, Rule 17Ad–252(e)(2) requires governance arrangements that support the objectives of owners and participants and consider the interests of other relevant stakeholders.

(1) Independent Directors

Registered clearing agencies currently use various definitions of *independence* and *independent director.* Some clearing agencies do not use the term *independent* to classify their board members; the closest equivalent to independent directors at these agencies is *non-participant directors* at the three DTCC agencies and *public directors* at OCC. In addition, current practices vary widely regarding the board and board committee requirements for independent directors (as the term is currently used by registered clearing agencies). For example, registered clearing agencies' existing requirements for the minimum percentage of independent directors on the board ranges from 11 percent at LCH SA [411] to 25 percent at OCC [412] to 56 percent at ICC.[413] The three DTCC clearing agencies require some *non-participant directors,* but do not specify a required minimum number or percentage. Table 3 summarizes the general board composition and independent director requirements of each operating registered clearing agency.

TABLE 3—BOARD COMPOSITION AND INDEPENDENT DIRECTOR REQUIREMENTS OF OPERATING REGISTERED CLEARING AGENCIES

Clearing agency	Board composition requirements	Definition of independent director
DTC, FICC, and NSCC (all use the same board as DTCC).	23 directors: 1 non-executive Chair, 1 DTCC executive (DTCC's Pres. & CEO), 13 participant-owner directors, 6 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*.).	A non-participant director is ''an individual who is not an officer, employee, or member of the Board of Directors of a DTC participant or FICC/NSCC member, including Sponsored Members, but excluding Limited Members, as those terms are defined in the relevant Rulebooks.'' (See DTCC Board of Directors Charter.[a])
OCC	20 directors: 1 management director (Chair), 5 public directors, 9 participant directors, 5 exchange directors. (*See https://www.theocc.com/Company-Information/Board-of-Directors;* OCC Board Charter.[b]).	A public director ''lacks material relationships to OCC, OCC's Management Committee, and other directors'' and is ''not affiliated with any national securities exchange, national securities association, designated contract market, futures commission merchant, or 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 5).

[409] *See* 17 CFR 240.17Ad–22(e)(5) and (e)(6). One commenter disagreed that Rule 17Ad–22 has ''solved the problem of market dominance'' (Better Markets, at 16). The Commission agrees with the commenter that although Rule 17Ad–22 mitigated the problem of market dominance, it did not eliminate the problem.

[410] 15 U.S.C. 78q–1(b)(3)(C).

[411] LCH's requirement for the board of director is to have between 3 to 18 members. The board composition rules state that ''at least two of the Independent Directors shall . . .'', suggesting that there must be at least 2 independent directors, which represents 11% of an 18-member board.

[412] OCC's requirement for the board of directors is to have 20 members, 5 of whom (25%) should be ''public directors.''

[413] ICC's requirement for the board of directors is to have 9 members, 5 of whom (55.6%) must be independent.

TABLE 3—BOARD COMPOSITION AND INDEPENDENT DIRECTOR REQUIREMENTS OF OPERATING REGISTERED CLEARING AGENCIES—Continued

Clearing agency	Board composition requirements	Definition of independent director
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])
LCH SA	3 to 18 directors (currently 11 with 5 independent): ''the board shall be composed of the 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 [f] at 3.).	Independent director ''means an independent director, who satisfies 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, Board of Directors Charter (June 2023), *available at https://www.dtcc.com/~/media/Files/Downloads/legal/policy-and-compliance/DTCC-BOD-Mission-and-Charter.pdf.* DTCC stated that ''a definition [of what currently constitutes an independent director] may in fact be found under the definition of a 'non-participant director' '' DTCC at 4.

[b] OCC, Board of Directors Charter and Corporate Governance Principles (May 26, 2022), *available at https://www.theocc.com/getmedia/99ed48a4-aa44-45ac-8dee-9399b479a1c8/board_of_directors_charter.pdf.*

[c] ICE, ICC Regulation and Governance Fact Sheet, *available at 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, *available at 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., *available athttps://s2.q4cdn.com/154085107/files/doc_downloads/governance_docs/ICE-Independence-Policy.pdf.*

[f] LCH SA, Terms of Reference of the Board (Sept. 9, 2020), *available at https://www.lch.com/system/files/media_root/LCH%20SA%20Boards%20Terms%20of%20Reference.pdf.*

(2) Nominating Committee

Five of the six operating registered 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. DTC, NSCC, and FICC require that the nominating committee be composed entirely of ''non-management'' directors; 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 that the committee be chaired by a ''public director'' and include at least one exchange director and at least one member director.[414] As stated previously, the definition of independent director varies across registered clearing agencies.[415]

All six registered clearing agency boards have fitness standards for directors, processes for evaluating directors, and processes for evaluating director independence. The fitness standards and processes for evaluating directors vary across registered 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 consultation with the Chairman,''[416] 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.''[417] ICC, which does not have a nominating committee, uses its risk committee to nominate four directors. ICC's direct parent company, ICE US Holding Company L.P., decides whether to elect the four nominees from the risk committee, and then appoints another five directors on their own.[418]

[414] *See* DTCC Governance Committee Charter 1 (Feb. 2020), *available at https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/Governance-Committee-Charter.pdf* (''All members of the Committee shall be members of the Board who are not employed by DTCC ('non-management' directors).''); LCH SA Terms of Reference of the Nomination Committee of the Board of Directors (Sept. 9, 2020), *available at 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), *available at 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.'').

[415] *See supra* Table 3 and accompanying text.

[416] OCC Governance and Nominating Committee Charter, *supra* note 414, at 3.

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

[418] ICC, ICE Clear Credit Regulation and Governance (Apr. 2022), at 2, *available at https://www.theice.com/publicdocs/clear_credit/ICE_Clear_Credit_Regulation_and_Governance.pdf.*

(3) Risk Management Committee

Five of the six operating registered clearing agencies have RMCs of the board.[419] The sixth registered clearing agency, ICC, has an RMC but has not identified it as a board committee. All six registered clearing agencies include representatives from clearing participants on the RMC, though only three registered clearing agencies require it.[420] Three of the six operating registered clearing agencies require the membership of the RMC to be re-evaluated annually.[421]

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

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

(c) Current Practices Regarding Management of Risks From Relationships With Service Providers for Core Services

The Commission already requires registered clearing agencies to manage risks from operations,[422] which can include risks associated with relationships with service providers.[423] The Commission is aware that at least some registered clearing agencies periodically inform their boards regarding risk management associated with service providers for core 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.[424] Insofar as service providers for core services are the providers of SCI systems, each registered clearing agency board likely already has written policies and procedures reasonably designed to, among other things, require senior management to: (1) evaluate and document the risks related to service provider relationships and whether the risks can be managed in a manner consistent with the registered clearing agency's risk management framework, (2) establish policies and procedures that govern service provider relationships, (3) monitor service provider relationships on an ongoing basis for deterioration in performance, change in risks, or other material issues, and (4) report all new service provider relationships, related policies and procedures, and ongoing monitoring to the board of directors.[425]

(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.[426] The Commission understands that registered clearing agency boards currently use both formal and informal channels to solicit, receive, and consider the viewpoints of participants and other relevant stakeholders.[427] Multiple commenters confirmed, for example, that registered clearing agencies are already required to solicit stakeholder viewpoints every time they propose a rule change as a self-regulatory organization (*i.e.,* pursuant to Rule 19b–4) or an advance notice requirement as a SIFMU.[428] Registered clearing agency participants acknowledge that their ability to offer viewpoints has yielded positive but mixed results.[429]

Regarding the proposed requirement that registered clearing agencies document the consideration of stakeholder views, one commenter stated that ''it is already standard practice for clearing agencies to create and maintain documentation of their consideration of market participants' viewpoints.'' [430]

C. Consideration of Benefits and Costs as Well as the Effects on Efficiency, Competition, and Capital Formation

The final rules are designed to facilitate the primary goal the Commission sought to achieve as articulated in the proposing release, namely: improving governance of registered clearing agencies by addressing the divergent incentives among the agencies' owners and participants, thereby improving the efficiency and effectiveness of the agencies' risk management and efforts to maintain fair, orderly, and efficient securities markets.

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

The benefits and costs discussed in this part are relative to the economic baseline discussed earlier, which includes registered clearing agencies' current practices. In some instances, the final rules reflect what the Commission

[419] DTC, NSC, FICC, OCC, and LCH SA.

[420] OCC, ICC, 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 56, at art. 28(1).

[421] OCC, ICC, and LCH SA.

[422] *See* 17 CFR 240.17Ad–22(d)(4) and (e)(17).

[423] 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, adopted updated guidance for banking organizations in 2023 regarding the management of risks arising from third-party relationships. *See* 88 FR 37920 (June 9, 2023).

[424] *See* 17 CFR 242.1000 through 1007.

[425] *See* Exchange Act Release No. 73639 (Nov. 19, 2014), 79 FR 72251 (Dec. 5, 2014) (''Regulation SCI Adopting Release''), 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.'').

[426] *See* 17 CFR 240.17Ad–22(e)(2)(vi).

[427] *See, e.g.,* CCP12, at 9; DTCC, at 12; LSEG, at 15; OCC, at 14; 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 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), *available at 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.'').

[428] *See, e.g.,* CCP12 at 9; DTCC at 13; ICE at 6–7; OCC at 15.

[429] *See, e.g.,* J.P. Morgan et al., *supra* note 427, 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).

[430] CCP12 at 10.

understands to be current practices at many registered clearing agencies. To the extent that a registered clearing agency's current practices could reasonably be considered in compliance with part of a final rule, the registered clearing agency, its participants, and the broader market will have already absorbed some of the benefits of the final rule. The final rules codify the current best practices and ensure that every registered clearing agency is required to continue including these elements in its governance standards.[431] By promoting better governance and enhanced risk management across all registered clearing agencies, the final rules will lead to efficiency improvements in the clearing agency market and the broader financial market. More resilient clearing agencies could ultimately contribute to the stability of the U.S. financial system.

The final rules will lead to certain additional costs for registered clearing agencies. These costs will vary depending on the scope of a registered clearing agency's current practices as it compares to the final rule's requirements and the size of the clearing agency, among other factors. For example, we anticipate minimal compliance costs to the registered clearing agencies where current practices could reasonably be considered in compliance with the final rules.[432] In these cases, registered clearing agencies could still potentially face indirect costs associated with the limitations on discretion that would result from the rules, including costs related to limiting a registered clearing agency's flexibility to choose different governance arrangements.[433]

The compliance costs will be higher for the registered clearing agencies where their current practices differ from the final rules' requirements. In these cases, many of the final rules could result in a registered clearing agency needing to amend its bylaws, rulebook, or other governance documents. Because registered clearing agencies are SROs, any such amendments that constitute rule changes would be subject to Commission review pursuant to Rule 19b–4. The final rules could also cause a registered clearing agency to make different business decisions, such as hiring and capital expenditure decisions, which would not be subject to the same Commission review process. These behavioral changes are difficult to predict and therefore hard to quantify, in part because of the number of assumptions that would be needed to forecast how registered clearing agencies will respond to the final rules.

The costs discussed in this part will be borne by registered clearing agencies and their participants. For registered clearing agencies owned by participants, all the costs will ultimately be passed on to these participants because they are residual beneficiaries of the clearing agency. For registered clearing agencies not owned by participants, the level of pass-through will depend upon a number of factors, including the lack of competition among clearing agencies. In both cases, the participants will likely pass through some of those costs to their customers, depending on factors such as the customers' sensitivities to costs, the amount of competition between participants for customers, and regulatory requirements.

The expected costs to implement the final rules are anticipated to be sufficiently small relative to the size of each registered clearing agency that the costs will not have a material effect on: (1) competition among the existing registered clearing agencies or on a new entrant's ability to enter the market; (2) capital formation, including registered clearing agencies' ability to raise capital; and (3) the efficiency of registered clearing agencies or their participants.

1. Economic Considerations for Final Rule Regarding Board Composition

As discussed in more detail above, final Rules 17Ad–25(b), (e), and (f) require that a majority of the board (or 34 percent, if a majority of the voting interests are directly or indirectly held by participants) be independent directors (as determined by the nominating committee and precluding certain circumstances that affect independence), establish minimum independent director requirements for the composition of certain board committees, and identify circumstances that would exclude a director from being an independent director.[434]

To the extent an operating registered clearing agency determines that its current board meets the minimum requirements for independent directors on the board and board committees, the final rule will not directly affect the effectiveness of the registered clearing agency's governance. To the same extent, the final rules will also have no direct effect on the management of divergent interests between owners and participants, among various types of participants, and between registered clearing agency stakeholders and the broader financial markets.

To the extent operating registered clearing agencies need to change the composition of their boards or board committees to meet the minimum requirements, the final rule will help promote more effective governance by providing impartial perspectives and helping mitigate the effect of the divergent interests between owners and participants, among various types of participants, and between registered clearing agency stakeholders and the broader financial markets. More effective governance will improve the effectiveness of a registered clearing agency's risk management practices, which will promote resilience at individual registered clearing agencies and in the broader financial markets.[435] For example, more effectively managing divergent interests will help the registered clearing agency better internalize the costs of participant defaults and non-default losses which will mitigate a registered clearing agency's incentive to underinvest in risk management services such as liquidity arrangements and risk modeling. The final rules will also help registered clearing agencies ensure that an appropriate risk-based margin system is in place.

One commenter stated that ''lopsided representation'' by larger participants on a governing body will ''enhance the market strength of the largest firms at the expense of a more competitive and diverse market environment.''[436] Given that the cleared derivatives market is an imperfect substitute for uncleared derivatives, some commentators also stated that large dealers may have an incentive to protect economic rents and therefore may urge boards to adopt policies that restrict the classes or

[431] One commenter stated, ''. . . the codification of [including participant representatives on the risk management committee] into a requirement will be beneficial, as it will ensure that registered clearing agencies will be obligated to meet what is currently akin to a 'best practice' '' (Barclays et al. at 2).

[432] For these registered clearing agencies, the compliance costs would require a small amount of resources, which would be used to review the clearing agency's policies and procedures in response to the adoption.

[433] For example, to the extent that registered clearing agencies have boards with a majority of independent directors and value their current ability to have less than a majority of independent directors on the board of directors, they may incur additional costs because they will lose the option to do so.

[434] *See supra* Part II.A.1 (discussing Rules 17Ad–25(b), (e), and (f)).

[435] *See* Paolo Saguato, The Unfinished Business of Regulating Clearinghouses, 2020 Colum. Bus. L. Rev. 449, 488 (2020), *available at 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 384.

[436] IDTA at 3.

volume of transactions that may use clearinghouse platforms.[437] Better management of divergent interests under the final rules will improve the ability of indirect participants to compete with direct participants of the registered clearing agency by, for example, providing indirect participants with enhanced access to registered clearing agency boards.

Some academic literature on corporate governance could be interpreted to suggest that, under the final definition of *independent director* and the minimum requirements for independent directors on the board and board committees, divergent interests[438] may continue to adversely affect governance, because independent directors in closely held companies may cede to the interests of controlling shareholders unless they are affirmatively incentivized to protect the interests of one or more stakeholder groups.[439] In this context, one paper suggests that although independent directors may not be an ultimate solution to the agency problem for all companies (especially when there is concentrated ownership), independent directors can contribute to effective corporate governance 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 constituency other than controlling shareholders.[440] Another author argues that including independent directors in the governance process provides a roadmap for effective corporate governance, but does not guarantee results in terms of favoritism and objectivity.[441] While these studies on the benefits of independent directors offer mixed results and note that independence alone is unlikely to be sufficient to further motivate a director to act solely in the public interest,[442] the studies also note that director independence, particularly when complemented with other governance requirements, may help mitigate divergent incentives.

Accordingly, the Commission anticipates that the final independence rules will help mitigate divergent incentives when complemented with, among other things: (1) existing governance rules that emphasize the registered clearing agency's responsibility to owners, participants and other stakeholders,[443] and (2) Commission enforcement of securities regulations.

In addition, standardizing the definition of *independent director* will improve efficiency by reducing economic frictions and search costs related to monitoring by stakeholders.

The Commission is aware of three primary costs associated with the final rules regarding the composition of the board. First, the final rules will cause registered clearing agency boards to expend resources memorializing information that has been gathered for consideration in determining each director's independence, and preserving the records of the determination. The Commission estimates that each operating registered clearing agency will incur a one-time burden of approximately $22,403[444] to comply with Rules 17Ad–25(b), (e), and (f). Registered clearing agencies will also expend future resources to repeat the above process of memorializing information and documenting a determination, possibly twice a year. The Commission estimates that each operating registered clearing agency will incur an annual, recurring burden of approximately $44,806[445] to comply with Rules 17Ad–25(b), (e), and (f).

Second, registered clearing agencies may need to add independent directors to the board, either by replacing directors or increasing the board size.[446] As mentioned earlier, approaches to defining independence for directors vary across registered clearing agencies. Thus, to the extent that a registered clearing agency's definition of an ''independent director'' conflicts with the final rules, including the prohibitions in Rule 17Ad–25(f), a registered clearing agency currently reporting a majority of its directors as independent (or 34 percent, if a majority of the voting interests are directly or indirectly held by participants) on its board may need to replace directors to comply with the rule requirements.[447]

Adding independent directors would require a registered clearing agency to expend resources conducting a search for new directors. The costs incurred by the registered clearing agency may vary based on whether it conducts its own search or retains an outside consultant.

[437] *See* Johnson, *supra* note 407, at 698–700.

[438] The divergent interests referred to here are those between owners and participants, among various types of participants, and between registered clearing agency stakeholders and the broader financial markets.

[439] *See, e.g.,* Lucian A. Bebchuk & Assaf Hamdani, Independent Directors and Controlling Shareholders, 165 Univ. Pa. L. Rev. 1271, 1274 (2017), *available at https://scholarship.law.upenn.edu/penn_law_review/vol165/iss6/1/* (taking the position that independent directors have incentives to go along with controlling shareholders' wishes because the directors depend on the controlling shareholders for election and retention, and 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); Donald C. Clarke, Three Concepts of the Independent Director, 32 Del. J. Corp. L. 73 (2007), *available at https://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=1045&context=faculty_publications,* at 83 (''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.''). *See also id.* at 85 (explaining that even if directors were independent of shareholders, ''[T]he role of the independent direct [as] one who is independent of profit-seeking shareholders as well as independent of management has not, however, found fertile soil in American corporate law scholarship or practice. The dominant view has been that directors who are responsible to many constituencies are in effect responsible to none . . .'').

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

[441] *See* Bruce Dravis, Director Independence and the Governance Process (Aug. 14, 2018), *available at https://www.americanbar.org/groups/business_law/publications/blt/2018/08/05_dravis/.*

[442] *See* Clarke, *supra* note 439, 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.'').

[443] *See, e.g.,* Rule 17Ad–22(e)(2).

[444] This figure is based on the analysis in *infra* Part V.A. The per-hour costs are from SIFMA's Management and Professional Earnings in the Securities Industry—2013, modified by Commission staff to account for an 1,800-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).

[445] This figure is based on the analysis in *infra* Part V.A. The per-hour costs are from SIFMA's Management and Professional Earnings in the Securities Industry—2013, *supra* note 444.

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

[447] On the other hand, a registered clearing agency that does not report a majority independent board (or 34 percent, if a majority of the voting interests are directly or indirectly held by participants) could determine that its current slate of directors already satisfies the independence requirements in the adopted rules.

The Commission estimates that retaining a recruitment specialist to secure an independent director could cost approximately $100,000 per director.[448]

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 interests are directly or indirectly held by participants) be independent could reduce the depth or breadth of relevant expertise that can be brought to registered clearing agency boards. A reduced level of combined experience on a registered clearing agency board might impair registered clearing agency efficiency in the near term. However, this potential cost is mitigated under the final rules by allowing eligible participant employees to serve as independent directors.[449] One commenter stated that allowing for the potential inclusion of participant employees as independent directors had several benefits, including industry expertise, strong alignment with the risk management and operational integrity of the registered clearing agency, and diverse perspectives.[450]

One commenter stated that adopting the proposed definition of *independent director* would impose costs on registered clearing agencies that are dual registered with other regulatory bodies because other regulatory bodies have different definitions of independence and it would require extra resources to evaluate a nominee's independence under different standards from multiple regulatory entities. As explained in Part II.A.3, any additional costs from evaluating independence under multiple regulatory regimes are insignificant.

2. Economic Considerations for Final Rules Regarding the Nominating Committee

As discussed in more detail above, Rule 17Ad–25(c) establishes 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 independence criteria.[451]

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

One commenter expressed concern that the additional burdens Rule 17Ad–25(c) placed on independent directors could discourage qualified individuals from being willing to serve on registered clearing agency boards.[452] The Commission does not think such a potential cost is significant, because several registered clearing agencies already have nominating committees that have a majority of independent directors, meaning that they have been able to find qualified directors. In addition, to the extent the new rules increase the amount of work done by independent directors, the burden on each independent director can be reduced by, for example, including more independent directors on the board to handle the increased workload.

Rule 17Ad–25(c) will cause registered clearing agency boards to expend resources reviewing, revising, and possibly creating governance documents and related policies and procedures. The Commission estimates that each operating registered clearing agency will incur a one-time burden of approximately $38,590[453] to comply with Rule 17Ad–25(c). Registered clearing agencies will 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 operating registered clearing agency will incur an annual, recurring burden of approximately $13,110[454] to comply with Rule 17Ad–25(c).

3. Economic Considerations for Final Rules Regarding the Risk Management Committee

As discussed in more detail above, Rule 17Ad–25(d) requires each registered clearing agency to establish a RMC (or committees) of the board and establish minimum requirements for the composition, reconstitution, and function of such RMCs.[455] 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 RMCs in Rule 17Ad–25(d). Those registered clearing agencies' governance documents and related policies and procedures will likely need minimal modifications. To the extent that a registered clearing agency's existing governance documents and related policies and procedures are already in compliance with the final rules, the incremental compliance costs associated with the rule will be minimal and the benefits of the rule will already be incorporated by market participants.

To the extent that a registered clearing agency's existing governance documents and related policies and procedures do not meet the requirements set out in the final rules, requiring that the RMC be a board committee will help make the board's oversight of risk management more effective by helping to ensure that a board committee is focused on risk management and by allowing the RMC to have delegated authority from the board. In addition, requiring that registered clearing agencies re-evaluate the RMC's membership annually will help prevent stagnation of RMC membership and stagnant viewpoints about risk management, while maintaining the registered clearing agency's discretion to preserve expertise on the RMC. Giving risk management a consistently higher priority and annually re-evaluating the RMC's

[448] The Commission is basing this estimate on a report by The Good Search, which explains that their average retainer for an executive search is between $85,000 and $100,000, and the fee charged by large retained executive search firms usually starts at $100,000. *See* The Good Search, Retained Search Fees, *available at https://tgsus.com/executive-search-blog/executive-search-fees-search-firm-pricing.* The $100,000 estimate serves as a reasonable proxy for the amount a recruitment firm might charge to conduct a national search for an independent director. The Commission did not receive any comments providing an estimated cost of finding an independent director.

[449] To be considered independent directors, participant employees must satisfy the requirements of Rule 17Ad–25, as explained in *supra* Part II.A.

[450] *See* DTCC at 4. *See also* Saguato at 3.

[451] *See supra* Part II.B.1 (discussing Rule 17Ad–25(c)).

[452] *See* ICE at 3.

[453] This figure is based on the analysis in *infra* Part V.B. The per-hour costs are from SIFMA's Management and Professional Earnings in the Securities Industry—2013, *supra* note 444.

[454] This figure is based on the analysis in *infra* Part V.B. The per hour cost is from SIFMA's Management and Professional Earnings in the Securities Industry—2013, *supra* note 444.

[455] *See supra* Part II.C.1 (discussing Rule 17Ad–25(d)).

membership will help registered clearing agencies act to limit their risk of failure.

Rule 17Ad–25(d) will cause registered clearing agency boards to expend resources reviewing, revising, and possibly creating governance documents and related policies and procedures. The Commission estimates that each operating registered clearing agency will incur a one-time burden of approximately $3,859 [456] to comply with Rule 17Ad–25(d). The Commission acknowledges that the cost may be higher for registered clearing agencies whose risk committees are not currently board committees. Registered clearing agencies will 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 operating registered clearing agency will incur an annual, recurring burden of approximately $1,311 [457] to comply with Rule 17Ad–25(d).

Multiple commenters expressed concern that rotating risk committee members on a regular basis could reduce expertise and institutional knowledge on the committee because members would be rotated out too frequently.[458] The Commission has addressed this potential economic cost by modifying the proposed rule so that registered clearing agencies are required to re-evaluate, but not necessarily rotate, the membership of the risk committee annually.[459]

4. Economic Considerations for Final Rules Regarding Conflicts of Interest Involving Directors or Senior Managers

As discussed in more detail above, Rules 17Ad–25(g) and (h) require policies and procedures that: (1) identify and document existing or potential conflicts of interest, mitigate or eliminate the conflicts of interest and document the actions taken,[460] and (2) obligate directors to report potential conflicts.[461]

Each registered clearing agency's existing policies and procedures for identifying, reporting, and mitigating conflicts of interest involving directors or senior managers will likely need minimal modifications. To the extent a registered clearing agency's existing policies and procedures are already in compliance with the final rules, the benefits discussed below will already be incorporated by market participants.

The final rules regarding managing conflicts of interest will benefit all clearing agencies by codifying current best practices, thus helping to ensure the continuity of these robust practices across all clearing agencies. This will benefit all clearing agencies and the broader financial markets by increasing the efficiency and resilience of the clearing market.

In addition, to the extent that the final rules require registered 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 registered clearing agency stakeholders.

Finally, to the extent a previously undisclosed conflict of interest resulted in less favorable outcomes for the registered clearing agency—such as higher expenses with service providers or the loss of business from smaller participants—the final rule will improve the registered clearing agency's profitability, operating efficiency, and effectiveness.

The final rules regarding conflicts of interest will cause registered clearing agency boards to expend resources reviewing, revising, and possibly creating governance documents and related policies and procedures. The Commission estimates that each operating registered clearing agency will incur a one-time burden of approximately $7,644 [462] to comply with Rules 17Ad–25(g) and (h). Registered clearing agencies will 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 operating registered clearing agency will incur an annual, recurring burden of approximately $2,622 [463] to comply with Rules 17Ad–25(g) and (h).

5. Economic Considerations for Final Rules Regarding Management of Risks From Relationships With Service Providers for Core Services

As discussed in Part II.E.1 above, Rule 17Ad–25(i) requires registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures reasonably designed to require senior management to identify, manage, and report the risks related to agreements with service providers for core services; provide ongoing monitoring of the service provider relationships; obtain evaluation, review, and approval of the service provider relationship from the board; and govern relationships with those service providers.[464]

To the extent a registered clearing agency does not currently have policies and procedures in place that could reasonably be considered in compliance with the final rule, the final rule will enhance the clearing agency's ability to assess potential risks presented by agreements with service providers of core services, including the potential for disruptions to the agency's operations. The ongoing monitoring requirement will enable the clearing agency to identify changes to, or increases in, the risks associated with agreements with service providers of core services and frame a timely response to these risks. The final rule will also assist the clearing agency in developing and pursuing policies and procedures for minimizing disruptions and harm to the agency's operations and customers should a risk associated with agreements with service providers be realized. Ultimately, the final rules will improve the resilience of registered clearing agencies and the stability of the broader financial system in the U.S.

Multiple commenters understood proposed Rule 17Ad–25(i) to duplicate the work already done by management or to shift the responsibility for oversight of service providers from senior management to the board, increasing board members' expertise or work requirements.[465] Some commenters explained that the additional work requirements associated with Rule 17Ad–25(i) might disincentivize potential candidates from serving on a registered clearing agency's board of directors.[466] The Commission has modified the proposed rule text to specify and delineate specific responsibilities of senior management and the board in the risk management

[456] This figure is based on the analysis in *infra* Part V.C. The per-hour costs are from SIFMA's Management and Professional Earnings in the Securities Industry—2013, *supra* note 444.

[457] This figure is based on the analysis in *infra* Part V.C. The per-hour cost is from SIFMA's Management and Professional Earnings in the Securities Industry—2013, *supra* note 444.

[458] *See, e.g.,* CCP12 at 6; DTCC at 6; LSEG at 12; ICE at 4–5; OCC at 26–27.

[459] *See supra* Part II.C.3.

[460] *See supra* Part II.D.1 (discussing Rule 17Ad–25(g)).

[461] *See supra* Part II.D.1 (discussing Rule 17Ad–25(h)).

[462] This figure is based on the analysis in *infra* Part V.D and Part V.E. The per-hour costs are from SIFMA's Management and Professional Earnings in the Securities Industry—2013, *supra* note 444.

[463] This figure is based on the analysis in *infra* Part V.D and Part V.E. The per-hour cost is from SIFMA's Management and Professional Earnings in the Securities Industry—2013, *supra* note 444.

[464] *See supra* Part II.E.1 (discussing Rule 17Ad–25(i)).

[465] *See supra* note 254 and related text.

[466] *See, e.g.,* CCP12 at 7; DTCC at 8–9; OCC at 2.

of service provider relationships.[467] Given the defined scope of the board's role, the Commission does not expect the rule will materially disincentivize potential candidates from serving on the board.

The final rules regarding the board's ultimate responsibility for the oversight of relationships with service providers for core services will cause registered clearing agencies to expend resources reviewing, revising, and possibly creating governance documents and related policies and procedures. For example, clearing agencies might need to create or revise policies for overseeing relationships with service providers for core services. The Commission estimates that each operating registered clearing agency will incur a one-time burden of approximately $38,590 [468] to comply with Rule 17Ad–25(i). Registered clearing agencies will 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 operating registered clearing agency will incur an annual, recurring burden of approximately $13,110 [469] to comply with Rule 17Ad–25(i).

Multiple commenters expressed concern that, in addition to the Commission's estimates of the initial and recurring costs to comply with Rule 17Ad–25(i), some registered clearing agencies may incur one-time costs to ''perform various policy and procedures reviews,'' provide a ''gap analysis and training on all updated policies and procedures to all relevant stakeholders,'' and to ''have the boards conduct their own review of CSP third-party plans.'' [470] One commenter estimated that, for its three participant-owned clearing agency subsidiaries, the additional initial cost per agency would be 317 hours.[471] Commenters also stated that some agencies may incur additional recurring costs related to ''monitoring compliance and documentation activities'' and ''preparing and presenting to the boards for review and approval plans for entering into third-party relationships with CSPs.'' [472] One commenter estimated that, for the three participant-owned clearing agencies, the additional recurring annual cost per agency would be 220 hours.[473] The Commission estimates that a monetary equivalent of these additional costs suggested by commenters would be an additional one-time cost of up to $157,707 [474] and an annual, recurring cost of up to approximately $96,140 [475] to comply with Rule 17Ad–25(i). The Commission anticipates that the additional costs discussed by the commenter would vary with the size of the registered clearing agency. Therefore, it is likely that each operating registered clearing agency will incur a one-time burden of between $38,590 and $196,297 [476] and an annual, recurring burden of between $13,110 and $109,250 [477] to comply with Rule 17Ad–25(i).

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

As discussed in more detail above, Rule 17Ad–25(j) requires 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.[478]

To the extent registered clearing agency boards' inadequate solicitation of stakeholder viewpoints has caused some stakeholder views not to be considered, the final rules regarding the solicitation, consideration, and documentation of stakeholders' views will improve boards' consideration of different stakeholder views. The improved consideration of different views is expected to help persuade stakeholders with divergent interests to assert their needs more vigorously, which will encourage debate among actors with different goals. More informed debates will, in turn, help to foster consensus with mandates and other decisions that are supported by a broader spectrum of stakeholders. Consequently, registered clearing agencies will identify and develop rule proposals that (to the extent the Commission considers them) will be more likely to meet the public interest requirements under section 17A of the Exchange Act.[479]

Some commenters pointed out additional potential benefits of the rule. One commenter stated that adopting the rule would ensure that all current and future registered clearing agencies are compliant with the current industry best practices.[480] Another commenter provided a specific use case for the rule, stating that requiring the consideration of stakeholder views could help registered clearing agencies facilitate the transition to clearing Treasury securities.[481]

One commenter stated that requiring registered clearing agencies to solicit and consider stakeholder viewpoints for all material changes in governance and operations would likely result in registered clearing agency governance becoming ''less dynamic and responsive to changes and risks in the markets they serve.'' [482] The Commission has modified the requirements for considering stakeholder viewpoints so that they only pertain to risk management and operations, as opposed to all governance and operations. Given that registered clearing agencies already solicit stakeholder viewpoints, the reduced scope of the rule is sufficiently focused that the requirement will not cause clearing agencies to be significantly less dynamic or responsive to changes and risks.

The final rules regarding obligations of the board will cause registered clearing agency boards to 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 operating registered clearing agency will incur a one-time burden of approximately $7,086 [483] to comply with Rule 17Ad–25(j).

[467] *See supra* Part II.E.3.

[468] This figure is based on the analysis in *infra* Part V.F. The per-hour costs are from SIFMA's Management and Professional Earnings in the Securities Industry—2013, *supra* note 444.

[469] This figure is based on the analysis in *infra* Part V.F. The per-hour cost is from SIFMA's Management and Professional Earnings in the Securities Industry—2013, *supra* note 444.

[470] *See,* DTCC at 10–11. *See also* CCP12 at 7.

[471] *See* DTCC at 10–11. DTCC estimated that its three subsidiary registered clearing agencies would have a combined additional initial burden of 950 hours.

[472] *See, e.g.,* DTCC at 11–12.

[473] *See* DTCC at 11–12. DTCC estimated that its three subsidiary registered clearing agencies would have a combined additional recurring burden of 660 hours.

[474] The calculation assumes that the additional hours of work would be equally split between an assistant general counsel and a compliance attorney. The per-hour costs are from SIFMA's Management and Professional Earnings in the Securities Industry—2013, *supra* note 444.

[475] The calculation assumes that all the additional work would be done by a compliance attorney. The per-hour cost is from SIFMA's Management and Professional Earnings in the Securities Industry—2013, *supra* note 444.

[476] $38,590 + $157,707 = $196,297.

[477] $13,110 + $96,140 = $109,250.

[478] *See supra* Part II.F.1 (discussing Rule 17Ad–25(j)).

[479] *See* 15 U.S.C. 78q–1(b)(3)(F).

[480] *See* Barclays et al. at 2.

[481] *See* Citadel at 1.

[482] DTCC at 3.

[483] This figure is based on the analysis in *infra* Part V.G. The per-hour costs are from SIFMA's Management and Professional Earnings in the Securities Industry—2013, *supra* note 444.

Registered clearing agency boards will 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 operating registered clearing agency will incur an annual, recurring burden of approximately $1,748 [484] to comply with Rule 17Ad–25(j).

D. Reasonable Alternatives to the Final Rules

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

When determining the content of its policies and procedures, each registered 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.[485]

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 could help promote efficient and effective practices and encourage regulated entities to 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.[486]

Many commenters discussed the balance of allowing governance flexibility while still improving registered clearing agency corporate governance and stability in the broader financial markets.[487] Some commenters thought the proposed rules were too prescriptive.[488]

However, registered clearing agencies may not fully internalize the social costs of differing incentives between owners and participants, among various types of participants, and between registered clearing agency stakeholders and the broader financial markets. Thus, allowing too much flexibility in clearing agency governance may not appropriately address the needs and incentives of the direct or indirect participants or the broader financial market.

The Commission believes that the final rules appropriately balance the effects and burdens of imposing more prescriptive governance requirements on registered clearing agencies while also enhancing the resilience of clearing markets and U.S. financial system.

2. Adopt More Prescriptive Governance Requirements

Several commenters thought the final rules should be more prescriptive than the proposed rules. For example, commenters recommended requiring that all registered clearing agency boards have a majority of independent directors,[489] preventing persons affiliated with participants from being considered independent,[490] using a five-year lookback period (instead of a one-year lookback period) when determining independence,[491] requiring that smaller participants be on the board and on board committees,[492] requiring that the chair of all board committees be independent,[493] requiring fitness standards for RMC members,[494] requiring term limits for RMC members,[495] requiring a registered clearing agency to promptly report to the Commission whenever the board does not follow the recommendation of the risk committee,[496] and requiring board members recuse themselves when they have a conflict of interest.[497] However, as discussed in the previous reasonable alternative, other commenters supported less prescriptive governance regulations for registered clearing agencies.

As discussed in the previous reasonable alternative, the Commission believes that the final rules appropriately balance the benefits and burdens of more prescriptive governance requirements against the benefits and risks of flexibility in governance and risk management. On the one hand, a more prescriptive governance approach could help ensure that registered clearing agencies internalize the social costs of differing incentives between owners and participants, among various types of participants, and between registered clearing agency stakeholders and the broader financial markets. On the other hand, adopting more prescriptive governance requirements could limit clearing agencies' flexibility to implement policies and procedures that are equally effective but also take into account the agency's unique characteristics and circumstances . The final rules strike a reasonable balance between these two considerations by codifying the current governance best practices to enhance registered clearing agency governance while still allowing registered clearing agencies to tailor governance structures, policies, and procedures to their specific needs.

3. Establish Limits on Participant Voting Interests

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.'' [498] Regulation MC proposed mitigating divergent incentives, especially between larger and smaller participant-owners, by imposing maximum voting interest limits on participants. Specifically, Regulation MC proposed that security-based swap clearing agencies be required to choose one of two governance alternatives: the Voting Interest Alternative and the Governance Interest Alternative. 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

[484] This figure is based on the analysis in *infra* Part V.G. The per-hour cost is from SIFMA's Management and Professional Earnings in the Securities Industry—2013, *supra* note 444.

[485] *See* CCA Standards Adopting Release, *supra* note 4, 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.'').

[486] *See* CCA Standards Adopting Release, *supra* note 4, at 70801; *see also* Randall S. Kroszner, Central Counterparty Clearing: History, Innovation, and Regulation, 30 Econ. Persp. 37, 41 (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.'').

[487] *See, e.g.,* DTCC at 3 (''We appreciate those aspects of the Proposal that balance effective governance with general principles of dynamism and flexibility, and any concerns or critiques we raise herein with respect to other aspects of the Proposal are informed by this same perspective.'').

[488] *See, e.g.,* CCP12 at 1 (''. . . some of the Proposed Rule regarding the governance and conflicts of interest of clearing agencies may be too prescriptive, given the diversity among clearing agencies and the need for these organizations to tailor their structures and governance for the markets and products they clear.'').

[489] *See* Better Markets, at 17. *Cf.* Saguato, at 2 (''the distinction in board composition between participant-owned . . . versus investor-owned clearing agencies . . . is [neither] necessary [nor] justified'').

[490] *See* Better Markets at 16; ISDA at 6; IDTA at 1.

[491] *See* LSEG at 5.

[492] *See* IDTA at 4.

[493] *See* LSEG at 13.

[494] *See* SIFMA AMG at 5.

[495] *See* ISDA at 3 (recommending risk committee members serve for at least two years and no more than five years); SIFMA AMG, at 5 (recommending a three-year term).

[496] *See* Saguato at 4; ISDA at 4.

[497] *See* Better Markets at 22.

[498] *See* Regulation MC Proposing Release, *supra* note 82, at 65882.

participant ownership or voting interests 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 interests in the clearing agency, and required that at least 51 percent of the board be independent directors.

One commenter proposed adopting rules similar to those proposed in Regulation MC and further supplementing it ''with more direct actions against the market power of large participants.'' [499] The same commenter stated that the reasons the Commission provided for not adopting the bright-line rules in Regulation MC were not sufficient.[500]

The Commission has not adopted ownership limits in the current rules because rules during the intervening time have significantly altered how registered clearing agencies must treat smaller participants.[501] In addition, while reduced participants' ownership in registered clearing agencies can potentially reduce the conflicts of interest between large and small and medium participants, it could also reduce incentives for participants to be actively involved in the agency's governance. This could also increase voting power of non-participant shareholders, thereby aggravating the conflict of interest between participants and non-participant owners. Given these considerations, the net benefit of limiting the voting interests of participants could be less than that under the final rules.

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

The final rules are intended, in part, to better manage divergent incentives of registered clearing agency owners and non-owner participants. One suggested cause of the incentive misalignment is owners' lack of at-risk capital (''skin in the game'').[502] Under the existing regulatory structure, for-profit registered 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).[503] In the Governance Proposing Release, the Commission also expressed its belief that the proposed rules would help facilitate registered clearing agencies' ability and motivation to adopt policies to further mitigate incentive misalignment, including a skin in the game requirement.

Multiple commenters voiced support for a skin in the game requirement.[504] One commenter disagreed with the Commission's belief expressed in the Governance Proposing Release that the proposed rules would help facilitate registered clearing agencies' ability to adopt policies such as skin in the game requirements and recommended that the Commission consider several risk management and resiliency initiatives, such as skin in the game, that were not within the scope of the rules encompassed in the proposal.[505]

For the reasons discussed in Part IV.B.3, the Commission continues to believe that the governance requirements in the final rules will help a registered clearing agency successfully manage the divergent incentives of its owners and participants. However, giving consideration to risk management and resiliency initiatives, such as skin in the game, could be appropriate in the future.[506]

5. Increase Public Disclosure

One of the purposes of the final rules is to increase transparency into board governance. Increased transparency could also be achieved by requiring registered clearing agencies to enhance their governance disclosures. For example, the Commission could require registered 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 requirement could include each director's affiliation with registered 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.

Transparency into board governance is beneficial for the clearing agency's investors, regulators, and market participants, as it would provide a more complete picture of the corporate governance in the clearing agencies industry and allow better assessment of risks and investor protection issues as it relates to each registered clearing agency. Increased public disclosure could be an effective alternative governance mechanism for clearing agencies if clearing agencies were subject to active market discipline by customers and investors. However, registered clearing agency currently have attenuated exposure to such market governance mechanisms because of limited competition among clearing agencies and the closely held nature of registered clearing agencies' ownership structures. Therefore, absent the final rules, it is possible that registered clearing agencies would not make any significant changes to their governance, operations, or risk management solely as a result of the increased public governance disclosure.

In addition, to the extent a registered clearing agency modified its governance, operations, or risk management in response to the increased public disclosure, absent the final rules, the clearing agency would be incentivized to enact policies that are beneficial to the clearing agency without necessarily considering the effects of those policies on the resilience and efficiency of the clearing market as a whole.

The final rules do not include increased public disclosure requirements because the current structure of the clearing agency market significantly limits the possible benefits.

6. Require Risk Working Group in Addition To Risk Committee

Multiple commenters recommended that the Commission require each registered clearing agency to have a risk working group, in addition to the RMC.[507] The risk working group would be one of the fora through which the registered clearing agency could solicit and consider stakeholders viewpoints regarding material developments in the

[499] Better Markets at 2,10.

[500] *See* Better Markets at 15.

[501] The Commission previously adopted rules to promote access to registered clearing agencies, including access for smaller participants. *See generally* Governance Proposing Release, *supra* note 2, at 51816–51817 (discussing, among other rules, 17 CFR 240.17Ad–22(b)(5) through (7)).

[502] *See, e.g.,* Saguato, *supra* note 435, 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.'').

[503] *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.'').

[504] *See, e.g.,* Better Markets at 5, 13–14; Barclays et al. at 4.

[505] ICI at 7 and n. 30. *See also* the discussion in Part II.A.4 accompanying note 75.

[506] Governance Proposing Release, *supra* note 2, at n.232 and accompanying text.

[507] *See, e.g.,* Barclays et al. at 2; ICI at 3; ISDA at 3; Saguato at 4; SIFMA AMG at 4; SIFMA at 3–4.

registered clearing agency's risk management, in accordance with Rule 17Ad–25(j).[508] Unlike the RMC, the risk working group would be an advisory group. To harmonize with the existing CFTC and EMIR requirements for a risk working group,[509] the Commission could require that the risk working group be chaired by an independent member of the board,[510] include indirect participants[511] and customers of participants (*i.e.,* end users),[512] not include owners,[513] and have its membership rotated on a regular basis.[514] The Commission could also require representatives from direct participants of varying sizes.[515]

Requiring a risk working group would benefit registered clearing agencies by clearly harmonizing with CTFC and EMIR requirements. On the other hand, requiring a risk working group could impose costs on a registered clearing agency if the registered clearing agency is not regulated by the CFTC or subject to EMIR and prefers to use a different forum to solicit and consider stakeholders viewpoints regarding material developments in the registered clearing agency's risk management. The Commission is not adopting a rule to require risk working groups because the benefits of doing so do not justify the potential costs of a clearing agency's reduced flexibility in how it structures its governance arrangements. The Commission's decision to not require a risk working group does not impose any additional costs on clearing agencies. Clearing agencies that are also regulated by the CFTC or subject to EMIR can use the requisite risk working group as a forum for satisfying the requirements of Rule 17Ad–25(j).

V. Paperwork Reduction Act

As discussed in the Governance Proposing Release, Rule 17Ad–25 contains ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[516] The Commission submitted the proposed collections of information to the Office of Management and Budget (''OMB'') for review in accordance with the PRA. The title of the information collection is ''Rule 17Ad–25—Clearing Agency Governance and Conflicts of Interest'' (OMB Control No. 3235–0800). 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 and previously in the Governance Proposing Release,[517] Rules 17Ad–25(b) through (d) and (g) through (j) each contain collections of information. The collections in Rules 17Ad–25(b) through (d) and (g) through (j) are mandatory.[518] To the extent that the Commission receives confidential information pursuant to this collection of information, such information would be kept confidential subject to the provisions of applicable law.[519]

Respondents under these rules are registered clearing agencies, of which there are currently eight.[520] The Commission continues to estimate for purposes of this PRA that one additional entity may seek to register as a clearing agency in the next three years, and so for purposes of this release the Commission has assumed nine respondents.

A. Rule 17Ad–25(b)

The requirements and purpose of Rule 17Ad–25(b), as modified at adoption, have been discussed in Part II.A and also in the Governance Proposing Release.[521] Specifically, the Commission is modifying Rule 17Ad–25(b)(2)(iii) with a technical change to specify that the documentation requirement applies to both the clearing agency's evaluation of director independence *and* its ultimate determination (*i.e.,* whether the director qualifies as an independent director or is not an independent director). Because the modification is consistent with the discussion of the proposed rule in the Governance Proposing Release, the burden is unchanged from the original proposal. Accordingly, the Commission continues to estimate that Rule 17Ad–25(b)(2) will require respondent clearing agencies to incur a one-time burden of 44 hours to memorialize information that has been gathered for the person(s) making the determination to consider prior to making it,[522] as well as 5 hours to document and preserve the records of the evaluation and determination.[523] The Commission also continues to estimate that the initial activities required by Rule 17Ad–25(b)(2) will impose an aggregate initial burden on respondent clearing agencies of 441 hours.[524] 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 continues to estimate that respondent clearing agencies will incur an ongoing annual burden of 98 hours to repeat the above process of memorializing information and documenting a determination twice a year.[525] The Commission also continues to estimate that the ongoing activities required by Rule 17Ad–25(b)(2) impose an aggregate ongoing

[508] *See* ISDA at 5 (suggesting a risk working group as a forum for soliciting and considering stakeholder viewpoints).

[509] The CFTC requirements for risk working groups are in 17 CFR 39.24(b). The EMIR requirements for risk working groups are in EMIR, *supra* note 56, Article 28. Multiple commenters encouraged harmonization with the CFTC's risk committee rule. *See, e.g.,* ICE at 5; ICI at 3; SIFMA AMG at 1.

[510] *See* EMIR, *supra* note 56, Article 28 (requiring that the risk committee be ''chaired by an independent member of the board.'').

[511] *See* EMIR, *supra* note 56, Article 28 (requiring that the risk committee ''shall be composed of representatives of its clearing members, independent members of the board and representatives of its clients.'').

[512] *See* 17 CFR 39.24(b)(11)(ii) (The CFTC requires that ''A risk management committee includes at least two clearing member representatives, and, if applicable, at least two representatives of customers of clearing members.'').

[513] *See* LSEG at 11 (''owners are not permitted to be on the RMC under EMIR'').

[514] *See* 17 CFR 39.24(b)(11)(iii) (The CFTC requires that ''membership of a risk management committee is rotated on a regular basis.'').

[515] Several commenters recommended requiring diverse representation from among participants (*See, e.g.,* IDTA at 3; CCP12 at 6).

[516] *See* 44 U.S.C. 3501 *et seq.*

[517] *See* Governance Proposing Release, *supra* note 2, at 51851.

[518] The existing record maintenance and preservation requirements in Rule 17a–1 require a registered clearing agency to keep and preserve at least one copy of all documents, including all correspondence, memoranda, papers, books, notices, accounts, and other such records as shall be made or received by it in the course of its business as such and in the conduct of its self-regulatory activity. Accordingly, under the existing provisions of Rule 17a–1, registered clearing agencies are required to preserve at least one copy of records created for the purposes of complying with Rule 17Ad–25 for at least five years, with the first two years in an easily accessible place.

[519] *See, e.g.,* 5 U.S.C. 552 *et seq.* Exemption 4 of the Freedom of Information Act provides an exemption for trade secrets and commercial or financial information obtained from a person and privileged or confidential. *See* 5 U.S.C. 552(b)(4). Exemption 8 of the Freedom of Information Act provides an exemption for matters that are contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions. *See* 5 U.S.C. 552(b)(8).

[520] The Governance Proposing Release identified ten respondents, based on nine registered clearing agencies; however, on November 9, 2023, the Commission approved the withdrawal of one registered clearing agency, reducing the number of respondents. *See* Release No. 34–98902 (Nov. 9, 2023).

[521] *See* Governance Proposing Release, *supra* note 2, at 51820–27.

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

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

[524] This figure is calculated as follows: 49 hours × 9 respondent clearing agencies = 441 hours.

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

burden on respondent clearing agencies of 882 hours.[526]

B. Rule 17Ad–25(c)

The requirements and purpose of Rule 17Ad–25(c) have been discussed in Part II.B and also in the Governance Proposing Release.[527] As discussed in the Governance Proposing Release,[528] Rule 17Ad–25(c)(1) through (4) 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).[529] Because the governance requirements in Rule 17Ad–25(c) are consistent with the discussion of the proposed rule in the Governance Proposing Release, the initial burden is unchanged from the original proposal. Therefore, the Commission continues to 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 rule. Accordingly, the Commission continues to estimate that respondent clearing agencies will incur an aggregate one-time burden of approximately 720 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.[530]

Rule 17Ad–25(c)(1) through (4) also impose ongoing burdens on a respondent clearing agency. As discussed in the Governance Proposing Release, the rule will require ongoing monitoring and compliance activities with respect to governance documents and related policies and procedures created in response to the rule, and ongoing documentation activities with respect to the implementation of a written process for a nominating committee to evaluate board nominees or directors, pursuant to the rule. In addition, as discussed in Part II.B.2, the Commission is modifying Rule 17Ad–25(c) in two ways: the Commission is modifying paragraph (1) to add that the nominating committee shall ''evaluate the independence of nominees and directors,'' in addition to nominees for serving as directors, and paragraph (4)(iv) in two places to specify that the evaluation process applies to nominees as well as directors. Because this modification is consistent with the discussion of the proposed rule in the Governance Proposing Release, the ongoing burden is unchanged from the original proposal. Accordingly, the Commission continues to estimate that the ongoing activities required by Rule 17Ad–25(c)(1) through (4) impose an aggregate annual burden on respondent clearing agencies of 270 hours.[531]

C. Rule 17Ad–25(d)

The requirements and purpose of Rule 17Ad–25(d) have been discussed in Part II.C and also in the Governance Proposing Release.[532] As discussed in the Governance Proposing Release,[533] the Commission understands that many registered clearing agencies currently have written governance arrangements that largely conform to the requirements for RMCs in Rules 17Ad–25(d)(1) and (2). Therefore, the Commission continues to 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 rule.[534] As discussed in Part II.C.3, the Commission is adopting Rule 17Ad–25(d) as proposed, with modifications. Specifically, Rule 17Ad–25(d)(1) has been modified to reflect that: (1) the RMC is ''of the board'' of the registered clearing agency; (2) the RMC's membership must be re-evaluated annually.'' Additionally, Rule 17Ad–25(d)(2) has been modified to reflect that the RMC's work must support the ''overall risk management, safety and efficiency of the registered clearing agency.'' However, these modifications would impose the same burden as the original proposal because, as discussed in the Governance Proposing Release, the proposed requirement to ''reconstitute'' the RMC provides each registered clearing agency with discretion to determine the appropriate timing for reconstitution, explaining that, for example, the charter for the RMC could establish that the committee will conduct a review of its members annually to assess whether the committee continues to be an accurate reflection of the clearing agency's owners and participants.[535] Accordingly, the Commission continues to estimate that respondent clearing agencies will incur an aggregate one-time burden of approximately 72 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.[536]

Rules 17Ad–25(d)(1) and (2) also impose ongoing burdens on a respondent clearing agency, including ongoing monitoring and compliance activities with respect to the governance documents and related policies and procedures created in response to the rule. The rule also requires ongoing documentation activities with respect to the establishment of an RMC. Although the Commission has modified Rule 17Ad–25(d)(1) and (2) for the same reasons as discussed above, the ongoing burden will be unchanged from the Governance Proposing Release. Accordingly, the Commission continues to estimate that the ongoing activities required by Rules 17Ad–25(d)(1) and (2) impose an aggregate annual burden on respondent clearing agencies of 27 hours.[537]

D. Rule 17Ad–25(g)

The requirements and purpose of Rule 17Ad–25(g) have been discussed in Part II.D and also in the Governance Proposing Release.[538] As discussed in the Governance Proposing Release, Rule 17Ad–25(g)(1) contains similar provisions to Rules 17Ad–22(d)(8) and 17Ad–22(e)(2), in that it references clear and transparent governance arrangements but also adds additional requirements that do not appear in those existing rules. The Commission expects that a respondent clearing agency may have written rules, policies, and procedures similar to the requirements

[526] This figure is calculated as follows: 98 hours × 9 respondent clearing agencies = 882 hours.

[527] *See* Governance Proposing Release, *supra* note 2, at 51828–30.

[528] *See id.* at 51852.

[529] 17 CFR 240.17ad–22(d)(8), (e)(2).

[530] This figure is calculated as follows: ((Assistant General Counsel for 30 hours) + (Compliance Attorney for 50 hours)) = 80 hours × 9 respondent clearing agencies = 720 hours.

[531] This figure is calculated as follows: (Compliance Attorney for 30 hours) × 9 respondent clearing agencies = 270 hours.

[532] *See* Governance Proposing Release, *supra* note 2, at 51830–33.

[533] *See id.* at 51852.

[534] Because the written governance arrangements at many registered clearing agencies already largely conform to the requirements for RMCs, 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 Rules 17Ad–25(d)(1) and (2). *See* Governance Proposing Release, *supra* note 2, at 51852.

[535] *See id.* at 51832–33.

[536] This figure is calculated as follows: ((Assistant General Counsel for 3 hours) + (Compliance Attorney for 5 hours)) = 8 hours × 9 respondent clearing agencies = 72 hours.

[537] This figure is calculated as follows: (Compliance Attorney for 3 hours) × 9 respondent clearing agencies = 27 hours.

[538] *See* Governance Proposing Release, *supra* note 2, at 51833–35.

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. Accordingly, the Commission continues to estimate that respondent clearing agencies will incur an aggregate one-time burden of approximately 72 hours to review and revise existing policies and procedures and to create new policies and procedures as necessary to ensure compliance with Rule 17Ad–25(g)(1).[539]

Rule 17Ad–25(g)(1) also imposes ongoing burdens on a respondent clearing agency, including ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. As discussed in the Governance Proposing Release, Rule 17Ad–25(g)(1) requires a registered clearing agency to update current policies and procedures or establish new policies and procedures to ensure compliance. The Commission continues to estimate that the ongoing activities required by Rule 17Ad–25(g)(1) impose an aggregate annual burden on respondent clearing agencies of 27 hours.[540]

Like paragraph (g)(1), paragraph (g)(2) also contains similar provisions to Rules 17Ad–22(d)(8) and 17Ad–22(e)(2), in that it references clear and transparent governance arrangements but also adds additional requirements that do not appear in those rules. As discussed in the Governance Proposing Release, the Commission continues to 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 Rule 17Ad–25(g)(1), they may not have current policies and procedures designed specifically to mitigate or eliminate and document how the conflict of interest was mitigated or eliminated, as required by Rule 17Ad–25(g)(2). Accordingly, the Commission continues to estimate that respondent clearing agencies will incur an aggregate one-time burden of approximately 45 hours to review and revise existing policies and procedures and to create new policies and procedures as necessary to help ensure compliance with Rule 17Ad–25(g)(2).[541]

Rule 17Ad–25(g)(2) also imposes ongoing burdens on a respondent clearing agency, including ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. As discussed in the Governance Proposing Release, Rule 17Ad–25(g)(2) requires updating current policies and procedures or establishing new policies and procedures to ensure compliance. The Commission continues to estimate that the ongoing activities required by Rule 17Ad–25(g)(2) impose an aggregate annual burden on respondent clearing agencies of 18 hours.[542]

E. Rule 17Ad–25(h)

The requirements and purpose of Rule 17Ad–25(h) have been discussed in Part II.D and also in the Governance Proposing Release.[543] As discussed in the Governance Proposing Release,[544] Rule 17Ad–25(h) contains similar provisions to Rules 17Ad–22(d)(8) and 17Ad–22(e)(2), in that it references clear and transparent governance arrangements but also adds additional requirements that do not appear in those rules. The Commission continues to 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. Accordingly, the Commission continues to estimate that respondent clearing agencies would incur an aggregate one-time burden of approximately 18 hours to review and revise existing policies and procedures and to create new policies and procedures as necessary to ensure compliance with Rule 17Ad–25(h).[545]

Rule 17Ad–25(h) also imposes ongoing burdens on a respondent clearing agency, including ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. The Commission continues to estimate that the ongoing activities required by Rule 17Ad–25(h) impose an aggregate annual burden on respondent clearing agencies of 9 hours.[546]

F. Rule 17Ad–25(i)

The requirements and purpose of Rule 17Ad–25(i) have been discussed in Part II.E and also in the Governance Proposing Release.[547] As discussed in the Governance Proposing Release,[548] certain aspects of the rule may be addressed in existing requirements. For example, Rule 17Ad–25(i)(1) references the existence of a risk management framework but does not itself require the creation of such framework, maintenance of which is instead required for covered clearing agencies under Rule 17Ad–22(e)(3)(i).[549] Additionally, as discussed above,[550] there are existing requirements for managing operational risk under Rule 17Ad–22(d)(4) and Rule 17Ad–22(e)(17).[551] Therefore, the Commission expects 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 rule. However, as discussed further in Part II.E, the Commission is modifying the rule in several ways in response to comments regarding potential interpretations of the proposed rule text and the resulting burdens, which some commenters believe are substantially higher than the estimates in the Governance Proposing Release.[552] Because these modifications in the final rule are intended to align the rule text with the Commission's expectations at proposal and generally accepted corporate governance principles, which are themselves generally aligned with the recommendations and analysis provided by commenters, the initial burden estimates in the original proposal remain accurate. The modifications are meant to clearly differentiate the roles of

[539] This figure is calculated as follows: ((Assistant General Counsel for 5 hours) + (Compliance Attorney for 3 hours)) = 8 hours × 9 respondent clearing agencies = 72 hours.

[540] This figure is calculated as follows: (Compliance Attorney for 3 hours) × 9 respondent clearing agencies = 27 hours.

[541] This figure is calculated as follows: ((Assistant General Counsel for 3 hours) + (Compliance Attorney for 2 hours)) = 5 hours × 9 respondent clearing agencies = 45 hours.

[542] This figure is calculated as follows: (Compliance Attorney for 2 hours) × 9 respondent clearing agencies = 18 hours.

[543] *See* Governance Proposing Release, *supra* note 2, at 51833, 51835.

[544] *See id.* at 51853–54.

[545] This figure is calculated as follows: ((Assistant General Counsel for 1 hours) + (Compliance Attorney for 1 hours)) = 2 hours × 9 respondent clearing agencies = 18 hours.

[546] This figure is calculated as follows: (Compliance Attorney for 1 hours) × 9 respondent clearing agencies = 9 hours.

[547] *See* Governance Proposing Release, *supra* note 2, at 51835–37.

[548] *See id.*

[549] *See* 17 CFR 240.17ad-22(e)(3)(i). In addition, the Commission notes that, currently, all registered clearing agencies are covered clearing agencies.

[550] *See supra* Part IV.B.4.c.

[551] 17 CFR 240.17ad–22(d)(4), (e)(17).

[552] *See* DTCC at 11 (stated that an additional 660 hours in annual burden would be required beyond the Commission's initial calculation).

senior management and the board in the context of Rule 17Ad–25(i) while preserving the intended impact of the proposed rule. In this regard, while the words and phrases in the proposed rule have changed and moved, the burdens remain unchanged. Accordingly, the Commission continues to estimate that respondent clearing agencies will incur an aggregate one-time burden of approximately 720 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.[553]

Rule 17Ad–25(i) also imposes ongoing burdens on a respondent clearing agency, including ongoing documentation, monitoring, and compliance activities with respect to the governance documents and related policies and procedures created in response to the rule. For the same reasons as those discussed above regarding the initial burdens of the final rule, the burdens in the original proposal remain an accurate assessment of the anticipated ongoing burdens. Accordingly, as discussed in the Governance Proposing Release,[554] the Commission continues to estimate that the ongoing activities required by Rule 17Ad–25(i) impose an aggregate annual burden on respondent clearing agencies of 270 hours.[555]

G. Rule 17Ad–25(j)

The requirements and purpose of Rule17Ad–25(j) have been discussed in Part II.F and also in the Governance Proposing Release.[556] As discussed in the Governance Proposing Release,[557] Rule 17Ad–25(j) contains similar provisions to Rules 17Ad–22(d)(8) and 17Ad–22(e)(2) but will also impose additional governance obligations that do not appear in existing requirements, such as obligations to solicit and document its consideration of input received from certain types of relevant stakeholders, including, for example, customers of clearing agency participants.[558] As discussed in Part II.F.3, the Commission has modified the rule at adoption so that the scope of topics on which a registered clearing agency seeks input under the rule is ''risk management and operations'' rather than ''governance and operations.'' [559] However, this modification specifies the scope that was originally intended and discussed in the Governance Proposing Release.[560] Accordingly, the Commission continues to expect that a respondent clearing agency may have written rules, policies, and procedures similar to some of the requirements in the 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 rule. In addition, the Commission continues to estimate that respondent clearing agencies will incur an aggregate one-time burden of approximately 126 hours to review and revise existing policies and procedures and to create new policies and procedures, as necessary.[561]

Rule 17Ad–25(j) also imposes ongoing burdens on a respondent clearing agency, including ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the rule. As discussed in the Governance Proposing Release, the rule will also require ongoing documentation activities with respect to the board's consideration of participants' and relevant stakeholders' views pursuant to the rule.[562] The Commission continues to estimate that the ongoing activities required by Rule 17Ad–25(j) impose an aggregate annual burden on respondent clearing agencies of 36 hours.[563]

H. Chart of Total PRA Burdens

Name of information collection	Type of burden	Number of respondents	Initial burden per entity (hours)	Ongoing burden per entity (hours)	Total annual burden per (hours) entity (hours)	Total industry burden (hours)
17Ad–25(b)	Recordkeeping	9	49	98	147	1,323
17Ad–25(c)	Recordkeeping	9	80	30	110	990
17Ad–25(d)	Recordkeeping	9	8	3	11	99
17Ad–25(g)	Recordkeeping	9	13	5	18	162
17Ad–25(h)	Recordkeeping	9	2	1	3	27
17Ad–25(i)	Recordkeeping	9	80	30	110	990
17Ad–25(j)	Recordkeeping	9	14	4	18	162

VI. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA'') requires the Commission, in promulgating rules, to consider the impact of those rules on small entities.[564] Section 603(a) of the Administrative Procedure Act,[565] 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.'' [566] 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 economic impact on a substantial number of small entities.[567] The Commission certified in the Governance Proposing Release, pursuant to section 605(b) of the RFA, that the proposed rules would not, if adopted, have a significant impact on a substantial number of small entities. The Commission received no comments on this certification.

[553] This figure is calculated as follows: ((Assistant General Counsel for 30 hours) + (Compliance Attorney for 50 hours)) = 80 hours × 9 respondent clearing agencies = 720 hours.

[554] *See* Governance Proposing Release, *supra* note 2, at 51854.

[555] This figure is calculated as follows: (Compliance Attorney for 30 hours) × 9 respondent clearing agencies = 270 hours.

[556] *See* Governance Proposing Release, *supra* note 2, at 51838.

[557] *See id.* at 51854.

[558] *See* 17 CFR 240.17ad–22(d)(8), (e)(2).

[559] *See supra* Part II.F.3 (discussing Rule 17Ad–25(j)).

[560] *See id.*

[561] This figure was calculated as follows: ((Assistant General Counsel for 8 hours) + (Compliance Attorney for 6 hours)) = 14 hours × 9 respondent clearing agencies = 126 hours.

[562] *See* Governance Proposing Release, *supra* note 2, at 51854.

[563] This figure was calculated as follows: (Compliance Attorney for 4 hours) × 9 respondent clearing agencies = 36 hours.

[564] *See* 5 U.S.C. 601 *et seq.*

[565] 5 U.S.C. 603(a).

[566] 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 rulemaking, are set forth in 17 CFR 240.0–10.

[567] *See* 5 U.S.C. 605(b).

A. Registered Clearing Agencies

Rule 17Ad–25 applies to all registered clearing agencies. For the purposes of Commission rulemaking and as applicable to 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 affiliated with any person (other than a natural person) that is not a small business or small organization.[568]

Based on the Commission's existing information about the clearing agencies currently registered with the Commission,[569] 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, no such entities would be ''small entities'' as defined in Exchange Act Rule 0–10.[570]

B. Certification

For the reasons described above, the Commission certifies that Rule 17Ad–25 does not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

VII. Other Matters

If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

Pursuant to the Congressional Review Act,[571] the Office of Information and Regulatory Affairs has designated these rules as not a ''major rule,'' as defined by 5 U.S.C. 804(2).

Statutory Authority

The Commission is adopting 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 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, 78j–4, 78k, 78k–1, 78*l,* 78m, 78n, 78n–1, 78*o,* 78*o*–4, 78*o*–10, 78p, 78q, 78q–1, 78s, 78u–5, 78w, 78x, 78dd, 78*ll,* 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, 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; and Pub. L. 111–203, 939A, 124 Stat. 1376 (2010); and Public Law 112–106, sec. 503 and 602, 126 Stat. 326 (2012), unless otherwise noted.

* * * * *

■ 2. Section 240.17ad–25 is added after § 240.17Ad–24 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 50 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 50 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 exists or existed during a lookback period of one year from the initial determination in paragraph (b)(2) and that reasonably could affect the independent judgment or decision-making of the director.

Service provider for core services means any person that, through a written services provider agreement for services provided to or on behalf of the registered clearing agency, on an ongoing basis, directly supports the delivery of clearance or settlement functionality or any other purposes material to the business of the registered clearing agency.

(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 interests 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 making such determination, a registered clearing agency must:

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

[568] *See* 17 CFR 240.0–10(d).

[569] *See supra* notes 379–380 and accompanying text (discussing volume of activity in the cleared SBS market and the value of transactions processed by DTCC and OCC). The notional value of CDS cleared by ICE was $23.8 trillion and $17.0 trillion in 2022 and 2021, respectively. *See* ICE, 2022 Annual Report,450739CLEANLPDF_LAN_26Mar202318511551_013.PDF (*q4cdn.com*). The notional value of CDS cleared by LCH SA was €3,367 billion and $2,283 billion in 2022 and 2021, respectively. *See* LCH Group Holdings Ltd., 2022 Annual Report, *https://www.lch.com/system/files/media_root/lch-group-holdings-limited-financial-statements-2022.pdf.* In each case, these volumes exceed the $500 million threshold for small entities.

[570] *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.

[571] 5 U.S.C. 801 *et seq.*

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

(iii) Document the evaluation and 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 and evaluate the independence of nominees and 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 affected 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 nominee or director would meet the definition of independent director in paragraphs (a) and (f) of this section, and whether each such nominee or director 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) of the board 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 re-evaluated annually 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 overall risk management, 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) *Management of risks from relationships with service providers for core services.* Each registered clearing agency must establish, implement, maintain, and enforce written policies and procedures reasonably designed to:

(1) Require senior management to evaluate and document the risks related to an agreement with a service provider

for core services, including under changes to circumstances and potential disruptions, and whether the risks can be managed in a manner consistent with the clearing agency's risk management framework;

(2) Require senior management to submit to the board of directors for review and approval any agreement that would establish a relationship with a service provider for core services, along with the risk evaluation required in paragraph (i)(1) of this section;

(3) Require senior management to be responsible for establishing the policies and procedures that govern relationships and manage risks related to such agreements with service providers for core services and require the board of directors to be responsible for reviewing and approving such policies and procedures; and

(4) Require senior management to perform ongoing monitoring of the relationship, and report to the board of directors for its evaluation of any action taken by senior management to remedy significant deterioration in performance or address changing risks or material issues identified through such monitoring; or if the risks or issues cannot be remedied, require senior management to assess and document weaknesses or deficiencies in the relationship with the service provider for submission to the board of directors.

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

By the Commission.

Dated: November 16, 2023.

Sherry R. Haywood,

Assistant Secretary.

[FR Doc. 2023–25807 Filed 12–4–23; 8:45 am]

BILLING CODE 8011–01–P