
March 9, 2015

The Honorable Jacob J. Lew
Chairman, Financial Stability Oversight Council
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: U.S. Regulatory Oversight of Central Counterparties

Dear Chairman Lew:

The undersigned companies all strongly support prudent risk management and transparency standards for central counterparties (CCPs), given their critical role in mitigating systemic risk. We welcome the opportunity to comment on the recent request by The Clearinghouse Association, an advocacy organization representing not CCPs, but the interests of the largest U.S. commercial banks,¹ that the Financial Stability Oversight Council directly intervene in the ongoing regulatory oversight of CCPs.

The Dodd-Frank Act and comparable international legislation, together with comprehensive new regulatory rulemaking, has transformed many parts of the financial services industry. In particular, the clearing mandate for swaps has had a dramatic impact on all swaps market participants, introduced new asset classes to clearing and broadly expanded regulatory oversight of swaps trading and risk management activities. As market participants assess and accept these changes, they have raised new challenges concerning the ownership, governance and regulatory oversight of CCPs.

Each of the undersigned owns and operates one or more CCPs, covering all major asset classes including cash equities and fixed income securities, equity options, repos, futures in all asset classes, credit default swaps and interest rate swaps. Our CCPs are fully and rigorously regulated. They have always been subject to comprehensive regulatory oversight designed to ensure that they are prepared to respond to a wide variety of extreme but plausible potential crises. As a result, we have navigated every major financial crisis and the failures of many member firms without disruption to our clearing operations and without any reliance on central bank, taxpayer, or other emergency government funding. Dodd-Frank enhanced this already strong regulatory oversight framework by subjecting all systemically important financial market utilities to prudential regulatory oversight by the Board of Governors of the Federal Reserve. Today, our supervisory and prudential regulators closely scrutinize all critical aspects of our businesses, including membership standards, ongoing counterparty credit monitoring, margining methodology, concentration risk management, guarantee fund methodology, collateral acceptance standards, liquidity, back-testing and stress-testing and overall financial resources and default management. We also routinely interact and consult with our clearing members, other market participants and industry experts, who offer a broad range of viewpoints regarding the best manner in which to manage the many risks that CCPs face.

The views of our clearing members and market participants are, in fact, well-represented in our governance processes.

¹ Letter dated January 9, 2015, from Paul Saltzman on behalf of the Association to Hon. Jacob J. Lew, Chairman of the Council. The Association is affiliated with a company that operates bank payments systems such as ACH and CHIPS. It is not affiliated with any CCP that margins, settles and guarantees financial industry transactions of the sort operated by the undersigned, nor does it represent our interests. Rather, the Association advocates on various regulatory and policy issues on behalf of its owner banks. (<https://www.theclearinghouse.org/about-tch/the-association>)

As recommended in the PFMI² and across all major jurisdictions, CCPs must maintain proper, transparent governance arrangements that define clear lines of responsibility and escalation of key issues. Each of us has established risk committees that include independent members and representatives from member institutions, who provide invaluable insight in enhancing CCP risk management and preserving the stability of the broader financial system. Our risk committee members are charged with representing the interests of the CCP, its clearing membership and customers broadly, and not the interests of their individual institutions or businesses. This ensures that our CCPs make risk management decisions with the benefit of input from both the member community and independent professionals. All of the topics addressed by the Association are under the purview of our risk committees and have been opined on by the industry representatives serving on them.

We appreciate the heightened public awareness of the critical risk-reducing role that CCPs play and the robust industry engagement on the clearing process and risk management issues. We are eager to enhance the market's understanding of the role of CCPs and the risk management benefits that they provide. We also welcome the contributions of the Council to the overall regulatory structure, in particular the Council's role in facilitating domestic and international regulatory coordination and its focus on systemic risk.

The Association letter, however, does not identify new areas of systemic risk or potential regulatory arbitrage, nor does it identify regulatory jurisdictional disputes or gaps in regulatory oversight. Instead, the Association asks the Council to mandate outcomes on narrow topics of interest to its members that are squarely within the authority of the supervisory and prudential regulators of the U.S. CCPs.³ The SEC and the CFTC, with the prudential supervision of the Board of Governors of the Federal Reserve, are actively and constructively engaged on these issues, and we strongly disagree with the Association's assertion that the standards applicable to CCPs are "inadequate to address the risks they pose." On the contrary, the SEC and the CFTC have adopted many additional requirements that address these topics. They are aware of the concerns of the Association and its members. More to the point, they have the responsibility and are best positioned to evaluate specific proposals against the unique products, services and risk management concerns of each CCP to determine the best approach. One size does not fit all under a topic as complex as the regulation of CCPs.

We agree with the Association that effective regulation is a critical element of ensuring the safety and soundness of our financial markets, but we disagree that the Council's direct intervention is necessary or even appropriate. The Association endorses several broad industry principles, outlined below, that we all support. Each of our CCPs has adopted multiple different mechanisms in support of these principles, and the broader industry does not adhere to any uniform view on best practices in implementation. These issues are complex and interrelated, and each CCP and its regulators must take into account a wide variety of factors in assessing them, including our differing corporate structures, our diverse clearing membership, our unique product offerings and the specific challenges presented by the different asset classes we clear. Our primary regulators are mindful of these distinctions and they are actively engaged with us on these topics.

1. Transparency.

CCPs have long provided a substantial amount of transparency concerning their operations through their public rule-books, rule filings and written policies and procedures that are broadly shared with their clearing members, regulators and often the general public. Additionally, many CCPs, including the CCPs managed by each of the undersigned, have published disclosure documents explaining how they address the CPSS-IOSCO PFMI, providing a public means by which market participants can compare CCPs and their adherence to internationally recognized and locally enforced best practices.⁴ Our CCPs have also committed to provide enhanced transparency to clearing members through the Payments Risk Committee (PRC) through a standardized reporting structure covering financial resources, collateral, CCP investments, backtesting and stress testing, thereby enhancing clearing members' assessment of their exposures across all CCP relationships.⁵

2 Principles for Financial Market Infrastructures (PFMI), as adopted by the Committee on Payments and Settlement Systems and the International Organization of Securities Commissions (CPSS-IOSCO). https://www.bis.org/cpmi/info_pfmi.htm. CPSS is now called the Commission on Payments and Market Infrastructures (CPMI).

3 DFA section 805(a)(2).

4 Last month CPMI also released recommended quantitative disclosure standards for CCPs that further complement the PFMI disclosure standards. <http://www.bis.org/cpmi/publ/d125.pdf>

5 http://www.newyorkfed.org/prc/files/report_130205.pdf

A great deal of the focus on transparency relates to the appropriate level of disclosure concerning stress testing. In addition to the disclosure mechanisms described above, the undersigned CCPs already provide detailed information to their risk committees as well as supervisory and prudential regulators covering back testing and stress testing results and associated margin model parameters, ensuring that members and regulators can properly evaluate the resilience of the CCP's financial safeguards. We believe that, as recognized in Dodd-Frank, each CCP's risk committees and supervisory regulator are best positioned to work directly with the CCP to evaluate stress testing methodologies and results, and also to consider the appropriate level of disclosure concerning stress testing.

2. Certainty.

We agree that clearing members should have full transparency regarding their current and potential obligations to the CCP, including margin requirements, default fund requirements and assessments, as well as the steps the CCP will take and the tools available to it in the event of a member default or losses beyond the CCP's prefunded resources. These specific structures are described in detail in each CCP's rules, and changes to these rules are subject to robust governance review, regulatory oversight, and a public and transparent review process. Clearing members additionally receive specific individual information and overall CCP financial safeguards information on a periodic basis, allowing them to manage their potential obligations in line with their risk appetite.

An additional area of focus for the Association and others has been whether and to what extent CCPs should contribute their own capital to their default management waterfalls. Although our CCPs have very different default management waterfalls, we all agree that because CCPs are not principal risk-taking institutions and because their continuation as institutions depends upon effective risk management and default management programs, there is no "moral hazard" to be cured by mandating a specific or uniform approach to CCP contributions. CCPs limit systemic risks through risk management and waterfall structures that impose greater collateral contribution requirements on clearing members when the risks of their cleared portfolios (or their businesses generally) increase, and this process is heavily scrutinized by our risk committees and our regulators. With full transparency into a CCP's financial safeguards and default management practices, clearing members and participants have sufficient information to evaluate the risk profile of the CCP and manage their own exposures.

3. Collateral Safeguards.

The industry is largely in agreement about the high quality standards that must be set for CCP collateral acceptance rules, and CCPs have adhered to recommended collateral principles for some time, whether imposed by regulators or under their internal governance procedures. We agree that CCPs should have collateral acceptance standards that are designed to safeguard clearing members' and customers' assets and are tailored to meet the liquidity and risk management needs of the individual CCP and its specific cleared product offerings. We agree with the Association that CCP collateral acceptance policies should limit collateral to assets that are of sound quality with minimal liquidity risk. We also agree that CCPs should only invest clearing member cash in assets with minimal credit, market and liquidity risks. We agree that CCPs should look to secure liquidity from reasonably diverse sources, as a prudential matter. Again, CCPs are already subject to the foregoing requirements under their own rules and applicable regulations, and they adhere to the objective of diversity in liquidity resources. CCPs perform regular reviews concerning their collateral programs in order to manage and limit market and investment risks, concentration risks and liquidity risks. Again, as with matters relating to transparency and certainty, each CCP's risk committees and supervisory regulator are best positioned to work with the CCP to evaluate the collateral requirements and liquidity programs that will best serve that CCP, its clearing members, and its market participants broadly.

4. Recovery & Wind-Down Planning.

Finally, we agree with the Association and other commenters that CCPs should have "adequate planning and tools" for recovery and continued operations and for wind-down in the event that recovery is not possible. CCPs currently maintain thorough and transparent default management rules, which are reviewed by our regulators and our risk committees.

In addition to the existing default management practices of CCPs, the CFTC has adopted, and the SEC has proposed,⁶

⁶ See CFTC Reg. 39.39(b) and SEC proposed rule 17Ad-22(e)(3). The Board of Governors has also adopted amendments to its PSR Policy that address these issues and provide a framework for cooperation with the SEC and CFTC. 12 CFR Chapter II: Policy on Payment System Risk, 79 FR 67326 (November 13, 2014).

rules that require CCPs that have been designated systemically important to develop and maintain plans for the recovery or orderly wind-down of the CCP (Resolution and Wind-Down Plans or RWPs). These plans—and the tools to implement them—are currently being developed by CCPs in close consultation with their risk committees, clearing members and other market participants. Any proposed changes to CCP rules that result will be subject to the public and transparent CCP rules review process. As with all other risk management tools, it is important to recognize that the unique nature of each CCP and the products it clears will necessitate unique solutions in each RWP.

RWPs will be critical components of CCP risk management frameworks. In order to be most effective, both applicable regulations and the RWPs themselves must allow for a certain amount of flexibility for the CCP and its regulators under a recovery or wind-down scenario. While consistency in regulation is important, it is essential that CCPs and their regulators have the ability to respond to unforeseeable circumstances as appropriate given the facts and circumstances at that time. We believe it would be imprudent for regulators to either prescribe or prohibit any specific CCP loss allocation or recovery tool, particularly at this early stage in the process and in the absence of a thorough analysis of the unique circumstances that may be faced by individual CCPs and the markets they support in various crisis scenarios.

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The shared principles described above have been broadly adopted in international standards and in current and proposed regulations applicable to CCPs, and our CCPs adhere to them in the implementation of their risk management frameworks. These principles align with U.S. and international regulatory regimes and industry best practices. Indeed, much of what financial services regulatory reform since 2008 has achieved is to bring needed enhancements in each of these areas to previously unregulated or lightly regulated markets. While those changes have expanded the role of CCPs into clearing new products, CCPs have long been central to the smooth functioning of the financial markets, and the existing regulatory oversight framework – now enhanced by Dodd-Frank – has supported centrally-cleared markets through many past crises and will continue to support the clearing of new products. The Association’s letter does not fairly account for the current regulatory regimes applicable to CCPs or the intense ongoing dialogue and engagement across the industry on CCP risk management. We commend the work of the Council, and our primary regulators, in continuing to promote financial stability and an overall reduction of systemic risk in the financial services industry. We will continue to work with our regulators, our clearing members and other interested parties as we each continue to evaluate, refine and refresh our risk management frameworks on an ongoing basis.

Sincerely,



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Executive Chairman and President
CME Group



Robert Druskin
Executive Chairman
The Depository Trust & Clearing Corporation



Scott A. Hill
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cc: Janet Yellen
Board of Governors of the Federal Reserve System

Thomas J. Curry
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