

The Systemic Risk Council

May 28, 2014

Securities & Exchange Commission
100 F Street, NE
Washington, DC 20549

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Dear Commissioners:

Central Clearing Counterparties (Clearinghouses or CCPs) play an essential role in our financial markets and even more so since passage of the Dodd-Frank Act.¹ Though CCPs can help reduce systemic risk by reducing counterparty exposure and establishing important collateral and margining requirements, they can also concentrate risk in a few large institutions whose failure could pose systemic risk. Given their role and risks, it is essential that CCPs have robust capital/loss absorbency and margin protections, as well as effective regulatory oversight and stress testing. It is also essential that their primary regulators, the SEC and CFTC, have and allocate the resources needed to adequately oversee, and police, these large, complex institutions.

Historically CCPs have performed well in crises, in part because transactions were simple and they were “cooperatives” where each member had significant “skin in the game.” Recent years, however, have witnessed significant changes in the nature of cleared products and in the structure of CCPs themselves. Many CCPs are now public companies or part of larger public firms, seeking to maximize shareholder return, and could pose potential “too big to fail” and moral hazard risks.

New cleared products, particularly swaps, are more complex than previously cleared financial products. These risks can run for years and raise a host of unforeseen risk-management challenges. Risk management has also changed. Firms are now using complicated portfolio margining and internal risk models that can break down in a crisis environment.

Finally, competition, while good for customer costs, can create risk management problems if companies are meeting price competition by reducing risk management protections, member risk or margin requirements.

While CCPs are very large, interconnected firms, they are not subject to the enhanced prudential requirements of Title I of the DFA – instead designated CCPs (“financial market utilities”) are subject to weaker, backstop oversight *and* receive potential Federal Reserve access and benefits. This is a perverse outcome that provides affirmative advantages to larger, more complex CCPs (and their shareholders) over smaller CCPs.

¹ The independent non-partisan Systemic Risk Council was formed by CFA Institute and the Pew Charitable Trusts to monitor and encourage regulatory reform of U.S. capital markets focused on systemic risk. The statements, documents and recommendations of the private sector, volunteer Council do not necessarily represent the views of the supporting organizations. The Council works collaboratively to seek agreement on all recommendations. This letter fairly reflects the consensus view of the Council, but does not bind individual members.

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To help address these risks:

CCPs Require Robust Risk Management Requirements. Given the role they play in the financial markets, CCPs must benefit from the full panoply of risk-management tools, including: strong loss absorbing capital, margin and regular stress testing requirements (including assessing how the failure of multiple, large clearing members would affect the CCP).

In addition to pre-funded capital and guaranty funds, it should be clear, in advance, that clearing members (and not the Federal Reserve or taxpayers) stand behind the organization should it run into financial trouble. If there is any question about clearing members' ability and willingness to stand behind a CCP in times of trouble, policymakers must fully address those issues now, before a crisis reduces firms' and policymakers' advanced planning and policy options.

Resolution Planning. CCPs should also create robust and credible resolution plans to ensure that they – and policymakers – can plan for (and mitigate) the potential systemic consequences of a CCP failure without taxpayer support. Important portions of these plans (including the size and nature of loss absorbing buffers) should be made public so that the public (and counterparties) can assess the risks associated with the CCP and its members.

The SEC & CFTC Require Effective, Long-Term Funding. While Title 8 of the Dodd-Frank Act provides new tools and authority for the regulation of the largest CCPs, and provides some back-up authority for the Federal Reserve, the SEC and CFTC remain the primary regulators of these entities and continue to lack the resources available to the other, self-funded, financial regulators. This lack of resources is a serious structural weakness.

Respectfully,



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