



October 7, 2022

Submitted Electronically via SEC.gov

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

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

Dear Ms. Countryman:

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

## **I. INTRODUCTION AND SUMMARY**

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

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

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

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

<sup>3</sup> *Id.* at 51820.

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

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

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

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

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<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at 51815.

<sup>6</sup> *Id.* at 51816.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

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

## II. IDTA COMMENTS ON PROPOSED RULES

### A. Board Composition and Requirements for Independent Directors

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

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

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

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<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at 51820.

<sup>12</sup> *Id.* at 51825.

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

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

## **B. Nominating Committee and Risk Committee**

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

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

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<sup>13</sup> *Id.* at 51820.

<sup>14</sup> *See* proposed rule 17Ad-25(c)(1), requiring each registered clearing agency to establish a nominating committee and a written evaluation.

<sup>15</sup> Proposed Rule at 51828.

<sup>16</sup> *Id.* 51828.

<sup>17</sup> *Id.* at 51830.

<sup>18</sup> *Id.* at 51830.

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

### **C. Conflicts of Interest**

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

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

## **III. ECONOMIC ANALYSIS**

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

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<sup>19</sup> *Id.* at 51832.

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

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

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

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

#### **IV. CONCLUSION**

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

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<sup>20</sup> Exec. Order No. 14036, 86 Fed. Reg. 36987 (July 14, 2021).

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at 36989.

<sup>23</sup> Proposed Rule at 51842.

<sup>24</sup> *Id.* at 51843.

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

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

Sincerely,



James Tabacchi  
Chairman  
Independent Dealer and Trader Association

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