

## Statement

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# Statement on Covered Clearing Agency Resilience and Recovery and Wind-Down Plans



**Commissioner Caroline A. Crenshaw**

**May 17, 2023**

Thank you, Chair Gensler. Clearing agencies play an increasingly important role in the capital markets.<sup>[1]</sup> As I've noted in the past, clearance and settlement infrastructure is often referred to as the "plumbing" of the markets<sup>[2]</sup> – and as someone who has been dealing with ongoing household plumbing issues, I believe that label is appropriate, as I can personally attest to the fundamental importance of plumbing to the smooth functioning of a household. By standing between buyers and sellers involved in securities transactions, clearing agencies help to ensure that those transactions are carried out promptly and accurately. They are also essential to managing risk; in particular, the risks that a counterparty will not perform and a trade will fail.

Because clearing agencies help to reduce risks in our capital markets, the SEC and other regulators have taken steps to encourage central clearing. Most recently, the Commission voted to propose rules and rule amendments designed to broaden the scope of central clearing in the Treasury markets.<sup>[3]</sup> As I noted at the time, increased central clearing in that market should decrease the overall amount of counterparty risk, reduce contagion risk, help avoid disorderly member defaults, and increase multilateral netting of transactions, which should in turn reduce operational and liquidity risks.<sup>[4]</sup>

However, when the use of central clearing increases, and transactions move from bilateral or trilateral settlement to a centralized clearing model, this concentrates risk in the clearing agency itself. Thus, the supervision and regulation of these entities becomes all the more important, to ensure appropriate risk management. To that end, we have previously proposed rules to help improve governance arrangements across all registered clearing agencies.<sup>[5]</sup> Building upon that effort, the proposal we are considering today is designed to improve the resilience of covered clearing agencies in two ways: first, by strengthening the rules relating to margin; and second, by establishing requirements for a covered clearing agency's recovery and wind-down plan.<sup>[6]</sup>

Specifically, as you've heard already from my colleagues, the proposal would require a covered clearing agency to have policies and procedures reasonably designed to monitor intraday exposures on an ongoing basis, and would provide additional specificity with respect to the circumstances in which a covered clearing agency should have policies and procedures to collect intraday margin. This should help improve risk management by ensuring that clearing agencies can react to intraday exposures as needed.

Margin calls are sometimes pointed to as a source of procyclicality – that is, as potentially worsening market crises because they are positively correlated with the overall state of the market. The covered clearing agencies are cognizant of this in setting margin requirements and calibrating their models so that they do not fluctuate too drastically in response to changing market conditions.<sup>[7]</sup> However, this change ensures that covered clearing agencies are aware of intraday exposures that may arise, rather than potentially remaining unaware of them and delaying any ability to react until end of day. Without intraday monitoring, covered clearing agencies could be unaware of credit risk during periods of market stress. Further, the requirement in the rule that a covered clearing agency specify the thresholds that would trigger intraday margin calls should help participants understand when they may be a subject to a margin call and allow them to plan accordingly.<sup>[8]</sup>

The proposal would also strengthen the existing rule regarding inputs to a covered clearing agencies' risk-based margin systems by expanding it to include all substantive inputs (not just price data), and providing more specificity with respect to the procedures a covered clearing agency should use when price data or other substantive inputs are not available. This should help ensure that a covered clearing agency's risk-based margin model can continue to operate in the event that the sources of data it relies upon become unavailable or unreliable, thereby improving the covered clearing agency's risk management.

The proposal would also prescribe certain elements for inclusion in a clearing agency's recovery and wind-down plans. Because of their importance to the markets, the failure of a covered clearing agency could result in significant liquidity, credit, or operational problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system.<sup>[9]</sup> The existing requirement for covered clearing agencies to have a plan for recovery and wind-down is intended to mitigate the likelihood of a disruption to the financial markets in the event of such a failure.

While many of the elements that would be required under the proposed rule are already included in covered clearing agencies' existing recovery and wind-down plans, codifying them will ensure that existing plans are consistent across clearinghouses and that plans for any new covered clearing agencies contain the required elements. This should help ensure that, in the event that a permanent cessation, sale, or transfer of one or more of a clearing agency's critical services becomes necessary, the process will take place in an orderly fashion that minimizes the disruption to the financial system and the potential harm to investors.

The proposal would also require the recovery and wind-down plans to be reviewed and tested on an annual basis. The testing process would include the covered clearing agency's participants, among other stakeholders. This is important, because a successful recovery or orderly wind-down will necessitate coordination between and among the clearing agency and its participants, particularly during periods of market stress.<sup>[10]</sup> Providing transparency to the covered clearing agency's participants regarding the plan through their participation in the testing process will help ensure that it is practical and effective.

Some regulators have issued guidance on clearing agency recovery and wind-down plans that is more prescriptive than the proposal we are considering today.<sup>[11]</sup> I look forward to hearing from commenters about whether there are aspects of our rule that should be more detailed or prescriptive with respect to the content of the plans. For example, should the Commission determine specific triggers for the implementation of the recovery and wind-down plan, or identify specific scenarios and analyses that the plans must address? I also look forward to comment on all other aspects of the proposal.

I will echo my colleagues in thanking the staff for their hard work on these proposals, in particular staff in the Division of Trading and Markets, the Division of Economic and Risk Analysis, and the Office of the General Counsel. As always, I am deeply appreciative of your efforts and your expertise. I believe this common-sense proposal should help protect investors and the markets by improving risk management at these fundamentally important institutions, and I am pleased to support it.

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[1] See, e.g., Bank for International Settlements, [Press Release: International committees complete the April 2015 workplan on central counterparty resilience, recovery and resolvability](#) (July 5, 2017) (“CCPs are an increasingly important part of the financial system, particularly following post-crisis reforms to mandate central clearing of standardised over-the-counter derivatives.”)

[2] Commissioner Caroline A. Crenshaw, [Statement on the Proposed Shortening of the Settlement Cycle](#) (Feb. 9, 2022).

[3] [Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule With Respect to U.S. Treasury Securities](#), Release No. 34-95763 (Sept. 14, 2022).

[4] Commissioner Caroline A. Crenshaw, [Statement on Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule With Respect to U.S. Treasury Securities](#) (Sept. 14, 2022).

[5] [Clearing Agency Governance and Conflicts of Interest](#), Release No. 34-95431 (Aug. 8, 2022).

[6] Covered Clearing Agency Resilience and Recovery and Wind-Down Plans, Release No. 34-XXXXX (May 17, 2023) (“Proposal”).

[7] See, e.g., [Order Granting Approval of Proposed Rule Change Concerning The Options Clearing Corporation’s Margin Methodology for Incorporating Variations in Implied Volatility](#), Release No. 34-95319 (July 19, 2022) (approving changes to Options Clearing Corporation’s margin methodology intended to limit procyclicality).

[8] Proposal at 24-25.

[9] Proposal at 38.

[10] Proposal at 59.

[11] See [Memorandum from Jeffrey M. Bandman, Acting Director, Division of Clearing and Risk, CFTC Letter No. 16-61](#) (July 21, 2016).