

# Regulatory Alert

Regulatory Insights for Financial Services

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## Clearing Agency Risk Management and “Living Wills”

The Securities and Exchange Commission (SEC) [proposes](#):

- Two amendments to existing Rule 17Ad-22(e) (the “Covered Clearing Agency Standards”) under the Securities Exchange Act regarding risk-based margin requirements applicable to covered clearing agencies (CCAs).
- A new rule regarding the contents of CCAs’ recovery and wind-down plans.

Key provisions are outlined below.

### Covered Clearing Agency Resilience, Recovery, and Wind-Down Plans

**Applicability.** “Covered clearing agencies” are defined as clearing agencies registered with the SEC under the Securities Exchange Act that provide the services of a central counterparty or a central securities depository. CCAs are subject to the CCA Standards, which require them to “establish, implement, maintain, and enforce written policies and procedures reasonably designed to, as applicable, meet certain minimum standards regarding, among other things, operations, governance, and risk management.”

**Proposed Amendments regarding Risk Management.** The SEC is proposing the following changes to Rule 17Ad-22(e)(6):

- Amendments to Rule 17Ad-22(e)(6)(ii) that would require a CCA that provides central counterparty (CCP) services to establish, implement, maintain, and enforce written policies and procedures reasonably designed to cover its credit exposures by establishing a risk-based margin system that, at a minimum:
  - Marks participant positions to market.
  - Collects margin (including variation margin or equivalent charges) at least daily.

- Monitors intraday exposures “on an ongoing basis”.
- Includes the authority and operational capacity to make intraday margin calls as frequently as necessary, “including when risk thresholds specified by the covered clearing agency are breached or when the products cleared or markets served display elevated volatility.”
- Amendments to Rule 17Ad-22(e)(6)(iv) that would:
  - Expand the scope of the rule to apply to both price data and other substantive inputs (i.e., from third parties) to a CCA’s risk-based margin system.
  - Further specify the level to which a CCA’s procedures must perform when price data or other substantive inputs are not available or reliable.
  - Provide that the procedures used when price data or other inputs are not available or reliable should include alternate sources or an alternate risk-based margin system (that does not similarly rely on the unavailable or unreliable substantive inputs).

**Proposed Contents of Recovery and Wind-Down Plans.** The SEC is proposing new Rule 17ad-26 which would establish the following requirements for CCAs’ recovery and wind-down plans.

- **Elements.** Proposed Rule 17ad-26(a) would require that CCAs’ recovery and wind-down plans identify and describe the following:
  1. Critical payment, clearing, and settlement services (herein, critical services) and their continuity in the event of recovery and during an orderly wind-down.
  2. Any service providers upon which the CCA relies to provide critical services and their continuity in the event of a recovery and during an orderly wind-

- down, including consideration of contractual obligations with service providers.
3. Scenarios that may prevent the CCA from providing critical services as a going concern, including scenarios arising from uncovered credit losses, uncovered liquidity shortfalls, or general business losses.
  4. Criteria that could trigger the implementation of the recovery and orderly wind-down plans, including the process used to monitor and determine whether the criteria have been met and applicable governance arrangements.
  5. Rules, policies, procedures, and any other tools the CCA would use in a recovery or orderly wind-down.
  6. How the rules, policies, procedures, and other tools would support timely implementation of recovery and wind-down plans.
  7. Procedures for informing the SEC as soon as practicable when the CCA is considering initiating a recovery or orderly wind-down.
  8. Procedures for testing the CCA's ability to implement the recovery and wind-down plans at least every 12 months, reporting of results to senior management and the Board, and procedures for amending the plans to address the testing results.
  9. Procedures for review of the plans by the Board at least every 12 months or following material changes to the system or environment in which the CCA operates that would significantly affect the viability or execution of the plans.
- **Definitions.** Proposed Rule 17ad-26(b) would clarify that recovery and wind-down plans cover two distinct events:
- A “recovery” would mean “the actions of a CCA, consistent with its rules, procedures, and other ex ante contractual arrangements, to address any uncovered loss, liquidity shortfall, or capital inadequacy, whether arising from participant default or other causes (such as business, operational, or other structural weaknesses), including actions to replenish any depleted prefunded financial resources and liquidity arrangements, as necessary to maintain the covered clearing agency’s viability as a going concern and to continue its provision of critical services.”
  - An “orderly wind-down” would mean “the actions of a covered clearing agency to effect the permanent cessation, sale, or transfer of one or more of its critical services in a manner that would not increase the risk of significant liquidity, credit, or operational problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system.” The SEC adds that CCAs should consider the separability of the parts of the CCA and whether there are certain portions of the CCA’s business that could be sold or transferred as separate businesses.

**Comment Period.** The SEC solicits comments on specific questions related to the proposed new rule and amendments and requests that they be submitted no later than 30 days after the date of publication in the Federal Register, or July 17, 2023, whichever is later.

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