

Statement of Richard Berner, Clinical Professor of Finance and Professor of Management Practice, NYU Stern School of Business and Co-Director, NYU Stern volatility and Risk Institute, on the Reports of the CFTC MRAC CCP Risk and Governance Subcommittee  
July 20, 2021

I commend Acting Chair Behnam for establishing the CFTC’s CCP Risk and Governance Subcommittee to advise the Commission and recommend governance for and ways to mitigate risk among clearinghouses, and between them and clearing members and end users (“market participants”), and to promote financial stability. I am pleased to have had the opportunity to engage in constructive dialog with CCPs and market participants to advance these goals.

The papers presented at the February 23, 2021 MRAC meeting on CCP Margin Methodologies and CCP Governance, and at the July 13, 2021 MRAC meeting, on CCP Liquidity and Stress Testing, and CCP Capital and Skin in the Game, represent some areas of agreement and recommendations among Subcommittee members. Notably, however, on CCP Transparency and Default Management, members were unable to reach any areas of agreement.<sup>1</sup>

Despite hard work by all Subcommittee members over the past 18 months, I think this represents a lost opportunity. All members say they support the broad goals of the MRAC and of the Subcommittee. In my view, therefore, the reason for failure to agree on recommendations to enhance CCP risk management and governance and support those goals, such as those proposed by market participants and elsewhere, is not hard to find. It reflects the asymmetric misalignment of incentives between U.S. CCPs and clearing members. That is manifested in their limited skin in the game and overall insufficient resource levels, which, together with their lack of meaningful transparency, creates safety and soundness risks that could jeopardize trust in the CCPs and in derivatives markets. As I see it, the Commission must address this misalignment.

Further, and more important in my view, the scope of the papers elides important financial stability goals. Among them: Central clearing mutualizes counterparty risk through multilateral netting, but transforms it into liquidity risk. In peacetime this is not problematic, as liquidity is not scarce. In stress periods, however, initial and variation margins surge procyclically, liquidity evaporates and CCPs’ actions to push the cost of these developments onto clearing members can lead at worst to fire sales as market participants dash for cash. In addition, the Subcommittee’s scope and, therefore, its papers, don’t address the critical need for strong protocols for recovery and resolution. The interconnectedness of CCPs – partly due to the extreme overlap in clearing membership – means that resilience must be considered across CCPs and borders, not piecemeal as done in these papers. Moreover, there are significant operational risks created partly by the concentration of functionality and lack of substitutability in CCPs that require significantly stepped-up resilience. Here too, misaligned incentives

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<sup>1</sup> Many of the discussion topics mirrored recommendations in [A Path Forward for CCP Resilience, Recovery, and Resolution](#), a paper co-authored by a group of nine buy-side and sell-side firms, released in 2019 and re-issued in March 2020 with an expanded group of twenty signatories. The paper proposed twenty recommendations to enhance CCPs’ resilience, recovery and resolution.

could result in outcomes that undermine the collective responsibility for achieving financial stability.<sup>2</sup> The Commission must address these too.

While the Subcommittee papers are thus incomplete, I urge the Commission, in collaboration with the SEC, the Federal Reserve and the FDIC in the US, and with relevant regulatory authorities abroad to: (1) effectively implement the recommendations in the papers and go beyond them, (2) address with regulatory intervention the misalignments represented by the papers' specific areas of disagreement, (3) address with regulatory intervention the market participants' perspectives on CCP Transparency, and (4) bring to the Financial Stability Oversight Council recommendations for regulatory or legislative changes to increase the resilience of CCPs, including enhanced firm and supervisory stress testing, skin in the game and appropriate default management and access to liquidity, and to clarify transparency and self-insurance for CCPs and rigorous protocols for recovery and resolution.

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<sup>2</sup> There is an extensive literature on these issues; for example, then-Governor Powell, [Central Clearing and Liquidity](#), at the Federal Reserve Bank of Chicago Symposium on Central Clearing, Chicago, Illinois, June 23, 2017; King et al, [Central Clearing and Systemic Liquidity Risk](#), FEDS, January 2020; FIA, [Revisiting Procyclicality: The Impact of the COVID Crisis on CCP Margin Requirements](#), October 2020, Hubbard and Kohn, [Brookings Report of the Taskforce on Financial Stability](#), June 2021, Chapter 7.