

## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Parts 39, 140, and 190

RIN Number 3038-AE06

### Derivatives Clearing Organizations and International Standards

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Commodity Futures Trading Commission (“Commission”) is proposing amendments to its regulations to establish additional standards for compliance with the derivatives clearing organization (“DCO”) core principles set forth in Section 5b(c)(2) of the Commodity Exchange Act (“CEA”) for systemically important DCOs (“SIDCOs”) and DCOs that elect to opt-in to the SIDCO regulatory requirements (“Subpart C DCOs”). SIDCOs and Subpart C DCOs would be required to comply with the requirements applicable to all DCOs, which are set forth in the Commission’s DCO regulations on compliance with core principles, to the extent those requirements are not inconsistent with the requirements of the regulations in this proposed rule. The proposed amendments include: Procedural requirements for opting in to the regulatory regime as well as substantive requirements relating to governance, financial resources, system safeguards, special default rules and procedures for uncovered losses or shortfalls, risk management, additional disclosure requirements, efficiency, and recovery and wind-down procedures. These additional requirements would also be consistent with the Principles for Financial Market Infrastructures (“PFMIs”) published by the Committee on Payment and Settlement Systems and the Board of the International Organization of Securities Commissions (“CPSS-IOSCO”). In addition, the Commission is proposing certain delegation provisions and certain technical clarifications.

**DATES:** Submit comments on or before September 16, 2013.

**ADDRESSES:** You may submit comments, identified by RIN number 3038-AE06, by any of the following methods:

- Agency Web site: <http://comments.cftc.gov>.
- Mail: Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW., Washington, DC 20581.
- Hand Delivery/Courier: Same as Mail, above.

• Federal eRulemaking Portal: <http://www.Regulations.gov>. Follow the instructions for submitting comments.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <http://www.cftc.gov>. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that may be exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in Commission regulation 145.

The Commission reserves the right but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from <http://www.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language.

All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

#### FOR FURTHER INFORMATION CONTACT:

Ananda Radhakrishnan, Director, Division of Clearing and Risk (“DCR”), at 202-418-5188 or [aradhakrishnan@cftc.gov](mailto:aradhakrishnan@cftc.gov); Robert B. Wasserman, Chief Counsel, DCR, at 202-418-5092 or [rwasserman@cftc.gov](mailto:rwasserman@cftc.gov); M. Laura Astrada, Associate Chief Counsel, DCR, at 202-418-7622 or [lastrada@cftc.gov](mailto:lastrada@cftc.gov); Peter A. Kals, Special Counsel, DCR, at 202-418-5466 or [pkals@cftc.gov](mailto:pkals@cftc.gov); Jocelyn Partridge, Special Counsel, DCR, at 202-418-5926 or [jpartridge@cftc.gov](mailto:jpartridge@cftc.gov); Tracey Wingate, Special Counsel, DCR, at 202-418-5319 or [twingate@cftc.gov](mailto:twingate@cftc.gov); or Kathryn L. Ballintine, Attorney-Advisor, DCR, at 202-418-5575 or [kballintine@cftc.gov](mailto:kballintine@cftc.gov), in each case, at the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW., Washington, DC 20581.

#### SUPPLEMENTARY INFORMATION:

##### Table of Contents

- I. Background
  - A. Regulatory Framework for Registered DCOs
  - B. Designation of DCOs as Systemically Important Under Title VIII of the Dodd-Frank Act
  - C. Existing Standards for SIDCOs
  - D. DCO Core Principles and Existing Regulations for Registered DCOs
  - E. PFMIs

F. The Role of the PFMIs in International Banking Standards

G. Proposed Rulemaking Applicable to SIDCOs and Subpart C DCOs

#### II. Discussion of Revised and Proposed Rules

- A. Regulation 39.2 (Definitions)
- B. Regulation 39.30 (Scope)
- C. Regulation 39.31 (Election To Become Subject to the Provisions of Subpart C)
- D. Regulation 39.32 (Governance for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)
- E. Regulation 39.33 (Financial Resources for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)
- F. Regulation 39.34 (System Safeguards for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)
- G. Regulation 39.35 (Default Rules and Procedures for Uncovered Losses or Shortfalls (Recovery) for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)
- H. Regulation 39.36 (Risk Management for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)
- I. Regulation 39.37 (Additional Disclosure for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)
- J. Regulation 39.38 (Efficiency for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)
- K. Regulation 39.39 (Recovery and Wind-Down for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)
- L. Regulation 39.40 (Consistency With the Principles for Financial Market Infrastructures)
- M. Regulation 39.41 (Special Enforcement Authority For Systemically Important Derivatives Clearing Organizations)
- N. Regulation 39.42 (Advance Notice of Material Risk-Related Rule Changes by Systemically Important Derivatives Clearing Organizations)
- O. Regulation 140.94 (Delegation of Authority to the Director of the Division of Clearing and Risk)
- P. Regulation 190.09 (Member Property)

#### III. Effective Date

#### IV. Related Matters

- A. Paperwork Reduction Act
- B. Regulatory Flexibility Act
- C. Consideration of Costs and Benefits

### I. Background

#### A. Regulatory Framework for Registered DCOs

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).<sup>1</sup> Title VII of the

<sup>1</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be

Dodd-Frank Act, entitled the “Wall Street Transparency and Accountability Act of 2010,”<sup>2</sup> amended the Commodity Exchange Act (“CEA” or the “Act”)<sup>3</sup> to establish a comprehensive regulatory framework for over-the-counter (“OTC”) derivatives, including swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing mandatory clearing and trade execution requirements on clearable swap contracts; (3) creating rigorous recordkeeping and real-time reporting regimes; and (4) enhancing the Commission’s rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission’s oversight.

Section 725(c) of the Dodd-Frank Act amended Section 5b(c)(2) of the CEA, which sets forth core principles that a DCO must comply with in order to register and maintain registration with the Commission. The core principles were originally added to the CEA by the Commodity Futures Modernization Act of 2000,<sup>4</sup> and, in 2001, the Commission issued guidance on DCO compliance with these core principles.<sup>5</sup> However, in furtherance of the goals of the Dodd-Frank Act to reduce risk, increase transparency, and promote market integrity, the Commission, pursuant to the Commission’s enhanced rulemaking authority,<sup>6</sup> withdrew the 2001 guidance and adopted regulations establishing standards for compliance with the DCO core principles.<sup>7</sup> As noted in the preamble to the final rule for Subpart A and Subpart B of part 39 of the Commission’s regulations (“Subpart A” and “Subpart B,” respectively), the implementing regulations of the DCO core principles, the Commission sought to provide legal certainty for market participants, strengthen the risk management practices of DCOs, and

increase overall confidence in the financial system by assuring “market participants and the public that DCOs are meeting minimum risk management standards.”<sup>8</sup>

#### *B. Designation of DCOs as Systemically Important Under Title VIII of the Dodd-Frank Act*

Title VIII of the Dodd-Frank Act, entitled “Payment, Clearing, and Settlement Supervision Act of 2010,”<sup>9</sup> was enacted to mitigate systemic risk in the financial system and promote financial stability.<sup>10</sup> Section 804 of the Dodd-Frank Act requires the Financial Stability Oversight Council (“Council”) to designate those financial market utilities (“FMUs”)<sup>11</sup> that the Council determines are, or are likely to become, systemically important.<sup>12</sup>

In determining whether an FMU is systemically important, the Council uses a detailed two-stage designations process, using certain statutory considerations<sup>13</sup> and other metrics to assesses, among other things, “whether possible disruptions [to the functioning of an FMU] are potentially severe, not necessarily in the sense that they themselves might trigger damage to the U.S. economy, but because such disruptions might reduce the ability of financial institutions or markets to perform their normal intermediation functions.”<sup>14</sup> On July 18, 2012, the Council designated eight FMUs as

systemically important under Title VIII.<sup>15</sup> Two of these designated FMUs are CFTC-registered DCOs<sup>16</sup> for which the Commission is the Supervisory Agency.<sup>17</sup>

#### *C. Existing Standards for SIDCOs*

Section 805 of the Dodd-Frank Act directs the Commission to consider relevant international standards and existing prudential requirements when prescribing risk management standards governing the operations related to payment, clearing, and settlement activities for FMUs that are (1) designated as systemically important by the Council and (2) engaged in activities for which the Commission is the Supervisory Agency.<sup>18</sup> More generally, Section 752 of the Dodd-Frank Act directs the Commission to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation of, among other things, swaps, futures, and options on futures.<sup>19</sup>

The Commission has previously reviewed the risk management

<sup>15</sup> See Press Release, Financial Stability Oversight Council, Financial Stability Oversight Council Makes First Designations in Effort to Protect Against Future Financial Crises (July 18, 2012), available at <http://www.treasury.gov/press-center/press-releases/Pages/tg1645.aspx>.

<sup>16</sup> While Chicago Mercantile Exchange, Inc. (“CME”), ICE Clear Credit LLC (“ICE Clear Credit”), and The Options Clearing Corporation (“OCC”) are the CFTC-registered DCOs that were designated as systemically important by the Council, the CFTC is the Supervisory Agency only for CME and ICE Clear Credit, the SEC serves as OCC’s Supervisory Agency.

<sup>17</sup> See Section 803(8)(A) of the Dodd-Frank Act (defining “Supervisory Agency” as the federal agency that has primary jurisdiction over a designated financial market utility under federal banking, securities or commodity futures laws).

<sup>18</sup> See Section 805(a)(2) of the Dodd-Frank Act. The Commission notes that under section 805 of the Dodd-Frank Act it also has the authority to prescribe risk management standards governing the operations related to payment, clearing, and settlement activities for FMUs that are designated as systemically important by the Council and are engaged in activities for which the Commission is the appropriate financial regulator.

<sup>19</sup> Section 752 of the Dodd-Frank Act, codified at 15 U.S.C. 8325, provides:

(a) In order to promote effective and consistent global regulation of swaps and security based swaps, the [CFTC], the Securities and Exchange Commission, and the prudential regulators (as that term is defined in section 1a(30) of the [CEA], as appropriate, shall consult and coordinate with foreign regulatory authorities on the establishment of international standards with respect to the regulation \* \* \* of swaps \* \* \* [and] swap entities \* \* \*.

(b) In order to promote effective and consistent global regulation of contracts of sale of a commodity for future delivery and options on such contracts, the [CFTC] shall consult and coordinate with foreign regulatory authorities on the establishment of international standards with respect to the regulation of contracts of a sale of a commodity for future delivery and on options on such contracts.

accessed at [http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/hr4173\\_enrolledbill.pdf](http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/hr4173_enrolledbill.pdf).

<sup>2</sup> Section 701 of the Dodd-Frank Act.

<sup>3</sup> 7 U.S.C. 1 *et seq.*

<sup>4</sup> See Commodity Futures Modernization Act of 2000, Public Law 106–554, 114 Stat. 2763 (2000).

<sup>5</sup> See A New Regulatory Framework for Clearing Organizations, 66 FR 45604 (Aug. 29, 2001) (adopting 17 CFR Part 39, Appendix A).

<sup>6</sup> See Section 725(c)(2)(i) of the Dodd Frank Act (giving the Commission explicit authority to promulgate rules regarding the core principles pursuant to its rulemaking authority under Section 8a(5) of the CEA, 7 U.S.C. 12a(5)).

<sup>7</sup> See Derivatives Clearing Organization General Provisions and Core Principles, 76 FR 69334 (Nov. 8, 2011).

<sup>8</sup> *Id.* at 69335.

<sup>9</sup> Section 801 of the Dodd-Frank Act.

<sup>10</sup> Section 802(b) of the Dodd-Frank Act.

<sup>11</sup> An FMU includes “any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person.” Section 803(6)(A) of the Dodd-Frank Act.

<sup>12</sup> Section 804(a)(1) of the Dodd-Frank Act. The term “systemically important” means “a situation where the failure of or a disruption to the functioning of a financial market utility . . . could create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the financial system of the United States.” Section 803(9) of the Dodd-Frank Act. See also Authority to Designate Financial Market Utilities as Systemically Important, 76 FR 44763, 44774 (July 27, 2011) (final rule).

<sup>13</sup> Under Section 804(a)(2) of the Dodd-Frank Act, in determining whether an FMU is or is likely to become systemically important, the Council must take into consideration the following: (A) The aggregate monetary value of transactions processed by the FMU; (B) the aggregate exposure of an FMU to its counterparties; (C) the relationship, interdependencies, or other interactions of the FMU with other FMUs or payment, clearing or settlement activities; (D) the effect that the failure of or a disruption to the FMU would have on critical markets, financial institutions or the broader financial system; and (E) any other factors the Council deems appropriate.

<sup>14</sup> 76 FR at 44766.

standards set forth in part 39 of the Commission's regulations in light of relevant international standards and existing prudential requirements to identify those areas in which additional risk management standards for SIDCOs would be appropriate. In 2010, the Commission proposed enhanced financial resource requirements for SIDCOs that would have required a SIDCO to (1) maintain sufficient financial resources to meet the SIDCO's financial obligations to its clearing members notwithstanding a default by the two clearing members creating the largest combined financial exposure for the SIDCO in extreme but plausible market conditions,<sup>20</sup> and (2) only count the value of assessments, after a 30% haircut, to meet up to 20% of the resources required to meet obligations arising from a default by the clearing member creating the second largest financial exposure.<sup>21</sup> In addition, in 2011 the Commission proposed to improve system safeguards for SIDCOs by enhancing certain business continuity and disaster recovery procedures.<sup>22</sup>

Because efforts to finalize the PFMI were ongoing at the time the Commission adopted certain amendments to part 39 applicable to DCOs, rules specific to SIDCOs could have put SIDCOs at a competitive disadvantage vis-à-vis foreign central counterparties ("CCPs") not yet subject to comparable rules. Moreover, at the time, because no DCO had been designated as systemically important by the Council, the Commission concluded it would be premature to finalize the SIDCO regulations in the Derivatives Clearing Organization General Provisions and Core Principles adopting release.<sup>23</sup> Instead, the Commission decided, consistent with Section 805(a)(1) of the Dodd-Frank Act,<sup>24</sup> to

monitor domestic and international developments concerning CCPs and reconsider the proposed SIDCO regulations in light of such developments. In 2013, after careful consideration of the comments on the 2010 proposed SIDCO rules and in light of domestic and international market and regulatory developments, the Commission finalized these proposed regulations in a manner consistent with the PFMI.<sup>25</sup> Specifically, in the final rules the Commission amended part 39 by creating a Subpart C and adding regulations that (1) increased the minimum financial resource requirements for SIDCOs, (2) restricted the use of assessments by SIDCOs in meeting such financial resource obligations, (3) enhanced the system safeguards requirements for SIDCOs, and (4) granted the Commission special enforcement authority over SIDCOs pursuant to Section 807 of the Dodd-Frank Act.<sup>26</sup>

#### *D. DCO Core Principles and Regulations for Registered DCOs*

As noted above, in order to register and maintain registration status with the Commission, DCOs must comply with all of the DCO core principles set forth in Section 5b(c)(2) of the CEA, as amended by Section 725 of the Dodd-Frank Act, as well as all applicable Commission regulations. However, for purposes of this proposal, the Commission would like to highlight the following requirements set forth in the core principles and related Commission regulations: Core Principle B (Financial Resources) and regulations 39.11 and 39.29; Core Principle D (Risk Management) and regulation 39.13; Core Principle G (Default Rules and Procedures) and regulation 39.16; Core Principle I (System Safeguards) and regulations 39.18 and 39.30; Core Principle L (Public Information) and regulation 39.21; Core Principle O (Governance Fitness Standards); Core Principle P (Conflicts of Interest); and Core Principle Q (Composition of Governing Boards).

#### **1. Core Principle B: Financial Resources**

Core Principle B requires DCOs to have "adequate financial, operational, and managerial resources, as determined by the Commission, to discharge each responsibility of the [DCO]." <sup>27</sup> Specifically, Core Principle B

requires a DCO to possess financial resources that, at a minimum, exceed the total amount that would enable the DCO to meet its financial obligations to its clearing members, notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible market conditions and to cover its operating costs for a period of one year, as calculated on a rolling basis. Regulation 39.11 codifies these minimum requirements for all DCOs.<sup>28</sup> Pursuant to regulation 39.29, however, a SIDCO that is systemically important in multiple jurisdictions or that is involved in activities with a more-complex risk profile must maintain financial resources sufficient to enable it to meet its financial obligations to its clearing members notwithstanding a default by the two clearing members creating the largest combined financial exposure for the SIDCO in extreme but plausible market conditions.<sup>29</sup>

#### **2. Core Principle D: Risk Management**

Core Principle D requires a DCO to ensure that it possesses the ability to manage the risks associated with discharging the responsibilities of the DCO through the use of appropriate tools and procedures. It further requires a DCO to measure its credit exposures to each clearing member not less than once each business day and to monitor each such exposure periodically during the business day. Core Principle D also requires a DCO to limit its exposure to potential losses from defaults by clearing members through margin requirements and other risk control mechanisms, to ensure that the DCO's operations would not be disrupted and non-defaulting clearing members would not be exposed to losses that non-defaulting clearing members cannot anticipate or control. Finally, Core Principle D provides that a DCO must require margin from each clearing member sufficient to cover potential exposures in normal market conditions and that each model and parameter used in setting such margin requirements must be risk-based and reviewed on a regular basis. Regulation 39.13

<sup>28</sup> Specifically, regulation 39.11 requires registered DCOs to maintain financial resources sufficient to cover a wide range of potential stress scenarios, which include, but are not limited to, the default of the participant and its affiliates that would potentially cause the largest aggregate credit exposure to the CCP in extreme but plausible market conditions, otherwise known as "Cover One."

<sup>29</sup> Financial resources sufficient to cover the default of the two participants creating the largest credit exposure in extreme but plausible circumstances is known as "over two." See also *infra* note 70.

<sup>20</sup> Financial Resources Requirements for Derivatives Clearing Organizations, 75 FR 63113, at 63119 (Oct. 14, 2010) (notice of proposed rulemaking).

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

<sup>22</sup> See Risk Management Requirements for Derivatives Clearing Organizations, 76 FR 3697, 3726–3727 (Jan. 20, 2011) (notice of proposed rulemaking). The proposal also implemented special enforcement authority over SIDCOs that, pursuant to section 807(c) of the Dodd-Frank Act, would have granted the Commission authority under the provisions of subsections (b) through (n) of section 8 of the Federal Deposit Insurance Act in the same manner and to the same extent as if the SIDCO were an insured depository institution and the Commission were the appropriate federal banking agency for such insured depository institution. See 76 FR at 3727.

<sup>23</sup> See 76 FR at 69352.

<sup>24</sup> The Commission notes again that Section 805(a)(1) of the Dodd-Frank Act requires the Commission to consider international standards in promulgating risk management rules.

<sup>25</sup> Enhanced Risk Management Standards for Systemically Important Derivatives Clearing Organizations, (final rule published in the **Federal Register** August 15, 2013) ("SIDCO Final Rule").

<sup>26</sup> *Id.*

<sup>27</sup> Section 5b(c)(2)(B) of the CEA, 7 U.S.C. 7a–1(c)(2)(B).

establishes the requirements that a DCO must meet in order to comply with Core Principle D, including documentation requirements, the methodology for the calculation and coverage of margin requirements, and the criteria and timing of stress tests that a DCO must conduct.<sup>30</sup>

### 3. Core Principle G: Default Rules and Procedures

Core Principle G requires a DCO to have rules and procedures designed to allow for the efficient, fair, and safe management of events during which clearing members become insolvent or otherwise default on their obligations to the DCO. In addition, Core Principle G requires a DCO to clearly state its default procedures, make its default rules publicly available, and ensure that it may take timely action to contain losses and liquidity pressures and to continue meeting its obligations. Regulation 39.16 establishes the minimum requirements that a DCO must meet in order to comply with Core Principle G, including the requirements for the DCO's default management plan and the procedures for dealing with the default and insolvency of a clearing member.

### 4. Core Principle I: System Safeguards

Core Principle I requires a DCO to establish and maintain a program of risk analysis and oversight that identifies and minimizes sources of operational risk through the development of appropriate controls and procedures, and automated systems that are reliable, secure, and have adequate scalable capacity. Core Principle I also requires that the emergency procedures, back-up facilities, and disaster recovery plans that a DCO is obligated to establish and maintain specifically allow for the timely recovery and resumption of the DCO's operations and the fulfillment of each obligation and responsibility of the DCO. Finally, Core Principle I requires that a DCO periodically conduct tests to verify that the DCO's back-up resources are sufficient to ensure daily processing, clearing, and settlement. Regulation 39.18 delineates the minimum requirements that a DCO must satisfy in order to comply with Core Principle I, including a recovery time objective of the next business day. In addition, regulation 39.30 requires a SIDCO to have a business continuity and disaster recovery plan with a recovery time objective of not later than two hours

following the disruption. Regulation 39.30 also requires a SIDCO to have geographic diversity in the resources used to enable the SIDCO to meet its recovery time objective.

### 5. Core Principle L: Public Information

Core Principle L requires a DCO to provide market participants sufficient information to enable the market participants to identify and evaluate accurately the risks and costs associated with using the DCO's services. More specifically, a DCO is required to make available to market participants information concerning the rules and operating and default procedures governing its clearing and settlement systems and also to disclose publicly and to the Commission the terms and conditions of each contract, agreement, and transaction cleared and settled by the DCO; each clearing and other fee charged to members; the DCO's margin-setting methodology; daily settlement prices; and other matters relevant to participation in the DCO's clearing and settlement activities. Regulation 39.21 sets forth the requirements a DCO must meet in order to comply with Core Principle L and details the information to be disclosed to the public and requirements regarding the method and timing of such disclosure.

### 6. Core Principle O: Governance Fitness Standards

Core Principle O requires a DCO to establish transparent governing arrangements to both fulfill public interest requirements and to permit the consideration of the views of owners and participants. In addition, Core Principle O requires a DCO to establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the DCO, any other individual or entity with direct access to the settlement or clearing activities of the DCO, and affiliated parties.

### 7. Core Principle P: Conflicts of Interest

Core Principle P requires a DCO to establish and enforce rules to minimize conflicts of interest in the decision making process of the DCO. Core Principle P further requires a DCO to establish a process for resolving conflicts of interest.

### 8. Core Principle Q: Composition of Governing Boards

Core Principle Q requires a DCO to ensure that the composition of the governing board or committee of the DCO includes market participants.

## E. PFMI

### 1. Overview

In the SIDCO Final Rule, the Commission determined that, for purposes of meeting its obligation pursuant to Section 805(a)(2)(A) of the Dodd-Frank Act, the PFMI, which were developed by CPSS-IOSCO over a period of several years,<sup>31</sup> were the international standards most relevant to the risk management of SIDCOs.<sup>32</sup>

In February 2010, CPSS-IOSCO launched a review of the existing sets of international standards for financial market infrastructures ("FMIs") in support of a broader effort by the Financial Stability Board ("FSB")<sup>33</sup> to strengthen core financial infrastructures and markets by ensuring that gaps in international standards were identified and addressed.<sup>34</sup> CPSS-IOSCO endeavored to incorporate in the review process lessons from the 2008 financial crisis and the experience of using the existing international standards, as well as policy and analytical work by other international committees including the Basel Committee on Banking Supervision ("BCBS").<sup>35</sup> The PFMI replace CPSS-IOSCO's previous international standards applicable to CCPs,<sup>36</sup> and establish international risk management standards for FMIs, including CCPs, that facilitate clearing

<sup>31</sup> See Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions, *Principles for Financial Market Infrastructures*, (April 2012) available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD377.pdf>. See also the Financial Stability Board June 2012 Third Progress Report on Implementation, available at [http://www.financialstabilityboard.org/publications/r\\_120615.pdf](http://www.financialstabilityboard.org/publications/r_120615.pdf) (Noting publication of the PFMI as achieving "an important milestone in the global development of a sound basis for central clearing of all standardised OTC derivatives").

<sup>32</sup> In making this determination, the Commission noted that "the adoption and implementation of the PFMI by numerous foreign jurisdictions highlights the role these principles play in creating a global, unified set of international risk management standards for CCPs." See SIDCO Final Rule.

<sup>33</sup> The FSB is an international organization that coordinates with national financial authorities and international policy organizations to develop and promote effective regulatory, supervisory and other financial sector policies. See generally <http://www.financialstabilityboard.org>.

<sup>34</sup> PFMI, ¶ 1.6.

<sup>35</sup> *Id.*

<sup>36</sup> The international standards for FMIs, prior to the publication of the PFMI, included, the *Core Principles for Systemically Important Payment Systems* published by CPSS in 2001, the *Recommendations for Securities Settlement Systems* published by CPSS-IOSCO in 2001, and the *Recommendations for Central Counterparties* published by CPSS-IOSCO in 2004 (collectively all three are referred to as the "CPSS-IOSCO Principles and Recommendations"). See PFMI, ¶¶ 1.4-1.5.

<sup>30</sup> The Commission also requires that a DCO's actual coverage of its initial margin requirements meet an established confidence level of at least 99%, based on data from an appropriate historic time period. See generally 17 CFR 39.13(g)(2)(iii).

and settlement.<sup>37</sup> In issuing the PFMI, CPSS-IOSCO sought to strengthen and harmonize existing international standards and incorporate new specifications for CCPs clearing OTC derivatives.<sup>38</sup> The objectives of the PFMI are to enhance the safety and efficiency of FMIs and, more broadly, reduce systemic risk and foster transparency and financial stability.<sup>39</sup>

The PFMI sets out 24 principles which address the risk and efficiency of an FMI's operations.<sup>40</sup> Assessments of observance with the PFMI focus also on the "key considerations" set forth for each of the principles.<sup>41</sup> While Subpart A and Subpart B incorporate the vast majority of the standards set forth in the PFMI,<sup>42</sup> the Commission, which is a member of the Board of IOSCO, intends to implement rules and regulations that are fully consistent with the standards set forth in the PFMI by the end of 2013. To that end, the Commission has recognized that in certain instances, the standards set forth in the PFMI may not be fully covered by the requirements set forth in Subpart A and Subpart B. Thus, this rulemaking would revise Subpart C to address those gaps, specifically with respect to the following PFMI principles: Principle 2 (Governance); Principle 3 (Framework for the comprehensive management of risks); Principle 4 (Credit risk); Principle 6 (Margin); Principle 7 (Liquidity risk); Principle 9 (Money settlements); Principle 14 (Segregation and portability); Principle 15 (General business risk); Principle 16 (Custody and investment risks); Principle 17 (Operational risk); Principle 21 (Efficiency and effectiveness); Principle 22 (Communication procedures and standards); and Principle 23 (Disclosure of rules, key procedures, and market data).

<sup>37</sup> The PFMI defines a "financial market infrastructure" as a "multilateral system among participating institutions, including the operator of the system, used for the purposes of clearing, settling, or recording payments, securities, derivatives, or other financial transactions." See PFMI, ¶ 1.8.

<sup>38</sup> See *id.*, ¶ 1.2.

<sup>39</sup> *Id.*, ¶ 1.15.

<sup>40</sup> See *id.*, ¶ 1.19.

<sup>41</sup> See Committee on Payment and Settlement Systems and the Board of the International Organization of Securities Commissions Principles for Financial Market Infrastructures: Disclosure Framework and Assessment Methodology (Dec. 2012) (hereinafter "Disclosure Framework and Assessment Methodology"), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD396.pdf>.

<sup>42</sup> Indeed, Subpart A and Subpart B were informed by the consultative report for the PFMI. See generally 76 FR at 69334.

## 2. Principle 2: Governance

Principle 2 addresses the governance arrangements of an FMI.<sup>43</sup> Specifically, it states that the governance arrangements of an FMI should be "clear and transparent, promote the safety and efficiency of the FMI, and support the stability of the broader financial system."<sup>44</sup> An FMI's governance arrangements must be documented and set forth "direct lines of responsibility and accountability," which are disclosed to owners, regulators, clearing members and their customers, and the public.<sup>45</sup> In addition, an FMI must clearly specify the roles and responsibilities of the board of directors and management, ensure that the board of directors and management have appropriate experience, design procedures to identify and resolve conflicts of interest for members of the board of directors, and regularly review the performance of the board of directors as a whole and individual directors.<sup>46</sup> In order to ensure that the board of directors has the appropriate incentive to fulfill its multiple roles, the board must typically include non-executive board members.<sup>47</sup> Further, the FMI's risk management framework must be clear, documented and reflect the risk-tolerance policy, assign responsibility and accountability for risk decisions, and specify how decisions will be made in crises and emergencies.<sup>48</sup> Finally, Principle 2 requires the FMI's "design, rules, overall strategy, and decisions to reflect appropriately the legitimate interests of its direct and indirect participants and other relevant stakeholders," and requires that "major decisions" be "clearly disclosed to relevant stakeholders" and to the public when there is "a broad market impact."<sup>49</sup>

## 3. Principle 3: Framework for the Comprehensive Management of Risks

Principle 3 addresses an FMI's risk management framework, requiring it to "comprehensively manage[] legal, credit, liquidity, operational, and other risks."<sup>50</sup> In addition, as part of its risk management framework, an FMI "must

regularly review" and develop tools to address "the material risks it bears from and poses to other entities . . . as a result of interdependencies,"<sup>51</sup> and "identify scenarios that may potentially prevent it from being able to provide its critical operations and services as a going concern."<sup>52</sup> Principle 3 further requires an FMI to "assess the effectiveness of a full range of options for recovery or orderly wind-down" and to "prepare appropriate plans for its recovery or orderly wind-down as a result of that assessment."<sup>53</sup> An FMI is required to "provide incentives" so that its participants and their customers "manage and contain the risks they pose to the FMI."<sup>54</sup> Finally, Principle 3 requires an FMI's risk management framework to be periodically reviewed.<sup>55</sup>

## 4. Principle 4: Credit Risk

Principle 4 addresses an FMI's credit risk, that is, the risk that a counterparty to the CCP will be unable to fully meet its financial obligations when due.<sup>56</sup> Generally, Principle 4 requires all FMIs to establish explicit rules and procedures to address any credit losses they may face as a result of an individual or combined default among its participants with respect to any of their obligations to the FMI.<sup>57</sup> These rules and procedures should also address how potentially uncovered credit losses would be allocated, how the funds an FMI may borrow from liquidity providers will be repaid, and how an FMI will replenish its financial resources that it may use during a stress event, such as a default, so that it can continue to operate in a safe and sound manner.<sup>58</sup> More specifically, Principle 4 states that "a CCP should cover its current and potential future exposures to each participant fully with a high degree of confidence using margin and other prefunded financial resources."<sup>59</sup> Additionally, Principle 4 provides that a CCP involved in activities with a more complex risk profile<sup>60</sup> or that is

<sup>51</sup> PFMI at Principle 3, K.C. 3.

<sup>52</sup> PFMI at Principle 3, K.C. 4.

<sup>53</sup> *Id.*

<sup>54</sup> PFMI at Principle 3, K.C. 2.

<sup>55</sup> PFMI at Principle 3, K.C. 1.

<sup>56</sup> The PFMI defines "credit risk" as the risk that a counterparty, whether a participant or other entity, will be unable to meet fully its financial obligations when due, or at any time in the future. PFMI at Annex H: Glossary.

<sup>57</sup> See PFMI at Principle 4, K.C. 7.

<sup>58</sup> See *id.*

<sup>59</sup> *Id.* at Principle 4, K.C. 4.

<sup>60</sup> Activities "with a more complex risk profile" include clearing financial instruments that are characterized by discrete jump-to-default price changes or that are highly correlated with potential participant defaults. *Id.* at Explanatory Note (hereinafter, "E.N.") 3.4.19.

systemically important in multiple jurisdictions should maintain additional financial resources sufficient to cover a wide range of potential stress scenarios, including, but not limited to, the default of the two participants and their affiliates that would potentially cause the largest aggregate credit exposure to the CCP in extreme but plausible market conditions.

#### 5. Principle 6: Margin

Principle 6 addresses an FMI's margin requirements and requires a CCP to use "an effective margin system that is risk-based and regularly reviewed" to "cover its credit exposures to its participants for all products."<sup>61</sup> Specifically, Principle 6 requires a CCP's margin system to take into account the "risks and particular attributes of each product, portfolio and market that it serves" and be calibrated accordingly.<sup>62</sup> Further, a CCP's margin system must have reliably sourced and timely price data.<sup>63</sup> A CCP's regular reviews of its margin models and coverage must include, at minimum, (i) rigorous daily backtesting, (ii) monthly sensitivity analyses, and (iii) regular "assessment of the theoretical and empirical properties" of the margin models, which consider a wide range of possible market conditions "including the most-volatile periods that have been experienced by the markets it serves and extreme changes in the correlation between prices."<sup>64</sup> Principle 6 also states that "[a] CCP should have the authority and operational capacity to make intraday margin calls and payments, both scheduled and unscheduled, to participants."<sup>65</sup>

#### 6. Principle 7: Liquidity risk

Principle 7 addresses the risk that an FMI may not have sufficient funds to meet its financial obligations as and when due.<sup>66</sup> Specifically, Principle 7 provides that an FMI manage its liquidity risks from a variety of sources, including participants, settlement banks, custodian banks, and liquidity providers<sup>67</sup> on an ongoing and timely basis<sup>68</sup> and regularly test the sufficiency of liquidity resources through rigorous

stress testing.<sup>69</sup> Additionally, Principle 7 provides that the minimum liquid resource requirement for CCPs should be resources that would permit Cover One, but a CCP that is involved in activities with a more complex risk profile or that is systemically important in multiple jurisdictions should "maintain additional liquidity resources sufficient to cover a wider range of potential stress scenarios," including resources that would permit Cover Two.<sup>70</sup> Principle 7 also sets forth specifications for qualifying liquidity resources which may be used to meet the minimum liquid resource requirement.<sup>71</sup>

#### 7. Principle 9: Money Settlements

Principle 9 addresses money settlements, stating that an FMI should minimize and strictly control the credit and liquidity risk arising from the use of commercial bank money.<sup>72</sup> In other words, an FMI should "monitor, manage, and limit its credit and liquidity risks arising from commercial settlement banks," by (i) establishing and monitoring "adherence to strict criteria for its settlement banks that take into account of, among other things, their regulation and supervision, creditworthiness, capitalization, access to liquidity, and operational reliability;"<sup>73</sup> and (ii) monitoring and managing "the concentration credit and liquidity exposures to its commercial settlement banks."<sup>74</sup>

#### 8. Principle 14: Segregation and Portability

Principle 14 addresses segregation and portability, stating that "a CCP should have rules and procedures that enable the segregation and portability of a participant's customers and the collateral provided to the CCP with respect to those positions."<sup>75</sup> A CCP's segregation and portability rules should, at a minimum, "effectively protect a participant's customers' positions and related collateral from the default or insolvency of that participant."<sup>76</sup> Further, Principle 14 states that a CCP's segregation and portability

arrangements should be disclosed, including whether the protection provided for customer collateral is on an individual or omnibus basis and whether there are any "constraints, such as legal or operational constraints" that may impair its ability to segregate or port a participant's customers' positions and related collateral."<sup>77</sup>

#### 9. Principle 15: General Business Risk

Principle 15 addresses general business risk, the inability of an FMI to continue as a going concern, requiring an FMI to "hold sufficient liquid net assets funded by equity to cover potential general business losses."<sup>78</sup> The liquid net assets should be sufficient, at all times, "to ensure a recovery or orderly wind-down of critical operations and services."<sup>79</sup> Specifically, "an FMI should maintain a viable recovery or orderly wind-down plan" that is supported by "liquid net assets funded by equity equal to at least six months of current operating expenses."<sup>80</sup>

#### 10. Principle 16: Custody and Investment Risk

Principle 16 addresses custody and investment risks, stating that an FMI should safeguard its own assets as well as the assets of its participants.<sup>81</sup> Specifically, the FMI should minimize the risk of loss on and delay in access to these assets.<sup>82</sup> In addition, the FMI's investments should be in instruments with minimal credit, market and liquidity risks.<sup>83</sup>

#### 11. Principle 17: Operational Risk

Principle 17 addresses the risk of deficiencies in information systems or internal processes, human errors, management failures, or disruptions from external events that will result in the reduction or deterioration of services provided by the FMI.<sup>84</sup> Principle 17 states that "[b]usiness continuity management should aim for timely recovery of operations and fulfillment [sic] of the FMI's obligations, including in the event of a wide-scale or

<sup>77</sup> PFMI's at Principle 14, K.C. 4.

<sup>78</sup> The PFMI's define "general business risk" as "any potential impairment of the FMI's financial position (as a business concern) as a consequence of a decline in its revenues or an increase in its expenses, such that expenses exceed revenues and result in a loss that must be charged against capital." PFMI's at Annex H: Glossary.

<sup>79</sup> PFMI's at Principle 15.

<sup>80</sup> *Id.* at K.C. 3. Such liquid net assets used to support the recovery and orderly wind-down plan should be held in addition to the assets required to cover participant defaults and other risks. *Id.*

<sup>81</sup> PFMI's at Principle 16.

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

<sup>84</sup> PFMI's, ¶ 2.9.

<sup>61</sup> PFMI's at Principle 6.

<sup>62</sup> *Id.* at Principle 6, K.C. 1.

<sup>63</sup> *See id.* at Principle 6, K.C. 2.

<sup>64</sup> *Id.* at Principle 6, K.C. 6.

<sup>65</sup> *Id.* at Principle 6, K.C. 4.

<sup>66</sup> The PFMI's define "liquidity risk" as "the risk that a counterparty, whether a participant or other entity, will have insufficient funds to meet its financial obligations as and when expected, although it may be able to do so in the future." *Id.* at Annex H: Glossary.

<sup>67</sup> *See* PFMI's at Principle 7, K.C. 1.

<sup>68</sup> *See* PFMI's at Principle 7, K.C. 2.

<sup>69</sup> *See* PFMI's at Principle 7, K.C. 9.

<sup>70</sup> PFMI's at Principle 7, K.C. 4. The term "Cover Two" refers to the requirement that a CCP maintain financial resources sufficient to enable it to meet its financial obligations to its clearing members notwithstanding a default by the two clearing members creating the largest combined financial exposure for the SIDCO in extreme but plausible market conditions.

<sup>71</sup> *See* PFMI's at Principle 7, K.C. 5–8.

<sup>72</sup> *Id.*

<sup>73</sup> *See* PFMI's at Principle 7, K.C. 3.

<sup>74</sup> *See id.*

<sup>75</sup> PFMI's at Principle 14.

<sup>76</sup> *Id.* at K.C. 1.

major disruption.”<sup>85</sup> Additionally, an FMI’s business continuity plan “should incorporate the use of a secondary site and should be designed to ensure that critical information technology (“IT”) systems can resume operations within two hours following disruptive events.”<sup>86</sup>

## 12. Principle 21: Efficiency and Effectiveness

Principle 21 addresses the efficiency and effectiveness of an FMI. An FMI should be designed to meet the needs of its participants and the markets it serves, in particular, with regard to choice of clearing and settlement arrangement, operating structure, scope of products cleared or settled and integration of technology and procedures.<sup>87</sup> An effective CCP reliably meets its obligations in a timely manner and achieves the public policy goals of safety and efficiency for participants and the markets it serves.<sup>88</sup>

## 13. Principle 22: Communication Procedures and Standards

Principle 22 addresses communication procedures and standards. An FMI should use, or at a minimum accommodate, internationally accepted communication procedures and standards.<sup>89</sup> These include common sets of rules across systems for exchange messages, standardized messaging formats, and reference data standards for identifying financial instruments and counterparties.

## 14. Principle 23: Disclosure of Rules, Key Procedures, and Market Data

Principle 23 addresses the disclosure of an FMI’s rules and procedures to participants and the public. An FMI should disclose its rules and procedures to participants, so that participants can have an “accurate understanding of the risks, fees, and other material costs they incur by participating in the FMI.”<sup>90</sup> Further, the FMI should make disclosures to the public regarding fees, basic operational information, and other relevant information, such as the responses to the Disclosure Framework published by CPSS–IOSCO,<sup>91</sup> so that prospective participants can also assess the risks, fees, and other material costs incurred by participating in the FMI.<sup>92</sup>

## F. The Role of the PFMI in International Banking Standards

The Commission notes that where a CCP is not prudentially supervised in a jurisdiction that has domestic rules and regulations that are consistent with the standards set forth in the PFMI, the implementation of certain international banking regulations will have significant cost implications for that CCP and its market participants.

In July of 2012, the BCBS,<sup>93</sup> the international body that sets standards for the regulation of banks, published the “Capital Requirements for Bank Exposures to Central Counterparties” (“Basel CCP Capital Requirements”), which sets forth interim rules governing the capital charges arising from bank exposures to CCPs related to OTC derivatives, exchange traded derivatives and securities financing transactions.<sup>94</sup> The Basel CCP Capital Requirements create financial incentives for banks<sup>95</sup> to clear financial derivatives with CCPs that are licensed in a jurisdiction where the relevant regulator has adopted rules or regulations that are consistent with the standards set forth in the PFMI. Specifically, the Basel CCP Capital Requirements introduce new capital charges based on counterparty risk for banks conducting financial derivatives transactions through a CCP.<sup>96</sup> These new capital charges relate to a bank’s

trade exposure and default fund exposure to a CCP.<sup>97</sup>

The capital charges for trade exposure are based upon a function multiplying exposure by risk weight. Risk weight is a measure that represents the likelihood that the loss to which the bank is exposed will be incurred, and the extent of that loss. The risk weight assigned under the Basel CCP Capital Requirements varies significantly depending on whether or not the counterparty is a qualified CCP (“QCCP”).<sup>98</sup> A QCCP is defined as an entity that (i) is licensed to operate as a CCP, and is permitted by the appropriate regulator to operate as such, and (ii) is prudentially supervised in a jurisdiction where the relevant regulator has established and publicly indicated that it applies to the CCP on an ongoing basis, domestic rules and regulations that are consistent with the PFMI.<sup>99</sup> If a bank transacts through a QCCP acting either as (1) a clearing member of a CCP for its own account or for clients<sup>100</sup> or (2) a client of a clearing member that enters into an OTC derivatives transaction with the clearing member acting as a financial intermediary, then the risk weight is a flat 2% for purposes of calculating the counterparty risk.<sup>101</sup> If

<sup>97</sup> Trade exposure is a measure of the amount of loss a bank is exposed to, based on the size of its position, given a CCP’s failure. Under the Basel CCP Capital Requirements, trade exposure is defined to include the current and potential future exposure of a bank acting as either a clearing member or a client to a CCP arising from OTC derivatives, exchange traded derivatives transactions or securities financing transactions, as well as initial margin. See Basel CCP Capital Requirements, Annex 4, Section I, A: General Terms. Current exposure, includes variation margin that is owed by the CCP, but not yet been received by the clearing member or client. *Id.*

Default fund exposure is a measure of the loss a bank acting as a clearing member is exposed to arising from the use of its contributions to the CCP’s mutualized default fund resources. See Basel CCP Capital Requirements, Annex 4, Section I, A: General Terms.

<sup>98</sup> See *id.* at Annex 4, Section IX, Exposures to Qualifying CCPs, paragraphs 110–119 (describing the methodology for calculating a bank’s trade exposure to a qualified CCP); see also *id.* at paragraph 126 (describing methodology for calculating a bank’s trade exposure to a non-qualifying CCP). “A QCCP is defined as an entity that (i) is licensed to operate as a CCP, and is permitted by the appropriate regulator to operate as such, and (ii) is prudentially supervised in a jurisdiction where the relevant regulator has established and publicly indicated that it applies to the CCP on an ongoing basis, domestic rules and regulations that are consistent with the PFMI.” See Section I, A: General Terms of the Basel CCP Capital Requirements).

<sup>99</sup> *Id.* at Section I, A: General Terms.

<sup>100</sup> The term “client” as used herein refers to a customer of a DCO.

<sup>101</sup> *Id.* at Section IX: Central Counterparties, paragraphs 110 and 114. Client trade exposures are risk-weighted at 2% if the following two conditions are met: (1) The offsetting transactions are identified by the CCP as client transactions and

<sup>85</sup> PFMI at Principle 17.

<sup>86</sup> *Id.* at Principle 17, K.C. 6.

<sup>87</sup> PFMI at Principle 21, K.C. 1.

<sup>88</sup> *Id.* at Principle 21, K.C. 2–3.

<sup>89</sup> PFMI at Principle 22, K.C. 1.

<sup>90</sup> PFMI at Principle 23.

<sup>91</sup> See Disclosure Framework and Assessment Methodology, *supra* note 41.

<sup>92</sup> See PFMI at E.N. 3.23.1.

<sup>93</sup> The BCBS is comprised of senior representatives of bank supervisory authorities and central banks from around the world including, Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. See Bank for International Settlements, Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems, December 2010 (revised June 2011), available at <http://www.bis.org/publ/bcbs189.htm>.

<sup>94</sup> See *Capital Requirements for Bank Exposures to Central Counterparties* (July 2012), available at [www.bis.org/publ/bcbs227.pdf](http://www.bis.org/publ/bcbs227.pdf). The Basel CCP Capital Requirements are one component of Basel III, a framework that “is part of a comprehensive set of reform measures developed by the BCBS to strengthen the regulation, supervision and risk management of the international banking sector.” See Bank for International Settlements’ Web site for compilation of documents that form the regulatory framework of Basel III, available at <http://www.bis.org/bcbs/basel3.htm>.

<sup>95</sup> “Bank” is defined in accordance with the Basel framework to mean a bank, banking group or other entity (*i.e.* bank holding company) whose capital is being measured. See *Basel III: A Global Regulatory Framework*, Definition of Capital, paragraph 51. The term “bank,” as used herein, also includes subsidiaries and affiliates of the banking group or other entity. The Commission notes that a bank may be a client and/or a clearing member of a DCO.

<sup>96</sup> See Basel CCP Capital Requirements, Annex 4, Section II, 6(i).



the CCP is non-qualifying, then risk weight is the same as a bilateral OTC derivative trade and the bank applies the corresponding bilateral risk-weight treatment, which is at least 20% if the CCP is a bank or as high as 100% if the CCP is a corporate institution.<sup>102</sup>

With respect to default fund exposure, whenever a clearing member bank is required to maintain capital for exposures arising from default fund contributions to a QCCP, the clearing member bank may apply one of two methodologies for determining the capital requirement: The risk-sensitive approach, or the 1250% risk weight approach.<sup>103</sup> The risk-sensitive approach considers various factors in determining the risk weight for a bank's default exposure to a QCCP such as (i) the size and quality of a QCCP's financial resources, (ii) the counterparty credit risk exposures of such a CCP, and (iii) the application of such financial resources via the CCP's loss bearing waterfall in the case one or more clearing members default.<sup>104</sup> The 1250% risk weight approach allows a clearing member bank to apply a 1250% risk weight to its default fund exposures to the QCCP, subject to an overall cap of 20% on the risk-weighted assets from all trade exposures to the QCCP.<sup>105</sup> In other words, banks with exposures to QCCPs have a cap on the capital charges related to their default fund exposure. In contrast, a clearing member bank with exposures to a non-qualified CCP must

collateral to support them is held by the CCP and/or clearing member, as applicable, under arrangements that prevent losses to the client due to the default or insolvency of the clearing member, or the clearing member's other clients, or the joint default or insolvency of the clearing member and any of its other clients and (2) relevant laws, regulations, contractual or administrative arrangements provide that the offsetting transactions with the defaulted or insolvent clearing member are highly likely to continue to be indirectly transacted through the CCP, or by the CCP, should the clearing member default or become insolvent.

However, in certain circumstances risk weight may increase. Specifically, if condition 1 is not met (*i.e.* where a client is not protected from losses in the case that the clearing member and another client of the clearing member jointly default or become jointly insolvent) but condition 2 is met, the banks trade exposure is risk-weighted at 4%. If neither condition 1 nor 2 is met, then the bank must capitalize its exposure to the CCP as a bilateral trade. *Id.* at paragraphs 115 and 116.

<sup>102</sup> See BCBS, *Consultative Document: Capitalisation of Bank Exposures to Central Counterparties*, paragraph 28 (Nov. 2011), available at <http://www.bis.org/publ/bcb206.htm>.

<sup>103</sup> See Basel CCP Capital Requirements, Annex 4, Section IX, paragraphs 121–125.

<sup>104</sup> *Id.* at paragraph 122. The Commission notes that the 1250% risk weight represents the reciprocal of the 8% capital ratio (which is the percentage of a bank's capital to its risk-weighted assets).

<sup>105</sup> *Id.* at paragraph 125.

apply a risk weight of 1250% with no cap for default fund exposures.<sup>106</sup>

Thus, the Basel CCP Capital Requirements provide incentives for banks, including their subsidiaries and affiliates, to clear derivatives through CCPs that are QCCPs by setting (1) lower capital charges for OTC derivatives transacted through a QCCP and (2) significantly higher capital charges for OTC derivatives transacted through non-qualifying CCPs. The increased capital charges for transactions through non-qualifying CCPs may have significant business and operational implications for U.S. DCOs that operate internationally and are not QCCPs. Specifically, banks faced with such higher capital charges may transfer their OTC derivatives business away from such DCOs to a QCCP in order to benefit from the preferential capital charges provided by Basel CCP Capital Requirements. Alternatively, banks may reduce or discontinue their OTC business altogether. Banks may also pass through the higher costs of transacting on a non-qualifying DCO that result from the higher capital charges to their customers. Accordingly, customers using such banks as intermediaries may transfer their business to an intermediary at a QCCP. In short, a DCO's failure to be a QCCP may cause it to face a competitive disadvantage retaining members and customers.

#### *G. Proposed Rulemaking Applicable to SIDCOs and Subpart C DCOs*

As described in detail in section II below, this proposed rulemaking would create a new category of DCO, a Subpart C DCO. A Subpart C DCO would include any registered DCO that elects to become subject to the provisions in Subpart C of part 39 of the Commission's regulations ("Subpart C"). Further, this rulemaking would revise Subpart C so that Subpart C would apply to SIDCOs and Subpart C DCOs, and would include new or revised standards for governance, financial resources, system safeguards, default rules and procedures for uncovered losses or shortfalls, risk management, disclosure, efficiency, and recovery and wind-down procedures. These requirements would address any remaining gaps between the Commission's regulations and the PFMI standards. Thus, Subpart C, together with the provisions in Subpart A and Subpart B, would establish domestic rules and regulations that are consistent with the PFMIs. As such, because SIDCOs and Subpart C DCOs would

have the requirements of Subpart A, Subpart B, and Subpart C applied to them on a continuing basis, SIDCOs and Subpart C DCOs would be QCCPs for purposes of the Basel CCP Capital Requirements.<sup>107</sup> The Commission requests comment on all aspects of the rules proposed herein, as well as comment on the specific provisions and issues highlighted in section II, below.

## **II. Discussion of Revised and Proposed Rules**

### *A. Regulation 39.2 (Definitions)*

The Commission proposes to amend regulation 39.2 by amending one definition and adding six definitions. First, the Commission proposes a technical amendment to the definition of "systemically important derivatives clearing organization." The definition now describes a SIDCO as a registered DCO "which has been designated by the [Council] to be systemically important . . . ." The proposed definition would describe a SIDCO as a registered DCO "which is currently designated . . . ." This revision is necessary to allow for the possibility that a systemic importance designation may be rescinded.<sup>108</sup>

Second, the Commission proposes to add a definition for the phrase "activity with a more complex risk profile," to provide greater clarity as to the types of activities that would trigger a Cover Two financial resources requirement. The Commission proposes to define "activity with a more complex risk profile" to include clearing credit default swaps, credit default futures, and derivatives that reference either credit default swaps or credit default futures, as well as any other activity designated as such by the Commission. By permitting activities to be added by Commission action, the proposed definition provides the Commission with flexibility to address new and innovative market activities. The phrase "activity with a more complex risk profile" appears in regulation 39.29 (Financial resources requirements), which this rulemaking proposes to revise and renumber as regulation 39.33. The phrase also appears in PFMI Principles 4 (Credit risk) and 7 (Liquidity risk).

The Commission also proposes to add a definition for the term "subpart C

<sup>107</sup> See discussion of QCCP status *supra* Section I.F.

<sup>108</sup> See 76 FR at 44775 (finalizing 12 CFR 1320.13(b), which states that "[t]he Council shall rescind a designation of systemic importance for a designated financial market utility if the Council determines that the financial market utility no longer meets the standards for systemic importance.").

<sup>106</sup> *Id.* at paragraph 127.



derivatives clearing organization.” As proposed, a “subpart C derivatives clearing organization” would include any registered DCO that is not a SIDCO and that has elected to become subject to Subpart C.

In addition, the Commission proposes to add definitions for “depository institution,” “U.S. branch and agency of a foreign banking organization,” and “trust company.” A “depository institution” would have the meaning set forth in Section 19(b)(1)(A) of the Federal Reserve Act (12 U.S.C. 461(b)(1)(A)). A “U.S. branch and agency of a foreign banking organization” would mean the U.S. branch and agency of a foreign banking organization as defined in Section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101). A “trust company” would mean a trust company that is a member of the Federal Reserve System, under Section 1 of the Federal Reserve Act (12 U.S.C. 221), but that does not meet the definition of “depository institution.”

The Commission requests comment on these definitions. In particular, the Commission requests comment on the potential costs and benefits resulting from or arising out of the proposed definition of “activity with a more complex risk profile.” The Commission requests that, where possible, commenters provide both quantitative data and detailed analysis in their comments, particularly with respect to estimates of costs and benefits. In addition, the Commission requests comment on whether there are alternative definitions that would provide a more effective or efficient means for achieving consistency with the standards set forth by the PFMI. The Commission requests that commenters include a detailed description of any such alternatives, and estimates of the costs and benefits of such alternatives.

#### B. Regulation 39.30 (Scope)

The Commission proposes to expand regulation 39.28 (and renumber it as regulation 39.30) so that Subpart C would apply to SIDCOs and Subpart C DCOs. As described above, the rules proposed in Subpart C address the gaps between Commission regulations and the standards set forth in the PFMI.<sup>109</sup> As such, a DCO that is subject to the requirements of Subpart A, Subpart B, and Subpart C should meet the requirements for QCCP status and benefit from the lower capital charges on clearing member banks and bank customers of clearing members for

exposures resulting from derivatives cleared through QCCPs.<sup>110</sup> Such a DCO may also be viewed more favorably by potential members or customers of members in that it would be seen to be held to international standards. Because of these potential benefits, the Commission proposes that a DCO that has not been designated to be systemically important should have the option to elect to become subject to Subpart C.<sup>111</sup>

With respect to SIDCOs, the Commission is committed to maintaining risk management standards that enhance the safety and efficiency of a SIDCO, reduce systemic risks, foster transparency and support the stability of the broader financial system.<sup>112</sup> To support financial stability, a SIDCO must operate in a safe and sound manner. If it fails to measure, monitor, and manage its risks effectively, a SIDCO could pose significant risk to its participants and the financial system more broadly.<sup>113</sup> The Commission shares the stated objectives of the PFMI, namely to enhance the safety and efficiency of FMIs and, more broadly, reduce systemic risk and foster transparency and financial stability.<sup>114</sup> The PFMI have been adopted and implemented by numerous foreign jurisdictions.<sup>115</sup> A global, unified set of

international risk management standards for systemically important CCPs can help support the stability of the broader financial system and, for the reasons set forth in the discussion below, the Commission proposes that SIDCOs be required to comply with all of the requirements set forth in part 39 of the Commission’s regulations, including the proposed standards set forth in Subpart C.

The Commission requests comment on the proposed rules. Specifically, and in light of the potential impact that a SIDCO’s failure could have on the U.S. financial system, the Commission requests comment on the potential costs and benefits resulting from, or arising out of, requiring SIDCOs to comply with Subpart C. The Commission requests that, where possible, commenters provide quantitative data and detailed analysis in their comments, particularly with respect to estimates of costs and benefits. In addition, the Commission requests comment on whether there are more effective or efficient means for achieving consistency with the standards set forth by the PFMI. The Commission requests that commenters include a detailed description of any such alternatives, and estimates of the costs and benefits of such alternatives.

#### C. Regulation 39.31 (Election To Become Subject to the Provisions of Subpart C)

As discussed above,<sup>116</sup> the Basel CCP Capital Requirements impose significantly higher capital charges on banks (including their subsidiaries and

<sup>110</sup> See *supra* Section I.F.

<sup>111</sup> As a technical matter, the Commission proposes to move existing paragraph (c) of renumbered regulation 39.30 (requiring a SIDCO to provide notice to the Commission in advance of any proposed change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the SIDCO, in accordance with the requirements of regulation 40.10) to proposed new regulation 39.42. Because the other provisions of proposed regulation 39.30 would pertain exclusively to the scope of Subpart C, it would be appropriate for existing paragraph (c) to be codified in a separate regulation. See *infra* Section II.N for further detail.

<sup>112</sup> See SIDCO Final Rule (Discussion of risk management standards). See also Section 805(b) of the Dodd-Frank Act.

<sup>113</sup> See *supra* Section I.E.

<sup>114</sup> PFMI ¶ 1.15.

<sup>115</sup> In Europe, the European Market Infrastructure Regulation and implementing technical standards entered into force on March 15, 2013, and establish standards for CCPs that are consistent with the PFMI. See Commission Delegated Regulation (EU) No 153/2013, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:052:0041:0074:EN:PDF>; and Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC Derivatives, Central Counterparties and Trade Repositories, preamble paragraph 90, 2012 O.J. (L 201), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:FULL:EN:PDF>.

In Asia, Singapore has adopted the PFMI into its financial regulations pertaining to FMIs. See Monetary Authority of Singapore, “Supervision of Financial Market Infrastructures in Singapore,” (January 2013), available at <http://www.mas.gov.sg/~media/MAS/About%20MAS/Monographs%20and%20information%20papers/>

*MAS Monograph Supervision of Financial Market Infrastructures in Singapore%202.pdf*.

In addition, Australia and Canada have publicly indicated their intent to adopt the PFMI. See Reserve Bank of Australia, “Consultation on New Financial Stability Standards,” (August 2012), available at <http://www.rba.gov.au/payments-system/clearing-settlement/consultations/201208-new-fin-stability-standards/index.html>; Canadian Securities Administrators Consultation Paper 91–406 “Derivatives: OTC Central Counterparty Clearing,” (June 20, 2012), available at [http://www.osc.gov.on.ca/documents/en/Securities-Category9/csa\\_20120620\\_91-406\\_counterparty-clearing.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category9/csa_20120620_91-406_counterparty-clearing.pdf).

In the United States, the SEC adopted a final rule that incorporates heightened risk management standards for CCPs that clear security-based swaps, based on, in part, the PFMI’s “Cover Two” standard for CCPs engaged in a more complex risk profile or that are systemically important in multiple jurisdictions. See 17 CFR 240.17Ad-22(b)(3) (2013) (requiring, in relevant part, SEC-registered clearing agencies (i.e., CCPs) to maintain sufficient financial resources to withstand, at a minimum, a default by the participant family to which they have the largest exposure in extreme but plausible conditions, provided that a security-based swap clearing agency, (i.e., a CCP that clears security-based swaps) shall maintain sufficient financial resources to withstand, at a minimum, a default by the two participant families to which it has the largest exposure in extreme but plausible market conditions).

<sup>116</sup> See discussion *supra* Section I.F.

<sup>109</sup> See also *supra* Section I.G.

affiliates) that clear derivatives through CCPs that do not qualify as QCCPs. Because such charges could create incentives for banks to migrate their business to CCPs that are QCCPs or to avoid clearing, U.S. DCOs that operate internationally, but that are not QCCPs, may face a substantial competitive disadvantage. It would appear that DCOs that have not been designated by the Council as systemically important should have the ability to be held to international standards and to attain QCCP status.<sup>117</sup> Accordingly, the Commission is proposing regulation 39.31, which would provide a mechanism whereby a DCO that has not been designated by the Council as systemically important may elect to become subject to the provisions of Subpart C (*i.e.*, may “opt” to become subject to the regulations otherwise applicable only to SIDCOs) and, thereby, attain QCCP status. The Commission is also proposing procedures for withdrawing or rescinding that election.

The proposed amendments to Subpart C are intended to enhance the financial integrity and operational security of a SIDCO, which is critically important to safeguarding the stability of the U.S. financial system. Accordingly, the Commission proposes that a SIDCO should be subject to all of the requirements set forth in Subpart C. The Commission recognizes, however, that the overall balance of the costs and benefits of this enhanced regulatory regime, including the benefits accruing from QCCP status, and the costs associated with the implementation of Subpart C, may vary among DCOs that are not SIDCOs. The proposed “opt-in” regime allows DCOs that are not designated by the Council as systemically important to weigh for themselves the costs and benefits of attaining QCCP status.

The authority provided by Sections 5b(c)(2)(A) and 8a(5) of the CEA permits the Commission to establish and enforce regulations applicable to specified categories of DCOs that affirmatively elect to become subject to such regulations. Indeed, the Commission notes that it applies, and maintains the authority to enforce, regulations to persons and entities that voluntarily register in certain capacities.<sup>118</sup>

<sup>117</sup> A DCO that is subject to the obligations contained in Subpart A, Subpart B, and Subpart C would be a QCCP.

<sup>118</sup> See, *e.g.*, Section 5b(b) of the CEA, 7 U.S.C. 7a–1(b) (voluntary registration as a DCO). The Commission recognizes that for such entities, the benefits of voluntary registration outweigh the costs of complying with the CEA and Commission regulations. Thus, the Commission permits such

Authority for proposed regulation 39.31 is also supported by Section 752 of the Dodd- Frank Act,<sup>119</sup> which, as described above, directs the Commission to consult and coordinate with foreign regulatory authorities on effective and consistent global regulation of swaps and futures. Expanding the application of Subpart C to include DCOs that have not been designated by the Council as systemically important, but that nonetheless wish to become subject to regulations that are fully consistent with the standards set forth in the PFMIs, helps promote the international consistency called for in Section 752.

The mandate of Section 15 of the CEA further supports the adoption of a flexible approach, permitting some non-SIDCOs, but not all DCOs, to be subject to the additional regulations of Subpart C. As discussed below in more detail, the Commission is required by Section 15(a)(1) to consider the costs and benefits of any proposed regulation prior to promulgating it.<sup>120</sup> The benefits of enhanced financial integrity and operational security, the benefits accruing from being held to international standards and from QCCP status, and the costs associated with the implementation of Subpart C, may vary among DCOs that have not been designated as systemically important. DCOs that wish to compete internationally may find compliance with Subpart C a necessary cost to operate on a global stage. Similarly, DCOs that have banks or bank affiliates as members may find such compliance important to their membership and, in turn, to their own business. Accordingly, the Commission proposes that, at this time, DCOs that are not designated as systemically important should be provided with the opportunity to become subject to Subpart C based upon their assessments of the benefits and burdens associated with meeting the regulations set out in this Subpart C.

The Commission emphasizes however, that, under the present proposal, once a non-SIDCO elects to become subject to Subpart C, that non-SIDCO would, as of the effective date of

entities to register with it, which registration necessarily entails continuing supervision by the Commission, compliance with the CEA and Commission regulations, and Commission authority to enforce the CEA and its regulations against such entities.

<sup>119</sup> See *supra* note 19.

<sup>120</sup> See *infra* Section IV.C (Consideration of Costs and Benefits); see also Section 15(a)(1) of the CEA, 7 U.S.C. 19(a)(1), stating that, “Before promulgating a regulation under this Act or issuing an order . . . the Commission shall consider the costs and benefits of the action of the Commission.”

the election, be subject to examination for compliance with Subpart C and to enforcement action for non-compliance. This status would continue until such time, if any, as the election is properly vacated as set forth in proposed regulation 39.31(e).

#### 1. Regulation 39.31(a): Eligibility Requirements

Proposed regulation 39.31(a) sets forth the two categories of entities that would be eligible to elect to become subject to the provisions in Subpart C. A DCO that is not a SIDCO could request such election using the procedures set forth in proposed regulation 39.31(b). An entity applying for registration as a DCO pursuant to regulation 39.3 (“DCO Applicant”) could request the election in conjunction with its application for registration (“Registration Application”) using the procedures set forth in proposed regulation 39.31(c).

#### 2. Regulation 39.31(b): Subpart C Election and Withdrawal Procedures for Registered DCOs

Proposed regulation 39.31(b) would establish the procedures by which a DCO that is already registered could elect to become subject to the provisions of Subpart C and the procedure by which it could withdraw that election. These procedures are intended to provide the Commission, clearing members, and customers (and regulators of such clearing members and customers) with assurance that the electing DCO will be held to and will be required to meet the standards set forth in Subpart C and in the PFMIs.

A DCO seeking to become subject to Subpart C would be required to file with the Commission a completed Subpart C Election Form, which is proposed to be included in part 39 of the Commission’s regulations as Appendix B thereto. The proposed Subpart C Election Form would include three parts: (1) General Instructions, (2) Elections and Certifications, and (3) Disclosures and Exhibits. As discussed below, a DCO Applicant requesting an election to become subject to Subpart C also would be required to file a Subpart C Election Form with the Commission.<sup>121</sup>

In the Elections and Certifications portion of the Subpart C Election Form, a DCO would be required to affirmatively elect to become subject to Subpart C and to specify the date upon which it seeks to make its election effective. The effective date selected by the DCO could be no earlier than ten business days after the date the Subpart C Election Form is filed with the

<sup>121</sup> See discussion *infra* Section II.C.3.

Commission. The DCO, through its duly authorized representative,<sup>122</sup> would be required to certify that, as of the effective date of its election, the DCO will be in compliance with Subpart C and will remain in compliance unless and until the DCO rescinds its election pursuant to proposed regulation 39.31(e), discussed below.<sup>123</sup> The DCO also would be required to certify, through its duly authorized representative, that all information contained in the Subpart C Election Form is “true, current and complete in all material respects.”

In the Disclosures and Exhibits portion of the Subpart C Election Form, a DCO would be required to provide a regulatory compliance chart that separately sets forth for proposed Subpart C regulations 39.32 through 39.39, citations to the relevant rules, policies and procedures of the DCO that address each such regulation and a summary of the manner in which the DCO will comply with each regulation. In addition, the DCO would be required to provide, in separate exhibits, any documents that demonstrate its compliance with proposed Subpart C regulations 39.32 through 39.36 and 39.39.<sup>124</sup> The Commission also proposes requiring the DCO to complete and to publish on the DCO’s Web site the DCO’s responses to the Disclosure Framework and to provide the Commission with the URL to the specific page where such responses can found.<sup>125</sup> The Disclosure Framework

would be required to be completed in accordance with section 2.0 and Annex A thereof<sup>126</sup> and would be expected to fully explain how the DCO complies with the standards set forth in the PFMI. As noted in section 2.5 of the Disclosure Framework, CPSS–IOSCO are in the process of developing a set of criteria for the disclosure by an FMI of quantitative information to enable stakeholders to evaluate FMIs and to make cross-comparisons (“Quantitative Information Disclosure”). The Commission proposes requiring the DCO, in the event that such criteria are published, to publish its Quantitative Information Disclosure on the DCO’s Web site and to provide the Commission, on its Subpart C Election Form, the URL to the specific page where the Quantitative Information Disclosure may be found.

Pursuant to proposed regulation 39.31(b)(2), the filing of a Subpart C Election Form would not create a presumption that the Subpart C Election Form is materially complete or that supplemental information would not be required. The Commission could, prior to the effective date, request that the DCO provide supplemental information in order to process the DCO’s Subpart C Election Form and the DCO would be required to file such supplemental information with the Commission. Proposed regulation 39.31(b)(3) also would require the DCO to promptly amend its Subpart C Election Form if it discovers a material omission or error in, or if there is a material change in, the information provided to the Commission in the Subpart C Election Form or other information provided in

connection with the Subpart C Election Form.

Once a Subpart C Election Form is filed by a DCO, the Commission may permit the DCO’s election to become subject to Subpart C to take effect as set forth in proposed regulation 39.31(b)(4) or may stay or deny the election under proposed regulation 39.31(b)(5). If the Commission stays or denies the election, it would issue written notification thereof to the DCO. Proposed regulation 39.31(b)(4) would provide that, unless the Commission stays or denies the DCO’s election to become subject to Subpart C, such election would become effective upon the later of: (1)(i) The effective date specified by the DCO in its Subpart C Election Form or (ii) ten business days after the DCO files its Subpart C Election Form with the Commission or (2) or upon the effective date set forth in written notification from the Commission that it shall permit the election to take effect after a stay issued pursuant to proposed regulation 39.31(b)(5). The Commission may provide written acknowledgement of receipt of the DCO’s Subpart C Election Form, as well as written acknowledgement that it has permitted the DCO’s election to become subject to Subpart C to take effect and the effective date of that election.<sup>127</sup> The Commission emphasizes that, consistent with the certification required to be provided by a DCO as part of its Subpart C Election Form, a DCO, as of the date its election to become subject to Subpart C becomes effective, would be held to the requirements of Subpart C and the DCO would become subject to potential enforcement action by the Commission for failure to comply with any such requirements. To the extent that compliance with Subpart C would require the DCO to implement new rules or rule amendments, all such rules or rule amendments must be approved or permitted to take effect prior to the effective date.

Proposed regulation 39.31(b)(7) would allow a DCO that has submitted a Subpart C Election Form to withdraw the form at any time prior to the effective date specified therein by filing a notice thereof with the Commission. Withdrawal, however, would not be permitted on or after the specified effective date. A DCO that wishes to rescind its election to become subject to

<sup>122</sup> The signatures required by the “Elections and Certifications” portion of the proposed Subpart C Election Form would be required to be the manual signatures of the duly authorized representatives of the DCO described in the instructions. If the Subpart C Election Form is filed by a corporation, the Elections and Certifications would be required to be signed in the name of the corporation by a principal officer duly authorized; if filed by a limited liability company, they would be required to be signed in the name of the limited liability company by a manager or member duly authorized to sign on the limited liability company’s behalf; if filed by a partnership, they would be required to be signed in the name of the partnership by a general partner duly authorized; and if filed by an unincorporated organization or association which is not a partnership, they would be required to be signed in the name of such organization or association by the managing agent (*i.e.*, a duly authorized person who directs or manages or who participates in the directing or managing of its affairs).

<sup>123</sup> See discussion *infra* Section II.C.5.

<sup>124</sup> This approach is consistent with the Form DCO that must be filed by DCO Applicants. The Form DCO requires DCO Applicants to submit to the Commission, as individual exhibits to the Form DCO, documents that demonstrate compliance with the requirements contained in Subpart B. 17 CFR Part. 39, Appendix A.

<sup>125</sup> This proposed obligation is consistent with the obligation under proposed regulation 39.37 of SIDCOs and Subpart C DCOs to complete and publically disclose their Disclosure Framework responses. See discussion *infra* Section II.I.

<sup>126</sup> Compliance with Section 2 and Annex A of the Disclosure Framework, collectively, would require the SIDCO or Subpart C DCO to provide “a comprehensive narrative disclosure for each applicable [PFMI] principle with sufficient detail and context to enable the reader to understand the [SIDCO’s or Subpart C DCO’s] approach to observing the principle. In addition, the SIDCO or Subpart C DCO would be required to provide: (1) An executive summary of the key points from the disclosure [responses]; (2) a summary of the major changes since the last update of the disclosure [responses]; (3) a description of the SIDCO or Subpart C DCO and the markets it serves, including basic data and performance statistics on its services and operations; (4) a description of the SIDCO’s or Subpart C DCO’s general organization and governance structure; (5) an overview of the SIDCO’s or Subpart C DCO’s legal and regulatory framework; (6) an explanation of the SIDCO’s or Subpart C DCO’s system design and operation; (6) a list of publicly available resources, including those referenced in the disclosure [responses], that may help a reader understand the SIDCO or Subpart C DCO and its approach to observing each applicable PFMI principle. The narrative disclosure for each principle would be required to provide sufficient detail and context “to enable a variety of readers with different backgrounds to understand the [SIDCO’s or Subpart C DCO’s] approach to observing the principle.” *Id.*

<sup>127</sup> The decision to approve, to deny or to stay an election to become subject to Subpart C may be made by, and the related written notices may be provided by, the Director of the Division of Clearing and Risk pursuant to the authority delegated to him or her under the proposed amendment to regulation 140.94. See *infra* Section II.O.

Subpart C after the effective date would be permitted to do so using the procedures set forth in proposed regulation 39.31(e).<sup>128</sup>

### 3. Regulation 39.31(c): Election and Withdrawal Procedures for DCO Applicants

Proposed regulation 39.31(c) sets forth procedures through which a DCO Applicant may request to become subject to the provisions of Subpart C at the time that the DCO Applicant files its Registration Application. These procedures are intended to provide the Commission with a basis to evaluate the DCO Applicant's ability to comply with the provisions of Subpart C, and ultimately to provide the Commission, potential members and customers (and regulators of such members and customers) with assurance that the DCO Applicant will, once DCO registration has been granted, be held to and will, in fact, meet the standards set forth in Subpart C and in the PFMI's.

The Commission encourages DCO Applicants to make their election to become subject to Subpart C at the time that their Registration Application is filed. The Commission anticipates considerable overlap between the information and documentation contained in a Registration Application filed by a DCO Applicant and the information and documentation that would be required to be submitted to the Commission as part of a Subpart C Election Form. It would appear that simultaneous filings would allow Commission resources to be used more efficiently and effectively.

As proposed, a DCO Applicant requesting an election to become subject to Subpart C would make such request by attaching a Subpart C Election Form to the Form DCO that the DCO Applicant files pursuant to regulation 39.31. The certifications, disclosures, and exhibits that would be required to be provided by a DCO Applicant in the Subpart C Election Form would be the same as those required of registered DCOs,<sup>129</sup> except that the DCO Applicant

would not specify an effective date for its election. Rather, the DCO Applicant would certify that, if the Commission permits its election to become subject to Subpart C to become effective, the DCO Applicant will be in compliance with the Subpart C regulations as of the date set forth in the Commission's notice thereof.

As with Subpart C Election Forms filed by registered DCOs, the filing of a Subpart C Election Form by a DCO Applicant would not create a presumption that the Subpart C Election Form is materially complete or that supplemental information would not be required. Under proposed regulation 39.31(c)(3), the Commission could, at any time during the Commission's review of the Subpart C Election Form, request that the DCO Applicant submit supplemental information in order for the Commission to process the DCO Applicant's Subpart C Election Form or its Registration Application and the DCO Applicant would be required to file such supplemental information. In addition, the DCO Applicant would be required by proposed regulation 39.31(c)(4) to promptly amend its Subpart C Election Form if it discovers a material omission or error in, or if there is a material change in, the information provided to the Commission in the Subpart C Election Form or other information provided in connection with the Subpart C Election Form.<sup>130</sup>

Under proposed regulation 39.31(c)(2), the Commission would review the Subpart C Election Form as part of the Commission's review of the DCO Applicant's Registration Application and the Commission, based upon its review and analysis of the information submitted in the Subpart C Election Form, could permit the DCO Applicant's election to take effect at the time it approves the Registration Application. The Commission would provide the DCO Applicant written notice of its determination to permit the election to become subject to Subpart C to become effective.<sup>131</sup> The Commission

notes that any Registration Application for which there is a Subpart C Election Form pending would be evaluated against the standards set forth in Subpart C as well as the standards set forth in Subpart A and Subpart B in order for the Commission to approve the Registration Application. That is, the Commission would not approve any such Registration Application if the Commission determines that the DCO Applicant's election to become subject to Subpart C should not become effective because the DCO Applicant has not demonstrated its ability to comply with the requirements of Subpart C. The DCO Applicant would be permitted to withdraw the Subpart C Election Form as set forth in proposed regulation 39.31(c)(5), however, prior to the Commission's taking action on the Registration Application.

Proposed regulation 39.31(c)(5) would permit a DCO Applicant to withdraw a request to become subject to Subpart C by filing with the Commission a notice of the withdrawal. The DCO Applicant could withdraw its Subpart C Election Form without withdrawing its Form DCO.

### 4. Regulation 39.31(d)—Public Information

Proposed regulation 39.31(d) would provide that certain portions of the Subpart C Election Form will be considered public documents that may routinely be made available for public inspection. Such portions include: The Elections and Certifications and Disclosures in the Subpart C Election Form, the rules of the DCO, the regulatory compliance chart, and any other part of the Subpart C Election Form that is not covered by a request for confidential treatment subject to regulation 145.9. This proposal is consistent with the transparent treatment typically afforded materials submitted in connection with applications to become registered with the Commission.<sup>132</sup>

### 5. Regulation 39.31(e)—Rescission

Proposed 39.31(e) would permit a Subpart C DCO to rescind its election to comply with Subpart C by filing a notice of its intent to rescind the election with the Commission. The Commission proposes that DCOs that "opt-in" to Subpart C should be permitted to rescind, subject to certain conditions. These conditions are intended to provide the DCO's members and

<sup>128</sup> See discussion *infra* Section II.C.5.

<sup>129</sup> The DCO Applicant would be required to: (1) Certify that all information contained in its Subpart C Election Form is "true, correct and complete in all material respects;" (2) provide a regulatory compliance chart that separately sets forth, for proposed Subpart C regulations 39.32 through 39.39, citations to the relevant rules, policies and procedures of the DCO Applicant that address each such regulation and a summary of the manner in which the DCO Applicant will comply with each regulation; (c) provide, as separate exhibits to the Subpart C Election Form, any documents that demonstrate the DCO Applicant's compliance with proposed Subpart C regulations 39.32 through 39.36 and 39.39; (d) complete and publish on the DCO Applicant's Web site, the DCO's responses to the

Disclosure Framework and provide the Commission with the URL to specific Web site page where such responses can be found; and (e) if applicable, publish on the DCO Applicant's Web site the DCO Applicant's Quantitative Information Disclosure and provide the Commission the URL to the specific page where such disclosure may be found.

<sup>130</sup> Proposed regulations 39.31(c)(3) and 39.31(c)(4) are consistent with regulations 39.3(a)(2) and 39.3(a)(3) governing DCO application amendments and the submission of supplemental information in connection with a DCO application, respectively. 17 CFR 39.31(a)(2)–(3).

<sup>131</sup> The decision to permit a DCO to become subject to Subpart C may be made by, and notice thereof may be provided by, the Director of the Division of Clearing and Risk, as set forth in

Commission regulation 140.94, as proposed to be amended herein. See discussion *infra* Section II.O.

<sup>132</sup> See, e.g., 17 CFR 39.3(a)(5) (setting forth those portions of DCO Registration Applications that are considered public information).

customers, and the regulators of such members and customers, notice of, and time to take such actions as these entities may deem appropriate in light of, the DCO's decision to rescind its election. As discussed above, the Commission proposes that a SIDCO should be required to comply with the Subpart C provisions unless and until the SIDCO's designation as systemically important is rescinded by the Council.<sup>133</sup>

As proposed, the rescission of a DCO's election to become subject to Subpart C would become effective on the date specified by the Subpart C DCO in its notice of intent to rescind the Subpart C election, except that the rescission could not become effective any earlier than 90 days after the date the notice of intent to rescind is filed with the Commission. This proposed 90-day period is necessary to provide banks and other entities that wish to limit their cleared transactions to clearing solely through a QCCP (*e.g.*, because of the preferential Basel CCP Capital Requirements applicable to exposures to derivatives cleared through a QCCP) sufficient time to transfer their business to another Subpart C DCO or SIDCO. The Subpart C DCO would be required to comply with all of the provisions of Subpart C until such rescission is effective. The Commission also proposes requiring that the notice of intent to rescind include a certification that the Subpart C DCO has complied with and will comply with the notice requirements set forth in proposed regulation 39.31(e)(3).

Proposed regulation 39.31(e)(3)(i) would require a Subpart C DCO that files a notice of intent to rescind to provide periodic notices to each of its clearing members, and to have rules in place requiring each of its clearing members to provide such notices to each of the clearing member's customers. Specifically, a Subpart C DCO would be required to issue the following notices to its clearing members: (1) No later than the filing with the Commission of the notice of its intent to rescind its election to be subject to Subpart C, written notice that the Subpart C DCO intends to file such notice and the date that the rescission is intended to take effect, and (2) on the effective date of the rescission of its election to be subject to Subpart C, written notice that the rescission has become effective. These notices appear necessary to ensure that the Subpart C

DCO's clearing members and customers are afforded sufficient time to consider and react to the implications of the Subpart C DCO's rescission of its election to be subject to Subpart C.

Proposed regulation 39.31(e)(3)(ii) would also require a Subpart C DCO to: (1) No later than the date it files a notice of its intent to rescind its election to be subject to Subpart C, provide notice to the general public of its intent to rescind such election; (2) on the effective date of the rescission of its election to be subject to Subpart C, provide written notice to the general public that the rescission has become effective; and (3) remove all references to its Subpart C DCO (and QCCP) status on its Web site and in all other materials that it provides to its clearing members and customers, other market participants, or members of the public. As discussed herein, because of the potential capital impact of transacting through a clearinghouse that is not a QCCP, these public notices would appear necessary to ensure that market participants are afforded sufficient time to consider and react to a Subpart C DCO's rescission of its election to be subject to Subpart C. However, the Commission proposes that the notices to the general public required by this subsection may be accomplished through publication on the Subpart C DCO's Web site.

In addition, the employees and representatives of the Subpart C DCO would be prohibited by proposed regulation 39.31(e)(3)(iii) from making any reference to the organization as a Subpart C DCO (or QCCP) on and after the date that the notice of its intent to rescind its election to become subject to Subpart C is filed. Because the QCCP recognition that accompanies Subpart C DCO status provides significant benefits to those transacting through a Subpart C DCO, it would be inappropriate and misleading to permit a DCO to hold itself out as a Subpart C DCO (or QCCP) once it has filed a notice of intention to rescind that status, even though the rescission is not immediately effective.

Proposed regulation 39.31(e)(4) provides that the rescission of a DCO's election to be subject to Subpart C would not affect the authority of the Commission concerning any activities or events occurring during the time that the DCO maintained its status as a Subpart C DCO. That is, the Subpart C DCO is continually obligated to, and would be subject to enforcement action for failure to, comply with the Subpart C provisions during the time that it was subject to Subpart C and maintained its Subpart C DCO status.

Proposed regulation 39.31(f) would provide that a SIDCO that is registered

with the Commission, but whose designation of systemic importance is rescinded by the Council, shall immediately be deemed to be a Subpart C DCO. Such Subpart C DCO would be subject to the Subpart C provisions unless and until it elects to rescind its status as a Subpart C DCO.

The Commission requests comment on all aspects of proposed regulation 39.31 including, without limitation, the following:

(1) All aspects of the proposed Subpart C election eligibility requirements including, without limitation, the appropriateness of permitting DCO Applicants to request to become subject to Subpart C at the time of filing their Registration Applications. If DCO Applicants should not be permitted to request to become subject to Subpart C at the time of filing their Registration Applications, what would be the basis for such prohibition and what would be a suitable waiting period after registration with the Commission for making a Subpart C Election Form filing?

(2) All aspects of the proposed Subpart C Election Form including, without limitation, the following:

(a) The elections and certifications contained therein and the disclosures and exhibits required;

(b) whether DCOs and DCO Applicants should be permitted to amend or supplement their Subpart C Election Form; and

(c) possible incentives to encourage DCOs and DCO Applicants to file Subpart C Election Forms that are accurate and complete at the time of filing, in order to avoid amendments, supplements and withdrawals.

(3) Whether the Commission should require the Subpart C Election Form certifications to be made under penalty of perjury.

(4) All aspects of the proposed election and withdrawal procedures applicable to DCOs including, without limitation, the following:

(a) The appropriateness of permitting a DCO to designate the effective date of its status as a Subpart C DCO that is subject to the provisions of Subpart C;

(b) The appropriateness of the ten-business-day waiting period prior to a DCO's status as a Subpart C DCO becoming effective, any suggested alternative time frame, and the reasons why such alternatives would be preferable; and

(c) The circumstances under which it would be appropriate for the Commission to provide written acknowledgement of receipt of the Subpart C Election Form and/or the effective date of the DCO's Subpart C

<sup>133</sup> See 12 CFR 1320.13(b) (procedure for the Council to rescind a designation of systemic importance for a systemically important financial market utility).

DCO status, and the form of such acknowledgment.

(5) All aspects of the proposed election and withdrawal procedures applicable to DCO Applicants including, without limitation, the following:

(a) The prohibition against approving a Registration Application if a related Subpart C Election Form is pending and the Commission has determined that the DCO Applicant's request to become subject to Subpart C should not take effect;

(b) The circumstances under which it may be appropriate for the Commission to approve a Registration Application, but to stay or deny an election to become subject to Subpart C;

(c) If the Commission were to approve a Registration Application, but deny an election to become subject to Subpart C, whether the DCO Applicant should be required to wait a particular amount of time (and if so, what amount of time would be appropriate) before being permitted to elect to become subject to Subpart C pursuant to proposed 39.31(b);

(d) If an election to become subject to Subpart C could be stayed when a Registration Application is approved, whether the stay should be limited to a particular time period (and if so, what time period) after which the election must be permitted to take effect or be denied; and

(e) Any incentives, including but not limited to any waiting period after registration for eligibility to elect to become a Subpart C DCO, to encourage DCO Applicants to submit their Subpart C Election Form with their Registration Applications.

(6) The circumstances under which a DCO or DCO Applicant should be permitted to withdraw its Subpart C Election Form.

(7) All aspects of the proposed procedures for rescinding an election to become subject to Subpart C including, without limitation, the following:

(a) The information that must be contained with the notice of intent to rescind;

(b) The benefits and burden of the mandatory 90-day waiting period between the filing of the notice of intent to rescind and the date the rescission is effective;

(c) The timing, content and methods, and the costs and benefits, of providing the required notices to clearing members, the customers of clearing members, and the general public;

(d) The requirement to remove and refrain from references to the DCO as a Subpart C DCO (and QCCP) and the timing thereof;

(e) The burden of a Subpart C DCO's rescission on bank clearing members and the bank customers of such Subpart C DCO's clearing members, including the costs associated with unwinding and/or transferring positions; and

(f) Whether any alternative or additional conditions should be required of a Subpart C DCO beyond the proposed 90-day waiting period (and if so what alternative or additional conditions would be appropriate). For example, is 90 days sufficient time for clearing members and their customers to take such action as they may deem appropriate in light of such rescission?

(8) Any alternative approach to permitting a DCO or DCO Applicant to elect to become subject to Subpart C.

(9) The provision that a SIDCO whose status as a designated financial market utility is rescinded by the Financial Stability Oversight Council, be immediately deemed to be a Subpart C DCO, pending an election by the former SIDCO to rescind Subpart C DCO status.

(10) What additional disclosures should the Commission require or what other measures should the Commission take to help ensure that Subpart C DCOs obtain QCCP status?

(11) The costs and potential benefits resulting from or arising out of, permitting a DCO to elect to become subject to the provisions of Subpart C, any aspect of the procedures for allowing such election under proposed regulation 39.31, and any aspect of any suggested alternative procedures.

For each comment submitted, the Commission requests that each commenter please provide detailed rationale supporting the response, as well as quantitative data where practicable, particularly with respect to estimates of costs and benefits.

#### *D. Regulation 39.32 (Governance for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)*

The Commission proposes to add regulation 39.32 in order to implement DCO Core Principles O (Governance Fitness Standards), P (Conflicts of Interest), and Q (Composition of Governing Boards) for SIDCOs and Subpart C DCOs in a manner that is consistent with PFMI Principle 2 (Governance).<sup>134</sup>

<sup>134</sup> In 2010 and 2011, the Commission proposed regulations concerning the governance of DCOs (the "2010/2011 Proposals"). See Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 FR 63732 (Oct. 18, 2010); see also Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and

As discussed above, DCO Core Principle O states that each DCO must establish governance arrangements that are transparent to fulfill public interest requirements and to permit the consideration of the views of owners and participants.<sup>135</sup> DCO Core Principle O also requires each DCO to establish and enforce appropriate fitness standards for (i) directors, (ii) members of any disciplinary committee, (iii) members of the DCO, (iv) any other individual or entity with direct access to the settlement or clearing activities of the DCO, and (v) any party affiliated with any entity mentioned in (i)–(v) above. In addition, DCO Core Principle P requires each DCO to establish and enforce rules to minimize conflicts of interest in the decision making process of the DCO, and DCO Core Principle Q states that each DCO must ensure that the composition of the governing board or committee of the DCO includes market participants. These core principles are substantively similar to PFMI Principle 2, which states that a CCP "should have governance arrangements that are clear and transparent, promote the safety and efficiency of [the CCP], and support the stability of the broader financial system, other relevant public interest considerations, and the objectives of relevant stakeholders." Additionally, under PFMI Principle 2, a CCP should have procedures for managing conflicts of interest among board members and board members and managers should be required have "appropriate skills," "incentives," and "experience."<sup>136</sup>

The governance requirements set forth in proposed regulation 39.32 are designed to enhance risk management and controls by promoting fitness standards for directors and managers, promoting transparency of governance arrangements, and making sure that the interests of a SIDCO's or Subpart C DCO's clearing members and, where relevant, customers are taken into account. Because of the potential impact that a SIDCO's failure could have on the U.S. financial markets, the Commission is proposing these requirements for SIDCOs. Moreover, it would be beneficial to Subpart C DCOs, their members and customers, and the financial system generally to apply these standards to Subpart C DCOs.

Swap Execution Facilities, 76 FR 722 (Jan. 8, 2011). The Commission notes that the regulations contained in the 2010/2011 Proposals are the subject of a separate rulemaking and, as such, the Commission does not intend to address or include those regulations in this rulemaking.

<sup>135</sup> See *supra* Section I.D.6.

<sup>136</sup> PFMIs at Principle 2, K.C. 4–5.

Specifically, subsection (a) (General rules) would require a SIDCO or Subpart C DCO to establish governance arrangements that: (1) Are written, clear and transparent, place a high priority on the safety and efficiency of the SIDCO or Subpart C DCO, and explicitly support the stability of the broader financial system and other relevant public interest considerations; (2) ensure that the design, rules, overall strategy, and major decisions of the SIDCO or Subpart C DCO appropriately reflect the legitimate interests of clearing members, customers of clearing members, and other relevant stakeholders; and (3) disclose, to an extent consistent with other statutory and regulatory requirements on confidentiality and disclosure: (i) Major decisions of the board of directors to clearing members, other relevant stakeholders, and to the Commission, and (ii) major decisions of the board of directors having a broad market impact to the public.<sup>137</sup>

Subsection (b) (Governance arrangements) would require the rules and procedures of a SIDCO or Subpart C DCO to: (1) Describe the SIDCO's or Subpart C DCO's management structure; (2) clearly specify the roles and responsibilities of the board of directors and its committees, including the establishment of a clear and documented risk management framework; (3) clearly specify the roles and responsibilities of management; (4) establish procedures for managing conflicts of interest among board members; and (5) assign responsibility and accountability for risk decisions and for implementing rules concerning default, recovery, and wind-down.

Subsection (c) (Fitness standards for the board of directors and management) would require that board members and managers have the appropriate experience, skills, incentives and integrity; risk management and internal control personnel have sufficient independence, authority, resources and access to the board of directors; and that the board of directors include members who are not executives, officers or employees of the SIDCO or Subpart C DCO or of their affiliates.

The Commission requests comment on all aspects of these proposals. The Commission is particularly interested in the following: In light of the potential impact that a SIDCO's failure could have on the U.S. financial system, would compliance with proposed

regulation 39.32 reduce systemic risks? Would applying proposed regulation 39.32 to SIDCOs and to Subpart C DCOs contribute to the goals articulated in the Dodd-Frank Act, particularly the goals of Titles VII and VIII of the Dodd-Frank Act? If so, in what ways? If not, why not? What alternatives, if any, to proposed regulation 39.32 would be more effective in reducing systemic risk or accomplishing the goals articulated in the Dodd-Frank Act? Is proposed regulation 39.32 consistent with the PFMI's? If not, what changes need to be made to achieve such consistency? What alternatives to proposed regulation 39.32, if any, would be more effective or efficient for achieving consistency with the standards set forth by the PFMI's? Can proposed regulation 39.32 be effectively implemented and complied with? If not, what changes can be made to permit effective implementation and compliance? What are the potential benefits and costs resulting from, or arising out of, requiring SIDCOs to comply with regulation 39.32? The Commission also requests comment on the potential costs and benefits resulting from, or arising out of, requiring Subpart C DCOs to comply with regulation 39.32. In considering costs and benefits, commenters are requested to address the effect of the proposed regulation not only on a DCO, but also on the DCO's clearing members, the customers of clearing members, and the financial system more broadly. The Commission requests that, where possible, commenters provide quantitative data in their comments, particularly with respect to estimates of costs and benefits. The Commission requests that commenters include a detailed description of any alternatives to proposed regulation 39.32 and estimates of the costs and benefits of such alternatives.

*E. Regulation 39.33 (Financial Resources Requirements for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)*

In 2013, the Commission finalized financial resource requirements for SIDCOs in a manner that parallels the financial resources standard in Principle 4 of the PFMI's.<sup>138</sup> Regulation 39.29 requires a SIDCO that is systemically important in multiple jurisdictions, or that is involved in activities with a more complex risk profile, to meet a Cover Two requirement, *i.e.* financial resources sufficient to enable it to meet its financial obligations to its clearing

members notwithstanding a default by the two clearing members creating the largest combined financial exposure in extreme but plausible market conditions. Moreover, where a clearing member controls another clearing member or is under common control with another clearing member, regulation 39.29 also requires SIDCOs to treat affiliated clearing members as a single clearing member for the purposes of the Cover Two requirement. In addition, regulation 39.29 prohibits a SIDCO from using assessments as a financial resource to meet this Cover Two standard.

The Commission proposes to further amend regulation 39.29 to enhance financial resources requirements for SIDCOs and Subpart C DCOs and to achieve consistency with the relevant provisions of the PFMI's, in particular Principle 4 and Principle 7.

The Commission first proposes to renumber existing regulation 39.29 to 39.33 and to apply the requirements set forth therein to Subpart C DCOs. The Commission further proposes, for purposes of organization, deleting from paragraph (a)(1) the requirement that, where a clearing member controls another clearing member or is under common control with another clearing member, a SIDCO treat affiliated clearing members as a single clearing member (the "Clearing Member Aggregation Requirement"). The Commission proposes to include such language in new paragraph (a)(4) to clarify that the Clearing Member Aggregation Requirement applies when a SIDCO or Subpart C DCO calculates its financial resources requirements under regulation 39.33(a) as well as its liquidity resources requirements under regulation 39.33(c).

The Commission also proposes amending paragraph (a) to state that the Commission shall, if it deems appropriate, determine whether a SIDCO or Subpart C DCO is systemically important in multiple jurisdictions. In making this determination, the Commission would, in order to limit such determinations to appropriate cases, review whether another jurisdiction had determined the SIDCO or Subpart C DCO to be systemically important according to a designations process that considers whether the foreseeable effects of a failure or disruption of the derivatives clearing organization could threaten the stability of each relevant jurisdiction's financial system. In addition, the Commission proposes amending paragraph (a) to state that the Commission shall also determine, if it deems appropriate, whether any of the activities of a SIDCO

<sup>137</sup> The provisions concerning transparency describe which information, including the identities of board members, should be disclosed to the public and/or the Commission.

<sup>138</sup> See SIDCO Final Rule.



or Subpart C DCO, in addition to clearing credit default swaps, credit default futures, and any derivatives that reference either, has a more complex risk profile and may take into consideration characteristics such as non-linear and discrete jump-to-default price changes.<sup>139</sup> In addition and in light of the proposed liquidity provisions discussed below, the Commission proposes a technical clarification to paragraph (a)(1) to make clear that such a SIDCO or Subpart C DCO must meet its “credit exposure” (rather than “financial obligations”) to its clearing members notwithstanding a default by the two clearing members creating the largest “aggregate credit” (rather than “combined financial”) exposure in extreme but plausible market conditions. The Commission also proposes amending paragraph (b) to clarify that the prohibition on including assessments as a financial resource applies to calculating financial resources needed to cover the default of the largest and, where applicable, second largest clearing member, in extreme but plausible circumstances.<sup>140</sup>

The Commission proposes adding paragraphs (c), (d), and (e) to address the liquidity of SIDCOs’ and Subpart C DCOs’ financial resources. These new paragraphs are intended to address the gaps between current part 39 requirements and standards set forth in Principle 7.<sup>141</sup>

<sup>139</sup> The Commission’s proposed amendment to regulation 140.94(a) would delegate the authority to make these determinations to the Director of the Division of Clearing and Risk.

<sup>140</sup> The preamble to the SIDCO Final Rule adopting release made clear that paragraph (b) applied to both Cover One and Cover Two, but the Commission has decided to add clarifying language to the regulation text. See generally SIDCO Final Rule.

<sup>141</sup> As discussed above in Section I.E.6, Principle 7, K.C. 2 requires a CCP to measure, monitor, and manage liquidity risk effectively. This includes the CCP maintaining sufficient liquid resources in all relevant currencies in order to effect same-day and, where applicable, intraday and multiday settlement of payment obligations in a wide range of potential stress scenarios, including the default of the participant that would create the largest aggregate payment obligations in extreme but plausible market conditions. In addition, Principle 7, K. C. 5 limits a CCP to counting only certain qualifying liquid resources for the purpose of meeting its financial resources requirement. These resources include: Cash in the currency of the requisite obligations, held either at the central bank of issue or at a creditworthy commercial bank; committed lines of credit; or high quality, liquid, general obligations of a sovereign nation. In addition, Principle 7, K. C. 4 states that a CCP that is systemically important in multiple jurisdictions or that is involved in activities with a more complex risk profile should consider maintaining sufficient qualifying liquid resources to meet the default of the two participants that would create the largest aggregate payment obligations in such circumstances. Principle 7, K. C. 7 also requires a CCP to monitor its liquidity providers, including

Proposed paragraph (c)(1) would require a SIDCO or Subpart C DCO to maintain eligible liquidity resources that will enable the SIDCO or Subpart C DCO to meet its intraday, same-day, and multiday settlement obligations, as defined in regulation 39.14(a), with a high degree of confidence under a wide range of stress scenarios, including the default of the member creating the largest liquidity requirements under extreme but plausible circumstances. Maintaining resources that enable the DCO to meet these obligations will help prevent a SIDCO or Subpart C DCO from defaulting on its obligations to non-defaulting clearing members, which is particularly important for a SIDCO because of the potential impact that the failure of a SIDCO could have on the U.S. financial markets.

Proposed paragraph (c)(2) would require a SIDCO or Subpart C DCO to maintain liquidity resources that are sufficient to satisfy the obligations required by new paragraph (c)(1) in all relevant currencies for which the SIDCO or Subpart C DCO has settlement obligations to its clearing members. A SIDCO should be able promptly to meet its obligations in each relevant currency. If a SIDCO has sufficient funds to meet an obligation, but the funds are not in the correct currency, then the SIDCO cannot meet that obligation in a timely manner, which could lead to a disruption of the SIDCO’s services. Such disruption could, in turn, have a significant impact on the financial stability of the U.S. economy.

Proposed paragraph (c)(3) would limit a SIDCO or Subpart C DCO to using only certain types of liquidity resources to satisfy the minimum liquidity requirement set forth in proposed paragraph (c)(1).<sup>142</sup> Among these “qualifying liquidity resources” are “committed lines of credit,” “committed foreign exchange swaps,” and “committed repurchase agreements.” “Committed” is intended to connote a legally binding contract under which a liquidity provider agrees to provide the relevant liquidity resource without delay or further evaluation of the DCO’s

clearing members, by undertaking due diligence to confirm that they have sufficient information to understand and manage their liquidity risks and have the capacity to perform as required under their commitments to the CCP.

<sup>142</sup> In determining whether the liquidity resources that are eligible under paragraph (c)(3) are sufficient to meet the obligation specified under paragraph (c)(1) (resources that “enable” the DCO to meet its settlement obligations), it is important to avoid double counting. For example, one may not count both a committed repurchase arrangement and U.S. Treasury Bills that would be used to collateralize that arrangement.

creditworthiness, *e.g.*, a line of credit that cannot be withdrawn at the election of the liquidity provider during times of financial stress, or in the event of the default of a member of the SIDCO or Subpart C DCO.<sup>143</sup> The proposed list of these resources is consistent with those set forth in Principle 7. Also consistent with Principle 7, proposed paragraph (c)(1)(ii) would require a SIDCO or Subpart C DCO that is systemically important in multiple jurisdictions, or that is involved in activities with a more complex risk profile, to consider maintaining eligible liquidity resources that, at a minimum, will enable it to meet its intraday, same-day, and multiday settlement obligations, stress scenarios that include a default of the two clearing members creating the largest aggregate liquidity obligation for the DCO in extreme but plausible market conditions. The financial integrity of a SIDCOs and or Subpart C DCOs might be enhanced if it considers meeting this enhanced standard.

Under proposed paragraph (c)(3)(ii), a SIDCO or Subpart C DCO would be required to take appropriate steps to verify that its qualifying liquidity arrangements do not include material adverse change provisions and are enforceable, and will be highly reliable, even in extreme but plausible market conditions. This requirement is consistent with Principle 7.

Also consistent with Principle 7, under proposed paragraph (c)(4), if a SIDCO or Subpart C DCO maintains liquid financial resources in addition to those required to satisfy the Cover One requirement, then those resources should be in the form of assets that are likely to be saleable with proceeds available promptly or acceptable as collateral for lines of credit, swaps, or repurchase agreements on an *ad hoc* basis. In addition, Principle 7 provides and proposed paragraph 39.33(c)(4) requires that a SIDCO or Subpart C DCO should consider maintaining collateral with low credit, liquidity, and market risks that is typically accepted by a central bank of issue for any currency in which it may have settlement obligations, but shall not assume the availability of emergency central bank credit as a part of its liquidity plan.<sup>144</sup>

<sup>143</sup> Times of financial stress, and the event of the default of a member of the DCO are, of course, the times when reliable liquidity arrangements are most needed.

<sup>144</sup> It should be noted that the requirement of proposed paragraph (c)(4) that a SIDCO or Subpart C DCO consider maintaining certain types of collateral, like the requirement of proposed paragraph (c)(1)(ii), does not include a requirement as to the decision to be made following such consideration.

These provisions are designed to enhance the financial condition of SIDCOs and Subpart C DCOs and help reinforce stability.<sup>145</sup>

Pursuant to proposed paragraphs (d)(1)–(2), a SIDCO or Subpart C DCO would be required to monitor its liquidity providers in a manner consistent with Principle 7. Proposed paragraph (d)(1) would define “liquidity provider” to mean any of the following: (i) A depository institution, a U.S. branch and agency of a foreign banking organization, a trust company, or a syndicate of depository institutions, U.S. branches and agencies of foreign banking organizations, or a trust companies providing a line of credit, foreign exchange swap facility or repurchase facility to the SIDCO or Subpart C DCO; and (ii) Any other counterparty relied upon by a SIDCO or Subpart C DCO to meet its minimum liquidity resources requirement under paragraph (c) of this section. Moreover, under proposed paragraph (d)(5), a SIDCO with access to accounts and services at a Federal Reserve Bank is encouraged to use those services, where practical, to enhance its management of liquidity risk.<sup>146</sup> In addition, proposed paragraph (d)(4) would require a SIDCO or Subpart C DCO to regularly test its procedures for accessing its liquidity resources. Finally, pursuant to new subsection (e) and consistent with Principle 4, a SIDCO or Subpart C DCO would be required to document its supporting rationale for, and have appropriate governance arrangements relating to, the amount of total financial resources it maintains pursuant to regulation 39.33(a) and the amount of total liquidity resources it maintains pursuant to regulation 39.33(c).<sup>147</sup>

The Commission requests comment on all aspects of proposed regulation 39.33. The Commission is particularly interested in the following:

<sup>145</sup> See generally Financial Stability Oversight Council 2012 Annual Report, Appendix A at 163 (finding that “the contagion effect of a CME failure could impose material financial losses on CME’s clearing members and other market participants (such as customers) and could lead to increased liquidity demands and credit problems across financial institutions, especially those that are active in the futures and options markets.”).

<sup>146</sup> Under Section 806(a) of the Dodd-Frank Act, 12 U.S.C. 5465(a), the Board may authorize a Federal Reserve Bank to establish and maintain an account for an FMU, which, as described above in Section I.B., includes a SIDCO. A SIDCO with access to accounts and services at a Federal Reserve Bank would be required to comply with related rules published by the Board of Governors of the Federal Reserve System. See generally Financial Market Utilities, 78 FR 14024 (Mar. 4, 2013) (proposal by the Board of rules to govern accounts held by designated FMUs).

<sup>147</sup> This provision is consistent with PFMI Principle 4, K.C. 4.

Are the proposed considerations in paragraph (a)(2) for determining whether a DCO is systemically important in multiple jurisdictions and in paragraph (a)(3) for determining whether it is engaged in activities with a more complex risk profile workable? Should alternative considerations be used?

In proposed paragraph (d)(4), should the Commission specify the frequency with which a SIDCO or Subpart C DCO must test its procedures for accessing its liquidity resources? In proposed paragraph (c)(3)(i)(E)(1) and (c)(3)(ii), the Commission permits highly marketable collateral to be used as a liquidity resource provided that such collateral is held in custody and investments that are readily available and convertible into cash with prearranged and highly reliable funding arrangements, even in extreme but plausible market conditions. As such, the Commission proposes to permit as a liquidity resource obligations of the United States Treasury or high quality, liquid, general obligations of a sovereign nation provided that such obligations are readily available and convertible into cash pursuant to prearranged and highly reliable funding arrangements. This is consistent with the language of the PFMI.<sup>148</sup> Should the requirement be for funding arrangements that are committed? The Commission requests comment on whether there are any highly reliable funding arrangements that meet the requirements of the proposed regulations that are not committed funding arrangements.

In addition, in light of the potential impact that a SIDCO’s failure could have on the U.S. financial system, would compliance with proposed regulation 39.33 reduce systemic risks? Would proposed regulation 39.33 contribute to the goals articulated in the Dodd-Frank Act, particularly the goals of Titles VII and VIII of the Dodd-Frank Act? If so, in what ways? If not, why not? What alternatives, if any, to proposed regulation 39.33 would be more effective in reducing systemic risk or accomplishing the goals articulated in the Dodd-Frank Act? Is proposed regulation 39.33 consistent with the PFMI? Are there more effective or efficient means for achieving consistency with the liquidity standards set forth in Principle 7? If not, what changes need to be made to achieve such consistency? What alternatives to proposed regulation 39.33, if any, would be more effective or efficient for achieving consistency with the standards set forth by the PFMI? The

Commission requests that commenters include a detailed description of any such alternatives and estimates of the costs and benefits of such alternatives. Should regulation 39.33 provide that only a SIDCO can be deemed systemically important in multiple jurisdictions? Can proposed regulation 39.33 be effectively implemented and complied with? If not, what changes can be made to permit effective implementation and compliance? What are the potential costs and benefits resulting from, or arising out of, requiring a SIDCO to comply with proposed regulation 39.33? What are the potential costs and benefits resulting from, or arising out of, requiring Subpart C DCOs to comply with proposed regulation 39.33? In considering costs and benefits, commenters are requested to address the effect of the proposed regulation not only on a DCO, but also on the DCO’s clearing members, the customers of clearing members, and the financial system more broadly. The Commission requests that, where possible, commenters provide quantitative data in their comments, particularly with respect to estimates of costs and benefits.

#### *F. Regulation 39.34 (System Safeguards for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)*

In 2013, the Commission finalized regulation 39.30, which enhanced system safeguards requirements for SIDCOs for business continuity and disaster recovery, and included a two-hour recovery time objective (“RTO”) for SIDCOs.<sup>149</sup> As discussed in the adopting release, the two-hour RTO is consistent with Principle 17 of the PFMI and increases the soundness and operating resiliency of the SIDCO, which in turn, increases the overall stability of the U.S. financial markets.<sup>150</sup> The Commission proposes renumbering regulation 39.30 as regulation 39.34 and amending the regulation to cover SIDCOs and Subpart C DCOs as well as a technical correction to paragraph (b) to make clear that subparagraphs (1), (2), and (3) concern each activity necessary for the daily processing, clearing, and settlement of existing and new contracts. Finally, to provide flexibility to address the practical burdens of obtaining the necessary physical and technological resources, and of organizing human resources, as appropriate to implement a two-hour RTO, the Commission proposes amending the regulation to allow the

<sup>149</sup> See SIDCO Final Rule.

<sup>150</sup> *Id.*

<sup>148</sup> See PFMI Principle 7, K.C. 5.

Commission to, upon application, grant newly designated SIDCOs and Subpart C DCOs up to one year to comply with the provisions of regulation 39.34.

The Commission requests comment on all aspects of proposed regulation 39.34. The Commission is particularly interested in the following: Would applying proposed regulation 39.34 to Subpart C DCOs contribute to the goals articulated in the Dodd-Frank Act, particularly the goals of Titles VII and VIII of the Dodd-Frank Act? If so, in what ways? If not, why not? What alternatives, if any, to proposed regulation 39.34 would be more effective in reducing systemic risk or accomplishing the goals articulated in the Dodd-Frank Act? Is proposed regulation 39.34 consistent with the PFMI? If not, what changes need to be made to achieve such consistency? What alternatives to proposed regulation 39.34, if any, would be more effective or efficient for achieving consistency with the standards set forth by the PFMI? The Commission requests that commenters include a detailed description of any such alternatives and estimates of the costs and benefits of such alternatives. Can proposed regulation 39.34 be effectively implemented and complied with? If not, what changes can be made to permit effective implementation and compliance? What are the potential costs and benefits resulting from, or arising out of, requiring a SIDCO to comply with proposed regulation 39.34? What are the potential costs and benefits resulting from, or arising out of, requiring Subpart C DCOs to comply with proposed regulation 39.34? In considering costs and benefits, commenters are requested to address the effect of the proposed regulation not only on a DCO, but also on the DCO's clearing members, the customers of clearing members, and the financial system more broadly. The Commission requests that, where possible, commenters provide quantitative data in their comments, particularly with respect to estimates of costs and benefits.

*G. Regulation 39.35 (Default Rules and Procedures for Uncovered Credit Losses or Liquidity Shortfalls (Recovery) for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)*

The Commission is proposing regulation 39.35, which adds requirements pursuant to DCO Core Principle G, to address certain potential gaps between Commission regulations

and Principles 4 and 7.<sup>151</sup> In particular, proposed regulation 39.35 is designed to protect SIDCOs, Subpart C DCOs, their members and customers, and the financial system more broadly by requiring SIDCOs and Subpart C DCOs to have plans and procedures to address credit losses and liquidity shortfalls beyond their prefunded resources, thus promoting their ability to promptly fulfill their obligations and continue to perform their critical functions.

Regulation 39.16 currently requires a DCO to adopt procedures permitting it to take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a default on the obligations of a clearing member to the DCO.<sup>152</sup> Proposed regulation 39.35 would require SIDCOs and Subpart C DCOs to adopt additional procedures to address certain issues arising from extraordinary stress events, including the default of one or more clearing members. Specifically, consistent with Principle 4 of the PFMI, proposed paragraph (a) would require a SIDCO or Subpart C DCO to adopt rules and procedures addressing the following:

1. How the SIDCO or Subpart C DCO would allocate losses exceeding the financial resources available to the SIDCO or Subpart C DCO;
2. How the SIDCO or Subpart C DCO would arrange for the repayment of any funds the SIDCO or Subpart C DCO may borrow; and
3. How the SIDCO or Subpart C DCO would replenish any financial resources it may employ during such a stress event, so that the SIDCO or Subpart C DCO would be able to continue to operate in a safe and sound manner.

Consistent with Principle 7 of the PFMI, proposed paragraph (b) would require a SIDCO or Subpart C DCO to establish rules and procedures enabling it to promptly meet all of its settlement obligations, on a same day and, where appropriate, on an intraday and multiday basis, in the context of the occurrence of either or both of the following scenarios: (i) Following an individual or combined default involving one or more clearing members' obligations to the SIDCO or

Subpart C DCO or (ii) if there is an unforeseen liquidity shortfall exceeding the financial resources of the SIDCO or Subpart C DCO. Such rules and procedures should be established *ex ante* and may provide for the means of: increasing available assets (e.g. by using assessments) and/or reducing the size of liabilities (e.g. by engaging in variation margin haircuts or tear-ups); as well as obtaining liquidity from participants (e.g. through rules-based repurchase arrangements); employing a sequenced application of such tools; and replenishing any credit and liquidity resources that may be employed during a stress event.

Proposed regulation 39.35 addresses significant consequences that could result from a clearing member's default. Specifically, a DCO might not have sufficient financial resources following a clearing member's default either to cover the default or to fulfill its settlement obligations. Similarly, a DCO may be unable to fulfill its settlement obligations due to a liquidity shortfall exceeding its financial resources. In order to avoid the negative effect on its clearing members, their customers, and on the financial system more broadly of a DCO's failure promptly to meet its settlement obligations, it would be prudent for a DCO to have a recovery plan that addresses these scenarios and, given their importance to the U.S. financial system, it is critical for SIDCOs to have such plans. In addition, because this plan would be specified in the DCO's rules and/or procedures, it would be disclosed to clearing members, their customers, and the broader public. Such transparency would likely help clearing members, their customers, and other market participants properly allocate capital and other resources as well as facilitate the development of their own recovery plans.

The Commission requests comment on all aspects of these proposals. The Commission is particularly interested in the following: In light of the potential impact that a SIDCO's failure could have on the U.S. financial system, would compliance with proposed regulation 39.35 reduce systemic risks? Would proposed regulation 39.35 contribute to the goals articulated in the Dodd-Frank Act, particularly the goals of Titles VII and VIII of the Dodd-Frank Act? If so, in what ways? If not, why not? What alternatives, if any, to proposed regulation 39.35 would be more effective in reducing systemic risk or accomplishing the goals articulated in the Dodd-Frank Act? Is proposed regulation 39.35 consistent with the PFMI? If not, what changes need to be made to achieve such consistency?

<sup>151</sup> DCO Core Principle G requires a DCO to have rules and procedures "designed to allow for the efficient, fair, and safe management of events during which [clearing] members or participants—(I) become insolvent; or (II) otherwise default on the obligations of the members or participants to the [DCO]." Each DCO "is required to (I) clearly state the default procedures on the [DCO]; (II) make publicly available the default rules of the [DCO]; and (III) ensure that the [DCO] may take timely action—(aa) to contain losses and liquidity pressures; and (bb) to continue meeting each obligation of the DCO." See *supra* Section I.D.3.

<sup>152</sup> 17 CFR 39.16(c).

What alternatives to proposed regulation 39.35, if any, would be more effective or efficient for achieving consistency with the standards set forth by the PFMI? Can proposed regulation 39.35 be effectively implemented and complied with? If not, what changes can be made to permit effective implementation and compliance? What are the potential benefits and costs resulting from, or arising out of, requiring SIDCOs to comply with regulation 39.35? The Commission also requests comment on the potential costs and benefits resulting from, or arising out of, requiring Subpart C DCOs to comply with regulation 39.35. In considering costs and benefits, commenters are requested to address the effect of the proposed regulation not only on a DCO, but also on the DCO's clearing members, the customers of clearing members, and the financial system more broadly. The Commission requests that, where possible, commenters provide quantitative data in their comments, particularly with respect to estimates of costs and benefits. The Commission requests that commenters include a detailed description of any alternatives to proposed regulation 39.35 and estimates of the costs and benefits of such alternatives.

#### *H. Regulation 39.36 (Risk Management for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)*

Proposed regulation 39.36 would include additional risk management requirements for SIDCOs and Subpart C DCOs. As noted above, regulation 39.13 establishes the risk management requirements that a DCO would have to meet in order to comply with Core Principle D<sup>153</sup> including, among other things, specific criteria for stress tests that a DCO must conduct.<sup>154</sup> For

example, regulation 39.13(h)(3)(ii) requires a registered DCO to, "on a weekly basis, conduct stress tests with respect to each clearing member account, by house origin and by each customer origin, and each swap portfolio...under extreme but plausible market conditions." However, pursuant to this provision, a DCO has reasonable discretion in determining the methodology used to conduct such stress tests.

The Commission is proposing regulation 39.36 to address certain differences between Commission regulations and Principles 4, 6, 7, and 9.<sup>155</sup> In particular, proposed regulation 39.36 would require a SIDCO or Subpart C DCO to enhance its stress testing procedures in ways that will make it more likely that the SIDCO or Subpart C DCO will be able to understand the risks posed by its members, so that it can ensure that the relationship between its resources and obligations enables it to meet its obligations promptly.

Specifically, and consistent with Principle 4, proposed regulation 39.36(a)(1) would require a SIDCO or Subpart C DCO to perform stress testing, on a daily basis, of its financial resources using predetermined parameters and assumptions. In addition, proposed regulation 39.36(a)(2) would require a SIDCO or Subpart C DCO to perform comprehensive analyses of stress testing scenarios and underlying parameters to ascertain that they are appropriate for determining the SIDCO's or Subpart C DCO's required level of financial resources in current and evolving market conditions. Proposed regulation 39.36(a)(3) would also require a SIDCO or Subpart C DCO to perform the analyses in proposed regulation 39.36(a)(2) "at least monthly when products cleared or markets served display high volatility, become less liquid, or when the size or concentration of positions held by clearing members increases significantly." A SIDCO or Subpart C DCO would also be required to "evaluate [its] stress testing scenarios, models, and underlying parameters more frequently than once a month," where appropriate. For purposes of the analyses in proposed regulation 39.36(a)(1) and proposed regulation 39.36(a)(2), proposed regulation 39.36(a)(4) would require a SIDCO or Subpart C DCO to include the following stress scenarios for both defaulting clearing members' positions and possible price changes in liquidation

periods: (i) Relevant peak historic price volatilities; (ii) shifts in other market factors including, as appropriate, price determinants and yield curves; (iii) multiple defaults over various time horizons; (iv) simultaneous pressures in funding and asset markets; and (v) a range of forward-looking stress scenarios in a variety of extreme but plausible market conditions. Moreover, proposed regulation 39.36(a)(5) would require each SIDCO and Subpart C DCO to establish procedures for reporting stress test results to its risk management committee or board of directors, as appropriate, and for using the results to assess the adequacy of, and to adjust the SIDCO's or Subpart C DCO's total financial resources. Finally, proposed regulation 39.36(a)(6) would require each SIDCO and Subpart C DCO to use the results of its financial resources stress testing to help make sure it meets the minimum financial resources requirement set forth in proposed regulation 39.33(a).

In addition, and consistent with Principle 7, the Commission is proposing stress testing requirements for liquidity resources that are analogous to the stress testing requirements for financial resources in proposed regulation 39.36(a), with the exception that the stress testing scenarios required by proposed regulation 39.36(c)(5) should consider the following: (i) All entities that might pose material liquidity risks to the DCO, including settlement banks, permitted depositories, liquidity providers, and other entities; (ii) intraday and multiday scenarios, where appropriate; (iii) interlinkages between its clearing members and the multiple roles that they may play in the SIDCO's or Subpart C DCO's risk management (e.g., scenarios where a clearing member or its affiliate is also a liquidity provider); and (iv) the probability of multiple failures and contagion effect among clearing members.

Proposed regulation 39.36(c)(7) would require a SIDCO or Subpart C DCO to use the results of such stress tests to make certain that it meets the financial resources requirement set forth in regulation 39.33(a), and the liquidity resources requirements set forth in regulation 39.33(c). In addition, each SIDCO and Subpart C DCO would be required to perform, on an annual basis, a full validation of its financial risk management model and its liquid risk management model.

Proposed paragraphs (a), (c), (d), and (e) are important because stress testing scenarios, underlying risk factors that constitute such scenarios, and the relationship between different risk

<sup>153</sup> DCO Core Principle D requires each DCO to possess the ability to manage the risks associated with discharging the responsibilities of the DCO through the use of appropriate tools and procedures. It further requires each DCO to measure its credit exposures to each clearing member not less than once during each business day and to monitor each such exposure periodically during the business day. Core Principle D also requires each DCO to limit its exposure to potential losses from defaults by clearing members, through margin requirements and other risk control mechanisms, to reduce the risk that its operations would not be disrupted and that non-defaulting clearing members would not be exposed to losses that non-defaulting clearing members cannot anticipate or control. Finally, Core Principle D requires that the margin that the DCO requires from each clearing member be sufficient to cover potential exposures in normal market conditions, and that each model and parameter used in setting such margin requirements be risk-based and reviewed on a regular basis.

<sup>154</sup> See *supra* Section I.D.2.

<sup>155</sup> See discussion of Principles 4 and 6 *supra* Sections I.E.4, I.E.5.

factors are dynamic, and need to be updated due to changing market conditions. For example, use of relative, instead of absolute, changes in interest rates may be sufficient in a normal interest rate environment, but can lead to nonsensical estimates during low rate periods. In other words, changes in a particular risk factor during unusually volatile periods may be more extreme than any in the existing scenarios. In addition, it is important for SIDCOs and Subpart C DCOs to stress test both their financial resources and liquidity resources. While stress testing financial resources helps SIDCOs and Subpart C DCOs make sure they have the right amount, SIDCOs and Subpart C DCOs need access to liquid assets subject to arrangements in which they can promptly be convertible to cash to fulfill their obligations in a timely manner. As such, stress testing liquidity resources is a critical exercise for SIDCOs and Subpart C DCOs as such testing will help ensure that SIDCOs and Subpart C DCOs have enough resources to cover their obligations at the time and on the day that such obligations are due. Moreover, given the significant role SIDCOs play in the U.S. financial markets, it would appear that obtaining an in-depth understanding of potential liquidity needs through comprehensive stress testing under a broad range of scenarios is critical for a SIDCO's effective risk management.

As noted above, Principle 6 requires a CCP's margin system to take into account the "risks and particular attributes of each product, portfolio and market that it serves" and be calibrated accordingly.<sup>156</sup> In particular, Principle 6 requires a CCP to conduct a "sensitivity analysis" of its margin system at least monthly, and, more frequently, when appropriate. Accordingly, consistent with the standards set forth in Principle 6, paragraph (c) of proposed regulation 39.36 would require a SIDCO or Subpart C DCO to conduct a sensitivity analysis of its margin model at least monthly to analyze and monitor model performance and overall margin coverage. Moreover, paragraph (c) would require the sensitivity analysis to involve reviewing a wide range of parameter settings and assumptions that reflect possible market conditions in order to understand how the level of margin coverage might be affected by highly stressed market conditions. The parameters and assumptions used by a SIDCO or Subpart C DCO would be expected to capture a variety of historical and hypothetical conditions, including the most volatile periods that have been

experienced by the markets served by the SIDCO or Subpart C DCO and extreme changes in the correlations between prices. In addition, the sensitivity analysis would be conducted on both actual and hypothetical positions, and would include testing of the abilities of the models or model components to produce accurate results using actual or hypothetical datasets and assessing the impact of different model parameter settings. The SIDCO or Subpart C DCO would also be required to evaluate potential losses in clearing members' proprietary positions and, where appropriate, customer positions. With respect to SIDCOs and Subpart C DCOs that are involved in activities with a more complex risk profile, the Commission proposes requiring such SIDCOs and Subpart C DCOs to take into consideration parameter settings that reflect the potential impact of the simultaneous default of two clearing members and consider the underlying credit instruments.<sup>157</sup> Proposed regulation 39.36(d) would require a SIDCO or Subpart C DCO regularly to conduct an assessment of the theoretical and empirical properties of its margin model for all products it clears, and proposed regulation 39.36(e) would require a SIDCO or Subpart C DCO to perform, on an annual basis, a full validation of its financial risk management model and its liquid risk management model. Moreover, under proposed paragraph (f), and consistent with Principle 16, custody and investment arrangements for a systemically important derivatives clearing organization's and subpart C derivatives clearing organization's own funds and assets would be subject to the same requirements as those specified in § 39.15 of this chapter for funds and assets of clearing members. This includes establishing standards and procedures that are designed to protect and ensure safety as specified in § 39.15(a), custody arrangements that minimize the risk of loss or of delay in access by the DCO as specified in § 39.15(c), and limitation of investments to instruments with minimal credit, market, and liquidity risks as specified in § 39.15(e).

It is vitally important that all DCOs obtain an in-depth understanding of their exposure to credit risk. As financial derivatives markets expand globally and counterparty credit risk increases in size and complexity, a DCO's ability to assess its exposure to

credit risk becomes even more critical. These proposed regulations are intended to enhance the ability of SIDCOs and Subpart C DCOs to manage their risk exposure. Because a SIDCO plays a significant role in the financial markets, accurate and dynamic risk management is critical not only to the SIDCO, but also to the stability of the broader U.S. financial system.

Under proposed paragraph (g), and consistent with Principle 9, a SIDCO or Subpart C DCO would be required to monitor, manage, and limit its credit and liquidity risks arising from its settlement banks.<sup>158</sup> Specifically, a SIDCO or Subpart C DCO would be required to establish, and monitor adherence to, strict criteria for its settlement banks that take account of, among other things, their regulation and supervision, creditworthiness, capitalization, access to liquidity, and operational reliability. In addition, a SIDCO or Subpart C DCO would be required to monitor and manage the concentration of credit and liquidity exposures to its settlement banks. In order to mitigate both the probability of being exposed to a settlement bank's failure and the potential losses and liquidity pressures to which it would be exposed in the event of such a failure, each SIDCO and Subpart C DCO should, where reasonable and practicable, use multiple settlement banks instead of one and consider using different settlement banks for different functions, such as depositing funds, investing funds or holding liquidity resources.<sup>159</sup>

The Commission requests comment on all aspects of proposed regulation 39.36. The Commission is particularly interested in the following: In light of the potential impact that a SIDCO's failure could have on the U.S. financial system, would compliance with proposed regulation 39.36 reduce systemic risks? Would proposed regulation 39.36 contribute to the goals articulated in the Dodd-Frank Act, particularly the goals of Titles VII and VIII of the Dodd-Frank Act? If so, in what ways? If not, why not? What alternatives, if any, to proposed regulation 39.36 would be more effective in reducing systemic risk or accomplishing the goals articulated in the Dodd-Frank Act? Is proposed regulation 39.36 consistent with the PFMLs? If not, what changes need to be made to achieve such consistency? What alternatives to proposed

<sup>158</sup> See discussion of Principle 9 *supra* Section I.E.7.

<sup>159</sup> See PFMLs at E.N. 3.9.5, 3.9.6. These issues could be avoided by a SIDCO to the extent it uses Federal Reserve Bank accounts and services pursuant to proposed regulation 39.33(d)(5).

<sup>156</sup> See *supra* Section I.E.5.

<sup>157</sup> See *supra* Section I.E. (discussing "Cover Two" in connection with revised regulation 39.33 (financial resources)). See generally PFMLs at E.N. 3.6.17.

regulation 39.36, if any, would be more effective or efficient for achieving consistency with the standards set forth by the PFMI's? Can proposed regulation 39.36 be effectively implemented and complied with? If not, what changes can be made to permit effective implementation and compliance? What are the potential benefits and costs resulting from, or arising out of, requiring SIDCOs to comply with regulation 39.36? The Commission also requests comment on the potential costs and benefits resulting from, or arising out of, requiring Subpart C DCOs to comply with regulation 39.36. In considering costs and benefits, commenters are requested to address the effect of the proposed regulation not only on a DCO, but also on the DCO's clearing members, the customers of clearing members, and the financial system more broadly. The Commission requests that, where possible, commenters provide quantitative data in their comments, particularly with respect to estimates of costs and benefits. The Commission requests that commenters include a detailed description of any alternatives to proposed regulation 39.36 and estimates of the costs and benefits of such alternatives.

*I. Regulation 39.37 (Additional Disclosure for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)*

The Commission is proposing regulation 39.37 to set forth additional public disclosure requirements for SIDCOs and Subpart C DCOs.<sup>160</sup> These requirements are intended to address differences between current requirements and PFMI Principles 14 and 23. In particular, proposed regulation 39.37 is designed to enable members of SIDCOs and Subpart C DCOs, their customers, and the general public to understand the risk of exposures to such DCOs, and to promote their ability to evaluate the quality of such DCOs, thereby enhancing competition and market discipline.

Specifically, proposed regulation 39.37 would require SIDCOs and Subpart C DCOs to disclose certain information to the public and to the Commission. First, consistent with Principle 23, a SIDCO or Subpart C DCO

would be required to disclose its responses to the CPSS-IOSCO Disclosure Framework, discussed in section II.C.2, above. Further, a SIDCO or Subpart C DCO would be required to review and update at least every two years and following material changes to the SIDCO's or Subpart C DCO's system or its environment, its responses to the Disclosure Framework to ensure the continued accuracy and usefulness of the responses.<sup>161</sup> A material change to the SIDCO's or Subpart C DCO's system or environment is a change that would significantly change the accuracy and usefulness of the SIDCO's or Subpart C DCO's existing responses. Proposed regulation 39.37 would also require a SIDCO or Subpart C DCO to disclose, publicly and to the Commission, relevant basic data on transaction volume and values. This requirement is intended to be consistent with the Quantitative Information Disclosure that CPSS-IOSCO are in the process of developing.<sup>162</sup>

Also under proposed regulation 39.37, a SIDCO or Subpart C DCO would be required, consistent with Principle 14, to publish its rules, policies, and procedures describing whether customer funds are protected on an individual or omnibus basis and whether customer funds are subject to any legal or operational constraints that may impair the ability of the SIDCO or Subpart C DCO to segregate or port the positions and related collateral of a clearing member's customers. This additional transparency, particularly with respect to information regarding the protection of customer positions and related collateral, is important for the safe and effective transfer of positions and collateral in a default, resolution or insolvency scenario.<sup>163</sup> The Commission notes that the ability to transfer customer positions and associated collateral may reduce the need to liquidate positions, which liquidation could create substantial losses for customers and further disrupt the stability of the financial markets during times of market stress. In addition, these proposed additional disclosures will help regulators and market participants assess SIDCOs and Subpart C DCOs, particularly with respect to a SIDCO's or Subpart C DCO's compliance with the PFMI's. Because of a SIDCO's importance to the U.S. financial markets, it would appear that

such public assessment will help provide comfort to market participants, which could prove to be a stabilizing force in times of severe market stress.

The Commission requests comment on all aspects of these proposals. The Commission is particularly interested in the following: In light of the potential impact that a SIDCO's failure could have on the U.S. financial system, would compliance with proposed regulation 39.37 reduce systemic risks? Would proposed regulation 39.37 contribute to the goals articulated in the Dodd-Frank Act, particularly the goals of Titles VII and VIII of the Dodd-Frank Act? If so, in what ways? If not, why not? What alternatives, if any, to proposed regulation 39.37 would be more effective in reducing systemic risk or accomplishing the goals articulated in the Dodd-Frank Act? Is proposed regulation 39.37 consistent with the PFMI's? If not, what changes need to be made to achieve such consistency? What alternatives to proposed regulation 39.37, if any, would be more effective or efficient for achieving consistency with the standards set forth by the PFMI's? Can proposed regulation 39.37 be effectively implemented and complied with? If not, what changes can be made to permit effective implementation and compliance? What are the potential benefits and costs resulting from, or arising out of, requiring SIDCOs to comply with regulation 39.37? The Commission also requests comment on the potential costs and benefits resulting from, or arising out of, requiring Subpart C DCOs to comply with regulation 39.37. In considering costs and benefits, commenters are requested to address the effect of the proposed regulation not only on a DCO, but also on the DCO's clearing members, the customers of clearing members, and the financial system more broadly. The Commission requests that, where possible, commenters provide quantitative data in their comments, particularly with respect to estimates of costs and benefits. The Commission requests that commenters include a detailed description of any alternatives to proposed regulation 39.37 and estimates of the costs and benefits of such alternatives.

*J. Regulation 39.38 (Efficiency for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)*

Consistent with Principle 21, proposed regulation 39.38 would require a SIDCO or Subpart C DCO to design efficiently and effectively its clearing and settlement arrangements,

<sup>160</sup> Public disclosure requirements for all registered DCOs are set forth in Regulation 39.21, which implements DCO Core Principle L (Public Information), and requires DCOs to provide to market participants sufficient information to enable them to identify and evaluate accurately the risks and costs associated with using the services of the DCO.

<sup>161</sup> Available at: <http://www.bis.org/publ/cpss106.pdf>.

<sup>162</sup> See *supra* section II.C.2. for a discussion of the Quantitative Information Disclosure (referencing section 2.5 of the CPSS-IOSCO Disclosure Framework).

<sup>163</sup> See PFMI's at E.N. 3.14.1.

operating structure and procedures, product scope, and use of technology. In addition, a SIDCO or Subpart C DCO would be required to establish clearly defined goals and objectives that are measurable and achievable, including goals with regards to minimum service levels, risk management expectations, and business priorities. Moreover, a SIDCO or Subpart C DCO would be required to facilitate efficient payment, clearing, and settlement by accommodating internationally accepted communication procedures and standards. The explanatory notes to Principle 21 provide that an efficient CCP has the required resources to perform its functions<sup>164</sup> and the efficiency of the CCP depends on the choice of clearing and settlement arrangement, operating structure, scope of products cleared or settled, and integration of technology and procedures.<sup>165</sup> In addition, the explanatory notes state that an effective CCP reliably meets its obligations in a timely manner and achieves the public policy goals of safety and efficiency for participants and the markets it serves.<sup>166</sup> Finally, consistent with Principle 22, proposed regulation 39.38(d) would require each SIDCO and Subpart C DCO to facilitate efficient payment, clearing, and settlement by accommodating internationally accepted communication procedures and standards.

It would appear to be prudent for SIDCOs and Subpart C DCOs to comply with such international standards of efficiency and effectiveness. A SIDCO or Subpart C DCO that is inefficient or ineffective could distort financial activity and market structure, increasing financial and other risks to the SIDCO's or Subpart C DCO's participants.<sup>167</sup> Although there is no DCO Core Principle specifically directed at efficiency and effectiveness, furthering these goals would improve compliance with Core Principle D (requiring, in part, that a DCO ensure it has the ability to manage the risks associated with discharging its responsibilities through the use of appropriate tools and procedures) and Core Principle G (requiring, in part, that a DCO have rules and procedures designed to allow for the efficient, fair, and safe management of events during which members or participants become insolvent or other default).

The Commission requests comment on all aspects of these proposals. The

Commission is particularly interested in the following: In light of the potential impact that a SIDCO's failure could have on the U.S. financial system, would compliance with proposed regulation 39.38 reduce systemic risks? Would proposed regulation 39.38 contribute to the goals articulated in the Dodd-Frank Act, particularly the goals of Titles VII and VIII of the Dodd-Frank Act? If so, in what ways? If not, why not? What alternatives, if any, to proposed regulation 39.38 would be more effective in reducing systemic risk or accomplishing the goals articulated in the Dodd-Frank Act? Is proposed regulation 39.38 consistent with the PFMI's? If not, what changes need to be made to achieve such consistency? What alternatives to proposed regulation 39.38, if any, would be more effective or efficient for achieving consistency with the standards set forth by the PFMI's? Can proposed regulation 39.38 be effectively implemented and complied with? If not, what changes can be made to permit effective implementation and compliance? What are the potential benefits and costs resulting from, or arising out of, requiring SIDCOs to comply with regulation 39.38? The Commission also requests comment on the potential costs and benefits resulting from, or arising out of, requiring Subpart C DCOs to comply with regulation 39.38. In considering costs and benefits, commenters are requested to address the effect of the proposed regulation not only on a DCO, but also on the DCO's clearing members, the customers of clearing members, and the financial system more broadly. The Commission requests that, where possible, commenters provide quantitative data in their comments, particularly with respect to estimates of costs and benefits. The Commission requests that commenters include a detailed description of any alternatives to proposed regulation 39.38 and estimates of the costs and benefits of such alternatives.

*K. Regulation 39.39 (Recovery and Wind-Down For Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)*

The Commission is proposing regulation 39.39 to require a SIDCO or Subpart C DCO to maintain viable plans for recovery and orderly wind-down. In particular, regulation 39.39 is designed to protect the members of such DCOs and their customers, as well as the financial system more broadly from the consequences of a disorderly failure of such a DCO.

As noted above, Principle 3 requires a CCP to have a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, and other risks.<sup>168</sup> Under Principle 3, such a framework would include identifying scenarios that may prevent the CCP from providing critical operations and services as a going concern and would assess the effectiveness of a full range of options for recovery or orderly wind-down. Similarly, Principle 15 requires a CCP to identify, monitor, and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that the CCP can continue operations and services as a going concern if those losses materialize.<sup>169</sup> Further, these liquid net assets should, at all times, be sufficient to allow for recovery or orderly wind-down of critical operations and services.<sup>170</sup> Although there is no Core Principle that pertains directly to the establishment of a recovery and wind-down plan, proposed regulation 39.37 promotes concepts set forth in Core Principles B (Financial Resources), D (Risk Management), G (Default Rules and Procedures), and I (System Safeguards).<sup>171</sup>

Accordingly, proposed regulation 39.39 requires a SIDCO or Subpart C DCO to develop additional plans that specifically address "recovery" and "wind-down." The Commission proposes defining "recovery" as the actions of a SIDCO or Subpart C DCO, consistent with its rules, procedures, and other *ex-ante* contractual arrangements, to address any uncovered credit loss, liquidity shortfall, capital inadequacy, or business, operational or other structural weakness, including the replenishment of any depleted pre-funded financial resources and liquidity arrangements, as necessary to maintain the SIDCO's or Subpart C DCO's viability as a going concern so that it can continue to provide its critical services without requiring the commencement of an insolvency proceeding or the use of resolution powers by the Federal Deposit Insurance Corporation or any other relevant resolution authority. The Commission proposes defining "wind-down" as the actions of a SIDCO or Subpart C DCO to effect the permanent cessation or sale or transfer of one or more services. The Commission is also proposing to add a definition for

<sup>164</sup> See PFMI's at E.N. 3.21.1.

<sup>165</sup> PFMI's at E.N. 3.21.2.

<sup>166</sup> PFMI's at E.N. 3.21.5.

<sup>167</sup> PFMI's at E.N. 3.21.1.

<sup>168</sup> See *supra* Section I.E.3.

<sup>169</sup> See *supra* Section I.E.9.

<sup>170</sup> See *id.*

<sup>171</sup> See *supra* Section I.D.1-4.



“general business risk,” which would mean any potential impairment of a SIDCO’s or Subpart C DCO’s financial position, as a business concern, as a consequence of a decline in its revenues or an increase in its expenses, such that expenses exceed revenues and result in a loss that the SIDCO or Subpart C DCO must charge against capital. In addition, the Commission proposes defining “operational risk” to mean the risk that deficiencies in information systems or internal processes, human errors, management failures or disruptions from external events will result in the reduction, deterioration, or breakdown of services provided by a SIDCO or Subpart C DCO. Finally, the Commission is proposing to define “unencumbered liquid financial assets” to include cash and highly liquid securities. These proposed definitions are designed to be consistent with the meaning of such terms in the PFMI. The Commission requests comment as to whether these definitions are appropriate. Specifically, the Commission requests comment on whether the definition of “recovery” is appropriate in light of emerging international consensus.

The Commission is proposing to require each SIDCO and Subpart C DCO to maintain viable plans for: (i) Recovery or orderly wind-down, necessitated by credit losses or liquidity shortfalls; and (ii) recovery or orderly wind-down, necessitated by general business risk, operational risk, or any other risk that threatens the SIDCO’s or Subpart C DCO’s viability as a going concern. The Commission also proposes requiring that the recovery and wind-down plans of SIDCOs and Subpart C DCOs meet certain standards, set forth in proposed subsection (c). Specifically, the Commission proposes requiring a SIDCO or Subpart C DCO to identify scenarios that may potentially prevent it from being able to provide its critical operations and services as a going concern and assess the effectiveness of a full range of options for recovery or orderly wind-down. The SIDCO’s or Subpart C DCO’s plans should also include procedures for informing the Commission, as soon as practicable, when the recovery plan is initiated or wind-down is pending, as well as procedures for providing the Commission and any other relevant authorities (e.g., the Federal Deposit Insurance Corporation) with information necessary for resolution planning.

Proposed regulation 39.39(d) requires that the recovery and wind-down plans of a SIDCO or Subpart C DCO be supported by certain resources.

Specifically, in evaluating the resources available to cover any uncovered credit losses or liquidity shortfalls as part of its recovery or wind-down plans necessitated by credit losses or liquidity shortfalls, a SIDCO or Subpart C DCO would be permitted to consider, among other things, assessments of additional resources provided for under its rules that it reasonably expects to collect from non-defaulting members. In addition, a SIDCO or Subpart C DCO would be required to maintain sufficient unencumbered liquid financial assets, funded by the equity of its owners, to implement its recovery or wind-down plans necessitated by general business risk, operational risk, or any other risk that threatens the SIDCO’s or Subpart C DCO’s viability as a going concern. Moreover, while the resources required by regulation 39.11(a)(2) may be sufficient to maintain a SIDCO’s or Subpart C DCO’s recovery or wind-down plans necessitated by general business risk, operational risk, or any other risk that threatens the SIDCO’s or Subpart C DCO’s viability as a going concern, a SIDCO or Subpart C DCO would be required to (i) analyze such plans, including the particular circumstances and risks associated with the SIDCO or Subpart C DCO, and (ii) maintain any additional resources that may be necessary to implement such plans.<sup>172</sup> A SIDCO or Subpart C DCO would be required to comply with regulation 39.11(e)(2) in allocating sufficient financial resources to implement its recovery or wind-down plans necessitated by general business risk, operational risk, or any other risk that threatens the SIDCO’s or Subpart C DCO’s viability as a going concern. Moreover, such plans would need to include evidence and analysis to support the conclusion that the amount considered necessary is, in fact, sufficient to implement them.

Proposed regulation 39.39(d)(3) would prohibit counting the resources maintained to meet the requirements of regulations 39.11(a)(1) and 39.33 as available, in whole or in part, for uses other than addressing the default of one or more clearing members. Further, proposed regulation 39.39(d)(3) would prohibit a SIDCO or Subpart C DCO from counting the same resources as available to address both its recovery or orderly wind-down, necessitated by

credit losses or liquidity shortfalls; and its recovery or orderly wind-down, necessitated by general business risk, operational risk, or any other risk that threatens the SIDCO’s or Subpart C DCO’s viability as a going concern. In other words, if a SIDCO or Subpart C DCO allocates resources, in whole or in part, to execute its recovery plans required by proposed regulation 39.39(b)(1), it may not allocate those same resources, in whole or in part, to satisfy the requirements of proposed regulation 39.39(b)(2).<sup>173</sup> In addition, resources may be allocated only to the extent the use of that resource is not otherwise limited by the CEA, Commission regulations, the SIDCO’s or Subpart C DCO’s rules, or any contractual arrangements to which the SIDCO or Subpart C DCO is a party.

Finally, under 39.39(e), a SIDCO or Subpart C DCO would be required to maintain viable plans for raising additional financial resources, including, where appropriate, capital, in a scenario in which it is unable, or virtually unable, to comply with any financial resource requirements set forth in part 39. These plans would also have to be approved by the SIDCO’s or Subpart C DCO’s board of directors and be updated regularly.

These proposed regulations are intended to address certain differences between existing Commission regulations and the standards set forth in the PFMI. In addition, it would appear to be necessary for a SIDCO to maintain and regularly update a recovery and wind-down plan so as to reduce or attempt to control the potential impact a failure or disruption of the SIDCO’s operations would have on the stability of the U.S. financial markets.

The Commission requests comment on all aspects of these proposals. The Commission is particularly interested in the following: In light of the potential impact that a SIDCO’s failure could have on the U.S. financial system, would compliance with proposed regulation 39.39 reduce systemic risks? Would proposed regulation 39.39 contribute to the goals articulated in the Dodd-Frank Act, particularly the goals of Titles VII and VIII of the Dodd-Frank Act? If so, in what ways? If not, why not? What alternatives, if any, to proposed regulation 39.39 would be more effective in reducing systemic risk or accomplishing the goals articulated in the Dodd-Frank Act? Is proposed regulation 39.39 consistent with the PFMI? If not, what changes need to be

<sup>172</sup> Thus, the requirements of proposed § 39.39(d)(2) and existing § 39.11(a)(2) are overlapping, rather than alternative. A SIDCO or Subpart C DCO whose plan pursuant to § 39.39(b)(2) anticipates completion of wind-down in three months would nonetheless be held to the requirement of one year of operating costs specified in § 39.11(a)(2).

<sup>173</sup> This is consistent with the approach taken in § 39.11(b)(3).

made to achieve such consistency? What alternatives to proposed regulation 39.39, if any, would be more effective or efficient for achieving consistency with the standards set forth by the PFMI's? Can proposed regulation 39.39 be effectively implemented and complied with? If not, what changes can be made to permit effective implementation and compliance? What are the potential benefits and costs resulting from, or arising out of, requiring SIDCOs to comply with regulation 39.39? The Commission also requests comment on the potential costs and benefits resulting from, or arising out of, requiring Subpart C DCOs to comply with regulation 39.39. In considering costs and benefits, commenters are requested to address the effect of the proposed regulation not only on a DCO, but also on the DCO's clearing members, the customers of clearing members, and the financial system more broadly. The Commission requests that, where possible, commenters provide quantitative data in their comments, particularly with respect to estimates of costs and benefits. The Commission requests that commenters include a detailed description of any alternatives to proposed regulation 39.39 and estimates of the costs and benefits of such alternatives.

*L. Regulation 39.40 (Consistency With the PFMI's)*

Proposed regulation 39.40 would make clear that Subpart C is intended to establish regulations that, together with Subpart A and Subpart B, are consistent with the DCO Core Principles set forth in Section 5b(c)(2) of the CEA and the PFMI's. Specifically, to the extent of any ambiguity, the Commission intends to interpret the regulations set forth in part 39 in a manner that is consistent with the standards set forth in the PFMI's. Such consistency would appear to promote international harmonization and is intended to allow the bank clearing members and bank customers of SIDCOs and Subpart C DCOs to receive the more favorable capital treatment under the Basel CCP Capital Requirements.

The Commission requests comment on all aspects of these proposals. Specifically, the Commission requests comment on whether there are more effective or efficient means for achieving consistency with the standards set forth by the PFMI's. The Commission requests that commenters include a detailed description of any such alternatives and estimates of the costs and benefits of any such alternatives.

*M. Regulation 39.41 (Special Enforcement Authority for Systemically Important Derivatives Clearing Organizations)*

In 2013, the Commission adopted regulation 39.31, which implemented special enforcement authority over SIDCOs granted to the Commission under section 807(c) of the Dodd-Frank Act.<sup>174</sup> The Commission is not proposing any changes to regulation 39.31 other than to renumber it as regulation 39.41.

*N. Regulation 39.42 (Advance Notice of Material Risk-Related Rule Changes by Systemically Important Derivatives Clearing Organizations)*

The Commission proposes moving existing paragraph (c) of regulation 39.30 (Scope) to proposed regulation 39.42.<sup>175</sup> This provision instructs a SIDCO to provide advance notice to the Commission of any proposed change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the SIDCO, in accordance with regulation 40.10.<sup>176</sup> Because the other provisions of proposed revised regulation 39.28 (renumbered as regulation 39.30) pertain to the scope of Subpart C,<sup>177</sup> it would be appropriate for paragraph (d) to be codified in a separate regulation. No substantive change is intended.

*O. Regulation 140.94 (Delegation of Authority to the Director of the Division of Clearing and Risk)*

The Commission proposes amending regulation 140.94 so that certain Commission functions contained in these proposed regulations would be delegated to the Director of the Division of Clearing and Risk and to such staff members as the Director may designate. Specifically, the Commission proposes to delegate all functions reserved to the Commission in proposed regulation 39.31 including, for example, the authority to request that a DCO provide information supplementing a Subpart C Election Form that it has filed with the Commission; to determine whether an election to be subject to Subpart C should be permitted to become effective, stayed or denied; and to provide any notices regarding the foregoing. The Commission also proposes to delegate to the Director of the Division of Clearing and Risk and to his or her designees the

decision described in regulation 39.34(d) (whether to grant a SIDCO or a Subpart C DCO up to one year to comply with any provision of regulation 39.34).

*P. Regulation 190.09 (Member Property)*

Certain of the proposed requirements for SIDCOs and Subpart C DCOs necessitate certain clarifications to part 190 of the Commission's regulations. Specifically, proposed regulation 39.35(a) would require a SIDCO or Subpart C DCO to "adopt explicit rules and procedures that address fully any loss arising from any individual or combined default relating to any clearing members' obligations to the SIDCO or Subpart C DCO." Proposed regulation 39.37(b) would require a SIDCO or Subpart C DCO to maintain viable plans for recovery and orderly wind-down. In addition, SIDCOs and Subpart C DCOs must comply with Core Principle R, which require all registered DCOs to "have a well-founded, transparent, and enforceable legal framework for each aspect of the activities of the DCO."

The Commission notes that the risk management practices of DCOs vary depending, in part, on the types of assets that the DCO clears. For example, some DCOs ring-fence mutualized default resources related to certain asset classes separately from resources related to other such classes, in part, because of the different risk profiles associated with those asset classes and a desire among members to avoid exposure to contributions to mutualized resources for asset classes in which such members do not participate. In such cases, the DCOs have updated their financial safeguards arrangements to accommodate these differences.<sup>178</sup>

Recognizing the diversity of financial safeguard arrangements among DCOs, it would appear to be prudent to clarify certain language in part 190 to materially aid compliance with Core Principle R and the proposed regulations specified above. Specifically, regulation 190.09 defines the scope of "member property" in the context of a DCO bankruptcy. The Commission notes that when regulation

<sup>174</sup> See SIDCO Final Rule.

<sup>175</sup> See *supra* Section II.B and note 111.

<sup>176</sup> The Commission promulgated this provision as part of the SIDCO Final Rule.

<sup>177</sup> See *supra* Section II.B. (discussing proposed revised regulation 39.28, renumbered as regulation 39.30).

<sup>178</sup> For example, CME Clearing has three independent guaranty funds and financial safeguards: one for interest rate swap contracts (IRS Contracts), one for credit default swap contracts (CDS Contracts), and one for futures and cleared OTC products, other than IRS or CDS (the Base Guaranty Fund). See Rule 802.A of the CME Rulebook in respect of the Base Guaranty Fund, Rule 8G802.A of the CME Rulebook in respect of IRS Contracts, and Rule 8H802.A of the CME Rulebook in respect of CDS Contracts, each of which is available at <http://www.cmegroup.com/rulebook/CME/>.

190.09(b) was first proposed and adopted in the early 1980s, DCOs did not hold specific and independent guaranty funds for different product classes within a single legal entity. As such, the definition of “member property” in regulation 190.09(b) does not expressly address the treatment of independent guaranty fund deposits in the context of a DCO bankruptcy. Thus, to avoid interference with the rules of a DCO governing the operation of such funds, the Commission proposes the clarifications discussed below.

Therefore, the Commission proposes amending paragraph (b) of regulation 190.09 to clarify that the scope of member property will be determined based on the by-laws and rules of the relevant DCO. Specifically, this amendment would clarify that the inclusion of guaranty fund contributions and other property as “member property” in the context of a DCO bankruptcy would be subject to the by-laws or rules of the DCO. Thus, under proposed regulation 190.09(b), the Commission proposes that a DCO’s distinct guaranty funds, which are established for separate product classes by the DCO’s by-laws or rules, shall be treated separately from one another to the extent required by the DCO’s by-laws or rules.

The Commission requests comment on all aspects of this proposal. Specifically, the Commission requests comment on whether the amendments to regulation 190.09 will impose any costs on DCOs, clearing members, or other market participants, and whether there are more effective or efficient means for recognizing the diversity of financial safeguard arrangements among DCOs in a bankruptcy. The Commission requests that commenters include a detailed description of any such alternatives and estimates of the costs and benefits of such alternatives.

### III. Effective Date

Revised regulation 190.09 would take effect upon publication of the final rulemaking in the **Federal Register**. Proposed regulations 39.31 and 140.94 would take effect on December 13, 2013. All of the other revised and proposed regulations set forth herein would take effect on December 31, 2013, in accordance with the Commission’s goal of implementing DCO regulations consistent with the PFMI by the end of calendar year 2013.

### IV. Related Matters

#### A. Paperwork Reduction Act

The Paperwork Reduction Act (“PRA”), 44 U.S.C. 3501 et seq.,

provides that an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number from the Office of Management and Budget (“OMB”). This rulemaking contains recordkeeping and reporting requirements that are collections of information within the meaning of the PRA. In particular, although the Commission does not anticipate that more than ten persons will respond initially to this collection of information, the term “ten or more persons,” which triggers PRA compliance, has been deemed to apply to “[a]ny recordkeeping, reporting, or disclosure requirement contained in a rule of general applicability.” 5 CFR. 1320.3(c)(4). The Commission will submit an information collection request in the form of an amendment to existing OMB control number 3038–0081.

This rulemaking contains many provisions that would qualify as collections of information, for which the Commission has already sought and obtained a control number from OMB. The burden hours associated with those provisions are not replicated here because the Commission is obligated to account for PRA burden once, and the PRA encourages multiple applications of a single collection.<sup>179</sup> Accordingly, the burdens associated with the collections contained in this proposed rulemaking, and the information collection request that will be submitted to OMB, have been estimated only to the extent that the proposed rulemaking imposes collections of information that OMB has not yet reviewed and approved.

It should be noted that among the thirteen DCOs presently registered with the Commission, only two are SIDCOs. Moreover, not all remaining DCOs or all DCO Applicants are likely to elect to become Subpart C DCOs (for example, DCOs that are based outside of the U.S. may seek to obtain QCCP status through regulation by their home country regulator). Thus, the burden calculations herein are based on an estimate of how many DCOs are SIDCOs and how DCOs and DCO Applicants are likely to elect to become Subpart C DCOs. Additionally, many of the collections herein, in particular those related to electing Subpart C DCO status, are expected to be one-time events for a DCO. It is anticipated that three DCOs will elect to become subject to Subpart C in the year following the adoption of final rules, with possibly

one or two additional elections thereafter.

Finally, it is not possible to precisely estimate the reporting and recordkeeping burden for the SIDCOs and Subpart C DCOs that will be affected by the collections contained in this rulemaking, as the actual burden will be dependent on the operations and staffing of each particular SIDCO and Subpart C DCO and the manner in which they choose to implement compliance with certain requirements. Therefore, the burden estimates below are meant to be a composite of the burdens that will be absorbed across all SIDCOs and Subpart C DCOs, to the extent that the provisions for which information collection burdens are applicable.

#### 1. Collections Only Applicable to Subpart C DCOs

Proposed regulations 39.31(b) and 39.31(c) would establish the process whereby DCO and DCO Applicants, respectively, may elect to become Subpart C DCOs subject to the provisions of Subpart C. The election involves filing the proposed Subpart C Election Form that would be contained in proposed appendix B to part 39 (including completing the certifications therein, providing proposed exhibits A through G, and drafting and publishing the DCO’s responses to the Disclosure Framework, and, when applicable, the DCO’s Quantitative Information Disclosure). Additionally, paragraphs (b)(2) and (c)(3) of proposed regulation 39.31 provide for Commission requests for supplemental information from those requesting Subpart C DCO status; paragraphs (b)(3) and (c)(4) require amendments to the Subpart C Election Form in the event that a DCO or DCO Applicant, respectively, discovers a material omission or error in, or if there is a material change in, the information provided in the Subpart C Election Form; paragraphs (b)(7) and (c)(5) permit a DCO or DCO Applicant, respectively, to submit a notice of withdrawal to the Commission in the event the DCO or DCO Applicant determines not to seek Subpart C DCO status prior to such status becoming effective; and paragraph (e) establishes the procedures by which a Subpart C DCO may rescind its Subpart C DCO status after it has been permitted to take effect. Each of these requirements implies recordkeeping that would be produced by a DCO to the Commission on an occasional basis to demonstrate compliance with the proposed rules.

It is estimated presently that it is likely that only three DCOs will elect to become Subpart C DCOs, but it has been

<sup>179</sup> See 35 U.S.C. 3501(2) and (3).

conservatively estimated below that, collectively, five DCOs or DCO Applicants may elect to become Subpart C DCOs. It is unlikely that any DCO or DCO Applicant will withdraw its election to become subject to Subpart C prior to such election becoming effective, but an estimate of compliance with the withdrawal procedures by one DCO has been included below. It is estimated presently that it is likely that none of the Subpart C DCOs will elect to rescind its election, but it has been conservatively estimated below that one Subpart C DCO may rescind its election. Consequently, the burden hours for the proposed collection of information in this rulemaking have been estimated as follows:

*Reporting—Certifications—Subpart C Election Form*

Estimated number of reporters: 5  
Estimated number of reports per reporter: 1  
Average number of hours per report: 25  
Estimated gross annual reporting burden: 125

*Reporting—Exhibits A through G—Subpart C Election Form*

Estimated number of reporters: 5  
Estimated number of reports per reporter: 1  
Average number of hours per report: 155  
Estimated gross annual reporting burden: 775

*Reporting—Preparing and Publishing Disclosure Framework Responses*

Estimated number of reporters: 5  
Estimated number of reports per reporter: 1  
Average number of hours per report: 200  
Estimated gross annual reporting burden: 1,000

*Reporting—Preparing Quantitative Information Disclosures*

Estimated number of reporters: 5  
Estimated number of reports per reporter: 1  
Average number of hours per report: 80  
Estimated gross annual reporting burden: 400

*Reporting—Requests for Supplemental Information*

Estimated number of reporters: 5  
Estimated number of reports per reporter: 5  
Average number of hours per report: 45  
Estimated gross annual reporting burden: 1,125

*Reporting—Amendments to Subpart C Election Form*

Estimated number of reporters: 5  
Estimated number of reports per

reporter: 3  
Average number of hours per report: 8  
Estimated gross annual reporting burden: 120

*Reporting—Withdrawal Notices*

Estimated number of reporters: 1  
Estimated number of reports per reporter: 1  
Average number of hours per report: 2  
Estimated gross annual reporting burden: 2

*Reporting—Rescission Notices*

Estimated number of reporters: 1  
Estimated number of reports per reporter: 75  
Average number of hours per report: 3  
Estimated gross annual reporting burden: 225

*Recordkeeping*

Estimated number of recordkeepers: 5  
Estimated number of records per recordkeeper: 82  
Average number of hours per record: 1  
Estimated gross annual recordkeeping burden: 410

2. Collections Applicable Both to SIDCOs and Subpart C DCOs

Proposed regulations 39.32(a) and (b) establish governance requirements applicable to each SIDCO and Subpart C DCO, including specific provisions requiring written and disclosed governance arrangements and the disclosure of certain decisions on particular, not regularly scheduled, occasions, to the Commission, the SIDCO or Subpart C DCO's clearing members, other relevant stakeholders and/or the public. Proposed regulation 39.33(d) requires a SIDCO or Subpart C DCO to conduct due diligence on its liquidity providers and to conduct periodic testing with respect to its access to liquidity resources. Proposed regulation 39.33(e) establishes documentation requirements with respect to the supporting rationale for the financial and liquidity resources it maintains pursuant to proposed regulations 39.33(a) and 39.33(c), respectively.

Proposed regulation 39.36(c)(6) requires each SIDCO and Subpart C DCO to report stress test results to its risk management committee or board of directors. Proposed regulation 39.37(a) requires each SIDCO and Subpart C DCO to complete and to publicly disclose its responses to the Disclosure Framework and, when applicable, to complete and disclose a Quantitative Information Disclosure. As described above and as accounted for in the previous portion of this PRA burden

estimate, these tasks will be conducted by Subpart C DCOs as part of their election to become subject to Subpart C. SIDCOs and DCOs also are required to update their Disclosure Framework responses and Quantitative Information Disclosure every two years. Proposed regulations 39.37(c) and (d) require each SIDCO or Subpart C DCO to disclose, publicly and to the Commission, certain data on transaction volume and values and their rules, policies, and procedures related to the segregation and the portability of customers' positions and funds.

Proposed regulation 39.38 requires each SIDCO or Subpart C DCO to establish a process to review the efficiency and effectiveness of its clearing and settlement arrangements, operating structure and procedures, scope of products cleared and use of technology. Finally, proposed regulations 39.39(b) and (c) require each SIDCO and Subpart C DCO to develop and maintain viable plans for the recovery or wind-down of the SIDCO or Subpart C DCO necessitated by certain circumstances. Each of these requirements implies recordkeeping that would be produced by the SIDCO or Subpart C DCO to the Commission on an occasional basis to demonstrate compliance with the proposed rules.

It is not possible to estimate with precision how many DCOs may, in the future, be determined to be SIDCOs and how many may elect to become Subpart C DCOs, but it conservatively has been estimated below that, collectively, a total of seven DCOs may be determined to be SIDCOs or may opt to become Subpart C DCOs. Presently, there are two SIDCOs and it has been estimated that five DCOs will elect to become Subpart C DCOs. Consequently, the burden hours for the proposed collection of information in this rulemaking have been estimated as follows:

*Reporting—Governance Requirements—*

*Written Governance Arrangements*

Estimated number of reporters: 7  
Estimated number of reports per recordkeeper: 1  
Average number of hours per report: 200  
Estimated gross annual reporting burden: 1,400

*Reporting—Governance Requirements—Required Disclosures*

Estimated number of reporters: 7  
Estimated number of reports per recordkeeper: 6  
Average number of hours per report: 3  
Estimated gross annual reporting burden: 126

*Reporting—Financial and Liquidity Resource Documentation*  
 Estimated number of reporters: 7  
 Estimated number of reports per recordkeeper: 1  
 Average number of hours per report: 120  
 Estimated gross annual reporting burden: 840

*Reporting—Stress Test Results*  
 Estimated number of reporters: 7  
 Estimated number of reports per recordkeeper: 16  
 Average number of hours per report: 14  
 Estimated gross annual reporting burden: 1,568

*Reporting—Preparing and Publishing Disclosure Framework Responses (SIDCOs only)*  
 Estimated number of reporters: 2  
 Estimated number of reports per recordkeeper: 1  
 Average number of hours per report: 200  
 Estimated gross annual reporting burden: 400

*Reporting—Updating and Republishing Disclosure Framework Responses (SIDCOs and Subpart C DCOs)*  
 Estimated number of reporters: 7  
 Estimated number of reports per recordkeeper: 1  
 Average number of hours per report: 80  
 Estimated gross annual reporting burden: 560

*Reporting—Preparing and Publishing Quantitative Information Disclosures (SIDCOs only)*  
 Estimated number of reporters: 2  
 Estimated number of reports per reporter: 1  
 Average number of hours per report: 80  
 Estimated gross annual reporting burden: 160

*Reporting—Updating and Republishing Quantitative Information Disclosures (SIDCOs and Subpart C DCOs)*  
 Estimated number of reporters: 7  
 Estimated number of reports per recordkeeper: 1  
 Average number of hours per report: 35  
 Estimated gross annual reporting burden: 245

*Reporting—Transaction, Segregation, Portability Disclosures*  
 Estimated number of reporters: 7  
 Estimated number of reports per recordkeeper: 2  
 Average number of hours per report: 35  
 Estimated gross annual reporting burden: 490

*Reporting—Efficiency and Effectiveness Review*

Estimated number of reporters: 7  
 Estimated number of reports per recordkeeper: 1  
 Average number of hours per report: 3  
 Estimated gross annual reporting burden: 21

*Reporting—Recovery and Wind-Down Plan*  
 Estimated number of reporters: 7  
 Estimated number of reports per recordkeeper: 1  
 Average number of hours per report: 480  
 Estimated gross annual reporting burden: 3,360

*Recordkeeping—Liquidity Resource Due Diligence and Testing*  
 Estimated number of recordkeepers: 7  
 Estimated number of records per recordkeeper: 4  
 Average number of hours per record: 10  
 Estimated gross annual recordkeeping burden: 280

*Recordkeeping—Financial and Liquidity Resources, Excluding Due Diligence and Testing*  
 Estimated number of recordkeepers: 7  
 Estimated number of records per recordkeeper: 4  
 Average number of hours per record: 10  
 Estimated gross annual recordkeeping burden: 280

*Recordkeeping—Generally*  
 Estimated number of recordkeepers: 7  
 Estimated number of records per recordkeeper: 28  
 Average number of hours per record: 10  
 Estimated gross annual recordkeeping burden: 1960

### 3. Information Collection Comments

The Commission invites the public and other Federal agencies to comment on any aspect of the proposed information collection requirements discussed above. Pursuant to 44 U.S.C.3506(c)(2)(B), the Commission will consider public comments on such proposed requirements in:

- Evaluating whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;
- Evaluating the accuracy of the estimated burden of the proposed information collection requirements, including the degree to which the methodology and the assumptions that the Commission employed were valid;
- Enhancing the quality, utility, and clarity of the information proposed to be collected; and
- Minimizing the burden of the proposed information collection

requirements on SIDCOs and Subpart C DCOs, including through the use of appropriate automated, electronic, mechanical, or other technological information collection techniques, *e.g.*, permitting electronic submission of responses.

Copies of the submission from the Commission to OMB are available from the CFTC Clearance Officer, 1155 21st Street NW., Washington, DC 20581, (202) 418-5160 or from <http://RegInfo.gov>. Organizations and individuals desiring to submit comments on the proposed information collection requirements should send those comments to:

- The Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503, Attn: Desk Officer of the Commodity Futures Trading Commission;
- (202) 395-6566 (fax); or
- [OIRAsubmissions@omb.eop.gov](mailto:OIRAsubmissions@omb.eop.gov) (email).

Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rulemaking, and please refer to the **ADDRESSES** section of this rulemaking for instructions on submitting comments to the Commission. OMB is required to make a decision concerning the proposed information collection requirements between thirty (30) and sixty (60) days after publication of the NPRM in the **Federal Register**. Therefore, a comment to OMB is best assured of receiving full consideration if OMB (as well as the Commission) receives it within thirty (30) days of publication of this NPRM. The time frame for commenting on the PRA does not affect the deadline established by the Commission on the proposed rules, provided in the **DATES** section of this rulemaking.

### B. Regulatory Flexibility Act

The Regulatory Flexibility Act (“RFA”) requires that agencies consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact.<sup>180</sup> The rules proposed by the Commission will only affect DCOs. The Commission has previously established certain definitions of “small entities” to be used by the Commission in evaluating the impact of its regulations on small entities in accordance with the

<sup>180</sup> 5 U.S.C. 601 *et seq.*

RFA.<sup>181</sup> The Commission has previously determined that DCOs are not small entities for the purpose of the RFA.<sup>182</sup> Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed rules will not have a significant economic impact on a substantial number of small entities.

### C. Consideration of Costs and Benefits

#### 1. Introduction

Section 15(a) requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.<sup>183</sup>

Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission's cost and benefit considerations in accordance with Section 15(a) are discussed below.

#### 2. Background

As discussed above, this proposed rulemaking would: Address gaps between part 39 of the Commission's regulations and the standards set forth in the PFMI; provide a procedure for Subpart C DCOs to elect to become subject to the provisions of Subpart C; and make related technical amendments to regulation 190.09. As proposed, revised Subpart C, together with Subpart A and Subpart B, would establish regulations that are consistent with the PFMI.<sup>184</sup>

#### 3. Costs and Benefits of the Proposed Rules

##### a. Costs

The Commission does not have quantification or estimation of the costs associated with the proposed regulations. However, in qualitative terms, the Commission recognizes that the proposed regulations are comprehensive and, compared to the status quo, may impose important costs on SIDCOs and Subpart C DCOs depending, in particular, on the SIDCO's or Subpart C DCO's current financial and liquid resources, and risk

management framework. In particular, these proposed regulations may require SIDCOs and Subpart C DCOs to undertake a comprehensive review and analysis of their current policies, procedures, and systems in order to determine where it may be necessary to design and implement additional or alternative policies, procedures, and systems. Such costs may increase operational, administrative, and compliance costs for a SIDCO or Subpart C DCO. The Commission requests comment on the potential costs of the proposed regulations on SIDCOs and Subpart C DCOs, including, where possible, quantitative data. In addition, the Commission requests comment on the competitive impact, the costs as well as benefits, resulting from, or arising out of, requiring SIDCOs to comply with the provisions set forth in Subpart C, while permitting other registered DCOs to elect to become subject to these requirements (or to forego such election).

In addition to the costs for SIDCOs and Subpart C DCOs, the Commission has considered the costs the proposed regulations would impose upon market participants and the public. To the extent costs increase, the Commission notes that higher trading prices for market participants (*i.e.*, increased clearing fees, guaranty fund contributions, and margin fees, etc.) may discourage market participation and result in decreased liquidity and reduced price discovery.

##### i. Regulation 39.31 (Election To Become Subject to the Provisions of Subpart C)

As discussed above, proposed regulation 39.31 would set forth the procedures a DCO would be required to follow to elect to become subject to the provisions of Subpart C.<sup>185</sup> Proposed paragraph (b) would require a registered DCO to file a completed Subpart C Election Form with the Commission. The form appears in proposed Appendix B to Subpart C and is modeled after Form DCO, which the Commission promulgated in 2011 as part of the DCO General Provisions and Core Principles final rule.<sup>186</sup> Proposed paragraph (c) would require the same of a DCO that applies for registration with the Commission and that wants to be subject to the provisions of Subpart C as of the date the DCO is registered with the Commission. The Subpart C Election Form would include disclosures and exhibits wherein the DCO would be

required to provide the following: a regulatory compliance chart; citations to the relevant rules, policies, and procedures of the DCO that addresses each Subpart C regulation; and a summary of the manner in which the DCO would comply with each regulation. In addition, the DCO would be required to provide, in separate exhibits, all documents that demonstrate the DCO's compliance with proposed regulations 39.32 through 39.36 and proposed regulation 39.39. A DCO would also be required to complete responses to the Disclosure Framework and publish a copy of its responses on its Web site.

The Commission notes that proposed regulation 39.31 would only apply to a DCO that the Council has not designated to be systemically important and that elects to become subject to the provisions of Subpart C. Proposed regulation 39.31, by providing an opt-in procedure and a procedure to rescind such election offers the benefit of permitting a DCO that is not systemically important may weigh (i) (1) the cost of preparing a comprehensive and complete Subpart C Election Form in accordance with the requirements set forth in proposed regulation 39.31 and (2) the costs associated with the requirements set forth in Subpart C against (ii) the benefit of attaining QCCP status, and, thus, to decide for itself whether to become subject to Subpart C.

As discussed below, a Subpart C DCO's compliance with the provisions of Subpart C would cause the Subpart C DCO to incur certain costs. Some of these costs may then be incurred, indirectly, by the Subpart C DCO's clearing members and their customers. The Commission requests comments concerning examples of such costs. If a clearing member or its customer would incur greater costs by clearing through a Subpart C DCO rather than through a DCO that has not opted-in to Subpart C, then that clearing member or customer may decide not to clear through a Subpart C DCO. The Commission requests comment as to how these indirect costs may be mitigated. The Commission also requests comment concerning the extent to which a DCO's analysis of whether the costs of being a Subpart C DCO may outweigh the benefits could be affected by the possibility that some of the costs may be incurred indirectly by clearing members and their customers.

In addition to the requests for comment set forth above, the Commission requests comment concerning the costs associated with the Subpart C Election Form, including without limitation, the election and

<sup>181</sup> Policy Statement and Establishment of Definitions of "Small Entities" for Purposes of the Regulatory Flexibility Act, 47 FR 18618 (Apr. 30, 1982).

<sup>182</sup> See 66 FR at 45609.

<sup>183</sup> 7 U.S.C. 19(a).

<sup>184</sup> See *supra* Section I.G.

<sup>185</sup> See *supra* Section II.C (discussing proposed regulation 39.31).

<sup>186</sup> DCO General Provisions and Core Principles, 76 FR 69334 (Nov. 8, 2011) (final rule).

withdrawal procedures set forth in proposed regulation 39.31, as well as the requirements surrounding completion and publication of responses to the Disclosure Framework. The Commission also requests that each commenter provide quantitative data where practicable, as well as a detailed rationale supporting the response.

The Commission notes that pursuant to proposed paragraph (e), a Subpart C DCO would be permitted, subject to a 90 day notice period, to rescind its election to become subject to the provisions of Subpart C. As a result of the rescission, the DCO would no longer be considered a QCCP, which would likely create important costs for bank clearing members and the bank customers of a DCO's clearing members due to the higher capital costs that they would incur as a result of clearing transactions through the DCO that is no longer a QCCP.<sup>187</sup> Alternatively, clearing members and their customers may choose to end their clearing activities and transact through another DCO that is a QCCP, with either choice imposing costs on those clearing members and their customers.

As discussed in section II.C., above, the Commission requests comments on the potential costs to a Subpart C DCO to comply with all aspects of proposed regulation 39.32, including the cost of the opting-in process (including but not limited to the completion of the Subpart C Election Form) and the process for rescinding such an opting-in (including the notices required) and any costs that would be imposed on other market participants or the financial system more broadly.

#### ii. Regulation 39.32 (Governance for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

As discussed above, proposed regulation 39.32 establishes governance requirements for SIDCOs and Subpart C DCOs that are consistent with the PFMI and establish rules and procedures concerning conflicts of interest, compensation policies, organizational structure, and fitness standards for directors and officers.<sup>188</sup> Specifically, SIDCOs and Subpart C DCOs would be required to have written governance arrangements that are clear and transparent, that place a high priority on the safety and efficiency of the SIDCO or Subpart C DCOs, and that explicitly support the stability of the broader

financial system and other relevant public interest considerations of clearing members, customers of clearing members, and other relevant stakeholders. In addition, these governance arrangements would be required to reflect the legitimate interests of clearing members, customers of clearing members, and other relevant stakeholders. To an extent consistent with other statutory and regulatory requirements on confidentiality and disclosure, SIDCO's and Subpart C DCOs would also be required to disclose major decisions of the board.<sup>189</sup> Proposed regulation 39.32 would require the rules and procedures of SIDCOs and Subpart C DCOs to: (1) Describe the SIDCO's or Subpart C DCO's management structure; (2) clearly specify the roles and responsibilities of the board of directors and its committees, including the establishment of a clear and documented risk management framework; (3) clearly specify the roles and responsibilities of management; (4) establish appropriate compensation policies; (5) establish procedures for managing conflicts of interest among board members; and (6) assign responsibility and accountability for risk decisions and for implementing rules concerning default, recovery, and wind-down. Finally, proposed regulation 39.32 would require that the board members and managers of SIDCOs and Subpart C DCOs have the appropriate experience, skills, incentives and integrity; risk management and internal control personnel have sufficient independence, authority, resources and access to the board of directors; and that the board of directors include members who are not executives, officers or employees of the SIDCO or Subpart C DCO or of their affiliates.

To the extent these requirements affect the behavior of a DCO, costs could arise from additional hours a DCO's employees might need to spend analyzing the compliance of the DCO's rules and procedures with these requirements, designing and drafting new or amended rules and procedures where the analysis indicates that these are necessary, and implementing these new or amended rules and procedures. These costs are difficult for the Commission to assess in the abstract because the proposed regulation grants a DCO a certain amount of discretion in determining which rules and procedures should be adopted to comply with the proposed regulation. As discussed in section II.D., above, the Commission requests comments on the

potential costs to a SIDCO or Subpart C DCO to comply with all aspects of proposed regulation 39.32, and any costs that would be imposed on other market participants or the financial system more broadly. As noted above, the Commission specifically requests comment on alternative means to establish governance requirements consistent with the PFMI, and the costs (or cost savings) associated with such alternatives.

#### iii. Regulation 39.33 (Financial Resources for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

##### (a.) Regulation 39.33(a): Cover Two

As discussed above, proposed amended regulation 39.33(a) would require a Subpart C DCO to comply with the Cover Two minimum financial resource standard for all of its activities if the Subpart C DCO: (1) Is involved in activities with a more complex risk profile or (2) is systemically important in multiple jurisdictions. This requirement currently applies to all SIDCOs.<sup>190</sup>

The cost of the Cover Two requirement for a Subpart C DCO that meets either or both of the two criteria described above<sup>191</sup> includes the opportunity cost<sup>192</sup> of the additional financial resources needed to satisfy the guaranty fund requirements for the risk of loss resulting from the default of the clearing member creating the second largest credit exposure.<sup>193</sup> In addition, the possibility exists that some market participants will port their positions from a Subpart C DCO that either (1) is deemed systemically important in multiple jurisdictions or (2) clears products of a more complex risk profile to another DCO for which neither (1) nor (2) applies because the value of the Cover Two protection to these market participants is less than the price at which that protection is being offered. These market participants will transact with SIDCOs or Subpart C DCOs that

<sup>190</sup> See *supra* Section II.E (discussing proposed revised regulation 39.33).

<sup>191</sup> All Subpart C DCOs would bear the administrative cost of determining whether they meet either of the criteria.

<sup>192</sup> For Subpart C DCOs that are not deemed systemically important in multiple jurisdictions or that do not clear products with a more complex risk profile, the Cover One financial resources requirement would continue to apply, and therefore, these Subpart C DCOs would not face increased opportunity costs associated with the proposed regulation.

<sup>193</sup> In the event that these additional resources would need to be raised by the Subpart C DCO, as opposed to reallocated, this cost would be the funding cost for raising these additional resources.

<sup>187</sup> See *supra* Section I.F (discussing the treatment for non-QCCP clearing members under the Basel CCP Capital Requirements).

<sup>188</sup> See *supra* Section II.D (discussing proposed regulation 39.32).

<sup>189</sup> *Id.*



operate under Cover One, which is a lower financial resources requirement, and thus, get the benefit of lower transactional fees and forego the enhanced protections associated with the SIDCOs or Subpart C DCOs. However, the potential cost to a SIDCO or a Subpart C DCO subject to the Cover Two requirement and to the goal of systemic risk reduction would likely be mitigated because: (a) Not every product offered by a SIDCO or Subpart C DCO would be available at other DCOs and (b) a SIDCO or Subpart C DCO may offer benefits not available to a DCO does not elect to become subject to the provisions of Subpart C, that is not designated as systemically important, and/or that does not clear products with a more complex risk profile. This would therefore reduce the likelihood that market participants would port their positions to other DCOs. As indicated in section II.E. (description of proposed regulation 39.33), above, the Commission requests comment on these costs, including quantitative data, if available.

(b.) Regulation 39.33(b): Valuation of Financial Resources

Proposed amended regulation 39.33(b) would prohibit SIDCOs and Subpart C DCOs from including assessments as part of their calculation of the financial resources available to cover the default of the clearing member creating the largest credit exposure and, where applicable, the default of the two clearing members creating the largest aggregate credit exposure, in extreme but plausible circumstances, *i.e.*, Cover One or Cover Two.<sup>194</sup> This requirement currently applies to all SIDCOs and would be expanded to include Subpart C DCOs. The costs associated with the prohibition on the use of assessments by a Subpart C DCO in calculating its obligations under regulation 39.33(a) would include the opportunity cost of the additional pre-funded financial resources needed to replace the value of such assessments, which may require an infusion of additional capital. In addition, as with the Cover Two requirement, market participant demand may shift from a SIDCO or a Subpart C DCO subject to the Cover Two requirement to a DCO with a lower capitalization requirement. As indicated in Section II.E, above, the Commission requests comment on these costs, including quantitative data, if available.

(c.) Regulation 39.33(c), (d) and (e): Liquidity

Proposed regulation 39.33(c) would require a SIDCO and a Subpart C DCO to maintain eligible liquidity resources that will enable it to meet its intraday, same-day and multiday settlement obligations, in all relevant currencies, with a high degree of confidence under a wide range of stress scenarios notwithstanding a default by the clearing member creating the largest aggregate liquidity obligation. Eligible resources are limited to cash in the currency of the requisite obligation, held at the central bank of issue or a creditworthy commercial bank, certain highly marketable collateral, subject to certain prearranged and highly reliable funding arrangements, and various committed liquidity arrangements. These arrangements must be reliable and enforceable in extreme but plausible market conditions, and must not contain material adverse change clauses.

In addition, a SIDCO or Subpart C DCO that is systemically important in multiple jurisdictions or that is involved in activities with a more complex risk profile would be required to consider maintaining liquidity resources that would enable it to meet the default of the two clearing members creating the largest aggregate payment obligation. If a SIDCO or Subpart C DCO maintains liquid financial resources in addition to those required to satisfy the minimum financial resources requirement set forth in regulations 39.11(a)(1) and 39.33(a), then those resources should be in the form of assets that are likely to be saleable or acceptable as collateral for lines of credit, swaps, or repurchase agreements on an *ad hoc* basis.<sup>195</sup>

Proposed regulation 39.33(d) would impose a duty on SIDCOs and Subpart C DCOs to perform due diligence on their liquidity providers in order to determine their ability to perform reliably their commitments to provide liquidity. Finally, proposed regulation 39.33(e) would require SIDCOs and Subpart C DCOs to document their supporting rationale for the amount of financial resources they maintain pursuant to proposed regulation 39.33(a) and the amount of liquidity resources they maintain pursuant to proposed regulation 39.33(c).<sup>196</sup>

Proposed regulations 39.33(c)-(e) may result in additional costs for a SIDCO or Subpart C DCO with respect to analyzing and measuring intra-day, same-day, and multiday liquidity

requirements in all relevant currencies, developing plans to meet those requirements, obtaining eligible liquidity resources and making eligible liquidity arrangements, reviewing and monitoring each liquidity provider's risks and reliability (including through periodic testing of access to liquidity), and documenting the DCO's basis for conclusions with respect to its financial resources and liquidity resources requirements. These proposed regulations also will require stress testing and other analysis of such resources as compared with the DCO's liquidity needs. Specifically, with regards to proposed regulation 39.33(c), there may be costs involved in obtaining cash in the relevant currencies or arranging for qualifying liquidity commitments, such as a committed line of credit, to satisfy the minimum financial resources requirement set forth in regulation 39.11(a)(1) (*i.e.*, Cover One). Obtaining these committed financial resources would involve administrative expenses such as the negotiation and drafting of committed arrangements, as well as costs arising from the payment of fees to liquidity providers. In addition, there may be operational costs involved in calculating the liquidity resources requirements at the Cover One level on an intraday, same-day, and multiday basis over the course of a default. This calculation may require undertaking a complex analysis of the SIDCO's or Subpart C DCO's exposures and processes, including various models, and, where appropriate, designing and implementing changes to either create or modify existing internal processes. While this analysis may involve costs, it would appear that it will improve the SIDCO's or Subpart C DCO's financial condition, as described below in section 2.b.iii. of the benefits section.

Proposed regulation 39.33(d) may increase administrative costs to the extent that a SIDCO or a Subpart C DCO is required to review and monitor its liquidity provider's capacity and reliability to perform its liquidity obligations to the DCO. In addition, proposed regulation 39.33(e) may impose an administrative cost to document the SIDCO or Subpart C DCO's rationale for the financial resources it maintains.

As discussed in section II.E., above, the Commission requests comments on the potential costs to a SIDCO or a Subpart C DCO in complying with all aspects of proposed regulation 39.33 and any costs that would be imposed on other market participants or the financial system more broadly. As noted above, the Commission specifically

<sup>194</sup> See *supra* Section II.E (discussing proposed revised regulation 39.33).

<sup>195</sup> *Id.*

<sup>196</sup> *Id.*

requests comment on alternative means to establish financial resources and liquidity requirements consistent with the PFMI (including, *e.g.*, through alternative definitions of terms), and the costs (or cost savings) associated with such alternatives.

iv. Regulation 39.34 (System Safeguards for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

As discussed above, proposed amended regulation 39.34 would require SIDCOs and Subpart C DCOs to comply with enhanced system safeguards requirements.<sup>197</sup> While SIDCOs are already subject to these requirements, the Commission proposes expanding this regulation to include Subpart C DCOs. The proposed regulation could increase operational costs for Subpart C DCOs by requiring additional resources, including with respect to personnel, technology (*e.g.*, hardware and software) and the purchase or rental of premises in order to achieve geographic dispersal of resources. In particular, the costs of moving from a next-day RTO, the minimum standard established by the DCO core principles and current regulation 39.18, to a two-hour RTO as required by proposed regulation 39.34, may be significant. Additionally, the implementation of a two-hour RTO may impose one-time costs to establish the enhanced resources and recurring costs to operate the additional resources. As discussed in section II.F. above, the Commission requests comments on the potential costs to a Subpart C DCO in complying with all aspects of proposed regulation 39.34, and any costs that would be imposed on other market participants or the financial system more broadly. As noted above, the Commission specifically requests comment on alternative means to establish, for Subpart C DCOs, system safeguards requirements consistent with the PFMI and the costs (or cost savings) associated with such alternatives.

v. Regulation 39.35 (Default Rules and Procedures for Uncovered Losses or Shortfalls (Recovery) for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

Proposed regulation 39.35 would require SIDCOs and Subpart C DCOs to adopt policies and procedures to address certain issues arising from extraordinary stress events, including the default of one or more clearing

members.<sup>198</sup> The costs associated with these default rules and procedures may include administrative costs to: review and analyze current policies and procedures; design and draft new or amended policies and procedures; and implement the new or amended policies and procedures. Such default rules and procedures must sufficiently (1) allocate uncovered credit losses and (2) enable a SIDCO or Subpart C DCO to promptly meet all of its obligations in the event of a default by one or more clearing members or an unforeseen liquidity shortfall exceeding the financial resources of the SIDCO or Subpart C DCO. As discussed in section II.G. above, the Commission requests comments on the potential costs to a SIDCO or a Subpart C DCO in complying with all aspects of proposed regulation 39.35, and any costs that would be imposed on other market participants or the financial system more broadly. As noted above, the Commission specifically requests comment on alternative means to establish requirements, in a manner consistent with the PFMI, for adopting rules and procedures for uncovered losses or shortfalls, and the costs (or cost savings) associated with such alternatives.

vi. Regulation 39.36 (Risk Management for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

Proposed regulation 39.36 would impose enhanced risk management requirements for a SIDCO or Subpart C DCO, including, but not limited to, specific criteria for stress tests of financial resources, specific criteria for sensitivity analysis of margin models, specific criteria for stress tests of liquidity resources, requirements surrounding the monitoring and management of credit and liquidity risks arising out of settlement banks, and requirements surrounding the custody and investment of a SIDCO's or Subpart C DCO's own funds and assets.<sup>199</sup> Complying with this regulation could involve operational costs to perform the required testing, monitoring and analyses, which may include: A comprehensive analysis of existing stress testing scenarios; the design of new and/or alternative stress testing scenarios; and the design of a sensitivity analysis; the creation of a system for comprehensively monitoring, managing and limiting credit and liquidity risks

arising out of settlement banks; and the implementation of controls surrounding the custody and investment of a SIDCO's or Subpart C DCO's own funds and assets. In addition, there may be costs associated with the modification and/or creation of processes necessary to support the enhanced risk management requirements in the proposed regulation. There would also be ongoing costs to conduct such risk management, analyze the results, and take action based on such results. In particular, to the extent that the analyses and monitoring reveal the need for additional financial or liquidity resources, there would be costs associated with obtaining such resources. In addition, there may be administrative and other costs associated with the management of a SIDCO's or Subpart C DCO's settlement bank exposures. As discussed in section II.H., above, the Commission requests comments on the potential costs to a SIDCO or a Subpart C DCO in complying with all aspects of proposed regulation 39.36, and any costs that would be imposed on other market participants or the financial system more broadly. As noted above, the Commission specifically requests comment on alternative means to establish risk management requirements consistent with the PFMI, and the costs (or cost savings) associated with such alternatives.

vii. Regulation 39.37 (Additional Disclosure for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

Proposed regulation 39.37 would set forth additional public disclosure requirements for a SIDCO and Subpart C DCO, including the disclosure of, and updates to, the DCO's responses to the Disclosure Framework for FMIs.<sup>200</sup> Complying with this regulation may impose administrative costs to conduct a comprehensive analysis of the SIDCO or Subpart C DCO's policies, procedures and systems as well as the costs associated with the design, drafting and implementation of any new or modified policies, procedures and systems that would be necessary to comply with the proposed regulation. As discussed in section II.I. above, the Commission requests comments on the potential costs to a SIDCO or a Subpart C DCO in complying with all aspects of proposed regulation 39.37, and any costs that would be imposed on other market participants or the financial system

<sup>197</sup> See *supra* Section II.F (discussing proposed regulation 39.34).

<sup>198</sup> See *supra* Section II.G (discussing proposed regulation 39.35).

<sup>199</sup> See *supra* Section II.H (discussing proposed regulation 39.36).

<sup>200</sup> See *supra* Section II.I (discussing proposed regulation 39.37).

more broadly. As noted above, the Commission specifically requests comment on alternative means to establish disclosure requirements consistent with the PFMI, and the costs (or cost savings) associated with such alternatives.

viii. Regulation 39.38 (Efficiency for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

Proposed regulation 39.38 would require a SIDCO or a Subpart C DCO to comply with certain efficiency standards regarding its clearing and settlement arrangements, operating structure and procedures, product scope, and use of technology. In addition, a SIDCO or Subpart C DCO would be required to establish clearly defined goals and objectives that are measurable and achievable, including minimum service levels, risk management expectations, and business priorities.<sup>201</sup> SIDCOs and Subpart C DCOs would also be required to facilitate efficient payment, clearing and settlement by accommodating internationally accepted communication procedures and standards. The costs associated with the proposed regulation may include the administrative costs of conducting a comprehensive review and analysis of the SIDCO's or Subpart C DCO's policies, procedures and systems, and where appropriate, the design, drafting and implementation of new or modified policies, procedures and systems to establish the goals and objectives necessary to comply with this regulation. There may also be administrative costs associated with establishing a mechanism to review the DCO's compliance with the proposed regulation, as well as operational costs associated with designing and implementing processes to accommodate internationally accepted communications standards. As discussed in section II.J. above, the Commission requests comments on the potential costs to a SIDCO or a Subpart C DCO in complying with all aspects of proposed regulation 39.38, and any costs that would be imposed on other market participants or the financial system more broadly. As noted above, the Commission specifically requests comment on alternative means to establish a requirement for efficiency standards consistent with the PFMI, and the costs (or cost savings) associated with such alternatives.

ix. Regulation 39.39 (Recovery and Wind-Down for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

Proposed regulation 39.37 would require a SIDCO or Subpart C DCO to maintain viable plans for recovery and orderly wind-down, in cases necessitated by (1) credit losses or liquidity shortfalls and (2) general business risk, operational risk, or any other risk that threatens the DCO's viability as a going concern. This would require the DCO to identify scenarios that may prevent a SIDCO or Subpart C DCO from being able to provide its critical operations and services as a going concern and to assess the effectiveness of a full range of options for recovery or orderly wind-down.

The proposed regulation would also require a SIDCO or Subpart C DCO to evaluate the resources available to meet the plan to cover credit losses and liquidity shortfalls, and to maintain sufficient unencumbered liquid financial assets to implement the plan to cover other risks. The latter point requires a SIDCO or Subpart C DCO to analyze whether its particular circumstances and risks require it to maintain liquid net assets to fund the plan that are in addition to those resources currently required by regulation 39.11(a)(2).

This proposed regulation may impose costs on a SIDCO or Subpart C DCO to the extent it will be necessary to undertake a comprehensive qualitative and quantitative analysis of the credit, liquidity, general business, operational and other risks that may threaten the DCO's ability to provide its critical operations and services as a going concern, to design and draft plans to mitigate and address those risks, to analyze whether the DCO's resources allocated to recovery and/or wind-down are sufficient to implement those plans. This analysis may lead to the design of alternative and/or additional scenarios to be included in stress testing, the drafting of new or revised policies for a recovery and/or wind-down plan, and potentially the necessity of maintaining additional resources or procedures to obtain such resources in the event they are needed. Moreover, the regulation prohibits the double counting of available resources—that is, resources considered as available to meet the recovery and orderly wind-down plan for credit losses and liquidity shortfalls cannot be considered as available to meet the recovery and orderly wind-down plan for general business risk, operational risk, and other risks (or vice-

versa). This may result in the need to maintain a larger quantum of total resources to meet both plans which, depending on the resources maintained, may involve costs arising from factors such as greater use of capital by the DCO, or greater capital charges for clearing members arising out of their commitments to contribute default resources.

As discussed in section II.K. above, the Commission requests comments on the potential costs to a SIDCO or a Subpart C DCO in complying with all aspects of proposed regulation 39.39, and any costs that would be imposed on other market participants or the financial system more broadly. As noted above, the Commission specifically requests comment on alternative means to establish, consistent with the PFMI, a requirement for the adoption of a recovery and wind-down plan, and the costs (or cost savings) associated with such alternatives.

b. Benefits

As explained in the subsections that follow, this proposed rule would hold SIDCOs and Subpart C DCOs to enhanced regulatory standards, which are designed to promote the financial strength, operational integrity, security, and reliability of these organizations and to reduce the likelihood of their disruption or failure. This would then increase the overall stability of the U.S. financial markets. As the PFMI note, FMIs, including CCPs (*i.e.* DCOs), play a critical role in fostering financial stability.<sup>202</sup> This is particularly the case with respect to SIDCOs. The Council has determined that the failure of or a disruption to the functioning of a SIDCO could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system.<sup>203</sup>

In addition, the proposed regulations would help ensure that SIDCOs and Subpart C DCOs are held to international standards in order to provide them with the opportunity to gain QCCP status. As discussed above, attaining QCCP status would provide clearing members that are banks, as well as banks that are customers of clearing members, with the benefit of complying with less onerous capital requirements, pursuant to the Basel CCP Capital Requirements, than if the SIDCO or

<sup>202</sup> PFMI, E.N. 1.1.

<sup>203</sup> See <http://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx> (describing the designations of CME and ICE Clear Credit to be systemically important financial market utilities) and see *supra* Section I.C.

<sup>201</sup> See *supra* Section II.J (discussing proposed regulation 39.38).

Subpart C DCO were not a QCCP.<sup>204</sup> In turn, this may increase a SIDCO or Subpart C DCO's competitiveness vis-à-vis non-U.S. clearing organizations that demonstrate compliance with international standards and are QCCPs.

i. Regulation 39.31 (Election To Become Subject to the Provisions of Subpart C)

The procedures set forth in proposed regulation 39.31, together with the proposed Subpart C Election Form, are intended to promote the protection of market participants and the public. These proposed procedures would require the Commission's staff to conduct a comprehensive and thorough review of a DCO that elects to become subject to the provisions of Subpart C. In addition, the international Basel CCP Capital Requirements provide incentives for banks to clear derivatives through CCPs that are qualified CCPs or "QCCPs" by setting lower capital charges for exposures arising from derivatives cleared through a QCCP and setting significantly higher capital charges for exposures arising from derivatives cleared through non-qualifying CCPs. These proposed regulations are consistent with the international standards set forth in the PFMI and address the remaining divergences between part 39 of the Commission's regulations and the PFMI, which will provide an opportunity for a Subpart C DCO to gain QCCP status.

Without regulation 39.31, a DCO that is not designated by the Council as being systemically important would not have the opportunity to gain QCCP status, thereby potentially putting such a DCO at a significant competitive disadvantage compared to SIDCOs and non-U.S. clearing organizations. This would ultimately be to the detriment of such a DCO's clearing members and their customers.<sup>205</sup> The Commission also notes that by clearing through a Subpart C DCO, a clearing member and its customers would be afforded the benefits of clearing through a DCO subject to enhanced risk management, operational, and other standards. The Commission requests comment concerning the extent to which clearing members and their customers would benefit from the additional standards to which a Subpart C DCO and SIDCO would be subject.

Proposed regulation 39.31 would provide a benefit to a Subpart C DCO by allowing the Subpart C DCO to weigh

for itself the costs and benefits of maintaining QCCP status. The notice requirements would provide important benefits to clearing members of the rescinding Subpart C DCO (and their customers), particularly those that are banks or bank affiliates, by providing them with advance notice to permit them to assess their options and take any actions they deem appropriate with respect to clearing at a DCO that has acted to rescind its election to be held to the standards of Subpart C (and thus to renounce status as a QCCP).

In addition to the requests for comments detailed above, the Commission invites public comment on its cost-benefit considerations. Specifically, the Commission seeks comment, including quantitative data, if available, concerning the costs and benefits associated with having an opt-in process for DCOs that have not been designated as systemically important by the Council to elect to be subject to Subpart C, the proposed process for that election, and the costs and benefits that may be incurred and realized by the clearing members and customers of a Subpart C DCO that rescinds its election to become subject to the provisions of Subpart C. In addition, the Commission seeks comment on whether the notice requirements, the 90 day notice period and the requirements set forth in proposed regulation 39.31(e)(3)(iii) are sufficient to mitigate the costs associated with a Subpart C DCO's ability to rescind its election. Commenters are also invited to submit with their comment letters any data or other information that they may have quantifying or qualifying the costs and benefits of the proposed regulations.

ii. Regulation 39.32 (Governance for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

The requirements set forth in proposed regulation 39.32 would appear to be beneficial to the extent that they cause a SIDCO or Subpart C DCO to internalize and/or more appropriately allocate certain costs that would otherwise be borne by clearing members, customers of clearing members, and other relevant stakeholders. Such requirements would also appear to promote market stability because the governance arrangements of SIDCOs and Subpart C DCOs would be required to explicitly support the stability of the financial system and other relevant public interest considerations of clearing members, customers of clearing members, and

other relevant stakeholders,<sup>206</sup> and reflect the legitimate interests of clearing members, customers of clearing members, and other relevant stakeholders. Finally, the governance arrangements required by proposed regulation 39.32 would promote a more efficient, effective, and reliable DCO risk management and operating structure.

As discussed in section II.D. above, the Commission requests comments on the potential benefits to a SIDCO and a Subpart C DCO in complying with all aspects of proposed regulation 39.32, and any benefits that would be realized by other market participants (including members of such a DCO and their customers) or the financial system more broadly. As noted above, the Commission specifically requests comment on alternative means to address these issues, and the benefits associated with such alternatives.

iii. Regulation 39.33 (Financial Resources for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

As described above, proposed regulation 39.33(a), as revised, would be expanded to include Subpart C DCOs and require those Subpart C DCOs that engage in an activity with a more complex risk profile (e.g., clearing credit default swaps or credit default futures), or that are systemically important in multiple jurisdictions, to comply with the Cover Two minimum financial resources requirement.<sup>207</sup> This regulation currently applies to SIDCOs. Proposed regulation 39.33(a) would increase the financial stability of Subpart C DCOs that are engaged in activities with a more complex risk profile or that are systemically important in multiple jurisdictions because it would require such Subpart C DCOs to comply with enhanced minimum financial resource requirements. Compliance with such standards, in turn, could increase the overall stability of the U.S. financial markets because enhancing a Subpart C DCO's financial resources requirements from the minimum of Cover One to a more stringent Cover Two standard helps to ensure the affected Subpart C DCO will have greater financial resources to meet its obligations to market participants, including in the case of defaults by multiple clearing members. These added financial resources lessen the likelihood of the

<sup>204</sup> See *supra* Section I.F.

<sup>205</sup> See *supra* Section I.F. (discussing QCCP status and the Basel CCP Capital Requirements); see also *supra* Section II.C. (discussing proposed regulation 39.31).

<sup>206</sup> See *supra* Section II.D. (discussing proposed regulation 39.32).

<sup>207</sup> See *supra* Section II.E. (discussing proposed revised regulation 39.33).

Subpart C DCO's failure which, in times of market turmoil, could increase the risk to the stability of the U.S. financial system.<sup>208</sup> By bolstering certain Subpart C DCO's resources, regulation 39.33(a) contributes to the financial integrity of the financial markets and reduces the likelihood of systemic risk from spreading through the financial markets due to the Subpart C DCO's failure or disruption. In addition, the approach of obtaining resources in such low-stress periods avoids the need to call for additional resources from clearing members during less stable, more volatile times, which would have procyclical effects on the U.S. financial markets.

As described above, proposed regulation 39.33(a)(2) would provide the Commission with the ability to determine that a SIDCO or a Subpart C DCO is systemically important in multiple jurisdictions, considering whether the DCO is a SIDCO and whether the DCO has been determined to be systemically important by one or more foreign jurisdictions pursuant to a designation process that considers whether the foreseeable effects of a failure or disruption of the SIDCO or Subpart C DCO could threaten the stability of each relevant jurisdiction's financial system. Moreover, proposed regulation 39.33(a)(3) would provide the Commission with the ability to expand the definition of "activity with a more complex risk profile" beyond clearing credit default swaps or credit default futures. These provisions give the Commission the flexibility to determine, under appropriate circumstances, what particular SIDCOs or Subpart C DCOs (or DCOs that engage in certain activities) would need to maintain Cover Two default resources. Such a decision would help to ensure that the affected SIDCO or Subpart C DCO would have greater financial resources to meet its obligations to market participants, including in the case of defaults by multiple clearing members. These added financial resources would decrease the likelihood that the SIDCO or Subpart C DCO would fail, thus contributing to the integrity and stability of the financial markets.

Proposed regulation 39.33 would also prohibit a Subpart C DCO from using assessments to meet its default resource obligations, *i.e.*, those under regulations 39.11(a)(1) and 39.33(a). This prohibition currently applies to SIDCOs. Prohibiting the use of assessments by a Subpart C DCO in meeting its default resource requirement would appear to increase the financial

stability of the Subpart C DCO, which in turn, would increase the overall stability of the U.S. financial markets.

Assessment powers are more likely to be exercised during periods of financial market stress. If, during such a period, a clearing member defaults and the loss to the Subpart C DCO is sufficiently large to deplete (1) the collateral posted by the defaulting clearing member, (2) the defaulting clearing member's guaranty fund contribution, and (3) the remaining pre-funded default fund contributions, a Subpart C DCO's exercise of assessment powers over the non-defaulting clearing members may exacerbate a presumably already weakened financial market. The demand by a Subpart C DCO for more capital from its clearing members could force one or more additional clearing members into default because they cannot meet the assessment. The inability to meet the assessment could lead clearing members and/or their customers to de-leverage (*i.e.*, sell off their positions) in falling asset markets, which further drives down asset prices and may result in clearing members and/or their customers defaulting on their obligations to each other and/or to the Subpart C DCO. In such extreme circumstances, assessments could trigger a downward spiral and lead to the destabilization of the financial markets. Prohibiting the use of assessments by a Subpart C DCO in meeting default resources requirements is intended to require the Subpart C DCO to retain more financial resources upfront, *i.e.*, to prefund its financial resources requirement to cover its potential exposure.

The increase in prefunding of financial resources by a Subpart C DCO may increase costs to clearing members of that Subpart C DCO (*e.g.*, requiring clearing members to post additional funds with the Subpart C DCO), but it also reduces the likelihood that the Subpart C DCO will require additional capital infusions during a time of financial stress when raising such additional capital is expensive relative to market norms. By increasing prefunded financial resources, a Subpart C DCO becomes less reliant on the ability of its clearing members to pay an assessment, more secure in its ability to meet its obligations, and more viable in any given situation, even in the case of multiple defaults of clearing members. Accordingly, proposed regulation 39.33(b) would increase the financial security and reliability of the Subpart C DCO, which will, therefore, further increase the overall stability of the U.S. financial markets.

As described above, proposed regulation 39.33(c) would require a SIDCO or Subpart C DCO to maintain a minimum level of eligible liquidity resources that would permit the DCO to satisfy its intraday, same-day, and multi-day settlement obligations in all relevant currencies. Proposed regulation 39.33(d) would require a SIDCO or Subpart C DCO to undertake due diligence to confirm that each liquidity provider upon which the DCO relies has the capacity to perform its commitments to provide liquidity (and to regularly test its own procedures for accessing its liquidity resources) and would require a SIDCO with access to accounts and services at a Federal Reserve Bank to use such services where practical. Proposed regulation 39.33(e) would require a SIDCO or Subpart C DCO to document its supporting rationale for, and to have adequate governance arrangements relating to, the amount of total financial resources it maintains and the amount of total liquidity resources it maintains.

These requirements would increase the likelihood that a SIDCO or Subpart C DCO would promptly meet its settlement obligations in a variety of market conditions. In determining the resources that would be necessary to meet the qualifying liquid resources requirements, a SIDCO or Subpart C DCO may need to undertake a complex analysis of the SIDCO's or Subpart C DCO's exposures and processes, including various models, and, where appropriate, designing and implementing changes to either create or modify existing internal processes and documenting the rationale for the amount of total financial and total liquidity resources the SIDCO or Subpart C DCO maintains. These efforts are likely to contribute to a better *ex ante* understanding by the SIDCO's or Subpart C DCO's management of the liquidity risks the DCO is likely to face in a stress scenario, resources that are calculated to enable the DCO to completely meet its settlement obligations on a prompt basis despite the default of a clearing member, and better assurance of its ability to rely on the commitments of its liquidity providers.

The result of this analysis and these enhanced resources is likely to be better preparation to meet liquidity challenges promptly, and a greater likelihood that the DCO would efficiently and effectively meet its obligations promptly in a default scenario. This improved preparation and enhanced likelihood of the SIDCO or Subpart C DCO's prompt meeting of its own obligations will benefit the DCO's clearing members and

<sup>208</sup> See *supra* Section I.B.

their customers by avoiding an inability to meet settlement obligations that might cause knock-on liquidity problems to such clearing members and their customers. The harm to clearing members and customers from a failure of a SIDCO or Subpart C DCO to meet its obligations promptly would be especially serious in a time of general financial stress. The assurance of the DCO meeting its settlement obligations promptly would also redound to the benefit of the larger financial system by mitigating systemic risk.

As discussed in section II.E. above, the Commission requests comments on the potential benefits to a SIDCO or a Subpart C DCO in complying with all aspects of proposed regulation 39.33, and any benefits that would be realized by other market participants or the financial system more broadly. As noted above, the Commission specifically requests comment on alternative means to address these issues, and the benefits associated with such alternatives.

iv. Regulation 39.34 (System Safeguards for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

As discussed above, proposed amended regulation 39.34 would require SIDCOs and Subpart C DCOs to comply with enhanced system safeguards requirements.<sup>209</sup> While SIDCOs are already subject to these requirements, the Commission proposes expanding this regulation to include Subpart C DCOs. A two-hour RTO in a Subpart C DCO's BC-DR plan would increase the soundness and operating resiliency of the Subpart C DCO. The two-hour RTO ensures that even in the event of a wide-scale disruption, the potential negative effects upon U.S. financial markets would be minimized because the affected Subpart C DCO would recover rapidly and resume its critical market functions. This would allow other market participants to process their transactions, including those participants in locations not directly affected by the disruption. The two-hour RTO would increase a Subpart C DCO's resiliency by requiring the Subpart C DCO to have the resources and technology necessary to resume operations promptly. This resiliency, in turn, would increase the overall stability of the U.S. financial markets.

As discussed in section II.F. above, the Commission requests comments on the potential benefits to a SIDCO or a Subpart C DCO in complying with all aspects of proposed regulation 39.34,

and any benefits that would be realized by other market participants or the financial system more broadly. As noted above, the Commission specifically requests comment on alternative means to address these issues, and the benefits associated with such alternatives.

v. Regulation 39.35 (Default Rules and Procedures for Uncovered Losses or Shortfalls (Recovery) for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

As discussed above, proposed regulation 39.35 would require SIDCOs and Subpart C DCOs to adopt explicit rules and procedures for: (i) Allocating uncovered credit losses and (ii) meeting all settlement obligations in a variety of market conditions.<sup>210</sup> The analysis SIDCOs and Subpart C DCOs would need to perform to create these rules and procedures are likely to contribute to a better ex ante understanding by the SIDCO or Subpart C DCO of the scenarios that would lead to uncovered credit losses or liquidity shortfalls. This analysis would also enable the SIDCO or Subpart C DCO to more effectively and efficiently meet its obligations promptly, thereby avoiding harm to clearing members and their customers from a default. In addition, requiring SIDCOs and Subpart C DCOs to have clear rules and procedures addressing such scenarios would be beneficial for clearing members and their customers in that these rules and procedures would provide clearing members with a better understanding of the members' own obligations, and the extent to which the SIDCO or Subpart C DCO would perform its obligations to its clearing members during periods of market stress. This understanding would, in turn, contribute to the ability of clearing members and their customers to tailor their own contingency plans to address those circumstances. Improved preparation by SIDCOs, Subpart C DCOs, and their clearing members will also redound to the benefit of the larger financial system by mitigating systemic risk.

As discussed in section II.G. above, the Commission requests comments on the potential benefits to a SIDCO or a Subpart C DCO in complying with all aspects of proposed regulation 39.35, and any benefits that would be realized by other market participants or the financial system more broadly. As noted above, the Commission specifically requests comment on alternative means

to address these issues, and the benefits associated with such alternatives.

vi. Regulation 39.36 (Risk Management for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

As discussed above, the enhanced risk management requirements set forth in proposed regulation 39.36 are designed to help SIDCOs and Subpart C DCOs manage their risk exposure.<sup>211</sup> For example, the proposed provisions would require SIDCOs and Subpart C DCOs to stress test their financial resources, stress test their liquidity resources, and conduct regular sensitivity analyses of their margin methodologies. The analyses performed under the proposed requirements would appear to increase the DCO's ability to mitigate and address credit risks, and to create proper incentives for members with respect to the exposures they create to the SIDCO or Subpart C DCO by enabling the DCO to tie risk exposures to margin requirements. In addition, proposed regulation 39.36 would require a SIDCO or Subpart C DCO to monitor, manage and limit its credit and liquidity risks arising from its settlement banks, as well invest its own funds and assets in instruments with minimal credit, market, and liquidity risks. This provision would also appear to increase the SIDCO's or Subpart C DCO's ability to mitigate and address the probability of being exposed to a settlement bank's failure and the potential losses and liquidity pressures to which the SIDCO or Subpart C DCO would be exposed in the event of such a failure. This, in turn, would benefit members of such DCOs and their customers, as discussed above. It would also appear that by enhancing the reliability and stability of SIDCOs and Subpart C DCOs, the overall stability of the U.S. financial markets will be strengthened.

As discussed in section II.H. above, the Commission requests comments on the potential benefits to a SIDCO or a Subpart C DCO in complying with all aspects of proposed regulation 39.36, and any benefits that would be realized by members of such DCOs and their customers, as well as other market participants or the financial system more broadly. As noted above, the Commission specifically requests comment on alternative means to address these issues, and the benefits associated with such alternatives.

<sup>194</sup> See *supra* Section II.F (discussing proposed regulation 39.34).

<sup>210</sup> See *supra* Section II.G (discussing proposed regulation 39.35).

<sup>211</sup> See *supra* Section II.H (discussing proposed regulation 39.36).

vii. Regulation 39.37 (Additional Disclosure for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

The disclosure requirements set forth in proposed regulation 39.37<sup>212</sup> would be beneficial to clearing members of SIDCOs and Subpart C DCOs, as well as to customers of clearing members, because they would provide transparency and certainty concerning the processes, operations and exposures of these DCOs. In particular, proposed paragraph (d) would require a SIDCO or Subpart C DCO to publicly disclose its policies and procedures concerning the segregation and portability of customers' positions and funds. These disclosures would enable clearing members and their customers to better understand their respective exposures to the SIDCO or Subpart C DCO, to better choose a DCO that fits their needs, and, in turn, to create incentives for safe and effective operations of SIDCOs and Subpart C DCOs.

As discussed in section II.I. above, the Commission requests comments on the potential benefits to a SIDCO or a Subpart C DCO in complying with all aspects of proposed regulation 39.37, and any benefits that would be realized by members of such DCOs and their customers, as well as other market participants or the financial system more broadly. As noted above, the Commission specifically requests comment on alternative means to address these issues, and the benefits associated with such alternatives.

viii. Regulation 39.38 (Efficiency for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

The efficiency requirements set forth in proposed regulation 39.38 would be beneficial to clearing members of SIDCOs and Subpart C DCOs, as well as to customers of clearing members, because they would require these DCOs to regularly endeavor to improve their clearing and settlement arrangements, operating structures and procedures, product offerings, and use of technology. In addition, SIDCOs and Subpart C DCOs would be required to facilitate efficient payment, clearing and settlement by accommodating internationally accepted communication procedures and standards, which could result in operational efficiency for market participants. As a result, members of such DCOs and their customers, as well as the marketplace

more broadly, may be offered more efficient clearing services that may be easier to access at an operational level.

As discussed in section II.J. above, the Commission requests comments on the potential benefits to a SIDCO or a Subpart C DCO in complying with all aspects of proposed regulation 39.38, and any benefits that would be realized by members of such DCOs, their customers, as well as other market participants or the financial system more broadly. As noted above, the Commission specifically requests comment on alternative means to address these issues, and the benefits associated with such alternatives.

ix. Regulation 39.39 (Recovery and Wind-Down for Systemically Important Derivatives Clearing Organizations and Subpart C Derivatives Clearing Organizations)

As discussed above, proposed regulation 39.39 would require a SIDCO and Subpart C DCO to maintain viable plans for recovery and orderly wind-down, in cases necessitated by (1) credit losses or liquidity shortfalls and (2) general business risk, operational risk, or any other risk that threatens the derivatives clearing organization's viability as a going concern. This would require the DCO to identify scenarios that may prevent a SIDCO or Subpart C DCO from being able to provide its critical operations and services as a going concern and to assess the effectiveness of a full range of options for recovery or orderly wind-down.

The proposed regulation would also require a SIDCO or Subpart C DCO to evaluate the resources available to meet the plan to cover credit losses and liquidity shortfalls, and to maintain sufficient unencumbered liquid financial assets to implement the plan to cover other risks. The latter point requires a SIDCO or Subpart C DCO to analyze whether its particular circumstances and risks require it to maintain liquid net assets to fund the plan that are in addition to those resources currently required by regulation 39.11(a)(2).<sup>213</sup>

The complex analysis and plan preparation that a SIDCO or Subpart C DCO would undertake to comply with the proposed regulation, including designing and implementing changes to existing plans, are likely to contribute to a better *ex ante* understanding by the SIDCO's or Subpart C DCO's management of the challenges the DCO would face in a recovery or wind-down scenario, and thus better preparation to

meet those challenges. This improved preparation would help reduce the possibility of market disruptions and financial losses to clearing members and their customers. By maintaining and regularly updating recovery and wind-down plans, and maintaining resources and arrangements designed to meet the requirements of such plans, the DCO will better be able to mitigate the impact that a threat to, or a disruption of, a SIDCO's or Subpart C DCO's operations would have on customers, clearing members, and, more broadly, the stability of the U.S. financial markets. By reducing the possibility that a DCO would default in a disorganized fashion, the proposed regulation would also help to reduce the likelihood of a failure by the DCO to meet its obligations to its members, thereby enhancing protection for members of such a DCO and their customers, as well as helping to avoid the systemic effects of DCO failure.

As discussed in section II.K. above, the Commission requests comments on the potential benefits to a SIDCO or a Subpart C DCO in complying with all aspects of proposed regulation 39.39, and any benefits that would be realized by members of such DCOs and their customers, as well as other market participants or the financial system more broadly. As noted above, the Commission specifically requests comment on alternative means to address these issues, and the benefits associated with such alternatives.

#### 4. Section 15(a) Factors

##### i. Protection of Market Participants and the Public

The proposed regulations create additional standards for compliance with the CEA, which include governance standards, enhanced financial resources and liquidity resource requirements, system safeguard requirements, special default rules and procedures for uncovered losses or shortfalls, enhanced risk management requirements, additional disclosure requirements, efficiency standards, and standards for recovery and wind-down procedures. They also include procedures for Subpart C DCOs to elect to be held to such additional standards, and procedures to rescind such election. These standards and procedures would further the protection of members of SIDCOs and Subpart C DCOs, customers of such members, as well as other market participants and the public by increasing the financial stability and operational security of SIDCOs and Subpart C DCOs. These proposed regulations could, more broadly, increase the stability of the U.S.

<sup>212</sup> See *supra* Section II.I (discussing proposed regulation 39.37).

<sup>213</sup> See *supra* Section II.K (discussing proposed regulation 39.39).



financial markets. A designation of systemic importance under Title VIII means the failure of a SIDCO or the disruption of its clearing and settlement activities could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets, thereby threatening the stability of the U.S. financial markets. The regulations contained in this proposed rule are designed to help ensure that SIDCOs continue to function even in extreme circumstances, including multiple defaults by clearing members and wide-scale disruptions. While there may be increased costs associated with the implementation of the proposed rules, the increased costs associated with the implementation of the proposed rules for Subpart C DCOs would be borne only by those DCOs that have not been designated systemically important under Title VIII and that elect to become subject to the provisions of Subpart C. Some of those costs would ultimately be borne by clearing members of such Subpart C DCOs, and by customers of such clearing members.

The costs of this rulemaking would be mitigated by the countervailing benefits of stronger resources, improved design, more efficient and effective processes, and enhanced planning that would lead to increased safety and soundness of SIDCOs and the reduction of systemic risk, which protect market participants and the public from the adverse consequences that would result from a SIDCO's failure or a disruption in its functioning. Similarly, the proposed regulations would increase the safety and soundness of Subpart C DCOs so that they may continue to operate even in extreme circumstances, which would, in turn, better protect members of such DCOs, their customers, and also market participants and the public, particularly during time of severe market stress.

#### ii. Efficiency, Competitiveness, and Financial Integrity

The regulations set forth in this proposed rulemaking would promote the financial strength and stability of SIDCOs and Subpart C DCOs, as well as, more broadly, efficiency and greater competition in the global markets. Proposed regulation 39.38 expressly promotes efficiency in the design of a SIDCO's or Subpart C DCO's settlement and clearing arrangements, operating structure and procedures, scope of products cleared, and use of technology. The proposed regulation also requires SIDCOs and Subpart C DCOs to accommodate internationally accepted communication procedures and standards to facilitate efficient payment,

clearing, and settlement. In addition, the proposed regulations promote efficiency insofar as SIDCOs and Subpart C DCOs that operate with enhanced financial and liquidity resources, enhanced risk management requirements, increased system safeguards, and wind-down or recovery plans are more secure and are less likely to fail.

The proposed regulations would also promote competition because they are consistent with the international standards set forth in the PFMI and will help to ensure that SIDCOs are held to international standards and thus are enabled to gain QCCP status and accordingly avoid an important competitive disadvantage relative to similarly situated foreign CCPs that meet international standards and are QCCPs. Moreover, by allowing other DCOs to elect to become subject to the provisions of Subpart C and thus the opportunity to meet international standards and to gain QCCP status, the proposed regulations promote competition among registered DCOs, and between registered DCOs and foreign CCPs that meet international standards and are QCCPs. Conversely, the Commission notes that these enhanced financial resources and risk management standards are also associated with additional costs and to the extent that SIDCOs and Subpart C DCOs pass along the additional costs to their clearing members and, indirectly, those clearing members' customers, participation in the affected markets may decrease and have a negative impact on price discovery. However, it would appear that such higher transactional costs should be offset by the lower capital charges granted to clearing members and customers for exposures resulting from transactions that are cleared through SIDCOs and Subpart C DCOs that are also QCCPs.

Additionally, enhanced risk management and operational standards would promote financial integrity by leading to SIDCOs and Subpart C DCOs to be more secure and less likely to fail. By increasing the stability and strength of the SIDCOs and Subpart C DCOs, the proposed regulations would help SIDCOs and Subpart C DCOs to meet their obligations in extreme circumstances and be able to resume operations even in the face of wide-scale disruption, which contributes to the financial integrity of the financial markets. Moreover, in requiring (1) more financial resources to be pre-funded by expanding the potential losses those resources are intended to cover and restricting the means for satisfying those resource requirements, and (2) requiring greater liquidity resources, the

requirements of these proposed regulations seek to lessen the incidence of pro-cyclical demands for additional resources and, in so doing, promote both financial integrity and market stability. These efforts would redound to the benefit of clearing members and their customers, as well as the financial system more broadly.

#### iii. Price Discovery

The regulations in this proposed rulemaking would enhance financial resources, liquidity resources, risk management standards, disclosure standards, and recovery planning for SIDCOs and Subpart C DCOs which may result in increased public confidence, which, in turn, might lead to expanded participation in the affected markets (including markets with products with a more complex risk profile). The expanded participation in these markets (*i.e.*, greater transactional volume) may have a positive impact on price discovery. Conversely, the Commission notes that these proposed regulations are also associated with additional costs and to the extent that SIDCOs and Subpart C DCOs pass along the additional costs to their clearing members and, indirectly, to their clearing members' customers, participation in the affected markets may decrease and have a negative impact on price discovery. However, it is the Commission's belief that such higher transactional costs should be offset by the lower capital charges granted to clearing members and customers with exposures resulting from transactions cleared through SIDCOs and Subpart C DCOs that are deemed QCCPs.

#### iv. Sound Risk Management Practices

The regulations in this proposed rulemaking contribute to the sound risk management practices of SIDCOs and Subpart C DCOs because the requirements would promote the safety and soundness of SIDCOs and Subpart C DCOs by: (1) Enhancing the financial resources requirements and liquidity resource requirements; (2) enhancing understanding of credit and liquidity risks and related governance arrangements; (3) enhancing system safeguards to facilitate the continuous operation and rapid recovery of activities;<sup>214</sup> (4) enhancing risk management standards by creating new stress testing and sensitivity analysis

<sup>214</sup> As mentioned above, this proposed rulemaking would extend to Subpart C DCOs the system safeguards requirements currently applicable to SIDCOs. *See supra* Section II.F (discussing proposed revised regulation 39.34 (system safeguards)).

requirements; (5) promoting the active management of credit and liquidity risks arising from settlement banks;<sup>215</sup> and (6) enhancing risk management by establishing rules and procedures addressing uncovered credit losses or liquidity shortfalls, and recovery and wind-down planning for credit risks and for business continuity and operational risks.<sup>216</sup> In addition, by strengthening financial and liquidity resource requirements, enhancing risk management standards, and enhancing disclosure and recovery planning requirements, these proposed regulations would provide greater certainty for clearing members of such DCOs, their customers, and other market participants that obligations of the SIDCOs and Subpart C DCOs will be honored, and provide certainty and security to market participants that potential disruptions will be reduced and, by extension, the risk of loss of capital and liquidity will be reduced.

#### v. Other Public Interest Considerations

The Commission notes the strong public interest for jurisdictions to either adopt the PFMI or establish standards consistent with the PFMI in order to allow CCPs licensed in the relevant jurisdiction to gain QCCP status. As emphasized throughout this proposed rulemaking, SIDCOs and Subpart C DCOs that are held to international standards and that gain QCCP status might hold a competitive advantage in the financial markets by, *inter alia*, helping bank clearing members and bank customers avoid the much higher capital charges imposed by the Basel CCP Capital Requirements on exposures to non-QCCPs. Moreover, because “enhancements to the regulation and supervision of systemically important financial market utilities . . . are necessary . . . to support the stability of the broader financial system,”<sup>217</sup> adopting these proposed rules would promote the public interest in a more stable broader financial system.

#### List of Subjects in 17 CFR Part 39

Commodity futures, Risk management, Settlement procedures, Default rules and procedures, System safeguards.

For the reasons stated in the preamble, the Commission proposes to amend 17 CFR part 39 as follows:

<sup>215</sup> See *supra* Section II.H (discussing proposed regulation 39.36).

<sup>216</sup> See *supra* Section II.G (discussing proposed regulation 39.35); see also *supra* Section II.K (discussing proposed regulation 39.39).

<sup>217</sup> See Section 802(a)(4) of the Dodd-Frank Act (Congressional Findings).

## PART 39—DERIVATIVES CLEARING ORGANIZATIONS

■ 1. The authority citation for part 39 is amended to read as follows:

**Authority:** 7 U.S.C. 2, 7a–1, and 12a; 12 U.S.C. 5464; 15 U.S.C. 8325.

■ 2. Revise § 39.2 to read as follows:

### § 39.2 Definitions.

For the purposes of this part: *Activity with a more complex risk profile* includes:

(1) Clearing credit default swaps, credit default futures, or derivatives that reference either credit default swaps or credit default futures and

(2) Any other activity designated as such by the Commission pursuant to § 39.33(a)(3).

*Back test* means a test that compares a derivatives clearing organization's initial margin requirements with historical price changes to determine the extent of actual margin coverage.

*Customer* means a person trading in any commodity named in the definition of commodity in section 1a(9) of the Act or in § 1.3 of this chapter, or in any swap as defined in section 1a(47) of the Act or in § 1.3 of this chapter; *Provided, however*, an owner or holder of a house account as defined in this section shall not be deemed to be a customer within the meaning of section 4d of the Act, the regulations that implement sections 4d and 4f of the Act and § 1.35, and such an owner or holder of such a house account shall otherwise be deemed to be a customer within the meaning of the Act and §§ 1.37 and 1.46 of this chapter and all other sections of these rules, regulations, and orders which do not implement sections 4d and 4f of the Act.

*Customer account* or *customer origin* means a clearing member account held on behalf of customers, as that term is defined in this section, and which is subject to section 4d(a) or section 4d(f) of the Act.

*Depository institution* has the meaning set forth in section 19(b)(1)(A) of the Federal Reserve Act (12 U.S.C. 461(b)(1)(A)).

*House account* or *house origin* means a clearing member account which is not subject to section 4d(a) or 4d(f) of the Act.

*Key personnel* means derivatives clearing organization personnel who play a significant role in the operations of the derivatives clearing organization, the provision of clearing and settlement services, risk management, or oversight of compliance with the Act and Commission regulations and orders. Key personnel include, but are not limited to, those persons who are or perform the functions of any of the following: Chief

executive officer; president; chief compliance officer; chief operating officer; chief risk officer; chief financial officer; chief technology officer; and emergency contacts or persons who are responsible for business continuity or disaster recovery planning or program execution.

*Stress test* means a test that compares the impact of potential extreme price moves, changes in option volatility, and/or changes in other inputs that affect the value of a position, to the financial resources of a derivatives clearing organization, clearing member, or large trader, to determine the adequacy of the financial resources of such entities.

*Subpart C derivatives clearing organization* means any derivatives clearing organization, as defined in section 1a(15) of the Act and § 1.3(d) of this chapter, which:

(1) Is registered as a derivatives clearing organization under section 5b of the Act;

(2) Is not a systemically important derivatives clearing organization; and

(3) Has become subject to the provisions of this Subpart C, pursuant to § 39.31.

*Systemically important derivatives clearing organization* means a financial market utility that is a derivatives clearing organization registered under section 5b of the Act, which is currently designated by the Financial Stability Oversight Council to be systemically important and for which the Commission acts as the Supervisory Agency pursuant to 12 U.S.C. 5462(8).

*U.S. branch and agency of a foreign banking organization* means the U.S. branch and agency of a foreign banking organization as defined in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101).

*Trust company* means a trust company that is a member of the Federal Reserve System, under section 1 of the Federal Reserve Act (12 U.S.C. 221), but that does not meet the definition of depository institution.

■ 3. In Subpart B, add and reserve §§ 39.28 and 39.29.

■ 4. Revise Subpart C to read as follows:

### Subpart C—Provisions Applicable to Systemically Important Derivatives Clearing Organizations and Derivatives Clearing Organizations That Elect To Be Subject to the Provisions of Subpart C

Sec.

39.30 Scope.

39.31 Election to become subject to the provisions of subpart C.

39.32 Governance for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.

- 39.33 Financial resources for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.
- 39.34 System safeguards for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.
- 39.35 Default rules and procedures for uncovered losses or shortfalls (recovery) for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.
- 39.36 Risk management for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.
- 39.37 Additional disclosure for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.
- 39.38 Efficiency for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.
- 39.39 Recovery and wind-down for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.
- 39.40 Consistency with the Principles for Financial Market Infrastructures.
- 39.41 Special enforcement authority for systemically important derivatives clearing organizations.
- 39.42 Advance notice of material risk-related rule changes by systemically important derivatives clearing organizations.
- Appendix A to Part 39—Form DCO Derivatives Clearing Organization Application for Registration
- Appendix B to Part 39—Subpart C Election Form

**Subpart C—Provisions Applicable to Systemically Important Derivatives Clearing Organizations and Derivatives Clearing Organizations That Elect To Be Subject to the Provisions of Subpart C**

**§ 39.30 Scope.**

(a) The provisions of this subpart C apply to each of the following: A subpart C derivatives clearing organization, a systemically important derivatives clearing organization, and any derivatives clearing organization, as defined under section 1a(15) of the Act and § 1.3(d) of this chapter, seeking to become a subpart C derivatives clearing organization pursuant to § 39.31.

(b) A systemically important derivatives clearing organization is subject to the provisions of subparts A and B of this part in addition to the provisions of this subpart.

(c) A subpart C derivatives clearing organization is subject to the provisions of subparts A and B of this part in addition to the provisions of this subpart except for §§ 39.41 and 39.42 of this subpart.

**§ 39.31 Election to become subject to the provisions of subpart C.**

(a) *Election eligibility.* (1) A derivatives clearing organization that is registered with the Commission and that is not a systemically important derivatives clearing organization may elect to become a subpart C derivatives clearing organization subject to the provisions of this subpart, using the procedures set forth in paragraph (b) of this section.

(2) An applicant for registration as a derivatives clearing organization pursuant to § 39.3 may elect to become a subpart C derivatives clearing organization subject to the provisions of this subpart as part of its application for registration using the procedures set forth in paragraph (c) of this section.

(b) *Election and withdrawal procedures applicable to registered derivatives clearing organizations.* (1) Election. A derivatives clearing organization that is registered with the Commission and that is not a systemically important derivatives clearing organization may request that the Commission accept its election to become a subpart C derivatives clearing organization by filing with the Commission a completed Subpart C Election Form. The Subpart C Election Form shall include the election and all certifications, disclosures and exhibits, as provided in appendix B to this part and any amendments or supplements thereto filed with the Commission pursuant to paragraphs (b)(2) and (b)(3) of this section.

(2) Submission of supplemental information. The filing of a Subpart C Election Form does not create a presumption that the Subpart C Election Form is materially complete or that supplemental information will not be required. The Commission, at any time prior to the effective date, as provided in paragraph (b)(4) of this section, may request that the derivatives clearing organization submit supplemental information in order for the Commission to process the Subpart C Election Form, and the derivatives clearing organization shall file such supplemental information with the Commission.

(3) Amendments. A derivatives clearing organization shall promptly amend its Subpart C Election Form if it discovers a material omission or error in, or if there is a material change in, the information provided to the Commission in the Subpart C Election Form or other information provided in connection with the Subpart C Election Form.

(4) Effective date. A derivatives clearing organization's election to

become a subpart C derivatives clearing organization shall become effective:

(i) Upon the later of the following, provided the Commission has neither stayed nor denied such election as set forth in paragraph (b)(5) of this section.

(A) The effective date specified by the derivatives clearing organization in its Subpart C Election Form; or

(B) Ten business days after the derivatives clearing organization files its Subpart C Election Form with the Commission;

(ii) Or upon the effective date set forth in written notification from the Commission that it shall permit the election to take effect after a stay issued pursuant to paragraph (b)(5) of this section.

(5) Stay or denial of election. Prior to the effective date set forth in paragraph (b)(4)(i) of this section, the Commission may stay or deny a derivatives clearing organization's election to become a subpart C derivatives clearing organization by issuing a written notification thereof to the derivatives clearing organization.

(6) Commission acknowledgement. The Commission may acknowledge, in writing, that it has received a Subpart C Election Form filed by a derivatives clearing organization and that it has permitted the derivatives clearing organization's election to become subject to the provisions of this subpart C to take effect, and the effective date of such election.

(7) Withdrawal of election. A derivatives clearing organization that has filed a Subpart C Election Form may withdraw an election to become subject to the provisions of this subpart C at any time prior to the date that the election is permitted to take effect by filing with the Commission a notice of the withdrawal of election.

(c) *Election and withdrawal procedures applicable to applicants for registration as derivatives clearing organization—*(1) Election. An applicant for registration as a derivatives clearing organization that requests an election to become subject to the provisions of this subpart C may make that request by attaching a completed Subpart C Election Form to the Form DCO that it files pursuant to § 39.3. The Subpart C Election Form shall include the election and all certifications, disclosures and exhibits, as provided in appendix B to part 39, and any amendments or supplements thereto filed with the Commission pursuant to paragraphs (c)(3) or (c)(4) of this section.

(2) Election review and effective date. The Commission shall review the applicant's Subpart C Election Form as part of the Commission's review of its

application for registration pursuant to § 39.3(a). The Commission may permit the applicant's election to take effect at the time it approves the applicant's application for registration by providing written notice thereof to the applicant. The Commission shall not approve any application for registration filed pursuant to § 39.3(a) for which a Subpart C Election Form is pending, if the Commission determines that the applicant's election to become subject to Subpart C should not become effective because the applicant has not demonstrated its ability to comply with the applicable provisions of this subpart.

(3) Submission of supplemental information. The filing of a Subpart C Election Form does not create a presumption that the Subpart C Election Form is materially complete or that supplemental information will not be required. At any time during the Commission's review of the Subpart C Election Form, the Commission may request that the applicant submit supplemental information in order for the Commission to process the Subpart C Election Form and the applicant shall file such supplemental information with the Commission.

(4) Amendments. An applicant for registration as a derivatives clearing organization shall promptly amend its Subpart C Election Form if it discovers a material omission or error in, or if there is a material change in, the information provided to the Commission in the Subpart C Election Form or other information provided in connection with the Subpart C Election Form.

(5) Withdrawal of election. An applicant for registration as a derivatives clearing organization may withdraw an election to become subject to the provisions of this subpart C by filing with the Commission a notice of the withdrawal of its Subpart C Election Form at any time prior to the date that the Commission approves its application for registration as a derivatives clearing organization. The applicant may withdraw its Subpart C Election Form without withdrawing its Form DCO.

(d) *Public information.* The following portions of the Subpart C Election Form will be public: The Elections and Certifications and Disclosures in the Subpart C Election Form, the rules of the derivatives clearing organization, the regulatory compliance chart, and any other portion of the Subpart C Election Form not covered by a request for confidential treatment complying with the requirements of § 145.9 of this chapter.

(e) *Rescission of election*—(1) Notice of intent to rescind. A subpart C derivatives clearing organization may rescind its election to be subject to the provisions of this subpart C and terminate its status as a subpart C derivatives clearing organization by filing with the Commission a notice of its intent to rescind such election. The notice of intent to rescind the election shall include:

(i) The effective date of the rescission; and

(ii) A certification signed by the relevant duly authorized representative of the subpart C derivatives clearing organization, as specified in paragraph three of the General Instructions to the Subpart C Election Form, stating that the subpart C derivatives clearing organization:

(A) Has provided the notice to its clearing members required by paragraph (e)(3)(i)(A) of this section;

(B) Will provide the notice to its clearing members required by paragraph (e)(3)(i)(B) of this section;

(C) Has provided the notice to the general public required by paragraph (e)(3)(ii)(A) of this section;

(D) Will provide notice to the general public required by paragraph (e)(3)(ii)(B) of this section; and

(E) Has removed all references to the organization as a subpart C derivatives clearing organization and a qualifying central counterparty on its Web site and in all other material that it provides to its clearing members and customers, other market participants or members of the public, as required by paragraph (e)(3)(ii)(C) of this section.

(2) Effective date. The rescission of the election to be subject to the provisions of this subpart C shall become effective on the date set forth in the notice of intent to rescind the election filed by the subpart C derivatives clearing organization pursuant to § 39.31(e)(1), provided that the rescission may become effective no earlier than 90 days after the notice of intent to rescind the election is filed with the Commission. The subpart C derivatives clearing organization shall continue to comply with all of the provisions of this subpart C until such effective date.

(3) Additional notice requirements.

(i) A subpart C derivatives clearing organization shall provide the following notices, at the following times, to each of its clearing members and shall have rules in place requiring each of its clearing members to provide the following notices to each of the clearing member's customers:

(A) No later than the filing of a notice of its intent to rescind its election to be

subject to the provisions of this subpart C, written notice that it intends to file such notice with the Commission and the effective date thereof; and

(B) On the effective date of the rescission of its election to be subject to the provisions of this subpart C, written notice that the rescission has become effective.

(ii) A subpart C derivatives clearing organization shall:

(A) No later than the filing of a notice of its intent to rescind its election to be subject to the provisions of this subpart C, provide notice to the general public, displayed prominently on its Web site, of its intent to rescind its election to be subject to the provisions of this subpart C;

(B) On and after the effective date of the rescission of its election to be subject to the provisions of this subpart C, provide notice to the general public, displayed prominently on its Web site, that the rescission has become effective; and

(C) Prior to the filing of a notice of its intent to rescind its election to become subject to the provisions of this subpart C, remove all references to the derivatives clearing organization's status as a subpart C derivatives clearing organization and a qualifying central counterparty on its Web site and in all other materials that it provides to its clearing members and customers, other market participants, or the general public.

(iii) The employees and representatives of a derivatives clearing organization that has filed a notice of its intent to rescind its election to be subject to the provisions of this subpart C shall refrain from referring to the organization as a subpart C derivatives clearing organization and a qualifying central counterparty on and after the date that the notice of intent to rescind the election is filed.

(4) Effect of rescission. The rescission of a subpart C derivatives clearing organization's election to be subject to the provisions of this subpart C shall not affect the authority of the Commission concerning any activities or events occurring during the time that the derivatives clearing organization maintained its status as a subpart C derivatives clearing organization.

(f) *Loss of designation as a systemically important derivatives clearing organization.* A systemically important derivatives clearing organization whose designation of systemic importance is rescinded by the Financial Stability Oversight Council, shall immediately be deemed to be a subpart C derivatives clearing organization and shall continue to

comply with the provisions of this subpart C unless such derivatives clearing organization elects to rescind its status as a subpart C derivatives clearing organization in accordance with the requirements of paragraph (e) of this section.

(g) All forms and notices required by this § 39.31 shall be filed electronically with the Secretary of the Commission in the format and manner specified by the Commission.

**§ 39.32 Governance for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.**

(a) *General rules.* (1) Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall have governance arrangements that:

- (i) Are written;
- (ii) Are clear and transparent;
- (iii) Place a high priority on the safety and efficiency of the systemically important derivatives clearing organization or subpart C derivatives clearing organization; and
- (iv) Explicitly support the stability of the broader financial system and other relevant public interest considerations of clearing members, customers of clearing members, and other relevant stakeholders.

(2) The board of directors shall make certain that the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's design, rules, overall strategy, and major decisions appropriately reflect the legitimate interests of clearing members, customers of clearing members, and other relevant stakeholders.

(3) To an extent consistent with other statutory and regulatory requirements on confidentiality and disclosure:

- (i) Major decisions of the board of directors should be clearly disclosed to clearing members, other relevant stakeholders, and to the Commission; and
- (ii) Major decisions of the board of directors having a broad market impact should be clearly disclosed to the public;

(b) *Governance arrangements.* Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall have governance arrangements that:

- (1) Are clear and documented;
- (2) To an extent consistent with other statutory and regulatory requirements on confidentiality and disclosure, are disclosed, as appropriate, to the Commission and to other relevant authorities, to clearing members and to

customers of clearing members, to the owners of the systemically important derivatives clearing organization or subpart C derivatives clearing organization, and to the public;

(3) Describe the structure pursuant to which the board of directors, committees, and management operate;

(4) Include clear and direct lines of responsibility and accountability;

(5) Clearly specify the roles and responsibilities of the board of directors and its committees, including the establishment of a clear and documented risk management framework;

(6) Clearly specify the roles and responsibilities of management;

(7) Describe procedures for identifying, addressing, and managing conflicts of interest involving members of the board of directors;

(8) Describe procedures pursuant to which the board of directors oversees the chief risk officer, risk management committee, and material risk decisions;

(9) Assign responsibility and accountability for risk decisions, including in crises and emergencies; and

(10) Assign responsibility for implementing the:

- (i) Default rules and procedures required by §§ 39.16 and 39.35;
- (ii) System safeguard rules and procedures required by §§ 39.18 and 39.34; and

(iii) Recovery and wind-down plans required by § 39.39.

(c) *Fitness standards for board of directors and management.* Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall maintain policies to make certain that:

- (1) The board of directors consists of suitable individuals having appropriate skills and incentives;
- (2) The board of directors includes individuals who are not executives, officers or employees of the systemically important derivatives clearing organization or subpart C derivatives clearing organization or an affiliate thereof;

(3) The performance of the board of directors and the performance of individual directors are reviewed on a regular basis;

(4) Managers have the appropriate experience, skills, and integrity necessary to discharge operational and risk management responsibilities; and

(5) Risk management and internal control personnel have sufficient independence, authority, resources, and access to the board of directors so that the operations of the systemically important derivatives clearing

organization or subpart C derivatives clearing organization are consistent with the risk management framework established by the board of directors.

**§ 39.33 Financial resources requirements for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.**

(a) *General rule.* (1) Notwithstanding the requirements of § 39.11(a)(1), each systemically important derivatives clearing organization and subpart C derivatives clearing organization that, in either case, is systemically important in multiple jurisdictions or is involved in activities with a more complex risk profile shall maintain financial resources sufficient to enable it to meet its credit exposure to its clearing members notwithstanding a default by the two clearing members creating the largest aggregate credit exposure for the derivatives clearing organization in extreme but plausible market conditions.

(2) The Commission shall, if it deems appropriate, determine whether a systemically important derivatives clearing organization or subpart C derivatives clearing organization is systemically important in multiple jurisdictions. In determining whether a systemically important derivatives clearing organization or subpart C derivatives clearing organization is systemically important in multiple jurisdictions, the Commission shall consider whether the derivatives clearing organization:

- (i) Is a systemically important derivatives clearing organization, as defined by § 39.2; or
- (ii) Has been determined to be systemically important by one or more jurisdictions other than the United States pursuant to a designation process that considers whether the foreseeable effects of a failure or disruption of the derivatives clearing organization could threaten the stability of each relevant jurisdiction's financial system.

(3) The Commission shall, if it deems appropriate, determine whether any of the activities of a systemically important derivatives clearing organization or a subpart C derivatives clearing organization, in addition to clearing credit default swaps, credit default futures, and any derivatives that reference either credit default swaps or credit default futures, has a more complex risk profile. In determining whether an activity has a more complex risk profile, the Commission will consider characteristics such as discrete jump-to-default price changes or high correlations with potential participant defaults as factors supporting (though

not necessary for) a finding of a more complex risk profile.

(4) For purposes of this section 39.33, if a clearing member controls another clearing member or is under common control with another clearing member, such affiliated clearing members shall be deemed to be a single clearing member.

(b) *Valuation of financial resources.* Notwithstanding the provisions of § 39.11(d)(2), assessments for additional guaranty fund contributions (*i.e.*, guaranty fund contributions that are not pre-funded) shall not be included in calculating the financial resources available to meet a systemically important derivatives clearing organization's or subpart C derivatives clearing organization's obligations under paragraph (a) of this section or § 39.11(a)(1).

(c) *Liquidity resources*—(1) *Minimum amount of liquidity resources.*

(i) Notwithstanding the provisions of § 39.11(e)(1)(ii), each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall maintain eligible liquidity resources that, at a minimum, will enable it to meet its intraday, same-day, and multiday obligations to perform settlements, as defined in § 39.14(a)(1), with a high degree of confidence under a wide range of stress scenarios that should include, but not be limited to, a default by the clearing member creating the largest aggregate liquidity obligation for the systemically important derivatives clearing organization or subpart C derivatives clearing organization in extreme but plausible market conditions.

(ii) A systemically important derivatives clearing organization and subpart C derivatives clearing organization that is subject to § 39.33(a)(1) shall consider maintaining eligible liquidity resources that, at a minimum, will enable it to meet its intraday, same-day, and multiday obligations to perform settlements, as defined in § 39.14(a)(1), with a high degree of confidence under a wide range of stress scenarios that should include, but not be limited to, a default of the two clearing members creating the largest aggregate liquidity obligation for the systemically important derivatives clearing organization or subpart C derivatives clearing organization in extreme but plausible market conditions.

(2) *Satisfaction of settlement in all relevant currencies.* Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall maintain

liquidity resources that are sufficient to satisfy the obligations required by paragraph (c)(1) of this section in all relevant currencies for which the systemically important derivatives clearing organization or subpart C derivatives clearing organization has obligations to perform settlements, as defined in § 39.14(a)(1), to its clearing members.

(3) *Qualifying liquidity resources.* (i) Only the following liquidity resources are eligible for the purpose of meeting the requirement of paragraph (c)(1) of this section:

(A) Cash in the currency of the requisite obligations, held either at the central bank of issue or at a creditworthy commercial bank;

(B) Committed lines of credit;

(C) Committed foreign exchange swaps;

(D) Committed repurchase agreements; or

(E) (1) Obligations of the United States Treasury or high quality, liquid, general obligations of a sovereign nation.

(2) The assets described in paragraph (c)(3)(i)(E)(1) of this section must be readily available and convertible into cash pursuant to prearranged and highly reliable funding arrangements.

(ii) With respect to the arrangements described in paragraph (c)(3)(i) of this section, the systemically important derivatives clearing organization or subpart C derivatives clearing organization must take appropriate steps to verify that such arrangements do not include material adverse change provisions and are enforceable, and will be highly reliable, in extreme but plausible market conditions.

(4) *Additional liquidity resources.* If a systemically important derivatives clearing organization or subpart C derivatives clearing organization maintains financial resources in addition to those required to satisfy paragraph (c)(1) of this section, then those resources should be in the form of assets that are likely to be saleable with proceeds available promptly or acceptable as collateral for lines of credit, swaps, or repurchase agreements on an *ad hoc* basis. A systemically important derivatives clearing organization or subpart C derivatives clearing organization should consider maintaining collateral with low credit, liquidity, and market risks that is typically accepted by a central bank of issue for any currency in which it may have settlement obligations, but shall not assume the availability of emergency central bank credit as a part of its liquidity plan.

(d) *Liquidity providers.* (1) For the purposes of this paragraph, a liquidity provider means:

(i) A depository institution, a U.S. branch and agency of a foreign banking organization, a trust company, or a syndicate of depository institutions, U.S. branches and agencies of foreign banking organizations, or trust companies providing a line of credit, foreign exchange swap facility or repurchase facility to a systemically important derivatives clearing organization or subpart C derivatives clearing organization;

(ii) Any other counterparty relied upon by a systemically important derivatives clearing organization or subpart C derivatives clearing organization to meet its minimum liquidity resources requirement under paragraph (c) of this section.

(2) In fulfilling its obligations under paragraph (c) of this section, each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall undertake due diligence to confirm that each of its liquidity providers, whether or not such liquidity provider is a clearing member, has:

(i) Sufficient information to understand and manage the liquidity provider's liquidity risks; and

(ii) The capacity to perform as required under its commitments to provide liquidity to the systemically important derivatives clearing organization or subpart C derivatives clearing organization.

(3) Where relevant to a liquidity provider's ability reliably to perform its commitments with respect to a particular currency, the systemically important derivatives clearing organization or subpart C derivatives clearing organization may take into account the liquidity provider's access to the central bank of issue of that currency.

(4) Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall regularly test its procedures for accessing its liquidity resources under paragraph (c)(3)(i) of this section, including testing its arrangements under paragraph (c)(3)(ii) and its relevant liquidity provider(s) under paragraph (d)(1) of this section.

(5) A systemically important derivatives clearing organization with access to accounts and services at a Federal Reserve Bank, pursuant to section 806(a) of the Dodd-Frank Act, 12 U.S.C. 5465(a), shall use these services, where practical.

(e) *Documentation of financial resources and liquidity resources.* Each

systemically important derivatives clearing organization and subpart C derivatives clearing organization shall document its supporting rationale for, and have appropriate governance arrangements relating to, the amount of total financial resources it maintains pursuant to paragraph (a) of this section and the amount of total liquidity resources it maintains pursuant to paragraph (c) of this section.

**§ 39.34 System safeguards for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.**

(a) Notwithstanding § 39.18(e)(3), the business continuity and disaster recovery plan described in § 39.18(e)(1) for each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall have the objective of enabling, and the physical, technological, and personnel resources described in § 39.18(e)(1) shall be sufficient to enable, the systemically important derivatives clearing organization or subpart C derivatives clearing organization to recover its operations and resume daily processing, clearing, and settlement no later than two hours following the disruption, for any disruption including a wide-scale disruption.

(b) To facilitate its ability to achieve the recovery time objective specified in paragraph (a) of this section in the event of a wide-scale disruption, each systemically important derivatives clearing organization and subpart C derivatives clearing organization must maintain a degree of geographic dispersal of physical, technological and personnel resources consistent with the following for each activity necessary for the daily processing, clearing, and settlement of existing and new contracts:

(1) Physical and technological resources (including a secondary site), sufficient to enable the entity to meet the recovery time objective after interruption of normal clearing by a wide-scale disruption, must be located outside the relevant area of the physical and technological resources the systemically important derivatives clearing organization or subpart C derivatives clearing organization normally relies upon to conduct that activity, and must not rely on the same critical transportation, telecommunications, power, water, or other critical infrastructure components the entity normally relies upon for such activities;

(2) Personnel, who live and work outside that relevant area, sufficient to

enable the entity to meet the recovery time objective after interruption of normal clearing by a wide-scale disruption affecting the relevant area in which the personnel the entity normally relies upon to engage in such activities are located;

(3) The provisions of § 39.18(f) shall apply to these resource requirements.

(c) Each systemically important derivatives clearing organization and subpart C derivatives clearing organization must conduct regular, periodic tests of its business continuity and disaster recovery plans and resources and its capacity to achieve the required recovery time objective in the event of a wide-scale disruption. The provisions of § 39.18(j) apply to such testing.

(d) The Commission may, upon application, grant an entity, which has been designated as a systemically important derivatives clearing organization or that has elected to become subject to subpart C, up to one year to comply with any provision of this section.

**§ 39.35 Default rules and procedures for uncovered credit losses or liquidity shortfalls (recovery) for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.**

(a) *Allocation of uncovered credit losses.* Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall adopt explicit rules and procedures that address fully any loss arising from any individual or combined default relating to any clearing members' obligations to the systemically important derivatives clearing organization or subpart C derivatives clearing organization. Such rules and procedures shall address how the systemically important derivatives clearing organization or subpart C derivatives clearing organization would:

(1) Allocate losses exceeding the financial resources available to the systemically important derivatives clearing organization or subpart C derivatives clearing organization;

(2) Repay any funds it may borrow; and

(3) Replenish any financial resources it may employ during such a stress event, so that the systemically important derivatives clearing organization or subpart C derivatives clearing organization can continue to operate in a safe and sound manner.

(b) *Allocation of uncovered liquidity shortfalls.* (1) Each systemically important derivatives clearing organization and subpart C derivatives

clearing organization shall establish rules and/or procedures that enable it promptly to meet all of its settlement obligations, on a same day and, as appropriate, intraday and multiday basis, in the context of the occurrence of either or both of the following scenarios:

(i) An individual or combined default involving one or more clearing members' obligations to the systemically important derivatives clearing organization or subpart C derivatives clearing organization; or

(ii) A liquidity shortfall exceeding the financial resources of the systemically important derivatives clearing organization or subpart C derivatives clearing organization.

(2) The rules and procedures described in paragraph (b)(1) of this section shall:

(i) Enable the systemically important derivatives clearing organization or subpart C derivatives clearing organization promptly to meet its payment obligations in all relevant currencies;

(ii) Be designed to enable the systemically important derivatives clearing organization or subpart C derivatives clearing organization to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations; and

(iii) Address the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's process to replenish any liquidity resources it may employ during a stress event so that it can continue to operate in a safe and sound manner.

**§ 39.36 Risk management for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.**

(a) *Stress tests of financial resources.*

In addition to conducting stress tests pursuant to § 39.13(h)(3), each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall conduct stress tests of its financial resources in accordance with the following standards and practices:

(1) Perform, on a daily basis, stress testing of its financial resources using predetermined parameters and assumptions;

(2) Perform comprehensive analyses of stress testing scenarios and underlying parameters to ascertain their appropriateness for determining the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's required level of financial resources in current and evolving market conditions;



(3) Perform the analyses required by paragraph (a)(2) of this section at least monthly and when products cleared or markets served display high volatility or become less liquid, when the size or concentration of positions held by clearing members increases significantly, or as otherwise appropriate, evaluate the stress testing scenarios, models, and underlying parameters more frequently than once a month;

(4) For the analyses required by paragraph (a)(1) and paragraph (a)(2) of this section, include a range of relevant stress scenarios, in terms of both defaulting clearing members' positions and possible price changes in liquidation periods. The scenarios considered shall include, but are not limited to, the following:

(i) Relevant peak historic price volatilities;

(ii) Shifts in other market factors including, as appropriate, price determinants and yield curves;

(iii) Multiple defaults over various time horizons;

(iv) Simultaneous pressures in funding and asset markets; and

(v) A range of forward-looking stress scenarios in a variety of extreme but plausible market conditions.

(5) Establish procedures for:

(i) Reporting stress test results to its risk management committee or board of directors, as applicable; and

(ii) Using the results to assess the adequacy of, and to adjust, its total amount of financial resources; and

(6) Use the results of stress tests to support compliance with the minimum financial resources requirement set forth in § 39.33(a).

(b) *Sensitivity analysis of margin model.*

(1) Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall, at least monthly and more frequently as appropriate, conduct a sensitivity analysis of its margin models to analyze and monitor model performance and overall margin coverage. Sensitivity analysis shall be conducted on both actual and hypothetical positions.

(2) For the purposes of this paragraph (b), a sensitivity analysis of a margin model includes:

(i) Reviewing a wide range of parameter settings and assumptions that reflect possible market conditions in order to understand how the level of margin coverage might be affected by highly stressed market conditions. The range of parameters and assumptions should capture a variety of historical and hypothetical conditions, including

the most volatile periods that have been experienced by the markets served by the systemically important derivatives clearing organization or subpart C derivatives clearing organization and extreme changes in the correlations between prices.

(ii) Testing of the ability of the models or model components to produce accurate results using actual or hypothetical datasets and assessing the impact of different model parameter settings.

(iii) Evaluating potential losses in clearing members' proprietary positions and, where appropriate, customer positions.

(3) A systemically important derivatives clearing organization or subpart C derivatives clearing organization involved in activities with a more complex risk profile shall take into consideration parameter settings that reflect the potential impact of the simultaneous default of clearing members and, where applicable, the underlying credit instruments.

(c) *Stress tests of liquidity resources.* Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall conduct stress tests of its liquidity resources in accordance with the following standards and practices:

(1) Perform, on a daily basis, stress testing of its liquidity resources using predetermined parameters and assumptions;

(2) Perform comprehensive analyses of stress testing scenarios and underlying parameters to ascertain their appropriateness for determining the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's required level of liquidity resources in current and evolving market conditions;

(3) Perform the analyses required by paragraph (c)(2) of this section at least monthly and when products cleared or markets served display high volatility or become less liquid, when the size or concentration of positions held by clearing members increases significantly, or as otherwise appropriate, evaluate its stress testing scenarios, models, and underlying parameters more frequently than once a month;

(4) For the analyses required by paragraph (c)(1) and paragraph (c)(2) of this section, include a range of relevant stress scenarios, in terms of both defaulting clearing members' positions and possible price changes in liquidation periods. The scenarios considered shall include, but are not limited to, the following:

(i) Relevant peak historic price volatilities;

(ii) Shifts in other market factors including, as appropriate, price determinants and yield curves;

(iii) Multiple defaults over various time horizons;

(iv) Simultaneous pressures in funding and asset markets; and

(v) A range of forward-looking stress scenarios in a variety of extreme but plausible market conditions.

(5) For the scenarios enumerated in paragraph (c)(4) of this section, consider the following:

(i) All entities that might pose material liquidity risks to the systemically important derivatives clearing organization or subpart C derivatives clearing organization, including settlement banks, permitted depositories, liquidity providers, and other entities,

(ii) Multiday scenarios as appropriate,

(iii) Inter-linkages between its clearing members and the multiple roles that they may play in the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's risk management; and

(iv) The probability of multiple failures and contagion effect among clearing members.

(6) Establish procedures for:

(i) Reporting stress test results to its risk management committee or board of directors, as applicable; and

(ii) Using the results to assess the adequacy of, and to adjust its total amount of liquidity resources.

(7) Use the results of stress tests to support compliance with the liquidity resources requirement set forth in § 39.33(c).

(d) Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall regularly conduct an assessment of the theoretical and empirical properties of its margin model for all products it clears.

(e) Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall perform, on an annual basis, a full validation of its financial risk management model and its liquid risk management model.

(f) *Custody and investment risk.*

Custody and investment arrangements of a systemically important derivatives clearing organization's and subpart C derivatives clearing organization's own funds and assets shall be subject to the same requirements as those specified in § 39.15 of this chapter for the funds and assets of clearing members, and shall apply to the derivatives clearing

organization's own funds and assets to the same extent as if such funds and assets belonged to clearing members.

(g) *Settlement banks.* Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall:

(1) Monitor, manage, and limit its credit and liquidity risks arising from its settlement banks;

(2) Establish, and monitor adherence to, strict criteria for its settlement banks that take account of, among other things, their regulation and supervision, creditworthiness, capitalization, access to liquidity, and operational reliability; and

(3) Monitor and manage the concentration of credit and liquidity exposures to its settlement banks.

**§ 39.37 Additional disclosure for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.**

In addition to the requirements of § 39.21, each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall:

(a) Complete and publicly disclose its responses to the Disclosure Framework for Financial Market Infrastructures published by the Committee on Payment and Settlement Systems and the Board of the International Organization of Securities Commissions;

(b) Review and update its responses disclosed as required by paragraph (a) of this section at least every two years and following material changes to the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's system or the environment in which it operates. A material change to the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's system or the environment in which it operates is a change that would significantly change the accuracy and usefulness of the existing responses;

(c) Disclose, publicly and to the Commission, relevant basic data on transaction volume and values; and

(d) Disclose, publicly and to the Commission, rules, policies, and procedures concerning segregation and portability of customers' positions and funds, including whether each of:

(1) Futures customer funds, as defined in § 1.3(jjjj) of this chapter;

(2) Cleared Swaps Customer Collateral, as defined in § 22.1 of this chapter; or

(3) Foreign futures or foreign options secured amount, as defined in § 1.3(rr) of this chapter is:

(i) Protected on an individual or omnibus basis or

(ii) Subject to any constraints, including any legal or operational constraints that may impair the ability of the systemically important derivatives clearing organization or subpart C derivatives clearing organization to segregate or transfer the positions and related collateral of a clearing member's customers.

**§ 39.38 Efficiency for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.**

(a) *General rule.* In order to meet the needs of clearing members and markets, each systemically important derivatives clearing organization and subpart C derivatives clearing organization should efficiently and effectively design its:

(1) Clearing and settlement arrangements;

(2) Operating structure and procedures;

(3) Scope of products cleared; and

(4) Use of technology.

(b) *Review of efficiency.* Each systemically important derivatives clearing organization and subpart C derivatives clearing organization should establish a mechanism to review, on a regular basis, its compliance with paragraph (a) of this section.

(c) *Clear goals and objectives.* Each systemically important derivatives clearing organization and subpart C derivatives clearing organization should have clearly defined goals and objectives that are measurable and achievable, including in the areas of minimum service levels, risk management expectations, and business priorities.

(d) Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall facilitate efficient payment, clearing and settlement by accommodating internationally accepted communication procedures and standards.

**§ 39.39 Recovery and wind-down for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.**

(a) *Definitions.* For purposes of this section:

(1) *General business risk* means any potential impairment of a systemically important derivatives clearing organization's or subpart C derivatives clearing organization's financial position, as a business concern, as a consequence of a decline in its revenues or an increase in its expenses, such that expenses exceed revenues and result in a loss that the derivatives clearing

organization must charge against capital.

(2) *Wind-down* means the actions of a systemically important derivatives clearing organization or subpart C derivatives clearing organization to effect the permanent cessation or sale or transfer of one or more services.

(3) *Recovery* means the actions of a systemically important derivatives clearing organization or subpart C derivatives clearing organization, consistent with its rules, procedures, and other *ex-ante* contractual arrangements, to address any uncovered credit loss, liquidity shortfall, capital inadequacy, or business, operational or other structural weakness, including the replenishment of any depleted pre-funded financial resources and liquidity arrangements, as necessary to maintain the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's viability as a going concern.

(4) *Operational risk* means the risk that deficiencies in information systems or internal processes, human errors, management failures or disruptions from external events will result in the reduction, deterioration, or breakdown of services provided by a systemically important derivatives clearing organization or subpart C derivatives clearing organization.

(5) *Unencumbered liquid financial assets* include cash and highly liquid securities.

(b) *Recovery and wind-down plan.* Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall maintain viable plans for:

(1) Recovery or orderly wind-down, necessitated by uncovered credit losses or liquidity shortfalls; and, separately,

(2) Recovery or orderly wind-down necessitated by general business risk, operational risk, or any other risk that threatens the derivatives clearing organization's viability as a going concern.

(c) (1) In developing the plans specified in paragraph (b) of this section, the systemically important derivatives clearing organization or subpart C derivatives clearing organization shall identify scenarios that may potentially prevent it from being able to meet its obligations, provide its critical operations and services as a going concern and assess the effectiveness of a full range of options for recovery or orderly wind-down. The plans shall include procedures for informing the Commission, as soon as practicable, when the recovery plan is initiated or wind-down is pending,

(2) A systemically important derivatives clearing organization or subpart C derivatives clearing organization shall have procedures for providing the Commission and the Federal Deposit Insurance Corporation with information needed for purposes of resolution planning.

(d) *Financial resources to support the recovery and wind-down plan.*

(1) In evaluating the resources available to cover an uncovered credit loss or liquidity shortfall as part of its recovery plans pursuant to paragraph (b)(1) of this section, a systemically important derivatives clearing organization or subpart C derivatives clearing organization may consider, among other things, assessments of additional resources provided for under its rules that it reasonably expects to collect from non-defaulting clearing members.

(2) Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall maintain sufficient unencumbered liquid financial assets, funded by the equity of its owners, to implement its recovery or wind-down plans pursuant to paragraph (b)(2) of this section. In general, the financial resources required by § 39.11(a)(2) may be sufficient, but the systemically important derivatives clearing organization or subpart C derivatives clearing organization shall analyze its particular circumstances and risks and maintain any additional resources that may be necessary to implement the plans. In allocating sufficient financial resources to implement the plans, the systemically important derivatives clearing organization or subpart C derivatives clearing organization shall comply with § 39.11(e)(2). The plan shall include evidence and analysis to

support the conclusion that the amount considered necessary is, in fact, sufficient to implement the plans.

(3) Resources counted in meeting the requirements of §§ 39.11(a)(1) and 39.33 may not be allocated, in whole or in part, to the recovery plans required by paragraph (b)(2) of this section. Other resources may be allocated, in whole or in part, to the recovery plans required by either paragraph (b)(1) or paragraph (b)(2) of this section, but not both paragraphs, and only to the extent the use of such resources is not otherwise limited by the Act, Commission regulations, the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's rules, or any contractual arrangements to which the systemically important derivatives clearing organization or subpart C derivatives clearing organization is a party.

(e) *Plan for raising additional financial resources.* All systemically important derivatives clearing organizations and subpart C derivatives clearing organizations shall maintain viable plans for raising additional financial resources, including, where appropriate, capital, in a scenario in which the systemically important derivatives clearing organization or subpart C derivatives clearing organization is unable, or virtually unable, to comply with any financial resources requirements set forth in this part. This plan shall be approved by the board of directors and be updated regularly.

#### **§ 39.40 Consistency with the Principles for Financial Market Infrastructures.**

This subpart C is intended to establish standards which, together with subparts A and B of this part, are consistent with section 5b(c) of the Act and the Principles for Financial Market

Infrastructures published by the Committee on Payment and Settlement Systems and the Board of the International Organization of Securities Commissions and should be interpreted in that context.

#### **§ 39.41 Special enforcement authority for systemically important derivatives clearing organizations.**

For purposes of enforcing the provisions of Title VIII of the Dodd-Frank Act, a systemically important derivatives clearing organization shall be subject to, and the Commission has authority under the provisions of subsections (b) through (n) of section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818) in the same manner and to the same extent as if the systemically important derivatives clearing organization were an insured depository institution and the Commission were the appropriate Federal banking agency for such insured depository institution.

#### **§ 39.42 Advance notice of material risk-related rule changes by systemically important derivatives clearing organizations.**

A systemically important derivatives clearing organization shall provide notice to the Commission in advance of any proposed change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the systemically important derivatives clearing organization, in accordance with the requirements of § 40.10 of this chapter.

- 5. Redesignate the Appendix to Part 39 as Appendix A to Part 39.
- 6. Add appendix B to Part 39 to read as follows:

#### **Appendix B to Part 39—Subpart C Election Form**

BILLING CODE 6351-01-P

**COMMODITY FUTURES TRADING COMMISSION****SUBPART C ELECTION FORM****GENERAL INSTRUCTIONS****GENERAL INSTRUCTIONS**

**Intentional misstatements or omissions of fact may constitute federal criminal violations (7 U.S.C. § 13 and 18 U.S.C. § 1001).**

**DEFINITIONS**

Unless the context requires otherwise, all terms used in this Subpart C Election Form have the same meaning as in the Commodity Exchange Act ("Act"), and in the General Rules and Regulations of the Commodity Futures Trading Commission ("Commission") thereunder. All references to Commission regulations are found at 17 CFR Ch. 1.

For purposes of this Subpart C Election Form, the term "Applicant" shall mean a derivatives clearing organization that is filing this Subpart C Election Form with a Form DCO as part of an application for registration as a derivatives clearing organization pursuant to Section 5b of the Act and 17 CFR 39.3(a).

**GENERAL INSTRUCTIONS**

1. Any derivatives clearing organization requesting an election to become subject to subpart C of part 39 of the Commission's regulations must file this Subpart C Election Form. The Subpart C Election Form includes the election to be subject to the provisions of subpart C of part 39 of the Commission's regulations, certain required certifications, disclosures, and exhibits, and any supplements or amendments thereto filed pursuant to 17 CFR 39.31(b) or (c) (collectively, the "Subpart C Election Form").
2. Individuals' names, except the executing signature, shall be given in full (Last Name, First Name, Middle Name).
3. The signatures required in this Subpart C Election Form shall be the manual signatures of: a duly authorized representative of the derivatives clearing organization as follows: If the Subpart C Election Form is filed by a corporation, it must be signed in the name of the corporation by a principal officer duly authorized; if filed by a limited liability company, it must be signed in the name of the limited liability company by a manager or member duly authorized to sign on the limited liability company's behalf; if filed by a partnership, it must be signed in the name of the partnership by a general partner duly authorized; if filed by an unincorporated organization or association which is not a partnership, it must be signed in the name of such organization or association by the managing agent, i.e., a duly authorized person who directs or manages or who participates in the directing or managing of its affairs.
4. All applicable items must be answered in full.
5. Under Section 5b of the Act and the Commission's regulations thereunder, the Commission is authorized to solicit the information required to be supplied by this Subpart C Election Form from any Applicant seeking registration as a derivatives clearing organization and from any registered derivatives clearing organization.

6. Disclosure of the information specified in this Subpart C Election Form is mandatory prior to the processing of the election to become a derivatives clearing organization subject to the provisions of subpart C to part 39 of the Commission's regulations. The Commission may determine that additional information is required in order to process such election.
7. A Subpart C Election Form that is not prepared and executed in compliance with applicable requirements and instructions may be returned as not acceptable for filing. Acceptance of this Subpart C Election Form, however, shall not constitute a finding that the Subpart C Election Form is acceptable as filed or that the information is true, current or complete.
8. Except as provided in 17 CFR 39.31(d), in cases where a derivatives clearing organization submits a request for confidential treatment with the Secretary of the Commission pursuant to the Freedom of Information Act and 17 CFR 145.9, information supplied in this Subpart C Election Form will be included routinely in the public files of the Commission and will be made available for inspection by any interested person.

#### **APPLICATION AMENDMENTS**

1. 17 CFR 39.31(b)(3) and (c)(4) require a derivatives clearing organization that has submitted a Subpart C Election Form to promptly amend its Subpart C Election Form if it discovers a material omission or error in, or if there is a material change in, the information provided to the Commission in the Subpart C Election Form or other information provided in connection with the Subpart C Election Form. When amending a Subpart C Election Form, a derivatives clearing organization must re-file the Election and Certifications page, amended if necessary, and including all required executing signatures, and attach thereto revised exhibits or other materials marked to show changes, as applicable.

#### **WHERE TO FILE**

This Subpart C Election Form must be filed electronically with the Secretary of the Commission in the format and manner specified by the Commission.

## **COMMODITY FUTURES TRADING COMMISSION**

### **SUBPART C ELECTION FORM**

#### **ELECTION AND CERTIFICATIONS**

---

**Exact Name of the Derivatives Clearing Organization  
(as set forth in its charter, if an Applicant,  
or as set forth in its most recent order of registration, if registered with the Commission)**

- ☐ Check here and complete sections 1 and 3 below, if the organization is an Applicant.
- ☐ Check here and complete sections 2 and 3 below, if the organization currently is registered with the Commission as a derivatives clearing organization.

1. The derivatives clearing organization named above hereby elects to become subject to the provisions of subpart C to part 39 of the Commission's regulations in the event that the Commission approves its application for registration as a derivatives clearing organization.

The derivatives clearing organization and the undersigned each certify that, in the event that the Commission approves the derivatives clearing organization's application for registration and permits its election to become subject subpart C to part 39 of the Commission's regulations to take effect, the derivatives clearing organization will be in compliance with such regulations as of the date set forth in the notice thereof provided by the Commission pursuant to 17 CFR 39.31(c)(2) and will remain in compliance until such election is rescinded pursuant to 17 CFR 39.31(e).

---

\_\_\_\_\_  
Name of Derivatives Clearing Organization

By: \_\_\_\_\_  
\_\_\_\_\_  
Manual Signature of Duly Authorized Person

\_\_\_\_\_  
Print Name and Title of Signatory

2. The derivatives clearing organization named above hereby elects to become subject to the provisions of subpart C to part 39 of the Commission's regulations as of:

\_\_\_\_\_ ("Effective Date")  
[insert date, which must be **at least 10 business days after the date this Subpart C Election Form is filed with the Commission**].

The derivatives clearing organization and the undersigned each certify that, as of the Effective Date set forth above, the derivatives clearing organization shall be in compliance with subpart C to part 39 of the Commission's regulations and shall remain in compliance with such regulations until the election is rescinded pursuant to 17 CFR 39.31(e).

---

\_\_\_\_\_  
Name of Derivatives Clearing Organization

By: \_\_\_\_\_  
\_\_\_\_\_  
Manual Signature of Duly Authorized Person

\_\_\_\_\_  
Print Name and Title of Signatory

3. The derivatives clearing organization named above has duly caused this Subpart C Election Form (which includes, as an integral part thereof, the Election and Certifications and all Disclosures and Exhibits) to be signed on its behalf by its duly authorized representative as of the \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_. The derivatives clearing organization and the undersigned each represent hereby that, to the best of their knowledge, all information contained in this Subpart C Election Form is true, current and complete in all material respects. It is understood that all required items including, without limitation, the Election and Certifications and Disclosures and Exhibits, are considered integral parts of this Subpart C Election Form.

\_\_\_\_\_  
Name of Derivatives Clearing Organization

By: \_\_\_\_\_

\_\_\_\_\_  
Manual Signature of Duly Authorized Person

\_\_\_\_\_  
Print Name and Title of Signatory

## COMMODITY FUTURES TRADING COMMISSION

### PART 39, SUBPART C ELECTION FORM

#### DISCLOSURES AND EXHIBITS

Each derivatives clearing organization that requests an election to become subject to the provisions set forth in subpart C to part 39 of the Commission's regulations shall provide the Disclosures and Exhibits set forth below:

#### **DISCLOSURES:**

The derivatives clearing organization shall:

1. Publish on its website in a readily identifiable location the derivatives clearing organization's responses to the Disclosure Framework for Financial Market Infrastructures ("Disclosure Framework"), published by the Committee on Payment and Settlement Systems ("CPSS") and the Board of International Organization of Securities Commissions ("IOSCO") that are required to be completed pursuant to 17 CFR 39.37. The derivatives clearing organization's responses must be completed in accordance with section 2.0 and Annex A of the Disclosure Framework and must fully explain how the derivatives clearing organization observes the Principles for Financial Market Infrastructures ("PFMIs") published by CPSS and IOSCO.

Provide the URL to the specific page on the derivatives clearing organization's website where its responses to the Disclosure Framework may be found:

\_\_\_\_\_



2. In the event that CPSS and IOSCO publish the criteria for the disclosure by a Financial Market Infrastructure (“FMI”) of quantitative information to enable stakeholders to evaluate FMIs and to make cross comparisons referenced in section 2.5 of the Disclosure Framework (“Quantitative Information Disclosure”), publish such Quantitative Information Disclosure in a readily identifiable location on the derivatives clearing organization’s website.

If applicable, provide the URL to the specific page on the derivatives clearing organization’s website where its Quantitative Information Disclosure may be found:

---

#### **EXHIBITS:**

#### **EXHIBIT INSTRUCTIONS:**

1. The derivatives clearing organization must include a Table of Contents listing each Exhibit required by this Subpart C Election Form.
2. The Exhibits must be labeled as specified in this Subpart C Election Form. If any Exhibit requires information that is related to, or duplicative of, information required to be included in another Exhibit or, if the derivatives clearing organization is an Applicant, in its Form DCO, the derivatives clearing organization may summarize such information and provide a cross-reference to the Exhibit in this Subpart C Election Form that contains the required information.

The derivatives clearing organization shall provide the following Exhibits to this Subpart C Election Form:

#### **EXHIBIT A – COMPLIANCE WITH SUBPART C**

Attach, as **Exhibit A**, a regulatory compliance chart that’s separately sets forth for §§ 39.32-39.39 of the Commission’s regulations, citations to the relevant rules, policies, and procedures of the derivatives clearing organization that address each such regulation and a summary of the manner in which the derivatives clearing organization will comply with each regulation. All citations and compliance summaries shall be separated by individual regulation and shall be clearly labeled with the corresponding regulation.

#### **EXHIBIT B – GOVERNANCE**

Attach, as **Exhibit B**, documents that demonstrate compliance with the governance requirements set forth in § 39.32 of the Commission’s regulations.

#### **EXHIBIT C – FINANCIAL RESOURCES**

Attach, as **Exhibit C**, documents that demonstrate compliance with the financial resource requirements set forth in § 39.33 of the Commission’s regulations.

#### **EXHIBIT D – SYSTEM SAFEGUARDS**

Attach, as **Exhibit D**, documents that demonstrate compliance with the system safeguard requirements set forth in § 39.34 of the Commission’s regulations.

#### **EXHIBIT E – DEFAULT RULES AND PROCEDURES FOR UNCOVERED LOSSES OR SHORTFALLS**

Attach, as **Exhibit E**, documents that demonstrate compliance with the requirements for default rules and procedures for uncovered losses or shortfalls set forth in § 39.35 of the Commission’s regulations.

**EXHIBIT F – RISK MANAGEMENT**

Attach, as **Exhibit F**, documents that demonstrate compliance with the risk management requirements set forth in § 39.36 of the Commission's regulations.

**EXHIBIT G – RECOVERY AND WIND-DOWN**

Attach, as **Exhibit G**, documents that demonstrate compliance with the recovery and wind-down requirements set forth in § 39.39 of the Commission's regulations.

BILLING CODE 6351-01-C

**PART 140—ORGANIZATION, FUNCTIONS AND PROCEDURES OF THE COMMISSION**

■ 7. The authority citation for part 140 continues to read as follows:

*Authority:* 7 U.S.C. 2 and 12a.

■ 8. Amend § 140.94 to add new paragraphs (c)(12), (c)(13) and (c)(14) as follows:

**§ 140.94 Delegation of authority to the Director of the Division of Clearing and Risk.**

\* \* \* \* \*

(c) \* \* \*

(12) All functions reserved to the Commission in § 39.31 of this chapter; and

(13) The authority to approve the application described in § 39.34(d) of this chapter.

\* \* \* \* \*

**PART 190—BANKRUPTCY**

■ 9. The authority citation for part 190 continues to read as follows:

*Authority:* 7 U.S.C. 1a, 2, 4a, 6c, 6d, 6g, 7a, 12, 19, and 24, and 11 U.S.C. 362, 546, 548, 556, and 761–766, unless otherwise noted.

■ 10. In § 190.09, revise paragraph (b) to read as follows:

**§ 190.09 Member property.**

\* \* \* \* \*

(b) *Scope of member property.* Member property shall include all money, securities and property received, acquired, or held by a clearing organization to margin, guarantee or secure, on behalf of a clearing member, the proprietary account, as defined in § 1.3 of this chapter, any account not belonging to a foreign futures or foreign options customer pursuant to the proviso in § 30.1(c), and any Cleared Swaps Proprietary Account, as defined in § 22.1: *Provided, however*, that any guaranty deposit or similar payment or deposit made by such member and any capital stock, or membership of such member in the clearing organization shall also be included in member property after payment in full, in each case in accordance with the by-laws or rules of the clearing organization, of that portion of:

(1) The net equity claim of the member based on its customer account; and

(2) Any obligations due to the clearing organization which may be paid therefrom, including any obligations due from the clearing organization to the customers of other members.

Issued in Washington, DC on August 12, 2013, by the Commission.

**Melissa D. Jurgens,**  
*Secretary of the Commission.*

**Appendix to Notice of Proposed Rulemaking on Derivatives Clearing Organizations and International Standards—Commission Voting Summary**

**Note:** The following appendix will not appear in the Code of Federal Regulations.

**Appendix 1—Commission Voting Summary**

On this matter, Chairman Gensler and Commissioners Chilton, O'Malia, and Wetjen voted in the affirmative.

[FR Doc. 2013-19845 Filed 8-15-13; 8:45 am]

BILLING CODE 6351-01-P