AMS will continue to seek assistance across USDA as appropriate on this issue.

A few commenters requested that the NOP address concerns with the current use of antibiotics in organic tree fruit production through ensuring compliance with § 205.206(a)(3). Section 205.206(a) requires producers to use management practices to prevent disease through crop rotation, sanitation measures and cultural practices. Section 205.206(a)(3) lists specific cultural practices that enhance crop health, including selection of plant species and varieties with regard to suitability to site-specific conditions and resistance to prevalent pests, weeds, and diseases. Certifying agents are responsible for ensuring that all organic producers use management practices to prevent disease. Certifying agents verify that organic producers are meeting all USDA organic requirements including utilizing preventative management practices to prevent disease.

These same commenters also stated that, as part of a strategy for addressing fire blight in organic apple and pear production, the NOP should consider variances under § 205.290 to allow antibiotic use in instances when fire blight disease puts orchards at risk. Temporary variances for the use of a synthetic substance that is not on the National List (i.e. use of tetracycline after October 21, 2014) cannot be granted per the current requirements at § 205.290(e).

F. Effective Date

This final rule reflects recommendations submitted to the Secretary by the NOSB. The amendment to the listing of one exempted substance and the addition of two substances to the National List were based on petitions from the industry and evaluated by the NOSB using criteria in OFPA and the NOP regulations. Because the amendments have been subject to extensive discussion and public comment and are considered vital to organic crops, processing and livestock production, AMS believes that producers and handlers should be able to use them on their operations as soon as possible. Furthermore, tetracycline is due to expire from the National List on October 21, 2012; this action must be finalized by October 21, 2012, to ensure that organic apple and pear producers have access to this substance for two additional years beyond its current expiration date. Accordingly, AMS finds that good cause exists under 5 U.S.C. 553(d)(3) for not postponing the effective date of this rule until 30 days after publication in the **Federal Register**.

Available online at: *http://www.nifa.usda.gov/funding/rfas/pdfs/12_orei.pdf*.

List of Subjects in 7 CFR Part 205

Administrative practice and procedure, Agriculture, Animals, Archives and records, Imports, Labeling, Organically produced products, Plants, Reporting and recordkeeping requirements, Seals and insignia, Soil conservation.

For the reasons set forth in the preamble, 7 CFR part 205, Subpart G is amended as follows:

PART 205—NATIONAL ORGANIC PROGRAM

■ 1. The authority citation for 7 CFR part 205 continues to read as follows:

Authority: 7 U.S.C. 6501–6522.

■ 2. Section 205.601 paragraph (i)(12) is revised to read as follows:

§ 205.601 Synthetic substances allowed for use in organic crop production.

* * * * *

(i) * * *

(12) Tetracycline, for fire blight control in apples and pears only until October 21, 2014.

* * * * *

■ 3. Section 205.603 is amended by:

■ A. Redesignating paragraphs (b)(2) through (b)(7) as paragraphs (b)(3) through (b)(8); and

■ B. Adding paragraph (b)(2) to read as follows:

§ 205.603 Synthetic substances allowed for use in organic livestock production.

* * * * *

(b) * * *

(2) Formic acid (CAS # 64–18–6)—for use as a pesticide solely within honeybee hives.

* * * * *

■ 4. In § 205.605(a), the substance ''Attapulgite'' is added in alphabetical order to read as follows:

§ 205.605 Nonagricultural (nonorganic) substances allowed as ingredients in or on processed products labeled as ''organic'' or ''made with organic (specified ingredients or food groups(s)).''

* * * * *

(a) * * *

Attapulgite—as a processing aid in the handling of plant and animal oils.

* * * * *

Dated: July 27, 2012.

David R. Shipman,

Administrator, Agricultural Marketing Service.

[FR Doc. 2012–18819 Filed 8–1–12; 8:45 am]

BILLING CODE 3410–02–P

FEDERAL RESERVE SYSTEM

12 CFR Part 234

[Regulation HH; Docket No. R–1412]

RIN 7100–AD 71

Financial Market Utilities

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is publishing a final rule, Regulation HH, Designated Financial Market Utilities. This rule implements provisions of sections 805(a) and 806(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (''Dodd-Frank Act'' or ''Act''), including risk-management standards for financial market utilities (''FMUs'') that are designated as systemically important by the Financial Stability Oversight Council (the ''Council'') and standards for determining when a designated FMU is required to provide advance notice of proposed changes to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the designated FMU.

DATES: This final rule is effective September 14, 2012.

FOR FURTHER INFORMATION CONTACT: Jennifer A. Lucier, Assistant Director (202) 872–7581 or Kathy C. Wang, Senior Financial Services Analyst (202) 872–4991, Division of Reserve Bank Operations and Payment Systems; Christopher W. Clubb, Senior Counsel (202) 452–3904 or Kara L. Handzlik, Senior Attorney (202) 452–3852, Legal Division; for users of Telecommunications Device for the Deaf (TDD) only, contact (202) 263–4869.

SUPPLEMENTARY INFORMATION:

I. Background

Title VIII of the Dodd-Frank Act, titled the ''Payment, Clearing, and Settlement Supervision Act of 2010,'' was enacted to mitigate systemic risk in the financial system and to promote financial stability, in part, through enhanced supervision of designated FMUs.[1] Section 803 of the Dodd-Frank

[1] The Dodd-Frank Act, Public Law 111–203, 124 Stat. 1376, was signed into law on July 21, 2010.

Act defines an FMU as a 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. The basic risks that FMUs must manage include credit risk, liquidity risk, settlement risk, operational risk, and legal risk. These risks arise between financial institutions and FMUs as they settle payments and other financial transactions. In order to maintain financial stability, FMUs must be well-designed and operated in a safe and sound manner. If a systemically important FMU fails to measure, monitor, and manage its risks effectively, it could pose significant risk to its participants and the financial system more broadly.

Under section 805(a)(1) of the Dodd-Frank Act, the Board is required to promulgate risk-management standards governing the operations related to the payment, clearing, and settlement (''PCS'') activities of certain FMUs that are designated as systemically important by the Council. Section 805(a)(1) of the Act also requires the Board to take into consideration relevant international standards and existing prudential requirements in prescribing the regulations. For a designated FMU that is a derivatives clearing organization (''DCO'') registered under section 5b of the Commodity Exchange Act or a clearing agency registered under section 17A of the Securities Exchange Act of 1934 (collectively, ''designated clearing entities''), the Commodity Futures Trading Commission (''CFTC'') or the Securities and Exchange Commission (''SEC''), respectively, are granted authority to prescribe regulations, in consultation with the Council and the Board, containing applicable risk-management standards.[2]

Section 805(b) of the Act sets out the following objectives and principles for the risk-management standards: (a) Promote robust risk management, (b) promote safety and soundness, (c) reduce systemic risks, and (d) support the stability of the broader financial system. Section 805(c) of the Act states that risk-management standards may address areas such as (1) risk-management policies and procedures, (2) margin and collateral requirements, (3) participant or counterparty default policies and procedures, (4) the ability to complete timely clearing and settlement of financial transactions, (5) capital and financial resource requirements for designated FMUs, and (6) other areas that are necessary to achieve the objectives and principles for risk-management standards.

In addition, section 806(e)(1) of the Dodd-Frank Act requires a designated FMU to provide 60 days' advance notice to its Supervisory Agency of any proposed change to its rules, procedures, or operations that could, as defined in rules of each Supervisory Agency, materially affect the nature or level of risks presented by the designated FMU. Under section 803(b) of the Act, a ''Supervisory Agency'' means the federal agency that has primary jurisdiction over a designated FMU under federal banking, securities, or commodity futures laws.[3]

In April 2011, the Board published for comment a notice of proposed rulemaking (''NPRM'') to propose a new part to the Code of Federal Regulations (12 CFR part 234, Regulation HH) to establish risk-management standards for designated FMUs and requirements for advance notice of material changes to a designated FMU's rules, procedures, or operations.[4] The public comment period closed on May 19, 2011.

II. Summary of Public Comments and Analysis

The Board received twelve public comment letters on the NPRM. Comments were submitted by two payment systems, seven industry and other groups, one bank, and two other commenters. In general, the comments pertained broadly to three categories: (i) Risk-management standards, (ii) advance notice requirements and the materiality definition, and (iii) other miscellaneous comments. The Board considered these comments in developing its final rule as discussed in more detail below.[5]

A. Risk-Management Standards

1. International Standards

Proposed § 234.3 sets out risk-management standards for designated FMUs that are payment systems, and proposed § 234.4 sets out risk-management standards for central counterparties (''CCPs'') and central securities depositories (''CSDs''), based on the international risk-management standards developed by the Committee on Payment and Settlement Systems (''CPSS'') and the Technical Committee of the International Organization of Securities Commissions (''IOSCO''). These international standards were the Core Principles for Systemically Important Payment Systems (the ''Core Principles'') developed by the CPSS in 2001, and the Recommendations for Securities Settlement Systems and the Recommendations for Central Counterparties (collectively, the ''CPSS–IOSCO Recommendations'') developed jointly by the CPSS and IOSCO in 2001 and 2004, respectively. The Board believes these standards are the appropriate basis for setting initial risk-management standards under Title VIII for several reasons. First, section 805(a)(1) of the Act directs the Board to consider relevant international standards in prescribing risk-management standards under Title VIII. As explained in the NPRM, the Core Principles and the CPSS–IOSCO Recommendations were the international standards most relevant to risk management of FMUs.[6] Second, FMUs are familiar with these standards as the long-standing basis for Part I of the Federal Reserve Policy on Payment System Risk (''PSR policy'').[7] Third, the Board has significant experience applying these international standards to large-value payment and settlement systems pursuant to its PSR policy.

CPSS and IOSCO recently conducted a comprehensive review of risk-management standards for PCS systems. On April 16, 2012, CPSS and IOSCO issued the final report on the ''Principles for Financial Market Infrastructures,'' which includes an updated, harmonized, and strengthened set of international risk-management standards (the ''PFMI'').[8] CPSS and IOSCO intend for the PFMI to replace the Core Principles and CPSS–IOSCO Recommendations. As noted in the NPRM, the Board anticipates that it will review the new international standards, consult with other appropriate agencies and the Council, and seek public comment on the adoption of revised

[2] Under section 805(a)(2) of the Act, the CFTC and the SEC are also required to take relevant international standards and existing prudential requirements into consideration in prescribing regulations containing risk-management standards governing designated clearing entities.

[3] A Supervisory Agency includes the SEC and CFTC with respect to their respective designated clearing entities (as defined above), the appropriate federal banking agencies (including the Board) with respect to FMUs that are institutions described in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), and the Board with respect to a designated FMU that is otherwise not subject to the jurisdiction of any of the agencies listed above.

[4] See 76 FR 18445 (Apr. 4, 2011).

[5] In addition, the Board is adopting several changes intended to clarify the requirements of the regulation.

[6] See 76 FR at 18447.

[7] The PSR policy is available on the Board's public Web site at: *http://www.federalreserve.gov/paymentsystems/psr_policy.htm*.

[8] The *Principles for Financial Market Infrastructures* are available at *http://www.bis.org/publ/cpss101a.pdf*. The final report reflects comments received during the public consultation period from March 10, 2011 to July 29, 2011.

standards for designated FMUs based on the new international standards.

Commenters generally appeared to support the Board's approach of using the Core Principles and CPSS–IOSCO Recommendations as a basis for its risk-management standards for designated FMUs under section 805 of the Act. Two commenters explicitly stated their support for the Board's approach. Two other commenters stated that the proposed risk-management standards were largely prudent and sensible.

One commenter was also supportive of the Board's intention to evaluate the new international standards once they are final for the purposes of revising Regulation HH. Two other commenters expressed some general reservations with respect to the new international standards; one of the commenters cautioned the Board against adopting the new international standards ''in full,'' because doing so would include principles that may not directly relate to the risks posed by the designated FMUs and contemplated by Title VIII.

After considering the public comments and for the reasons stated above, the Board continues to believe that the most suitable approach to establishing initial risk-management standards under Title VIII of the Act is to use the Core Principles and CPSS–IOSCO Recommendations as the basis for the standards promulgated by this notice, and to proceed with consideration of the PFMI as the basis for any future revisions. The Board agrees with commenters that international standards that are not, in some way or to some degree, related to existing or potential risks posed to or by a designated FMU should not be adopted for purposes of section 805 of the Act. As noted in the NPRM, the Board acknowledged that the scope of the Core Principles and CPSS–IOSCO Recommendations is broad and proposed to adopt by regulation particular standards, or portions thereof, that relate to the risks presented to or by a designated FMU, rather than those standards, or portions thereof, that apply more generally to financial markets or regulators. Similarly, the Board anticipates evaluating the appropriateness of each of the new PFMI for the purpose of possible revisions to Regulation HH.

2. Applicability of Standards to Retail Payment Systems

Proposed § 234.3 is based on the entire set of the Core Principles. Some commenters questioned whether three standards included in the Core Principles could be applied to retail payment systems, particularly automated clearinghouses (''ACH'') and check clearinghouses, should those systems be designated as systemically important by the Council. Specifically, proposed § 234.3(a)(3) would require any FMU that is designated on the basis of its role as operator of a payment system to have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks. Proposed § 234.3(a)(4) would require any designated FMU that is designated on the basis of its role as operator of a payment system to provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day. Proposed § 234.3(a)(5) would require any designated FMU that is designated on the basis of its role as operator of a payment system, and in which multilateral netting takes place, to, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation.

The Board received several comments on the applicability of these risk-management standards to retail payment systems, should they be designated by the Council. Several commenters stated their support for an exemption for retail payment systems from designation as systemically important by the Council under the Dodd-Frank Act. The Council, however, determined not to categorically exclude FMUs operating retail payment or other systems in its rule regarding the FMU designation process.[9] As a result, commenters provided feedback on the ability of retail payment systems to meet certain of the Board's proposed risk-management standards in the event the Council decides to designate them.

One commenter specifically referenced proposed § 234.3(a)(3)–(5) as risk-management standards that, while appropriate risk controls for truly systemically important payment systems, were generally inapplicable (or had no relevance) to payments systems such as ACH clearing arrangements that permit the return of transactions within a certain timeframe. One commenter argued that the standard in proposed § 234.3(a)(3) regarding the management of credit and liquidity risk would have no application where a system that did not assume credit and liquidity risks in the first place by committing to pay funds that it had not received and where the payment system participants expect to manage their own credit and liquidity risks. Two commenters also stated that proposed § 234.3(a)(4) on settlement finality contradicts long-standing and established practices of ACH rules that allow for certain transactions to be reversed or returned for any reason until the banking day after the settlement date. One commenter stated that application of proposed § 234.3(a)(5) regarding the ability to complete settlement in the event the single largest participant is unable to settle would require a fundamental change in the nature of ACH debit transactions and the abolishment of the right to return the transaction. In general, these commenters stated that they do not believe that, if designated, retail payment systems would be able to comply with these proposed standards and, accordingly, asked that such systems be exempted from them.

The Board notes that the proposed risk-management standards were designed to apply to large-value payment systems. This approach is consistent with the direction of the Council expressed in its final rule on the FMU designation process. Specifically, the Council stated that, within payment systems, it expects to focus at this time on FMUs that operate large-value systems and not on FMUs that operate low-value systems (such as check and ACH).[10] The Council also decided not to include considerations more narrowly tailored to the characteristics of retail payment systems because the Council did not believe they were necessary or appropriate given the current focus for designations.

Given the Council's focus on large-value systems, the Board does not anticipate that the Council will designate a FMU under Title VIII on the basis of its role as operator of a retail payment system. However, because the authority to designate systemically important FMUs resides with the Council, not the Board, the Board cannot be assured of the type of FMU the Council may designate in the future. In the event that the Council designates an FMU on the basis of its role as operator of a retail payment system, the Board would review, at that time, whether the risk-management standards in § 234.3 were appropriate for that

[9] See 76 FR 44763, 44769 (July 27, 2011).

[10] See 76 FR at 44769. The Council also decided, however, against including in the final rule any categorical exclusion for FMUs operating retail payment or other systems, both because there are not clear distinctions between various types of systems, and because such an exclusion would impair the Council's ability to respond appropriately to new information, changed circumstances, and future developments.

designated FMU, as it would for any type of newly designated FMU.

In order to accommodate this review in the event that an unanticipated type of FMU is designated, and in consideration of the comments, the Board is adopting in the final rule a modification to proposed §§ 234.3(b) and 234.4(b) that clarifies that the application of individual risk-management standards could be waived in a situation where such standards could not appropriately be applied to a particular designated FMU. Both §§ 234.3(b) and 234.4(b) will be amended by inserting text that states ''[t]he Board, by order, may waive the application of a standard or standards to a particular designated financial market utility where the risks presented by or the design of that designated financial market utility would make the application of the standard or standards inappropriate.'' This revision is intended to bridge any gap between Council designation of a new type of designated FMU and the process of promulgating regulations appropriate for the new type of designated FMU, if necessary.

In addition, the Board notes that with respect to a designated FMU that operates more than one payment system (e.g., one large-value and one retail), standards would apply only with respect to the system that provided the basis for the Council's designation of the FMU. The Board is modifying § 234.3(a) and (b) to clarify this point. The Board also is making a parallel modification to § 234.4(a) and (b).[11]

The Board is also modifying §§ 234.3(a) and 234.4(a) to require a designated FMU to ''implement rules, procedures, or operations designed to ensure that it meets or exceeds'' the risk-management standards set forth in these sections. In addition, the word ''should'' has been deleted from the individual standards to clarify that these are requirements with which a designated FMU must comply.

3. Scope of Risk-Management Standards

As noted above, the proposed risk-management standards for designated FMUs that operate as payment systems, CCPs, or CSDs are based on the Core Principles and CPSS–IOSCO Recommendations. Each set includes separate standards relating to efficiency, access criteria, and governance. Several commenters suggested that the Board eliminate some or all of these three proposed standards for payment systems, arguing that they address system operating issues that are outside the scope of the systemic risk issues contemplated by Title VIII of the Dodd-Frank Act. Specifically, the commenters questioned whether proposed § 234.3(a)(8), (9), and (10) regarding efficiency, access criteria, and governance, respectively, were relevant to systemic risk.[12] The applicability of the efficiency standard was a common concern of the commenters that raised questions about the scope of the risk-management standards; a subset of these commenters also questioned whether either the access criteria or governance standard was within the scope of risk management. These standards in general were viewed as admirable goals that designated FMUs should aim to achieve, but nevertheless as goals that should be driven by market forces and not by regulatory mandate.

Efficiency. The efficiency standard in proposed § 234.3(a)(8) states that an FMU that is designated on the basis of its role as operator of a payment system should provide a means of making payments that is practical for its users and efficient for the economy. Several commenters argued that the efficiency standard exceeds the Act's objectives because it addresses operating system issues and not risk matters. One commenter argued that whether a form of payment is practical and efficient is largely a matter of judgment that is better left to the market and its participants.

The Board believes the efficiency standard furthers the objectives set out in Title VIII of the Act to reduce systemic risks and support the stability of the broader financial system.

A designated FMU supports the ongoing functioning and stability of the market it serves by providing effective, reliable PCS services to its participants and, in particular, completing timely clearing and settlement of financial transactions. An FMU that is designed or managed inefficiently or impractically may ultimately distort financial activity and market structure, increasing not only the financial and other risks of an FMU's participants, but also the risks of their customers and end users. To avoid such outcomes, a designated FMU should consider the tradeoffs between, and seek a reasonable balance of, safety (i.e., risk management) and efficiency (i.e., direct and indirect costs) when designing and managing the system. For example, overly demanding financial resource requirements may create a liquidity demand so high that it would be impractical for participants to meet. Although liquidity is very important, an FMU that accumulates excessive liquid resources from its participants intraday may increase the participants' opportunity cost of sending each payment. In such cases, participants that become liquidity constrained may be forced to delay submitting certain time- or mission-critical payments.

Additionally, an FMU's design, operating structure, scope of PCS activities, and use of technology can influence its efficiency and can ultimately provide incentives for market participants to use, or not use, the FMU's services. For example, in certain cases, inefficiently designed systems may increase costs to the point where it would be cost-prohibitive for participants to use the FMU, and possibly drive market participants toward less safe alternatives, such as bilateral clearing or settlement on the books of the participants. In such cases, risks to the market participants increase as they seek less safe opportunities to lower direct costs; this behavior may reintroduce risk into the market that the FMU was intended to mitigate.

As these examples suggest, a designated FMU must function efficiently, as well as safely, and provide services that are appropriate to the needs of its users without becoming cost-prohibitive to use. A designated FMU that is inefficient can have a direct, negative impact on financial stability. Accordingly, the Board believes that it is appropriate for a supervisor of a designated FMU to take into account the need for practical and efficient design of the designated FMU as part of the set of risk-management standards set forth in Regulation HH. For these reasons, the Board is adopting the efficiency standards in proposed §§ 234.3(a)(8) and 234.4(a)(6) essentially as set out in the NPRM.

Access criteria. The access criteria standard in proposed § 234.3(a)(9) states that a payment system should have objective and publicly disclosed criteria for participation, which permit fair and open access. Some commenters argued that the access criteria standard did not relate to any of the risks contemplated by Title VIII of the Act. One commenter stated that the actions taken by the payment system, CSD, or CCP, create or mitigate risk, not the rules governing who can participate in them. Another commenter noted that the participation structure for payment systems can vary broadly and, while the participation criteria for these systems could be an issue for competition law, it was

[11] To conform to these modifications, the Board is revising the definitions in § 234.2 (a), (b), and (e).

[12] One commenter raised similar concerns with the corresponding access criteria and governance standards in proposed § 234.4(a)(2) and (8) with respect to CSDs and CCPs.

difficult to see how the criteria could directly affect the risks that were the focus of Title VIII.

The Board believes that access criteria are important to a designated FMU's risk-management framework and affect the level of risk a designated FMU presents to the financial system. Access criteria are typically referred to as an FMU's ''first line of defense'' in ensuring it admits financial institutions that will be able to meet their obligations and not expose the FMU or its other participants to unacceptable risk. Access criteria need to be designed to ensure that participants meet appropriate operational, financial, and legal requirements to allow them to meet their obligations on a timely basis.[13] However, these criteria need to be balanced against the FMU's ability to effectively serve the market it supports, in particular markets that are subject to a statutory requirement for central clearing or settlement through an FMU. Although a designated FMU may use risk-based measures to control access, requirements that are unnecessarily discriminatory or overly restrictive can minimize the FMU's overall effectiveness.

Criteria that allow for fair and open access also may help achieve the Title VIII objectives of reducing systemic risk and supporting the overall stability of the financial system. A fair and open approach to participation criteria may help prevent the concentration of financial activity (and therefore risk) into a few large participants. By encouraging the reduction of risk concentration, the proposed standard helps lower the likelihood that a few financial institutions will be perceived as ''too big to fail.'' Broad participation in a designated FMU can, for example, increase the effectiveness of multilateral netting, facilitate crisis management by applying a consistent set of rules and procedures (e.g., default management, loss mutualization), and improve overall market transparency by increasing the number of transactions processed by the FMU. Accordingly, access criteria that do not permit fair and open access may reduce the overall risk-reduction benefits that a designated FMU can offer.

For these reasons, the Board is adopting the access criteria standards in proposed §§ 234.3(a)(9) and 234.4(a)(2) essentially as set out in the NPRM.

Governance. The governance standard in proposed § 234.3(a)(10) states that a payment system's governance arrangements should be effective, accountable, and transparent. Some commenters claimed that although the decisions made by a designated FMU's governing body can affect the risks it presents, the particular governance structure itself presents no such risks. Conversely, one commenter supported inclusion of the governance standard, stating that weak governance practices and poor risk-management procedures at designated FMUs could pose hazards both to participating financial institutions and to the market as a whole. Another commenter stated that risk management effectively encompasses governance, among other areas.

The Board believes that effective, accountable, and transparent governance arrangements are critical to the effective risk management of a designated FMU. A strong governance arrangement provides a sound basis for compliance with the other risk-management standards in Regulation HH. A number of tools or techniques discussed in the Core Principles with respect to the governance standard have proved to be effective in ensuring effective governance, such as written strategic objectives and plans for achieving them and separation of risk management and audit functions from day-to-day operations. The Board expects supervisors to review a designated FMU's governance arrangements against the background of these and other relevant techniques in order to promote robust risk management. In addition, given the role of the FMU's board of directors in setting the overall risk-management framework of the designated FMU, the Board believes that a weak or ineffective governance structure could have systemic implications for the participants of the service, other FMUs, and other markets. Accordingly, the Board believes that a supervisor should consider a designated FMU's governance arrangements when performing its systemic risk review. For these reasons, the Board is adopting the governance standard in proposed §§ 234.3(a)(10) and 234.4(a)(8) essentially as set out in the NPRM.

4. Independent Model Validation

Proposed § 234.4(a)(17) requires a designated FMU that operates as a CCP to use margin requirements to limit its credit exposures to participants in normal market conditions and use risk-based models and parameters that are reviewed regularly. In addition, proposed § 234.4(a)(17)(i) would require a CCP to provide for annual model validation consisting of evaluating the performance of the CCP's margin models and the related parameters and assumptions associated with such models by a qualified person who does not perform functions associated with the CCP's margin models (except as part of the annual model validation) and also does not report to such a person.[14] Two commenters noted that proposed § 234.4(a)(17)(i), although on the right track, should stress explicitly the complete independence of the organization conducting the validation. One of the commenters believed models must be validated annually by a qualified and independent organization with no financial stake in the outcome because no employee of a systemically important CCP should be expected to resist the inevitable direct and indirect pressures of management who may have incentives to achieve a less-appropriate and less-independent outcome. The other commenter also stated that model validation must be performed by a truly independent party with no financial stake in the outcome of the validation and expressed concern that a validator that is not sufficiently independent would face the conflict of interest that would lead designated FMUs to lower their margins in order to attract business and increase profits.

The Board believes that a validator must be able to offer independent, unbiased conclusions and recommendations as part of the margin model validation process. It is unlikely that the person who was responsible for initially developing the margin model would be able to provide an independent, unbiased assessment of the product. Similarly, it appears unlikely that a person under the functional control of the developer would be able to provide independent, unbiased validation of the model without the influence of the developer and concern for employment security. Accordingly, proposed § 234.4(a)(17)(i) would require that the model validation be conducted by a qualified person who does not perform functions associated with the CCP's margin model, such as development and implementation, and does not report to such a person.[15]

[13] For example, a designated FMU may set access criteria based on risk measures such as capital ratios, risk ratings, or other indicators.

[14] Proposed § 234.4(a)(17)(i) inadvertently referred to the margin models of the ''clearing agency.'' The Board has revised these references to ''central counterparty'' in the final rule.

[15] This position is generally consistent with current supervisory guidance on model risk management by banks. See SR letter 11–7, p.3 (Apr. 4, 2011), which states:

Validation involves a degree of independence from model development and use. Generally, validation is done by staff who are not responsible for model development or use and do not have a stake in whether a model is determined to be valid.

Continued

The Board recognizes the concern expressed in the comments that there may be financial considerations beyond the validator's immediate employment security, and that there may be situations where a validator from outside the CCP may be needed to provide an appropriately independent validation. In such cases, the Board may hold a particular designated FMU to a stricter definition of independent validation that is appropriate for the level of risk presented by the designated FMU. Proposed § 234.4(b) allows for the Board, by order, to apply heightened risk-management standards to a particular designated FMU in response to the risks presented by that designated FMU. As a generally applicable standard, however, the Board believes it is appropriate to recognize basic requirements for an independent validation. For these reasons, the Board is adopting proposed § 234.4(a)(17)(i) essentially as set out in the NPRM.

5. Financial Resource Coverage

Proposed § 234.4(a)(15) would require a designated FMU that is acting as a CSD to institute risk controls that include collateral requirements and limits, and ensure timely settlement in the event that the participant with the largest payment obligation is unable to settle when the CSD extends intraday credit. Proposed § 234.4(a)(18) would require a designated FMU that is acting as a CCP to maintain sufficient financial resources to withstand, at a minimum, a default by the participant to which it has the largest exposure in extreme but plausible market conditions. The Board specifically requested comment on whether such designated FMUs should be required to maintain sufficient financial resources to withstand the default by the participant with the largest exposure or obligation in extreme but plausible market conditions, where the ''participant'' means the family of affiliated participants when there is more than one affiliated participant (''cover one''), or whether such designated FMUs should be required to maintain sufficient financial resources to withstand the defaults by the two participants, plus any affiliated participants, with the largest exposures or obligations in extreme but plausible market conditions (''cover two'').

Two commenters stated that, if the Board continued to base its financial resources standard on the number of participants that pose large risk exposures to a CCP, they supported the higher cover two requirement. One commenter cited the ''interconnectedness of financial institutions'' as one of the central dangers, which must be addressed by financial reforms and a reason for adopting a cover two standard. This commenter also suggested that the Board's rule should conform to a similar standard proposed by the CFTC for systemically important DCOs, which included a cover two requirement.[16] The other commenter supported a cover two standard because, during a period of extreme market stress, it cannot be guaranteed that there will be only a single default. Neither commenter, however, provided any analysis to support its contention that a cover two standard would be more appropriate as a generally applicable standard.

Both commenters, however, expressed a preference for a financial resource coverage requirement based on an additional measurement as determined by a percentage of aggregate exposure, and suggested that the default rate used in stress tests be based on the larger of (a) the two members representing the largest exposure to the CCP and (b) the members constituting at least 33 percent of the exposures in aggregate to the CCP. The two commenters believed that the additional measurement captures the risk of a diverse, but interconnected, membership.

As noted in the NPRM, the Board's proposed financial resources standards would apply a heightened cover one requirement because the term ''participant'' would be interpreted as the largest family of affiliated participants if there was more than one affiliated participant. The Board believes that this interpretation will address the interconnectedness of participants through corporate ownership structures. With respect to risks presented by other types of interconnectedness (i.e., through common participation across markets or FMUs), the standards for a designated FMU's financial resource coverage, as with all other standards set out in the regulation, are generally applicable standards. The Board expects that a designated FMU would employ a risk-management framework that is appropriate for the risks faced by the FMU and the FMU may, at its own initiative, institute a cover two financial resource coverage requirement. In addition, the Board may require, by order, a particular designated FMU to exceed the generally applicable standards set out in the regulation to address the risks presented by, including those borne by, the FMU.[17] Although the existing cover one standard was adopted by the Board in its PSR policy and applied in its supervision of payment and settlement systems since 1994, the Board has applied heightened financial resource coverage requirements when the appropriate situation arose. Therefore, although the Board agrees with the commenters that, in some cases, a higher requirement would be more appropriate to the level of risk presented by a particular designated FMU, the Board believes, at this time, that the most appropriate course is to adopt the cover one standard as generally applicable and impose a higher standard, including possibly a cover two standard, on a case-by-case basis when appropriate. The Board will consider the appropriateness of adopting a cover two standard in the context of possible revisions to Regulation HH in light of the PFMI. Accordingly, the Board is adopting the cover one standard in § 234.4(a)(15) and (18) essentially as set out in the NPRM.

The Board believes the commenters' concern regarding appropriately addressing the interconnectedness of a designated FMU's participants and the suggestion of applying the additional measurement using a percentage of aggregate exposure are important to consider. Before determining the viability of this approach, however, the Board believes further analysis is needed regarding how the suggested additional measure would be applied, and such analysis could include identifying situations in which the additional aggregate exposure measure would capture risk that is not addressed by either a cover one or cover two standard, an explanation of how the additional measure would be calculated (including the appropriate time horizon to use), and an explanation of why a 33 percent aggregate exposure standard would be most appropriate for this approach. The Board will consider this approach further in the context of revisions to Regulation HH in light of

As a practical matter, some validation work may be most effectively done by model developers and users; it is essential, however, that such validation work be subject to critical review by an independent party, who should conduct additional activities to ensure proper validation. Overall, the quality of the validation process is indicated by critical review by objective, knowledgeable parties and the actions taken to address issues identified by those parties.

[16] On November 8, 2011, pursuant to its authority under Title VII of the Dodd-Frank Act, the CFTC published its final rule on risk-management standards for DCOs. The CFTC elected to adopt a cover one requirement for all DCOs, and delay risk-management related rulemakings for systemically important DCOs until a later time. See 76 FR 69334 (Nov. 8, 2011).

[17] *See* § 234.4(b).

the PFMI. The Board welcomes and will review any supporting research on this issue that is submitted.

6. Legal Certainty of Netting Arrangements

One commenter raised an issue regarding designated FMUs that allow netting of payments to and from individual participants. The commenter stated that, to ensure that the netting will be honored in a bankruptcy or other insolvency proceeding, Regulation HH must require that the designated FMU demonstrate that, under the policies, procedures, and documentation of the designated FMU, the netting permitted by the designated FMU will be given legal effect in default and insolvency situations through an analysis provided by outside legal counsel that is a nationally recognized expert in matters of corporate insolvency.

The Board recognizes the importance of legal certainty of a designated FMU's transactions, not only during default and insolvency situations, but also at all other times. To address these concerns, the Board proposed standards regarding a designated FMU's legal framework for payment systems, as well as CSDs and CCPs. For example, proposed § 234.4(a)(1) states that the CSD or CCP should have a well-founded, transparent, and enforceable legal framework for each aspect of its activities in all relevant jurisdictions. As explained in the NPRM, the Board expects that a designated FMU will manage its legal risks within the context of currently applicable statutes and regulations, so it can ensure that its rules, procedures, and contractual provisions will be enforceable with a high degree of certainty.[18]

Legal certainty of each aspect of a designated FMU's activities (including its netting function) is expected to be supported by existing law in all relevant jurisdictions. Obtaining an opinion of outside counsel is one method for a designated FMU to judge legal certainty of its rules and procedures, but it is not the only method. In many cases, the designated FMU's in-house counsel may be better positioned to evaluate the intricacies of the designated FMU's netting arrangements and the law of the jurisdictions that are relevant to the designated FMU's operations. In addition, obtaining an opinion of outside counsel could involve significant expense for the designated FMU, depending on the complexity and number of relevant jurisdictions. The Board does not believe it is appropriate to impose such costs as a general expectation when they may not be necessary in all cases. Whether legal certainty must be supported by an opinion of outside counsel or may be verified by in-house counsel is a decision that may be made initially by management of the designated FMU. In the event the Board determines in a particular situation that an opinion by outside counsel is warranted, it could require such an opinion in that case. For these reasons, the Board believes that the legal framework standard as proposed is sufficient to address the concerns raised by the commenter.

7. Costs of Risk-Management Standards to Participants

One commenter urged the Board to ensure that the benefits of enhanced risk-management standards exceed the costs of implementing the standards on banks and their customers. The commenter stated that banks will feel the effects of the risk-management standards because any designated FMUs with whom the banks transact business will likely pass on the costs and constraints of enhanced supervisory oversight to their participants.

The Board is keenly aware of the need to weigh the costs and benefits of particular rulemakings. Section 805(a) of the Act requires the Board to prescribe risk-management standards governing the operations related to the PCS activities of designated FMUs. The Board's discretion lies not in whether risk-management standards must be promulgated, but rather in how the Board can best avoid unnecessary burden associated with the standards.

With respect to the benefits of the risk-management standards, section 805(b) states that the objectives and principles for the standards are to (1) Promote robust risk management; (2) promote safety and soundness; (3) reduce systemic risks; and (4) support the stability of the broader financial system. The benefit of reducing systemic risk is, of course, difficult to quantify. Generally speaking, however, an FMU that is better positioned to withstand disruptive systemic events would result in much smaller costs being borne by the FMU, and its participants, and, more generally, the financial system and taxpayers.

The costs of the risk-management standards can be viewed as a designated FMU's incremental expenses in establishing and maintaining the systems and procedures necessary to meet the standards, and other Regulation HH requirements, over and above the risk-management measures the FMU would have otherwise adopted for business reasons. As the commenter noted, such costs are generally passed on to a designated FMU's participants. These costs could take the form of higher transaction costs, margin or collateral costs, and capital requirements. These costs should be weighed against the societal benefit of stability in the financial system and the economy more broadly.

As explained in the NPRM, the Board proposed to adopt the Core Principles and CPSS–IOSCO Recommendations as the basis for the risk-management standards required by the Act, in part because that approach strikes a reasonable balance between furthering the Act's goals of enhanced risk management and financial stability and controlling the costs imposed on the FMUs. As explained in the NPRM, the Core Principles and CPSS–IOSCO Recommendations were formulated by central banks and securities regulators over several years and with considerable discussion and input from the financial services industry. The Federal Reserve collaborated with participating financial system authorities in developing the three sets of standards. In addition, the SEC and CFTC participated in the development of the CPSS–IOSCO Recommendations. The three sets of standards, particularly those relevant to payment systems, have been incorporated into the Board's PSR policy for many years. Further, the Board has used these standards, in conjunction with relevant laws and other Federal Reserve policies, when exercising its authority with respect to supervising payment and securities settlement systems.[19] FMUs that are likely to be designated by the Council, as well as their participants, are well-acquainted with these standards and, in many cases, such FMUs have already incorporated these standards into their governance, risk-management, and operating frameworks. The Board, therefore, does not anticipate material additional costs associated with adopting the Core Principles and CPSS–IOSCO Recommendations into its regulation for participants in payment systems already managing towards these standards.

Although these standards would be generally applicable, the Board is retaining the authority to impose a more stringent standard or waive a standard

[18] 76 FR at 18447.

[19] The Core Principles and the Recommendations for Securities Settlement Systems were incorporated into the PSR policy in 2004 (*http://www.federalreserve.gov/boarddocs/press/other/2004/20041126/default.htm*). The Recommendations for Central Counterparties was incorporated into the PSR policy in 2007 (*http://www.federalreserve.gov/newsevents/press/other/20070112a.htm*).

on a case-by-case basis in situations where it is warranted.[20] The Board believes this is a more cost-effective approach to achieving the risk management objectives of Title VIII of the Act. For example, when a situation that warrants a higher standard is discovered, the Board will exercise its authority to tailor a higher standard for the risks presented. In addition, alternatively, if review of the PFMI demonstrates that a higher standard is more appropriate for general application, the Board will consider a revision to the regulation.

B. Advance Notice of Material Changes

1. Materiality Threshold

Section 806(e) of the Act requires a designated FMU to provide 60 days' advance notice to its Supervisory Agency of any proposed change to its rules, procedures, or operations ''that could, as defined in rules of each Supervisory Agency, materially affect the nature or level of risks presented'' by the designated FMU. Proposed § 234.5(c)(1) states that the term ''materially affect the nature or level of risks presented'' means matters as to which there is a ''reasonable possibility that the change could materially affect the performance of clearing, settlement, or payment functions or the overall nature or level of risk presented by the designated financial market utility.'' Proposed § 234.5(c)(2) provides a non-exclusive list of changes that would materially affect the nature or level of risks presented, including changes that affect participant eligibility or access criteria; product eligibility; risk management; settlement failure or default procedures; financial resources; business continuity and disaster recovery plans; daily or intraday settlement procedures; scope of services; non-routine changes to the underlying technological framework for PCS functions; or governance. Proposed § 234.5(c)(3) provides a non-exclusive list of changes that would not materially affect the nature or level of risks presented, including a change that does not modify the contractual rights or obligations of the designated FMU or its participants; a change that does not adversely affect the safeguarding of securities, collateral, or funds for which the designated FMU is responsible; a routine technology upgrade; a routine administrative change; or a non-substantive change to rules, procedures, or other documentation.

The Board requested comments on all aspects of its proposed materiality rule, particularly on the appropriateness of the definition of ''materially affect the nature or level of risks presented'' and the utility of the non-exclusive lists for material and non-material changes. Commenters generally stated that the materiality standard would benefit from one or more of the following three adjustments: (1) A narrower scope of the definition itself, (2) a shorter list of inclusions, or (3) a more expansive list of exclusions.

''Reasonable possibility.'' Several commenters stated that the definition of ''materially affect the nature or level of risks presented'' is overly vague and were concerned that the Board would be flooded with advance notices of non-material changes as a result. Three commenters generally stated that the definition of materiality is too vague and suggest a more narrowly drawn definition to provide for expeditious review. One commenter suggested revising the proposed materiality standard, which requires notice of proposed changes that have ''a reasonable possibility'' of material effect, to require notice only for those changes that are ''reasonably likely'' to have a material effect. The commenter stated that, with the proposed definition, designated FMUs were highly likely to err in favor of significantly ''over-disclosing'' changes to their rules, procedures, and operations, which would be overly burdensome to both the Board and the industry.

The Board believes the proposed definition sets an appropriate minimum threshold for advance notices at this time. Proposed § 234.5(c) asks the designated FMU to consider whether it is reasonably possible that a change could have a material effect on the performance of its PCS functions or its overall risk profile. The Board recognizes that ''possible'' is a lower threshold than ''likely.'' Section 806(e)(1) of the Act uses the phrase ''could * * * materially affect'' the PCS functions or its overall risk profile of the designated FMU. This word choice indicates possibility, rather than likelihood.[21] If Congress had intended that advance notices be submitted only for changes that were likely to have a material effect, it could easily have framed it in that way. In addition, when the Board seeks to fulfill its statutory responsibility, the lower threshold is appropriate to ensure that it is able to review a broad sampling of the types of material changes that the designated FMU normally makes in its operations. As the designated FMU submits advance notices, the Board will be able to provide feedback and filter out the specific types of rule changes normally considered by that particular designated FMU that do not warrant advance notices. Within this framework, the Board anticipates that it will be able to more precisely balance the regulatory burden of the advance notice requirement with its need to receive advance notice of material changes for the supervision of a particular designated FMU contemplated by Title VIII of the Act.

Further, the suggested revision would require the designated FMU to determine which changes were likely to materially affect the performance of its PCS functions or its overall risk profile. Making this judgment without any input from the Board would increase the risk that the designated FMU would not submit an advance notice to the Board that the Board would determine could have a material effect. This not only could subject the designated FMU to supervisory criticism and possible modification or rescission of the change, but also could prevent the Board from obtaining valuable insight into the operations of the designated FMU as contemplated by the statute.

Although a lower materiality threshold initially may result in a higher number of advance notice filings, the Board does not believe that this is a reason to change the definition. The Board will provide guidance, through ongoing dialogue during the supervisory process, to assist a designated FMU in determining whether a proposed change requires advanced notice. For the reasons set out above, the Board is retaining the ''reasonable possibility'' language in the definition of ''materially affect the nature or level of risks presented'' in § 234.5(c)(1) of the final rule.

''Performance of clearing, settlement, or payment functions.'' One commenter suggested deleting from the materiality definition the phrase ''performance of clearing, settlement, or payment functions.'' The commenter stated that the proposed definition of materiality overreaches the statutory purpose of ensuring sound risk management by requiring advance notice of changes that affect the performance of PCS functions in addition to the overall nature or level or risks presented. The commenter stated that changes implemented by the

[20] One example of this approach is the financial resource coverage standard in § 234.4(a)(15) and (18) (cover one versus cover two).

[21] ''Could'' is commonly defined as the past tense of ''can,'' and is used to indicate ''possibility.'' ''Likely'' is defined as ''possessing or displaying the qualities or characteristics that make something probable.'' American Heritage Dictionary of the English Language (Fourth Edition), *http://ahdictionary.com/.*

designated FMU that relate to the broad category of ''performance,'' as opposed to risk, are more appropriately vetted in the competitive marketplace.

In referring to the performance of PCS functions, the Board intended to provide additional guidance to the scope of the advance notice requirement by including an express focus on the PCS functions of a designated FMU. The Board believes that the language in proposed § 234.5(c)(1) appropriately implements the statutory authority provided by the Act. To address the commenters' concerns and provide clarity regarding the scope of the advance notice requirement in § 234.5(c)(1), the Board is adopting a revision to the proposed regulatory text to state that the term ''materially affect the nature or level of risks presented'' means matters as to which there is a reasonable possibility that the change could ''materially affect the overall nature or level of risk presented by the designated financial market utility, including risk arising in the performance of payment, clearing, or settlement functions.'' [22] This revision ensures that the definition follows the statutory authority, while also providing an indication that the Board expects designated FMUs to pay particular attention to providing advance notice of proposed changes to its rules, procedures, or operations regarding the performance of its PCS functions that could materially affect the nature or level of risks presented by the designated FMU. The additional guidance, however, does not limit the scope of ''materially affect the nature or level of risks presented'' to only those risks arising in the performance of PCS functions. A proposed change to any of the designated FMU's rules, procedures, or operations that could materially affect the nature or level of risks presented by the designated FMU should be the subject of an advance notice, regardless of whether it is regarding the performance of PCS functions.

Non-exclusive lists. Four commenters stated that the non-exclusive list of material changes in proposed § 234.5(c)(2) was too broad or the non-exclusive list of non-material changes in proposed § 234.5(c)(3) was too narrow. The commenters acknowledged the value of providing guidance regarding changes that were material or not material, but generally stated that the proposed lists did not appropriately draw this dividing line.

One commenter stated that most items included on the material list in proposed § 234.5(c)(2) are described in a manner that would require a designated FMU to provide the Board notice of changes that would not necessarily affect the nature or level of risk in any manner. In particular, the commenter noted that ''financial resources'' is included in the list in proposed § 234.5(c)(2)(v), but is not modified by any quantitative or qualitative measure, so a designated FMU would be required to submit advance notice of any change in its financial resources, even changes that are not material, such as any changes that in any way affect capital, access to credit, or liquidity. Two commenters cited the ''scope of services'' item in proposed § 234.5(c)(2)(viii) as another example of an overly broad requirement that is unrelated to risk. For similar reasons, two commenters suggested deleting the ''governance'' item in proposed § 234.5(c)(2)(x). One commenter also suggested deleting the ''participant eligibility or access'' item in proposed § 234.5(c)(2)(i).

The Board believes that material changes in the areas listed in proposed § 234.5(c)(2) could affect a designated FMU's core functions and, as a result, might affect its ability to manage its risks appropriately and to continue to conduct systemically important PCS services. This may, in turn, affect the designated FMU's ability to comply with the risk-management standards set out in §§ 234.3 and 234.4 to which they will be held. The list of material changes provided in proposed § 234.5(c)(2) was intended to track those risk-management standards, and the reasons for including these items in the list of material changes requiring an advance notice are similar in most cases. For example, the importance of understanding material changes in the financial resources of a designated FMU acting as a payment system would be critical to assessing the ability of the designated FMU to continue to provide systemically important PCS services in the event of a default, as well as its compliance with several of the proposed risk-management standards, such as the capability to ensure timely completion of daily settlements as set out in proposed § 234.3(a)(5).

To address the commenters' concerns that de minimis changes to the areas listed in § 234.5(c)(2) would require an advance notice, the Board is adopting revised language in the final rule to clarify that the changes that ''materially affect'' the areas listed would be considered changes that materially affect the nature or level of risks presented by the designated FMU.

Also, as explained above regarding the risk-management standard for governance in proposed § 234.3(a)(10), the Board believes that effective, accountable, and transparent governance arrangements are critical to effective risk management of a designated FMU. As a result, changes that materially affect a designated FMU's governance arrangements should be submitted pursuant to the advance notice process.

Similarly, the Board believes that access criteria can help ensure that a designated FMU admits financial institutions that will be able to meet their obligations and not expose the FMU or its other participants to risk, including through risk measures such as capital ratios, risk ratings, or other indicators. For this reason, the Board will have an interest in receiving advance notice of any material changes to a designated FMU's participant eligibility or access criteria. Finally, understanding the scope of services offered by an FMU that is designated on the basis of its role as operator of a payment system is fundamental to being able to have a clear understanding of the payment system's risk profile. A designated FMU's services could affect the financial risks participants face through their participation in the system, as well as the level of risk that the designated FMU is incurring by providing the services.

Commenters also suggested revising the list of non-material changes in proposed § 234.5(c)(3).[23] One commenter stated that certain examples on the non-material list are so narrowly drawn as to be unhelpful in marking a reasonable line between circumstances that may compel advance notice and those that may not. As an example, the commenter cited the example of ''a change that does not modify the contractual rights or obligations of the designated financial market utility or persons using its payment, clearing, or settlement services'' set out in proposed § 234.5(c)(3)(i) and noted these types of changes, in essence, would be the types of clerical, non-substantive changes separately identified in proposed § 234.5(c)(3)(v). Another commenter

[22] The risks presented by the designated FMU's performance of its PCS functions can go beyond the effect on the designated FMU itself and reach its participants or the market more broadly.

[23] One commenter suggested that the final rule include in the non-material list of proposed § 234.5(c)(3) a greater range of operating rule changes for designated FMUs participating in the retail payment systems. As explained above, however, the Council has indicated that it expects to focus at this time on FMUs that operate large-value systems and not on FMUs that operate low-value systems, such as check or ACH. 76 FR 44763, 44769 (July 2011).

supported a broad application of the example set forth in § 234.5(c)(3)(ii) (''a change to an existing procedure, control, or service that does not adversely affect the safeguarding of securities, collateral, or funds in the custody or control of the designated financial market utility or for which it is responsible'').

After taking into consideration the comments noted above and reexamining the list of non-material changes, the Board is eliminating the examples in proposed §§ 234.5(c)(3)(i) and (ii). With respect to proposed § 234.5(c)(3)(i), the Board recognizes the commenter's concern; however, the Board believes it is more prudent to capture a wider range of proposed changes at this time and therefore is reluctant to expand the example's breadth. In addition, the Board is concerned that a broad application of the non-material change set forth in proposed § 234.5(c)(3)(ii) might inadvertently create an overlap with the advance notice requirement for material change set forth in § 234.5(c)(2)(iii) because both changes fall broadly within the area of risk management. In order to avoid this overlap, and any resulting confusion, the Board is removing the example in proposed § 234.5(c)(3)(ii).

The list provided by the Board in § 234.5(c)(3) is not meant to be exhaustive. The Board believes that it is difficult to draw a bright line that could be uniformly applicable to all designated FMUs between changes that would require advance notice and those that would not because of the range of different designs and functions. The Board believes, at this time, that routine changes like those listed in the remaining examples of § 234.5(c)(3) would be considered clearly non-material for the purposes of triggering the 60-day advance notice requirement. In addition, the Board believes that changes to fees, prices, or other charges for services provided by the designated FMU constitute business decisions that would not require advance notice. To that end, the Board is adopting an explicit exclusion for fees, prices, or other charges in § 234.5(c)(3)(ii). As mentioned above, as the supervisory process develops with a particular designated FMU, the Board anticipates that it will reach an understanding with the FMU about what constitutes a non-material rule change for that FMU that would not require advance notice.

2. Expedited Review

Proposed § 234.5(a) includes procedural requirements regarding advance notices of material changes, such as the required content of the notices and the procedures and timing for the methods for approving such changes. These provisions essentially reiterate similar provisions in section 806(e) of the Dodd-Frank Act. Some commenters were concerned that the open-ended time frame for the Board to request additional information on a material change would unnecessarily delay action on certain changes to rules, procedures, or operations that are time sensitive, but do not materially affect the level of risks posed by the designated FMU. As a means of expediting the processing of advance notice submissions, commenters made several suggestions to limit the time of the Board's review, such as (a) establishing a 10-day preliminary determination window in which the Board determines whether a proposed change requires advance notice or a full 60-day review and (b) limiting the Board's authority to request additional information to assess the effects of the proposed change to within the first 30 days of the review period. The commenters were generally concerned that the Board would engage in an indefinite and extended review of advance notices that would hinder a designated FMU's ability to manage its business.

As a general matter, the Board recognizes the importance of reducing regulatory burden and being diligent in reviewing proposed material changes in a timely manner. Section 806(e)(1)(I) of the Act permits a designated FMU to implement a change in less than 60 days from the filing of the advance notice if its Supervisory Agency notifies the designated FMU that it does not object to the proposed change and authorizes the designated FMU to implement the change at an earlier date. The Board incorporated this statutory provision in proposed § 234.5(a)(8) and is retaining this provision in the final rule. This provision provides a mechanism for the Board to complete its review and inform the designated FMU that it may proceed before the expiration of the 60-day advance notice period. The Board expects to use this procedure as appropriate. The Board, however, recognizes that it must balance the need for expediency with the need to conduct a thorough review of any necessary supporting documentation or information related to a proposed change, in order to make an informed decision consistent with its statutory responsibilities. Therefore, the timeliness of the Board's review may depend, in part, on the completeness of the information provided by and level of engagement with the designated FMU prior to and following the submission of the advance notice.

3. Advance Notice by Rule-Setting Bodies

Two commenters responsible for developing and setting rules for retail payment systems suggested that the Board's advance notice procedure permit the submission of a proposed rule change by the rule-writing body and that such submission satisfy the advance notice requirement for any designated payment system operating subject to the rules. As an initial matter, the Board will be mindful of the need for efficiency and minimizing regulatory burden, while also ensuring that the Board receives the necessary information on a timely basis in order to fulfill its responsibilities under the Act. The Board notes, however, that although such rule-writing arrangements exist for several retail payment networks, as noted above, such systems are not expected to be designated by the Council as systemically important at this time. If the Council designates any payment systems subject to such rule-writing arrangements and the Board is the Supervisory Agency for that system, the Board would review, at that time, the appropriate means for such systems to submit advance notices.

4. Emergency Changes

One commenter requested that the Board take care in allowing designated FMUs to make immediate emergency changes to their governing rules under proposed § 234.5(b), particularly with respect to customer collateral and margin requirements. The commenter stated that situations that justify alteration of loss mutualization standards from international standards are rare and should be carefully scrutinized. The commenter also requested that the Board incorporate CPSS–IOSCO principles with regard to customer collateral and margin requirements so as to ensure that designated FMUs will apply loss mutualization standards that comport with international standards.

Section 806(e)(2) of the Act contemplates the possibility that designated FMUs may need to implement material changes to their rules, procedures, or operations in emergency situations and includes a mechanism allowing for the ex-post notification of the Supervisory Agency regarding such emergency material changes. This mechanism was incorporated into proposed § 234.5(b). In order to take advantage of the emergency change process, a designated

FMU is required to explain to the Board within 24 hours of the implementation of the change, among other things, the nature of the emergency and the reason the changes was necessary for the designated FMU to continue to provide its services in a safe and sound manner. Pursuant to Title VIII and the proposed rule, the Board may require modification or rescission of the change if it finds that the change is not consistent with the purposes of the Act or rules or standards prescribed thereunder. The Board expects that emergency changes, including any changes to customer collateral and margin requirements, will occur rarely and will be carefully scrutinized.

5. Advance Notice and Competitive Issues

Two commenters raised concerns regarding the advance notice procedure for designated FMUs that offer services that compete with services offered by the Federal Reserve Banks (''Reserve Banks''). One commenter involved in check imaging stated that if Reserve Banks engaged in check image services were not subject to the advance notice procedure under proposed § 234.5(a) and private-sector check-image-exchange rules were subject to the advance notice procedure, the Reserve Banks would enjoy a significant competitive advantage over the private-sector competitors. This commenter believed that the Reserve Banks would be able to change their check-image rules without being subject to the same delay and uncertainty as the competing designated FMU under the advance notice procedure. The commenter suggested that the Board include within the final rule provisions that seek to mitigate the potential for a negative impact on competition that may arise from the advance notice procedure for designated FMUs. Another commenter stated that it was beyond the scope of systemic risk regulation for the Board to ''force a delay in implementing business-related changes; particularly in a competitive market in which the Reserve Banks offer the competing alternative.''

The Board is cognizant of the competition between the Reserve Banks and private-sector service providers in certain financial services, including check and funds transfer services, and has long-standing policies to address such competitive issues. Under the Federal Reserve Act, the Board has general supervisory authority over the Reserve Banks, including the Reserve Banks' provision of payment and settlement services (''Reserve Bank financial services''), that is much more extensive in scope than the authority provided under Title VIII over designated FMUs.[24] In practice, Board oversight of the Reserve Banks in many ways goes beyond the typical supervisory framework for private-sector entities, including the framework provided by Title VIII. For example, the Board applies robust risk-management standards to the relevant Reserve Bank financial services; conducts regular examinations; and reviews key strategic initiatives, prices and service terms, proposed material changes, and ongoing operations.

The Board conducts regular examinations of the Reserve Bank financial services covering, among other things, operational safety and soundness and management effectiveness. It also regularly monitors the services' operations and initiatives through reports, discussions with Reserve Bank management, and its oversight liaison roles on various Reserve Bank management groups. The Board is also involved in reviewing or approving proposed changes to the Reserve Banks' rules, procedures, and operations, including those involving Reserve Bank financial services, from their inception. The Board's oversight of these proposed changes is significantly broader and more detailed than the Title VIII advance notice procedures. For example, the Board reviews all changes to the Reserve Banks' operating circulars, approves the Reserve Banks' budgets, including budgets related to the Reserve Bank financial services, and approves major strategic initiatives, and the associated expenditures.

Moreover, the Board recognizes the critical role Reserve Bank financial services, particularly the Fedwire Funds and Fedwire Securities services, play in the financial system and is committed to strong and effective supervision of these services that is comparable to, or exceeds, the requirements placed on similar private-sector entities. For example, the Board expects the Fedwire services to meet or exceed the Board's PSR policy standards, which are consistent with the Regulation HH standards applied to designated FMUs. In addition, the Board will hold the Reserve Banks to advance notice requirements with respect to proposed material changes to Fedwire rules, procedures, and operations that are the same as, or higher than, the requirements for designated FMUs that are supervised by the Board.[25] Moreover, if the Council designates an FMU on the basis of its role as operator of a payment system that competes with another Reserve Bank service, the Board will ensure that the competing Reserve Bank service is held to the same or higher requirements as those set forth in Regulation HH.

In addition, in order to address any competitive inequalities between Reserve Bank priced services and similar services provided by private sector entities, the Monetary Control Act of 1980 (the ''MCA'') requires Reserve Bank priced services to be priced explicitly and that fees be established on basis of all direct and indirect costs actually incurred, including taxes that would have been paid and a return on capital that would have been provided had the services been furnished by a private business firm.[26] As required by the MCA, the Board also has established a set of pricing principles that governs the schedule of fees for the Reserve Bank priced services, which must give due regard to competitive factors.[27] Board policy also requires that Federal Reserve actions are implemented in a manner that ensures fairness to other providers of payment services.[28] In light of these policies, the Board believes that changes to Reserve Bank priced services rules or operating circulars are subject to no less scrutiny, and in many cases more scrutiny, than the review contemplated by Title VIII's advance notice procedure.

III. Administrative Law Matters

A. Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) (''RFA'') generally requires an agency to perform an initial and a final regulatory flexibility analysis on the impact a rule is expected to have on small entities. However, under section 605(b) of the RFA, the regulatory flexibility analysis otherwise required under section 604 of the RFA is not required if an agency certifies, along with a statement providing the factual basis for such certification, that the rule will not have a significant economic impact on a substantial number of small entities. Based on current information, the Board believes that the payment systems that would likely be designated by the Council would not be ''small entities'' for purposes of the RFA, and

[24] 12 U.S.C. 221 *et seq.*

[25] See the Board's policy on ''Oversight of Key Financial Infrastructures'' related to Reserve Bank Systems at *http://www.federalreserve.gov/paymentsystems/over_rbsystems.htm.*

[26] 12 U.S.C. 248a. These costs are included in the private-sector adjustment factor for pricing Reserve Bank priced services.

[27] 12 U.S.C. 248a(c)(3).

[28] The Board policy can be found at: *http://www.federalreserve.gov/paymentsystems/pfs_standards.htm.*

so, the final rule likely would not have a significant economic impact on a substantial number of small entities. The authority to designate FMUs, however, resides with the Council, rather than the Board, and the Board therefore cannot be assured of the identity of the FMUs that the Council may designate in the future. Accordingly, the Board has prepared the following final regulatory flexibility analysis pursuant to section 604 of the RFA.

1. *Statement of the need for, and objectives of, the final rule.* In accordance with Sections 805(a) and 806(e) of the Dodd-Frank Act, the Board is adopting the final rule as Regulation HH, new Part 234 of Title 12 of the Code of Federal Regulations. The final rule establishes risk-management standards for systemically important FMUs and standards for determining when advance notice is required to be provided by a designated FMU that proposes to change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the designated financial market utility. The reasons and justification for the final rule are described above in the Supplementary Information.

2. *Summary of the significant issues raised by public comment on Board's initial analysis, the Board's assessment of such issues, and a statement of any changes made as a result of such comments.* The Board did not receive any public comments regarding its initial regulatory flexibility analysis.

3. *Small entities affected by the final rule.* The final rule would affect FMUs that the Council designates as systemically important to the U.S. financial system for which the Board is the Supervisory Agency. The Board estimates that fewer than five large-value payment systems would meet these conditions and be affected by this rule. Pursuant to regulations issued by the Small Business Administration (the ''SBA'') (13 CFR 121.201), a ''small entity'' includes an establishment engaged in providing financial transaction processing, reserve and liquidity services, or clearinghouse services with an average revenue of $7 million or less (NAICS code 522320). As noted in the NPRM, the Board does not currently believe that any of the payment systems that would likely be designated by the Council would be ''small entities'' pursuant to the SBA regulation. In addition, the Board does not believe at this time that, pursuant to section 803(8) of the Dodd-Frank Act, it would be the Supervisory Agency for any FMU that operates as a central securities depository or central counterparty and that would likely be designated by the Council.

4. *Recordkeeping, reporting, and compliance requirements.* The final rule imposes certain reporting and recordkeeping requirements for a designated FMU. (See, for example, § 234.3(a)(3) (requiring clearly defined procedures for the management of credit risks and liquidity risks); § 234.5(a)(1) and (2) (requiring advance notice of changes that could materially affect the nature or level of risks presented by the designated FMU), and § 234.5(b)(2) and (3) (requiring notice of an emergency change implemented by a designated FMU).) The final rule also contains a number of compliance requirements, including the standards that the designated FMU must meet, such as having a well-founded legal basis under all relevant jurisdictions and having rules and procedures that enable participants to understand clearly the FMU's impact on each of the financial risks they incur by participation in it. Payment systems under the Board's jurisdiction (including certain payment systems the Board believes could be designated as systemically important) are generally already expected to meet these standards, or are at least familiar with these standards, so the rule would not likely impose material additional costs on those payment systems.

5. *Significant alternatives to the revisions.* Section 805(a) of the Act requires the Board to prescribe risk-management standards governing the operations related to PCS activities of designated FMUs, so other administrative methods for accomplishing the goals of the Act were not considered. One alternative to adopting risk-management standards based on the relevant international standards was to develop a different set of risk-management standards specifically for purposes of section 805(a) of the Act. As explained in the NPRM and above, the Board proposed to adopt the Core Principles and CPSS–IOSCO Recommendations as the basis for establishing initial risk-management standards required by section 805(a) of the Act, in part, because this approach presented advantageous cost efficiencies for the regulators and the FMUs. Furthermore, the new standards set forth in the PFMI were still under development at the time of the NPRM and not available for consideration as an alternative. As explained above, the Core Principles and CPSS–IOSCO Recommendations were formulated by central banks and securities regulators with considerable discussion and industry consultation. In particular, the Federal Reserve collaborated with participating financial system authorities and consulted with FMUs and their participants in developing the standards. In addition, the SEC and CFTC participated in the development of the CPSS–IOSCO Recommendations. The Board incorporated these standards in its PSR policy in 2004 and 2007 and has been guided by the policy, in conjunction with relevant laws and other Federal Reserve policies, when exercising its authority with respect to supervising large-value payment and securities settlement systems.[29] Payment systems that would likely be designated by the Council, therefore, would likely be familiar with the Core Principles and could implement them promptly with relatively less burden than if the Board developed a different set of standards to implement section 805(a) of the Act.

B. Competitive Impact Analysis

As a matter of policy, the Board subjects all operational and legal changes that could have a substantial effect on payment system participants to a competitive impact analysis, even if competitive effects are not apparent on the face of the proposal.[30] Pursuant to this policy, the Board assesses whether proposed changes ''would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve in providing similar services'' and whether any such adverse effect ''was due to legal differences or due to a dominant market position deriving from such legal differences.'' If, as a result of this analysis, the Board identifies an adverse effect on the ability to compete, the Board then assesses whether the associated benefits—such as improvements to payment system efficiency or integrity—can be achieved while minimizing the adverse effect on competition.

This final rule promulgates risk-management standards and advance notice requirements for designated FMUs, as required by Title VIII of the Act. Some FMUs may be designated on the basis of their role as operators of payment systems that compete with similar services provided by the Reserve Banks, and designation subjects the FMU to an enhanced supervisory framework. Commenters have raised concerns regarding the Reserve Banks obtaining a competitive advantage over private-sector competitors through the

[29] See footnote 19.

[30] See ''The Federal Reserve in the Payments System,'' Fed. Res. Reg. Svc. § 9–1550, 9–1558 (Apr. 2009).

Board imposing a less-stringent supervisory framework on the Reserve Banks priced services than would be imposed on a competing designated FMU. As noted above, Board oversight of the Reserve Banks goes well beyond the typical supervisory framework for private-sector entities, including the framework provided by Title VIII. The Board applies risk-management standards to the Reserve Banks' Fedwire and other financial services that are at least as stringent as those applied to designated FMUs pursuant to Title VIII. Further, the Board will hold Reserve Banks to procedural requirements that are the same as, or higher than, the requirements for designated FMUs supervised by the Board, with respect to advance notice of material changes to the rules, procedures, or operations of Reserve Bank priced services that compete with designated FMUs. Therefore, the Board does not believe the final rule promulgating risk-management standards or advance notice requirements for designated FMUs under Title VIII will have any direct and material adverse effect on the ability of other service providers to compete with the Reserve Banks.

C. Paperwork Reduction Act Analysis

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR part 1320, Appendix A.1), the Board reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget. As noted in the proposal, for purposes of calculating burden under the Paperwork Reduction Act, a ''collection of information'' involves 10 or more respondents. Any collection of information addressed to all or a substantial majority of an industry is presumed to involve 10 or more respondents (5 CFR 1320.3(c), 1320.3(c)(4)(ii)). The Board estimates there are fewer than 10 respondents, and these respondents do not represent all or a substantial majority of the participants in payment, clearing, and settlement systems. Therefore, no collections of information pursuant to the Paperwork Reduction Act are contained in the final rule. The Board did not receive any comments on this analysis.

The Board has a continuing interest in the public's opinion of the collection of information. Comments on the collection of information should be sent to Cynthia Ayouch, Acting Federal Reserve Board Clearance Officer, Division of Research and Statistics, Mail Stop 95–A, Board of Governors of the Federal Reserve System, Washington, DC 20551, with copies of such comments sent to the Office of Management and Budget, Paperwork Reduction Project (7100–0199), Washington, DC 20503.

List of Subjects in 12 CFR Part 234

Banks, Banking, Credit, Electronic funds transfers, Financial market utilities, Securities.

Authority and Issuance

For the reasons set forth in the preamble, the Board amends 12 CFR, Chapter II by adding part 234, as set forth below.

PART 234—DESIGNATED FINANCIAL MARKET UTILITIES (REGULATION HH)

Authority: 12 U.S.C. 5461 *et seq.*

§ 234.1 Authority, purpose, and scope.

(a) *Authority.* This part is issued under the authority of sections 805, 806, and 810 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) (Pub. L. 111–203, 124 Stat. 1376; 12 U.S.C. 5464, 5465, and 5469).

(b) *Purpose and scope.* This part establishes risk-management standards governing the operations related to the payment, clearing, and settlement activities of designated financial market utilities. The risk-management standards do not apply, however, to a designated financial market utility that is a derivatives clearing organization registered under section 5b of the Commodity Exchange Act (7 U.S.C. 7a–1) or a clearing agency registered with the Securities and Exchange Commission under section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q–1), which are governed by the risk-management standards promulgated by the Commodity Futures Trading Commission or the Securities and Exchange Commission, respectively, for which each is the Supervisory Agency (as defined below). In addition, this part sets out requirements and procedures for a designated financial market utility that proposes to make a change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the designated financial market utility and for which the Board is the Supervisory Agency.

§ 234.2 Definitions.

As used in this part:

(a) *Central counterparty* means an entity that interposes itself between the counterparties to trades, acting as the buyer to every seller and the seller to every buyer.

(b) *Central securities depository* means an entity that holds securities in custody to enable securities transactions to be processed by means of book entries or an entity that enables securities to be transferred and settled by book entry either free of or against payment.

(c) *Designated financial market utility* means a financial market utility (as defined in paragraph (d) of this section) that the Financial Stability Oversight Council has designated under section 804 of the Dodd-Frank Act (12 U.S.C. 5463).

(d) *Financial market utility* has the same meaning as the term defined in section 803(6) of the Dodd-Frank Act (12 U.S.C. 5462(6)).

(e) *Payment system* means a set of payment instructions, procedures, and rules for the transfer of funds among system participants.

(f) *Supervisory Agency* has the same meaning as the term is defined in section 803(8) of the Dodd-Frank Act (12 U.S.C. 5462(8)).

§ 234.3 Standards for payment systems.

(a) A designated financial market utility that is designated on the basis of its role as the operator of a payment system must implement rules, procedures, or operations designed to ensure that it meets or exceeds the following risk-management standards with respect to the payment, clearing, and settlement activities of that payment system:

(1) The payment system has a well-founded legal basis under all relevant jurisdictions.

(2) The payment system's rules and procedures enable participants to have a clear understanding of the payment system's impact on each of the financial risks they incur through participation in it.

(3) The payment system has clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the payment system operator and the participants and which provide appropriate incentives to manage and contain those risks.

(4) The payment system provides prompt final settlement on the day of value, during the day and at a minimum at the end of the day.

(5) A payment system in which multilateral netting takes place is, at a

minimum, capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation.

(6) Assets used for settlement are a claim on the central bank or other assets that carry little or no credit risk and little or no liquidity risk.

(7) The payment system ensures a high degree of security and operational reliability and has contingency arrangements for timely completion of daily processing.

(8) The payment system provides a means of making payments that is practical for its users and efficient for the economy.

(9) The payment system has objective and publicly disclosed criteria for participation, which permit fair and open access.

(10) The payment system's governance arrangements are effective, accountable, and transparent.

(b) The Board, by order, may apply heightened risk-management standards to a particular designated financial market utility in accordance with the risks presented by that designated financial market utility. The Board, by order, may waive the application of a standard or standards to a particular designated financial market utility where the risks presented by or the design of that designated financial market utility would make the application of the standard or standards inappropriate.

§ 234.4 Standards for central securities depositories and central counterparties.

(a) A designated financial market utility that is designated on the basis of its role as a central securities depository or a central counterparty must implement rules, procedures, or operations designed to ensure that it meets or exceeds the following risk-management standards with respect to the payment, clearing, and settlement activities of that central securities depository or central counterparty:

(1) The central securities depository or central counterparty has a well-founded, transparent, and enforceable legal framework for each aspect of its activities in all relevant jurisdictions.

(2) The central securities depository or central counterparty requires participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the central securities depository or central counterparty. The central securities depository or central counterparty has procedures in place to monitor that participation requirements are met on an ongoing basis. The central securities depository's or central counterparty's participation requirements are objective and publicly disclosed, and permit fair and open access.

(3) The central securities depository or central counterparty holds assets in a manner whereby risk of loss or of delay in its access to them is minimized. Assets invested by a central securities depository or central counterparty are held in instruments with minimal credit, market, and liquidity risks.

(4) The central securities depository or central counterparty identifies sources of operational risk and minimizes them through the development of appropriate systems, controls, and procedures; has systems that are reliable and secure, and has adequate, scalable capacity; and has business continuity plans that allow for timely recovery of operations and fulfillment of the central securities depository's or central counterparty's obligations.

(5) The central securities depository or central counterparty employs money settlement arrangements that eliminate or strictly limit its settlement bank risks, that is, its credit and liquidity risks from the use of banks to effect money settlements with its participants and requires funds transfers to the central securities depository or central counterparty be final when effected.

(6) The central securities depository or central counterparty is cost-effective in meeting the requirements of participants while maintaining safe and secure operations.

(7) The central securities depository or central counterparty evaluates the potential sources of risks that can arise when the central securities depository or central counterparty establishes links either cross-border or domestically to settle transactions or clear trades, and ensures that the risks are managed prudently on an ongoing basis.

(8) The central securities depository or central counterparty has governance arrangements that are clear and transparent to fulfill public interest requirements and to support the objectives of owners and participants and promotes the effectiveness of a central securities depository's or central counterparty's risk-management procedures.

(9) The central securities depository or central counterparty provides market participants with sufficient information for them to identify and evaluate accurately the risks and costs associated with using its services.

(10) The central securities depository or central counterparty establishes default procedures that ensures that the central securities depository or central counterparty can take timely action to contain losses and liquidity pressures and to continue meeting its obligations and provides for key aspects of the default procedures to be publicly available.

(11) The central securities depository or central counterparty ensures that final settlement occurs no later than the end of the settlement day and requires that intraday or real-time finality be provided where necessary to reduce risks.

(12) The central securities depository or central counterparty eliminates principal risk by linking securities transfers to funds transfers in a way that achieves delivery versus payment.

(13) The central securities depository or central counterparty states its obligations with respect to physical deliveries, and the risks from these obligations are identified and managed.

(14) The central securities depository immobilizes or dematerializes securities certificates and transfers them by book entry to the greatest extent possible.

(15) The central securities depository institutes risk controls that include collateral requirements and limits, and ensure timely settlement in the event that the participant with the largest payment obligation is unable to settle when the central securities depository extends intraday credit.

(16) The central counterparty measures its credit exposures to its participants at least once a day and limits its exposures to potential losses from defaults by its participants in normal market conditions so that the operations of the central counterparty would not be disrupted and non-defaulting participants would not be exposed to losses that they cannot anticipate or control.

(17) The central counterparty uses margin requirements to limit its credit exposures to participants in normal market conditions and uses risk-based models and parameters to set margin requirements and reviews them regularly. Specifically, the central counterparty—

(i) Provides for annual model validation consisting of evaluating the performance of the central counterparty's margin models and the related parameters and assumptions associated with such models by a qualified person who does not perform functions associated with the central counterparty's margin models (except as part of the annual model validation) and does not report to such a person.

(ii) Reviews and backtests margin models and parameters at least quarterly.

(18) The central counterparty maintains sufficient financial resources to withstand, at a minimum, a default by the participant to which it has the largest exposure in extreme but plausible market conditions.

(b) The Board, by order, may apply heightened risk-management standards to a particular designated financial market utility in accordance with the risks presented by that designated financial market utility. The Board, by order, may waive the application of a standard or standards to a particular designated financial market utility where the risks presented by or the design of that designated financial market utility would make the application of the standard or standards inappropriate.

§ 234.5 Changes to rules, procedures, or operations.

(a) *Advance notice.*

(1) A designated financial market utility shall provide at least 60-days advance notice to the Board of any proposed change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the designated financial market utility.

(2) The notice of the proposed change shall describe—

(i) The nature of the change and expected effects on risks to the designated financial market utility, its participants, or the market; and

(ii) How the designated financial market utility plans to manage any identified risks.

(3) The Board may require the designated financial market utility to provide additional information necessary to assess the effect the proposed change would have on the nature or level of risks associated with the utility's payment, clearing, or settlement activities and the sufficiency of any proposed risk-management techniques.

(4) A designated financial market utility shall not implement a change to which the Board has an objection.

(5) The Board will notify the designated financial market utility of any objection before the end of 60 days after the later of—

(i) The date the Board receives the notice of proposed change; or

(ii) The date the Board receives any further information it requests for consideration of the notice.

(6) A designated financial market utility may implement a change if it has not received an objection to the proposed change before the end of 60 days after the later of—

(i) The date the Board receives the notice of proposed change; or

(ii) The date the Board receives any further information it requests for consideration of the notice.

(7) With respect to proposed changes that raise novel or complex issues, the Board may, by written notice during the 60-day review period, extend the review period for an additional 60 days. Any extension under this paragraph will extend the time periods under paragraphs (a)(5) and (a)(6) of this section to 120 days.

(8) A designated financial market utility may implement a proposed change before the expiration of the applicable review period if the Board notifies the designated financial market utility in writing that the Board does not object to the proposed change and authorizes the designated financial market utility to implement the change on an earlier date, subject to any conditions imposed by the Board.

(b) *Emergency changes.*

(1) A designated financial market utility may implement a change that would otherwise require advance notice under this section if it determines that—

(i) An emergency exists; and

(ii) Immediate implementation of the change is necessary for the designated financial market utility to continue to provide its services in a safe and sound manner.

(2) The designated financial market utility shall provide notice of any such emergency change to the Board as soon as practicable and no later than 24 hours after implementation of the change.

(3) In addition to the information required for changes requiring advance notice in paragraph (a)(2) of this section, the notice of an emergency change shall describe—

(i) The nature of the emergency; and

(ii) The reason the change was necessary for the designated financial market utility to continue to provide its services in a safe and sound manner.

(4) The Board may require modification or rescission of the change if it finds that the change is not consistent with the purposes of the Dodd-Frank Act or any applicable rules, order, or standards prescribed under section 805(a) of the Dodd-Frank Act.

(c) *Materiality.*

(1) The term ''materially affect the nature or level of risks presented'' in paragraph (a)(1) of this section means matters as to which there is a reasonable possibility that the change would materially affect the overall nature or level of risk presented by the designated financial market utility, including risk arising in the performance of payment, clearing, or settlement functions.

(2) A change to rules, procedures, or operations that would materially affect the nature or level of risks presented includes, but is not limited to, changes that materially affect any one or more of the following:

(i) Participant eligibility or access criteria;

(ii) Product eligibility;

(iii) Risk management;

(iv) Settlement failure or default procedures;

(v) Financial resources;

(vi) Business continuity and disaster recovery plans;

(vii) Daily or intraday settlement procedures;

(viii) The scope of services, including the addition of a new service or discontinuation of an existing service;

(ix) Technical design or operating platform, which results in non-routine changes to the underlying technological framework for payment, clearing, or settlement functions; or

(x) Governance.

(3) A change to rules, procedures, or operations that does not meet the conditions of paragraph (c)(2) of this section and would not materially affect the nature or level of risks presented includes, but is not limited to the following:

(i) A routine technology systems upgrade;

(ii) A change in a fee, price, or other charge for services provided by the designated financial market utility;

(iii) A change related solely to the administration of the designated financial market utility or related to the routine, daily administration, direction, and control of employees; or

(iv) A clerical change and other non-substantive revisions to rules, procedures, or other documentation.

By order of the Board of Governors of the Federal Reserve System, July 27, 2012.

Robert deV. Frierson,

Deputy Secretary of the Board.

[FR Doc. 2012–18762 Filed 8–1–12; 8:45 am]

BILLING CODE P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 21

Alaskan Fuel Hauling as a Restricted Category Special Purpose Flight Operation

AGENCY: Federal Aviation Administration (FAA), (DOT).

ACTION: Notice of policy.

SUMMARY: This notice of policy announces Alaskan fuel hauling as a restricted category special purpose