The authority described in "Subtitle VII, Part A, Subpart III, Section 44701: General requirements." Under that section, Congress charges the FAA with promoting safe flight of civil aircraft in air commerce by prescribing regulations for practices, methods, and procedures the Administrator finds necessary for safety in air commerce. This regulation is within the scope of that authority because it addresses an unsafe condition that is likely to exist or develop on products identified in this rulemaking action.

**Regulatory Findings**

We determined that this AD will not have federalism implications under Executive Order 13132. This AD will not have a substantial direct effect on the States, on the relationship between the national Government and the States, or on the distribution of power and responsibilities among the various levels of government.

For the reasons discussed above, I certify this regulation:

1. Is not a “significant regulatory action” under Executive Order 12866,
2. Is not a “significant rule” under the DOT Regulatory Policies and Procedures (44 FR 11034, February 26, 1979),
3. Will not affect intrastate aviation in Alaska, and
4. Will not have a significant economic impact, positive or negative, on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

**List of Subjects in 14 CFR Part 39**

Air transportation, Aircraft, Aviation safety, Incorporation by reference, Safety.

**Adoption of the Amendment**

Accordingly, under the authority delegated to me by the Administrator, the FAA proposes to amend 14 CFR part 39 as follows:

**PART 39—AIRWORTHINESS DIRECTIVES**

1. The authority citation for part 39 continues to read as follows:

   **Authority:** 49 U.S.C. 106(g), 40113, 44701.

   § 39.13 [Amended]

   2. The FAA amends § 39.13 by removing AD 99–07–10, Amendment 39–11095 (64 FR 14824, March 29, 1999), and adding the following new AD:


   (a) Effective Date

   This airworthiness directive (AD) becomes effective September 19, 2013.

   (b) Affected ADs

   This AD rescinds AD 99–07–10, Amendment 39–11095 (64 FR 14824, March 29, 1999).

   (c) Applicability

   This AD applies to PIAGGIO AERO INDUSTRIES S.p.A Model P–180 airplanes, all serial numbers, certificated in any category.

   (d) Subject

   Joint Aircraft System Component (JASC)/Air Transport Association (ATA) of America Code 54; Nacelles/Pylons.

   Issued in Kansas City, Missouri, on July 25, 2013.

   Earl Lawrence,
   Manager, Small Airplane Directorate, Aircraft Certification Service.

   [FR Doc. 2013–19816 Filed 8–14–13; 8:45 am]

   **BILLING CODE 4910–13–P**

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**COMMODITY FUTURES TRADING COMMISSION**

**17 CFR Part 39**

**RIN 3038–AC98**

**Enhanced Risk Management Standards for Systemically Important Derivatives Clearing Organizations**

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Final rule.

**SUMMARY:** The Commodity Futures Trading Commission (“Commission” or “CFTC”) is adopting final regulations to implement enhanced risk management standards for systemically important derivatives clearing organizations that include increased financial resources requirements for systemically important derivatives clearing organizations that are involved in activities with a more complex risk profile or that are systemically important in multiple jurisdictions, the prohibited use of assessments by systemically important derivatives clearing organizations in calculating their available default resources, and enhanced system safeguards for systemically important derivatives clearing organizations for business continuity and disaster recovery (“BC–DR”). This final rule also implements special enforcement authority over systemically important derivatives clearing organizations granted to the Commission under section 807(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).
I. Background

A. Core Principles for DCOs

On July 21, 2010, President Obama signed the Dodd-Frank Act. 1 Title VII of the Dodd-Frank Act, entitled the “Wall Street Transparency and Accountability Act of 2010,” amended the Commodity Exchange Act (“CEA”) or the “Act”) 2 to establish a comprehensive regulatory framework for over-the-counter (“OTC”) derivatives, including swaps. The legislation was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing mandatory clearing and trade execution requirements on cleared swap contracts; (3) creating rigorous recordkeeping and real-time reporting regimes; and (4) enhancing the Commission’s rulemaking and enforcement authorities with respect to, among others, all registered entities and intermediaries subject to the Commission’s oversight.

Section 725(c) of the Dodd-Frank Act amended section 5b(c)(2) of the CEA, which sets forth core principles that a derivatives clearing organization (“DCO”) must comply with to register and maintain registration with the Commission. The core principles were originally added to the CEA by the Commodity Futures Modernization Act of 2000 (“CFMA”). 3 and in 2001, the Commission issued guidance on DCO compliance with these core principles. 4 However, in furtherance of the goals of the Dodd-Frank Act to reduce risk, increase transparency, and promote market integrity, the Commission, pursuant to the Commission’s enhanced rulemaking authority, 5 withdrew the 2001 guidance and adopted regulations establishing standards for compliance with the DCO core principles. 6

As noted in the preamble to the adopting release for subparts A and B of part 39 of the Commission’s regulations, the regulations that implement the DCO core principles, the Commission sought to provide legal certainty for market participants, strengthen the risk management practices of DCOs, and increase overall confidence in the financial system by assuring the public that DCOs are meeting minimum risk management standards. 7 These risk management standards include, in part:

(1) With respect to financial resources, (a) Core Principle B, which requires DCOs to have “adequate financial, operational, and managerial resources, as determined by the Commission, to discharge each responsibility of the [DCO],” 8 and (b) Commission regulation 39.11, which requires a DCO to maintain sufficient financial resources to meet its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible market conditions, 9 and permits the inclusion of assessment powers to meet a limited portion of the DCO’s default resources requirement; 10 and

(2) with respect to business continuity, (a) Core Principle I, which requires DCOs to “establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allows for (I) the timely recovery and resumption of operations of the [DCO], and (II) the fulfillment of each obligation and responsibility of the [DCO],” 11 and (b) Commission regulation 39.18, which requires a DCO to maintain a BC–DR plan, emergency procedures, and physical, technological, and personnel resources sufficient to enable the DCO to resume daily processing, clearing, and settlement no later than the next business day following the disruption of its operations. 12

B. Designation of Systemically Important Derivatives Clearing Organizations Under Title VIII of the Dodd-Frank Act

Title VIII of the Dodd-Frank Act, entitled “Payment, Clearing, and Settlement Supervision Act of 2010,” 13

1 Core Principle B also expressly requires DCOs to “possess financial resources that, at a minimum, exceed the total amount that would (I) enable the organization to meet its financial obligations to its members and participants notwithstanding a default by the member or participant creating the largest financial exposure for that organization in extreme but plausible market conditions; and (II) enable the [DCO] to cover operating costs of the [DCO] for a period of 1 year (as calculated on a rolling basis).” Section 5b(c)(2)(B) of the CEA, 7 U.S.C. 7a–1(c)(3)(B) (emphasis added).


14 17 CFR 39.11(a)(1) (implementing Core Principle B pertaining to financial resources).

15 See 17 CFR 39.11(d)(2)(iii) (requiring a DCO to apply a 30 percent haircut to the value of potential assessments); see also 17 CFR 39.11(d)(2)(v) (permitting a DCO to count the value of assessments, after the 30 percent haircut, to meet up to 20 percent of its default obligations).

16 Core Principle I also requires DCOs to “establish and maintain a program of risk analysis and oversight to identify and minimize sources of operational risk through the development of appropriate controls and procedures, and automated systems, that are reliable, secure, and have adequate scalable capacity,” and “periodically conduct tests to verify that the backup resources of the [DCO] are sufficient to ensure daily processing, clearing, and settlement.” Section 5b(c)(2)(I) of the CEA, 7 U.S.C. 7a–1(c)(2)(I).

17 17 CFR 39.18(e)(3) (implementing Core Principle I pertaining to system safeguards).

18 Section 801 of the Dodd-Frank Act.
was enacted to mitigate systemic risk in the financial system and promote financial stability.\textsuperscript{15} Section 804 of the Dodd-Frank Act requires the Financial Stability Oversight Council (“Council”)\textsuperscript{16} to designate those financial market utilities (“FMUs”) that the Council determines are, or are likely to become, systemically important.\textsuperscript{17} An FMU includes “any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person.”\textsuperscript{18} As noted by the Council, FMUs form a critical part of the nation’s financial infrastructure. They exist in many markets to support and facilitate the transfer, clearing or settlement of financial transactions, and their smooth operation is integral to the soundness of the financial system and the U.S. economy. However, their function and interconnectedness also concentrate a considerable amount of risk in the financial system due, in large part, to the interdependencies, either directly through operational, contractual or affiliation linkages, or indirectly through end payment, clearing, and settlement processes. In other words, problems at one FMU could trigger significant liquidity and credit disruptions at other FMUs or financial institutions.\textsuperscript{19}

In determining whether an FMU is systemically important, the Council uses a two-stage designation process, applying certain statutory considerations and other metrics to assess, among other things, “whether possible disruptions [to the functioning of an FMU] are potentially severe, not necessarily in the sense that they themselves might trigger damage to the U.S. economy, but because such disruptions might reduce the ability of financial institutions or markets to perform their normal intermediation functions.”\textsuperscript{20} On July 18, 2012, the Council designated eight FMUs as systemically important under Title VIII.\textsuperscript{21} Two of these designated FMUs are CFTC-regulated for which the Commission is the Supervisory Agency.\textsuperscript{22} Such designated CFTC-registered DCOs are also known as systemically important derivatives clearing organizations (“SIDCOs”).\textsuperscript{23}

C. Standards for SIDCOs Under Title VIII of the Dodd-Frank Act

Section 805 of the Dodd-Frank Act directs the Commission to consider relevant international standards and existing prudential requirements when prescribing risk management standards governing the operations related to payment, clearing, and settlement activities for FMUs that are designated as systemically important by the Council, and (2) engaged in activities for which the Commission is the Supervisory Agency.\textsuperscript{24} Under Title VIII, the objectives and principles for these risk management standards are to:

1. Promote risk management;
2. Promote safety and soundness;
3. Reduce systemic risks; and
4. Support the stability of the broader financial system.\textsuperscript{25}

As outlined in section 805(c), these standards may address such areas 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 resources requirements for designated [FMUs]; and
6. Other areas that are necessary to achieve the objectives and principles in section 805(b) of the Dodd-Frank Act.

The Commission has reviewed the risk management standards set forth in part 39 of the Commission’s regulations in light of recently promulgated relevant international standards and existing prudential requirements to identify

\textsuperscript{26} Specifically, under Commission regulations, a systemically important derivatives clearing organization is a “financial market utility that is a derivatives clearing organization registered under Section 5b of the Act, which has been designated by the Financial Stability Oversight Council to be systemically important and for which the Commission acts as the Supervisory Agency pursuant to Section 803(b) of the [Dodd-Frank Act].” See 17 CFR 39.2.

\textsuperscript{27} The Commission notes that it also has the authority to prescribe the risk management standards governing the operations related to payment, clearing, and settlement activities for FMUs that are designated as systemically important by the Council and that are engaged in activities for which the Commission is the appropriate financial regulator. Furthermore, section 805 establishes a review mechanism by which the Commission may intervene if the Board of Governors of the Federal Reserve System (the “Board”) determines that the existing risk management standards set by the Commission “are insufficient to prevent or mitigate significant liquidity, credit, operational, counterparty or other risks to the financial markets or to the financial stability of the United States.” Section 805(a)(2)(B) of the Dodd-Frank Act.
those areas in which additional risk management standards for SIDCOs would be necessary and appropriate.

D. Principles for Financial Market Infrastructures

1. Overview

The Commission has determined that the international standards most relevant to the risk management of SIDCOs, for purposes of meeting the Commission’s obligation pursuant to section 805(a)(2)(A) of the Dodd-Frank Act, are the Principles for Financial Market Infrastructures (“PFMIs”), which were developed by the Bank for International Settlements’ Committee on Payment and Settlement Systems (“CPSS”) and the Technical Committee of the International Organization of Securities Commissions (“IOSCO”) (collectively, “CPSS–IOSCO”). The Commission notes that the adoption and implementation of the PFMIs by numerous foreign jurisdictions highlights the role these principles play in creating a global, unified set of international risk management standards for central counterparties (“CCPs”). Moreover, the Commission, which is a member of the Board of IOSCO, is working towards implementing rules and regulations that are fully consistent with the PFMIs by the end of 2013.

The PFMIs establish international risk management standards for financial market infrastructures (“FMIs”), including CCPs, that facilitate clearing and settlement. In February 2010, CPSS–IOSCO launched a review of the existing sets of international standards for FMIs in support of a broader effort by the Financial Stability Board (“FSB”) to strengthen core financial infrastructures and markets by ensuring that gaps in international standards are identified and addressed. CPSS–IOSCO endeavored to incorporate in its review process lessons from the 2008 financial crisis and the experience of using the existing international standards, as well as policy and analytical work by other international committees including the Basel Committee on Banking Supervision (“BCBS”). The PFMIs replace CPSS–IOSCO’s previous recommendations applicable to CCPs. In issuing the PFMIs, CPSS–IOSCO sought to strengthen and harmonize existing international standards and incorporate new specifications for CCPs clearing OTC derivatives. The stated objectives of the PFMIs are to enhance the safety and efficiency of FMIs and, more broadly, reduce systemic risk and foster transparency and financial stability.

The PFMIs set out 24 principles addressing various risk components of an FMI’s operations, including, as most relevant to this final rule, credit and operational risk.

2. Principle 4: Credit Risk

Principle 4 addresses the risk that a counterparty to the CCP will be unable to meet its financial obligations when due. Specifically, Principle 4 states that a “CCP should cover its current and potential future exposures to each participant fully with a high degree of confidence using margin and other prefunded financial resources.” Additionally, Principle 4 provides that a CCP involved in activities with a more complex risk profile or that is systemically important in multiple jurisdictions should maintain additional financial resources sufficient to cover a wide range of potential stress scenarios, including, but not limited to, the default of the two participants and their affiliates that would potentially cause the largest aggregate credit exposure to the CCP in extreme but plausible market conditions.


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

31 The PFMIs set out 24 principles addressing various risk components of an FMI’s operations, including, as most relevant to this final rule, credit and operational risk.

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

33 PFMIs, Background, 1.6.

34 Id.

35 The international standards for FMIs, prior to the publication of the PFMIs, included the “Recommendations for Securities Settlement Systems” published by CPSS–IOSCO in 2001, and the “Recommendations for Central Counterparties” published by CPSS–IOSCO in 2004 (collectively the “CPSS–IOSCO Principles and Recommendation”). See PFMIs, Background, 1.4 and 1.5.

36 Id. at Introduction, 1.2.

37 Id. at Background, 1.15.

38 Pursuant to the PFMIs, key risks faced by FMIs include legal, credit, liquidity, general business, custody, investment, and operational risks. See id. at Overview of Key Risks in Financial Market Infrastructures, 2.1.

39 The PFMIs define “credit risk” as the “risk that a counterparty, whether a participant or other entity, will be unable to meet fully its financial obligations when due, or at any time in the future.” Id. at Annex H: Glossary, 2.

40 Id. at Principle 4: Credit Risk, Key Consideration 4.

41 Such activities “with a more complex risk profile” include clearing financial instruments that are characterized by discrete jump-to-default price changes or that are highly correlated with potential participant defaults. Id. at Principle 4: Credit Risk, Explanatory Note 5.4.19.

42 Id. at Principle 4: Credit Risk. Financial resources sufficient to cover the default of the two participants and their affiliates creating the largest credit exposure in extreme but plausible market conditions are sometimes referred to as cover...
More generally, Principle 4 states that all FMI s should establish explicit rules and procedures to address any credit losses they may face as a result of an individual or combined default among its participants with respect to any of their obligations to the FMI.\[44 These rules and procedures should also address how potentially uncovered credit losses would be allocated, how the funds an FMI may borrow from liquidity providers would be repaid, and how an FMI would replenish the financial resources used during a stress event, such as a default, so that the FMI can continue to operate in a safe and sound manner.\[44

3. Principle 17: Operational Risk

Principle 17 addresses the risk of deficiencies in information systems or internal processes, human errors, management failures, or disruptions from external events that will result in the reduction or deterioration of services provided by the FMI.\[45 Principle 17 states that “[b]usiness continuity management should aim for the reduction or deterioration of internal processes, human errors, and default fund exposure to a CCP.\[52 China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. See Bank for International Settlements’ Basel Committee on Banking Supervision, “Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems,” (December 2010, revised June 2011), available at http://www.bis.org/publ/bcbs189.htm (“Baseline III: A Global Regulatory Framework”).

6 The Basel III: A Global Framework for Financial Stability. The capital charges for trade exposure are based upon a function that multiplies exposure by risk weight. Risk weight is a measure that represents the likelihood that the loss to which the bank is exposed will be incurred, and the extent of that loss. The risk weight assigned under the BCBS standards varies significantly depending on whether or not the counterparty is a “qualified” CCP (“QCCP”).\[53 A “QCCP” is defined as an entity that (1) is licensed to operate as a CCP, and is permitted by the appropriate regulator to operate as such, and (2) is prudentially supervised in a jurisdiction where the relevant regulator has established and publicly indicated that it applies to the CCP on an ongoing basis, domestic rules and regulations that are consistent with the PFMIs.\[54 If a bank transacts through a QCCP acting either as (1) a clearing member of a CCP for its own account or for clients,\[55 or (2) a client of a clearing member that enters into an OTC derivatives transaction with the clearing member acting as a financial intermediary, then the risk weight is 2 percent for purposes of calculating the counterparty risk.\[56 If mutualized default fund resources. See Basel CCP Capital Requirements, Annex 4, section I, A: General Terms. BIS defines “potential future exposure” as “the additional exposure that a counterparty might potentially assume during the life of a contract or set of contracts beyond the current replacement cost of the contract or set of contracts.” See Bank for International Settlements’ Committee on Payment and Settlement Systems, “A Glossary of Terms Used in Payment and Settlement Systems,” (March 2003), available at http://www.bis.org/publ/cps00b.pdf.

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the CCP is non-qualifying, then the risk weight is the same as a bilateral OTC derivative trade and the bank applies the corresponding bilateral risk-weight treatment, which is at least 20 percent if the CCP is a bank, or as high as 100 percent if the CCP is a corporate financial institution.\(^5^7\)

With respect to default fund exposure, whenever a clearing member bank is required to capitalize for exposures arising from default fund contributions to a QCCP, the clearing member bank may apply one of two methodologies for determining the capital requirement:

The risk-sensitive approach, or the 1250 percent risk-weight approach.\(^5^8\) The risk-sensitive approach considers various factors in determining the risk weight for a bank’s default exposure to a QCCP, such as (1) the size and quality of a QCCP’s financial resources, (2) the counterparty credit risk exposures of such CCP, and (3) the application of such financial resources via the CCP’s loss bearing waterfall in the event one or more clearing members default.\(^5^9\) The 1250 percent risk-weight approach allows a clearing member bank to apply a 1250 percent risk weight to its default fund exposures to the QCCP, subject to an overall cap of 20 percent on the risk-weighted assets from all trade exposures to the QCCP.\(^6^0\) In other words, banks with exposures to QCCPs have a cap on their default fund exposure. In contrast, a clearing member bank with exposures to a non-qualified CCP must apply a risk weight of 1250 percent with no cap for default fund exposures.\(^6^1\)

Thus, the Basel CCP Capital Requirements provide incentives for banks to clear derivatives through CCPs that are QCCPs by setting lower capital charges for exposures arising from derivatives cleared through a QCCP and setting significantly higher capital charges for exposures arising from derivatives cleared through non-qualifying CCPs. The increased capital charges for transactions through non-qualifying CCPs may have significant business and operational implications for U.S. DCOs, particularly SIDCOs that operate internationally and are not QCCPs.\(^6^2\) Specifically, banks faced with much higher capital charges might transfer their OTC derivatives business away from such SIDCO to a QCCP in order to benefit from the preferential capital charges provided by the Basel CCP Capital Requirements.

Alternatively, banks might reduce or discontinue their OTC business altogether. Banks might also pass on to their customers the higher costs of transacting with a non-qualifying DCO as a result of the higher capital treatment. Accordingly, customers using such banks as intermediaries would have an incentive to transfer their business to an intermediary that clears at a QCCP. In short, a SIDCO’s failure to be a QCCP may cause it to face a competitive disadvantage retaining members and customers.

As discussed further below in Section VI, the incentives noted in the foregoing paragraph have important implications for the cost and benefit considerations required by section 15(a) of the CEA.

E. Existing Prudential Requirements

In April 2011, a year before the PFMIs were published, the Board proposed regulation HH, which sets forth, in part, risk management standards for those FMUs, for which the Board is the Supervisory Agency, that have been designated systemically important by the Council under Title VIII.\(^6^3\) The Board, in proposing regulation HH, stated that the risk management standards most relevant to the risk management of FMUs, and the most appropriate basis for setting initial risk management standards under Title VIII, were the then-current international risk management standards set by CPSS–IOSCO’s Principles and Recommendations.\(^6^4\) The Board did note, in both its proposed and final rulemaking, that CPSS–IOSCO intended to update and replace the CPSS–IOSCO Principles and Recommendations with the PFMs, and the Board anticipated at that time that it would review the PFMs, consult with other appropriate agencies and the Council, and seek public comment on the adoption of the revised international standards.\(^6^5\)

F. Risk Management Standards for SIDCOs

As noted above, the CEA specifies certain core principles that all DCOs must comply with in order to register and maintain registration with the Commission. Core Principle B sets out minimum financial resources requirements for all DCOs and expressly states that a DCO must have “adequate financial, operational, and managerial resources, as determined by the Commission, to discharge each responsibility of the DCO.”\(^6^6\) Moreover, under Core Principle I, a DCO must have procedures, facilities, and a disaster recovery plan that allow it to, on an emergency basis, have a “timely recovery and resumption” of its operations, and fulfill each of its obligations and responsibilities.\(^6^7\) In light of the statutory language described above, and because the failure of or a disruption to the functioning of a SIDCO could “create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the financial system of the United States,”\(^6^8\) the Commission, in

\(^5^7\) See Bank for International Settlements’ Basel Committee on Banking Supervision, “Consultative Document: Capitalisation of Bank Exposures to Central Counterparties,” (November 2011; revised July 2012), paragraph 28, available at http://www.bis.org/publ/bcbs189.pdf (stating that “the applicable risk weight [for clearing member trades with a non-qualifying CCP] would be at least 20% if the CCP is a bank) or 100% (if it is a corporate financial institution according to the definition included in paragraph 272 of the Basel framework, revised by Basel III’’); see also Basel III: A global regulatory framework for more resilient banks and banking systems (2011), paragraph 102, available at http://www.bis.org/publ/bcbs260.pdf (stating that “the corresponding bilateral risk-weight is the same as a bilateral OTC exposure”).

\(^5^8\) See Basel CCP Capital Requirements, Annex 4, section IX, paragraphs 109–112.

\(^5^9\) See at paragraph 125. See also Basel CCP Capital Requirements, Annex 4, section IX, paragraphs 121–123. The Commission notes that the 1250 percent risk weight represents the reciprocal of the 8 percent capital ratio, which is the percentage of a bank’s capital to its risk-weighted assets (i.e., 1250 percent times 8 percent equals 100 percent).

\(^6^0\) Id. at paragraph 122.

\(^6^1\) Id. at paragraph 125. See also Basel CCP Capital Requirements, Annex 4, section IX, paragraphs 125 (explaining that “More specifically, under [the 1250 percent risk-weight] approach, the Risk Weighted Assets (RWA) for both bank i’s trade and default fund exposures to each CCP are equal to: Min [2% * TEi + 1250% * DFi; 20% * TRi] where TEi is bank i’s trade exposure to the CCP, as measured by the bank according to paragraphs 110 to 112 of this Annex; and DFi is bank i’s pre-funded contribution to the CCP’s default fund.”).

\(^6^2\) The Commission notes that the failure of SIDCOs to be QCCPs may negatively impact the broader US derivatives market as well. For example, higher clearing costs may result in fewer transactions, and less overall liquidity.

\(^6^3\) Notice of Proposed Rulemaking for Financial Market Utilities (“Regulation HH”), 76 FR 18445 (April 4, 2011) Financial Market Utilities (proposing regulation HH in accordance with section 805 of the Dodd-Frank Act, which directed the Board to establish risk management standards governing the operations related to the payment, clearing, and settlement activities of those FMUs that have been designated as systemically important by the Council for which the Board is the Supervisory Agency. Note, however, that FMUs that are registered as clearing agencies with the SEC under section 17A of the Securities Exchange Act of 1934, or that are registered as DCOs with the CFTC under section 5h of the CEA are expressly exempt from regulation HH.).

\(^6^4\) Id. at 18447.

\(^6^5\) Id. at 18448; see also Financial Market Utilities (“Regulation HH”), 77 FR 45907, 45908 (Aug. 2, 2012) (final rule).

\(^6^6\) Section 5b(c)(2)(B) of the CEA, 7 U.S.C. 7a–1(c)(2)(B) (emphasis added).

\(^6^7\) Section 5b(c)(2)(C) of the CEA, 7 U.S.C. 7a–1(c)(2)(C).

\(^6^8\) See supra discussion in n.17.
acquiescence with section 5(b)(2) of the Act, proposed heightened requirements to increase the minimum financial resources requirements for SIDCOs, restrict the use of assessments in meeting such obligations, enhance the systemic safeguards for SIDCOs, and grant the Commission special enforcement authority over SIDCOs pursuant to section 807 of the Dodd-Frank Act.

First, the Commission proposed to increase the amount of financial resources a SIDCO must maintain in order to comply with Core Principle B and Commission regulation 39.11. Regulation 39.11, in part, (1) requires a DCO to maintain sufficient financial resources to meet its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible market conditions, provided that if a clearing member controls another clearing member on common control with another clearing member, affiliated clearing members shall be deemed to be a single clearing member for the purposes of this provision; and (2) permits a DCO to include the value of potential assessments, subject to a 30 percent haircut, in calculating up to 20 percent of the default resource requirements. For SIDCOs, the Commission proposed a regulation that would require a SIDCO to maintain sufficient financial resources to meet the SIDCO’s financial obligations to its clearing members notwithstanding a default by the two clearing members creating the largest combined financial exposure for the SIDCO in extreme but plausible market conditions, and (2) only count the value of assessments, after a 30 percent haircut, to meet up to 20 percent of the resources required to meet obligations arising from a default by the clearing member creating the second largest financial exposure.

In addition to financial resources requirements, the Commission also proposed to improve system safeguards for SIDCOs by enhancing certain BC-DR procedures. Core Principle I requires a DCO to establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allows for the timely recovery and resumption of operations. Pursuant to Commission regulation 39.18, the required recovery time objective would be no later than the next business day. However, because the systemic importance of SIDCOs carries with it a responsibility to be reliably available on a near-continuous basis to fulfill their obligations, the Commission proposed a regulation that would require a SIDCO to have a BC-DR plan with the objective of enabling, and the physical, technological, and personnel resources sufficient to enable, the SIDCO to recover its operations and resume daily processing, clearing, and settlement no later than two hours following the disruption, including a wide-scale disruption.

As part of the Commission’s proposed regulations for SIDCOs, the Commission also included special enforcement authority over SIDCOs pursuant to section 807(c) of the Dodd-Frank Act, which would grant the Commission authority under the provisions of subsections (b) through (n) of section 8 of the Federal Deposit Insurance Act (“FDIA”) in the same manner and to the same extent as if the SIDCO were an insured depository institution and the Commission were the appropriate federal banking agency for such insured depository institution.

The Commission requested comments on the proposed regulations.

increased financial resources requirements for SIDCOs, initially closed on December 13, 2010, but was extended until June 3, 2011. The comment period for the proposed rule on Risk Management Requirements for Derivatives Clearing Organizations, which proposed a two-hour recovery time and special enforcement authority, closed on April 25, 2011.

Because efforts to finalize the PFMs were ongoing, new rules could have put SIDCOs at a competitive disadvantage vis-à-vis foreign CCPs not yet subject to comparable rules, and, at the time, no DCO had been designated as systemically important by the Council, the Commission concluded it would be premature to finalize the SIDCO regulations in the Derivatives Clearing Organization Core Principles adopting release. Instead, the Commission decided, consistent with section 805(a)(1) of the Dodd-Frank Act, to monitor domestic and international developments concerning CCPs and reconsider the proposed SIDCO regulations in light of such developments.

As discussed above, since the final adoption of subparts A and B of part 39 of the Commission’s regulations implementing the DCO core principles, there have been significant domestic and international developments, including (1) the publication of the final PFMs in April 2012, (2) the designation of two registered DCOs for which the Commission is the Supervisory Agency, as systemically important by the Council, and (3) the adoption of the Basel CCP Capital Requirements in July 2012, which provide for significantly less favorable capital treatment for bank exposures to CCPs unless the relevant regulator of the CCP establishes regulations that are consistent with the PFMs by the end of
these commenters expressed concern that heightened requirements for SIDCOs could place them at a competitive disadvantage vis-à-vis other DCOs and foreign CCPs that clear and settle similar OTC derivatives.\footnote{id.8}

Two commenters, Mr. Michael Greenberger and LCH. Clearnet Group Limited ("LCH"), generally supported the proposed financial resources requirements for SIDCOs.\footnote{id.9} ICE Clear Credit LLC ("ICC"), one of the two existing SIDCOs, stated that it currently is in compliance with the proposed cover two requirement and acknowledged "the importance of clearing houses with more complex risk management requirements maintaining robust financial resources."\footnote{id.10} Both the International Swaps and Derivatives Association ("ISDA") and Americans for Financial Reform ("AFR") suggested alternative approaches to the proposed cover two requirement for SIDCOs.\footnote{id.11} ISDA encouraged the Commission to consider "whether the appropriate size of a SIDCO's financial resources should be determined following an assessment by the Commission of the specific risks posed by the relevant SIDCO and the individual products it clears, rather than set to a uniform level that may be either insufficient or overly conservative."\footnote{id.12} AFR stated that a SIDCO's "minimum financial resources requirements should be based on risk exposure as well as the number of defaults because while in a concentrated market, a single default can have great consequence," and in "a more diverse market, the probability of multiple defaults is greater and is a more meaningful scenario."\footnote{id.13}

OCC, however, disagreed with the necessity to impose a cover two requirement on all SIDCOs.\footnote{id.14} OCC argued that the Commission should not impose a rigid financial resources requirement on every SIDCO because mandating the default of the two largest clearing members for purposes of calculating the financial resources requirement does not necessarily have a beneficial result in that "it restricts the ability of a DCO to measure its resources against those contingencies that it deems to be the most likely threats to its liquidity and solvency."\footnote{id.15} OCC agreed that all clearing organizations should consider possible simultaneous defaults by multiple clearing members but that the simultaneous defaults of a clearing organization's two largest clearing members, at least in the context of how that might occur within OCC, seem extremely implausible.\footnote{id.16} OCC did state that "the clearing of OTC derivatives presents unique risk management concerns, and, depending on the particular product and applicable risk management framework, perhaps even heightened concerns that warrant special regulatory treatment."\footnote{id.17}

Additionally, OCC argued for international consistency on this issue, and encouraged the Commission to follow the PFMs and "avoid taking final action on the Proposed Rules prior to receiving greater clarity in terms of the positions and proposals that European and U.K. legislators and regulators and CPSS-IOSCO eventually adopt."\footnote{id.18}

The Futures Industry Association ("FIA") and, in its initial comment letter, CME commented that the proposed cover two requirement for SIDCOs could competitively disadvantage SIDCOs in both domestic and international markets.\footnote{id.19} FIA stated that the proposed regulation would create a two-tier system between those DCOs designated as systemically important and those DCOs that are not designated as such.\footnote{id.20} FIA believes that the two-tier system could put SIDCOs at a competitive disadvantage to the extent that they need to increase margin or guaranty fund requirements to cover the additional cost of covering the risk of loss resulting from the default of the second largest clearing member.\footnote{id.21} In this regard, FIA recommended that the Commission require all DCOs, not just SIDCOs, to maintain sufficient financial resources to withstand the default of the two clearing members creating the largest combined financial exposure for...
the DCO in extreme but plausible market conditions.\textsuperscript{114} CME’s initial comment letter echoed FIA’s approach, arguing that having lower financial resources requirements for DCOs that are not SIDCOs would allow those DCOs to offer lower guaranty fund and margin requirements.\textsuperscript{115} According to CME, this “would likely attract additional volume to at least some non-systemically important DCOs and transform them into de facto SIDCOs.”\textsuperscript{116} CME argued that until such time as a “de facto SIDCO” was designated as systemically important by the Council, SIDCOs would be competitively disadvantaged because the “de facto SIDCO” would be operating under the lower and less costly general regulatory standards for DCOs.\textsuperscript{117} CME argued that such a result would disregard the objectives of Title VIII.\textsuperscript{118} CME suggested that the Commission, in lieu of adopting the proposed regulation, adopt a regulation thatsubjects SIDCOs to more frequent stress testing (e.g., bi-monthly rather than monthly) and reporting requirements (e.g., monthly rather than quarterly).\textsuperscript{119} Following publication of the PFMIs and the Basel CCP Capital Requirements, CME submitted a supplemental comment letter stating that its subsidiary, CME Clearing began offering clearing services for the interest rate swap and credit default swap markets.\textsuperscript{120} As a result, CME Clearing has three distinct guaranty funds: one for interest rate swap products (“IRS Guaranty Fund”); one for credit default swap products (“CDS Guaranty Fund”); and one for futures and other cleared OTC products (“Base Guaranty Fund”).\textsuperscript{121} Moreover, CME stated that the IRS Guaranty Fund and the CDS Guaranty Fund are already sized to the cover two standard.\textsuperscript{122} While CME stated that it is satisfied with the size of the Base Guaranty Fund, which is currently set to meet a cover one standard, CME anticipates that the Commission will promulgate a cover two standard as part of the Commission’s implementation of the standards set forth in the PFMIs.\textsuperscript{123} As such, CME requested that the Commission “consider the impact to clearing firms when specifying the timelines associated with compliance with the cover [two] standard and suggests as long a time horizon as possible for implementation,” with “an effective date of the end of 2013, or later to the extent practicable to maintain QCCP status in accordance with BCBS 227, which we believe would assist in minimizing the impact to the clearing firm community.”\textsuperscript{124} Additionally, LCH, which was supportive of the proposal, urged the Commission “to minimize the divergence” between U.S.-regulated CCPs and other CCPs and ensure a level playing field between SIDCOs and other large CCPs around the world by conforming as much as possible the Commission’s final rules on SIDCOs to the global standards set forth by the PFMIs.\textsuperscript{125}

The Commission notes that Core Principle B requires DCOs to have “adequate financial, operational, and managerial resources, as determined by the Commission, to discharge each responsibility of the DCO.”\textsuperscript{126} Pursuant to Core Principle B, DCOs must be able to meet a cover one requirement. As discussed above, because of the impact that the failure of or a disruption to the operations of a SIDCO could have on the U.S. financial markets, the Commission proposed increased standards for SIDCOs. However, after consideration of the comments, and consistent with the directive in section 805 of the Dodd-Frank Act to consider relevant international standards and existing prudential requirements, the Commission is adopting regulation 39.29(a) with a revision in order to harmonize U.S. regulations with international CCP risk management standards.\textsuperscript{127}

Specifically, rather than apply the cover two requirement to all SIDCOs, the revised regulation 39.29(a) would parallel the financial resources standard in Principle 4 of the PFMIs and only require a SIDCO that is systemically important in multiple jurisdictions or that is involved in activities with a more complex risk profile to maintain financial resources sufficient to enable it to meet its financial obligations to its clearing members notwithstanding a default by the two clearing members creating the largest combined financial exposure for the SIDCO in extreme but plausible market conditions, provided that if a clearing member controls another clearing member or is under common control with another clearing member, affiliated clearing members shall be deemed to be a single clearing member for the purposes of this provision.\textsuperscript{128}

Thus, regulation 39.29(a) will promote consistency and efficiency in the financial markets by holding SIDCOs to the same cover two standard as similarly situated foreign CCPs. Additionally, because the PFMIs set forth international risk management standards for CCPs, this international harmonization should mitigate some of the competition concerns raised by the commenters. Moreover, adoption of this revised regulation is part of the Commission’s broader efforts to adopt and implement regulations that are consistent with the PFMIs so that SIDCOs operating internationally can be considered QCCPs. Such QCCP status should help a SIDCO avoid competitive harm internationally by providing bank clearing members and clients with the opportunity to obtain the more favorable capital charges set forth by the Basel CCP Capital Requirements.\textsuperscript{129}

After careful review and consideration of the comments, and in light of international standards and prudential regulations, the Commission is adopting a regulation 39.29(a), as revised, to require the cover two standard for those SIDCOs that are systemically important in multiple jurisdictions or that are involved in activities with a more complex risk profile.

\textsuperscript{114}Id.
\textsuperscript{115}See CME December Letter at 7.
\textsuperscript{116}Id.
\textsuperscript{117}Id. at 7–8.
\textsuperscript{118}Id. at 8.
\textsuperscript{119}Id.
\textsuperscript{120}CME 2013 Letter at 2.
\textsuperscript{121}CME 2013 Letter at 2–3.
\textsuperscript{122}CME 2013 Letter at 3.
\textsuperscript{123}Id.
\textsuperscript{124}Id.
\textsuperscript{125}See LCH December Letter at 1–2 (citing to the Bank for International Settlements’ Committee on Payment and Settlement Systems September 2010 report entitled Market Structure Developments in the Clearing Industry: Implications for Financial Stability for the opinion that “regulatory complexity, and with it the potential for regulatory arbitrage, may in extreme but plausible market conditions be further mitigated when competing CCPs are regulated by different authorities and/or are located in different jurisdictions.” Id. at 4.
\textsuperscript{126}Section 5b(c)(2)(B) of the CEA, 7 U.S.C. 7a–1(c)(2)(B).
\textsuperscript{127}The Commission finds the comments arguing for international regulatory consistency to be persuasive and recognizes the importance of harmonizing U.S. regulations with international CCP risk management standards.
\textsuperscript{128}See supra n. 41.42. Moreover, the same proviso regarding the treatment of affiliate clearing members as set out in 39.11(a)[1], i.e., “if a clearing member controls another clearing member or is under common control with another clearing member, affiliated clearing members shall be deemed to be a single clearing member for the purposes of this provision” is incorporated in regulation 39.29(a) and is repeated in the rule text for clarity. See also 75 FR 63116 (stating that as DCOs, SIDCOs are still subject to Title VII and the regulations thereunder, except to the extent that the Commission proposes higher standards pursuant to Title VIII).
\textsuperscript{129}See supra section I.D.4. for a more detailed discussion on the role of the PFMIs in international banking. See also CME 2013 Letter at 2 (stating that “it is important to CME [Clearing] to be designated a QCCP . . . in order for [its] market participants to obtain optimal capital treatment for their business at CME [Clearing].”).
B. Proposed Regulation 39.29(b)

Regulation 39.29(b), as proposed, would have precluded SIDCOs from counting the value of assessments in calculating the resources available to meet their financial resources requirements as well.

The Commission received five comment letters from market participants regarding the specific requirements set forth in proposed regulation 39.29(b). FIA agreed with the Commission’s proposed limitation on the use of assessments by SIDCOs, stating that the proposed limitation was reasonable, prudent, and sufficient to ensure that a SIDCO does not unduly rely on its assessment power. In contrast, AFR argued that the use of assessments in calculating the resources available to meet a SIDCO’s obligations under proposed regulation 39.29(b) should be prohibited. AFR emphasized that a DCO should be financially viable at all times, regardless of whether it might be possible to call on its members to provide additional capital. In addition, ICC, one of the two existing SIDCOs, stated that it does not rely upon its right of assessment to meet the cover two standard and CME, the parent company of the other existing SIDCO, stated that “each of [CME Clearing’s] guaranty funds are prefunded by the respective clearing members.” More broadly, Chris Barnard commented that the use of assessments by DCOs may cause procyclical problems and increase systemic risk in times of financial stress.

The Commission recognizes the potential pro-cyclical effects of assessments and agrees that a SIDCO should not be permitted to use the value of assessments in calculating the resources available to meet its obligations under regulation 39.29(a). “Pro-cyclicality,” as defined in the PFMIs, refers to “changes in risk-management practices that are positively correlated with market, business, or credit cycle fluctuations and that may cause or exacerbate financial instability.” In the context of assessments, a SIDCO’s call for additional capital from its clearing members in order to cover any losses in a default scenario (generally needed on an expedited basis) may trigger greater distress on the financial markets, which presumably have already been weakened. In other words, in a stressed market where credit is tightening and margin calls are increased, a SIDCO’s assessment of additional claims upon its clearing members may well exacerbate already weakened financial markets by potentially forcing clearing members and/or their customers to deleverage in falling asset markets, which will further drive down asset prices and stifle liquidity, or force clearing members to default in their obligations to the SIDCO. This in turn could start a downward spiral which, combined with restricted credit, might lead to additional defaults of clearing members and/or their customers, and would play a significant role in the destabilization of the financial markets. In striking a balance between the need for SIDCOs to effectively and efficiently use their resources and the mitigation of procyclical behavior, the Commission believes prefunding default obligations is the appropriate mechanism for SIDCOs to meet their default resource obligations.

As discussed above, Core Principle B requires DCOs to have “adequate financial, operational, and managerial resources, as determined by the Commission, to discharge each responsibility of the DCO.” Moreover, the PFMIs require a CCP to use prefunded financial resources to cover current and potential future exposures, which may include initial margin, contributions to a prefunded default arrangement (e.g., a guaranty fund), and a specified portion of the CCP’s own funds. In addition, the PFMIs encourage CCPs to address procyclical in their margin arrangements and state that “a CCP could consider increasing the size of its prefunded default arrangements to limit the need and likelihood of large or unexpected margin calls in times of market stress.” Prefunding financial resources requires market participants to pay more during times of relative market stability and low-market volatility through prefunded default arrangement contributions. However, paying more during a period of economic stability or even an upturn may “result in additional protection and potentially less costly and less disruptive adjustments in periods of high market volatility.”

The Commission believes the role of a SIDCO, in part, is to add stability and confidence in the financial markets, and to the extent that the prohibition of the inclusion of the value of assessments by SIDCOs in calculating their default resource requirements helps to stem pro-cyclical and the potential weakening of financial markets, the Commission is in favor of this approach. Moreover, prohibition of the inclusion of the value of assessments will help ensure that a SIDCO has, when needed, adequate resources to discharge each of its responsibilities.

Accordingly, after consideration of the comments, relevant international standards, and existing prudential requirements, the Commission is adopting regulation 39.29(b) with a revision to prohibit the use of assessments by SIDCOs in calculating financial resources available to meet the SIDCO’s obligations under regulation 39.29(a).

III. Regulation 39.30

Regulation 39.30(a), as proposed, would have required a SIDCO to have a BC-DR plan, that has the objective of, and the physical, technological, and personnel resources sufficient to, enable the SIDCO to recover operations and resume daily processing, clearing, and settlement no later than two hours following a disruption, including a wide-scale disruption.

The waterfall may include a defaulter’s initial margin, the defaulter’s contribution to a prefunded default arrangement, a specified portion of the CCP’s own funds, and other participants’ contributions to a prefunded default arrangement.

The following definitions pertaining to system safeguards were codified at 17 CFR 39.18(a):


See 39 CFR 76 at 3726. The following definitions pertaining to system safeguards were codified at 17 CFR 39.18(a):
In order to achieve the specified recovery time objective ("RTO") in proposed regulation 39.30(a), proposed regulation 39.30(b) would have required SIDCOs to maintain a geographic dispersal of physical, technological, and personnel resources.\textsuperscript{149} Pursuant to proposed regulation 39.30(b)(1), physical and technological resources would have to be located outside the relevant area of the infrastructure the entity normally relies upon to conduct activities necessary to the clearance and settlement of existing and new contracts, and the entity could not rely on the same critical transportation, telecommunications, power, water, or other critical infrastructure components the entity normally relies upon for such activities.\textsuperscript{150} Additionally, proposed regulation 39.30(b)(2) would have required SIDCOs to maintain personnel sufficient to meet the RTO after interruption of normal clearing by a wide-scale disruption affecting the relevant area, who live and work outside the relevant area.\textsuperscript{151} To avoid duplication and maximize flexibility, proposed regulation 39.30(b)(3)\textsuperscript{152} provided that SIDCOs could use the outsourcing provisions applicable to non-SIDCO DCOs as set forth in regulation 39.18(f).\textsuperscript{153}

Regulation 39.30(c), as proposed, would have required that each SIDCO conduct regular, periodic tests of its BC–DR plans and resources, and of its capacity to achieve the required RTO in the event of a wide-scale disruption.\textsuperscript{154} Additionally, proposed regulation 39.30(c) incorporated the provisions of regulation 39.18(c) concerning testing by DCOs, including the purpose of the testing, the conduct of the testing, and reporting and review of the testing.\textsuperscript{155}

The Commission received five comment letters regarding the specific requirements set forth in proposed regulation 39.30(a).\textsuperscript{156} One commenter stated that the recovery time for its technology systems is currently approximately two hours based upon past disaster recovery tests,\textsuperscript{157} and three commentators opposed the two-hour RTO.\textsuperscript{158} ICC, one of the two existing SIDCOs, acknowledged "the importance of maintaining market integrity during disruptive events" and noted that a two-hour RTO is consistent with Principle 17 of the PFMs.\textsuperscript{159} In addition, ICC stated that the "two-hour benchmark is unlikely to require [it] to hire additional personnel or to require a different level of cross-training related to its wide-scale disruption plan," and that it is "unlikely that [ICC] will incur any additional backup technology costs related to the CFTC's proposed RTO."\textsuperscript{160}

Both Intercontinental Exchange, Inc. ("ICE") and CME, on the other hand, expressed concern that requiring a more stringent RTO for SIDCOs would impose significant costs.\textsuperscript{161} ICE argued that "assigning an RTO to a SIDCO instead of assigning the objective the RTO is intended to achieve adds significant cost to a SIDCO's business continuity program but does not necessarily increase overall resilience of the financial system."\textsuperscript{162} ICE and CME also highlighted the approach referenced in the Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System (the "Sound Practices Paper"),\textsuperscript{163} published in 2003, which argued for a same-business-day RTO with a two-hour RTO as an aspirational goal for clearing and settlement organizations.\textsuperscript{164} CME urged the Commission to adopt the same approach as the Sound Practices Paper for SIDCOs, i.e., the same-business-day RTO with a two-hour RTO on a voluntary basis.\textsuperscript{165} In addition, CME stated that "[m]oving to a 2-hour RTO would impose enormous costs on SIDCOs, and the CFTC has provided no cost/benefit analysis in connection with this aspect of the proposed Regulation."\textsuperscript{166} Nonetheless, in a supplemental comment letter, CME stated that "in light of the systemic importance of CME [Clearing]'s clearing functions and the intended benefits, including compliance with the PFMI requirements for critical information technology, CME [Clearing] has obtained budget approval and allocated resources towards a two hour RTO and will be working throughout 2013 towards achieving a two hour RTO."\textsuperscript{167} OCC commented that, though a laudable goal, a two-hour RTO was not consistently achievable without sacrificing core DCO functions and increasing the risks of error and backlogs.\textsuperscript{168} In addition, OCC argued that in its experience, it often takes three hours to fully recover and meet its responsibilities and avoid significant market disruption.\textsuperscript{169} OCC also argued that further efforts to reduce RTO would not be cost-effective and could increase rather than decrease reliability risk.\textsuperscript{170}

With respect to commenters' concerns that the proposed regulation will significantly increase costs on SIDCOs, the Commission recognizes these concerns but notes that a systemic importance designation under Title VIII means that the failure of a SIDCO to meet its obligations will have a greater impact on the U.S. financial system than the failure of a DCO not so designated. Thus, the Commission believes the financial system has a vested interest in enhancing risk management requirements for SIDCOs to increase a SIDCO's financial resiliency and to

\textsuperscript{149} See 76 FR at 3726–3727.
\textsuperscript{150} Id.
\textsuperscript{151} Id. at 3727.
\textsuperscript{152} Id.
\textsuperscript{153} See 17 CFR 39.18(f) (stating, in relevant part, that a DCO may maintain the resources required under BC–DR procedures enumerated in regulation 39.18(e)(1) by either (1) Using its own employees as personnel, and property that it owns, licenses, or leases (own property); or (2) Through written contractual arrangements with another derivatives clearing organization or other service provider (outsourcing).)

\textsuperscript{154} See 76 FR at 3727.
\textsuperscript{156} See ICC Letter at 2.
\textsuperscript{158} ICC Letter at 2.
\textsuperscript{159} Id.
\textsuperscript{160} See ICE Letter at 7; CME March Letter at 14.
\textsuperscript{161} ICE Letter at 8.
\textsuperscript{163} See id; see also 17 CFR 39.18(j).
\textsuperscript{164} Id. at 17812 (stating that core clearing and settlement organizations should develop the capacity to recover and resume clearing and settlement activities within the business day on which the disruption occurs with the overall goal of achieving recovery and resumption within two hours after an event).
\textsuperscript{165} CME March Letter at 15.
\textsuperscript{166} OCC Letter at 19.
\textsuperscript{167} OCC Letter at 19.
\textsuperscript{168} Id.
\textsuperscript{169} Id.
\textsuperscript{170} Id.
mitigate the risk of significant liquidity or credit problems spreading among financial institutions or markets, threatening the stability of the U.S. financial system. In the event of a widespread disruption, the resiliency of the U.S. financial markets might depend on the rapid recovery of SIDCOs to support critical market functions and thereby allow other market participants (i.e., the counterparties) to process their transactions. In addition, in such a scenario, it is reasonable to assume that there will be other market participants in locations not affected by the disruption that will need to clear and settle pending transactions as well. In short, the failure of a SIDCO to complete core clearing and settlement functions within a rapid period could create systemic liquidity and credit dislocations on a global scale.

Additionally, the Commission notes that while it may be true that a two-hour RTO was an aspirational goal in 2003, standards and technology have advanced in the last ten years. As discussed above, the current international standard for CCPs, as set forth by the PFMIs, is to have a BC–DR plan that incorporates a two-hour RTO. Specifically, the PFMIs state that an FMI’s business continuity plan “should incorporate the use of a secondary site and should be designed to ensure that critical information technology systems can resume operations within two hours following disruptive events.” Because the two-hour RTO is the international standard and foreign CCPs are anticipated to operate under this timeframe, any competitive disadvantages to SIDCOs in implementing this regulation should be mitigated because all similarly situated CCPs will be operating under this standard. Indeed, ICC, one of the two existing SIDCOs, has stated that it is unlikely that it will need to hire additional personnel or incur additional technology costs to meet this standard. Moreover, as discussed above, CME Clearing, the other existing SIDCO, “has obtained budget approval and allocated resources towards a two hour RTO and will be working throughout 2013 towards achieving a two hour RTO.”

The Commission believes that enhancing the system safeguard requirements a SIDCO must maintain under Core Principle I will increase stability in the financial markets and is therefore consistent with Title VIII’s objectives. Moreover, regulation 39.30(a) will promote regulatory consistency for SIDCOs and similarly situated CCPs because the two-hour RTO is the international standard, under the PFMIs, for CCPs operating in other jurisdictions. As discussed above, the Commission is fully committed to adopting and implementing regulations that are consistent with the PFMIs to ensure that SIDCOs are QCCEs under the Basel CCP Capital Requirements so that banks transacting through SIDCOs can receive preferential capital treatment. Therefore, the Commission is adopting regulation 39.30(a) as proposed.

The Commission did not receive any comments regarding proposed regulations 39.30(b) or 39.30(c). Therefore, for reasons stated in the proposal, the Commission is adopting regulations 39.30(b) and 39.30(c) as proposed. However, to mitigate costs, the Commission notes that regulation 39.30(b) should be interpreted in a manner consistent with the PFMIs, which state “[a] particular site may be primary for certain functions and secondary for others. It is not intended that an FMI would be required to have numerous separate secondary sites for each of its essential functions.”

IV. Regulation 39.31
Regulation 39.31 proposed to codify the special enforcement authority granted to the Commission over SIDCOs pursuant to section 807(c) of the Dodd-Frank Act, which states that for purposes of enforcing the provisions of Title VIII of the Dodd-Frank Act, a SIDCO is subject to, and the Commission has authority under, provisions (b) through (a) of section 8 of the FDIA in the same manner and to the same extent as if the SIDCO were an insured depository institution and the Commission were the appropriate Federal banking agency for such insured depository institution. The Commission did not receive any comment letters on this proposed regulation, which tracks the statutory text in section 807 of the Dodd-Frank Act. Therefore, for reasons stated in the proposal, the Commission is adopting regulation 39.31 as proposed.

V. Effective Date and Compliance Dates
For purposes of publication in the Code of Federal Regulations, all of the rules adopted herein will have an effective date of 60 days after publication in the Federal Register. The Commission received three comments, however, requesting additional time to come into compliance with these rules. Regarding the compliance date of regulation 39.29, OCC requested that DCOs be afforded a reasonable amount of time to raise “any material amount of additional resources” and requested a delayed implementation of two years. CME stated that the financial resources that DCOs are required to maintain will increase dramatically and requested an implementation period of no less than 180 days. Regarding the compliance date of regulation 39.30, the Commission has proposed a compliance date of one year after publication of the final rules or July 12, 2012. OCC commented that this is a short and burdensome deadline that will be difficult to meet and encouraged the Commission to adopt a two-year compliance period for the requirements applicable to SIDCOs. The Commission received no comments regarding regulation 39.31.

Given the mandate to implement these standards, and the necessity of SIDCOs to fulfill their obligations on a near continuous basis, after careful consideration of the comments received, the Commission is extending the compliance date for regulations 39.29 and 39.30 to December 31, 2013.

VI. Consideration of Costs and Benefits
A. Introduction
Section 15(a) requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.

173 See supra n. 46, 47 (referring to the PFMIs, Principle 17: Operational Risk).
174 Id.
175 See supra n. 160 and accompanying text.
Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission’s cost and benefit considerations in accordance with section 15(a) are discussed below.

B. Background

In this final rulemaking, the Commission is adopting regulations to implement enhanced risk management standards for SIDCOs. As noted above, consistent with the DCO core principles and section 805 of the Dodd-Frank Act, which requires the Commission to consider relevant international and existing prudential requirements when prescribing risk management standards for SIDCOs, the Commission proposed the following enhanced requirements for SIDCOs:

1. Regulation 39.29(a) which would require a SIDCO to maintain sufficient resources to meet a “cover two” standard in order to comply with Core Principle B; (2) regulation 39.29(b) which would strictly limit the value of assessments that could be used in meeting that requirement; (3) regulation 39.30 which would require a SIDCO to have a BC–DR plan with a two-hour RTO in order to comply with Core Principle I (“two-hour RTO”); and (4) regulation 39.31 which, under section 807(c) of the Dodd-Frank Act, grants the Commission special enforcement authority over SIDCOs.

As also discussed above, after the Commission proposed the SIDCO risk management standards and received comments, the PFMIs were published. The PFMIs establish international risk management standards for FMIs, including CCPs, that facilitate clearing and settlement. The PFMIs also play a significant role in the Basel Core Capital Requirements, which introduce new capital charges based on counterparty risk for banks conducting financial derivatives transactions through a CCP. These capital charges vary significantly depending on whether or not the counterparty is a QCCP, that is, a CCP that is subject to regulations consistent with the PFMIs. Effectively, the Basel CCP Capital Requirements incentivize banks to clear derivatives through QCCPs by setting lower capital charges for exposures arising from derivatives cleared through a QCCP and setting significantly higher capital charges for exposures arising from derivatives cleared through non-qualifying CCPs. As discussed further below, these differences in capital charges are extremely important in considering whether to adopt requirements for SIDCOs, which are consistent with the PFMIs, or requirements that fall short of that standard.

In light of the directive of section 805 of the Dodd-Frank Act to consider relevant international standards and existing prudential requirements when prescribing risk management standards for designated systemically important FMUs, as well as the recent publication of the PFMIs, and public comments on the proposed SIDCO regulations, the Commission has determined it is necessary and appropriate to finalize the proposed enhanced risk management standards for SIDCOs. However, in order to harmonize the proposed regulations with the existing international standards set forth by the PFMIs, as requested by some commenters, the Commission has revised proposed regulation 39.29(a) and 39.29(b). Rather than apply the cover two requirement to all SIDCOs, revised regulation 39.29(a) parallels the financial resources standard in Principle 4 of the PFMIs and only requires a SIDCO that is systemically important in multiple jurisdictions or that is involved in activities with a more complex risk profile to maintain financial resources sufficient to meet the cover two requirement. Revised regulation 39.29(b), which is also consistent with Principle 4 of the PFMIs, prohibits a SIDCO from the use of assessments in calculating its financial resources available to meet the SIDCO’s obligations under regulation 39.29(a).

The Commission considered the following alternatives: (1) Not to adopt any of the proposed SIDCO risk management regulations; (2) to adopt the SIDCO risk management regulations only as proposed, or (3) to adopt the proposed SIDCO risk management regulations with revisions consistent with relevant international standards and existing prudential requirements.

As detailed above, the Commission has concluded it is necessary and appropriate in this final rulemaking to adopt regulation 39.29, as revised, regulation 39.30, as proposed, and regulation 39.31, as proposed.

In the discussion that follows, the Commission considers the costs and benefits of the final rulemaking in light of the comments it received and section 15(a) of the CEA. As the regulation in section 39.31 is imposed by the Dodd-Frank Act, any associated costs and benefits are the result of statutory directives as determined by Congress, not an act of Commission discretion.

For the remaining regulations in this rulemaking, 39.29(a) (cover two), 39.29(b) (prohibition of assessments) and 39.30 (two-hour RTO), the Commission considers the costs and benefits attributable to these enhanced requirements against the DCO regulatory framework established in part 39, which provides minimum risk standards for DCOs and sets the baseline for cost and benefit considerations. Specifically, regulation 39.11 (implementing DCO Core Principle B) sets a cover one standard as the minimum financial resources requirement for all DCOs whereas regulation 39.29(a) sets a cover two financial resources requirement for all SIDCOs engaged activities with a more complex risk profile or that are systemically important in multiple jurisdictions. Regulation 39.11 permits the inclusion of assessment powers, to a limited extent, in calculating whether a DCO meets its default resources requirement, whereas regulation 39.29(b) prohibits the use of assessments by SIDCOs in meeting those obligations. Regulation 39.18 requires a DCO to have an RTO of no later than the next business day following the disruption of its operations whereas regulation 39.30 (implementing DCO Core Principle I) requires SIDCOs to have a BC–DR plan with a two-hour...
RTO following the disruption of its operations.

The Commission invited public comment on all aspects of the proposed SIDCO rulemaking but did not receive any comments with quantitative data from which the Commission could calculate the costs and benefits of the proposed enhanced requirements. The Commission did receive qualitative comments on the Commission’s proposed consideration of costs and benefits generally, as well as specifically to the requirements central to this final rule: Cover two, use of assessments and two-hour RTO. These comments are summarized below in connection with the Commission’s consideration of the costs and benefits of the final rules being promulgated herein.

C. Benefits and Costs of the Final Rule

1. Benefits

As explained in the subsections that follow, this final rule promotes the financial strength, operational security and reliability of SIDCOs, reduces systemic risk, and increases the stability of the broader U.S. financial system. In addition, the regulations harmonize U.S. regulations with international standards which will, in important ways, place SIDCOs on a level playing field with their competitors in the global financial markets:

a. Regulation 39.29(a): Cover Two

The cover two requirement increases the financial stability of certain SIDCOs which, in turn, increases the overall stability of the U.S. financial markets. This is so because enhancing a SIDCO’s financial resources requirements from the minimum of cover one to a more stringent cover two standard helps to ensure the affected SIDCO will have greater financial resources to meet its obligations to market participants, including in the case of defaults by multiple clearing members. These added financial resources lessen the likelihood of the SIDCO’s failure which, given the designation of systemically important, could threaten the stability of the US financial system.209 By bolstering certain SIDCOs’ resources, regulation 39.29(a) contributes to the financial integrity of the financial markets and reduces the likelihood of systemic risk from spreading through the financial markets due to one of those SIDCOs’ failure or disruption.

According to commenters, existing SIDCOs already fund their default resources using a cover two standard for products with a more complex risk profile.201 Although the benefit associated with regulation 39.29(a) is somewhat lessened by the already established practice of cover two by the relevant SIDCOs, there is a long-term benefit of setting the cover two standard as the new regulatory minimum to ensure that even in periods of apparent stability and low market volatility, these SIDCOs will continue to have increased financial resource requirements and, ultimately, greater financial stability. This approach of obtaining resources in such low-stress periods avoids the need to call for additional resources from clearing members during less stable, more volatile times, which would have pro-cyclical effects on the U.S. financial markets.202 In addition, the cover two requirement will apply to SIDCOs deemed systemically important in multiple jurisdictions.

b. Regulation 39.29(b): Prohibited Use of Assessments To Meet Regulation 39.29(a) Obligations

As discussed below and throughout this release, the Commission believes that prohibiting the use of assessments by a SIDCO in meeting its default resource obligations (i.e., those under regulations 39.11(a)(1) and 39.29(a)) increases the financial stability of the SIDCO, which in turn, increases the overall stability of the U.S. financial markets.

Assessment powers are more likely to be exercised during periods of financial market stress. If during such a period, a clearing member defaults and the loss to the SIDCO is sufficiently large to deplete (1) the collateral posted by the defaulting entity, (2) the defaulting entity’s default fund contribution, and (3) the remaining preference fund contributions, a SIDCO’s exercise of assessment powers over the non-defaulting clearing member may exacerbate a presumably already weakened financial market. The demand by a SIDCO for more capital from its clearing members could force one or more additional clearing members into default because they cannot meet the assessment. The inability to meet the assessment could lead clearing members and/or their customers to de-leverage (i.e., sell off their positions) in falling asset markets, which further drives down asset prices and may result in clearing members and/or their customers defaulting on their obligations to each other and/or to the SIDCO. In such extreme circumstances, assessments could trigger a downward spiral and lead to the destabilization of the financial markets. Prohibiting the use of assessments by a SIDCO may increase costs to clearing members of that SIDCO (e.g. requiring clearing members to post additional funds with the SIDCO),203 but it also reduces the likelihood that the SIDCO will require additional capital infusions during a time of financial stress when raising such additional capital is expensive relative to market norms. By increasing prefunded financial resources, a SIDCO becomes less reliant on the ability of its clearing members to pay an assessment, more secure in its ability to meets its obligations, and more viable in any given situation, even in the case of multiple defaults of clearing members. Accordingly, regulation 39.29(b) increases the financial security and reliability of the SIDCO which will thereby further increase the overall stability of the U.S. financial markets.

c. Regulation 39.30: Two-Hour RTO

A two-hour RTO in a SIDCO’s BC–DR plan increases the soundness and operating resiliency of the SIDCO, which in turn, increases the overall stability of the U.S. financial markets.

Given the significant role SIDCOs play within the financial market infrastructure and the need to preserve, to the greatest extent practicable, their near-continuous operation, regulation 39.30 prescribes an enhanced RTO of two hours. The two-hour RTO ensures that even in the event of a wide-scale disruption, the potential negative effects upon U.S. financial markets be minimized because the affected SIDCO will recover rapidly and resume its critical market functions, thereby allowing other market participants to process their transactions, even those participants in locations not directly affected by the disruption. The two-hour RTO increases a SIDCO’s operational resiliency by requiring the SIDCO to have the resources and technology necessary to resume operations promptly. This resiliency, in turn, increases the overall stability of the U.S. financial markets.

200 See supra section I.B.
201 See ICC Letter at 1. See also CME 2013 Letter at 2–3.
202 See supra section II.B. for discussion on the pro-cyclical impact of assessments.
203 Id.
d. Benefits of QCCP Status

As discussed above, the international Basel CCP Capital Requirements provide incentives for banks to clear derivatives through CCPs that are qualified CCPs or “QCCPs” by setting lower capital charges for exposures arising from derivatives cleared through a QCCP and setting significantly higher capital charges for exposures arising from derivatives cleared through non-qualifying CCPs. The enhanced risk management standards for SIDCOs adopted in this final rulemaking are consistent with the international standards set forth in the PFMIs and address part of the remaining divergences between part 39 of the Commission’s regulations and the PFMIs, which will provide an opportunity for SIDCOs to gain QCCP status. The Commission believes there is a benefit to being a SIDCO if it is able to offer to its clearing members and their customers the favorable capital treatment under the Basel CCP Capital Requirements.

2. Costs

The Commission requested but did not receive any quantitative data or specific cost estimates associated with the proposed regulations. However, in qualitative terms, the Commission recognizes that this final rule may impose important costs on SIDCOs depending on the financial resources requirements and system safeguards procedures the SIDCOs currently implement. In other words, the costs range from minimal (to the extent SIDCOs are already operating, or planning to operate, consistent with the final rules) to significant (for those who are not). To the extent costs increase, the Commission has considered that higher trading costs for market participants (i.e., increased clearing fees, guaranty fund contributions, and margin fees, etc.) may discourage market participation and result in decreased liquidity and reduced price discovery. However, the Commission has also considered the costs to market participants and the public if these regulations are not adopted. Significantly, without these regulations to ensure that SIDCOs operate under certain enhanced risk management standards, in a manner that is consistent with internationally accepted standards, the financial integrity and security of the U.S. financial markets would be at a greater risk relative to international markets. This, too, could adversely affect the attractiveness of the U.S. financial markets subject to the Commission’s jurisdiction as compared to foreign competitors. In addition, without the final rule, SIDCOs would not have the opportunity to gain QCCP status, thereby putting them at a significant competitive disadvantage in the global financial markets which, again, would be to the detriment of their clearing members and their customers. The Commission notes that to the extent it addresses the remaining divergences between part 39 of the Commission’s regulations and the PFMIs through future rulemakings, and these rulemakings, along with the regulations adopted herein, do not provide an opportunity for non-SIDCO DCOs to obtain QCCP status, this would place such non-SIDCO DCOs at a competitive disadvantage to SIDCOs. Moreover, the resulting cost to the DCOs would be the inability to offer the favorable capital treatment under the Basel CCP Capital Requirements to their customers and clearing members.

a. Regulation 39.29(a): Cover Two

The cost of the cover two requirement for certain SIDCOs includes the opportunity cost of the additional financial resources required to satisfy the guaranty fund requirements for the risk of loss resulting from the default of the second largest clearing member. As discussed above in more detail, the Commission received comments from market participants addressing the costs associated with a cover two standard. OCC argued that if heightened risk management standards are imposed on a DCO in such a way as to substantially increase the costs for clearing members and their customers to clear transactions through a SIDCO rather than a non-SIDCO, there is risk of undermining the goals of both Titles VII and VIII of the Dodd-Frank Act by driving clearing volume to less-regulated clearinghouses. FIA commented that the cover two requirement would put SIDCOs at a competitive disadvantage to other DCOs to the extent that they need to increase margin or guaranty fund requirements to cover the default of the second largest clearing member. FIA recommended that the Commission adopt an alternative approach by extending the cover two requirement to all DCOs, not just SIDCOs, and allow ample time for DCOs to come into compliance. CME stated that a cover two requirement would allow some DCOs to offer lower guaranty fund and margin requirements, which would attract additional volume to that DCO and make it a de facto SIDCO. SIDCOs would then be at a competitive disadvantage relative to the de facto SIDCO until such time as the de facto SIDCO was designated as a SIDCO. ICC, one of the two existing SIDCOs, on the other hand, is in compliance with the cover two requirement and therefore, would not incur additional costs to meet the cover two requirement.

As noted above, and in comment letters from CME and ICC, SIDCOs already implement the cover two standard for products with a more complex risk profile, and therefore, the costs of compliance with cover two should be mitigated given these existing practices. However, there are likely to be costs associated with the uncertainty as to whether a SIDCO is deemed systemically important in multiple jurisdictions and what constitutes a product with a more complex risk profile. These costs are associated with business planning, i.e., how to fund a cover two requirement. In addition, the possibility exists that some market participants will port their positions from a SIDCO that either (1) is deemed systemically important in multiple jurisdictions or (2) clears products of a more complex risk profile to another SIDCO for which neither (1) nor (2) applies or to another DCO that is not...
systemically important because the value of the cover two protection to these market participants is less than the price at which that protection is being offered. These market participants will transact with DCOs that operate under cover one, which is a lower financial resources requirement, and thus, get the benefit of lower transactional fees and forego the enhanced protections associated with the SIDCOs. Such an event adversely impacts the reduction in systemic risk that the cover two standard affords.

However, the potential cost to the SIDCO and to the goal of systemic risk reduction is likely mitigated because (a) not every product offered by the SIDCO is available at other DCOs and (b) a SIDCO may offer benefits not available to a DCO that is not designated as systemically important, thereby reducing the likelihood that market participants will port their positions to other DCOs.

b. Regulation 39.29(b): Prohibition on the Use of Assessments in Calculation of Default Resources To Meet Obligations Under Regulation 39.29(a)

The costs associated with the prohibited use of assessments by SIDCOs in calculating the SIDCO’s obligations under regulation 39.29(a) include the opportunity cost of the additional financial resources needed to replace the value of such assessments. This may require an infusion of additional capital. The cost of this regulation should be mitigated for SIDCOs because neither CME Clearing nor ICC, the two existing SIDCOs, rely on assessments to meet their default fund obligations for products with a more complex risk profile.

Additionally, analogous to the case with the cover two standard, market participant demand may shift from a SIDCO to a DCO with a lower capitalization requirement.

c. Regulation 39.30: Two-Hour RTO

The Commission recognizes that a two-hour RTO may increase operational costs for SIDCOs by requiring additional resources, including personnel, technological and geographically dispersed resources, in order to comply with the final rule. Moreover, the implementation of a two-hour RTO is expected to impose one-time costs to set up the enhanced resources as well as recurring costs to operate the additional resources. However, as noted above, the Commission requested but did not receive quantitative data from which to estimate the dollar costs associated with implementing a two-hour RTO, and in particular the costs of moving from a next day RTO, the minimum standard established by the DCO core principles and regulation 39.18, to a two-hour RTO as required by regulation 39.30. The Commission did, however, receive qualitative comments regarding the costs associated with the two-hour RTO, which are discussed in more detail above. For example, CME, ICE and OCC all initially opposed the enhanced RTO, citing the increase of costs associated with the proposed regulation 39.30. However, more recently, the Commission received comments from CME and ICC acknowledging the importance of the two-hour RTO and their intent to implement a two-hour RTO.

D. Section 15(a) Factors

1. Protection of Market Participants and the Public

The enhanced financial resources requirements and system safeguard requirements for SIDCOs, as set forth in this final rulemaking, will further the protection of market participants and the public by increasing the financial stability and operational security of SIDCOs, and more broadly, increase the stability of the U.S. financial markets. A designation of systemic importance under Title VIII means the failure of a SIDCO or the disruption of its clearing and settlement activities could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets, thereby threatening the stability of the U.S. financial markets. The regulations contained in this final rule are designed to help ensure that SIDCOs continue to function even in extreme circumstances, including multiple defaults by clearing members and wide-scale disruptions.

While there may be increased costs associated with the implementation of the final rules, these costs are mitigated by the countervailing benefits of the increased safety and soundness of the SIDCOs and the reduction of systemic risk, which protect market participants and the public form the adverse consequences that would result from a SIDCO failure or a disruption in its functioning.

2. Efficiency, Competitiveness, and Financial Integrity

The regulations set forth in this final rulemaking will promote financial strength and stability of SIDCOs, as well as, more broadly, efficiency and greater competition in the global markets. The regulations promote efficiency insofar as SIDCOs that operate with enhanced financial resources as well as increased system safeguards are more secure and are less likely to fail. The regulations promote competition because they are consistent with the international standards set forth in the PFMIs and will help to ensure that SIDCOs are afforded the opportunity to gain QCCP status and thus avoid an important competitive disadvantage relative to similarly situated foreign CCPs that are QCCPs. Additionally, by increasing the stability and strength of the SIDCOs, the regulations in the final rule help to ensure that SIDCOs can meet their obligations in the most extreme circumstances and can resume operations even in the face of wide-scale disruption, which contributes to the financial integrity of the financial markets. In requiring more SIDCO financial resources to be pre-funded by (1) expanding the potential losses those resources are intended to cover and (2) restricting the means for satisfying those resource requirements, i.e. through prohibiting the use of assessments in determining guarantee fund contributions, the requirements of this final rule seek to lessen the incidence of pro-cyclical demands for additional funding resources and, in so doing, promote both financial integrity and market stability.

3. Price Discovery

The regulations in the final rulemaking enhance risk management standards for SIDCOs which may result in increased public confidence, which, in turn, might lead to expanded participation in the affected markets, i.e. products with a more complex risk profile. The expanded participation in these markets (i.e. greater transactional

219 See supra n. 139 and accompanying text for a discussion of pro-cyclicality.
volume) may have a positive impact on price discovery. Conversely, the Commission notes that these enhanced risk management standards are also associated with additional costs and to the extent that SIDCOs pass along the additional costs to their clearing members and customers, participation in the affected markets may decrease and have a negative impact on price discovery. However, it is the Commission’s belief that such higher transactional costs should be greatly offset by the lower capital charges granted to clearing members and customers clearing derivative transactions through SIDCOs that are deemed QCCPs.

4. Sound Risk Management Practices

The regulations in the final rulemaking contribute to the sound risk management practices of SIDCOs because the requirements promote the safety and soundness of the SIDCOs by (1) enhancing the financial resources requirements, which provide greater certainty for market participants that all obligations will be honored by the SIDCOs and (2) enhancing system safeguards to facilitate the continuous operation and rapid recovery of activities, which provide certainty and security to market participants that potential disruptions will be reduced and, by extension, the risk of loss of capital and liquidity will be reduced.

5. Other Public Interest Considerations

The Commission notes the strong public interest for jurisdictions to either adopt the PFMIs or establish standards consistent with the PFMIs in order to allow CCPs licensed in the relevant jurisdiction to gain QCCP status. As emphasized throughout this rulemaking, SIDCOs that gain QCCP status will avoid a competitive disadvantage in the financial markets by avoiding the much higher capital charges imposed by the Basel CCP Capital Requirements. Moreover, because “enhancements to the regulation and supervision of systemically important financial market utilities . . . are necessary . . . to support the stability of the broader financial system,” 220 adopting these rules promotes the public interest in a more stable broader financial system.

VII. Related Matters

A. Paperwork Reduction Act

The Commission may not conduct or sponsor, and a registered entity is not required to respond to, a collection of information unless it displays a currently valid Office of Management and Budget (OMB) control number. The Commission’s adoption of §§ 39.28, 39.29, 39.30, and 39.31 (DCO) imposes no new information collection requirements on registered entities within the meaning of the Paperwork Reduction Act.221 The OMB has previously assigned control numbers for the required collections of information under a prior related rulemaking to which this rulemaking relates.222 The titles for the previous collections of information are “Part 40, Provisions Common to Registered Entities”, OMB control number 3038–0093, “Financial Resources Requirements for Derivatives Clearing Organizations, OMB control number 3038–0066,” “Information Management Requirements for Derivatives Clearing Organizations, OMB control number 3038–0069,” “General Regulations and Derivatives Clearing Organizations, OMB control number 3038–0081,” and “Risk Management Requirements for Derivatives Clearing Organizations, OMB control number 3038–0076.” This rulemaking is applicable to a subset of DCOs designated as SIDCOs, who must comply with existing information collection requirements for DCOs.

B. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires that agencies consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact. The rules proposed by the Commission will affect only DCOs designated as SIDCOs. The Commission has previously established certain definitions of “small entities” to be used by the Commission in evaluating the impact of its regulations on small entities in accordance with the RFA. The Commission has previously determined that DCOs are not small entities for the purpose of the RFA.223 Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed rules will not have a significant economic impact on a substantial number of small entities.

List of Subjects in 17 CFR Part 39

Commodity futures, Consumer protection, Enforcement authority, Financial resources, Reporting and recordkeeping requirements, Risk management.

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

PART 39—DERIVATIVES CLEARING ORGANIZATIONS

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


2. Add subpart C to read as follows:

Subpart C—Provisions Applicable to Systemically Important Derivatives Clearing Organizations

§ 39.28 Scope.

39.28 Financial resources requirements.

39.30 System safeguards.

39.31 Special enforcement authority.

Subpart C—Provisions Applicable to Systemically Important Derivatives Clearing Organizations

§ 39.28 Scope.

(a) The provisions of this subpart C apply to any derivatives clearing organization, as defined in section 1a(15) of the Act and § 1.3(d) of this chapter.

(1) Which is registered or deemed to be registered with the Commission as a derivatives clearing organization, is required to register as such with the Commission pursuant to section 5b(a) of the Act, or which voluntarily registers as such with the Commission pursuant to section 5b(b) or otherwise; and

(2) Which is a systemically important derivatives clearing organization as defined in § 39.2.

(b) A systemically important derivatives clearing organization is subject to the provisions of subparts A and B of this part 39 except to the extent different requirements are imposed by provisions of this subpart C.

(c) A systemically important derivatives clearing organization shall provide notice to the Commission in advance of any proposed change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the systemically important derivatives clearing organization, in accordance with the requirements of § 40.10 of this chapter.

220 See section 604(a)(4) of the Dodd-Frank Act (Congressional findings).

221 44 U.S.C. 3501 et seq.

222 76 FR 69334 at 69428.

§ 39.29 Financial resources requirements.

(a) General rule. Notwithstanding the requirements of § 39.11(a)(1), a systemically important derivatives clearing organization that is systemically important in multiple jurisdictions or that is involved in activities with a more complex risk profile shall maintain financial resources sufficient to enable it to meet its financial obligations to its clearing members notwithstanding a default by the two clearing members creating the largest combined financial exposure for the systemically important derivatives clearing organization in extreme but plausible market conditions; Provided that if a clearing member controls another clearing member or is under common control with another clearing member, affiliated clearing members shall be deemed to be a single clearing member for the purposes of this provision.

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

§ 39.30 System safeguards.

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

(b) To ensure its ability to achieve the recovery time objective specified in paragraph (a) of this section in the event of a wide-scale disruption, each systemically important derivatives clearing organization must maintain a degree of geographic dispersal of physical, technological and personnel resources consistent with the following:

1. For each activity necessary to the clearance and settlement of existing and new contracts, physical and technological resources, sufficient to enable the entity to meet the recovery time objective after interruption of normal clearing by a wide-scale disruption, must be located outside the relevant area of the infrastructure the entity normally relies upon to conduct that activity, and must not rely on the same critical transportation, telecommunications, power, water, or other critical infrastructure components the entity normally relies upon for such activities;

2. Personnel, sufficient to enable the entity to meet the recovery time objective after interruption of normal clearing by a wide-scale disruption affecting the relevant area in which the personnel the entity normally relies upon to engage in such activities are located, must live and work outside that relevant area;

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

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

(d) The requirements of this section shall apply to a derivatives clearing organization not earlier than one year after such derivatives clearing organization is designated as systemically important.

§ 39.31 Special enforcement authority.

For purposes of enforcing the provisions of Title VIII of the Dodd-Frank Act, a systemically important derivatives clearing organization shall have the objective of enabling, and the physical, technological, and personnel resources described in § 39.18(e)(1) shall be sufficient to enable, the derivatives clearing organization to recover its operations and resume daily processing, clearing, and settlement no later than two hours following the disruption, for any disruption including a wide-scale disruption. To ensure its ability to achieve the recovery time objective specified in paragraph (a) of this section in the event of a wide-scale disruption, each systemically important derivatives clearing organization must maintain a degree of geographic dispersal of physical, technological and personnel resources consistent with the following:

- For each activity necessary to the clearance and settlement of existing and new contracts, physical and technological resources, sufficient to enable the entity to meet the recovery time objective after interruption of normal clearing by a wide-scale disruption, must be located outside the relevant area of the infrastructure the entity normally relies upon to conduct that activity, and must not rely on the same critical transportation, telecommunications, power, water, or other critical infrastructure components the entity normally relies upon for such activities;

- Personnel, sufficient to enable the entity to meet the recovery time objective after interruption of normal clearing by a wide-scale disruption affecting the relevant area in which the personnel the entity normally relies upon to engage in such activities are located, must live and work outside that relevant area;

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

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

- The requirements of this section shall apply to a derivatives clearing organization not earlier than one year after such derivatives clearing organization is designated as systemically important.

- Special enforcement authority.

For purposes of enforcing the provisions of Title VIII of the Dodd-Frank Act, a systemically important derivatives clearing organization shall have the objective of enabling, and the physical, technological, and personnel resources described in § 39.18(e)(1) shall be sufficient to enable, the derivatives clearing organization to recover its operations and resume daily processing, clearing, and settlement no later than two hours following the disruption, for any disruption including a wide-scale disruption.

To ensure its ability to achieve the recovery time objective specified in paragraph (a) of this section in the event of a wide-scale disruption, each systemically important derivatives clearing organization must maintain a degree of geographic dispersal of physical, technological and personnel resources consistent with the following:

- For each activity necessary to the clearance and settlement of existing and new contracts, physical and technological resources, sufficient to enable the entity to meet the recovery time objective after interruption of normal clearing by a wide-scale disruption, must be located outside the relevant area of the infrastructure the entity normally relies upon to conduct that activity, and must not rely on the same critical transportation, telecommunications, power, water, or other critical infrastructure components the entity normally relies upon for such activities;

- Personnel, sufficient to enable the entity to meet the recovery time objective after interruption of normal clearing by a wide-scale disruption affecting the relevant area in which the personnel the entity normally relies upon to engage in such activities are located, must live and work outside that relevant area;

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

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

- The requirements of this section shall apply to a derivatives clearing organization not earlier than one year after such derivatives clearing organization is designated as systemically important.

- Special enforcement authority.

For purposes of enforcing the provisions of Title VIII of the Dodd-Frank Act, a systemically important derivatives clearing organization shall have the objective of enabling, and the physical, technological, and personnel resources described in § 39.18(e)(1) shall be sufficient to enable, the derivatives clearing organization to recover its operations and resume daily processing, clearing, and settlement no later than two hours following the disruption, for any disruption including a wide-scale disruption.

To ensure its ability to achieve the recovery time objective specified in paragraph (a) of this section in the event of a wide-scale disruption, each systemically important derivatives clearing organization must maintain a degree of geographic dispersal of physical, technological and personnel resources consistent with the following:

- For each activity necessary to the clearance and settlement of existing and new contracts, physical and technological resources, sufficient to enable the entity to meet the recovery time objective after interruption of normal clearing by a wide-scale disruption, must be located outside the relevant area of the infrastructure the entity normally relies upon to conduct that activity, and must not rely on the same critical transportation, telecommunications, power, water, or other critical infrastructure components the entity normally relies upon for such activities;

- Personnel, sufficient to enable the entity to meet the recovery time objective after interruption of normal clearing by a wide-scale disruption affecting the relevant area in which the personnel the entity normally relies upon to engage in such activities are located, must live and work outside that relevant area;

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

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

- The requirements of this section shall apply to a derivatives clearing organization not earlier than one year after such derivatives clearing organization is designated as systemically important.