



# FEDERAL REGISTER

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Vol. 78

Monday,

No. 231

December 2, 2013

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Part VI

## Commodity Futures Trading Commission

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17 CFR Parts 39, 140, and 190

Derivatives Clearing Organizations and International Standards; Final Rule

## COMMODITY FUTURES TRADING COMMISSION

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

RIN 3038-AE06

### Derivatives Clearing Organizations and International Standards

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Final rule.

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

**DATES:** This rule is effective December 31, 2013, except for the amendments to 17 CFR 39.31 and 140.94, which are effective December 13, 2013, and the amendments to 190.09, which are effective December 2, 2013.

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#### I. Background

##### A. Regulatory Framework for Registered DCOs

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).<sup>1</sup> Title VII of the Dodd-Frank Act, entitled the “Wall Street Transparency and Accountability Act of 2010,”<sup>2</sup> amended the Commodity Exchange Act (“CEA” or the “Act”)<sup>3</sup> to establish a comprehensive regulatory framework for over-the-counter (“OTC”) derivatives, including swaps.

Section 725(c) of the Dodd-Frank Act amended Section 5b(c)(2) of the CEA, which sets forth core principles that a DCO must comply with in order to register and maintain registration with the Commission. In furtherance of the goals of the Dodd-Frank Act to reduce risk, increase transparency, and promote market integrity, the Commission, pursuant to the Commission’s enhanced rulemaking authority,<sup>4</sup> adopted regulations establishing standards for compliance with the DCO core principles.<sup>5</sup>

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

Title VIII of the Dodd-Frank Act, entitled “Payment, Clearing, and Settlement Supervision Act of 2010,”<sup>6</sup>

<sup>1</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at [http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/hr4173\\_enrolledbill.pdf](http://www.cftc.gov/ucm/groups/public/@swaps/documents/file/hr4173_enrolledbill.pdf).

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

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

<sup>4</sup> See Section 725(c)(2)(i) of the Dodd-Frank Act (giving the Commission explicit authority to promulgate rules regarding the core principles pursuant to its rulemaking authority under Section 8a(5) of the CEA, 7 U.S.C. 12a(5)).

<sup>5</sup> See Derivatives Clearing Organization General Provisions and Core Principles, 76 FR 69334 (Nov. 8, 2011). These regulations are set forth in Subpart A and Subpart B of part 39 of the Commission’s regulations (“Subpart A” and “Subpart B,” respectively).

<sup>6</sup> Section 801 of the Dodd-Frank Act.

was enacted to mitigate systemic risk in the financial system and promote financial stability.<sup>7</sup> Section 804 of the Dodd-Frank Act requires the Financial Stability Oversight Council (“Council”) to designate those financial market utilities (“FMUs”)<sup>8</sup> that the Council determines are, or are likely to become, systemically important.<sup>9</sup>

In determining whether an FMU is systemically important, the Council uses a detailed two-stage designations process, using certain statutory considerations<sup>10</sup> 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.”<sup>11</sup> On July 18, 2012, the Council designated eight FMUs as systemically important under Title VIII.<sup>12</sup> Two of these are CFTC-registered

DCOs<sup>13</sup> for which the Commission is the Supervisory Agency.<sup>14</sup>

### C. Existing Standards for SIDCOs

Section 805 of the Dodd-Frank Act directs the Commission to consider relevant international standards and existing prudential requirements when prescribing risk management standards governing the operations related to payment, clearing, and settlement activities for FMUs that are (1) designated as systemically important by the Council and (2) engaged in activities for which the Commission is the Supervisory Agency.<sup>15</sup> More generally, Section 752 of the Dodd-Frank Act directs the Commission to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation of, among other things, swaps, futures, and options on futures.<sup>16</sup>

In 2013, after careful consideration of the comments on the rules that it had proposed for SIDCOs in 2010 and 2011,<sup>17</sup> and in light of domestic and international market and regulatory

developments, the Commission finalized regulations for SIDCOs in a manner consistent with the PFMIs.<sup>18</sup> Most recently, the Commission proposed the regulations for SIDCOs and Subpart C DCOs that are being adopted herein (the “Proposal”).<sup>19</sup>

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

As noted in the Proposal, in order to register and maintain registration status with the Commission, DCOs must comply with all of the DCO core principles set forth in Section 5b(c)(2) of the CEA, as amended by Section 725 of the Dodd-Frank Act, as well as all applicable Commission regulations. The Proposal did, however, identify and discuss those core principles and related Commission regulations that were most relevant to the proposed regulations. Specifically, the Proposal discussed the following DCO core principles and related Commission regulations: Core Principle B (Financial Resources) and regulations 39.11 and 39.29; Core Principle D (Risk Management) and regulation 39.13; Core Principle G (Default Rules and Procedures) and regulation 39.16; Core Principle I (System Safeguards) and regulations 39.18 and 39.30; Core Principle L (Public Information) and regulation 39.21; Core Principle O (Governance Fitness Standards); Core Principle P (Conflicts of Interest); and Core Principle Q (Composition of Governing Boards).<sup>20</sup>

### E. PFMIs

#### 1. Overview

In the SIDCO Final Rule, the Commission determined that, for purposes of meeting its obligation pursuant to Section 805(a)(2)(A) of the Dodd-Frank Act, the PFMIs, which were developed by CPSS–IOSCO over a period of several years,<sup>21</sup> were the

<sup>18</sup> Specifically, in that final rulemaking, the Commission amended part 39 by creating a Subpart C and adding regulations that (1) increased the minimum financial resource requirements for SIDCOs, (2) restricted the use of assessments by SIDCOs in meeting such financial resource obligations, (3) enhanced the system safeguards requirements for SIDCOs, and (4) granted the Commission special enforcement authority over SIDCOs pursuant to Section 807 of the Dodd-Frank Act. See Enhanced Risk Management Standards for Systemically Important Derivatives Clearing Organizations, 78 FR 49663 (Aug. 15, 2013) (“SIDCO Final Rule”).

<sup>19</sup> Derivatives Clearing Organizations and International Standards, 78 FR 50260 (Aug. 16, 2013) (notice of proposed rulemaking).

<sup>20</sup> For a summary and description of these core principles and Commission regulations, see 78 FR 50262–50263.

<sup>21</sup> See Committee on Payment and Settlement Systems and the Technical Committee of the

Continued

<sup>7</sup> Section 802(b) of the Dodd-Frank Act.

<sup>8</sup> An FMU includes any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person. Section 803(6)(A) of the Dodd-Frank Act.

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

<sup>10</sup> Under Section 804(a)(2) of the Dodd-Frank Act, in determining whether an FMU is or is likely to become systemically important, the Council must take into consideration the following: (A) The aggregate monetary value of transactions processed by the FMU; (B) the aggregate exposure of an FMU to its counterparties; (C) the relationship, interdependencies, or other interactions of the FMU with other FMUs or payment, clearing or settlement activities; (D) the effect that the failure of or a disruption to the FMU would have on critical markets, financial institutions or the broader financial system; and (E) any other factors the Council deems appropriate.

<sup>11</sup> 76 FR 44766.

<sup>12</sup> See Press Release, Financial Stability Oversight Council, Financial Stability Oversight Council Makes First Designations in Effort to Protect Against Future Financial Crises (July 18, 2012), available at <http://www.treasury.gov/press-center/press-releases/Pages/tg1645.aspx>.

<sup>13</sup> While Chicago Mercantile Exchange, Inc. (“CME Clearing”), ICE Clear Credit LLC (“ICE Clear Credit”), and The Options Clearing Corporation (“OCC”) are the CFTC-registered DCOs that were designated as systemically important by the Council, the CFTC is the Supervisory Agency only for CME Clearing and ICE Clear Credit; the Securities and Exchange Commission (“SEC”) serves as OCC’s Supervisory Agency.

<sup>14</sup> See Section 803(8)(A) of the Dodd-Frank Act (defining “Supervisory Agency” as the federal agency that has primary jurisdiction over a designated financial market utility under federal banking, securities or commodity futures laws).

<sup>15</sup> See Section 805(a)(2) of the Dodd-Frank Act. The Commission notes that, under section 805 of the Dodd-Frank Act, the Commission also has the authority to prescribe risk management standards governing the operations related to payment, clearing, and settlement activities for FMUs that are designated as systemically important by the Council and are engaged in activities for which the Commission is the appropriate financial regulator.

<sup>16</sup> Section 752(a) of the Dodd-Frank Act, codified at 15 U.S.C. 8325, provides, in relevant part, that in order to promote effective and consistent global regulation of swaps and security based swaps, the CFTC, the SEC, and the prudential regulators (as that term is defined in section 1a(30) of the CEA), as appropriate, shall consult and coordinate with foreign regulatory authorities on the establishment of international standards with respect to the regulation of swaps and swap entities. In addition, section 752(b) of the Dodd-Frank Act states that in order to promote effective and consistent global regulation of contracts of sale of a commodity for future delivery and options on such contracts, the CFTC shall consult and coordinate with foreign regulatory authorities on the establishment of international standards with respect to the regulation of contracts of a sale of a commodity for future delivery and on options on such contracts.

<sup>17</sup> See Financial Resources Requirements for Derivatives Clearing Organizations, 75 FR 63113, 63119 (Oct. 14, 2010) (notice of proposed rulemaking) and Risk Management Requirements for Derivatives Clearing Organizations, 76 FR 3697 (Jan. 20, 2011) (notice of proposed rulemaking).

international standards most relevant to the risk management of SIDCOs.<sup>22</sup> The PFMI's set out 24 principles which address the risk management and efficiency of a financial market infrastructure's ("FMI") operations.<sup>23</sup> Assessments of observance with the PFMI's focus also on the "key considerations" set forth for each of the principles.<sup>24</sup> While Subpart A and Subpart B of part 39 of the Commission's regulations incorporate the vast majority of the standards set forth in the PFMI's,<sup>25</sup> the Commission, which is a member of the Board of IOSCO, has an obligation under Section 805(a) of the Dodd-Frank Act to implement regulations relating to risk management that conform with applicable international standards. The PFMI's are such standards and, with this rulemaking, the Commission intends to adopt rules and regulations that are fully consistent with the standards set forth in the PFMI's by the end of 2013. To that end, the Commission has recognized that in certain instances, the standards set forth in the PFMI's may not be fully covered by the requirements set forth in Subpart A and Subpart B of part 39 of the Commission's regulations. Thus, this rulemaking revises Subpart C to address those gaps, specifically with respect to the following PFMI principles: Principle 2 (Governance); Principle 3 (Framework for the comprehensive management of risks); Principle 4 (Credit risk); Principle 6 (Margin); Principle 7 (Liquidity risk); Principle 9 (Money settlements); Principle 14 (Segregation and portability); Principle 15 (General

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

<sup>22</sup> In making this determination, the Commission noted that "the adoption and implementation of the PFMI's by numerous foreign jurisdictions highlights the role these principles play in creating a global, unified set of international risk management standards for CCPs." See 78 FR 49666.

<sup>23</sup> See *id.*, ¶ 1.19.

<sup>24</sup> See Committee on Payment and Settlement Systems and the Board of the International Organization of Securities Commissions Principles for Financial Market Infrastructures: Disclosure Framework and Assessment Methodology (Dec. 2012) (hereinafter "Disclosure Framework and Assessment Methodology"), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD396.pdf>.

<sup>25</sup> Indeed, Subpart A and Subpart B were informed by the consultative report for the PFMI's. See generally 76 FR 69334.

business risk); Principle 16 (Custody and investment risks); Principle 17 (Operational risk); Principle 21 (Efficiency and effectiveness); Principle 22 (Communication procedures and standards); and Principle 23 (Disclosure of rules, key procedures, and market data).<sup>26</sup>

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

The Commission notes that where a central counterparty ("CCP") is not prudentially supervised in a jurisdiction that has domestic rules and regulations that are consistent with the standards set forth in the PFMI's, the implementation of certain international banking regulations will have significant cost implications for that CCP and its market participants. In July of 2012, the Basel Committee on Banking Supervision ("BCBS"),<sup>27</sup> the international body that sets standards for the regulation of banks, published the "Capital Requirements for Bank Exposures to Central Counterparties" ("Basel CCP Capital Requirements"), which sets forth interim rules governing the capital charges arising from bank exposures to CCPs related to OTC derivatives, exchange traded derivatives, and securities financing transactions.<sup>28</sup> The Basel CCP Capital Requirements create financial incentives for banks, including their subsidiaries and affiliates,<sup>29</sup> to clear financial derivatives with CCPs that are

<sup>26</sup> For a summary and description of these principles, see 78 FR 50263–50266.

<sup>27</sup> The BCBS is comprised of senior representatives of bank supervisory authorities and central banks from around the world including, Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. See Bank for International Settlements, Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems, December 2010 (revised June 2011), available at <http://www.bis.org/publ/bcbs189.htm>.

<sup>28</sup> See "Capital Requirements for Bank Exposures to Central Counterparties" (July 2012), available at [www.bis.org/publ/bcbs227.pdf](http://www.bis.org/publ/bcbs227.pdf). The Basel CCP Capital Requirements are one component of Basel III, a framework that "is part of a comprehensive set of reform measures developed by the BCBS to strengthen the regulation, supervision and risk management of the international banking sector." See Bank for International Settlement's Web site for compilation of documents that form the regulatory framework of Basel III, available at <http://www.bis.org/bcbs/basel3.htm>.

<sup>29</sup> "Bank" is defined in accordance with the Basel framework to mean a bank, banking group or other entity (*i.e.* bank holding company) whose capital is being measured. See "Basel III: A Global Regulatory Framework," Definition of Capital, paragraph 51. The term "bank," as used herein, also includes subsidiaries and affiliates of the banking group or other entity. The Commission notes that a bank may be a client and/or a clearing member of a DCO.

prudentially supervised in a jurisdiction where the relevant regulator has adopted rules or regulations that are consistent with the standards set forth in the PFMI's. Specifically, the Basel CCP Capital Requirements introduce new capital charges based on counterparty risk for banks conducting financial derivatives transactions through a CCP.<sup>30</sup> These incentives include (1) lower capital charges for exposures arising from derivatives cleared through a qualified CCP ("QCCP") and (2) significantly higher capital charges for exposures arising from derivatives cleared through non-qualifying CCPs. A QCCP is defined as an entity that (i) is licensed to operate as a CCP, and is permitted by the appropriate regulator to operate as such, and (ii) is prudentially supervised in a jurisdiction where the relevant regulator has established and publicly indicated that it applies to the CCP, on an ongoing basis, domestic rules and regulations that are consistent with the PFMI's.<sup>31</sup>

The failure of a CCP to achieve QCCP status could result in significant costs to its bank customers. As one market participant noted, the "ramifications for failure to achieve QCCP status are onerous for banks' CCP exposures and can result in capital charges on trade exposures that are 10–20 times larger than capital charges for QCCP trade exposures."<sup>32</sup> The increased capital charges for transactions through non-qualifying CCPs may have significant business and operational implications for U.S. DCOs that operate internationally and are not QCCPs. For instance, banks faced with such higher capital charges may transfer their clearing business away from such DCOs to a QCCP in order to benefit from the preferential capital charges provided by the Basel CCP Capital Requirements. Alternatively, banks may reduce or discontinue their clearing business altogether. Banks may also pass through the higher costs of transacting on a non-qualifying DCO that result from the higher capital charges to their customers. Accordingly, customers using such banks as intermediaries may transfer their business to an intermediary at a QCCP. In short, a DCO's failure to be a QCCP may cause it to face a competitive disadvantage in retaining members and customers.

<sup>30</sup> See Basel CCP Capital Requirements, Annex 4, Section II, 6(i). See generally 78 FR 50266–50267.

<sup>31</sup> See Basel CCP Capital Requirements, Section I, A: General Terms.

<sup>32</sup> CME at 5, n. 18.

### G. New Regulations Applicable to SIDCOs and Subpart C DCOs

As described in detail in section II below, this final rulemaking includes a new defined term, a Subpart C DCO, to allow registered DCOs that are not SIDCOs to elect to become subject to the provisions in Subpart C of part 39 of the Commission's regulations ("Subpart C"). Further, this rulemaking revises Subpart C so that Subpart C applies to SIDCOs and Subpart C DCOs, and includes new or revised standards for governance, financial resources, system safeguards, default rules and procedures for uncovered losses or shortfalls, risk management, disclosure, efficiency, and recovery and wind-down procedures. These requirements address the remaining gaps between the Commission's regulations and the PFMI standards. Thus, Subpart C, together with the provisions in Subpart A and Subpart B, establish domestic rules and regulations that are consistent with the PFMI. Because Subparts A, B, and C apply to SIDCOs and Subpart C DCOs on a continuing basis, SIDCOs and Subpart C DCOs should be QCCPs for purposes of the Basel CCP Capital Requirements.<sup>33</sup>

The Commission received twelve comment letters, nine of which commented on the Proposal.<sup>34</sup> All nine of these letters were generally supportive of the Proposal's goals. Given the importance of obtaining QCCP status for a U.S.-based DCO, the Commission requested comment on additional measures that the Commission should take to help ensure that Subpart C DCOs obtain QCCP status. MGEX responded by asserting that steps should be taken to "ensure that the [Commission's] proposed regulations will be recognized by applicable regulators as being consistent with the PFMI and that all DCOs subject to those regulations would be considered QCCPs in all relevant jurisdictions."<sup>35</sup> MGEX also requested that the Commission "coordinate with other regulators" to provide a "uniform framework that recognizes the oversight provided by multiple regulatory

jurisdictions so as not to unnecessarily burden DCOs with requirements established by multiple regulatory jurisdictions.<sup>36</sup> As noted in the Proposal, the Commission believes that the Subpart C regulations in combination with the provisions contained in Subpart A and Subpart B would establish domestic rules and regulations that are consistent with the PFMI. Because SIDCOs and Subpart C DCOs would have the requirements of Subpart A, Subpart B and Subpart C applied to them on a continuing basis, such entities should qualify as QCCPs for purposes of the Basel CCP Capital Requirements.<sup>37</sup> In addition, the Commission notes that it actively coordinates with other domestic and international regulators informally, as required by applicable law (such as through the rulemaking consultation process under Title VIII), and through participation in several working groups and international organizations (such as IOSCO).<sup>38</sup> ISDA, which expressed support for the Commission's goal of implementing regulations for DCOs that are consistent with the PFMI by the end of 2013, suggested that the Commission issue this rulemaking as an interim final rule "so that market participants will have an opportunity to provide additional substantive comments."<sup>39</sup> The Commission declines to do so. As is the case with other regulations, part 39 of the Commission's regulations may be reviewed or revised by the Commission as necessary.

The following section will address discuss the comments received on specific aspects of the Proposal in connection with explaining each of the amended and new regulations adopted herein.

<sup>36</sup> *Id.* In addition, ISDA's comment letter addressed the Commission's examination of SIDCOs and Subpart C DCOs. Specifically, ISDA stated that revised Subpart C should specify whether the Commission will evaluate a SIDCO's or Subpart C DCO's compliance with Subpart C as part of its general rule enforcement review program, or whether SIDCOs and Subpart C DCOs will be subject to a more rigorous and more frequent (*e.g.*, annual) review process. ISDA at 4. This comment does not pertain to any of the proposed regulations and is, therefore, outside the scope of the Proposal. However, the Commission notes that Section 807(a) of the Dodd-Frank Act requires the Commission to examine a SIDCO at least once annually.

<sup>37</sup> 78 FR 50297.

<sup>38</sup> The Commission intends to cooperate with other regulators, both domestically and internationally, to foster efficient and effective communication and consultation so that we may support each other in fulfilling our respective mandates with respect to SIDCOs and Subpart C DCOs. *See* PFMI, Responsibility E.

<sup>39</sup> ISDA at 1.

## II. Discussion of Revised and New Regulations

### A. Regulation 39.2 (Definitions)

The Commission proposed amending regulation 39.2 by revising one definition and adding six new defined terms. First, the Commission proposed a technical amendment to the definition of "systemically important derivatives clearing organization." The definition had described a SIDCO as a registered DCO "which has been designated by the [Council] to be systemically important . . ." The proposed definition described a SIDCO as a registered DCO "which is currently designated . . ."

Second, the Commission proposed to add a definition for the phrase "activity with a more complex risk profile," to provide greater clarity as to the types of activities that would trigger a Cover Two financial resources requirement. The Commission proposed to define "activity with a more complex risk profile" to include clearing credit default swaps, credit default futures, and derivatives that reference either credit default swaps or credit default futures, as well as any other activity designated as such by the Commission. The phrase "activity with a more complex risk profile" currently appears in regulation 39.29 (Financial resources requirements), which the Commission proposed to revise and renumber as regulation 39.33.<sup>40</sup>

The Commission also proposed to add a definition for the term "subpart C derivatives clearing organization." The proposed definition would include any registered DCO that is not a SIDCO and that has elected to become subject to Subpart C.

Finally, the Commission proposed to add definitions for "depository institution," "U.S. branch or agency of a foreign banking organization," and "trust company." These terms are used in the provisions concerning liquidity set forth in paragraphs (c) and (d) of revised regulation 39.29, which the Proposal renumbered as regulation 39.33.<sup>41</sup> As proposed, a "depository institution" would have the meaning set forth in Section 19(b)(1)(A) of the Federal Reserve Act (12 U.S.C. 461(b)(1)(A)). A "U.S. branch or agency of a foreign banking organization" would mean the U.S. branch or agency of a foreign banking organization as defined in Section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101). A "trust company" would mean a trust company that is a member of the Federal Reserve System, under

<sup>40</sup> *See* Section II.E., *infra*.

<sup>41</sup> *See id.*

<sup>33</sup> *See* QCCP definition *supra* Section I.F.

<sup>34</sup> All comment letters are available through the Commission's Web site at: <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1391>. Comments addressing the Proposal were received from the European Commission and the following parties: CME Group Inc. ("CME"); The Futures Industry Association ("FIA"); IntercontinentalExchange, Inc. ("ICE"); International Swaps and Derivatives Association Inc. ("ISDA"); LCH.Clearnet Group Limited ("LCH"); The Minneapolis Grain Exchange ("MGEX"); New York Portfolio Clearing LLC ("NYPC"); and Chris Barnard.

<sup>35</sup> MGEX at 6.

Section 1 of the Federal Reserve Act (12 U.S.C. 221), but that does not meet the definition of “depository institution.”

The Commission received only one comment on the substance of the proposed definitions. Chris Barnard stated that he approved of the fact that the definition of “activity with a more complex risk profile” includes credit default swaps and other activities designated as such by the Commission under regulation 39.33(a).

In addition, the Commission received a comment regarding the wording of a defined term. MGEX expressed concern regarding the title “Subpart C DCO.” Specifically, MGEX stated that the title “itself implies to the public that the [Subpart C] DCO is of significantly lesser status” as compared to a SIDCO.<sup>42</sup> MGEX requested that the Commission instead use the term “Qualified Central Counterparty” in its regulations and to define that term to include any DCO that is held to the standards set forth in Subpart C. The Commission declines to adopt this suggestion.

SIDCOs and registered DCOs that elect to opt-in to these heightened standards are not identically situated in that a SIDCO is required to comply with the standards set forth in Subpart C because of its importance to the US financial markets. In other words, a Subpart C DCO may rescind its election whereas a SIDCO may not. In addition, there may be circumstances in which the Commission may want to apply a particular regulation only to SIDCOs. For example, regulation 39.41, enacted pursuant to section 807c of the Dodd-Frank Act, grants the Commission special enforcement authority over SIDCOs, but not Subpart C DCOs. Moreover, SIDCOs are required to comply with regulation 40.10, enacted consistent with section 806 of the Dodd-Frank Act, which, among other things, requires them to provide notice to the Commission not less than 60 days in advance of proposed changes to their rules, procedures, or operations that could materially affect the nature or level of risks presented by the systemically important derivatives clearing organization. This requirement is not imposed on Subpart C DCOs. Thus, it is necessary and appropriate for the Commission to retain the ability to differentiate between SIDCOs and other registered DCOs in its regulations.

Moreover, as discussed below, MGEX and other commenters have noted that the proposed opt-in structure is important in that it allows registered DCOs that are not SIDCOs to be eligible for QCCP status. Once a Subpart C DCO

successfully attains QCCP status, the Commission notes that, in general, its regulations do not prohibit a Subpart C DCO (or a SIDCO) from stating that it is a QCCP in its marketing materials. Indeed, the Commission expects that Subpart C DCOs would market themselves as QCCPs, which is why a Subpart C DCO is prohibited from marketing itself as a QCCP while in the process of rescinding its election.

For the reasons stated above, the Commission believes that the proposed revised and new definitions are appropriate and, therefore, is adopting them as proposed.

#### B. Regulation 39.30 (Scope)

The Commission proposed expanding regulation 39.28 (and renumbering it regulation 39.30) so that Subpart C would apply to SIDCOs and Subpart C DCOs. As described above, the rules proposed in Subpart C address the gaps between Commission regulations and the standards set forth in the PFMI.<sup>43</sup> As such, a DCO that is subject to the requirements of Subpart A, Subpart B, and Subpart C should meet the requirements for QCCP status and benefit from the lower capital charges on clearing member banks and bank customers of clearing members for exposures resulting from derivatives cleared through QCCPs.<sup>44</sup> Such a DCO may also be viewed more favorably by potential members or customers of members in that it would be seen to be held to international standards.

The Commission requested comment on the proposed rules.

LCH and MGEX argued that the amended and new provisions of Subpart C should pertain to all registered DCOs. LCH asserted that the BCBS capital rules provide significant incentives for a DCO to meet the high standards embodied in the PFMI or face the real risk that bank clearing members will cease to clear through them and therefore all DCOs should be required to comply with these standards.<sup>45</sup> MGEX argued that the Commission’s proposed opt-in regime grants SIDCOs an unfair competitive advantage over other DCOs.<sup>46</sup> MGEX suggested that the Commission consider holding all registered DCOs to these higher standards and to provide an “opt-out” mechanism for those registered DCOs that are not SIDCOs that do not wish to attain QCCP status.<sup>47</sup> In addition, LCH and MGEX requested that, if the Commission elects to finalize

the proposed regulations with the opt-in regime, DCOs be permitted to petition the Commission for additional time to comply with all of the Subpart C regulations.<sup>48</sup>

The Commission has decided to adopt regulation 39.30 as proposed. First, because of the potential benefits resulting from QCCP status, as described above, the Commission believes that a DCO that has not been designated to be systemically important should have the option to elect to become subject to Subpart C.<sup>49</sup> However, the Commission does not believe that a DCO that is not a SIDCO should be required to be held to Subpart C if it does not elect to because of the potential costs associated with compliance with these standards. In addition, and as discussed in more detail below, those DCOs that elect to be held to Subpart C may choose the effective date of their election. Because a Subpart C DCO is not required to comply with the regulations set forth in Subpart C until the specified effective date, a Subpart C DCO has a certain amount of control over the date on which it must comply with the Subpart C regulations.

Further, the Commission concludes that a SIDCO should be required to comply with revised Subpart C in order to maintain risk management standards that enhance the safety and efficiency of a SIDCO, reduce systemic risks, foster transparency, and support the stability of the broader financial system.<sup>50</sup> In order to support financial stability, a SIDCO must operate in a safe and sound manner. If it fails to measure, monitor, and manage its risks effectively, a SIDCO could pose significant risk to its participants and the financial system more broadly.<sup>51</sup> The Commission shares the stated objectives of the PFMI, namely to enhance the safety and efficiency of FMI and, more broadly, reduce systemic risk and foster transparency and financial stability.<sup>52</sup> As discussed in the Proposal, the PFMI

<sup>48</sup> LCH at 3–4; MGEX at 4.

<sup>49</sup> As a technical matter, the Commission proposed to move existing paragraph (c) of renumbered regulation 39.30 (requiring a SIDCO to provide notice to the Commission in advance of any proposed change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the SIDCO, in accordance with the requirements of regulation 40.10) to proposed new regulation 39.42. Because the other provisions of proposed regulation 39.30 would pertain exclusively to the scope of Subpart C, it would be appropriate for existing paragraph (c) to be codified in a separate regulation. See *infra* Section II.N. for further detail.

<sup>50</sup> See SIDCO Final Rule (Discussion of risk management standards). See also Section 805(b) of the Dodd-Frank Act.

<sup>51</sup> See *supra* Section I.E.

<sup>52</sup> PFMI ¶ 1.15.

<sup>43</sup> See also *supra* Section I.G.

<sup>44</sup> See *supra* Section I.F.

<sup>45</sup> LCH at 3.

<sup>46</sup> MGEX at 2–3.

<sup>47</sup> MGEX at 3.

<sup>42</sup> MGEX at 4.

have been adopted and implemented by numerous foreign jurisdictions.<sup>53</sup> The Commission notes that none of the commenters opposed holding all SIDCOs to the Subpart C regulations. The Commission believes that a global, unified set of international risk management standards for systemically important CCPs can help support the stability of the broader financial system. As such, for the reasons described above and in the Proposal, the Commission believes that SIDCOs should be required to comply with all of the requirements set forth in part 39 of the Commission's regulations, including the standards set forth in Subpart C, as revised herein.

*C. Regulation 39.31 (Election to become subject to the provisions of Subpart C)*

As discussed above and in the Proposal,<sup>54</sup> the Basel CCP Capital Requirements impose significantly higher capital charges on banks (including their subsidiaries and affiliates) that clear financial derivatives through CCPs that do not qualify as QCCPs (*i.e.*, CCPs that are licensed and supervised in a jurisdiction where the relevant regulator applies to the CCP, on an ongoing basis, domestic rules and regulations that are not consistent with the PFMI's).<sup>55</sup> Because such charges could create incentives for banks to migrate their business to CCPs that are QCCPs or to avoid clearing,<sup>56</sup> U.S. DCOs that operate internationally, but are not QCCPs, may face a substantial competitive disadvantage. The Subpart C requirements, as amended herein, address any remaining gaps between the Commission's existing regulations and the PFMI standards.<sup>57</sup> Accordingly, a DCO that is subject to the collective obligations contained in Subpart A, Subpart B and Subpart C should be a QCCP for purposes of the Basel CCP Capital Requirements.<sup>58</sup>

Regulation 39.31, as proposed, would provide a mechanism whereby a DCO that has not been designated by the Council as systemically important may elect to become subject to the provisions of Subpart C (*i.e.*, may "opt" to become

subject to the regulations otherwise applicable only to SIDCOs) and, thereby, attain QCCP status, should the DCO individually determine that the benefits of achieving such status outweigh the costs associated with implementing the Subpart C regulations. The Commission also proposed procedures for withdrawing or rescinding that election.

The Commission received five comment letters regarding proposed regulation 39.31.<sup>59</sup> These comments generally supported the adoption of procedures that would provide non-SIDCO DCOs the opportunity to become QCCPs through adherence to an enhanced regulatory regime.<sup>60</sup> LCH, for example, "strongly supported" the adoption of "heightened regulatory standards that would allow both SIDCOs and non-SIDCOs to be QCCPs."<sup>61</sup> The European Commission similarly stated that central counterparties "that wish to operate under safer standards and compete on the basis of the quality of their risk-management . . . should not be prevented from doing so."<sup>62</sup>

MGX and LCH disagreed, however, with the proposed "opt-in" approach and suggested alternative means for achieving the Commission's objectives.<sup>63</sup> As mentioned above, both LCH and MGEX suggested that the Commission require all currently registered DCOs to be held to the enhanced regulatory requirements proposed to be applicable only to SIDCOs and Subpart C DCOs.<sup>64</sup> LCH asserted that "it is important for all CCPs which clear swaps and other derivatives . . . to adhere to the higher standards."<sup>65</sup> MGEX claimed that requiring DCOs that have not been designated by the Council as systemically important to "opt-in" to Subpart C compliance is "unnecessarily burdensome and discriminatory" in comparison to the regulatory treatment of SIDCOs.<sup>66</sup> In support of its position, MGEX noted that SIDCOs will be held to the same standards as Subpart C DCOs, but will not be required to submit a Subpart C Election Form, or to

otherwise engage in the Subpart C election process in order to become a QCCP.<sup>67</sup> MGEX contended that requiring all currently registered DCOs to be held to the enhanced regulatory regime would negate the need for a Subpart C Election Form and, therefore, would treat all DCOs identically in terms of their registration status and requirements, which would enable DCOs to spend the time that they would otherwise spend on preparing a Subpart C Election Form on ensuring their compliance with the Subpart C regulations.<sup>68</sup>

MGEX recognized, however, "a number of potential issues" with universal application of the Subpart C requirements.<sup>69</sup> For example, this proposed alternative, by itself, would not provide flexibility for DCOs that do not wish to be held to the higher standards and could require the Commission to expend "considerable resources to verify compliance for each currently registered DCO shortly after implementation" and to engage in the processes necessary to revoke the Subpart C DCO status of those DCOs that fail to satisfy the proposed regulations.<sup>70</sup> Both MGEX and LCH suggested alternatives. Specifically, these commenters recommended that the Commission replace the proposed "opt-in" regime with a regime under which the Subpart C standards would be applicable to all DCOs, but a DCO would be permitted to "opt-out" of the heightened standards, if it believed that attaining QCCP status was not important for its business.<sup>71</sup> Both entities recommended that the opt-out regime be accompanied by an extension of the compliance deadline<sup>72</sup> for all or some of the substantive proposed Subpart C regulations.<sup>73</sup> Specifically, LCH and MGEX voiced concern that it would be difficult or unlikely for non-SIDCO DCOs to satisfy the Subpart C election and implementation requirements necessary to achieve QCCP status prior

<sup>53</sup> See 78 FR 50260, 50268.

<sup>54</sup> See discussion of the role of the PFMI's in international banking standards *supra* Section I.F., 78 FR 50266–9.

<sup>55</sup> See Basel CCP Capital Requirements at Section I.A.: General Terms.

<sup>56</sup> As noted above, banks alternatively may reduce or discontinue their clearing business or pass through to their customers any higher costs of transacting through a DCO that is not a QCCP. See discussion of the role of the PFMI's in International Banking Standards *supra* Section I.F.; 78 FR 50267, 50269.

<sup>57</sup> See discussion of the new regulations applicable to SIDCOs and Subpart C DCOs *supra* Section I.G.

<sup>58</sup> *Id.*

<sup>59</sup> Comments on proposed regulation 39.31 were received from the European Commission, FIA, ISDA, LCH and MGEX.

<sup>60</sup> See, *e.g.*, European Commission at 1, LCH at 2, MGEX at 1–2.

<sup>61</sup> LCH at 1. See also MGEX at 1 ("MGEX applauds the Commission for attempting to establish an avenue by which DCOs not designated as systemically important could qualify for [QCCP] status.")

<sup>62</sup> European Commission at 1.

<sup>63</sup> See LCH at 2–4, MGEX at 2–6.

<sup>64</sup> See LCH at 3, MGEX at 3.

<sup>65</sup> LCH at 2.

<sup>66</sup> MGEX at 2.

<sup>67</sup> *Id.*

<sup>68</sup> MGEX at 3–4.

<sup>69</sup> MGEX at 3.

<sup>70</sup> *Id.*

<sup>71</sup> See LCH at 2–4, MGEX at 3–4.

<sup>72</sup> The Commission notes that, there is no general "compliance deadline" for non-SIDCO DCOs. While a non-SIDCO that wishes to become a Subpart C DCO must satisfy all of the Subpart C requirements (except the specific obligations for which the DCO is permitted to apply for additional time to comply) at the time it elects to become subject to Subpart C, a DCO is not required to make that election at any particular time or at all, unless it determines that the cost of such compliance is usurped by the benefits it would receive through Subpart C status.

<sup>73</sup> LCH at 2–4, MGEX at 3–4.

to December 31, 2013.<sup>74</sup> LCH specifically stated that additional time is necessary to come into compliance with the regulations “governing financial resources, system safeguards, risk management, and recovery and wind-down plans.”<sup>75</sup> Both MGEX and LCH commented on the particular difficulty of developing a recovery and wind down plan citing, respectively, the “complexity and potential effects the contents of such a plan would have on the operation of a DCO”<sup>76</sup> and the fact that the Commission has not previously proposed any requirements with respect to such plans.<sup>77</sup>

In support of their requests for additional time to comply with the Subpart C requirements, LCH and MGEX cited the time needed to identify gaps between their current rules and procedures and the Subpart C regulations, to implement any necessary changes to comply with the Subpart C regulations, and to prepare and submit their Subpart C Election Forms.<sup>78</sup> Both entities objected to the amount of time between the publication of the Proposal and the time when compliance will be required in order to qualify for QCCP status by the end of the 2013.<sup>79</sup>

MGEX also objected to the alleged disparate treatment afforded SIDCOs which “have been able to prepare for compliance with the enhanced standards at least since the release of the PFMI in April 2012.”<sup>80</sup> In addition, LCH asserted that, as proposed, the Commission would be requiring Subpart C DCOs to come into compliance with all aspects of the PFMI “prior to many non-US CCPs.”<sup>81</sup> LCH suggested that

<sup>74</sup> LCH at 2, MGEX at 2. The Basel III Counterparty Credit Risk and Exposures to Central Counterparties—Frequently Asked Questions (“Basel III FAQs”) state that, if a CCP’s primary regulator has publicly stated that it is working towards implementing regulations consistent with the PFMI, then such CCP may be treated as a QCCP until December 31, 2013. After December 31, 2013, the Basel III FAQs state that the CCP’s primary regulator must have implemented regulations consistent with the PFMI and these regulations must be applied to the CCP on an ongoing basis in order for such CCP to be eligible for QCCP status. See Basel III FAQs, Question 5.6, available at: <http://www.bis.org/publ/bcbs237.pdf>.

<sup>75</sup> See LCH at 3, 4.

<sup>76</sup> MGEX at 4.

<sup>77</sup> See LCH at 3, 4.

<sup>78</sup> See LCH at 3, MGEX at 3.

<sup>79</sup> See LCH at 4, MGEX at 2.

<sup>80</sup> MGEX at 2.

<sup>81</sup> LCH at 4. In support of this assertion, however, LCH cites to just one aspect of the Subpart C requirements—the recovery and wind-down plans—which may not be required of certain EU CCPs in order to become and maintain QCCP status. Specifically, LCH asserts that “CCPs in the European Union will not be required to provide recovery and wind-down plans to become and remain QCCPs as EMIR, which implements the PFMI in Europe, does not include such a

adopting the final regulations, but permitting compliance at a later date, would allow the Commission to adopt the PFMI prior to the end of 2013 while, at the same time, providing DCOs with an “ability to achieve QCCP status by the end of 2013.”<sup>82</sup>

The Commission continues to believe that non-SIDCO DCOs that are willing and able to satisfy the enhanced regulatory requirements contained in Subpart C, should, when they are able to do so, be afforded the opportunity to attain QCCP status and to reap the benefits that may result from that designation<sup>83</sup> and that the application of Subpart C non-SIDCO DCOs that wish to become subject to regulations that are consistent with the standards set forth in the PFMI helps promote the international consistency called for in Section 752 of the Dodd-Frank Act.<sup>84</sup> Commenters addressing proposed regulation 39.31 were unanimously supportive of this objective. Accordingly, the Commission has determined to adopt a regulatory framework that permits a DCO that has not been designated as systemically important by the Council to elect to become subject to the heightened standards set forth in Subpart C.

In response to the comments recommending that the Commission apply the regulatory requirements to all DCOs or employ an “opt-out” regime in lieu of the proposed “opt-out” procedures, the Commission notes that neither commenter advocating such alternatives provided any quantitative

requirement. EU legislation implementing the recovery and wind resolution aspects of the PFMI is not expected to be proposed by the European Commission until early next year” and “implementation is unlikely before 2016 at the earliest.” *Id.* LCH also notes that laws in some EU jurisdictions will require CCPs to have recovery plans prior to implementation of EU legislation. LCH at 4, n. 4. As noted below, the Commission will permit SIDCOs and Subpart C DCOs the opportunity to request that the Commission grant the SIDCO or Subpart C DCO an extension of the deadline with respect to recovery and wind-down plans for up to one year. See *infra* Section II.K. (Regulation 39.39 (Recovery and wind down for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)).

<sup>82</sup> See LCH at 2, 4. LCH claims that requiring a Subpart C DCO to comply with the Subpart C regulations by the end of 2013 would “likely result in Subpart C DCO’s not being able to achieve QCCP status prior to that time” and that the failure of a Subpart C DCO to achieve QCCP status would put the Subpart C DCO at a competitive disadvantage to non-QCCPs that are “grandfathered” as QCCPs. LCH at 2. As noted below, the Commission believes that permitting Subpart C DCOs a broad-based opportunity to delay compliance with the Subpart C regulations, as suggested by LCH, could put a DCO at greater risk of failing to obtain QCCP status.

<sup>83</sup> See 78 FR 50268–50269.

<sup>84</sup> See discussion of existing standards for SIDCOs *supra* Section I.C.

data or qualitative analyses of the costs and benefits of its suggested alternatives, particularly as compared to the Commission’s Proposal. The Commission believes it would be inappropriate to adopt the proffered alternatives absent such analyses and without sufficient opportunity for the public to review and comment upon them.

The Commission also is concerned that an “opt-out” regime would unfairly shift certain costs associated with the Subpart C regulations to those non-SIDCO DCOs that do not intend to avail themselves of the opportunity to become QCCPs. Specifically, regulation 39.31, as proposed and finalized herein, would require only those non-SIDCO DCOs that wish to become subject to the Subpart C regulations (and to attain the benefits of QCCP status) to complete and file a Subpart C Election Form. Non-SIDCO DCOs that do not wish to become subject to the Subpart C regulations (nor to obtain the benefits of QCCP status) are not obligated to take any further action. In contrast, an “opt-out” regime would impose an obligation to file an opt-out application on those DCOs that do not intend to seek the benefit of QCCP status, while removing the Subpart C Election Form obligation from those DCOs that do.

In response to commenters’ requests for additional time for Subpart C DCOs to comply with the new Subpart C regulations, and as discussed in more detail below, the Commission has determined that it would be appropriate to permit SIDCOs and Subpart C DCOs to request extensions of time to comply with the requirements for system safeguards, default rules and procedures for uncovered credit losses or liquidity, and recovery and wind-down plans contained in regulations 39.34, 39.35 and 39.39, respectively.<sup>85</sup> The Commission is declining, however, to permit requests from a DCO for, or to generally provide, a wholesale extension of time to comply with the new Subpart C regulations. Thus, a DCO seeking to become a Subpart C DCO will otherwise be required to be in compliance with the Subpart C regulations at the time it makes its

<sup>85</sup> See *infra* Section II.F. (Regulation 39.34 (System safeguards for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)), Section G (Regulation 39.35 (Default rules or procedures for uncovered credit losses or liquidity shortfalls (recovery) for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)), and Section II.K (Regulation 39.35 (Recovery and wind-down for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)).



Subpart C election. The new Subpart C regulations finalized herein seek to provide DCOs that have not been designated by the Council as systemically important the opportunity to qualify as QCCPs. Despite LCH's assertion to the contrary,<sup>86</sup> the Commission is concerned that a broad-based extension of the compliance deadline (in contrast to individually justified extensions with respect to particular requirements) would be more likely to jeopardize the ability of a Subpart C DCO to achieve QCCP status. As noted above, rules and regulations that are consistent with the PFMI must be *implemented* by the end of 2013.<sup>87</sup> Moreover, as noted above, a QCCP is defined, in part, as a CCP that is prudentially supervised in a jurisdiction where the relevant regulator applies to the CCP, on an ongoing basis, domestic rules and regulations that are consistent with the PFMI.<sup>88</sup>

The Commission further notes that a non-SIDCO DCO is obligated to comply with the Subpart C regulations only if—and when—the DCO affirmatively elects to become subject to such regulations, based upon its own examination of the benefits (including, but not limited to, the opportunity to attain QCCP status) and burdens thereof. No non-SIDCO DCO is obligated to elect to become a Subpart C DCO and thereby comply with the Subpart C regulations by December 31, 2013 or any other date unless it believes that it is prudent to do so in light of its particular business. The Commission stands ready to review the application of any DCO that is prepared to be held to the Subpart C standards, whether the DCO is prepared to do so on December 31, 2013 or any later date.

The Commission also disagrees with commenters' assertions that potential Subpart C DCOs have only recently been advised of the nature of the additional regulations to which they, if they choose, will be subject. The final PFMI were published in April of 2012. In the same month, the Commission and other domestic financial regulators issued a joint press release explicitly notifying the public of the publication of the final PFMI.<sup>89</sup> At a minimum, therefore, DCOs have been on notice of the specific requirements of the PFMI since

April 2012. Moreover, the Basel CCP Capital Requirements were published in July of 2012, and as mentioned above, the Basel FAQs, which were published in December of 2012, state that during 2013, if a CCP regulator has not yet implemented the PFMI but has publicly stated that it is working towards implementing these principles, the CCPs that are regulated by the CCP regulator may be treated as QCCPs.<sup>90</sup> Thus, by December of 2012, DCOs were on notice of the preferential capital treatment that would result from becoming subject to regulations that are consistent with the PFMI by the end of 2013.

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

Regulation 39.31(a), as proposed, set forth the two categories of entities that would be eligible to elect to become subject to the provisions in Subpart C. As proposed: (1) A DCO that is not a SIDCO could request such election using the procedures set forth in proposed regulation 39.31(b) and (2) an entity applying for registration as a DCO pursuant to regulation 39.3 (“DCO Applicant”) could request the election in conjunction with its application for registration (“Registration Application”) using the procedures set forth in proposed regulation 39.31(c). The Commission did not receive any comments specifically addressing proposed regulation 39.31(a). Accordingly, for the reasons cited in the Proposal,<sup>91</sup> the Commission is adopting regulation 39.31(a) as proposed.

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

Regulation 39.31(b), as proposed, would establish the procedures by which a DCO that is already registered could elect to become subject to the provisions of Subpart C and the procedure by which the DCO could withdraw that election.<sup>92</sup> Comments generally addressing the Proposal to adopt regulations that would permit a DCO to elect to become subject to Subpart C (*i.e.*, comments on the “opt-

in” regime) are discussed above.<sup>93</sup> In addition, the Commission received one comment referencing the Subpart C Election Form. MGEX asserted that the Commission should “waive” the Subpart C Election Form as “it seems overly burdensome and costly for a currently registered DCO to be required to complete an entirely new application which calls for submission of the same or similar information and analysis that the DCO previously provided [in its DCO Application]”.<sup>94</sup> In support of this request, MGEX cites to a statement in the Proposal that the Commission “anticipates considerable overlap between the information and documentation contained in the Registration Application files [sic] by a DCO Applicant and the information and documentation that would be required to be submitted to the Commission as part of the Subpart C Election Form.”<sup>95</sup> This reference is misplaced. The cited statement was made in the portion of the Proposal describing the proposed election and withdrawal procedures for new DCO applicants.<sup>96</sup> The “overlap in information and documentation” to which the Commission was referring is the overlap between the materials that would be submitted by *new* applicants for DCO registration in their DCO applications and the materials that a newly registered DCO would supply as part of a Subpart C Election Form submitted shortly thereafter.<sup>97</sup> In contrast, the information supplied by a currently registered DCO as part of the Form DCO that was filed when such DCO applied for registration is likely to be stale and would need to be updated.<sup>98</sup> Moreover, the Subpart C Election Form simply calls for the electing DCO to demonstrate its compliance with the requirements of Subpart C, with fairly minimal formatting requirements. The form is intended to provide the Commission, clearing members, and customers (and, significantly, the regulators of such

<sup>93</sup> See *supra* Section I.I.C. (Regulation 39.31 (Election to become subject to the provisions of Subpart C)).

<sup>94</sup> MGEX at 5.

<sup>95</sup> MGEX at 5 (citing 78 FR 50271).

<sup>96</sup> 78 FR 50271.

<sup>97</sup> This distinction is even more important in the case of a clearing organization, such as MGEX, that was “grandfathered in” to DCO status under the Commodity Futures Modernization Act of 2000 (Pub. L. No. 106–554, 114 Stat. 2763, sec. 112(f) (adding sec. 5a(b) to the CEA) and thus never filed an application for registration as a DCO.

<sup>98</sup> See Subpart C Election Form, Exhibit Instructions at no. 2, (“If the [DCO] is an *Applicant*, in its Form DCO, the [DCO] may summarize such information and provide a cross reference to the Exhibit in this Subpart C Election Form that contains the required information” (emphasis added)).

<sup>86</sup> Notwithstanding its timing concerns, LCH has indicated that it intends to “take advantage of the Subpart C election process. LCH at 3.

<sup>87</sup> See *supra* n 91.

<sup>88</sup> See *supra* Section I.F. (The Role of the PFMI in International Banking Standards).

<sup>89</sup> Joint Press Release, Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission and the Securities and Exchange Commission, CPSS–IOSCO Issue Final Report on Principles for Financial Market Infrastructures” (April 16, 2012).

<sup>90</sup> Basel III FAQs at 23. In the Final SIDCO Rule the Commission explicitly advised the public of its intention toward implementing regulations that are fully consistent with the PFMI by the end of 2013. See SIDCO Final Rule at 4966 (“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 PFMI by the end of 2013”).

<sup>91</sup> 78 FR 50298.

<sup>92</sup> 78 FR 50271, 50298–99.

clearing members and customers) with assurance that the electing DCO will be held to and will be required to meet the standards set forth in Subpart C.<sup>99</sup> Thus, the Commission continues to believe that it is necessary and appropriate to require DCOs electing to become subject to Subpart C to submit such information to the Commission.

MSEX further asserts that the Subpart C Election Form requirement puts Subpart C DCOs at a risk of “delayed regulatory approval” not borne by SIDCOs, which it claims are “grandfathered in to Subpart C . . . due to their SIDCO status.”<sup>100</sup> MEX states that to “ensure equal treatment” among all DCOs, any requirements to provide information as part of the Subpart C election process should be imposed upon SIDCOs as well.<sup>101</sup> The Commission notes that SIDCOs, having been designated as systemically important by the Council, are subject to annual examinations under Title VIII and are, therefore, in a different position than DCOs that have not been so designated, but wish to elect to be held to the same international standards in an effort to attain QCCP status. The Commission also notes that SIDCOs, as well as Subpart C DCOs, are required by regulation 39.37, as finalized herein, to complete and publically disclose their responses to the Disclosure Framework.<sup>102</sup> As such, and since SIDCOs are required to be subject to the Subpart C regulations, the Commission does not feel it necessary to require SIDCOs to complete a Subpart C Election Form. In addition, because the Commission declines to require all DCOs to comply with the regulations in Subpart C, the Subpart C Election Form is necessary to provide a mechanism by which a registered DCO may elect to become subject to Subpart C.

In its comments on proposed regulation 39.37, MEX also asserted that, while requiring the submission of a Quantitative Disclosure Document is “consistent with the PFMI,” the Commission should delay implementation of this requirement until the Quantitative Disclosure Document is finalized in order to allow DCOs time to review and comment upon it or to otherwise prepare for compliance.<sup>103</sup> The Commission confirms that, as noted in the Subpart C Election Form, as proposed and

finalized herein, completion and publication of the Quantitative Information Disclosure will not be required until the criteria for such disclosure has been finalized and published, which has not yet occurred.

Finally, MEX responded to the Commission’s request for comment<sup>104</sup> on whether or not the Commission should add a requirement that the certifications contained in the Subpart C Election Form be made under penalty of perjury. MEX opposed the addition of this requirement.<sup>105</sup> The Commission notes that such a requirement would be inconsistent with the current Form DCO, which does not include a similar requirement. Therefore, the Commission has decided not to add a perjury certification to the Subpart C Election Form.

Accordingly, after careful review and consideration of the comments, and for the reasons cited above and set forth in the Proposal,<sup>106</sup> the Commission is adopting regulation 39.31(b) as proposed. The Commission has, however, altered the Subpart C Election Form in two respects.

As discussed further below,<sup>107</sup> DCOs that seek to become Subpart C DCOs (as well as SIDCOs) will be permitted to request an extension of up to one year to comply with any of the provisions of regulations 39.34, 39.35, or 39.39 pursuant to those regulations.<sup>108</sup> The Commission has determined that, to the extent that a DCO elects to request any such extensions, it must do so prior to filing the Subpart C Election Form and the General Instructions to the Subpart C Election Form have been modified accordingly.<sup>109</sup> The Commission also has made technical modifications to the certifications contained in the Subpart C Election Form to account for any extensions of time granted pursuant to regulation 39.34(d) and/or 39.39(f).

<sup>104</sup> 78 FR 50272.

<sup>105</sup> MEX at 5.

<sup>106</sup> 78 FR 50268–69.

<sup>107</sup> See *infra* at sections II.F. (Regulation 39.34—System Safeguards), II.G. (Regulation 39.35—Default Rules and Procedures), and II.K. (Regulation 39.39 (Recovery and Wind-Down)).

<sup>108</sup> Regulation 39.34(d), as finalized herein, provides that the Commission may, upon request, grant a SIDCO or Subpart C DCO an extension of up to one year to comply with any of the provisions of regulation 39.34. Regulation 39.39(f), as finalized herein, similarly provides that a SIDCO or Subpart C DCO, upon request, may be granted an extension of up to one year to comply with the provisions of regulations 39.35 and 39.39. Any such requests made by a DCO seeking to become a Subpart C DCO will become part of that DCO’s Subpart C Election Form.

<sup>109</sup> The Commission notes that it is not prescribing a particular time period elapse between the filing of applications for compliance extensions and the filing of the Subpart C Election Form.

As noted in the Proposal,<sup>110</sup> the Commission emphasizes that, consistent with the certification required to be provided by a DCO as part of its Subpart C Election Form, a DCO, as of the date that its election to become subject to Subpart C becomes effective, would be held to the requirements of Subpart C. As of that date, the DCO would be subject to examination for compliance with Subpart C and to potential enforcement action for non-compliance. This status would continue until such time, if any, that the election is properly vacated as set forth in regulation 39.31(e), as finalized.<sup>111</sup> To the extent that compliance with Subpart C would require the DCO to implement new rules or rule amendments, all such rules or rule amendments must be approved or permitted to take effect prior to the effective date of the DCO’s election.

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

Regulation 39.31(c), as proposed, sets forth procedures through which a DCO Applicant could request to become subject to the provisions of Subpart C at the time the DCO Applicant files its Registration Application. The Commission did not receive any comments specifically addressing proposed regulation 39.31(c).<sup>112</sup> Accordingly, for the reasons cited in the Proposal,<sup>113</sup> the Commission is adopting regulation 39.31(c) as proposed. In the interest of administrative economy, the Commission continues to encourage DCO Applicants to make their election to become subject to Subpart C at the time that their Registration Application is filed. Simultaneous filings would appear to allow Commission resources to be used more efficiently and effectively.

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

Regulation 39.31(d), as proposed, would provide that certain portions of the Subpart C Election Form will be considered public documents that may routinely be made available for public inspection. The Commission did not receive any comments with respect to proposed regulation 39.31(d). Accordingly, for the reasons set forth in

<sup>110</sup> 78 FR 50269–50270.

<sup>111</sup> See *infra* Section II.C.5. (Regulation 39.31(e)—Rescission).

<sup>112</sup> See *supra* Section II.C. (Regulation 39.31 (Election to become Subject to Subpart C) for a discussion of comments regarding the proposed opt-in regime and process generally and the Subpart C Election Form.

<sup>113</sup> 78 FR 50271.

<sup>99</sup> See 78 FR 50269.

<sup>100</sup> MEX at 5.

<sup>101</sup> *Id.*

<sup>102</sup> See *supra* Section II.I. (Regulation 39.37 (Additional disclosure for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)).

<sup>103</sup> MEX at 8–9.

the Proposal,<sup>114</sup> the Commission is adopting regulation 39.31(d) as proposed.

#### 5. Regulations 39.31(e)—Rescission

Regulation 39.31(e), as proposed, would permit a Subpart C DCO to rescind its election to comply with Subpart C by filing a notice of its intent to rescind the election with the Commission. Such rescission would, however, be subject to certain conditions. As proposed, the rescission of a DCO's election to become subject to Subpart C would become effective on the date specified by the Subpart C DCO in its notice of intent to rescind the Subpart C election, except that the rescission could not become effective any earlier than 90 days after the date the notice of intent to rescind is filed with the Commission. The Subpart C DCO would be required to comply with all of the provisions of Subpart C until such rescission is effective and the Commission would retain its authority concerning any activities or events occurring during the time that the DCO maintained its status as a Subpart C DCO.

Regulation 39.31(e), as proposed, also would require a Subpart C DCO that files a notice of intent to rescind to (1) provide specified notices to each of its clearing members, and to have rules in place requiring each of its clearing members to provide such notices to each of the clearing member's customers; (2) provide specified notices to the general public; and (3) remove references to its Subpart C DCO (and QCCP) status on its Web site and in other materials that it provides to its clearing members and customers, other market participants, or members of the public. In addition, the employees and representatives of the Subpart C DCO would be prohibited from making any reference to the organization as a Subpart C DCO (or QCCP) on and after the date that the notice of its intent to rescind is filed.

The Commission received two comments addressing proposed regulation 39.31(e). ISDA recommended that the Commission modify the proposed regulation to require, as a condition to a Subpart C DCO's rescission of its Subpart C election, "to certify that it has obtained approval from clearing members (e.g., by member ballot) to rescind the election."<sup>115</sup> In response to ISDA's suggestion, the Commission believes that this is a matter of corporate governance and the DCO should follow its own policies and

procedures with respect to internal decisions regarding rescission. The Commission further notes that existing regulation 39.3(e) does not require a DCO to certify that it has obtained the approval of its clearing members to vacate its DCO registration prior to filing with the Commission a request to do so<sup>116</sup> and, thus, requiring the certification suggested by ISDA would be in tension with existing regulations. Accordingly, the Commission has declined to accept ISDA's recommendation.

FIA recommended that the Commission extend the time period between the date that a DCO files a notice of intent to rescind its election to be subject to Subpart C and the date that such rescission could become effective from 90 days to 180 days.<sup>117</sup> In support of its recommendation, the FIA agreed with the view voiced by the Commission in the Proposal<sup>118</sup> that a delay in the effective date of the rescission is necessary to provide banks and other entities that wish to limit their cleared transactions to clearing solely through a QCCP sufficient time to transfer their business to another Subpart C DCO or a SIDCO.<sup>119</sup> The FIA expressed concern, however, that the 90 day delay is insufficient "to allow a clearing member to make a determination whether to withdraw as a clearing member and, if it elects to do so, notify its customers, find one or more clearing members prepared to accept each customer and allow the new clearing member and each customer to negotiate the terms of their agreement."<sup>120</sup> The Commission recognizes that the clearing members of a DCO that has filed a notice of intent to rescind its election to become subject to Subpart C may need additional time to determine and to effectuate the actions they may wish to take in light of such filing and believes that a 180 day waiting period until such rescission may become effective is reasonable. Accordingly, the Commission has decided to lengthen the minimum time period between the date a notice of intent to rescind an election to become subject to Subpart C is filed and the date that such rescission may become effective to 180 days. For the reasons cited above and set forth in the Proposal,<sup>121</sup> the Commission is adopting

regulation 39.31(e) as proposed in all other respects.

#### 6. Regulations 39.31(f)—Loss of SIDCO Designation

Regulation 39.31(f), as proposed, would provide that a SIDCO that is registered with the Commission, but whose designation of systemic importance is rescinded by the Council,<sup>122</sup> would immediately be deemed to be a Subpart C DCO. Such Subpart C DCO would be subject to the Subpart C provisions unless and until it elects to rescind its status as a Subpart C DCO. The Commission did not receive any comments on proposed regulation 39.31(f). Accordingly, for the reasons set forth in the Proposal,<sup>123</sup> the Commission is adopting regulation 39.31(f) as proposed.

#### 7. Regulation 39.31(g)

Regulation 39.31(g), as proposed, provides that all forms and notices required by regulation 39.31 shall be filed electronically with the Secretary of the Commission in the format and manner specified by the Commission. The Commission did not receive any comments on proposed regulation 39.31(g) and, thus, is adopting the regulation as proposed.

#### *D. Regulation 39.32 (Governance for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)*

The Commission proposed adding regulation 39.32 in order to implement DCO Core Principles O (Governance Fitness Standards), P (Conflicts of Interest), and Q (Composition of Governing Boards) for SIDCOs and Subpart C DCOs in a manner that would be consistent with PFMI Principle 2 (Governance).<sup>124</sup>

As discussed above, DCO Core Principle O states that each DCO must establish governance arrangements that are transparent to fulfill public interest requirements and to permit the

<sup>122</sup> See 12 CFR 1320.13(b) (procedure for the Council to rescind a designation of systemic importance for a systemically important financial market utility).

<sup>123</sup> 78 FR 50272.

<sup>124</sup> In 2010 and 2011, the Commission proposed regulations concerning the governance of DCOs (the "2010/2011 Proposals"). See Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest, 75 FR 63732 (Oct. 18, 2010); see also Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities, 76 FR 722 (Jan. 8, 2011). The Commission notes that the regulations contained in the 2010/2011 Proposals are the subject of a separate rulemaking. The Commission is not addressing those regulations in this rulemaking.

<sup>116</sup> 17 CFR 39.3(e).

<sup>117</sup> FIA at 5.

<sup>118</sup> 78 FR 50272.

<sup>119</sup> FIA at 4.

<sup>120</sup> FIA at 4–5.

<sup>121</sup> 78 FR 50271–72.

<sup>114</sup> *Id.*

<sup>115</sup> ISDA at 3–4.

consideration of the views of owners and participants.<sup>125</sup> DCO Core Principle O also requires each DCO to establish and enforce appropriate fitness standards for (i) directors, (ii) members of any disciplinary committee, (iii) members of the DCO, (iv) any other individual or entity with direct access to the settlement or clearing activities of the DCO, and (v) any party affiliated with any entity mentioned in (i)–(v) above. In addition, DCO Core Principle P requires each DCO to establish and enforce rules to minimize conflicts of interest in the decision making process of the DCO, and DCO Core Principle Q states that each DCO must ensure that the composition of the governing board or committee of the DCO includes market participants. These core principles are substantively similar to PFMI Principle 2, which states that a CCP “should have governance arrangements that are clear and transparent, promote the safety and efficiency of [the CCP], and support the stability of the broader financial system, other relevant public interest considerations, and the objectives of relevant stakeholders.” Additionally, under PFMI Principle 2, a CCP should have procedures for managing conflicts of interest among board members, and board members and managers should be required to have “appropriate skills,” “incentives,” and “experience.”<sup>126</sup>

As proposed, subsection (a) (General rules) would require a SIDCO or Subpart C DCO to establish governance arrangements that: (1) Are written, clear and transparent, place a high priority on the safety and efficiency of the SIDCO or Subpart C DCO, and explicitly support the stability of the broader financial system and other relevant public interest considerations; (2) ensure that the design, rules, overall strategy, and major decisions of the SIDCO or Subpart C DCO appropriately reflect the legitimate interests of clearing members, customers of clearing members, and other relevant stakeholders; and (3) disclose, to an extent consistent with other statutory and regulatory requirements on confidentiality and disclosure: (i) Major decisions of the board of directors to clearing members, other relevant stakeholders, and to the Commission, and (ii) Major decisions of the board of directors having a broad market impact to the public.<sup>127</sup>

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

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

The Commission requested comment on proposed regulation 39.32 and asked that commenters include a detailed description of any alternatives to proposed regulation 39.32 and estimates of the costs and benefits of such alternatives. LCH commented that a SIDCO or Subpart C DCO should be permitted to petition the Commission for additional time to comply with new regulation 39.32 and with all other substantive regulations contained in this rulemaking. The Commission does not believe that a SIDCO or Subpart C DCO should be permitted to petition for additional time to comply with new regulation 39.32 for the reasons stated above.<sup>128</sup>

LCH also requested clarification as to which major decisions of the board of directors should be disclosed under new regulation 39.32(a)(3). LCH stated that a board may make a resolution that is not determinative, for example to commence exploratory negotiations for making an acquisition. LCH stated that it did not believe Principle 2 would require it to publish such a decision because Explanatory Note 3.2.18 to Principle 2 states that an FMI need not disclose a major decision where doing so would endanger commercial

confidentiality. The Commission agrees with LCH that there is a distinction between exploratory negotiations and a final decision. The Commission also agrees with the suggestion made in Explanatory Note 3.2.18 that it is reasonable for a DCO to focus on disclosing the “outcome” of decisions made by the board rather than decisions that are not determinative. It should also be noted that paragraph (a)(3) does not require a disclosure that would compromise “statutory and regulatory requirements on confidentiality and disclosure.”

Similarly, MGEX requested clarification as to: what qualifies as a “major decision” under proposed paragraph (a)(3); which “information” the Commission was referring to in footnote 137 of the Proposal; and whether the disclosure provision of paragraph (a) is intended to be a “reiteration of existing law[s] or regulation[s].” MGEX also suggested that paragraph (a) be amended to include a provision stating that a DCO may withhold disclosing a major decision of the board of directors if disclosing it would “stifle candid board debate or endanger commercial confidentiality.” The Commission agrees with MGEX that regulation 39.32 affords a DCO reasonable discretion in determining which decisions are “major” so as to warrant disclosure under paragraph (a)(3) and which decisions should not be disclosed due to concerns about confidentiality. Moreover, paragraph (a)(3) requires disclosure of “decisions,” rather than the debate preceding them. The Commission concludes that the language of proposed paragraph (a)(3) suffices in these regards.

ISDA commented that regulation 39.32 should address decision-making by a SIDCO or Subpart C DCO during a crisis or emergency. Specifically, ISDA suggests that there should be a provision requiring a SIDCO or Subpart C DCO to obtain the views and approval of member representatives (e.g. through the DCO’s risk committee or otherwise) before taking any material action in response to an emergency. The Commission has decided not to include this requested provision because the Commission has decided not to impose requirements beyond those required by Principle 2 as part of this rulemaking.

Accordingly, the Commission has decided to finalize regulation 39.32 as proposed. The governance requirements set forth in the proposed regulation were designed to enhance risk management and controls by promoting fitness standards for directors and managers, promoting transparency of

<sup>125</sup> See *supra* Section I.D.

<sup>126</sup> PFMI at Principle 2, K.C. 4–5.

<sup>127</sup> The provisions concerning transparency describe which information, including the identities of board members, should be disclosed to the public and/or the Commission.

<sup>128</sup> See *supra* Section II.C. (Regulation 39.31 (Election to become subject to the provisions of Subpart C)).

governance arrangements, and making sure that the interests of a SIDCO's or Subpart C DCO's clearing members and, where relevant, customers are taken into account. Because of the potential impact that a SIDCO's failure could have on the U.S. financial markets, the Commission believes that that these requirements should be applicable to SIDCOs. Moreover, it would be beneficial to Subpart C DCOs, their members and customers, and the financial system generally, for regulation 39.32 to apply to Subpart C DCOs.

*E. Regulation 39.33 (Financial resources requirements for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)*

In August of 2013, the Commission finalized Regulation 39.29, which sets forth financial resource requirements for SIDCOs in a manner that parallels the financial resources standard in Principle 4 of the PFMI.<sup>129</sup> The Commission proposed to amend regulation 39.29 to enhance financial resources requirements for SIDCOs and Subpart C DCOs and to achieve consistency with the relevant provisions of the PFMI, in particular Principle 4 and Principle 7.

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

The Commission also proposed amending paragraph (a) to state that the Commission shall, if it deems appropriate, determine whether a SIDCO or Subpart C DCO is systemically important in multiple jurisdictions. In making this determination, the Commission would, in order to limit such determinations to appropriate cases, review whether another jurisdiction had determined the SIDCO or Subpart C DCO to be systemically

important according to a designations process that considers whether the foreseeable effects of a failure or disruption of the derivatives clearing organization could threaten the stability of each relevant jurisdiction's financial system. In addition, the Commission proposed amending paragraph (a) to state that the Commission shall also determine, if it deems appropriate, whether any of the activities of a SIDCO or Subpart C DCO, in addition to clearing credit default swaps, credit default futures, or any derivatives that reference either, has a more complex risk profile and that in making this determination, the Commission may take into consideration characteristics such as non-linear and discrete jump-to-default price changes.<sup>130</sup> The Commission also proposed amending paragraph (b) to clarify that the prohibition on including assessments as a financial resource applies to calculating financial resources needed to cover the default of the largest and, where applicable, second largest clearing member, in extreme but plausible circumstances.<sup>131</sup>

The PFMI Explanatory Notes explain that liquidity risk arises in an FMI (such as a DCO) when settlement obligations are not completed when due as part of its settlement process. Liquidity risk can arise in a number of ways: between an FMI and its participants, between an FMI and other entities (such as the FMI's settlement banks and liquidity providers), or between an FMI's participants.<sup>132</sup> The Commission proposed adding paragraphs (c), (d), and (e) to address the liquidity of SIDCOs' and Subpart C DCOs' financial resources. The liquidity resources discussed in paragraphs (c), (d), and (e) should be sufficient to address the different exposures to liquidity risk applicable to that DCO.

Under proposed paragraph (c)(1), a SIDCO or Subpart C DCO would be required to maintain eligible liquidity resources that will enable the SIDCO or Subpart C DCO to meet its intraday, same-day, and multiday settlement obligations, as defined in regulation 39.14(a), with a high degree of confidence under a wide range of stress scenarios, including the default of the member creating the largest liquidity

requirements under extreme but plausible circumstances. Under proposed paragraph (c)(2), a SIDCO or Subpart C DCO would be required to maintain liquidity resources that are sufficient to satisfy the obligations required by new paragraph (c)(1) in all relevant currencies for which the SIDCO or Subpart C DCO has settlement obligations to its clearing members.

Under proposed paragraph (c)(3), a SIDCO or Subpart C DCO would be limited to using only certain types of liquidity resources to satisfy the minimum liquidity requirement set forth in proposed paragraph (c)(1).<sup>133</sup> Among these "qualifying liquidity resources" are "committed lines of credit," "committed foreign exchange swaps," and "committed repurchase agreements." "Committed" is intended to connote a legally binding contract under which a liquidity provider agrees to provide the relevant liquidity resource without delay or further evaluation of the DCO's creditworthiness, e.g., a line of credit that cannot be withdrawn at the election of the liquidity provider during times of financial stress, or in the event of the default of a member of the SIDCO or Subpart C DCO.<sup>134</sup>

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

Also consistent with Principle 7, under proposed paragraph (c)(4), if a SIDCO or Subpart C DCO maintains liquid financial resources in addition to those required to satisfy the Cover One requirement, then those resources should be in the form of assets that are likely to be saleable with proceeds available promptly or acceptable as collateral for lines of credit, swaps, or repurchase agreements on an *ad hoc* basis. In addition, Principle 7 provides and proposed paragraph 39.33(c)(4) requires that a SIDCO or Subpart C DCO should consider maintaining collateral with low credit, liquidity, and market

<sup>129</sup> The Commission's amendment to regulation 140.94(a) delegates the authority to make these determinations to the Director of the Division of Clearing and Risk.

<sup>131</sup> The preamble to the SIDCO Final Rule adopting release made clear that paragraph (b) applied to both Cover One and Cover Two, but the Commission has decided to add clarifying language to the regulation text. See generally SIDCO Final Rule.

<sup>132</sup> See PFMI, E.N. 3.7.1.

<sup>133</sup> In determining whether the liquidity resources that are eligible under paragraph (c)(3) are sufficient in amount to meet the obligation specified under paragraph (c)(1) (resources that "enable" the DCO to meet its settlement obligations), it is important to avoid double counting. For example, one may not count both a committed repurchase arrangement and U.S. Treasury Bills that would be used to collateralize that arrangement.

<sup>134</sup> Times of financial stress and the event of the default of a member of the DCO are, of course, the times when reliable liquidity arrangements are most needed.

<sup>129</sup> See SIDCO Final Rule 78 FR 49666.

risks that is typically accepted by a central bank of issue for any currency in which it may have settlement obligations, but shall not assume the availability of emergency central bank credit as a part of its liquidity plan.<sup>135</sup>

Pursuant to proposed paragraphs (d)(1)–(2), a SIDCO or Subpart C DCO would be required to monitor its liquidity providers in a manner consistent with Principle 7. Proposed paragraph (d)(1) would define “liquidity provider” to mean any of the following:

(i) A depository institution, a U.S. branch or agency of a foreign banking organization, a trust company, or a syndicate of depository institutions, U.S. branches or agencies of foreign banking organizations, or a trust companies providing a line of credit, foreign exchange swap facility or repurchase facility to the SIDCO or Subpart C DCO; and (ii) Any other counterparty relied upon by a SIDCO or Subpart C DCO to meet its minimum liquidity resources requirement under paragraph (c) of this section. In addition, proposed paragraph (d)(4) would require a SIDCO or Subpart C DCO to regularly test its procedures for accessing its liquidity resources. Finally, pursuant to proposed subsection (e) and consistent with Principle 4, a SIDCO or Subpart C DCO would be required to document its supporting rationale for, and have appropriate governance arrangements relating to, the amount of total financial resources it maintains pursuant to regulation 39.33(a) and the amount of total liquidity resources it maintains pursuant to regulation 39.33(c).<sup>136</sup>

The Commission requested comment on all aspects of proposed regulation 39.33. ISDA, MGEX and the European Commission each commented on paragraph (a)(1). ISDA requested clarification of the term “credit exposure,” which the Proposal used to replace the term “financial obligation,” which currently appears in regulation 39.29 (renumbered as regulation 39.33 as part of this rulemaking). In response to this comment, the Commission will revert to the term financial obligation.

MGEX requested clarification that a Subpart C DCO that is neither systemically important in multiple jurisdictions nor involved in activities with a more complex risk profile would

be required to meet only the Cover One financial resources requirement,<sup>137</sup> not the Cover Two requirement.<sup>138</sup> The Commission notes that MGEX understood paragraph (a)(1) correctly, and the Commission believes that the language in paragraph (a)(1) is sufficiently clear.

The European Commission disagreed with the Commission’s decision to require a SIDCO or Subpart C DCO to meet the Cover Two financial resources requirement only if it is systemically important in multiple jurisdictions or is involved in activities with a more complex risk profile. The European Commission suggested that all SIDCOs should be required to comply with the Cover Two requirement for the following reasons. First, any DCO that serves non-US clearing members or non-US trading venues is systemically important.<sup>139</sup> In addition, any DCO that is systemically important in the U.S. is systemically important internationally.<sup>140</sup> Second, requiring certain DCOs to meet the Cover One requirement while requiring other DCOs to meet the Cover Two requirement would be “detrimental to the object of building equal conditions of fair competition” between U.S.-registered DCOs and DCOs registered in other jurisdictions.<sup>141</sup> Third, banking regulators cannot deem various SIDCOs and Subpart C DCOs to all be QCCPs if some are required to meet the Cover One requirement while others are required to meet the Cover Two requirement.<sup>142</sup> Fourth, differing financial resources requirements would make the European Commission’s equivalence assessment of U.S.-registered DCOs more difficult.<sup>143</sup> Fifth, it would be more prudent from a risk management perspective if the Cover Two requirement applied to all products and not only those “with a more complex risk profile.”<sup>144</sup>

<sup>137</sup> Regulation 39.11 requires DCOs to maintain financial resources sufficient to cover a wide range of potential stress scenarios, which include, but are not limited to, the default of the participant and its affiliates that would potentially cause the largest aggregate financial exposure to the CCP in extreme but plausible market conditions, otherwise known as “Cover One.”

<sup>138</sup> The term “Cover Two” refers to the requirement that a DCO 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 loss (which would include both proprietary and customer accounts) for the SIDCO in extreme but plausible market conditions.

<sup>139</sup> European Commission at 2.

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

<sup>143</sup> European Commission at 2–3.

<sup>144</sup> European Commission at 3.

The applicability of the Cover Two requirement in paragraph (a)(1) is consistent with Principle 4 of the PFMI. Further, while the European Commission raises important points, further work would need to be done to consider the costs versus the benefits of imposing a Cover Two financial resources requirements on all DCOs regardless of whether that DCO was affirmatively found to be systemically important by the Council (or other jurisdictions) and regardless of the types of products that DCO clears. Nonetheless, the Commission notes that the two existing SIDCOs will, in fact, be subject to a Cover Two financial resources requirement.<sup>145</sup>

Chris Barnard commented that he supported the language of paragraph (a)(3) (determination of whether an activity has a more complex risk profile) and that it will appropriately result in higher financial resources requirements for such activities. Chris Barnard commented further that this should improve the robustness of a DCO’s clearing system and help protect the financial system from contagion.<sup>146</sup>

With respect to proposed paragraph (c)(2)(satisfaction of settlement in all relevant currencies), LCH commented that it seeks confirmation that the provision is intended to pertain to “material currencies only, which are indeed the ones [for which a liquidity shortfall would be] likely to disrupt the SIDCO’s [or Subpart C DCO’s] services and impact financial stability.”<sup>147</sup>

There is no support for the implied assertions that a DCO could fail to meet its obligations in certain currencies on time without disrupting its services or impacting financial stability, and that a DCO could forgo arrangements to meet its obligations in certain currencies consistent with Principle 7. Any default by a DCO to meet its obligations on time would be likely to disrupt its services and impact financial stability. Thus, in this context, new paragraph (c)(2) covers those currencies for which the SIDCO or Subpart C DCO has obligations to perform settlements, as defined in § 39.14(a)(1), to its clearing members.

<sup>145</sup> As discussed in the final rule on Enhanced Risk Management Standards for Systemically Important Derivatives Clearing Organizations, ICE Clear Credit clears credit default swaps (which is a product with a more complex risk profile) and currently meets a Cover Two requirement. See 78 FR 49670. Further, CME Clearing currently sizes its guaranty fund for interest rate swaps and its guaranty fund for credit default swaps to a Cover Two standard, and is required to meet a Cover Two standard for its base guaranty fund pursuant to regulation 39.29(a) by the end of 2013 because it clears credit default swaps. See 78 FR 49671.

<sup>146</sup> Chris Barnard at 2.

<sup>147</sup> LCH at 5.

<sup>135</sup> It should be noted that the requirement of proposed paragraph (c)(4) that a SIDCO or Subpart C DCO consider maintaining certain types of collateral, like the requirement of proposed paragraph (c)(1)(ii), does not include a requirement as to the decision to be made following such consideration.

<sup>136</sup> This provision is consistent with PFMI Principle 4, K.C. 4.

The Commission believes that this interpretation is consistent with Principle 7. To be sure, where an FMI's obligations in a particular currency are relatively small, the depth and complexity of the arrangements necessary to establish high reliability is likely proportionately less demanding.

In addition, with respect to proposed paragraph (c)(2), CME commented that it clears derivatives that settle in approximately 14 currencies and that it would be difficult to obtain committed credit facilities for currencies other than G-7 currencies.<sup>148</sup> For those other currencies, CME claimed that it would be forced to require a restrictive set of margin policies, including requiring a clearing member to post margin in the same currency as the settlement currency.<sup>149</sup> This, CME argued, would require CME's bank affiliated clearing members to face increased capital charges because it may be difficult for cash collateral in such currencies to receive bankruptcy remote treatment (and, therefore, a smaller capital requirement) unless such cash is posted with a central bank.<sup>150</sup>

As an initial matter, CME provided no support for the assertion that cash collateral would not be bankruptcy remote in the case of a DCO. To the contrary, section 761(10) of the Bankruptcy Code defines customer property to include both cash and securities, and 761(16) defines member property in terms of customer property. Section 766(i) provides that, in the case of the insolvency of a clearing organization, both customer and member property will be protected.<sup>151</sup> A SIDCO or Subpart C DCO will have discretion to determine the most efficient means of ensuring sufficient liquidity, which may include requiring (or incentivizing) members to post all or a part of their collateral in the settlement currency.

With respect to proposed paragraph (c)(3)(i)(E), CME commented that it is inconsistent with Principle 7 to require U.S. Treasury securities, which are held by a SIDCO or Subpart C DCO for purposes of meeting the minimum amount of liquidity resources required under proposed paragraph (c)(1), to be subject to "committed" funding arrangements.<sup>152</sup> CME commented that it interprets Principle 7 to require only "investments" to be subject to "prearranged and highly reliable funding arrangements" and not "highly

marketable collateral," of which U.S. Treasury securities are an example.<sup>153</sup>

CME stated further that the European Securities and Markets Authority (ESMA), the Monetary Authority of Singapore (MAS), and the Reserve Bank of Australia (RBA) have each taken a "more flexible approach" than proposed paragraph (c)(3)(i)(E) in interpreting the qualifying liquid resources provisions of Principle 7.<sup>154</sup> According to CME, these other regulators do not, in some cases, require highly marketable collateral such as U.S. Treasury securities to be subject to committed funding facilities.<sup>155</sup> In addition, CME stated that other regulators do not, in some cases, require highly marketable collateral to be subject to prearranged and highly reliable funding arrangements.<sup>156</sup>

ISDA commented that it would be neither necessary nor appropriate to require that U.S. Treasuries, used to satisfy the minimum liquid resources requirement, be subject to prearranged and highly reliable funding arrangements.<sup>157</sup> According to ISDA, such a requirement has the potential to exacerbate a liquidity crisis and pass on risk from the DCO to its liquidity providers.<sup>158</sup>

CME further argued that it would be unnecessary to require U.S. Treasury securities to be subject to committed funding arrangements because the U.S. Treasury market is the world's global standard for reliable liquidity and that same-day settlement of U.S. Treasury securities is reliably available in material sizes for a negligible yield concession of 1–2 basis points per annum.<sup>159</sup> CME noted that banks are permitted to classify U.S. Treasury securities as "High Quality Liquid Assets" (HQLA) under the Basel III capital rules. CME also stated that due to their robust liquidity and eligibility to be pledged at the Federal Reserve Bank discount window, U.S. Treasury securities are extremely safe for banks to accept under uncommitted repurchase agreements.<sup>160</sup>

CME also argued that there would be several negative consequences if the Commission required a DCO to arrange for U.S. Treasury securities to be subject to a committed funding arrangement.<sup>161</sup> First, CME stated that this provision would necessitate CME to limit the

amount of U.S. Treasury securities a CME-clearing member could deposit to meet initial margin and guaranty fund obligations.<sup>162</sup> To compensate, the clearing members would have to deposit additional cash. CME argued that this would be detrimental to bank affiliated clearing members because the Basel III capital rules may require banks to take higher capital charges for cash collateral than for other types of collateral, including U.S. Treasury securities because cash collateral is not confirmed to be bankruptcy remote.<sup>163</sup> CME also stated that there would be difficulties establishing a committed liquidity facility for U.S. Treasury securities. CME asserted that the banks that are affiliated with CME clearing members are the best sources of such liquidity resources, and such banks may be prevented from participating in a large committed facility because of the risk that they would breach their single counterparty exposure limits under proposed Basel III capital rules. As a result, bank affiliated clearing members may reduce their customer clearing business, which could, in turn, increase costs to customers or prevent customers from taking advantage of the risk mitigating benefits of central clearing.<sup>164</sup>

Finally, CME suggested that the market for committed liquidity facilities may not be large enough to offer a facility that would enable CME to satisfy the proposed liquidity provisions of regulation 39.33(c). CME also discussed a cost estimate for establishing committed facilities. This cost estimate is addressed in the cost benefit considerations, below.<sup>165</sup>

FIA also commented that U.S. Treasury securities should be considered a qualifying liquid resource under paragraph (c)(3), even if they are not subject to funding arrangements in accordance with proposed subparagraph (E)(2).<sup>166</sup> FIA argued that, alternatively, subparagraph (E)(2) should permit a DCO to arrange for U.S. Treasury securities to be subject to uncommitted repurchase agreements. FIA supports CME's comment that U.S. Treasury securities are "high quality liquid assets" under BCBS standards and have remained highly liquid during times of stress.<sup>167</sup>

However, in appealing to the standards established by other jurisdictions, CME acknowledged that

<sup>153</sup> CME at 3–4.

<sup>154</sup> CME at 4.

<sup>155</sup> *Id.*

<sup>156</sup> *Id.*

<sup>157</sup> ISDA at 4.

<sup>158</sup> *Id.*

<sup>159</sup> CME at 7–8.

<sup>160</sup> CME at 8.

<sup>161</sup> CME at 9–12.

<sup>162</sup> CME at 10.

<sup>163</sup> CME at 9. As noted above, this assertion is unsupported, and is contradicted by Subchapter IV of Chapter 7 of the Bankruptcy Code.

<sup>164</sup> CME at 11.

<sup>165</sup> CME at 12–13. See also section IV.C., *infra*.

<sup>166</sup> FIA at 3–4.

<sup>167</sup> *Id.*

<sup>148</sup> CME at 10.

<sup>149</sup> *Id.*

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

<sup>151</sup> 11 USC 761(i).

<sup>152</sup> CME at 10.

the EMIR Regulatory Technical Standards limit CCPs to “count[ing] highly marketable financial instruments . . . that the CCP *can demonstrate* are readily available and convertible into cash on a same day basis using prearranged and highly reliable funding arrangements, including in stressed market conditions.”<sup>168</sup> Similarly, CME refers to United Kingdom requirements for a liquidity resource to be qualifying that include that the CCP needs to “*demonstrate* its ability to liquidate the resource for same day cash.”<sup>169</sup> The Commission agrees that the obligation of a SIDCO or Subpart C DCO with respect to highly marketable collateral will be to demonstrate that, as stated in subparagraph (E)(2), those assets are, in fact, readily available and convertible into cash pursuant to prearranged and highly reliable funding arrangements, even in extreme but plausible market conditions.

ISDA commented that proposed paragraph (c)(3)(ii), which requires a SIDCO or Subpart C DCO to take steps to verify that the prearranged and highly reliable funding arrangements for U.S. Treasury securities or other sovereign bonds do not include material adverse change provisions, is unnecessary because the PFMI do not specifically require this.<sup>170</sup> ISDA also noted that credit arrangements generally include such clauses in order to protect the financial institution providing the credit, to protect that institution’s shareholders, and to prevent the spread of risk from a DCO to financial institutions.<sup>171</sup>

In light of these comments, the Commission has decided to make minor revisions to the language in 39.33(c)(3)(E)(1) and (E)(2) to more closely align with the language used in key consideration 5 to Principle 7.

The purpose of the reference to the material adverse change clauses is to ensure that a SIDCO or Subpart C DCO not rely on a credit or liquidity arrangement that can be declined (*i.e.*, would not be reliably enforceable) at the very point in time when the DCO would, in fact, need to use the arrangement. In other words, these funding arrangements are intended to ensure that a SIDCO or Subpart C DCO will be able to meet its obligations when they come due even after a default in extreme but plausible conditions. If a funding arrangement includes a

provision that there be no material adverse changes as a condition to draw, then such funding arrangement will not in fact serve its intended purpose. By contrast, a representation that there have been no material adverse changes for some period prior to execution of a liquidity arrangement, where the truth of such representation is not a condition to enforceability of the obligation to provide liquidity, would not be a condition that defeats the purpose of the liquidity arrangement. The Commission believes this interpretation is consistent with key consideration 5 of Principle 7, which states in relevant part that “For the purpose of meeting its minimum liquid resource requirement, an FMI’s qualifying liquid resources in each currency include . . . highly marketable collateral held in custody and investments that are readily available and convertible into cash with prearranged and highly reliable funding arrangements, even in extreme but plausible market conditions.”

Accordingly, the Commission has decided to modify paragraph (c)(3)(ii) to replace the phrase “material adverse change clause” with “material adverse change condition” and to add the “even in extreme but plausible market conditions” language from key consideration 5 to clarify this issue and to ensure consistency with Principle 7 with respect to this point.

With respect to proposed paragraph (c)(4), ISDA commented that if a SIDCO or Subpart C DCO maintains financial resources in an amount greater than the Cover One financial resources requirement, then the SIDCO or Subpart C DCO *should be required* to maintain collateral with a low credit risk to cover such greater amount.<sup>172</sup> ISDA also commented that the phrase “with proceeds available promptly” should be deleted because it does not appear in the PFMI and is not clearly defined.<sup>173</sup> The Commission notes that the financial resources at issue in this paragraph are in excess of those required by Principle 7 and regulation 39.33(a). Therefore, the Commission believes it is appropriate for attendant requirements to be less stringent than those that apply to required financial resources. In addition, the requirement in paragraph (c)(4) that a SIDCO or Subpart C DCO *should consider* maintaining collateral with low credit risk for any excess financial resources is consistent with Principle 7. Moreover, the Commission disagrees with ISDA and believe that the concept of “with proceeds available

promptly” is covered by, and consistent with, the PFMI.

In response to the Commission’s question as to whether proposed paragraph (d)(4) should specify the frequency with which a SIDCO or Subpart C DCO must test its procedures for accessing liquidity resources, MGEX commented that it believes the proposed language is sufficient.<sup>174</sup> MGEX commented that the proposed language appropriately affords a DCO the discretion to determine the frequency of testing its procedures for accessing liquidity resources.<sup>175</sup> MGEX stated that a DCO is in the best position to determine this frequency and that unnecessary, redundant testing would cause a DCO to incur unnecessary costs.<sup>176</sup>

The Commission has decided to finalize regulation 39.33 as modified above. New paragraphs (c), (d), and (e) are intended to address the gaps between current part 39 requirements and standards set forth in Principle 7.<sup>177</sup> The Commission believes these new provisions are appropriate and will reduce risk for SIDCOs and Subpart C DCOs, their clearing members, and customers of clearing members. In particular, new paragraph (c)(1) will help prevent a SIDCO or Subpart C DCO from defaulting on its obligations to non-defaulting clearing members, which is particularly important for a SIDCO because of the potential impact that the failure of a SIDCO could have on the U.S. financial markets, because

<sup>174</sup> MGEX at 7.

<sup>175</sup> *Id.*

<sup>176</sup> *Id.*

<sup>177</sup> Principle 7, K.C. 2 requires a CCP to measure, monitor, and manage liquidity risk effectively. This includes the CCP maintaining sufficient liquid resources in all relevant currencies in order to effect same-day and, where applicable, intraday and multiday settlement of payment obligations in a wide range of potential stress scenarios, including the default of the participant that would create the largest aggregate payment obligations in extreme but plausible market conditions. In addition, Principle 7, K. C. 5 limits a CCP to counting only certain qualifying liquid resources for the purpose of meeting its financial resources requirement. These resources include: cash in the currency of the requisite obligations, held either at the central bank of issue or at a creditworthy commercial bank; committed lines of credit; or high quality, liquid, general obligations of a sovereign nation. In addition, Principle 7, K. C. 4 states that a CCP that is systemically important in multiple jurisdictions or that is involved in activities with a more complex risk profile should consider maintaining sufficient qualifying liquid resources to meet the default of the two participants that would create the largest aggregate payment obligations in such circumstances. Principle 7, K. C. 7 also requires a CCP to monitor its liquidity providers, including clearing members, by undertaking due diligence to confirm that they have sufficient information to understand and manage their liquidity risks and have the capacity to perform as required under their commitments to the CCP.

<sup>168</sup> CME at 6, quoting European Market Infrastructure Regulation Regulatory Technical Standards, Article 33 (emphasis supplied here).

<sup>169</sup> CME at 6 (emphasis supplied).

<sup>170</sup> ISDA at 4.

<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

<sup>173</sup> ISDA at 4–5.



maintaining resources that enable the DCO to meet its intraday, same-day, and multiday settlement obligations. New paragraph (c)(2) will require a SIDCO to meet its obligations in each relevant currency in a timely manner. This is important because if a SIDCO has sufficient funds to meet an obligation, but the funds are not in the correct currency, then the SIDCO cannot meet that obligation in a timely manner, which could lead to a disruption of the SIDCO's services. Such disruption could, in turn, have a significant impact on the financial stability of the U.S. economy.

New paragraph (c)(1)(ii) will require a SIDCO or Subpart C DCO that is systemically important in multiple jurisdictions, or that is involved in activities with a more complex risk profile, to *consider* maintaining certain eligible liquidity resources that, at a minimum, will enable it to meet its intraday, same-day, and multiday settlement obligations, stress scenarios that include a default of the two clearing members creating the largest aggregate liquidity obligation for the DCO in extreme but plausible market conditions. The proposed list of these resources is consistent with those set forth in Principle 7. The financial integrity of a SIDCOs and or Subpart C DCOs might be enhanced if it *considers* meeting this enhanced standard. The provisions of new paragraph (c)(4) (pertaining to, among other issues, the liquidity of financial resources held in addition to those financial resources required by the Cover One standard) are designed to enhance the financial condition of SIDCOs and Subpart C DCOs and help reinforce stability.<sup>178</sup>

*F. Regulation 39.34 (System safeguards for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)*

In August of 2013, the Commission finalized regulation 39.30, which enhanced system safeguards requirements for SIDCOs with respect to business continuity and disaster recovery, and included a two-hour recovery time objective ("RTO").<sup>179</sup> As discussed in the adopting release, the two-hour RTO is consistent with Principle 17 of the PFMI and increases the soundness and operating resiliency

<sup>178</sup> See generally Financial Stability Oversight Council 2012 Annual Report, Appendix A at 163 (finding that "the contagion effect of a CME failure could impose material financial losses on CME's clearing members and other market participants (such as customers) and could lead to increased liquidity demands and credit problems across financial institutions, especially those that are active in the futures and options markets.").

<sup>179</sup> See SIDCO Final Rule 78 FR 49672-49674.

of the SIDCO, which in turn, increases the overall stability of the U.S. financial markets.<sup>180</sup> The Commission proposed renumbering regulation 39.30 as regulation 39.34 and amending the regulation to cover Subpart C DCOs in addition to SIDCOs. The Commission also made a technical correction to paragraph (b) to make clear that subparagraphs (1), (2), and (3) concern each activity necessary for the daily processing, clearing, and settlement of existing and new contracts. Finally, the Commission proposed amending the regulation to allow the Commission to, upon request, grant newly designated SIDCOs and Subpart C DCOs up to one year to comply with the provisions of regulation 39.34.<sup>181</sup>

MGEX commented that it "appreciates the additional time granted for complying" with regulation 39.34.<sup>182</sup> The Commission notes that MGEX's statement implies an automatic compliance extension, which is inaccurate because regulation 39.34(d) permits a SIDCO or Subpart C DCO to *request* that the Commission grant it up to one year to comply with regulation 39.34. In reviewing such requests, the Commission will be attentive to whether the DCO has a well-developed plan to comply with the requirement by the end of the requested extension, with reasonable milestones that can be monitored by the Commission. MGEX also commented that it would like flexibility in developing a business continuity and disaster recovery plan.<sup>183</sup> MGEX stated that the regulation would require it to hire three or four new employees outside of Minneapolis, which would be very costly.<sup>184</sup> MGEX suggested it would be less costly to comply with the regulation if it outsourced its business continuity compliance, but it does not wish to do that because employees, rather than contractors, are more likely to act in the best interests of MGEX.<sup>185</sup>

First, the Commission notes that to facilitate the two-hour RTO, regulation 39.34 specifically requires a SIDCO or Subpart C DCO to maintain personnel, who live and work outside the relevant

<sup>180</sup> *Id.*

<sup>181</sup> In response to comments received, regulation 39.39, as finalized herein, will permit the Commission, upon request, to grant newly designated SIDCOs and Subpart C DCOs up to one year to comply with the provisions of regulation 39.35 and 39.39. To harmonize regulation 39.34 with this revision, the Commission has determined to make a technical correction to proposed regulation 39.34 that replaces the phrase "upon application" with the phrase "upon request."

<sup>182</sup> MGEX at 7.

<sup>183</sup> *Id.*

<sup>184</sup> *Id.*

<sup>185</sup> *Id.*

area of the physical and technological resources the SIDCO or Subpart C DCO normally relies upon to conduct its clearing activities. This requirement might be met in a number of ways. As MGEX notes, one way is to engage outsourced personnel. An alternative would be to base employees at a geographically diverse location. In general, a SIDCO or Subpart C DCO does have flexibility in designing its business continuity and disaster recovery plan, although such plan must comply with the requirements set forth in regulation 39.34 as well as any other applicable Commission regulations. The Commission expects all SIDCOs and Subpart C DCOs to fully comply with these, and all other applicable, regulations, and anticipates that a registered DCO would carefully weigh any costs associated with compliance with Subpart C prior to electing to become subject to Subpart C. Second, the proposed amendment to allow the Commission, upon request, to grant newly designated SIDCOs and Subpart C DCOs up to one year to comply with the provisions of regulation 39.34 was intended to provide flexibility to address the time practically required to obtain the necessary physical and technological resources, and to organize human resources, as appropriate to implement a two-hour RTO. As such, the Commission has decided to finalize regulation 39.34 as proposed.

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

The Commission proposed regulation 39.35 in order to add requirements pursuant to DCO Core Principle G, to address certain potential gaps between Commission regulations and Principles 4 and 7.<sup>186</sup> Regulation 39.16 currently requires a DCO to adopt procedures permitting it to take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a default on the obligations of a clearing member to the

<sup>186</sup> DCO Core Principle G requires a DCO to have rules and procedures "designed to allow for the efficient, fair, and safe management of events during which [clearing] members or participants—(I) become insolvent; or (II) otherwise default on the obligations of the members or participants to the [DCO]." Each DCO "is required to (I) clearly state the default procedures on the [DCO]; (II) make publicly available the default rules of the [DCO]; and (III) ensure that the [DCO] may take timely action—(aa) to contain losses and liquidity pressures; and (bb) to continue meeting each obligation of the DCO." See *supra* Section I.D. and 78 FR 50263.

DCO.<sup>187</sup> Under proposed regulation 39.35, SIDCOs and Subpart C DCOs would be required to adopt additional procedures to address certain issues arising from extraordinary stress events, including the default of one or more clearing members. Specifically, consistent with Principle 4 of the PFMI, proposed paragraph (a) would require a SIDCO or Subpart C DCO to adopt rules and procedures addressing the following:

1. How the SIDCO or Subpart C DCO would allocate losses exceeding the financial resources available to the SIDCO or Subpart C DCO;

2. How the SIDCO or Subpart C DCO would arrange for the repayment of any funds the SIDCO or Subpart C DCO may borrow; and

3. How the SIDCO or Subpart C DCO would replenish any financial resources it may employ during such a stress event, so that the SIDCO or Subpart C DCO would be able to continue to operate in a safe and sound manner.

Consistent with Principle 7 of the PFMI, proposed paragraph (b) would require a SIDCO or Subpart C DCO to establish rules and procedures enabling it to promptly meet all of its settlement obligations, on a same day and, where appropriate, on an intraday and multiday basis, in the context of the occurrence of either or both of the following scenarios: (i) Following an individual or combined default involving one or more clearing members' obligations to the SIDCO or Subpart C DCO or (ii) if there is an unforeseen liquidity shortfall exceeding the financial resources of the SIDCO or Subpart C DCO. Such rules and procedures should be established *ex ante* and may provide for the means of: increasing available assets (*e.g.* by using assessments) and/or reducing the size of liabilities (*e.g.* by engaging in variation margin haircuts or tear-ups); as well as obtaining liquidity from participants (*e.g.* through rules-based repurchase arrangements); employing a sequenced application of such tools; and replenishing any credit and liquidity resources that may be employed during a stress event.

The Commission requested comment on all aspects of these proposals. MGEX requested additional time to comply with regulation 39.35, along the lines of proposed regulation 39.34(d), which permits a SIDCO or Subpart C to request that the Commission grant the SIDCO or Subpart C DCO additional time of up to one year to comply with regulation 39.34. MGEX commented that it would be very difficult, if not impossible, to

perform the analyses required to satisfy regulation 39.35 by December 31, 2013. The Commission agrees and has decided to permit a SIDCO or Subpart C DCO to request up to a one year extension to comply with regulation 39.35.<sup>188</sup>

The Commission notes that regulation 39.35 was designed to protect SIDCOs, Subpart C DCOs, their clearing members, customers of clearing members, and the financial system more broadly by requiring SIDCOs and Subpart C DCOs to have plans and procedures to address credit losses and liquidity shortfalls beyond their prefunded resources, thus promoting their ability to promptly fulfill their obligations and continue to perform their critical functions. As proposed, regulation 39.35 addresses significant consequences that could result from a clearing member's default. Specifically, a DCO might not have sufficient financial resources following a clearing member's default either to cover the default or to fulfill its settlement obligations. Similarly, a DCO may be unable to fulfill its settlement obligations due to a liquidity shortfall exceeding its financial resources. In order to avoid the negative effect on its clearing members, their customers, and on the financial system more broadly of a DCO's failure promptly to meet its settlement obligations, it would be prudent for a DCO to have a recovery plan that addresses these scenarios and, given their importance to the U.S. financial system, it is critical for SIDCOs to have such plans. In addition, because this plan would be specified in the DCO's rules and/or procedures, it would be disclosed to clearing members, their customers, and the broader public. Such transparency would likely help clearing members, their customers, and other market participants properly allocate capital and other resources as well as facilitate the development of their own recovery plans.

For the reasons set forth above and in the Proposal, the Commission has decided to finalize regulation 39.35 substantively as proposed but will permit a SIDCO or Subpart C DCO to request that the Commission grant up to a one year extension to comply with regulation 39.35 and regulation 39.39, as discussed below.<sup>189</sup>

<sup>188</sup> The Commission has delegated authority to approve such requests. See Section II.O. (discussion of regulation 140.94) *infra*.

<sup>189</sup> See new paragraph (f) of regulation 39.39 and Section II.K., *infra* (discussing regulation 39.39).

#### H. Regulation 39.36 (Risk management for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

As proposed, regulation 39.36 would establish additional risk management requirements for SIDCOs and Subpart C DCOs. Current regulation 39.13 establishes the risk management requirements that a DCO must meet in order to comply with Core Principle D<sup>190</sup> including, among other things, specific criteria for stress tests that a DCO must conduct.<sup>191</sup>

The Commission proposed regulation 39.36 in order to address certain gaps between Commission regulations and Principles 4, 6, 7, and 9.<sup>192</sup> In particular, proposed regulation 39.36 would require a SIDCO or Subpart C DCO to enhance its stress testing procedures in ways that will make it more likely that the SIDCO or Subpart C DCO will be able to understand the risks posed by its members, so that it can ensure that the relationship between its resources and obligations enables it to meet its obligations promptly.

The Commission requested comment on all aspects of proposed regulation 39.36.

MGEX, the European Commission, and Chris Barnard commented on proposed regulation 39.36(a) (stress tests of financial resources). MGEX stated that the regulation should permit a SIDCO or Subpart C DCO to have the flexibility to use stress test parameters that can be justified by relevant data and to select relevant time periods to review when conducting stress tests.<sup>193</sup> DCOs do have such flexibility, so long as the

<sup>190</sup> See 78 FR 50262–50263. DCO Core Principle D requires each DCO to possess the ability to manage the risks associated with discharging the responsibilities of the DCO through the use of appropriate tools and procedures. It further requires each DCO to measure its exposure to loss from the default of each clearing member not less than once during each business day and to monitor each such exposure periodically during the business day. Core Principle D also requires each DCO to limit its exposure to potential losses from defaults by clearing members, through margin requirements and other risk control mechanisms, to reduce the risk that its operations would not be disrupted and that non-defaulting clearing members would not be exposed to losses that non-defaulting clearing members cannot anticipate or control. Finally, Core Principle D requires that the margin that the DCO requires from each clearing member be sufficient to cover potential exposures in normal market conditions, and that each model and parameter used in setting such margin requirements be risk-based and reviewed on a regular basis.

<sup>191</sup> See *supra* Section I.D. Moreover, such stress tests should enable the SIDCO or Subpart C DCO to address procyclicality initial margin requirements and collateral haircuts, consistent with Principle 6, K.C. 3 and Principle 5, K.C. 3.

<sup>192</sup> See discussion of Principles 4 and 6 *supra* Section I.E.1.

<sup>193</sup> MGEX at 8.

<sup>187</sup> 17 CFR 39.16(c).

meet the performance standards set forth in the regulation.

The European Commission stated that regulation 39.36 should be more detailed in order to set a meaningful benchmark for all SIDCOs and Subpart C DCOs.<sup>194</sup> For example, the European Commission suggests that SIDCOs and Subpart C DCOs should be required to conduct an assessment of the theoretical and empirical properties of the margin model and that such requirement, should prescribe minimum liquidation periods for each type of product.<sup>195</sup> The European Commission noted that explanatory note 3.6.7 to Principle 6 states that “close-out periods should be set on a product-specific basis” because less liquid products may require longer close-out periods.<sup>196</sup> The European Commission opined that there should be a minimum liquidation period of two-days for “listed derivatives” (*i.e.*, futures and options) rather than the one-day minimum prescribed in current regulation 39.13(g)(2)(ii)(A).<sup>197</sup> The European Commission also stated more generally that its rules and this Commission’s rules diverge in the area of initial margin requirements and that this divergence “is a source of competitive distortion between the E.U.- and U.S.-listed derivative markets as well as a threat to global financial stability.”<sup>198</sup> The European Commission also stressed that this Commission’s risk management rules should do more to “mitigate the procyclicality inherent to initial margin.”<sup>199</sup>

Regulation 39.13(g)(2) already sets out minimum liquidation times for swaps, futures, and swaps on agricultural commodities, energy commodities, and metals. In addition, pursuant to regulation 39.13(g)(2), a DCO is already required to use “[s]uch longer liquidation time as is appropriate based on the specific characteristics of a particular product or portfolio” and the Commission expressly reserved the right to establish, by order, shorter or longer liquidation times for particular products or portfolios. Moreover, under that regulation, all DCOs are obligated to consider the appropriateness of liquidation times in light of the specific characteristics of particular products or portfolios. Reg. 39.36(b)(2)(i) has been amended to clarify this point with respect to SIDCOs and Subpart C DCOs.

Chris Barnard suggested that DCOs should be required to stress test the liquidity of its financial resources in such a way that considers market stress, idiosyncratic stress, combinations thereof.<sup>200</sup> In addition, Chris Barnard stated that assets used to offset projected funding needs should be discounted to reflect their credit risk and market volatility.<sup>201</sup> In response, the Commission notes that regulation 39.36(a), as proposed, would require a SIDCO or Subpart C DCO to address these topics.

With regard to paragraph (c)(6) (reporting stress test results to the risk management committee or board of directors), MGEX suggested that this provision should be amended to permit the reporting of high-level summaries, redacted versions, or subsets of stress test results.<sup>202</sup> Otherwise, MGEX stated that this provision would create conflicts of interest because stress test results reveal confidential information about MGEX clearing members, and members of the MGEX risk management committee or board of directors may also be MGEX clearing members.<sup>203</sup> The Commission expects that stress-tests will be reported to the board of directors at a summary level. In complying with new paragraph (c)(6), a DCO should structure its reporting and governance arrangements in such a way that balances effective governance and risk management with confidentiality considerations.

With respect to proposed regulation 39.36(e) (annual validation of financial and liquidity risk management models), Chris Barnard commented that persons responsible for the development, implementation, or operation of the systems and models being tested not carry out the annual validation.<sup>204</sup> The Commission agrees that would be a prudent aspect of an appropriately designed validation process.

The Commission has decided to finalize regulation 39.36 as amended with the clarification discussed above for the reasons discussed above and in the Proposal.

*I. Regulation 39.37 (Additional disclosure for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)*

The Commission proposed regulation 39.37 to set forth additional public disclosure requirements for SIDCOs and

Subpart C DCOs.<sup>205</sup> These requirements were intended to address differences between current requirements and PFMI Principles 14 and 23. In particular, proposed regulation 39.37 was designed to enable members of SIDCOs and Subpart C DCOs, their customers, and the general public to understand the risk of exposures to such DCOs, and to promote their ability to evaluate the quality of such DCOs, thereby enhancing competition and market discipline.

Specifically, proposed regulation 39.37 would require SIDCOs and Subpart C DCOs to disclose certain information to the public and to the Commission. First, consistent with Principle 23, a SIDCO or Subpart C DCO would be required to disclose its responses to the CPSS-IOSCO Disclosure Framework.<sup>206</sup> Further, to ensure the continued accuracy and usefulness of a SIDCO or Subpart C DCO’s responses, a SIDCO or Subpart C DCO would be required to review and update them (a) at least every two years and (b) following material changes to the SIDCO’s or Subpart C DCO’s system or its environment.<sup>207</sup> A material change to the SIDCO’s or Subpart C DCO’s system or environment is a change that would significantly change the accuracy and usefulness of the SIDCO’s or Subpart C DCO’s existing responses. Under proposed regulation 39.37(c), a SIDCO or Subpart C DCO would also be required to disclose, publicly and to the Commission, relevant basic data on transaction volume and values. This requirement is intended to be consistent with the Quantitative Information Disclosure that CPSS-IOSCO are in the process of developing.<sup>208</sup>

Also under proposed regulation 39.37, a SIDCO or Subpart C DCO would be required, consistent with Principle 14, to publish its rules, policies, and procedures describing whether customer funds are protected on an individual or omnibus basis and whether customer funds are subject to any legal or operational constraints that may impair the ability of the SIDCO or Subpart C DCO to segregate or port the

<sup>205</sup> Public disclosure requirements for all registered DCOs are set forth in Regulation 39.21, which implements DCO Core Principle L (Public Information), and requires DCOs to provide to market participants sufficient information to enable them to identify and evaluate accurately the risks and costs associated with using the services of the DCO.

<sup>206</sup> See also section II.C.2, *supra*.

<sup>207</sup> Available at: <http://www.bis.org/publ/cpss106.pdf>.

<sup>208</sup> See *supra* section II.C.2. for a discussion of the Quantitative Information Disclosure (referencing section 2.5 of the CPSS-IOSCO Disclosure Framework).

<sup>194</sup> European Commission at 3.

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

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

<sup>197</sup> European Commission at 3–4.

<sup>198</sup> European Commission at 4.

<sup>199</sup> *Id.*

<sup>200</sup> Chris Barnard at 2.

<sup>201</sup> *Id.*

<sup>202</sup> MGEX at 8.

<sup>203</sup> *Id.*

<sup>204</sup> Chris Barnard at 2.

positions and related collateral of a clearing member's customers.

The Commission requested comment on all aspects of these proposals. MGEX commented that it is premature for regulation 39.37(c) to require a SIDCO or Subpart C DCO to complete the CPSS-IOSCO Quantitative Disclosure Document because that document has not yet been made available for public comment.<sup>209</sup> It is for this reason that MGEX also stated that it cannot comment on the potential costs of complying with regulation 39.37(c).<sup>210</sup> The Commission notes that regulation 39.37(c) requires the disclosure of relevant basic data on transaction volume and values, which requirement is consistent with key consideration 5 in Principle 23. Further, given the Commission's goal of establishing regulations that are consistent with the PFMI's,<sup>211</sup> to the extent that final international standards are established for the disclosure of relevant basic data on transaction volume and values, SIDCOs and Subpart C DCOs should look to such standards in complying with the requirements set forth in regulation 39.37(c). Further, the Commission notes that on October 15, 2013, CPSS-IOSCO published a consultative document on public quantitative disclosure standards for central counterparties.<sup>212</sup> Moreover, CPSS-IOSCO states that these quantitative disclosures, together with the PFMI Disclosure framework also published by CPSS-IOSCO, would form the minimum disclosures expected of CCPs under Principle 23, Key Consideration 5, of the Principles.<sup>213</sup> Thus, if and when such public quantitative disclosure standards are finalized, the Commission would expect SIDCOs and Subpart C DCOs to look to such standards in complying with the requirements set forth in regulation 39.37(c). Moreover, the Commission notes that MGEX is not obligated to comply with regulation 39.37(c) unless and until MGEX elects to become subject to Subpart C. As discussed above, a DCO that is not a SIDCO may submit a Subpart C Election Form any time on or after the effective date of these final rules and may, should it so choose, delay such submission until such time as the public quantitative

disclosure standards for central counterparties are finalized.

The new additional disclosures will help regulators and market participants assess SIDCOs and Subpart C DCOs, particularly with respect to a SIDCO's or Subpart C DCO's compliance with the PFMI's. Because of a SIDCO's importance to the U.S. financial markets, such public assessment should help provide confidence to market participants, which could prove to be a stabilizing force in times of severe market stress. For the reasons set forth herein, and in the Proposal, the Commission has decided to adopt regulation 39.37 as proposed.

*J. Regulation 39.38 (Efficiency for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)*

Consistent with Principle 21, the Commission proposed regulation 39.38 in order to require a SIDCO or Subpart C DCO efficiently and effectively to design its clearing and settlement arrangements, operating structure and procedures, product scope, and use of technology. Further, under proposed regulation 39.38, a SIDCO or Subpart C DCO would be required to establish clearly defined goals and objectives that are measurable and achievable, including goals with regards to minimum service levels, risk management expectations, and business priorities. Moreover, a SIDCO or Subpart C DCO would be required to facilitate efficient payment, clearing, and settlement by accommodating internationally accepted communication procedures and standards. The explanatory notes to Principle 21 observe that an efficient CCP has the required resources to perform its functions<sup>214</sup> and the efficiency of the CCP depends on the choice of clearing and settlement arrangement, operating structure, scope of products cleared or settled, and integration of technology and procedures.<sup>215</sup> In addition, the explanatory notes state that an effective CCP reliably meets its obligations in a timely manner and achieves the public policy goals of safety and efficiency for participants and the markets it serves.<sup>216</sup> Finally, consistent with Principle 22, proposed regulation 39.38(d) would require each SIDCO and Subpart C DCO to facilitate efficient payment, clearing, and settlement by accommodating internationally

accepted communication procedures and standards.

The Commission requested comment on all aspects of these proposals. MGEX commented that regulation 39.38(d) should permit a SIDCO or Subpart C DCO to make independent business decisions for establishing communication methods that best serve its clearing members and market participants.<sup>217</sup> MGEX stated it is unclear as to whom or what organization is responsible for establishing international communication standards and would expect that there may be multiple acceptable communication methods.<sup>218</sup> MGEX suggested that the Commission take a flexible approach in reviewing the efficiency of a DCO's methods of communication.<sup>219</sup> The Commission notes that regulation 39.38(d) refers broadly to "internationally accepted communication procedures and standards." Therefore, the Commission believes that there may be more than one way for a SIDCO or Subpart C DCO to comply with regulation 39.38(d). The Commission appreciates MGEX suggestion regarding flexibility, but as examinations are fact specific, the Commission declines to discuss what approach it would or would not take in a particular review in the abstract.

It would appear to be prudent for SIDCOs and Subpart C DCOs to comply with such international standards of efficiency and effectiveness. A SIDCO or Subpart C DCO that is inefficient or ineffective could distort financial activity and market structure, increasing financial and other risks to the SIDCO's or Subpart C DCO's participants.<sup>220</sup> For the reasons set forth in the foregoing discussion, and in the Proposal, the Commission has decided to finalize regulation 39.38 as proposed.

*K. Regulation 39.39 (Recovery and wind-down for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)*

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

<sup>217</sup> MGEX at 9.

<sup>218</sup> *Id.*

<sup>219</sup> *Id.*

<sup>220</sup> PFMI's at E.N. 3.21.1.

<sup>209</sup> MGEX at 8–9.

<sup>210</sup> *Id.*

<sup>211</sup> See Section II.L. discussing Regulation 39.40 (Consistency with the Principles for Financial Market Infrastructures).

<sup>212</sup> CPSS-IOSCO, Consultative Report, Public Quantitative Disclosure Standards for Central Counterparties, October 15, 2013, available at <http://www.bis.org/publ/cpss114.pdf>.

<sup>213</sup> *Id.* at 1.

<sup>214</sup> See PFMI's at E.N. 3.21.1.

<sup>215</sup> PFMI's at E.N. 3.21.2.

<sup>216</sup> PFMI's at E.N. 3.21.5.

As noted above, Principle 3 requires a CCP to have a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, and other risks.<sup>221</sup> Under Principle 3, such a framework would include identifying scenarios that may prevent the CCP from providing critical operations and services as a going concern and would assess the effectiveness of a full range of options for recovery or orderly wind-down. Similarly, Principle 15 requires a CCP to identify, monitor, and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that the CCP can continue operations and services as a going concern if those losses materialize.<sup>222</sup> Further, these liquid net assets should, at all times, be sufficient to allow for recovery or orderly wind-down of critical operations and services.<sup>223</sup> Although there is no Core Principle that pertains directly to the establishment of a recovery and wind-down plan, proposed regulation 39.37 promotes concepts set forth in Core Principles B (Financial Resources), D (Risk Management), G (Default Rules and Procedures), and I (System Safeguards).<sup>224</sup>

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

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

The Commission proposed requiring each SIDCO and Subpart C DCO to maintain viable plans for: (i) Recovery or orderly wind-down, necessitated by credit losses or liquidity shortfalls; and (ii) recovery or orderly wind-down, necessitated by general business risk, operational risk, or any other risk that threatens the SIDCO’s or Subpart C DCO’s viability as a going concern. The Commission also proposed requiring that the recovery and wind-down plans of SIDCOs and Subpart C DCOs meet certain standards, set forth in proposed subsection (c).<sup>225</sup> Under proposed regulation 39.39(d), a SIDCO or Subpart C DCO would be required to establish recovery and wind-down plans that are supported by certain resources.

The Commission requested comment on all aspects of these proposals. In their comment letters, LCH, MGEX, and NYPC suggested that the Commission provide additional time to a SIDCO or Subpart C DCO for developing recovery and wind-down plans in accordance with regulation 39.39.<sup>226</sup> Further, NYPC suggested that a SIDCO or Subpart C not be required to comply with regulation 39.39 until (1) CPSS-IOSCO and the Financial Stability Board finalize their reports on CCP recovery and resolution and (2) CCPs have been allowed a reasonable amount of time to implement the guidance included in such

reports.<sup>227</sup> Because reports on CCP recovery and resolution are still under consideration by the relevant international bodies, and further work in these areas may inform the Commission’s views on a SIDCO’s or Subpart C DCO’s recovery or wind-down plans, the Commission has decided to permit a SIDCO or Subpart C DCO to request that the Commission grant the SIDCO or Subpart C DCO up to one year to comply with regulation 39.39 and 39.35 (Default rules and procedures), in a similar manner to the process by which a SIDCO or Subpart C DCO may request that the Commission grant the SIDCO or Subpart C additional time for complying with regulations 39.34 (System safeguards).<sup>228</sup>

ISDA suggested that regulation 39.39 include more details about the required recovery and wind-down plans, such as the details provided in CPSS-IOSCO’s Consultative Report, “Recovery of Financial Market Infrastructures.”<sup>229</sup> The Commission notes that the Consultative Report lists suggested tools, not mandatory standards.<sup>230</sup> This rulemaking, by contrast, is intended to address what the PFMI require. Therefore, it would be inappropriate for Subpart C to reflect the Consultative Report.

With respect to proposed regulation 39.39(b)(2), MGEX commented that the Commission should delete the phrase “or any other risk that threatens the DCO’s viability as a going concern.”<sup>231</sup> MGEX stated that Principle 15 requires a DCO to establish recovery and orderly wind-down plans necessitated only by general business risk or operational risk.<sup>232</sup> MGEX commented further that this phrase is ambiguous.<sup>233</sup> Although the phrase does not appear in Principle 15, the Commission notes that key consideration 3 of Principle 3 specifically requires an FMI to “identify scenarios that may potentially prevent it from being able to provide its critical operations and services as a going concern and assess the effectiveness of a full range of options for recovery or orderly wind-down.” Thus, the inclusion of the phrase “or any other risk that threatens the DCO’s viability as

<sup>227</sup> NYPC at 1–2.

<sup>228</sup> See new paragraph (f) of regulation 39.39, new paragraph (d) of regulation 39.34, footnote 108 *supra*, and Section II.G. *supra* (discussing regulation 39.35).

<sup>229</sup> ISDA at 1–2.

<sup>230</sup> The Consultative Report notes that it “is not intended to create additional standards for FMIs, or authorities, beyond those set out in the CPSS-IOSCO ‘Principles for financial market infrastructures’.” *Id.* at 1.

<sup>231</sup> MGEX at 10.

<sup>232</sup> MGEX at 9–10.

<sup>233</sup> *Id.*

<sup>221</sup> See *supra* Section I.E.1.

<sup>222</sup> See *supra id.*

<sup>223</sup> See *id.*

<sup>224</sup> See *supra* Section I.D.

<sup>225</sup> 78 FR 50282.

<sup>226</sup> LCH at 2–4, MGEX at 9, and NYPC at 2.

a going concern” is consistent with the PFMI. Moreover, a SIDCO or Subpart C DCO should be aware of, and have plans to address, the risks that threaten their viability without being limited in their analysis to pre-defined risks.

With respect to proposed regulation 39.39(d)(2), MGEX commented that a SIDCO or Subpart C DCO that demonstrates adequate liquidity capabilities should be permitted to use an established line of credit for meeting potential business losses, particularly if the line of credit is offered on the basis that the DCO meet “certain equity covenants.”<sup>234</sup> The Commission notes that, so long as the DCO has sufficient assets funded by the equity of its owners, arrangements such as this one may be effective in providing a DCO with a tool that would be adequate for providing the related liquidity necessary to comply with regulation 39.39(d)(2). A DCO would need to demonstrate that such an arrangement would: (i) enable the DCO to have sufficient unencumbered liquid financial assets to fund its recovery and wind-down plans and (ii) make that liquidity available to the DCO even in a scenario in which the DCO is facing recovery or wind-down. The Commission notes that regulation 39.39(d)(2) uses the phrase “funded by equity . . .” to connote financial resources that are part of the SIDCO’s or Subpart C DCO’s owners’ equity/ shareholder capital.<sup>235</sup>

For the reasons set forth above and in the Proposal, the Commission has decided to finalize regulation 39.39 substantively as proposed but, as discussed above, will permit a SIDCO or Subpart C DCO to request that the Commission grant the SIDCO or Subpart C DCO up to one year to comply with regulation 39.39.<sup>236</sup> This new regulation is intended to address certain differences between existing Commission regulations and the standards set forth in the PFMI. In addition, it would appear to be necessary for a SIDCO to maintain and (as part of such maintenance, regularly update) a recovery and wind-down plan so as to reduce, or attempt to control, the potential impact a failure or disruption of the SIDCO’s operations would have on the stability of the U.S. financial markets.

<sup>234</sup> *Id.*

<sup>235</sup> As mentioned earlier in this section, the phrase “funded by equity” comes from Principle 15. See also *supra* Section I.E.1.

<sup>236</sup> See new paragraph (d) of regulation 39.39 and Section II.G. *supra* (discussing regulation 39.35).

*L. Regulation 39.40 (Consistency with the Principles for Financial Market Infrastructures)*

Proposed regulation 39.40 was intended to make clear that Subpart C is intended to establish regulations that, together with Subpart A and Subpart B, are consistent with the DCO Core Principles set forth in Section 5b(c)(2) of the CEA and the PFMI. Specifically, to the extent of any ambiguity, the Commission intends to interpret the regulations set forth in part 39 in a manner that is consistent with the standards set forth in the PFMI.

The Commission requested comment on all aspects of this proposal. ISDA commented that regulation 39.40 should state that subpart C is intended to be consistent with the PFMI “except to the extent inconsistent with other regulations of the Commission.” According to ISDA, this would make clear that part 22, which pertains to the protection of Cleared Swaps Customer Collateral by DCOs and FCMs, would not be trumped by any future international standards, such as the CPSS-IOSCO Consultative Report, “Recovery of Financial Market Infrastructures.” The Commission notes that regulation 39.40 requires consistency with both the CEA and with the PFMI. Thus, ISDA’s suggested language is not necessary because an international standard that is not consistent with the CEA would not trump a Commission regulation that implements or derives from the CEA.

Consistency between part 39 and the PFMI would appear to promote international harmonization and is intended to allow the bank clearing members and bank customers of SIDCOs and Subpart C DCOs to receive the more favorable capital treatment under the Basel CCP Capital Requirements. For the reasons set forth above and in the Proposal, the Commission has decided to finalize regulation 39.40 as proposed.

*M. Regulation 39.41 (Special enforcement authority for systemically important derivatives clearing organizations)*

In August of 2013, the Commission adopted regulation 39.31, which implemented special enforcement authority over SIDCOs granted to the Commission under section 807(c) of the Dodd-Frank Act.<sup>237</sup> In the Proposal, the Commission renumbered regulation 39.31 as regulation 39.41 and did not propose any other changes. The Commission did not receive any comments on regulation 39.41 and thus,

<sup>237</sup> See SIDCO Final Rule.

as part of this final rulemaking, the Commission is adopting regulation 39.41 as proposed.

*N. Regulation 39.42 (Advance notice of material risk-related rule changes by systemically important derivatives clearing organizations)*

The Commission proposed moving existing paragraph (c) of regulation 39.30 (Scope) to proposed regulation 39.42.<sup>238</sup> This paragraph instructs a SIDCO to provide advance notice to the Commission of any proposed change to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the SIDCO, in accordance with regulation 40.10.<sup>239</sup> Because the other provisions of proposed revised regulation 39.28 (renumbered as regulation 39.30) pertain to the scope of Subpart C,<sup>240</sup> it would be appropriate for paragraph (d) to be codified in a separate regulation. The Proposal did not suggest any substantive amendments to this provision. The Commission did not receive any comments on regulation 39.41 and thus, as part of this final rulemaking, the Commission is moving the provision to regulation 39.42 as proposed.

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

The Commission proposed amending regulation 140.94 so that certain Commission functions contained in these proposed regulations would be delegated to the Director of the Division of Clearing and Risk and to such staff members as the Director may designate. Specifically, the Commission proposed to delegate all functions reserved to the Commission in proposed regulation 39.31 including, for example, the authority to request that a DCO provide information supplementing a Subpart C Election Form that it has filed with the Commission; to determine whether an election to be subject to Subpart C should be permitted to become effective, stayed or denied; and to provide any notices regarding the foregoing. The Commission also proposed to delegate to the Director of the Division of Clearing and Risk and to his or her designees the decision described in regulation 39.34(d) (whether to grant a SIDCO or a Subpart C DCO up to one year to comply with any provision of regulation 39.34).

<sup>238</sup> See *supra* Section II.B. and note 111.

<sup>239</sup> The Commission promulgated this provision as part of the SIDCO Final Rule.

<sup>240</sup> See *supra* Section II.B. (discussing proposed revised regulation 39.28, renumbered as regulation 39.30).

As discussed above, in response to comments from LCH, MGEX, and NYPC, the Commission has decided to permit a SIDCO or Subpart C DCO to request that the Commission grant the SIDCO or Subpart C DCO additional time of up to one year to comply with the requirements to establish default rules and procedures for uncovered losses or shortfalls pursuant to new regulation 39.35 and to establish recovery and wind-down plans pursuant to new regulation 39.39.<sup>241</sup> In this connection, just as proposed amended regulation 140.94 would delegate the disposition of such a request concerning compliance with regulation 39.34 to the Director of the Division of Clearing and Risk, the Commission has decided to delegate the disposition of a request for delayed compliance with regulation 39.39 to the Director of the Division of Clearing and Risk.<sup>242</sup> Otherwise, the Commission believes that the proposed amendments to regulation 140.94 provide appropriate delegations to the Director of the Division of Clearing and Risk. Therefore, the Commission has decided to finalize the other amendments as proposed.

#### *P. Regulation 190.09 (Member property)*

Certain of the proposed requirements for SIDCOs and Subpart C DCOs necessitated certain clarifications to part 190 of the Commission's regulations. Specifically, new regulation 39.35(a) requires a SIDCO or Subpart C DCO to "adopt explicit rules and procedures that address fully any loss arising from any individual or combined default relating to any clearing members' obligations to the SIDCO or Subpart C DCO." New regulation 39.39(b) requires a SIDCO or Subpart C DCO to maintain viable plans for recovery and orderly wind-down. In addition, SIDCOs and Subpart C DCOs must comply with Core Principle R, which require all registered DCOs to "have a well-founded, transparent, and enforceable legal framework for each aspect of the activities of the DCO." Recognizing the diversity of financial safeguard arrangements among DCOs, the Commission noted in the Proposal that it would appear to be prudent to clarify certain language in part 190 to materially aid compliance with Core Principle R and the proposed regulations specified above.

The Commission proposed amending paragraph (b) of regulation 190.09 to clarify that the scope of member

property will be determined based on the by-laws and rules of the relevant DCO.

The Commission requested comment on all aspects of this proposal. The Commission did not receive any comments on the proposed amendments to regulation 190.09. The Commission believes that the proposed amendments to regulation 190.09(b) make appropriate clarifications, as described above. For the reasons set forth herein and in the Proposal, the Commission has decided to finalize the amendments to regulation 190.09(b) as proposed.

### **III. Effective Date**

#### *A. Congressional Review Act*

This final rulemaking is a major rule for purposes of the Congressional Review Act ("CRA").<sup>243</sup> Generally, under the CRA, a major rule takes effect 60 days after the date on which the rule is published in the **Federal Register**.<sup>244</sup> However, Section 808(2) of the CRA provides that any rule which an agency for good cause finds that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest (and incorporates the finding and a brief statement of reasons therefore in the rule issued), shall take effect at such time as the federal agency promulgating the rule determines.<sup>245</sup> For the regulations in this final rule, the Commission has determined that good cause exists to waive the CRA effective date requirement and make the regulations effective in less than 60 days.

For revised regulation 190.09, the Commission is making the regulation effective upon publication. In accordance with section 808(2), the Commission finds good cause to make this provision effective upon publication because the regulation does not impose any new, substantive obligations on regulated entities and only serves to clarify an existing regulation in order to aid DCOs in their compliance with Commission regulations, including the final rules adopted herein. Moreover, the final regulation is being adopted as proposed, including the effective date. Market participants are thus familiar with the clarification and the timing of its implementation. Furthermore, the Commission received no comments on any aspect of revised regulation 190.09. Therefore, the Commission has determined that good cause exists to

make revised regulation 190.09 effective upon publication.

Regarding regulation 39.31, the Commission is making this regulation effective as of December 13, 2013. In accordance with section 808(2), the Commission finds that a 60 day effective date for this regulation is contrary to the public interest because such delay will cause public harm by significantly increasing (for the reasons discussed below) the costs for market participants to clear OTC and exchange-traded derivatives with DCOs. More broadly, the increase in costs will have an adverse effect on competition and may lead to a disruption in the financial markets. Regulation 39.31 does not impose any requirements on regulated entities; rather it is a permissive provision that gives DCOs that have not been designated as systemically important by the Council the opportunity to opt-into and become subject to the provisions of an enhanced regulatory scheme that is otherwise only applicable to SIDCOs.<sup>246</sup> Compliance with this enhanced regulatory scheme as well as existing Commission regulations is necessary for such DCOs to be subject to standards that are consistent with the PFMI, and thus enable them to gain QCCP status.<sup>247</sup> Attaining QCCP status will increase a DCO's ability to compete in the global financial markets by allowing such DCO to offer lower capital charges to banks (including their subsidiaries and affiliates) that clear derivative transactions with the DCO.<sup>248</sup> Banks that transact with U.S. DCOs that do not have QCCP status will be charged substantially higher capital charges which they may pass along to their bank customers.<sup>249</sup> In order to benefit from QCCP status by December 31, 2013,<sup>250</sup>

<sup>246</sup> See *supra* Sections I.B. and I.C.

<sup>247</sup> See *supra* Section I.F.

<sup>248</sup> *Id.*

<sup>249</sup> *Id.* See also CME at 5, n. 18 (stating that the "ramifications for failure to achieve QCCP status are onerous for banks' CCP exposures and can result in capital charges on trade exposures that are 10–20 times larger than capital charges for QCCP trade exposures.").

<sup>250</sup> See CME at 5, n. 18 (stating that "in order for banks to achieve preferential QCCP capital treatment for their exposures to given CCPs, the CCP's primary regulator, among other things, must have implemented the PFMI by January 1, 2014." See also "Basel III Counterparty Credit Risk and Exposures to Central Counterparties-Frequently Asked Questions" (December 2012) available at <http://www.bis.org/publ/bcbs237.pdf> (stating that during 2013, if a CCP's primary regulator has publicly stated that it is working towards implementing regulations consistent with the PFMI, then such CCP may be treated as a QCCP until the December 31, 2013. After December 31, 2013, the CCP's primary regulator must have implemented regulations consistent with the PFMI).

<sup>241</sup> See Sections II.G. and II.K, *supra*.

<sup>242</sup> Regulation 140.94(c)(13), as finalized, replaces the term "applications" with "requests" to comport with the language used in final regulations 39.34 and 39.39.

<sup>243</sup> See 5 U.S.C. 804(2) (defining a "major rule" for purposes of the Congressional Review Act).

<sup>244</sup> *Id.* at 801(a)(3).

<sup>245</sup> *Id.* at 808(2).

the Commission must receive a DCO's election form, as set out in regulation 39.31, by December 13, 2013. This date is necessary to allow the Commission a review period to stay, deny or permit the election by December 31, 2013. For those DCOs that wish to gain QCCP status, an effective date beyond December 13, 2013, would delay the election process and cause financial harm by adversely impacting the ability of these DCOs to compete with CCPs that have attained QCCP status by the end of 2013. Therefore the Commission has determined that good cause exists to make regulation 39.31 effective as of December 13, 2013.

The Commission is also making regulation 140.94 effective as of December 13, 2013. In accordance with section 804(3), the Commission finds that this provision is not covered by the CRA as it concerns agency management and procedures.<sup>251</sup> Nevertheless, in accordance with section 808(2), the Commission finds that a 60 day effective date for this regulation is not necessary because regulation 140.94 imposes no requirements on DCOs. Rather it amends the current regulation 140.94 to allow certain functions set forth in regulation 39.31 to be delegated to Commission staff, for which there is no need to provide for a delayed effective date. Therefore the Commission has determined that good cause exists to make regulation 140.94 effective as of December 13, 2013.

The remaining regulations, adopted herein,<sup>252</sup> require SIDCOs to establish additional enhanced standards, which along with existing Commission regulations, will enable SIDCOs to be compliant with the PFMI and thus, be able to attain QCCP status and offer the lower capital charges to banks, their subsidiaries and/or affiliates. For these regulations, the Commission is making the effective date as of December 31, 2013. For SIDCOs, a delay in attaining QCCP status beyond that date could create significant business and operational losses which in turn, could

and these regulations must be applied to the CCP on an ongoing basis in order for such CCP to be eligible for QCCP status).

<sup>251</sup> See 5 U.S.C. 804(3) (defining the term "rule" for purposes of the CRA not to include any rule relating to agency management or personnel or any rule of agency organization, procedure, or practice).

<sup>252</sup> These regulations set forth enhanced regulatory standards relating to governance, financial resources, system safeguards, risk management, special default rules and procedures for uncovered losses or shortfalls, additional disclosure requirements, efficiency, and recovery and wind-down procedures. Pursuant to Title VIII of the Dodd-Frank Act, the Commission prescribed these regulations in consultation with the Council and the Board. See Section 805 of the Dodd-Frank Act.

constrain the availability of liquidity and credit, thereby destabilizing the US financial markets. In accordance with section 808(2), the Commission finds that a 60 day effective date for these regulations is contrary to the public interest because such delay in obtaining QCCP status will cause public harm by significantly increasing the costs for market participants to clear OTC and exchange-traded derivatives with SIDCOs and hindering the ability of SIDCOs to compete with internationally similarly situated CCPs, which would be contrary to public interest. Therefore the Commission has determined that good cause exists to make the remaining regulations effective as of December 31, 2013.

#### B. Administrative Procedure Act

The Administrative Procedure Act ("APA") generally requires that the rules promulgated by an agency not be made effective less than 30 days after publication in the **Federal Register**, except for, inter alia, interpretative rules and statements of policy and as otherwise provided by the agency for good cause found.<sup>253</sup> For the same reasons cited above, the Commission also finds that good cause exists under the APA to make revised regulation 190.09, regulation 39.31 and regulation 140.94 effective on the dates set forth by the Commission.

Specifically, the Commission concludes that good cause exists to waive the 30 day effective date for revised regulation 190.09 because the regulation does not impose any new, substantive obligations on regulated entities and only clarifies the scope of an existing regulation. Thus, the Commission is of the view that this provision is not subject to the 30-day effective date requirement. Furthermore, because market participants are familiar with the regulation and no comments were received on the proposed change to the regulation, the Commission believes that a 30 day effective date is unnecessary and that good cause exists to make regulation 190.09 effective upon publication.

The Commission also concludes that good cause exists to waive the 30 day effective date for regulation 39.31 because a 30 day effective date would cause public financial harm by constraining the ability of certain DCOs to compete with other CCPs, particularly in global markets, which in turn, may substantially increase costs for market participants that transact in OTC and exchange traded derivatives. Moreover, as discussed above,

regulation 39.31 does not impose any requirements on regulated entities or alter the status quo in any way; rather it is a permissive provision that gives DCOs that have not been designated as systemically important by the Council the opportunity to opt-into and become subject to the provisions of an enhanced regulatory scheme that is otherwise only applicable to SIDCOs. Compliance with this enhanced regulatory scheme as well as existing Commission regulations is necessary for such DCOs to be subject to standards that are consistent with the PFMI, and thus enable them to gain QCCP status. Attaining QCCP status will increase a DCO's ability to compete in the global financial markets by allowing such DCO to offer lower capital charges to banks (including their subsidiaries and affiliates) that clear derivative transactions with the DCO. Banks that transact with U.S. DCOs that do not have QCCP status will be charged substantially higher capital charges which they may pass along to their bank customers. In order to benefit from QCCP status by December 31, 2013, the Commission must receive a DCO's election form, as set out in regulation 39.31, by December 13, 2013. This date is necessary to allow the Commission a review period to stay, deny or permit the election by December 31, 2013. For those DCOs that wish to gain QCCP status by December 31, 2013, an effective date beyond December 13, 2013, would delay the election process and cause financial harm by adversely impacting the ability of these DCOs to compete with CCPs that have attained QCCP status by the end of 2013. Therefore, the Commission has determined that good cause exists to make regulation 39.31 effective as of December 13, 2013.

Lastly, the Commission concludes that good cause exists to waive the 30 day effective date requirement for regulation 140.94 because the regulation pertains to agency management and procedures and imposes no duty on the Commission's regulated entities. Rather it amends the current regulation 140.94 to allow certain functions set forth in regulation 39.31 to be delegated to Commission staff, for which there is no need to provide for a delayed effective date. Therefore, the Commission has determined that good cause exists to make regulation 140.94 effective as of December 13, 2013. The effective date for the remaining regulations is December 31, 2013 in accordance with the APA.

<sup>253</sup> See generally 5 U.S.C. 553(d).



#### IV. Related Matters

##### A. Paperwork Reduction Act

The Paperwork Reduction Act (“PRA”), 44 U.S.C. 3501 et seq., provides that an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number from the Office of Management and Budget (“OMB”). This rulemaking contains recordkeeping and reporting requirements that are collections of information within the meaning of the PRA. Although the Commission does not anticipate that more than ten persons will respond initially to this collection of information, the term “ten or more persons,” which triggers PRA compliance, has been deemed to apply to “[a]ny recordkeeping, reporting, or disclosure requirement contained in a rule of general applicability.” 5 C.F.R. 1320.3(c)(4). This rule amends existing OMB control number 3038–0081, titled “General Regulations and Derivatives Clearing Organizations.” Therefore, the Commission has submitted this notice of final rulemaking along with supporting documentation for OMB’s review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11.

This rulemaking contains many provisions that would qualify as collections of information, for which the Commission has already sought and obtained a control number from OMB. The burden hours associated with those provisions are not replicated here because the Commission is obligated to account for PRA burden once, and the PRA encourages multiple applications of a single collection.<sup>254</sup> Accordingly, the burdens associated with the collections contained in this rulemaking, and the information collection request that has been submitted to OMB, have been estimated only to the extent that the rulemaking imposes collections of information that OMB has not yet reviewed and approved.

It should be noted that among the thirteen DCOs presently registered with the Commission, only two are SIDCOs. Moreover, not all remaining DCOs or all DCO Applicants are likely to elect to become Subpart C DCOs (for example, DCOs that are based outside of the U.S. may seek to obtain QCCP status through regulation by their home country regulator). Thus, the burden calculations herein are based on an estimate of how many DCOs are SIDCOs and how many DCOs and DCO Applicants are likely to elect to become

Subpart C DCOs. Additionally, many of the collections herein, in particular those related to electing Subpart C DCO status, are expected to be one-time events for a DCO. It is anticipated that three DCOs will elect to become subject to Subpart C in the year following the adoption of these final rules, with possibly one or two additional elections thereafter.

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

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

Regulations 39.31(b) and 39.31(c), as proposed and adopted, establish the process whereby DCO and DCO Applicants, respectively, may elect to become Subpart C DCOs subject to the provisions of Subpart C. The election involves filing the Subpart C Election Form that would be contained in appendix B to part 39 of the Commission’s regulations. The Subpart C Election Form involves completing the certifications therein, providing exhibits A through G, and drafting and publishing the DCO’s responses to the Disclosure Framework, and, when applicable, the DCO’s Quantitative Information Disclosure. Additionally, regulation 39.31(b)(2) and (c)(3), as proposed and adopted, provide for Commission requests for supplemental information from those requesting Subpart C DCO status; regulation 39.31(b)(3) and (c)(4), as proposed and adopted, require amendments to the Subpart C Election Form in the event that a DCO or DCO Applicant, respectively, discovers a material omission or error in, or if there is a material change in, the information provided in the Subpart C Election Form; regulation 39.31 (b)(7) and (c)(5), as proposed and adopted, permit a DCO or DCO Applicant, respectively, to submit a notice of withdrawal to the Commission in the event the DCO or DCO Applicant determines not to seek Subpart C DCO status prior to such status becoming effective; and

regulation 39.31(e), as proposed and adopted, establishes the procedures by which a Subpart C DCO may rescind its Subpart C DCO status after it has been permitted to take effect. Each of these requirements implies recordkeeping that would be produced by a DCO to the Commission on an occasional basis to demonstrate compliance with the rules. As noted above, the relevant final regulations were adopted as proposed and did not include any additional information collection requirements that would warrant a revision of the burden hour estimates.

The Proposal noted that, while it was likely that only three DCOs will elect to become Subpart C DCOs, it was conservatively estimated that, collectively, five DCOs or DCO Applicants may elect to become Subpart C DCOs. The Proposal also noted that, while it is unlikely that any DCO or DCO Applicant will withdraw its election to become subject to Subpart C prior to such election becoming effective, an estimate of compliance with the withdrawal procedures by one DCO was included in the burden hours for the information collection. Finally, the Proposal estimated that, while it is likely that none of the Subpart C DCOs will elect to rescind its election, the Commission conservatively estimated that one Subpart C DCO may rescind its election.

The Commission received one comment that referenced the estimated burden hours of the collection of information in this rulemaking. Specifically, MGEX referenced the “Commission’s estimate” of the “1,020 hours” that “would be required to complete the Subpart C Election Form” and the “1,125 hours estimated for responding to requests for supplemental information.”<sup>255</sup> MGEX did not, however, indicate that it disagreed with the burden hour assessments set forth in the Proposal. Accordingly, the Commission has not altered its calculations. The Commission did not receive any additional comments on its original hour burden estimates and believes that those estimates, as set forth below, remain appropriate for PRA purposes:

##### Reporting—Certifications—Subpart C Election Form

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

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

<sup>255</sup> MGEX at 2.

<sup>254</sup> See 35 U.S.C. 3501(2) and (3).

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

*Reporting—Preparing and Publishing Disclosure Framework Responses*  
 Estimated number of reporters: 5  
 Estimated number of reports per reporter: 1  
 Average number of hours per report: 200  
 Estimated gross annual reporting burden: 1,000

*Reporting—Preparing Quantitative Information Disclosures*  
 Estimated number of reporters: 5  
 Estimated number of reports per reporter: 1  
 Average number of hours per report: 80  
 Estimated gross annual reporting burden: 400

*Reporting—Requests for Supplemental Information*  
 Estimated number of reporters: 5  
 Estimated number of reports per reporter: 5  
 Average number of hours per report: 45  
 Estimated gross annual reporting burden: 1,125

*Reporting—Amendments to Subpart C Election Form*  
 Estimated number of reporters: 5  
 Estimated number of reports per reporter: 3  
 Average number of hours per report: 8  
 Estimated gross annual reporting burden: 120

*Reporting—Withdrawal Notices*  
 Estimated number of reporters: 1  
 Estimated number of reports per reporter: 1  
 Average number of hours per report: 2  
 Estimated gross annual reporting burden: 2

*Reporting—Rescission Notices*  
 Estimated number of reporters: 1  
 Estimated number of reports per reporter: 75  
 Average number of hours per report: 3  
 Estimated gross annual reporting burden: 225

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

## 2. Collections Applicable Both to SIDCOs and Subpart C DCOs

Regulations 39.32(a) and (b), as proposed and adopted, establish governance requirements applicable to each SIDCO and Subpart C DCO, including specific provisions requiring written and disclosed governance arrangements and the disclosure of certain decisions on particular, not regularly scheduled, occasions, to the Commission, the SIDCO or Subpart C DCO's clearing members, other relevant stakeholders and/or the public. Regulation 39.33(d), as proposed and adopted, requires a SIDCO or Subpart C

DCO to conduct due diligence on its liquidity providers and to conduct periodic testing with respect to its access to liquidity resources. Regulation 39.33(e), as proposed and adopted, establishes documentation requirements with respect to the supporting rationale for the financial and liquidity resources it maintains pursuant to regulations 39.33(a) and 39.33(c), respectively.

Regulation 39.36(c)(6), as proposed and adopted, requires each SIDCO and Subpart C DCO to report stress test results to its risk management committee or board of directors. Regulation 39.37(a), as proposed and adopted, requires each SIDCO and Subpart C DCO to complete and to publicly disclose its responses to the Disclosure Framework and, when applicable, to complete and disclose a Quantitative Information Disclosure. As described above and as accounted for in the previous portion of this PRA burden estimate, these tasks will be conducted by Subpart C DCOs as part of their election to become subject to Subpart C. SIDCOs and DCOs also are required to update their Disclosure Framework responses and Quantitative Information Disclosure every two years. Regulations 39.37(c) and (d), as proposed and adopted, require each SIDCO or Subpart C DCO to disclose, publicly and to the Commission, certain data on transaction volume and values and their rules, policies, and procedures related to the segregation and the portability of customers' positions and funds.

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

It is not possible to estimate with precision how many DCOs may, in the future, be determined to be SIDCOs and how many may elect to become Subpart C DCOs, but it was conservatively estimated in the Proposal that, collectively, a total of seven DCOs may be determined to be SIDCOs or may opt to become Subpart C DCOs. Presently, there are two SIDCOs and it has been

estimated that five DCOs will elect to become Subpart C DCOs.

The Commission did not receive any comments on the estimated costs or burden hours of this collection of information and the Commission believes that its original estimates, as set forth below and in the Proposal,<sup>256</sup> remain appropriate for PRA purposes:

*Reporting—Governance Requirements—Written Governance Arrangements*  
 Estimated number of reporters: 7  
 Estimated number of reports per recordkeeper: 1  
 Average number of hours per report: 200  
 Estimated gross annual reporting burden: 1,400

*Reporting—Governance Requirements—Required Disclosures*  
 Estimated number of reporters: 7  
 Estimated number of reports per recordkeeper: 6  
 Average number of hours per report: 3  
 Estimated gross annual reporting burden: 126

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

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

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

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

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

*Reporting—Updating and Republishing Quantitative Information Disclosures (SIDCOs and Subpart C DCOs)*  
 Estimated number of reporters: 7  
 Estimated number of reports per recordkeeper: 1

<sup>256</sup> 78 FR 50285–86.

Average number of hours per report: 35  
Estimated gross annual reporting burden: 245

*Reporting—Transaction, Segregation, Portability Disclosures*

Estimated number of reporters: 7  
Estimated number of reports per recordkeeper: 2  
Average number of hours per report: 35  
Estimated gross annual reporting burden: 490

*Reporting—Efficiency and Effectiveness Review*

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

*Reporting—Recovery and Wind-Down Plan*

Estimated number of reporters: 7  
Estimated number of reports per recordkeeper: 1  
Average number of hours per report: 480  
Estimated gross annual reporting burden: 3,360

*Recordkeeping—Liquidity Resource Due Diligence and Testing*

Estimated number of recordkeepers: 7  
Estimated number of records per recordkeeper: 4  
Average number of hours per record: 10  
Estimated gross annual recordkeeping burden: 280

*Recordkeeping—Financial and Liquidity Resources, Excluding Due Diligence and Testing*

Estimated number of recordkeepers: 7  
Estimated number of records per recordkeeper: 4  
Average number of hours per record: 10  
Estimated gross annual recordkeeping burden: 280

*Recordkeeping—Generally*

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

**B. Regulatory Flexibility Act**

The Regulatory Flexibility Act (“RFA”) requires that agencies consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact.<sup>257</sup> The rules adopted herein will only affect DCOs. The Commission has previously established certain definitions of “small entities” to be used by the Commission in evaluating the impact of its regulations on small entities in accordance with the RFA.<sup>258</sup> The Commission has previously determined that DCOs are not small

entities for the purpose of the RFA.<sup>259</sup> Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the rules adopted herein will not have a significant economic impact on a substantial number of small entities. The Chairman made the same certification in the proposed rulemaking, and the Commission did not receive any comments on the RFA.

**C. Consideration of Costs and Benefits**

**1. Introduction**

Section 15(a) requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.<sup>260</sup> Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission’s cost and benefit considerations in accordance with Section 15(a) are discussed below.

**2. Background**

In this final rulemaking, the Commission is adopting regulations to (1) address gaps between part 39 of the Commission’s regulations and the standards set forth in the PFMIs, (2) provide a mechanism for DCOs to elect to opt-in the SIDCO enhanced regulatory framework set out in the provisions of Subpart C; and (3) make related technical amendments to regulations 140.94 and 190.09. As finalized herein, revised Subpart C, together with Subpart A and Subpart B, will establish regulations that are consistent with the PFMIs<sup>261</sup> and provide SIDCOs and Subpart C DCOs with the opportunity to become QCCPs for purposes of the Basel CCP Capital Requirements.<sup>262</sup>

In promulgating the final rule, the Commission considered the following alternatives: (1) not to adopt any of the proposed additional standards for SIDCOs, (2) to adopt the proposed additional standards for SIDCOs only, (3) to adopt the proposed additional standards for SIDCOs and also for DCOs that have not been designated as systemically important by the Council

but that seek adherence to the enhanced regulatory framework for purposes of gaining QCCP status, or (4) to adopt the proposed additional standards for all DCOs. As detailed above, the Commission has concluded it is necessary and appropriate to adopt regulations which set forth enhanced regulatory standards for SIDCOs and also to extend this framework to DCOs that have not been designated systemically important in order to provide the opportunity to for all DCOs to become QCCPs.

The Commission invited public comment on all aspects of the proposed rulemaking, including (1) the competitive impact, the costs as well as benefits, resulting from, or arising out of, requiring SIDCOs to comply with the provisions set forth in Subpart C, while permitting other registered DCOs to elect to become subject to these requirements (or to forego such election), (2) the potential costs and benefits to a SIDCO or Subpart C DCO to comply with all aspects of the proposed rule, (3) alternative means to establish, for Subpart C DCOs, requirements consistent with the PFMIs and the costs (or cost savings) and benefits associated with such alternatives, and (4) any costs that would be imposed on and any benefits that would be conferred on other market participants or the financial system more broadly. As discussed above in more detail, the Commission received comment letters which generally supported the proposed rule and the Commission’s objective to harmonize U.S. regulations with the international standards set forth by the PFMIs.<sup>263</sup> However, the Commission received only one comment that provided quantitative data from which the Commission could calculate the costs and benefits of the proposed regulations.<sup>264</sup> The remainder of the comment letters provided qualitative comments on the Commission’s proposed consideration of costs and benefits, generally, as well as specifically with regard to certain proposed regulations. These comments are summarized below in connection with the Commission’s consideration of costs and benefits on the final rules being promulgated herein pursuant to section 15(a) of the CEA.

**3. Costs and Benefits of the Final Rule**

**a. Costs**

The Commission requested quantitative data or specific cost

<sup>257</sup> 5 U.S.C 601 *et seq.*

<sup>258</sup> Policy Statement and Establishment of Definitions of “Small Entities” for Purposes of the Regulatory Flexibility Act, 47 FR 18618 (Apr. 30, 1982).

<sup>259</sup> See 66 FR 45609.

<sup>260</sup> 7 U.S.C. 19(a).

<sup>261</sup> See *supra* Section I.G.

<sup>262</sup> See *supra* Section I.F. (discussion of the Basel CCP Capital Requirements).

<sup>263</sup> See generally Chris Barnard, NYPC, FIA, ICE, ISDA, European Commission, CME, LCH and MGEX comment letters.

<sup>264</sup> See generally CME comment letter.

estimates associated with the proposed regulations but commenters, other than CME, did not provide this information. Commenters did address the costs and benefits of the proposed rule in qualitative terms, as described below.<sup>265</sup>

As noted in the cost-benefit discussion in the Proposal,<sup>266</sup> the Commission recognizes that the regulations in this final rulemaking are comprehensive and that, compared against the status quo (the DCO regulatory framework set forth in Subpart A and B of part 39 of the Commission's regulations), these regulations may impose important costs on SIDCOs and Subpart C DCOs depending, in particular, on the SIDCO's or Subpart C DCO's current financial and liquid resources, and risk management framework. In particular, these regulations may require SIDCOs and Subpart C DCOs to undertake a comprehensive review and analysis of their current policies, procedures, and systems in order to determine where it may be necessary to design and implement additional or alternative policies, procedures, and systems. Such costs are likely to increase operational, administrative, and compliance costs for SIDCOs or Subpart C DCOs.

In addition to the costs for SIDCOs and Subpart C DCOs, the Commission has considered the costs these regulations may impose upon market participants and the public. To the extent costs increase, the Commission notes that higher trading prices for market participants (*i.e.*, increased clearing fees, guaranty fund contributions, 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 the regulations in this final rulemaking are not adopted.

Significantly, without these regulations to ensure that SIDCOs operate under certain enhanced risk management standards, in a manner consistent with internationally accepted standards, the security of the U.S. financial markets would be at a greater risk relative to international markets. This could affect the attractiveness of the U.S. financial markets subject to the Commission's jurisdiction as compared to foreign competitors. Moreover, SIDCOs and DCOs that wish to opt-into the enhanced regulatory framework 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.

i. Regulation 39.31 (Election to become subject to the provisions of subpart C)

Regulation 39.31 sets forth the procedures a DCO will be required to follow to elect to become subject to the provisions of Subpart C.<sup>267</sup> Specifically, paragraph (b) requires a registered DCO to file a completed Subpart C Election Form with the Commission. The form appears in Appendix B to Subpart C and is modeled after Form DCO, which the Commission promulgated in 2011 as part of the DCO General Provisions and Core Principles final rule.<sup>268</sup> Paragraph (c) requires the same of a DCO that applies for registration with the Commission and that wants to be subject to the provisions of Subpart C as of the date the DCO is registered with the Commission. The Subpart C Election Form includes disclosures and exhibits wherein the DCO is required to provide the following: a regulatory compliance chart; citations to the relevant rules, policies, and procedures of the DCO that addresses each Subpart C regulation; and a summary of the manner in which the DCO will comply with each regulation. In addition, the DCO is required to provide, in separate exhibits, all documents that demonstrate the DCO's compliance with regulations 39.32 through 39.36 and regulation 39.39, as finalized herein. A DCO is also required to complete responses to the Disclosure Framework and publish a copy of its responses on its Web site.

The Commission notes that regulation 39.31 only applies to a DCO that the Council has not designated to be systemically important and that *elects* to become subject to the provisions of Subpart C. By providing an opt-in procedure and a procedure to rescind such election, regulation 39.31, as adopted, offers the benefit of permitting a DCO that is not systemically important to compare the benefit of attaining QCCP status with the costs of preparing a comprehensive and complete Subpart C Election Form (in accordance with the requirements set forth in regulation 39.31) and complying with the requirements set forth in Subpart C and, thus, to decide for itself whether to become subject to Subpart C.

As discussed above in more detail, the Commission received 4 comment letters addressing the costs associated with specific regulations in the proposed

rule.<sup>269</sup> All of the commenters expressed support for the Commission's efforts to provide DCOs with the opportunity to become eligible for QCCP status by adhering to an enhanced regulatory scheme.<sup>270</sup> However, MGEX referred to the application process set forth in proposed regulation 39.31 as "burdensome" and "discriminatory" towards DCOs that have not been designated as systemically important.<sup>271</sup> In addition, MGEX suggested to the Commission two alternative methods to more efficiently implement regulations that are consistent with the PFMs: (1) require all DCOs to be subject to the enhanced regulatory requirements in Subpart C and grant an extended compliance schedule beyond December 31, 2013 or (2) provide an "opt-out" process for those DCOs that do not wish to be held to the higher regulatory standards and grant compliance extensions for those regulations that would be difficult for DCOs to implement by December 31, 2013.<sup>272</sup> LCH suggested that the Commission consider requiring the enhanced regulatory standards to apply to all DCOs and allow DCOs to petition the Commission for extended compliance with "more complex rules."<sup>273</sup> LCH also suggested an opt-out process for those DCOs that believe QCCP status is not important for their business.<sup>274</sup> As MGEX itself pointed out in its comment letter, requiring all DCOs to adhere to the enhanced requirements in Subpart C would impose considerable costs on DCOs that may not seek QCCP status.<sup>275</sup> The Commission believes a DCO should have the flexibility to determine what level of regulatory standard is appropriate for its particular business model. Regarding the suggested alternative opt-out provision, as stated previously, the Commission does not have quantitative data on the costs associated with implementing the regulations in this final rule but it is aware that costs may be significant. Further, the Commission is aware that imposing an enhanced regulatory framework on all DCOs even with an opt-out provision, without the necessary quantitative analysis, would be inappropriate and could result in financial harm to certain DCOs. Moreover, without a detailed quantitative analysis comparing the

<sup>269</sup> See generally MGEX, CME, LCH and European Commission comment letters.

<sup>270</sup> MGEX at 1–2; CME at 1, LCH at 2, and European Commission at 1.

<sup>271</sup> MGEX at 2.

<sup>272</sup> *Id.* at 3.

<sup>273</sup> LCH at 3.

<sup>274</sup> *Id.*

<sup>275</sup> MGEX at 3.

<sup>265</sup> See generally MGEX and LCH comment letters.

<sup>266</sup> 78 FR 50287.

<sup>267</sup> See *supra* Section II.C. (discussing regulation 39.31).

<sup>268</sup> See 76 FR 69448.

costs for each DCO that elects to opt-in (under the proposed rule) with the costs of each DCO that elects to opt-out of Subpart C compliance (under MGEX's alternative), the Commission cannot determine whether establishing an opt-out regime would be a more efficient means of implementing the PFMI than the Commission's proposed opt-in regime. Hence, at this time, the Commission cannot justify the cost burden that would result for DCOs if every DCO were required to comply with the Subpart C regulations.

MGEX and LCH also both suggested that to alleviate the compressed timeline for compliance, the Commission should allow compliance extensions. Specifically, LCH requested that "more complex rules, such as those governing financial resources, system safeguards, risk management, and recovery and wind-down plans" be given additional time for compliance.<sup>276</sup> Similarly, MGEX suggested "granting compliance extensions for those regulations that may be particularly difficult to implement by the December 31, 2013 deadline."<sup>277</sup> As highlighted by both MGEX and LCH, the Commission has already proposed an extended deadline for regulation 39.34 regarding system safeguards. The Commission is also extending the deadline for compliance with regulation 39.35 regarding default rules and procedures and regulation 39.39 regarding recovery and wind-down by permitting a SIDCO or Subpart C DCO to request that the Commission grant the SIDCO or Subpart C DCO up to a one year extension to comply with these regulations. However, because the very purpose of this final rule is to align the Commission's regulations with the PFMI and to provide DCOs the opportunity to become QCCPs, inherently a DCO must comply with all of the regulations. An extended compliance date for all the regulations or a large subset of the regulations, would call into the question whether the Commission has rules and regulations in place consistent with the PFMI and is applying these rules to the DCO on an ongoing basis as of December 31, 2013. Extending the compliance date could delay the ability of a Subpart C DCO or SIDCO to gain QCCP status and thus, increase costs for the DCO's clearing member banks and the customers of these banks. While the Commission recognizes the concerns expressed by the commenters regarding the compliance deadline for purposes of achieving QCCP status, the Commission notes that for DCOs that are not SIDCOs,

it is ultimately the decision of the DCO as to whether to elect to become a Subpart C DCO and if so, when to make such an election. Thus, the compliance dates proposed in this regulation are permissive and not mandatory for such DCOs.

The Commission requested comments regarding the costs associated with the actual opt-in process. However, although MGEX stated that the Subpart C Election Form would be overly burdensome, neither MGEX nor any other commenter provided comments quantifying the cost of opting-in, the costs associated with rescinding an opt-in (including the notices required), or the costs associated with the completion and publication of responses to the Disclosure Framework.

The Commission notes that pursuant to paragraph (e), a Subpart C DCO is permitted, subject to a 180 day notice period, to rescind its election to become subject to the provisions of Subpart C. As a result of the rescission, the DCO would no longer be considered a QCCP, which would likely create important costs for bank clearing members and the bank customers of the DCO's clearing members due to the higher capital costs that they would incur as a result of clearing transactions through the DCO that is no longer a QCCP.<sup>278</sup>

Alternatively, clearing members and their customers may choose to end their clearing activities and transact through another DCO that is a QCCP. Either choice would impose costs on those clearing members and their customers.

As the Commission has previously noted, a Subpart C DCO's compliance with the provisions of Subpart C will cause the Subpart C DCO to incur certain costs. Some of these costs may then be incurred, indirectly, by the Subpart C DCO's clearing members and their customers. The Commission requested but did not receive any comments concerning how these costs may be mitigated. Nor did the Commission receive any comments about the extent to which a DCO's analysis of the costs and benefits of being a Subpart C DCO could be affected by the possibility that some of the costs may be incurred indirectly by clearing members and their customers.

In the absence of input from market participants, the Commission lacks critical information necessary to make a reasonable assessment or quantify dollar costs associated with regulation 39.31. Each DCO has its own internal cost structure, management system, and

existing regulatory compliance framework. Thus, the way in which regulation 39.31 impacts each Subpart C DCO with respect to costs likely will vary. Accordingly, the Commission is unable to provide a reliable quantification of the costs associated with regulation 39.31, because, among other things, such a determination would require information concerning the business model and strategies of individual DCOs, about which the Commission did not receive information during the comment period. The Commission has no reason to believe, however, that the costs associated with the regulation would be unreasonable or inappropriate to achieve the regulatory objective of providing an opportunity for DCOs to opt-in to Subpart C. In addition, the Commission believes that the costs the regulation imposes would not, to any unnecessary extent, impede a DCO from electing to be subject to Subpart C.

ii. Regulation 39.32 (Governance for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

Regulation 39.32 establishes governance requirements for SIDCOs and Subpart C DCOs that are consistent with the PFMI and establish rules and procedures concerning conflicts of interest, compensation policies, organizational structure, and fitness standards for directors and officers.<sup>279</sup> Specifically, SIDCOs and Subpart C DCOs are required to have written governance arrangements that are clear and transparent, that place a high priority on the safety and efficiency of SIDCOs or Subpart C DCOs, and that explicitly support the stability of the broader financial system and other relevant public interest considerations of clearing members, customers of clearing members, and other relevant stakeholders. In addition, these governance arrangements are required to reflect the legitimate interests of clearing members, customers of clearing members, and other relevant stakeholders. To an extent consistent with other statutory and regulatory requirements on confidentiality and disclosure, SIDCOs and Subpart C DCOs are also required to disclose major decisions of the board.<sup>280</sup> Regulation 39.32 requires the rules and procedures of SIDCOs and Subpart C DCOs to: (1) Describe the SIDCO's or Subpart C DCO's management structure; (2) clearly specify the roles and responsibilities of

<sup>276</sup> LCH at 3.

<sup>277</sup> MGEX at 3.

<sup>278</sup> See *supra* Section I.F. (discussing the treatment for non-QCCP clearing members under the Basel CCP Capital Requirements).

<sup>279</sup> See *supra* Section II.D. (discussing regulation 39.32).

<sup>280</sup> *Id.*

the board of directors and its committees, including the establishment of a clear and documented risk management framework; (3) clearly specify the roles and responsibilities of management; (4) establish appropriate compensation policies; (5) establish procedures for managing conflicts of interest among board members; and (6) assign responsibility and accountability for risk decisions and for implementing rules concerning default, recovery, and wind-down. Finally, regulation 39.32 requires that the board members and managers of SIDCOs and Subpart C DCOs have the appropriate experience, skills, incentives and integrity; risk management and internal control personnel have sufficient independence, authority, resources and access to the board of directors; and that the board of directors include members who are not executives, officers or employees of the SIDCO or Subpart C DCO or of their affiliates.

As noted in the cost benefit section of the Proposal,<sup>281</sup> to the extent these requirements affect the behavior of a DCO, costs could arise from additional hours a DCO's employees might need to spend analyzing the compliance of the DCO's rules and procedures with these requirements, designing and drafting new or amended rules and procedures where the analysis indicates that these are necessary, and implementing these new or amended rules and procedures. The Commission continues to believe that these categories accurately summarize the sources of material costs that may be incurred in complying with regulation 39.32.

In the Proposal, the Commission requested comment on the potential costs to a SIDCO or Subpart C DCO to comply with all aspects of proposed regulation 39.32, and any costs that would be imposed on other market participants or the financial system more broadly. The Commission specifically requested comment on any alternative means to satisfy the requirements of regulation 39.32 in a manner consistent with the PFMI and for costs or cost savings associated with such alternatives.<sup>282</sup> The Commission did not receive any comments in response to these requests.

In the absence of input from market participants, the Commission lacks critical information necessary to make a reasonable assessment or quantify dollar costs associated with regulation 39.32. The Commission notes that regulation 39.32 grants a DCO a certain amount of discretion in determining the specifics

of the rules and procedures that should be adopted to comply with the regulation. Moreover, each DCO has its own internal cost structure, management system, and existing regulatory compliance framework. Thus, the way in which regulation 39.32 impacts each DCO with respect to initial and ongoing costs likely will vary. For example, some DCOs may already have rules and processes that comply with the regulation, in whole or in part, while other DCOs may not.

Accordingly, the Commission is unable to provide a reliable quantification of the costs associated with regulation 39.32, because, among other things, such a determination would require information concerning the business model and strategies of individual DCOs, about which the Commission did not receive information during the comment period. The Commission has no reason to believe, however, that the costs associated with the regulation would be unreasonable or inappropriate to achieve the regulatory objective of implementing the PFMI standards for SIDCOs and Subpart C DCOs. In addition, the Commission believes that the costs the regulation imposes would not, to any unnecessary extent, impede a DCO from electing to be subject to Subpart C.

iii. Regulation 39.33 (Financial resources for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

a.) Regulation 39.33(a): Cover Two

As discussed above, regulation 39.33(a), as revised, requires a Subpart C DCO to comply with the Cover Two minimum financial resource standard for all of its activities if the Subpart C DCO: (1) is involved in activities with a more complex risk profile or (2) is systemically important in multiple jurisdictions. This regulation currently applies to SIDCOs.<sup>283</sup>

The cost of the Cover Two requirement for a Subpart C DCO that meets either or both of the two criteria described above<sup>284</sup> includes the opportunity cost<sup>285</sup> of the additional financial resources needed to satisfy the

<sup>283</sup> See *supra* Section II.E. (discussing revised regulation 39.33).

<sup>284</sup> All Subpart C DCOs would bear the administrative cost of determining whether they meet either of the criteria.

<sup>285</sup> For Subpart C DCOs that are not deemed systemically important in multiple jurisdictions or that do not clear products with a more complex risk profile, the Cover One financial resources requirement would continue to apply, and therefore, these Subpart C DCOs would not face increased opportunity costs associated with the regulation.

guaranty fund requirements for the risk of loss resulting from the default of the clearing member creating the second largest financial exposure.<sup>286</sup> In addition, the possibility exists that some market participants will transfer their positions from a Subpart C DCO that either (1) is deemed systemically important in multiple jurisdictions or (2) clears products of a more complex risk profile to another DCO for which neither (1) nor (2) applies, because the value of the Cover Two protection to these market participants is less than the price at which that protection is being offered. These market participants will transact with SIDCOs or Subpart C DCOs that 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 and Subpart C DCOs that operate under Cover Two. However, the potential cost to a SIDCO or a Subpart C DCO subject to the Cover Two requirement and to the goal of systemic risk reduction would likely be mitigated because: (a) not every product offered by a SIDCO or Subpart C DCO would be available at other DCOs and (b) a SIDCO or Subpart C DCO may offer benefits not available to a DCO that operates under Cover One because it does not elect to become subject to the provisions of Subpart C, and is not designated as systemically important, and/or does not clear products with a more complex risk profile. This would therefore reduce the likelihood that market participants would transfer their positions to other DCOs.

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

As discussed above, regulation 39.33(b) prohibits SIDCOs and Subpart C DCOs from including assessments as part of their calculation of the financial resources available to cover the default of the clearing member creating the largest financial exposure and, where applicable, the default of the two clearing members creating the largest aggregate financial exposure, in extreme but plausible circumstances, *i.e.*, Cover One or Cover Two.<sup>287</sup> This prohibition currently applies to SIDCOs and would be expanded to include Subpart C DCOs. The costs associated with the prohibition on the use of assessments by a Subpart C DCO in calculating its obligations under regulation 39.33(a)

<sup>286</sup> In the event that these additional resources would need to be raised by the Subpart C DCO, as opposed to reallocated, this cost would be the funding cost for raising these additional resources.

<sup>287</sup> See *supra* Section II.E. (discussing revised regulation 39.33).

<sup>281</sup> 78 FR 50287.

<sup>282</sup> *Id.* at 50288.

would include the opportunity cost of the additional pre-funded financial resources needed to replace the value of such assessments, which may require an infusion of additional capital. In addition, as with the Cover Two requirement, market participant demand may shift from a SIDCO or a Subpart C DCO subject to the Cover Two requirement to a DCO with a lower capitalization requirement.

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

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

In addition, a SIDCO or Subpart C DCO that is systemically important in multiple jurisdictions or that is involved in activities with a more complex risk profile is required to *consider* maintaining liquidity resources that would enable it to meet the default of the two clearing members creating the largest aggregate payment obligation. If a SIDCO or Subpart C DCO maintains liquid financial resources in addition to those required to satisfy the minimum financial resources requirement set forth in regulation 39.11(a)(1) and proposed regulation 39.33(a), then those resources should be in the form of assets that are likely to be saleable or acceptable as collateral for lines of credit, swaps, or repurchase agreements on an *ad hoc* basis.<sup>288</sup>

Regulation 39.33(d) imposes a duty on SIDCOs and Subpart C DCOs to perform due diligence on their liquidity providers in order to determine their ability to perform reliably their commitments to provide liquidity. Finally, regulation 39.33(e) requires SIDCOs and Subpart C DCOs to

document their supporting rationale for the amount of financial resources they maintain pursuant to regulation 39.33(a) and the amount of liquidity resources they maintain pursuant to regulation 39.33(c).<sup>289</sup>

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

CME estimated that if it had to obtain committed funding arrangements to comply with regulation 39.33(c), its liquidity costs would approximately double.<sup>290</sup> This increase is based on their "assumption that the cost of committed liquidity or committed

repurchase facilities is approximately \$3 million for every \$1 billion of required committed facilities" or 30 basis points.<sup>291</sup> Additionally, CME commented that given the global clearing mandate slated to take effect over the next two years, liquidity requirements will significantly increase, which could potentially result in CME's liquidity costs increasing to \$120 to \$160 million per year.<sup>292</sup>

Based on CME's 30 basis point estimate, their increase in liquidity costs would translate into a liquidity exposure from the default of a single participant, including affiliates, (*i.e.*, Cover One) of \$40 billion to \$53 billion. The size of this potential exposure highlights the systemic importance of SIDCOs, such as CME, and how critical it is for a SIDCO to meet all of its obligations promptly even in extreme but plausible conditions. Consequently, while there may be costs associated with obtaining prearranged, highly reliable funding, these costs must be weighed against the potential disruptions and damage to the U.S. financial system if, during extreme but plausible market conditions, a SIDCO does not maintain sufficient liquidity to meet its financial obligations to its non-defaulting members promptly.

Moreover, as discussed above in more detail, the standard SIDCOs and Subpart C DCOs must meet under regulation 39.33(c) is to demonstrate the reliability of the requisite liquidity arrangements, even in extreme but plausible conditions. To the extent that a DCO is able to meet this burden through tools other than the use of a committed funding arrangement, and chooses to so, then the DCO would bear the cost of such an alternative arrangement, which may be lower than the costs of a committed funding arrangement.

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

<sup>291</sup> *Id.* Current and historic returns available on high quality sovereign bonds suggest that the actual costs of liquidity service may be less than the 30 basis points that CME estimates and therefore, CME's total liquidity costs would be lower than \$120 to \$160 million.

<sup>292</sup> CME at 13.

<sup>289</sup> *Id.*

<sup>290</sup> CME at 13.

<sup>288</sup> *Id.*

iv. Regulation 39.34 (System safeguards for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

As discussed above regulation 39.34, as revised, expands the enhanced system safeguards requirements already applicable to SIDCOs to include Subpart C DCOs.<sup>293</sup> As noted in the cost benefit section of the Proposal,<sup>294</sup> the regulation may increase operational costs for Subpart C DCOs by requiring additional resources, including, technology (*e.g.*, hardware and software) and the purchase or rental of premises in order to achieve geographic dispersal of resources. Moreover, business continuity planning inherently requires that personnel be trained in their roles and responsibilities under the plan, and this training consumes time and related resources.

The costs of moving from a next-day RTO, the minimum standard established by the DCO core principles and current regulation 39.18, to a two-hour RTO as required by proposed regulation 39.34, may be significant. Additionally, the implementation of a two-hour RTO may impose one-time costs to establish the enhanced resources and recurring costs to operate the additional resources. The Commission continues to believe that these categories accurately summarize the sources of material costs that may be incurred in complying with regulation 39.34.

In the Proposal, the Commission requested comment on the potential costs to a Subpart C DCO to comply with all aspects of proposed regulation 39.34 and any costs that would be imposed on other market participants or the financial system more broadly. The Commission specifically requested comment on any alternative means to satisfy the requirements of regulation 39.34 in a manner consistent with the PFMI and for costs or cost savings associated with such alternatives.<sup>295</sup> The Commission received one comment in response. MGEX stated that it would require three or four additional employees to comply with the geographic diversity requirements of this rule, unless MGEX were to engage outsourced personnel.

The Commission notes that MGEX could, alternatively, relocate existing positions (rather than increase its headcount). This would require MGEX to incur either relocation or hiring costs, as well as office space for the geographically diverse employees.

MGEX provided no estimates of the costs it might incur.

In the absence of input from market participants, the Commission lacks critical information necessary to make a reasonable assessment or quantify dollar costs associated with regulation 39.34. The Commission notes that regulation 39.34 grants a DCO a significant amount of discretion in determining how to comply with the regulation. Moreover, it is possible that each DCO has its own internal cost structure, management system, and existing regulatory compliance framework. Thus, the way in which regulation 39.34 impacts each DCO with respect to initial and ongoing costs likely will vary. For example, some DCOs may already have resources in place that comply with the regulation, in whole or in part, while other DCOs may not.

Accordingly, the Commission is unable to provide a reliable quantification of the costs associated with regulation 39.34, because, among other things, such a determination would require information concerning the business model and strategies of individual DCOs, about which the Commission did not receive information during the comment period. The Commission has no reason to believe, however, that the costs associated with the regulation would be unreasonable or inappropriate to achieve the regulatory objective of implementing the PFMI standards for Subpart C DCOs. In addition, the Commission believes that the costs the regulation imposes would not, to any unnecessary extent, impede a DCO from electing to be subject to Subpart C.

v. Regulation 39.35 (Default rules and procedures for uncovered losses or shortfalls (recovery) for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

As discussed above, regulation 39.35 requires SIDCOs and Subpart C DCOs to adopt rules and procedures to address certain issues arising from extraordinary stress events, including the default of one or more clearing members.<sup>296</sup> Such default rules and procedures must sufficiently (1) allocate uncovered credit losses and (2) enable a SIDCO or Subpart C DCO promptly to meet all of its obligations in the event of a default by one or more clearing members or an unforeseen liquidity shortfall exceeding the financial resources of the SIDCO or Subpart C DCO. As noted in the cost

benefit section of the Proposal,<sup>297</sup> the costs associated with these default rules and procedures may include administrative costs to: review and analyze current policies and procedures; design and draft new or amended policies and procedures; and implement the new or amended policies and procedures. The tools that a SIDCO or Subpart C DCO chooses to include in its default rules and procedures may involve capital costs. The Commission continues to believe that these categories accurately summarize the sources of material costs that may be incurred in complying with regulation 39.35.

In the Proposal, the Commission requested comment on the potential costs to a SIDCO or Subpart C DCO to comply with all aspects of proposed regulation 39.35, and any costs that would be imposed on other market participants or the financial system more broadly. The Commission specifically requested comment on any alternative means to satisfy the requirements of regulation 39.35 in a manner consistent with the PFMI and for costs or cost savings associated with such alternatives.<sup>298</sup> The Commission did not receive any comments in response to these requests.

In the absence of input from market participants, the Commission lacks critical information necessary to make a reasonable assessment or quantify dollar costs associated with regulation 39.35. The Commission notes that regulation 39.35 grants a DCO a certain amount of discretion in determining the specifics of the rules and procedures that should be adopted to comply with the regulation. Moreover, each DCO has its own internal cost structure, management system, and existing regulatory compliance framework. Thus, the way in which regulation 39.35 impacts each DCO with respect to initial and ongoing costs likely will vary. For example, some DCOs may already have rules and procedures that comply with the regulation, in whole or in part, while other DCOs may not.

Accordingly, the Commission is unable to provide a reliable quantification of the costs associated with regulation 39.35, because, among other things, such a determination would require information concerning the business model and strategies of individual DCOs, about which the Commission did not receive information during the comment period. The Commission has no reason to believe, however, that the costs associated with

<sup>293</sup> See *supra* Section II.F. (discussing regulation 39.34).

<sup>294</sup> 78 FR 50290.

<sup>295</sup> *Id.*

<sup>296</sup> See *supra* Section II.G. (discussing regulation 39.35).

<sup>297</sup> 78 FR 50290.

<sup>298</sup> *Id.*



the regulation would be unreasonable or inappropriate to achieve the regulatory objective of implementing the PFMI standards for SIDCOs and Subpart C DCOs. In addition, the Commission believes that the costs the regulation imposes would not, to any unnecessary extent, impede a DCO from electing to be subject to Subpart C.

vi. Regulation 39.36 (Risk management for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

Regulation 39.36 sets forth enhanced risk management requirements for a SIDCO or Subpart C DCO, including, but not limited to, specific criteria for stress tests of financial resources, specific criteria for sensitivity analysis of margin models, specific criteria for stress tests of liquidity resources, requirements surrounding the monitoring and management of credit and liquidity risks arising out of settlement banks, and requirements surrounding the custody and investment of a SIDCO's or Subpart C DCO's own funds and assets.<sup>299</sup> As noted in the Proposal,<sup>300</sup> complying with this regulation may involve operational costs to perform the required testing, monitoring and analyses, which may include: a comprehensive analysis of existing stress testing scenarios; the design of new and/or alternative stress testing scenarios; and the design of a sensitivity analysis; the creation of a system for comprehensively monitoring, managing and limiting credit and liquidity risks arising out of settlement banks; and the implementation of controls surrounding the custody and investment of a SIDCO's or Subpart C DCO's own funds and assets. In addition, there may be costs associated with the modification and/or creation of processes necessary to support the enhanced risk management requirements in the proposed regulation. There will also be ongoing costs to conduct such risk management, analyze the results, and take action based on such results. In particular, to the extent that the analyses and monitoring reveal the need for additional financial or liquidity resources, there would be costs associated with obtaining such resources. In addition, there may be administrative and other costs associated with the management of a SIDCO's or Subpart C DCO's settlement bank exposure. The Commission continues to believe that these categories accurately summarize the

sources of material costs that may be incurred in complying with regulation 39.36.

In the Proposal, the Commission requested comment on the potential costs to a SIDCO or Subpart C DCO to comply with all aspects of proposed regulation 39.36, and any costs that would be imposed on other market participants or the financial system more broadly. The Commission specifically requested comment on any alternative means to satisfy the requirements of regulation 39.36 in a manner consistent with the PFMIs and for costs or cost savings associated with such alternatives.<sup>301</sup> The Commission did not receive any comments in response to these requests.

In the absence of input from market participants, the Commission lacks critical information necessary to make a reasonable assessment or quantify dollar costs associated with regulation 39.36. The Commission notes that regulation 39.36 grants a DCO a certain amount of discretion in determining the specifics of the processes that should be adopted to comply with the regulation. Moreover, each DCO has its own internal cost structure, management system, and existing regulatory compliance framework. Thus, the way in which regulation 39.36 impacts each DCO with respect to initial and ongoing costs likely will vary. For example, some DCOs may already have processes that comply with regulation 39.36, in whole or in part, while other DCOs may not.

Accordingly, the Commission is unable to provide a reliable quantification of the costs associated with regulation 39.36, because, among other things, such a determination would require information concerning the operations of individual DCOs, about which the Commission did not receive information during the comment period. The Commission has no reason to believe, however, that the costs associated with the regulation would be unreasonable or inappropriate to achieve the regulatory objective of implementing the PFMI standards for SIDCOs and Subpart C DCOs. In addition, the Commission believes that the costs the regulation imposes would not, to any unnecessary extent, impede a DCO from electing to be subject to Subpart C.

vii. Regulation 39.37 (Additional disclosure for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

As discussed above, regulation 39.37 sets forth additional public disclosure requirements for a SIDCO and Subpart C DCO, including the disclosure of, and updates to, the DCO's responses to the Disclosure Framework for FMIs.<sup>302</sup> As noted in the Proposal,<sup>303</sup> complying with this regulation may impose administrative costs to conduct a comprehensive analysis of the SIDCO or Subpart C DCO's policies, procedures and systems as well as the costs associated with the design, drafting and implementation of any new or modified policies, procedures and systems that would be necessary to comply with the proposed regulation. The Commission continues to believe that these categories accurately summarize the sources of material costs that may be incurred in complying with regulation 39.37.

In the Proposal, the Commission requested comment on the potential costs to a SIDCO or Subpart C to comply with all aspects of proposed regulation 39.37, and any costs that would be imposed on other market participants or the financial system more broadly. The Commission specifically requested comment on any alternative means to satisfy the requirements of regulation 39.37 in a manner consistent with the PFMIs and for costs or cost savings associated with such alternatives.<sup>304</sup> The Commission did not receive any comments in response to these requests.

In the absence of input from market participants, the Commission lacks critical information necessary to make a reasonable assessment or quantify dollar costs associated with regulation 39.37. The Commission notes that regulation 39.37 grants a DCO a certain amount of discretion in determining the specifics of the procedures that should be adopted to comply with the regulation. Moreover, each DCO has its own internal cost structure, management system, and existing regulatory compliance framework. Thus, the way in which regulation 39.37 impacts each DCO with respect to initial and ongoing costs likely will vary. For example, some DCOs may already have rules and processes that comply with the regulation, in whole or in part, while other DCOs may not.

<sup>299</sup> See *supra* Section II.H. (discussing regulation 39.36).

<sup>300</sup> 78 FR 50290.

<sup>301</sup> *Id.*

<sup>302</sup> See *supra* Section II.I. (discussing regulation 39.37).

<sup>303</sup> 78 FR 50290–50291.

<sup>304</sup> *Id.*

Accordingly, the Commission is unable to provide a reliable quantification of the costs associated with regulation 39.37, because, among other things, such a determination would require information concerning the business model and strategies of individual DCOs, about which the Commission did not receive information during the comment period. The Commission has no reason to believe, however, that the costs associated with the regulation would be unreasonable or inappropriate to achieve the regulatory objective of implementing the PFMI standards for SIDCOs and Subpart C DCOs. In addition, the Commission believes that the costs the regulation imposes would not, to any unnecessary extent, impede a DCO from electing to be subject to Subpart C.

viii. Regulation 39.38 (Efficiency for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

As discussed above, regulation 39.38 requires a SIDCO or a Subpart C DCO to comply with certain efficiency standards regarding its clearing and settlement arrangements, operating structure and procedures, product scope, and use of technology. In addition, a SIDCO or Subpart C DCO is required to establish clearly defined goals and objectives that are measurable and achievable, including minimum service levels, risk management expectations, and business priorities.<sup>305</sup> SIDCOs and Subpart C DCOs are also required to facilitate efficient payment, clearing and settlement by accommodating internationally accepted communication procedures and standards. As outlined in the cost benefit section of the Proposal,<sup>306</sup> the costs associated with the regulation may include the administrative costs of conducting a comprehensive review and analysis of the SIDCO's or Subpart C DCO's policies, procedures and systems, and where appropriate, the design, drafting and implementation of new or modified policies, procedures and systems to establish the goals and objectives necessary to comply with this regulation. There may also be administrative costs associated with establishing a mechanism to review the DCO's compliance with the regulation, as well as operational costs associated with designing and implementing processes to accommodate internationally accepted

communications standards. The Commission continues to believe that these categories accurately summarize the sources of material costs that may be incurred in complying with regulation 39.38.

In the Proposal, the Commission requested comment on the potential costs to a SIDCO or Subpart C DCO to comply with all aspects of proposed regulation 39.38, and any costs that would be imposed on other market participants or the financial system more broadly. The Commission specifically requested comment on any alternative means to satisfy the requirements of regulation 39.38 in a manner consistent with the PFMIs and for costs or cost savings associated with such alternatives.<sup>307</sup> The Commission did not receive any comments in response to those requests.

In the absence of input from market participants, the Commission lacks critical information necessary to make a reasonable assessment or quantify dollar costs associated with regulation 39.38. The Commission notes that efficiency is inherently difficult to measure.

The Commission also notes that regulation 39.38 grants a DCO a certain amount of discretion in determining the specifics of the processes that should be adopted to comply with the regulation. Moreover, each DCO has its own internal cost structure and management system. Thus, the way in which regulation 39.38 impacts each DCO with respect to initial and ongoing costs likely will vary.

Accordingly, the Commission is unable to provide a reliable quantification of the costs associated with regulation 39.38, because, among other things, such a determination would require information concerning the business model and strategies of individual DCOs, about which the Commission did not receive information during the comment period. The Commission has no reason to believe, however, that the costs associated with the regulation would be unreasonable or inappropriate to achieve the regulatory objective of implementing the PFMI standards for SIDCOs and Subpart C DCOs. In addition, the Commission believes that the costs the regulation imposes would not, to any unnecessary extent, impede a DCO from electing to be subject to Subpart C.

ix. Regulation 39.39 (Recovery and wind-down for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

As discussed above, regulation 39.39 requires a SIDCO or Subpart C DCO to maintain viable plans for recovery and orderly wind-down, in cases necessitated by (1) credit losses or liquidity shortfalls and (2) general business risk, operational risk, or any other risk that threatens the DCO's viability as a going concern. This requires the DCO to identify scenarios that may prevent a SIDCO or Subpart C DCO from being able to provide its critical operations and services as a going concern and to assess the effectiveness of a full range of options for recovery or orderly wind-down. The regulation also requires a SIDCO or Subpart C DCO to evaluate the resources available to meet the plan to cover credit losses and liquidity shortfalls, and to maintain sufficient unencumbered liquid financial assets to implement the plan to cover other risks. The latter point requires a SIDCO or Subpart C DCO to analyze whether its particular circumstances and risks require it to maintain liquid net assets to fund the plan that are in addition to those resources currently required by regulation 39.11(a)(2).

As noted in the Proposal,<sup>308</sup> regulation 39.39 may impose costs on a SIDCO or Subpart C DCO to the extent it will be necessary to undertake a comprehensive qualitative and quantitative analysis of the credit, liquidity, general business, operational and other risks that may threaten the DCO's ability to provide its critical operations and services as a going concern, to design and draft plans to mitigate and address those risks, to analyze whether the DCO's resources allocated to recovery and/or wind-down are sufficient to implement those plans. This analysis may lead to the design of alternative and/or additional scenarios to be included in stress testing, the drafting of new or revised policies for a recovery and/or wind-down plan, and potentially the necessity of maintaining additional resources or procedures to obtain such resources in the event they are needed. Moreover, the regulation prohibits the double counting of available resources—that is, resources considered as available to meet the recovery and orderly wind-down plan for credit losses and liquidity shortfalls cannot be considered as available to meet the recovery and orderly wind-

<sup>305</sup> See *supra* Section II.J. (discussing regulation 39.38).

<sup>306</sup> 78 FR 50291.

<sup>307</sup> *Id.*

<sup>308</sup> 78 FR 50291.

down plan for general business risk, operational risk, and other risks (or vice-versa). This may result in the need to maintain a larger quantum of total resources to meet both plans which, depending on the resources maintained, may involve costs arising from factors such as greater use of capital by the DCO, or greater capital charges for clearing members arising out of their commitments to contribute default resources. The Commission continues to believe that these categories accurately summarize the sources of material costs that may be incurred in complying with regulation 39.39.

In the Proposal, the Commission requested comment on the potential costs to a SIDCO or Subpart C DCO to comply with all aspects of proposed regulation 39.39, and any costs that would be imposed on other market participants or the financial system more broadly. The Commission specifically requested comment on any alternative means to satisfy the requirements of regulation 39.39 in a manner consistent with the PFMI and for costs or cost savings associated with such alternatives.<sup>309</sup> The Commission did not receive any comments in response to these requests.

In the absence of input from market participants, the Commission lacks critical information necessary to make a reasonable assessment or quantify dollar costs associated with regulation 39.39. The Commission notes that regulation 39.39 grants a DCO a certain amount of discretion in determining the specifics of the rules, procedures, and arrangements that should be adopted to comply with the regulation. Moreover, each DCO has its own internal cost structure, management system, and existing regulatory compliance framework. Thus, the way in which regulation 39.39 impacts each DCO with respect to initial and ongoing costs likely will vary. For example, some DCOs may already have rules, processes, and arrangements that comply with the regulation, in whole or in part, while other DCOs may not.

Accordingly, the Commission is unable to provide a reliable quantification of the costs associated with regulation 39.39, because, among other things, such a determination would require information concerning the business model and strategies of individual DCOs, about which the Commission did not receive information during the comment period. The Commission has no reason to believe, however, that the costs associated with the regulation would be unreasonable or

inappropriate to achieve the regulatory objective of implementing the PFMI standards for SIDCOs and Subpart C DCOs. In addition, the Commission believes that the costs the regulation imposes would not, to any unnecessary extent, impede a DCO from electing to be subject to Subpart C.

#### b. Benefits

As explained in the subsections that follow, this final rule holds SIDCOs and Subpart C DCOs to enhanced regulatory standards, which are designed to promote the financial strength, operational integrity, security, and reliability of these organizations and to reduce the likelihood of their disruption or failure. This, in turn, increases the overall stability of the U.S. financial markets. As the PFMI notes, FMIs, including CCPs (*i.e.* DCOs), play a critical role in fostering financial stability.<sup>310</sup> This is particularly the case with respect to SIDCOs. The Council has determined that the failure of or a disruption to the functioning of a SIDCO could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system.<sup>311</sup> Thus, the final rule offers a substantial benefit vis-à-vis the status quo.

In addition, the regulations adopted in this final rulemaking are consistent with the international standards set forth in the PFMI and address the remaining divergences between part 39 of the Commission's regulations and the PFMI. These regulations will help ensure that SIDCOs and Subpart C DCOs are held to international standards in order to provide them with the opportunity to gain QCCP status. As discussed above, attaining QCCP status will provide clearing members that are banks, as well as banks that are customers of clearing members, with the benefit of complying with less onerous capital requirements, pursuant to the Basel CCP Capital Requirements, than if the SIDCO or Subpart C DCO were not a QCCP.<sup>312</sup> In turn, this may increase a SIDCO or Subpart C DCO's competitiveness vis-à-vis non-US clearing organizations that demonstrate compliance with international standards and are QCCPs.

<sup>310</sup> PFMI, E.N. 1.1.

<sup>311</sup> See <http://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx> (describing the designations of CME and ICE Clear Credit to be systemically important financial market utilities) and see *supra* Section I.C.

<sup>312</sup> See *supra* Section I.F.

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

The procedures set forth in regulation 39.31, together with the Subpart C Election Form, are intended to promote the protection of market participants and the public. These procedures require the Commission's staff to conduct a review of a DCO that elects to become subject to the provisions of Subpart C. The Subpart C Election Form provides the Commission, clearing members, and customers (and, significantly, the regulators of such clearing members and customers) with assurance that the electing DCO will be held to and will be required to meet the standards set forth in Subpart C.<sup>313</sup> Without regulation 39.31, a DCO that is not designated by the Council as being systemically important will not have the opportunity to gain QCCP status, thereby potentially putting such a DCO at a significant competitive disadvantage compared to SIDCOs and non-U.S. clearing organizations. This would ultimately be to the detriment of such a DCO's clearing members and their customers.<sup>314</sup> The Commission also notes that by clearing through a Subpart C DCO, a clearing member and its customers will be afforded the benefits of clearing through a DCO subject to enhanced risk management, operational, and other standards.

Regulation 39.31, as adopted herein, provides a benefit to a Subpart C DCO by allowing the Subpart C DCO the opportunity to weigh for itself the costs and benefits and to determine whether to maintain QCCP status. The notice requirements set forth in the regulation provide important benefits to clearing members of the rescinding Subpart C DCO (and their customers), particularly those that are banks or bank affiliates, by providing them with advance notice to permit them to assess their options and take any actions they deem appropriate with respect to clearing at a DCO that has acted to rescind its election to be held to the standards of Subpart C (and thus to renounce status as a QCCP).

ii. Regulation 39.32 (Governance for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

The requirements set forth in regulation 39.32 are beneficial to the extent that they cause a SIDCO or Subpart C DCO to internalize and/or more appropriately allocate certain costs

<sup>313</sup> See 78 FR 50269.

<sup>314</sup> See *supra* Section I.F. (discussing QCCP status and the Basel CCP Capital Requirements); see also *supra* Section I.C. (discussing regulation 39.31).

<sup>309</sup> *Id.*

that would otherwise be borne by clearing members, customers of clearing members, and other relevant stakeholders. Such requirements also promote market stability because the governance arrangements of SIDCOs and Subpart C DCOs are required to explicitly support the stability of the financial system and other relevant public interest considerations of clearing members, customers of clearing members, and other relevant stakeholders,<sup>315</sup> and reflect the legitimate interests of clearing members, customers of clearing members, and other relevant stakeholders. Finally, the governance arrangements required by regulation 39.32 promote a more efficient, effective, and reliable DCO risk management and operating structure.

As noted above, the Commission did not receive any comments focused specifically on the cost and benefit considerations relevant to regulation 39.32.

iii. Regulation 39.33 (Financial resources for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

As described above, regulation 39.33(a), as revised, expands the Cover Two minimum financial resources requirement to include Subpart C DCOs that engage in an activity with a more complex risk profile (*e.g.*, clearing credit default swaps or credit default futures), or that are systemically important in multiple jurisdictions.<sup>316</sup> This proposed regulation currently applies to SIDCOs. Regulation 39.33(a), as finalized herein, increases the financial stability of Subpart C DCOs subject to this regulation by requiring compliance with enhanced minimum financial resource requirements. Compliance with such standards, in turn, increases the overall stability of the U.S. financial markets because enhancing a Subpart C DCO's financial resources requirements from the minimum of Cover One to a more stringent Cover Two standard helps to ensure the affected Subpart C DCO will have greater financial resources to meet its obligations to market participants, including in the case of defaults by multiple clearing members. These added financial resources lessen the likelihood of the Subpart C DCO's failure which, in times of market turmoil, could increase the risk to the stability of the U.S. financial system.<sup>317</sup>

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

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

Regulation 39.33(b) prohibits a Subpart C DCO from using assessments to meet its default resource obligations, *i.e.*, those under regulations 39.11(a)(1) and 39.33(a). This prohibition currently applies to SIDCOs. Prohibiting the use of assessments by a Subpart C DCO in meeting its default resource requirement increases the financial stability of the Subpart C DCO, which in turn, will increase the overall stability of the U.S. financial markets.

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

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

As described above, regulations 39.33(c), (d) and (e) increase the likelihood that a SIDCO or Subpart C DCO will promptly meet its settlement

<sup>315</sup> See *supra* Section II.D. (discussing regulation 39.32).

<sup>316</sup> See *supra* Section II.E. (discussing revised regulation 39.33).

<sup>317</sup> See *supra* Section I.B.

obligations in a variety of market conditions. Liquidity arrangements that are highly reliable in stressed market conditions are important to enable the SIDCO or Subpart C DCO to promptly meet its cash obligations to its members. Ensuring that the SIDCO or Subpart C DCO can meet those obligations promptly, particularly in stressed market conditions, is an important firebreak to avoid loss of market confidence and cascading defaults.

Specifically, regulation 39.33(c) requires a SIDCO or Subpart C DCO to maintain a minimum level of eligible liquidity resources that would permit the DCO to satisfy its intraday, same-day, and multi-day settlement obligations in all relevant currencies. Regulation 39.33(d) requires a SIDCO or Subpart C DCO to undertake due diligence to confirm that each liquidity provider upon which the DCO relies has the capacity to perform its commitments to provide liquidity (and to regularly test its own procedures for accessing its liquidity resources). Proposed regulation 39.33(e) requires a SIDCO or Subpart C DCO to document its supporting rationale for, and to have adequate governance arrangements relating to, the amount of total financial resources it maintains and the amount of total liquidity resources it maintains.

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

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

iv. Regulation 39.34 (System safeguards for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

As discussed above, regulation 39.34, as revised, requires SIDCOs and Subpart C DCOs to comply with enhanced system safeguards requirements, including a two-hour RTO.<sup>318</sup> While SIDCOs are already subject to these requirements, the Commission expanded this regulation to include Subpart C DCOs. A two-hour RTO in a Subpart C DCO's BC-DR plan will increase the soundness and operating resiliency of the Subpart C DCO. The two-hour RTO ensures that even in the event of a wide-scale disruption, the potential negative effects upon U.S. financial markets would be minimized because the affected Subpart C DCO would recover rapidly and resume its critical market functions. This would allow other market participants to process their transactions, including those participants in locations not directly affected by the disruption. The two-hour RTO would increase a Subpart C DCO's resiliency by requiring the Subpart C DCO to have the resources and technology necessary to resume operations promptly. This resiliency, in turn, will increase the overall stability of the U.S. financial markets.

v. Regulation 39.35 (Default rules and procedures for uncovered losses or shortfalls (recovery) for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

Regulation 39.35, as detailed above, requires SIDCOs and Subpart C DCOs to adopt explicit rules and procedures for: i) allocating uncovered credit losses and ii) meeting all settlement obligations in

<sup>318</sup> See *supra* Section II.F. (discussing regulation 39.34).

a variety of market conditions.<sup>319</sup> The analysis SIDCOs and Subpart C DCOs will need to perform to create these rules and procedures are likely to contribute to a better *ex ante* understanding by the SIDCO or Subpart C DCO of the scenarios that would lead to uncovered credit losses or liquidity shortfalls. This analysis will also enable the SIDCO or Subpart C DCO to more effectively and efficiently meet its obligations promptly, thereby avoiding harm to clearing members and their customers from a default. In addition, requiring SIDCOs and Subpart C DCOs to have clear rules and procedures addressing such scenarios will be beneficial for clearing members and their customers in that these rules and procedures will provide clearing members with a better understanding of the members' own obligations, and the extent to which the SIDCO or Subpart C DCO would perform its obligations to its clearing members during periods of market stress. This understanding will, in turn, contribute to the ability of clearing members and their customers to tailor their own contingency plans to address those circumstances. Improved preparation by SIDCOs, Subpart C DCOs, and their clearing members will also redound to the benefit of the larger financial system by mitigating systemic risk.

vi. Regulation 39.36 (Risk management for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

As discussed above, Regulation 39.36 establishes enhanced risk management requirements designed to help SIDCOs and Subpart C DCOs manage their risk exposure.<sup>320</sup> These requirements include the stress testing of their financial resources, the stress testing of their liquidity resources, and conducting regular sensitivity analyses of their margin methodologies. The analyses performed to comply with this regulation will increase the DCO's ability to mitigate and address credit risks, and to create proper incentives for members with respect to the exposures they create to the SIDCO or Subpart C DCO by enabling the DCO to tie risk exposures to margin requirements. In addition, regulation 39.36 requires a SIDCO or Subpart C DCO to monitor, manage and limit its credit and liquidity risks arising from its settlement banks, as well invest its own funds and assets

<sup>319</sup> See *supra* Section II.G. (discussing regulation 39.35).

<sup>320</sup> See *supra* Section II.H. (discussing regulation 39.36).

in instruments with minimal credit, market, and liquidity risks.

Regulation 39.36, as adopted herein, increases the SIDCO's or Subpart C DCO's ability to mitigate and address the probability of being exposed to a settlement bank's failure and the potential losses and liquidity pressures to which the SIDCO or Subpart C DCO would be exposed in the event of such a failure. This, in turn, will benefit members of such DCOs and their customers, as discussed above. By enhancing the reliability and stability of SIDCOs and Subpart C DCOs, regulation 39.36 strengthens the overall stability of the U.S. financial markets.

vii. Regulation 39.37 (Additional disclosure for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

The disclosure requirements set forth in regulation 39.37<sup>321</sup> benefit clearing members of SIDCOs and Subpart C DCOs, as well as customers of clearing members, because they provide transparency and certainty concerning the processes, operations and exposures of these DCOs. In particular, paragraph (d) requires a SIDCO or Subpart C DCO to publicly disclose its policies and procedures concerning the segregation and portability of customers' positions and funds. These disclosures will enable clearing members and their customers to better understand their respective exposures to the SIDCO or Subpart C DCO, to better choose a DCO that fits their needs, and, in turn, to create incentives for safe and effective operations of SIDCOs and Subpart C DCOs.

viii. Regulation 39.38 (Efficiency for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

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

members of such DCOs and their customers, as well as the marketplace more broadly, may be offered more efficient clearing services that may be easier to access at an operational level.

ix. Regulation 39.39 (Recovery and wind-down for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations)

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

Regulation 39.39 also requires a SIDCO or Subpart C DCO to evaluate the resources available to meet the plan to cover credit losses and liquidity shortfalls, and to maintain sufficient unencumbered liquid financial assets to implement the plan to cover other risks. The latter point requires a SIDCO or Subpart C DCO to analyze whether its particular circumstances and risks require it to maintain liquid net assets to fund the plan that are in addition to those resources currently required by regulation 39.11(a)(2).<sup>322</sup>

The complex analysis and plan preparation that a SIDCO or Subpart C DCO will undertake to comply with this regulation, including designing and implementing changes to existing plans, are likely to contribute to a better *ex ante* understanding by the SIDCO's or Subpart C DCO's management of the challenges the DCO would face in a recovery or wind-down scenario, and thus better preparation to meet those challenges. This improved preparation will help reduce the possibility of market disruptions and financial losses to clearing members and their customers. By maintaining and regularly updating recovery and wind-down plans, and maintaining resources and arrangements designed to meet the requirements of such plans, the DCO will better be able to mitigate the impact that a threat to, or a disruption of, a SIDCO's or Subpart C DCO's operations would have on customers, clearing

members, and, more broadly, the stability of the U.S. financial markets. By reducing the possibility that a DCO would default in a disorganized fashion, regulation 39.39, as adopted herein, also helps to reduce the likelihood of a failure by the DCO to meet its obligations to its members, thereby enhancing protection for members of such a DCO and their customers, as well as helping to avoid the systemic effects of DCO failure.

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

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

The regulations finalized herein create additional standards for compliance with the CEA, which include governance standards, enhanced financial resources and liquidity resource requirements, system safeguard requirements, special default rules and procedures for uncovered losses or shortfalls, enhanced risk management requirements, additional disclosure requirements, efficiency standards, and standards for recovery and wind-down procedures. They also include procedures for Subpart C DCOs to elect to be held to such additional standards, and procedures to rescind such election. These standards and procedures will further the protection of members of SIDCOs and Subpart C DCOs, customers of such members, as well as other market participants and the public by increasing the financial stability and operational security of SIDCOs and Subpart C DCOs. Additionally, these regulations may, 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 these regulations, the increased costs associated with the implementation of the final rule for Subpart C DCOs would be borne only by those DCOs that have not been designated systemically important under Title VIII and that elect to become subject to the provisions of Subpart C. Some of those costs would ultimately be borne by clearing

<sup>321</sup> See *supra* Section II.I. (discussing regulation 39.37).

<sup>322</sup> See *supra* Section II.K. (discussing regulation 39.39).

members of such Subpart C DCOs, and by customers of such clearing members.

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

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

The regulations set forth in this final rulemaking promote the financial strength and stability of SIDCOs and Subpart C DCOs, as well as, more broadly, efficiency and greater competition in the global markets. Regulation 39.38, as finalized herein, expressly promotes efficiency in the design of a SIDCO's or Subpart C DCO's settlement and clearing arrangements, operating structure and procedures, scope of products cleared, and use of technology. The regulation also requires SIDCOs and Subpart C DCOs to accommodate internationally accepted communication procedures and standards to facilitate efficient payment, clearing, and settlement. In addition, the regulations finalized herein promote efficiency insofar as SIDCOs and Subpart C DCOs that operate with enhanced financial and liquidity resources, enhanced risk management requirements, increased system safeguards, and wind-down or recovery plans are more secure and are less likely to fail.

These regulations also promote competition because they are consistent with the international standards set forth in the PFMI and will help to ensure that SIDCOs are held to international standards and thus are enabled to gain QCCP status and accordingly avoid an important competitive disadvantage relative to similarly situated foreign CCPs that meet international standards and are QCCPs. Moreover, by allowing other DCOs to elect to become subject to the provisions of Subpart C and thus the

opportunity to meet international standards and to gain QCCP status, these regulations promote competition among registered DCOs, and between registered DCOs and foreign CCPs that meet international standards and are QCCPs. Conversely, the Commission notes that these enhanced financial resources and risk management standards are also associated with additional costs and to the extent that SIDCOs and Subpart C DCOs pass along the additional costs to their clearing members and, indirectly, those clearing members' customers, participation in the affected markets may decrease and have a negative impact on price discovery. However, it would appear that such higher transactional costs should (at least in the case of clearing members and customers that are banks or bank affiliates) be offset by the lower capital charges granted to bank or bank affiliated clearing members and customers for exposures resulting from transactions that are cleared through SIDCOs and Subpart C DCOs that are also QCCPs.

Additionally, enhanced risk management and operational standards promote financial integrity by leading to SIDCOs and Subpart C DCOs to be more secure and less likely to fail. By increasing the stability and strength of the SIDCOs and Subpart C DCOs, the regulations in this final rulemaking will help SIDCOs and Subpart C DCOs to meet their obligations in extreme circumstances and be able to resume operations even in the face of wide-scale disruption, which contributes to the financial integrity of the financial markets. Moreover, in requiring (1) more financial resources to be pre-funded by expanding the potential losses those resources are intended to cover and restricting the means for satisfying those resource requirements, and (2) requiring greater liquidity resources, the requirements of these regulations seek to lessen the incidence of pro-cyclical demands for additional resources and, in so doing, promote both financial integrity and market stability. By promoting the ability of SIDCOs and Subpart C DCOs to promptly meet their obligations to members, including in times of extreme market stress, they will mitigate the potential loss of market confidence, and the potential for cascading defaults. These efforts will redound to the benefit of clearing members and their customers, as well as the financial system more broadly.

#### c. Price Discovery

The regulations in this final rulemaking will enhance financial

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

#### d. Sound Risk Management Practices

The regulations in this final rulemaking contribute to the sound risk management practices of SIDCOs and Subpart C DCOs because the requirements promote the safety and soundness of SIDCOs and Subpart C DCOs by: (1) Enhancing the financial resources requirements and liquidity resource requirements; (2) enhancing understanding of credit and liquidity risks and related governance arrangements; (3) enhancing system safeguards to facilitate the continuous operation and rapid recovery of activities;<sup>323</sup> (4) enhancing risk management standards by creating new stress testing and sensitivity analysis requirements; (5) promoting the active management of credit and liquidity risks arising from settlement banks;<sup>324</sup> and (6) enhancing risk management by establishing rules and procedures addressing uncovered credit losses or liquidity shortfalls, and recovery and wind-down planning for credit risks and for business continuity and operational risks.<sup>325</sup> In addition, by strengthening

<sup>323</sup> As mentioned above, this rulemaking would extend to Subpart C DCOs the system safeguards requirements currently applicable to SIDCOs. See *supra* Section II.F. (discussing revised regulation 39.34 (system safeguards)).

<sup>324</sup> See *supra* Section II.H. (discussing regulation 39.36).

<sup>325</sup> See *supra* Section II.G. (discussing regulation 39.35); see also *supra* Section II.K. (discussing regulation 39.39).

financial and liquidity resource requirements, enhancing risk management standards, and enhancing disclosure and recovery planning requirements, the regulations in this final rule provide greater certainty for clearing members of such DCOs, their customers, and other market participants that obligations of the SIDCOs and Subpart C DCOs will be honored promptly (thereby facilitating market participants own management of risks, including mitigating the risk that participants will be faced, at a time of market stress, with a failure by the SIDCO or Subpart C DCO to promptly meet its obligations to them), and provide certainty and security to market participants that potential disruptions will be reduced and, by extension, the risk of loss of capital and liquidity will be reduced.

#### e. Other Public Interest Considerations

The Commission notes the strong public interest for jurisdictions to either adopt the PFMI or establish standards consistent with the PFMI in order to allow CCPs licensed in the relevant jurisdiction to gain QCCP status. As emphasized throughout this final rulemaking, SIDCOs and Subpart C DCOs that are held to international standards and that gain QCCP status might hold a competitive advantage in the financial markets by, *inter alia*, helping bank clearing members and bank customers avoid the much higher capital charges imposed by the Basel CCP Capital Requirements on exposures to non-QCCPs. Moreover, because “enhancements to the regulation and supervision of systemically important financial market utilities \* \* \* are necessary \* \* \* to support the stability of the broader financial system,”<sup>326</sup> adopting the regulations in this final rule will promote the public interest in a more stable broader financial system.

#### List of Subjects

##### 17 CFR Part 39

Commodity futures, Consumer protection, Default rules and procedures, Reporting and recordkeeping requirements, Risk management, Settlement procedures, System safeguards.

##### 17 CFR Part 140

Authority delegations (Government agencies), Conflict of interests, Organization and functions (Government agencies).

##### 17 CFR Part 190

Bankruptcy, Brokers, Commodity futures, Reporting and recordkeeping requirements.

For the reasons stated in the preamble, the Commodity Futures Trading Commission amends 17 CFR parts 39, 140, and 190 as follows:

#### PART 39—DERIVATIVES CLEARING ORGANIZATIONS

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

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

■ 2. Revise § 39.2 to read as follows:

##### § 39.2 Definitions.

For the purposes of this part:

*Activity with a more complex risk profile* includes:

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

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

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

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

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

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

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

*Key personnel* means derivatives clearing organization personnel who play a significant role in the operations of the derivatives clearing organization, the provision of clearing and settlement services, risk management, or oversight of compliance with the Act and Commission regulations and orders. Key personnel include, but are not limited to, those persons who are or perform the functions of any of the following: chief executive officer; president; chief compliance officer; chief operating officer; chief risk officer; chief financial officer; chief technology officer; and emergency contacts or persons who are responsible for business continuity or disaster recovery planning or program execution.

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

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

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

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

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

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

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

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

■ 3. Revise subpart C to read as follows:

<sup>326</sup> See Section 802(a)(4) of the Dodd-Frank Act (Congressional findings).



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

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

**§ 39.30 Scope.**

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

(b) A systemically important derivatives clearing organization is subject to the provisions of subparts A

and B of this part in addition to the provisions of this subpart.

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

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

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

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

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

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

(3) *Amendments.* A derivatives clearing organization shall promptly amend its Subpart C Election Form if it discovers a material omission or error

in, or if there is a material change in, the information provided to the Commission in the Subpart C Election Form or other information provided in connection with the Subpart C Election Form.

(4) *Effective date.* A derivatives clearing organization's election to become a subpart C derivatives clearing organization shall become effective:

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

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

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

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

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

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

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

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

this part, and any amendments or supplements thereto filed with the Commission pursuant to paragraphs (c)(3) or (4) of this section.

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

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

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

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

(d) *Public information.* The following portions of the Subpart C Election Form will be public: The Elections and Certifications and Disclosures in the

Subpart C Election Form, the rules of the derivatives clearing organization, the regulatory compliance chart, and any other portion of the Subpart C Election Form not covered by a request for confidential treatment complying with the requirements of § 145.9 of this chapter.

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

(i) The effective date of the rescission; and

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

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

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

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

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

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

(2) *Effective date.* The rescission of the election to be subject to the provisions of this subpart shall become effective on the date set forth in the notice of intent to rescind the election filed by the subpart C derivatives clearing organization pursuant to paragraph (e)(1) of this section, provided that the rescission may become effective no earlier than 180 days after the notice of intent to rescind the election is filed with the Commission. The subpart C derivatives clearing organization shall continue to comply with all of the provisions of this subpart until such effective date.

(3) *Additional notice requirements.* (i) A subpart C derivatives clearing organization shall provide the following

notices, at the following times, to each of its clearing members and shall have rules in place requiring each of its clearing members to provide the following notices to each of the clearing member's customers:

(A) No later than the filing of a notice of its intent to rescind its election to be subject to the provisions of this subpart, written notice that it intends to file such notice with the Commission and the effective date thereof; and

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

(ii) A subpart C derivatives clearing organization shall:

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

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

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

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

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

(f) *Loss of designation as a systemically important derivatives clearing organization.* A systemically

important derivatives clearing organization whose designation of systemic importance is rescinded by the Financial Stability Oversight Council, shall immediately be deemed to be a subpart C derivatives clearing organization and shall continue to comply with the provisions of this subpart unless such derivatives clearing organization elects to rescind its status as a subpart C derivatives clearing organization in accordance with the requirements of paragraph (e) of this section.

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

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

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

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

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

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

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

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

- (1) Are clear and documented;
- (2) To an extent consistent with other statutory and regulatory requirements on confidentiality and disclosure, are disclosed, as appropriate, to the Commission and to other relevant authorities, to clearing members and to customers of clearing members, to the owners of the systemically important derivatives clearing organization or subpart C derivatives clearing organization, and to the public;

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

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

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

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

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

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

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

(10) Assign responsibility for implementing the:

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

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

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

(1) The board of directors consists of suitable individuals having appropriate skills and incentives;

(2) The board of directors includes individuals who are not executives, officers or employees of the systemically important derivatives clearing organization or subpart C derivatives clearing organization or an affiliate thereof;

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

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

(5) Risk management and internal control personnel have sufficient independence, authority, resources, and access to the board of directors so that the operations of the systemically important derivatives clearing organization or subpart C derivatives clearing organization are consistent with the risk management framework established by the board of directors.

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

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

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

(i) Is a systemically important derivatives clearing organization, as defined by § 39.2; or

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

(3) The Commission shall, if it deems appropriate, determine whether any of the activities of a systemically important derivatives clearing organization or a subpart C derivatives clearing organization, in addition to clearing credit default swaps, credit default futures, and any derivatives that reference either credit default swaps or credit default futures, has a more complex risk profile. In determining whether an activity has a more complex

risk profile, the Commission will consider characteristics such as discrete jump-to-default price changes or high correlations with potential participant defaults as factors supporting (though not necessary for) a finding of a more complex risk profile.

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

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

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

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

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

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

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

(B) Committed lines of credit;

(C) Committed foreign exchange swaps;

(D) Committed repurchase agreements; or

(E) (1) Highly marketable collateral, including high quality, liquid, general obligations of a sovereign nation.

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

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

(4) *Additional liquidity resources.* If a systemically important derivatives clearing organization or subpart C derivatives clearing organization maintains financial resources in addition to those required to satisfy paragraph (c)(1) of this section, then those resources should be in the form of assets that are likely to be saleable with proceeds available promptly or acceptable as collateral for lines of credit, swaps, or repurchase agreements on an *ad hoc* basis. A systemically important derivatives clearing organization or subpart C derivatives clearing organization should consider maintaining collateral with low credit, liquidity, and market risks that is typically accepted by a central bank of

issue for any currency in which it may have settlement obligations, but shall not assume the availability of emergency central bank credit as a part of its liquidity plan.

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

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

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

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

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

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

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

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

(e) *Documentation of financial resources and liquidity resources.* Each systemically important derivatives clearing organization and subpart C

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

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

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

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

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

(2) Personnel, who live and work outside that relevant area, sufficient to enable the entity to meet the recovery time objective after interruption of

normal clearing by a wide-scale disruption affecting the relevant area in which the personnel the entity normally relies upon to engage in such activities are located;

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

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

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

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

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

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

(2) Repay any funds it may borrow; and

(3) Replenish any financial resources it may employ during such a stress event, so that the systemically important derivatives clearing organization or subpart C derivatives clearing organization can continue to operate in a safe and sound manner.

(b) *Allocation of uncovered liquidity shortfalls.* (1) Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall establish rules and/or procedures that enable it promptly to meet all of its settlement

obligations, on a same day and, as appropriate, intraday and multiday basis, in the context of the occurrence of either or both of the following scenarios:

(i) An individual or combined default involving one or more clearing members' obligations to the systemically important derivatives clearing organization or subpart C derivatives clearing organization; or

(ii) A liquidity shortfall exceeding the financial resources of the systemically important derivatives clearing organization or subpart C derivatives clearing organization.

(2) The rules and procedures described in paragraph (b)(1) of this section shall:

(i) Enable the systemically important derivatives clearing organization or subpart C derivatives clearing organization promptly to meet its payment obligations in all relevant currencies;

(ii) Be designed to enable the systemically important derivatives clearing organization or subpart C derivatives clearing organization to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations; and

(iii) Address the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's process to replenish any liquidity resources it may employ during a stress event so that it can continue to operate in a safe and sound manner.

**§ 39.36 Risk management for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.**

(a) *Stress tests of financial resources.*

In addition to conducting stress tests pursuant to § 39.13(h)(3), each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall conduct stress tests of its financial resources in accordance with the following standards and practices:

(1) Perform, on a daily basis, stress testing of its financial resources using predetermined parameters and assumptions;

(2) Perform comprehensive analyses of stress testing scenarios and underlying parameters to ascertain their appropriateness for determining the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's required level of financial resources in current and evolving market conditions;

(3) Perform the analyses required by paragraph (a)(2) of this section at least

monthly and when products cleared or markets served display high volatility or become less liquid, when the size or concentration of positions held by clearing members increases significantly, or as otherwise appropriate, evaluate the stress testing scenarios, models, and underlying parameters more frequently than once a month;

(4) For the analyses required by paragraphs (a)(1) and (2) of this section, include a range of relevant stress scenarios, in terms of both defaulting clearing members' positions and possible price changes in liquidation periods. The scenarios considered shall include, but are not limited to, the following:

- (i) Relevant peak historic price volatilities;
- (ii) Shifts in other market factors including, as appropriate, price determinants and yield curves;
- (iii) Multiple defaults over various time horizons;
- (iv) Simultaneous pressures in funding and asset markets; and
- (v) A range of forward-looking stress scenarios in a variety of extreme but plausible market conditions.

(5) Establish procedures for:

- (i) Reporting stress test results to its risk management committee or board of directors, as applicable; and
  - (ii) Using the results to assess the adequacy of, and to adjust, its total amount of financial resources; and
- (6) Use the results of stress tests to support compliance with the minimum financial resources requirement set forth in § 39.33(a).

(b) *Sensitivity analysis of margin model.* (1) Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall, at least monthly and more frequently as appropriate, conduct a sensitivity analysis of its margin models to analyze and monitor model performance and overall margin coverage. Sensitivity analysis shall be conducted on both actual and hypothetical positions.

(2) For the purposes of this paragraph (b), a sensitivity analysis of a margin model includes:

- (i) Reviewing a wide range of parameter settings and assumptions that reflect possible market conditions in order to understand how the level of margin coverage might be affected by highly stressed market conditions. The range of parameters and assumptions should capture a variety of historical and hypothetical conditions, including the most volatile periods that have been experienced by the markets served by the systemically important derivatives

clearing organization or subpart C derivatives clearing organization and extreme changes in the correlations between prices. The parameters and assumptions should be appropriate in light of the specific characteristics, considered on a current basis, of particular products and portfolios cleared.

(ii) Testing of the ability of the models or model components to produce accurate results using actual or hypothetical datasets and assessing the impact of different model parameter settings.

(iii) Evaluating potential losses in clearing members' proprietary positions and, where appropriate, customer positions.

(3) A systemically important derivatives clearing organization or subpart C derivatives clearing organization involved in activities with a more complex risk profile shall take into consideration parameter settings that reflect the potential impact of the simultaneous default of clearing members and, where applicable, the underlying credit instruments.

(c) *Stress tests of liquidity resources.* Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall conduct stress tests of its liquidity resources in accordance with the following standards and practices:

- (1) Perform, on a daily basis, stress testing of its liquidity resources using predetermined parameters and assumptions;
- (2) Perform comprehensive analyses of stress testing scenarios and underlying parameters to ascertain their appropriateness for determining the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's required level of liquidity resources in current and evolving market conditions;

(3) Perform the analyses required by paragraph (c)(2) of this section at least monthly and when products cleared or markets served display high volatility or become less liquid, when the size or concentration of positions held by clearing members increases significantly, or as otherwise appropriate, evaluate its stress testing scenarios, models, and underlying parameters more frequently than once a month;

(4) For the analyses required by paragraphs (c)(1) and (2) of this section, include a range of relevant stress scenarios, in terms of both defaulting clearing members' positions and possible price changes in liquidation periods. The scenarios considered shall

include, but are not limited to, the following:

- (i) Relevant peak historic price volatilities;
- (ii) Shifts in other market factors including, as appropriate, price determinants and yield curves;
- (iii) Multiple defaults over various time horizons;
- (iv) Simultaneous pressures in funding and asset markets; and
- (v) A range of forward-looking stress scenarios in a variety of extreme but plausible market conditions.

(5) For the scenarios enumerated in paragraph (c)(4) of this section, consider the following:

- (i) All entities that might pose material liquidity risks to the systemically important derivatives clearing organization or subpart C derivatives clearing organization, including settlement banks, permitted depositories, liquidity providers, and other entities,
- (ii) Multiday scenarios as appropriate,
- (iii) Inter-linkages between its clearing members and the multiple roles that they may play in the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's risk management; and
- (iv) The probability of multiple failures and contagion effect among clearing members.

(6) Establish procedures for:

- (i) Reporting stress test results to its risk management committee or board of directors, as applicable; and
  - (ii) Using the results to assess the adequacy of, and to adjust its total amount of liquidity resources.
- (7) Use the results of stress tests to support compliance with the liquidity resources requirement set forth in § 39.33(c).

(d) Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall regularly conduct an assessment of the theoretical and empirical properties of its margin model for all products it clears.

(e) Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall perform, on an annual basis, a full validation of its financial risk management model and its liquidity risk management model.

(f) *Custody and investment risk.* Custody and investment arrangements of a systemically important derivatives clearing organization's and subpart C derivatives clearing organization's own funds and assets shall be subject to the same requirements as those specified in § 39.15 for the funds and assets of

clearing members, and shall apply to the derivatives clearing organization's own funds and assets to the same extent as if such funds and assets belonged to clearing members.

(g) *Settlement banks.* Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall:

(1) Monitor, manage, and limit its credit and liquidity risks arising from its settlement banks;

(2) Establish, and monitor adherence to, strict criteria for its settlement banks that take account of, among other things, their regulation and supervision, creditworthiness, capitalization, access to liquidity, and operational reliability; and

(3) Monitor and manage the concentration of credit and liquidity exposures to its settlement banks.

**§ 39.37 Additional disclosure for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.**

In addition to the requirements of § 39.21, each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall:

(a) Complete and publicly disclose its responses to the Disclosure Framework for Financial Market Infrastructures published by the Committee on Payment and Settlement Systems and the Board of the International Organization of Securities Commissions;

(b) Review and update its responses disclosed as required by paragraph (a) of this section at least every two years and following material changes to the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's system or the environment in which it operates. A material change to the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's system or the environment in which it operates is a change that would significantly change the accuracy and usefulness of the existing responses;

(c) Disclose, publicly and to the Commission, relevant basic data on transaction volume and values; and

(d) Disclose, publicly and to the Commission, rules, policies, and procedures concerning segregation and portability of customers' positions and funds, including whether each of:

(1) Futures customer funds, as defined in § 1.3(jjjj) of this chapter;

(2) Cleared Swaps Customer Collateral, as defined in § 22.1 of this chapter; or

(3) Foreign futures or foreign options secured amount, as defined in § 1.3(rr) of this chapter is:

(i) Protected on an individual or omnibus basis or

(ii) Subject to any constraints, including any legal or operational constraints that may impair the ability of the systemically important derivatives clearing organization or subpart C derivatives clearing organization to segregate or transfer the positions and related collateral of a clearing member's customers.

**§ 39.38 Efficiency for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.**

(a) *General rule.* In order to meet the needs of clearing members and markets, each systemically important derivatives clearing organization and subpart C derivatives clearing organization should efficiently and effectively design its:

(1) Clearing and settlement arrangements;

(2) Operating structure and procedures;

(3) Scope of products cleared; and

(4) Use of technology.

(b) *Review of efficiency.* Each systemically important derivatives clearing organization and subpart C derivatives clearing organization should establish a mechanism to review, on a regular basis, its compliance with paragraph (a) of this section.

(c) *Clear goals and objectives.* Each systemically important derivatives clearing organization and subpart C derivatives clearing organization should have clearly defined goals and objectives that are measurable and achievable, including in the areas of minimum service levels, risk management expectations, and business priorities.

(d) Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall facilitate efficient payment, clearing and settlement by accommodating internationally accepted communication procedures and standards.

**§ 39.39 Recovery and wind-down for systemically important derivatives clearing organizations and subpart C derivatives clearing organizations.**

(a) *Definitions.* For purposes of this section:

(1) *General business risk* means any potential impairment of a systemically important derivatives clearing organization's or subpart C derivatives clearing organization's financial position, as a business concern, as a consequence of a decline in its revenues

or an increase in its expenses, such that expenses exceed revenues and result in a loss that the derivatives clearing organization must charge against capital.

(2) *Wind-down* means the actions of a systemically important derivatives clearing organization or subpart C derivatives clearing organization to effect the permanent cessation or sale or transfer of one or more services.

(3) *Recovery* means the actions of a systemically important derivatives clearing organization or subpart C derivatives clearing organization, consistent with its rules, procedures, and other *ex-ante* contractual arrangements, to address any uncovered credit loss, liquidity shortfall, capital inadequacy, or business, operational or other structural weakness, including the replenishment of any depleted pre-funded financial resources and liquidity arrangements, as necessary to maintain the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's viability as a going concern.

(4) *Operational risk* means the risk that deficiencies in information systems or internal processes, human errors, management failures or disruptions from external events will result in the reduction, deterioration, or breakdown of services provided by a systemically important derivatives clearing organization or subpart C derivatives clearing organization.

(5) *Unencumbered liquid financial assets* include cash and highly liquid securities.

(b) *Recovery and wind-down plan.* Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall maintain viable plans for:

(1) Recovery or orderly wind-down, necessitated by uncovered credit losses or liquidity shortfalls; and, separately,

(2) Recovery or orderly wind-down necessitated by general business risk, operational risk, or any other risk that threatens the derivatives clearing organization's viability as a going concern.

(c)(1) In developing the plans specified in paragraph (b) of this section, the systemically important derivatives clearing organization or subpart C derivatives clearing organization shall identify scenarios that may potentially prevent it from being able to meet its obligations, provide its critical operations and services as a going concern and assess the effectiveness of a full range of options for recovery or orderly wind-down. The plans shall include procedures for informing the

Commission, as soon as practicable, when the recovery plan is initiated or wind-down is pending.

(2) A systemically important derivatives clearing organization or subpart C derivatives clearing organization shall have procedures for providing the Commission and the Federal Deposit Insurance Corporation with information needed for purposes of resolution planning.

(d) *Financial resources to support the recovery and wind-down plan.*

(1) In evaluating the resources available to cover an uncovered credit loss or liquidity shortfall as part of its recovery plans pursuant to paragraph (b)(1) of this section, a systemically important derivatives clearing organization or subpart C derivatives clearing organization may consider, among other things, assessments of additional resources provided for under its rules that it reasonably expects to collect from non-defaulting clearing members.

(2) Each systemically important derivatives clearing organization and subpart C derivatives clearing organization shall maintain sufficient unencumbered liquid financial assets, funded by the equity of its owners, to implement its recovery or wind-down plans pursuant to paragraph (b)(2) of this section. In general, the financial resources required by § 39.11(a)(2) may be sufficient, but the systemically important derivatives clearing organization or subpart C derivatives clearing organization shall analyze its particular circumstances and risks and maintain any additional resources that may be necessary to implement the plans. In allocating sufficient financial resources to implement the plans, the systemically important derivatives clearing organization or subpart C derivatives clearing organization shall comply with § 39.11(e)(2). The plan shall include evidence and analysis to support the conclusion that the amount considered necessary is, in fact, sufficient to implement the plans.

(3) Resources counted in meeting the requirements of §§ 39.11(a)(1) and 39.33 may not be allocated, in whole or in part, to the recovery plans required by paragraph (b)(2) of this section. Other resources may be allocated, in whole or in part, to the recovery plans required by either paragraphs (b)(1) or (2) of this section, but not both paragraphs, and only to the extent the use of such resources is not otherwise limited by the Act, Commission regulations, the systemically important derivatives clearing organization's or subpart C derivatives clearing organization's rules, or any contractual arrangements to

which the systemically important derivatives clearing organization or subpart C derivatives clearing organization is a party.

(e) *Plan for raising additional financial resources.* All systemically important derivatives clearing organizations and subpart C derivatives clearing organizations shall maintain viable plans for raising additional financial resources, including, where appropriate, capital, in a scenario in which the systemically important derivatives clearing organization or subpart C derivatives clearing organization is unable, or virtually unable, to comply with any financial resources requirements set forth in this part. This plan shall be approved by the board of directors and be updated regularly.

(f) The Commission may, upon request, grant an entity, which has been designated as a systemically important derivatives clearing organization or that has elected to become subject to subpart C, up to one year to comply with any provision of this section or of § 39.35.

#### **§ 39.40 Consistency with the Principles for Financial Market Infrastructures.**

This subpart C is intended to establish standards which, together with subparts A and B of this part, are consistent with section 5b(c) of the Act and the Principles for Financial Market Infrastructures published by the Committee on Payment and Settlement Systems and the Board of the International Organization of Securities Commissions and should be interpreted in that context.

#### **§ 39.41 Special enforcement authority for systemically important derivatives clearing organizations.**

For purposes of enforcing the provisions of Title VIII of the Dodd-Frank Act, a systemically important derivatives clearing organization shall be subject to, and the Commission has authority under the provisions of subsections (b) through (n) of section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818) in the same manner and to the same extent as if the systemically important derivatives clearing organization were an insured depository institution and the Commission were the appropriate Federal banking agency for such insured depository institution.

#### **§ 39.42 Advance notice of material risk-related rule changes by systemically important derivatives clearing organizations.**

A systemically important derivatives clearing organization shall provide notice to the Commission in advance of any proposed change to its rules,

procedures, or operations that could materially affect the nature or level of risks presented by the systemically important derivatives clearing organization, in accordance with the requirements of § 40.10 of this chapter.

#### **§§ 39.28 and 39.29 [Added and Reserved]**

■ 4. In subpart B, add reserved §§ 39.28 and 39.29.

#### **Appendix to Part 39 [Redesignated as Appendix A to Part 39]**

■ 5. Redesignate the Appendix to Part 39—Form DCO Derivatives Clearing Organization Application for Registrations as Appendix A to Part 39—Form DCO Derivatives Clearing Organization Application for Registrations.

■ 6. Add appendix B to part 39 to read as follows:

#### **Appendix B to Part 39—Subpart C Election Form**

#### **COMMODITY FUTURES TRADING COMMISSION**

#### **SUBPART C ELECTION FORM**

##### *GENERAL INSTRUCTIONS*

**GENERAL INSTRUCTIONS:** Intentional misstatements or omissions of fact may constitute federal criminal violations (7 U.S.C. 13 and 18 U.S.C. 1001).

##### **DEFINITIONS**

Unless the context requires otherwise, all terms used in this Subpart C Election Form have the same meaning as in the Commodity Exchange Act ("Act"), and in the General Rules and Regulations of the Commodity Futures Trading Commission ("Commission") thereunder. All references to Commission regulations are found at 17 CFR Ch. 1.

For purposes of this Subpart C Election Form, the term "Applicant" shall mean a derivatives clearing organization that is filing this Subpart C Election Form with a Form DCO as part of an application for registration as a derivatives clearing organization pursuant to Section 5b of the Act and 17 CFR 39.3(a).

##### **GENERAL INSTRUCTIONS**

1. Any derivatives clearing organization requesting an election to become subject to subpart C of part 39 of the Commission's regulations must file this Subpart C Election Form. The Subpart C Election Form includes the election to be subject to the provisions of subpart C of part 39 of the Commission's regulations, certain required certifications, disclosures, and exhibits, and any supplements or amendments thereto filed pursuant to 17 CFR 39.31(b) or (c) (collectively, the "Subpart C Election Form").

2. Any derivatives clearing organization wishing to request an extension of up to one year to comply with any of the provisions of 17 CFR 39.34, 17 CFR 39.35 or 17 CFR 39.39, pursuant to 17 CFR 39.34(d) or 17 CFR 39.39(f) must do so prior to filing this



Subpart C Election Form. Such requests shall become part of this Subpart C Election Form.

3. Individuals' names, except the executing signature, shall be given in full (Last Name, First Name, Middle Name).

4. The signatures required in this Subpart C Election Form shall be the manual signatures of: a duly authorized representative of the derivatives clearing organization as follows: If the Subpart C Election Form is filed by a corporation, it must be signed in the name of the corporation by a principal officer duly authorized; if filed by a limited liability company, it must be signed in the name of the limited liability company by a manager or member duly authorized to sign on the limited liability company's behalf; if filed by a partnership, it must be signed in the name of the partnership by a general partner duly authorized; if filed by an unincorporated organization or association which is not a partnership, it must be signed in the name of such organization or association by the managing agent, i.e., a duly authorized person who directs or manages or who participates in the directing or managing of its affairs.

5. All applicable items must be answered in full.

6. Under Section 5b of the Act and the Commission's regulations thereunder, the Commission is authorized to solicit the information required to be supplied by this Subpart C Election Form from any Applicant seeking registration as a derivatives clearing organization and from any registered derivatives clearing organization.

7. Disclosure of the information specified in this Subpart C Election Form is mandatory prior to the processing of the election to become a derivatives clearing organization subject to the provisions of subpart C of part 39 of the Commission's regulations. The Commission may determine that additional information is required in order to process such election.

8. A Subpart C Election Form that is not prepared and executed in compliance with applicable requirements and instructions may be returned as not acceptable for filing. Acceptance of this Subpart C Election Form, however, shall not constitute a finding that the Subpart C Election Form is acceptable as filed or that the information is true, current or complete.

9. Except as provided in 17 CFR 39.31(d), in cases where a derivatives clearing organization submits a request for confidential treatment with the Secretary of the Commission pursuant to the Freedom of Information Act and 17 CFR 145.9, information supplied in this Subpart C Election Form will be included routinely in the public files of the Commission and will be made available for inspection by any interested person.

**APPLICATION AMENDMENTS**

17 CFR 39.31(b)(3) and (c)(4) require a derivatives clearing organization that has submitted a Subpart C Election Form to promptly amend its Subpart C Election Form if it discovers a material omission or error in, or if there is a material change in, the information provided to the Commission in

the Subpart C Election Form or other information provided in connection with the Subpart C Election Form. When amending a Subpart C Election Form, a derivatives clearing organization must re-file the Election and Certifications page, amended if necessary, and including all required executing signatures, and attach thereto revised exhibits or other materials marked to show changes, as applicable.

**WHERE TO FILE**

This Subpart C Election Form must be filed electronically with the Secretary of the Commission in the format and manner specified by the Commission.

**COMMODITY FUTURES TRADING COMMISSION**

**SUBPART C ELECTION FORM**

*ELECTION AND CERTIFICATIONS*

**Exact Name of the Derivatives Clearing Organization (as set forth in its charter, if an Applicant, or as set forth in its most recent order of registration, if registered with the Commission)**

Check here and complete sections 1 and 3 below, if the organization is an Applicant.

Check here and complete sections 2 and 3 below, if the organization currently is registered with the Commission as a derivatives clearing organization.

1. The derivatives clearing organization named above hereby elects to become subject to the provisions of subpart C of part 39 of the Commission's regulations in the event that the Commission approves its application for registration as a derivatives clearing organization.

The derivatives clearing organization and the undersigned each certify that, in the event that the Commission approves the derivatives clearing organization's application for registration and permits its election to become subject to subpart C of part 39 of the Commission's regulations:

a. The derivatives clearing organization will be in compliance with such regulations as of the date set forth in the notice thereof provided by the Commission pursuant to 17 CFR 39.31(c)(2), except to the limited extent that the Commission has granted the derivatives clearing organization an extension of time to comply with: (1) specified provisions of 17 CFR 39.34, pursuant to 17 CFR 39.34(d) and/or (2) specified provisions of 17 CFR 39.35 and/or 17 CFR 39.39, pursuant to 17 CFR 39.39(f);

b. The derivatives clearing organization will be in compliance with all provisions of 17 CFR 39.34, 39.35 and/or 39.39 for which the Commission, pursuant to 17 CFR 39.34(d) and/or 17

CFR 39.39(f), has granted an extension of time to comply in accordance with the terms of such extensions; and

c. The derivatives clearing organization will remain in compliance with the provisions contained in subpart C of part 39 of the Commission's regulations until this election is rescinded pursuant to 17 CFR 39.31(e).

\_\_\_\_\_  
Name of Derivatives Clearing Organization

\_\_\_\_\_  
Manual Signature of Duly Authorized Person

\_\_\_\_\_  
Print Name and Title of Signatory

2. The derivatives clearing organization named above hereby elects to become subject to the provisions of subpart C of part 39 of the Commission's regulations as of:

\_\_\_\_\_  
("Effective Date") [insert date, which must be at least 10 business days after the date this Subpart C Election Form is filed with the Commission].

The derivatives clearing organization and the undersigned each certify that:

a. As of the Effective Date set forth above, the derivatives clearing organization shall be in compliance with subpart C of part 39 of the Commission's regulations, except to the limited extent that the Commission has granted the derivatives clearing organization an extension of time to comply with: (1) specified provisions of 17 CFR 39.34, pursuant to 17 CFR 39.34(d) and/or (2) specified provisions of 17 CFR 39.35 and/or 17 CFR 39.39, pursuant to 17 CFR 39.39(f);

b. The derivatives clearing organization will be in compliance with all provisions of 17 CFR 39.34, 39.35 and/or 39.39 for which the Commission, pursuant to 17 CFR 39.34(d) and/or 17 CFR 39.39(f), has granted an extension of time to comply in accordance with the terms of such extensions; and

c. The derivatives clearing organization will remain in compliance with provisions contained in subpart C of part 39 of the Commission's regulations until this election is rescinded pursuant to 17 CFR 39.31(e).

\_\_\_\_\_  
Name of Derivatives Clearing Organization

\_\_\_\_\_  
Manual Signature of Duly Authorized Person

\_\_\_\_\_  
Print Name and Title of Signatory

3. The derivatives clearing organization named above has duly caused this Subpart C Election Form (which includes, as an integral part thereof, the Election and Certifications and all Disclosures and Exhibits) to be signed on its behalf by its duly authorized representative as of the \_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_. The

derivatives clearing organization and the undersigned each represent hereby that, to the best of their knowledge, all information contained in this Subpart C Election Form is true, current and complete in all material respects. It is understood that all required items including, without limitation, the Election and Certifications and Disclosures and Exhibits, are considered integral parts of this Subpart C Election Form.

\_\_\_\_\_  
Name of Derivatives Clearing Organization

\_\_\_\_\_  
Manual Signature of Duly Authorized Person

\_\_\_\_\_  
Print Name and Title of Signatory

## COMMODITY FUTURES TRADING COMMISSION

### PART 39, SUBPART C ELECTION FORM

#### DISCLOSURES AND EXHIBITS

Each derivatives clearing organization that requests an election to become subject to the provisions set forth in subpart C of part 39 of the Commission's regulations shall provide the Disclosures and Exhibits set forth below:

#### DISCLOSURES:

The derivatives clearing organization shall:

1. Publish on its Web site in a readily identifiable location the derivatives clearing organization's responses to the Disclosure Framework for Financial Market Infrastructures ("Disclosure Framework"), published by the Committee on Payment and Settlement Systems ("CPSS") and the Board of International Organization of Securities Commissions ("IOSCO") that are required to be completed pursuant to 17 CFR 39.37. The derivatives clearing organization's responses must be completed in accordance with section 2.0 and Annex A of the Disclosure Framework and must fully explain how the derivatives clearing organization observes the Principles for Financial Market Infrastructures ("PFMIs") published by CPSS and IOSCO.

Provide the URL to the specific page on the derivatives clearing organization's Web site where its responses to the Disclosure Framework may be found:

2. In the event that CPSS and IOSCO publish final criteria for the disclosure by a Financial Market Infrastructure ("FMI") of quantitative information to enable stakeholders to evaluate FMIs and to make cross comparisons referenced in section 2.5 of the Disclosure Framework ("Quantitative Information Disclosure"), publish such Quantitative Information Disclosure in a readily identifiable location on the derivatives clearing organization's Web site.

If applicable, provide the URL to the specific page on the derivatives clearing organization's Web site where its Quantitative Information Disclosure may be found:

#### EXHIBITS:

#### EXHIBIT INSTRUCTIONS:

1. The derivatives clearing organization must include a Table of Contents listing each Exhibit required by this Subpart C Election Form.

2. If the derivatives clearing organization is an Applicant, in its Form DCO, the derivatives clearing organization may summarize such information and provide a cross-reference to the Exhibit in this Subpart C Election Form that contains the required information.

The derivatives clearing organization shall provide the following Exhibits to this Subpart C Election Form:

#### EXHIBIT A—COMPLIANCE WITH SUBPART C

Attach, as Exhibit A, a regulatory compliance chart that separately sets forth for §§ 39.32–39.39 of the Commission's regulations, citations to the relevant rules, policies, and procedures of the derivatives clearing organization that address each such regulation and a summary of the manner in which the derivatives clearing organization will comply with each regulation. All citations and compliance summaries shall be separated by individual regulation and shall be clearly labeled with the corresponding regulation.

#### EXHIBIT B—GOVERNANCE

Attach, as Exhibit B, documents that demonstrate compliance with the governance requirements set forth in § 39.32 of the Commission's regulations.

#### EXHIBIT C—FINANCIAL RESOURCES

Attach, as Exhibit C, documents that demonstrate compliance with the financial resource requirements set forth in § 39.33 of the Commission's regulations.

#### EXHIBIT D—SYSTEM SAFEGUARDS

Attach, as Exhibit D, documents that demonstrate compliance with the system safeguard requirements set forth in § 39.34 of the Commission's regulations.

#### EXHIBIT E—DEFAULT RULES AND PROCEDURES FOR UNCOVERED LOSSES OR SHORTFALLS

Attach, as Exhibit E, documents that demonstrate compliance with the requirements for default rules and procedures for uncovered losses or shortfalls set forth in § 39.35 of the Commission's regulations.

#### EXHIBIT F—RISK MANAGEMENT

Attach, as Exhibit F, documents that demonstrate compliance with the risk management requirements set forth in § 39.36 of the Commission's regulations.

#### EXHIBIT G—RECOVERY AND WIND-DOWN

Attach, as Exhibit G, documents that demonstrate compliance with the recovery and wind-down requirements set forth in § 39.39 of the Commission's regulations.

## PART 140—ORGANIZATION, FUNCTIONS AND PROCEDURES OF THE COMMISSION

■ 7. The authority citation for part 140 continues to read as follows:

**Authority:** 7 U.S.C. 2(a)(12), 12a, 13(c), 13(d), 13(e), and 16(b).

■ 8. Amend § 140.94 to add new paragraphs (c)(12) and (c)(13) to read as follows:

**§ 140.94 Delegation of authority to the Director of the Division of Swap Dealer and Intermediary Oversight and the Director of the Division of Clearing and Risk.**

\* \* \* \* \*

(c) \* \* \*  
(12) All functions reserved to the Commission in § 39.31 of this chapter; and

(13) The authority to approve the requests described in §§ 39.34(d) and 39.39(f) of this chapter.

\* \* \* \* \*

## PART 190—BANKRUPTCY

■ 9. The authority citation for part 190 continues to read as follows:

**Authority:** 7 U.S.C. 1a, 2, 4a, 6c, 6d, 6g, 7a, 12, 19, and 24, and 11 U.S.C. 362, 546, 548, 556, and 761–766, unless otherwise noted.

■ 10. In § 190.09, revise paragraph (b) to read as follows:

**§ 190.09 Member property.**

\* \* \* \* \*

(b) *Scope of member property.* Member property shall include all money, securities and property received, acquired, or held by a clearing organization to margin, guarantee or secure, on behalf of a clearing member, the proprietary account, as defined in § 1.3 of this chapter, any account not belonging to a foreign futures or foreign options customer pursuant to the proviso in § 30.1(c) of this chapter, and any Cleared Swaps Proprietary Account, as defined in § 22.1 of this chapter: *Provided, however,* that any guaranty deposit or similar payment or deposit made by such member and any capital stock, or membership of such member in the clearing organization shall also be included in member property after payment in full, in each case in accordance with the by-laws or rules of the clearing organization, of that portion of:

(1) The net equity claim of the member based on its customer account; and

(2) Any obligations due to the clearing organization which may be paid therefrom, including any obligations due from the clearing organization to the customers of other members.

Issued in Washington, DC, on November 15, 2013, by the Commission.

**Melissa D. Jurgens,**

*Secretary of the Commission.*

**Note:** The following appendices will not appear in the Code of Federal Regulations.

**Appendices to Derivatives Clearing Organizations and International Standards—Commission Voting Summary and Statement of Chairman**

**Appendix 1—Commission Voting Summary**

On this matter, Chairman Gensler and Commissioners Chilton, O'Malia, and Wetjen voted in the affirmative; no Commissioner voted in the negative.

**Appendix 2—Statement of Chairman Gary Gensler**

I support the final rule to complete the process of bringing clearinghouse risk management rules in line with international standards.

In the fall of 2011, the Commission adopted a comprehensive set of rules for the risk management of clearinghouses. These final rules were consistent with international standards, as evidenced by the Principles for Financial Market Infrastructures (PFMIs) consultative document that had been published by the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (CPSS-IOSCO).

In April of 2012, CPSS-IOSCO issued final principles. Based upon these final principles, it was appropriate to augment our rules in certain areas to meet those standards,

particularly relating to systemically important clearinghouses.

These final rules will implement the remaining items from the PFMI's in our clearinghouse rules. They will enable clearinghouses designated by the Financial Stability Oversight Council as systemically important (SIDCOs) to be qualifying central counterparties for the purposes of international bank capital standards. This permits banks and bank affiliates that are members (or customers of members) of the SIDCOs to benefit from favorable capital treatment for their exposures to these SIDCOs. The final rules also implement an opt-in mechanism to permit other clearinghouses to elect to be held to these additional standards, and thus benefit from the same capital treatment.

[FR Doc. 2013-27849 Filed 11-29-13; 8:45 am]

**BILLING CODE 6351-01-P**