

Advance Notice of Proposed Rulemaking Regarding Authority to Designate Financial Market Utilities as Systemically Important

AGENCY: Financial Stability Oversight Council.

ACTION: Advance Notice of Proposed Rulemaking.

SUMMARY: Sections 112(a)(2)(J) and 804(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “DFA”) give the Financial Stability Oversight Council (the “Council”) the authority to identify and designate as systemically important a financial market utility if the Council determines that the failure, 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(6) of the DFA generally defines a “financial market utility” as 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 that person.¹ The utility-like arrangements used to settle financial transactions, whether involving payments, securities, derivatives, or other similar financial instruments, are critical parts of the financial infrastructure for the economy and are integral to the soundness of the financial system and overall economic performance. The importance of these arrangements has been highlighted by the recent period of market stress.

This advance notice of proposed rulemaking (ANPR) invites public comment on the criteria and analytical framework that should be applied by the Council in designating financial market utilities under the DFA.

DATES: Comments on this ANPR must be received by [INSERT DATE 30 DAYS AFTER FEDERAL REGISTER PUBLICATION]

ADDRESSES: Comments should be directed to [INSERT CONTACT INFORMATION]

SUPPLEMENTARY INFORMATION

I. BACKGROUND

The Council, which was established by section 111 of the DFA, has ten voting members and 5 nonvoting members.² It has several duties, including monitoring the financial services marketplace to identify

¹ Section 803(6)(B) of the DFA excludes certain entities from the definition of a financial market utility, including designated contract markets and national securities exchanges.

² The voting members consist of the Secretary of the Treasury who also is the Chairperson of the Council, the Chairman of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Director of the Bureau of Consumer Financial Protection, the Chairman of the Securities and Exchange Commission, the Chairperson of the Federal Deposit Insurance Corporation, the Chairperson of the Commodity Futures Trading Commission, the Director of the Federal Housing Finance Agency, the Chairman of the National Credit Union Administration Board, and an independent member having insurance expertise appointed by the President with the advice and consent of the Senate. The nonvoting members are the Director of the Office of Financial Research; the Director of the Federal Insurance Office; and a State insurance commissioner, a State banking supervisor, and a

potential threats to the financial stability of the United States and identifying those financial market utilities that should be designated by the Council as systemically important and subject to enhanced examination, supervision, enforcement and reporting standards and requirements.

Financial market utilities exist in a number of markets and provide many benefits, but also concentrate risk. The payment and settlement processes of such systems are also highly interdependent, either directly through operational, contractual or affiliation linkages, or indirectly through liquidity flows or common participants. Problems in the completion of settlement at one system could spill over to other systems or financial institutions in the form of liquidity and credit disruptions.

Through this ANPR the Council is seeking to gather information as it begins to develop the specific criteria and analytical framework by which it will designate financial market utilities³ as systemically important⁴ under Title VIII of the DFA. This ANPR does not address the designation criteria and analytical framework for payment, clearing, or settlement activities carried out by financial institutions⁵, which the Council is considering separately.

a. Considerations in making a determination

Under section 804(a)(2) of the DFA, in making a determination on whether the financial market utility should be designated as systemically important, the Council must consider:

- (A) The aggregate monetary value of transactions processed by the financial market utility;
- (B) The aggregate exposure of the financial market utility to its counterparties;
- (C) The relationship, interdependencies, or other interactions of the financial market utility with other financial market utilities or payment, clearing or settlement activities;
- (D) The effect that the failure of or a disruption to the financial market utility would have on critical markets, financial institutions, or the broader financial system; and
- (E) Any other factors that the Council deems appropriate.

b. Process for making a determination

Under the provisions of the DFA, the Council generally must provide a financial market utility with advance notice that it proposes to make a determination, and the financial market utility has up to 30 days to request a hearing.⁶ The Council must schedule the hearing within 30 days of receipt of the request. After holding a hearing, the Council has up to 60 days to make a final determination. If a financial

State securities commissioner (or an officer performing like functions), each designated by a selection process determined by their respective state supervisors or commissioners.

3 As defined in Section 803(6) of the DFA.

4 As defined in Section 803(9) of the DFA.

5 As defined in Section 803(7) of the DFA.

6 The Council may waive or modify the advance notice and hearing requirements if the Council determines it is necessary to prevent or mitigate an immediate threat to the financial system posed by the FMU. DFA § 804(c)(3).

market utility does not make a timely request for a hearing, the Council must notify the firm of its final determination within 30 days of the expiration of the 30-day period in which a hearing could have been requested. In making a determination, the Council must consult with the relevant supervisory agency for the financial market utility⁷ and the Board of Governors of the Federal Reserve System. Once designated, the Council can rescind a designation. The Council is not requesting comment on these procedural requirements in this ANPR.

II. CRITERIA FOR DESIGNATION

1. What quantitative and qualitative information should the Council use to measure the factors it is required to consider in Section 804(a)(2) when making determinations under Section 804 of the DFA? How should quantitative and qualitative considerations be incorporated into the determination process?
2. Can the considerations listed in section 804(a)(2) be broken down into easily measured factors that the Council should use to determine whether financial market utilities are systemically important? Are there certain levels of quantitative measures (e.g., for value and exposure) or qualitative characteristics (e.g., registered clearing agencies versus exempt clearing agencies) that should trigger a review for systemic importance by the Council?
3. Which of the considerations listed in section 804(a)(2) are most important for the Council to consider? Should the application of the considerations differ depending on the type of FMU, and if so how?
4. How should the Council measure and assess the aggregate monetary value of transactions processed by financial market utilities?
 - a. For each type of financial market utility (e.g., central counterparty, funds transfer system), what is the best approach for measuring value (e.g., notional values, margin flows, net versus gross values)?
 - b. What time horizon/statistics should be used when assessing value (e.g., daily, monthly or annual averages; daily, monthly, or annual peaks?). Should the Council consider historical values, projected future values, or both?
 - c. Should different measures be applied to different types of financial market utilities based on their activities, products, or markets?
 - d. What is the best approach for measuring potential aggregate monetary values for start-up financial market utilities?
 - e. Should certain payment systems that transfer relatively low aggregate values be considered by the Council for designation as systemically important given that the system's failure or

⁷ As defined in Section 803(8) of the DFA.

- disruption could still cause widespread disruption, especially if there is no ready alternative means of making payments? For example, the failure or disruption of a system used extensively to make payments could leave a significant portion of the general public with unexpected overdrafts and/or lack of liquid funds. If so, what factors should the Council consider in making a determination of systemic importance for such systems?
5. How should the Council measure and assess the aggregate exposure of financial market utilities engaged in payment, clearing, or settlement activities to its counterparties?
 - a. How should the Council identify the extent to which financial market utilities bear and create risk exposures for themselves and their participants?
 - b. What measures of exposure should be considered (e.g., liquidity exposures, current and potential future counterparty credit exposures, operational risk, the degree of concentration of exposures across participants)?
 - c. For each type of financial market utility (e.g., central counterparty, funds transfer system), what is the best approach for measuring current credit exposure or, where relevant, potential future exposures? For liquidity (funding), how might the Council assess the potential liquidity risks that a financial market utility may bear or liquidity risks it may impose on the broader financial system should it fail to settle as expected?
 6. How should the Council identify, measure, and assess the effects of relationships, interdependencies, and other interactions of financial market utilities listed as considerations in section 804(a)(2)?
 - a. What role should models of interdependencies (e.g., correlations; stress tests) play in the Council's determinations?
 - b. What role should the nature of participants or counterparties play in the Council's determinations (e.g., common participants across utilities, systemic importance of participants)?
 - c. Should the Council consider the legal, corporate, or contractual relationships of financial market utilities in assessing relationships, interdependencies, and other interactions (e.g., common holding company, joint ventures, cross-margining agreements, service provider relationships)?
 - d. Should the Council consider whether there are readily available substitutes for the payment, clearing, and settlement services of financial market utilities?
 7. How should the Council assess whether failures or disruptions to a financial market utility could potentially threaten the financial system of the United States?
 - a. What measures, information and thresholds should be used in assessing the effect of a financial market utility failure or disruption on critical markets and financial institutions? For example, how might the Council assess potential credit and liquidity effects and spillovers from a financial market utility disruption?

- b. What factors should the Council consider when determining whether markets served by financial market utilities are critical? What qualitative or quantitative characteristics might lead the Council to scope in or out particular markets?
8. Title VIII of the DFA contains distinct provisions with respect to financial market utilities and financial institutions engaged in payment, clearing and settlement activities. What factors should the Council consider in distinguishing between a systemically important financial market utility and a financial institution that is very substantially engaged in a systemically important payment, clearing, or settlement activity?
9. What other types of information would be effective in helping the Council determine systemic importance? What additional factors does your organization consider when assessing exposure to, or the interconnectedness of, financial market utilities?
10. What role should international considerations play in designating financial market utilities?