

# SECURITIES AND EXCHANGE COMMISSION

## 17 CFR Part 240

[Release No. 34-78963; File No. S7-23-16]

RIN 3235-AL48

### Definition of “Covered Clearing Agency”

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule amendments.

**SUMMARY:** The Securities and Exchange Commission (“SEC” or “Commission”) proposes to amend the definition of “covered clearing agency” under Rule 17Ad-22 to mean a registered clearing agency that provides the services of a central counterparty (“CCP”), central securities depository (“CSD”), or a securities settlement system (“SSS”). The Commission also proposes a definition of “securities settlement system” and proposes to amend the definitions of “central securities depository services” to facilitate the proposed amendment to “covered clearing agency.” In addition, the Commission proposes to amend the definition of “sensitivity analysis” under Rule 17Ad-22 to expand the scope of covered clearing agencies subject to requirements thereunder. These amendments are proposed pursuant to Section 17A of the Securities Exchange Act of 1934 (“Exchange Act”) and the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”), enacted in Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”).

**DATES:** Submit comments on or before December 12, 2016.

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-23-16 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-1090.

All submissions should refer to File Number S7-23-16. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission’s Internet website (<http://www.sec.gov/rules/proposed.shtml>).

Comments are also available for website viewing and printing in the Commission’s Public Reference Room, 100 F Street, N.E., Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission’s website. To ensure direct electronic receipt of such notifications, sign up through the “Stay Connected” option at <http://www.sec.gov> to receive notifications by e-mail.

**FOR FURTHER INFORMATION CONTACT:** Jeffrey Mooney, Assistant Director;

Stephanie Park, Senior Special Counsel; Matthew Lee, Branch Chief; Elizabeth Fitzgerald, Branch Chief; or DeCarlo McLaren, Attorney-Adviser; Office of Market Infrastructure, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-7010, at (202) 551-5710.

**SUPPLEMENTARY INFORMATION:** The Commission proposes to amend the definition of “covered clearing agency” in Rule 17Ad-22(a)(5) to mean a registered clearing agency that provides the services of a CCP, CSD, or SSS. The Commission further proposes to define “securities settlement system” under Rule 17Ad-22 to mean a clearing agency that enables securities to be transferred and settled by book entry according to a set of predetermined multilateral rules.<sup>1</sup> The Commission also proposes to amend Rule 17Ad-22(a)(3) to define “central securities depository” to mean a clearing agency that is a securities depository as described in Section 3(a)(23)(A) of the Exchange Act.<sup>2</sup>

In addition, the Commission proposes to amend the definition of “sensitivity analysis” in Rule 17Ad-22(a)(16) to expand its coverage, so that the policies and procedures of all covered clearing agencies that are CCPs provide for a sensitivity analysis that considers the most volatile relevant periods, where practical, that have been experienced by the markets served by the covered clearing agency.<sup>3</sup>

In developing these proposed amendments, Commission staff has consulted with the Financial Stability Oversight Council (“FSOC”), Commodity Futures Trading Commission

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<sup>1</sup> To facilitate this proposed addition, the Commission would renumber the remaining definitions in Rule 17Ad-22(a).

<sup>2</sup> See 15 U.S.C. 78c(a)(23)(A).

<sup>3</sup> If the proposed definition of “securities settlement system” is adopted, the definition of “sensitivity analysis” would move to Rule 17Ad-22(a)(17).

(“CFTC”), and Board of Governors of the Federal Reserve System (“FRB”).<sup>4</sup> The Commission has also considered the relevant international standards as required by Section 805(a)(2)(A) of the Clearing Supervision Act.<sup>5</sup> The relevant international standards for CCPs, CSDs, and SSSs are the *Principles for Financial Market Infrastructures* (“PFMI”).<sup>6</sup>

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<sup>4</sup> See 12 U.S.C. 5472.

<sup>5</sup> See 12 U.S.C. 5464(a)(2)(A).

<sup>6</sup> See Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions (“CPSS-IOSCO”), *Principles for Financial Market Infrastructures* (Apr. 16, 2012), available at <http://www.bis.org/publ/cpss101a.pdf>.

The PFMI sets forth twenty-four principles for financial market infrastructures (“FMIs”), each of which includes a headline standard and a list of key considerations that further explain the headline standard. Accompanying explanatory notes further discuss the objectives of and rationales for the standards, as well as provide guidance on how the standards can be implemented. See *id.* at 17. Commission staff co-chaired the working group within CPSS-IOSCO that drafted both the consultative and final versions of the PFMI. In 2014, the CPSS became the Committee on Payments and Market Infrastructures (“CPMI”).

CPMI-IOSCO has published subsequent guidance relevant to implementation of the PFMI. See PFMI: Disclosure framework and Assessment methodology (Dec. 2012), available at <http://www.bis.org/cpmi/publ/d106.pdf> (“PFMI disclosure framework”); Recovery of FMIs (Oct. 2014), available at <http://www.bis.org/cpmi/publ/d121.pdf>; Public quantitative disclosure standards for CCPs (Feb. 2015), available at <http://www.bis.org/cpmi/publ/d125.pdf> (“PFMI quantitative disclosures”); Guidance on cyber resilience for FMIs (Nov. 2015, consultative report), available at <http://www.bis.org/cpmi/publ/d138.pdf>; Resilience and recovery of CCPs: Further guidance on the PFMI (Aug. 2016, consultative report), available at <http://www.bis.org/cpmi/publ/d149.pdf>.

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## **I. Introduction**

The Commission preliminarily believes that amending the definition of “covered clearing agency” would further the Commission’s ongoing efforts to enhance the regulatory framework

for clearing agencies.<sup>7</sup> As discussed below, the Commission preliminarily believes that registered clearing agencies providing the services of CCPs, CSDs, and SSSs perform a critical role for the U.S. securities markets and the broader U.S. financial system by helping to reduce risk and by providing transparency to the markets. In light of this critical role, the Commission preliminarily believes that the definition of “covered clearing agency” should be expanded to include all such clearing agencies, which would make them subject to the enhanced requirements of Rule 17Ad-22(e).

### **A. Regulatory Framework**

Below is an overview of the relevant regulatory requirements for registered clearing agencies and for clearing agencies operating pursuant to an exemption from registration (“exempt clearing agencies”).

#### **1. Exchange Act**

Section 17A of the Exchange Act directs the Commission to facilitate the establishment of (i) a national system for the prompt and accurate clearance and settlement of securities transactions and (ii) linked or coordinated facilities for clearance and settlement of securities transactions.<sup>8</sup> In facilitating the establishment of the national clearance and settlement system, the Commission must have due regard for the public interest, the protection of investors, the

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<sup>7</sup> With these proposed rule amendments and guidance, the Commission is not re-opening comment on the rules adopted by the Commission in the CCA Standards adopting release with respect to those entities already subject to the adopted rules. See Exchange Act Release No. 34-78961, (Sept. 28, 2016) (“CCA Standards adopting release”).

<sup>8</sup> See 15 U.S.C. 78q-1(a)(2); see also Report of the Senate Committee on Banking, Housing & Urban Affairs, S. Rep. No. 94-75, at 4 (1975) (urging that “[t]he Committee believes the banking and security industries must move quickly toward the establishment of a fully integrated national system for the prompt and accurate processing and settlement of securities transactions”).

safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents.<sup>9</sup>

As discussed further below, clearing agencies are broadly defined in the Exchange Act and undertake a variety of functions.<sup>10</sup> Under Section 17A and Rule 17Ab2-1,<sup>11</sup> an entity that meets the definition of a clearing agency is required to register with the Commission or obtain from the Commission an exemption from registration prior to performing the functions of a clearing agency. To grant registration to a clearing agency, the Exchange Act requires the Commission to determine that the rules and operations of the applicant clearing agency meet the standards set forth in Section 17A.<sup>12</sup> Specifically, Section 17A(b)(3) provides that a clearing agency shall not be registered unless the Commission determines that the clearing agency's rules are consistent with the Exchange Act. In so doing, the Commission must determine that, among other things, (i) the clearing agency is so organized and has the capacity to be able to facilitate the prompt and accurate clearance and settlement of securities transactions and to safeguard securities or funds in its custody or control, (ii) the rules of the clearing agency assure a fair representation of its members and participants in the selection of its directors and administration of its affairs, (iii) the rules of the clearing agency provide for the equitable allocation of

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<sup>9</sup> See 15 U.S.C. 78q-1(a)(2)(A).

<sup>10</sup> See 15 U.S.C. 78c(a)(23)(A); see also infra note 40 and accompanying text (setting forth the definition of "clearing agency" under the Exchange Act).

<sup>11</sup> See 17 CFR 240.17Ab2-1.

<sup>12</sup> See 15 U.S.C. 78q-1(b)(3)(A)–(I) (identifying nine determinations that the Commission must make regarding the rules and structure of a clearing agency to grant registration). In 1980, the Commission published a statement of the views and positions of Commission staff regarding the requirements of Section 17A. See Exchange Act Release No. 16900 (June 17, 1980), 45 FR 41920 (June 23, 1980).

reasonable dues and fees, and (iv) the rules of the clearing agency are designed to promote the prompt and accurate clearance and settlement of securities transactions.<sup>13</sup> Section 17A(b)(1) further provides that upon the Commission’s motion or upon a clearing agency’s application, the Commission may conditionally or unconditionally exempt a clearing agency from any provision of Section 17A of the Exchange Act or the rules or regulations thereunder if the Commission finds that such exemption is consistent with the public interest, the protection of investors, and the purposes of Section 17A, including the prompt and accurate clearance and settlement of securities and funds.<sup>14</sup>

Following this registration process, the Commission supervises registered clearing agencies using various tools. One of these tools is Rule 17a-1 under the Exchange Act, which requires every registered clearing agency to keep and preserve at least one copy of all documents, including all correspondence, memoranda, papers, books, notices, accounts, and other such records as shall be made or received by it in the course of its business as such and in the conduct of its self-regulatory activity for a period not less than five years and, upon request of any representative of the Commission, to promptly furnish to the possession of such representative copies of any such documents required to be kept.<sup>15</sup> Another of these tools is the rule filing process for self-regulatory organizations (“SROs”),<sup>16</sup> set forth in Section 19(b) of the Exchange Act and rules and regulations thereunder. A registered clearing agency is required to

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<sup>13</sup> See 15 U.S.C. 78q-1(b)(3)(A), (C), (D), (F).

<sup>14</sup> See 15 U.S.C. 78q-1(b)(1).

<sup>15</sup> See 17 CFR 240.17a-1(a)–(c); see also 15 U.S.C 78q(a)(1), (2).

<sup>16</sup> Upon registration, registered clearing agencies are SROs under Section 3(a)(26) of the Exchange Act. See 15 U.S.C. 78c(a)(26).

file with the Commission any proposed rule or proposed change in, addition to, or deletion from the registered clearing agency's rules.<sup>17</sup> The Commission publishes all proposed rule changes for comment and reviews them. Proposed rule changes are generally required to be approved by the Commission prior to going into effect; however, certain types of proposed rule changes take effect upon filing with the Commission.<sup>18</sup> When reviewing a proposed rule change, the Commission considers the submissions of the clearing agency together with any comments received on the proposed rule change in making a determination of whether the proposed rule change is consistent with the requirements of the Exchange Act. In addition, Section 17A of the Exchange Act further provides the Commission with authority to adopt rules as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act and prohibits a clearing agency from engaging in any activity in contravention of such rules and regulations.<sup>19</sup>

In addition, Commission staff conducts examinations of registered and exempt clearing agencies to assess, among other things, existing and emerging risks, compliance with applicable statutory and regulatory requirements (including any terms and conditions set forth in an order granting registration or an exemption from registration), and a clearing agency's oversight of compliance by its participants with its rules. Section 21(a) of the Exchange Act provides the

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<sup>17</sup> An SRO must submit proposed rule changes to the Commission for review and approval pursuant to Rule 19b-4 under the Exchange Act. A stated policy, practice, or interpretation of an SRO, such as its written policies and procedures, would generally be deemed to be a proposed rule change. See 15 U.S.C. 78s(b)(1); 17 CFR 240.19b-4.

<sup>18</sup> See 15 U.S.C. 78s(b)(3)(A) (setting forth the types of proposed rule changes that take effect upon filing with the Commission). The Commission may temporarily suspend those rule changes within 60 days of filing and institute proceedings to determine whether to approve or disapprove the rule changes. See 15 U.S.C. 78s(b)(3)(C).

<sup>19</sup> See 15 U.S.C. 78q-1(d).

Commission with authority to initiate and conduct investigations to determine if there have been violations of the federal securities laws.<sup>20</sup> Section 19(h) of the Exchange Act also provides the Commission with authority to institute civil actions seeking injunctive and other equitable remedies and/or administrative proceedings arising out of such investigations.<sup>21</sup>

## **2. Dodd-Frank Act**

Title VII of the Dodd-Frank Act provides the Commission with authority to regulate certain over-the-counter (“OTC”) derivatives. Specifically, Title VII added provisions to the Exchange Act that (i) require entities performing the functions of a clearing agency with respect to security-based swaps (“security-based swap clearing agencies”) to register with the Commission, and (ii) direct the Commission to adopt rules with respect to security-based swap clearing agencies.<sup>22</sup>

The Clearing Supervision Act, enacted in Title VIII of the Dodd-Frank Act, provides for the enhanced regulation of certain financial market utilities (“FMUs”).<sup>23</sup> FMUs include clearing agencies that manage or operate a multilateral system for the purpose of transferring, clearing, or

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<sup>20</sup> See 15 U.S.C. 78u(a).

<sup>21</sup> See 15 U.S.C. 78s(h).

<sup>22</sup> See 15 U.S.C. 78q-1(i), (j); Dodd-Frank Act, Sec. 763(b), 124 Stat. at 1768–69 (adding paragraphs (i) and (j) to Section 17A of the Exchange Act).

<sup>23</sup> The objectives and principles for the risk management standards prescribed under the Clearing Supervision Act shall be to (i) promote robust risk management; (ii) promote safety and soundness; (iii) reduce systemic risks; and (iv) support the stability of the broader financial system. Further, the Clearing Supervision Act states that the standards may address areas such as risk management policies and procedures; margin and collateral requirements; participant or counterparty default policies and procedures; the ability to complete timely clearing and settlement of financial transactions; capital and financial resources requirements for designated FMUs; and other areas that are necessary to achieve the objectives and principles described above. See 12 U.S.C. 5464(b), (c).

settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the FMU.<sup>24</sup> FSOC has designated certain FMUs as systemically important or likely to become systemically important (“SIFMUs”).<sup>25</sup> SIFMUs are required to file 60-days advance notice of changes to rules, procedures, and operations that could materially affect the nature or level of risk presented by the SIFMU (“advance notice”).<sup>26</sup> The Clearing Supervision Act authorizes the Commission to object to changes proposed in such an advance notice, which would prevent the clearing agency from implementing the change.<sup>27</sup> The Clearing Supervision Act also provides for enhanced coordination between the Commission and FRB by allowing for regular on-site examinations and information sharing.<sup>28</sup> The Clearing Supervision Act further provides that the Commission and CFTC shall coordinate with the FRB

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<sup>24</sup> See 12 U.S.C. 5462(6). The definition of “financial market utility” in Section 803(6) of the Clearing Supervision Act contains a number of exclusions that include, but are not limited to, certain designated contract markets, registered futures associations, swap data repositories, swap execution facilities, national securities exchanges, national securities associations, alternative trading systems, security-based swap data repositories, security-based swap execution facilities, brokers, dealers, transfer agents, investment companies, and futures commission merchants. See 12 U.S.C. 5462(6)(B).

<sup>25</sup> See 12 U.S.C. 5463. An FMU is systemically important if the failure of or a disruption to the functioning of such FMU 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. See 12 U.S.C. 5462(9).

<sup>26</sup> See 12 U.S.C. 5465(e)(1)(A); 17 CFR 240.19b-4(n). The Commission published a final rule concerning the filing of advance notices for designated clearing agencies in 2012. See Exchange Act Release No. 34-67286 (June 28, 2012), 77 FR 41602 (July 13, 2012); see also 17 CFR 240.17Ad-22(a)(8) (defining “designated clearing agency”).

<sup>27</sup> See 12 U.S.C. 5465(e).

<sup>28</sup> See 12 U.S.C. 5466.

to jointly develop risk management supervision programs for SIFMUs.<sup>29</sup> In addition, the Clearing Supervision Act provides that the Commission and CFTC may each prescribe risk management standards governing the operations related to payment, clearing, and settlement activities (“PCS activities”) of SIFMUs for which each is the supervisory agency, in consultation with the FSOC and FRB and taking into consideration relevant international standards and existing prudential requirements.<sup>30</sup>

### **3. Rule 17Ad-22**

In 2012, the Commission adopted Rule 17Ad-22 under the Exchange Act to strengthen the substantive regulation of registered clearing agencies, promote the safe and reliable operation of registered clearing agencies, and improve efficiency, transparency, and access to registered clearing agencies.<sup>31</sup> At that time, the Commission noted that the implementation of Rule 17Ad-22 would be an important first step in developing the regulatory changes contemplated by Titles VII and VIII of the Dodd-Frank Act.<sup>32</sup> In this regard, Rule 17Ad-22(b) established certain

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<sup>29</sup> See 12 U.S.C. 5472; see also Risk Management Supervision of Designated Clearing Entities (July 2011), available at <https://www.federalreserve.gov/publications/other-reports/files/risk-management-supervision-report-201107.pdf> (describing the joint supervisory framework of the Commission, CFTC, and FRB) (“Risk Management Supervision Report”).

<sup>30</sup> See 12 U.S.C. 5464(a)(2). The Commission notes that, under Rule 17Ad-22(a)(8), a SIFMU for which the Commission is the supervisory agency is a “designated clearing agency.” See 17 CFR 240.17Ad-22(a)(8).

<sup>31</sup> See Exchange Act Release No. 34-71699 (Mar. 12, 2014), 79 FR 16865 (Mar. 26, 2014), corrected at 79 FR 29507, 29513 (May 22, 2014) (“CCA Standards proposing release”); see also 17 CFR 240.17Ad-22; Exchange Act Release No. 34-68080 (Oct. 22, 2012), 77 FR 66219, 66225–26 (Nov. 2, 2012) (“Clearing Agency Standards adopting release”).

<sup>32</sup> See Clearing Agency Standards adopting release, *supra* note 31, at 66224–25.

requirements for clearing agencies that provide CCP services, and Rule 17Ad-22(d) established requirements for the operation and governance of all registered clearing agencies.<sup>33</sup>

Contemporaneously with this proposal, the Commission has taken another step in its development of an enhanced regulatory regime for clearing agencies and expanded the requirements under Rule 17Ad-22 by adopting new paragraph (e).<sup>34</sup> Rule 17Ad-22(e) builds on the existing framework by establishing requirements for registered clearing agencies that meet the definition of a “covered clearing agency,” as discussed further below. Rule 17Ad-22(e) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to address the following topics concerning its operation and governance:

- general organization (including legal basis, governance, a framework for the comprehensive management of risks, and recovery planning);
- financial risk management (including credit risk, collateral, margin, and liquidity risk);
- settlement (including settlement finality, money settlements, and physical deliveries);
- CSDs and exchange-of-value settlement systems;
- default management (including default rules and procedures and segregation and portability);
- business and operational risk management (including general business risk, custody and investment risks, and operational risk);

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<sup>33</sup> See 17 CFR 240.17Ad-22(b), (d).

<sup>34</sup> See CCA Standards adopting release, supra note 7, at 463–477.

- access (including access and participation requirements, tiered participation arrangements, and links);
- efficiency (including efficiency and effectiveness and communication procedures and standards); and
- transparency.

As described in the CCA Standards adopting release, a covered clearing agency is subject to the requirements in Rule 17Ad-22(e), whereas a registered clearing agency that is not a covered clearing agency is subject to the requirements in Rule 17Ad-22(d).<sup>35</sup> As noted in the CCA Standards adopting release, the Commission continues to believe that the availability of Rules 17Ad-22(d) and (e) help ensure that the Commission can efficiently regulate registered clearing agencies depending on the specific activity and risks that each type of clearing agency poses to the U.S. markets.<sup>36</sup> In particular, Rule 17Ad-22(d) provides a set of requirements for registered clearing agencies that are not covered clearing agencies. The Commission expects to continue to use these two sets of requirements to regulate the national system for clearance and settlement as the varied entities that constitute it, including both covered clearing agencies and registered clearing agencies that are not covered clearing agencies, continue to emerge and evolve.

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<sup>35</sup> See CCA Standards adopting release, supra note 7, at 36–40. Rule 17Ad-22(d) sets forth minimum requirements for the operation and governance of registered clearing agencies. Under this rule proposal, all registered clearing agencies and covered clearing agencies would remain subject to the requirements in Section 17A of the Exchange Act and the relevant Commission rules and regulations thereunder, including Rules 17Ad-22(a) and (c). Covered clearing agencies would also remain subject to Rule 17Ad-22(e), and registered clearing agencies that are not covered clearing agencies would remain subject to Rule 17Ad-22(d). Registered clearing agencies that provide CCP services would also remain subject to Rule 17Ad-22(b).

<sup>36</sup> See id. at 38.

## **B. Distinctions among Clearing Agencies**

Section 17A of the Exchange Act was adopted in response to the paperwork crisis of the late 1960s that nearly brought the securities industry to a standstill and directly or indirectly resulted in the failure of large numbers of broker-dealers because the industry's clearance and settlement procedures were inefficient and lacked automation.<sup>37</sup> When Congress added Section 17A to the Exchange Act as part of the Securities Acts Amendments of 1975, it made the following four findings: (i) the prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership and the safeguarding of securities and funds related thereto, are necessary for the protection of investors and persons facilitating transactions by and acting on behalf of investors; (ii) inefficient procedures for clearance and settlement impose unnecessary costs on investors and persons facilitating transactions by and acting on behalf of investors; (iii) new data processing and communications techniques create the opportunity for more efficient, effective, and safe procedures for clearance and settlement; and (iv) the linking of all clearance and settlement facilities and the development of uniform standards and procedures for clearance and settlement will reduce unnecessary costs and increase the protection of investors and persons facilitating transactions by and acting on behalf of investors.<sup>38</sup> Congress therefore directed the Commission to facilitate the establishment of a

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<sup>37</sup> The paperwork crisis resulted from sharply increased trading volumes and historic industry inattention to securities processing, as demonstrated by inefficient, duplicative and highly manual clearance and settlement system, poor records, insufficient controls over funds and securities, and use of untrained personnel to perform processing functions. See, e.g., Commission, Study of Unsafe and Unsound Practices of Brokers and Dealers, H.R. Doc. No. 231, 92d Cong., 1st Sess. 13 (1971).

<sup>38</sup> See 15 U.S.C. 78q-1(a)(1)(A)–(D).

national system for the prompt and accurate clearance and settlement of securities transactions.<sup>39</sup>

The Commission's ability to achieve these goals and its supervision of the national system for clearance and settlement is based upon the regulation of the various entities that operate as clearing agencies.

In defining "clearing agency," Section 3(a)(23) of the Exchange Act contemplates a broad variety of roles and functions. Pursuant to Section 3(a)(23), a "clearing agency" is any person who does the following:

- acts as an intermediary in making payments or deliveries or both in connection with securities transactions;
- provides facilities for the comparison of data regarding the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities;
- acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry, without physical delivery of securities certificates (such as a securities depository); or
- otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates (such as a securities depository).<sup>40</sup>

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<sup>39</sup> See 15 U.S.C. 78q-1 *et seq.*; see also *supra* note 8.

<sup>40</sup> See 15 U.S.C. 78c(a)(23)(A); see also *supra* note 10 and accompanying text. In light of its potential breadth, the definition excludes, among others, any national securities exchange or

From these broad categories, a number of different types of clearing agencies have emerged under the Commission’s regulatory oversight of the national system for clearance and settlement.<sup>41</sup> As discussed below, the Commission’s historical approach in drawing distinctions among the various clearing agencies operating within the national system for clearance and settlement has, to a large degree, been predicated on the range of clearing agency functions performed within that system and whether, in response to these and other elements, the appropriate regulatory response is registration or an exemption from registration. Where registration is required, the complete set of regulation adopted by the Commission pursuant to its authority under Section 17A of the Exchange Act applies. As discussed above, those clearing agencies that perform on a broad basis CCP and CSD services have been required to register and are subject to the full range of Commission rules and regulations for clearing agencies.<sup>42</sup> Where the Commission has granted an exemption from registration, exemptive conditions tailored to the particular clearing agency functions performed by the clearing agency operate as the primary regulatory requirements.

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registered securities association solely by reason of its providing facilities for comparison of data respecting the terms of settlement of securities transactions effected on such exchange or by means of any electronic system operated or controlled by such association. See 15 U.S.C. 78c(a)(23)(B)(ii).

<sup>41</sup> In addition to those discussed below in Part I.B, the Commission has also previously stated that entities called “clearing corporations” fall within the definition of “clearing agency” under the Exchange Act. Clearing corporations provide a range of clearance and settlement services but may not necessarily fall within the definition of “CCP” or “CSD.” See Exchange Act Release No. 20221 (Sept. 23, 1983), 48 FR 45167 (Oct. 3, 1983) (order approving the clearing agency registration of four depositories and four clearing corporations).

<sup>42</sup> The Commission has also granted an exemption from registration as a clearing agency to certain entities that perform a limited amount of CSD services for U.S. securities in certain instances. See infra note 54.

## 1. Registered Clearing Agencies

Three common functions of registered clearing agencies are the functions of a CCP, CSD, and SSS. Each is described below.

A clearing agency performs the functions of a CCP when it interposes itself between the counterparties to a trade, acting functionally as the buyer to every seller and the seller to every buyer.<sup>43</sup> Currently, CCPs make up five of the six active clearing agencies registered with the Commission, and four of those five CCPs are covered clearing agencies subject to Rule 17Ad-22(e).<sup>44</sup>

A clearing agency performs the functions of a CSD when it (i) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry without physical delivery of securities certificates, or (ii) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates.<sup>45</sup> A CSD may also provide asset services, which may include the administration of corporate actions and redemptions. One of the six active registered clearing agencies provides securities depository services for the U.S. securities markets and is commonly referred to as a

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<sup>43</sup> See 17 CFR 240.17Ad-22(a)(1); Clearing Agency Standards adopting release, supra note 31, at 66229.

<sup>44</sup> The CCPs that make up five of the six active clearing agencies registered with the Commission are Fixed Income Clearing Corporation (“FICC”), ICE Clear Credit (“ICC”), ICE Clear Europe (“ICEEU”), National Securities Clearing Corporation (“NSCC”), and The Options Clearing Corporation (“OCC”). As discussed in more detail below, of those five CCPs, ICC is the only CCP that is currently not a covered clearing agency subject to Rule 17Ad-22(e).

<sup>45</sup> See 15 U.S.C. 78c(a)(23)(A); 17 CFR 240.17Ad-22(a)(2).

CSD.<sup>46</sup> This clearing agency providing CSD services is also a covered clearing agency subject to Rule 17Ad-22(e).

A clearing agency also may perform the functions of an SSS. An SSS is generally understood to be a clearing agency that enables securities to be transferred and settled by book entry according to a set of predetermined multilateral rules.<sup>47</sup> In the Commission’s experience, SSS functions may be performed in a single registered clearing agency that also provides CSD services. For example, on prior occasions the Commission has included book-entry transfers as among the functions of a CSD.<sup>48</sup> In the U.S. securities markets, such functions are currently performed by the one registered clearing agency providing securities depository services noted above, which is a covered clearing agency subject to Rule 17Ad-22(e).<sup>49</sup>

Five of the six active registered clearing agencies noted above are SIFMUs—i.e., they have been designated systemically important by FSOC pursuant to the Clearing Supervision Act.<sup>50</sup> As previously discussed, the Clearing Supervision Act provides for, among other things,

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<sup>46</sup> See 17 CFR 240.17Ad-22(a)(3); Clearing Agency Standards adopting release, *supra* note 31, at 66229. This registered clearing agency is the Depository Trust Company (“DTC”).

<sup>47</sup> See *infra* notes 83-88 and accompanying text (describing the range of services that a clearing agency may provide in connection with the settlement of securities transactions).

<sup>48</sup> See, e.g., Clearing Agency Standards adopting release, *supra* note 31, at 66253.

<sup>49</sup> See, e.g., Exchange Act Release No. 34-77991 (June 3, 2016), 81 FR 37232, 37232–33 (June 9, 2016) (notice describing in part the relationship between DTC’s depository and book-entry services).

<sup>50</sup> On July 18, 2012, the FSOC designated as systemically important the following then-registered clearing agencies: CME Group (“CME”), DTC, FICC, ICC, NSCC, and OCC. The Commission is the supervisory agency for DTC, FICC, NSCC, and OCC, and the CFTC is the supervisory agency for CME and ICC. The Commission jointly regulates ICC and OCC with the CFTC. In addition, the Commission jointly regulates ICE Clear Europe (“ICEEU”), which has not been designated as systemically important by FSOC, with the CFTC and Bank of England. DTC, FICC, NSCC, OCC, and ICEEU are covered clearing agencies subject to Rule 17Ad-22(e).

the enhanced regulation of SIFMUs, reflecting the fact that such entities are critical market infrastructures that may pose a systemic risk to the U.S. financial system. Each of the SIFMUs have generally been described as providing the services of a CCP or CSD.<sup>51</sup>

## 2. Exempt Clearing Agencies

In addition to registered clearing agencies, currently the Commission has granted exemptions from clearing agency registration to five exempt clearing agencies.<sup>52</sup> The Commission's exemptive orders contain tailored conditions that, among other things, take into account the range of clearing agency functions performed by each entity. Three exempt clearing agencies provide trade matching services, which are services that generally constitute comparison of data respecting the terms of settlement of securities transactions.<sup>53</sup> The remaining two exempt clearing agencies are non-U.S. entities that perform a limited range of clearing agency functions, including certain CSD and collateral management services.<sup>54</sup>

In addition, prior to the effective date of Title VII of the Dodd-Frank Act, the Commission issued a temporary exemption from the registration requirements for clearing

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<sup>51</sup> See, e.g., FSOC, 2012 Annual Report, at 163–187, available at <https://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>.

<sup>52</sup> The five exempt clearing agencies are Clearstream, Euroclear Bank SA/NV, Omgeo Matching Services – US, LLC, Bloomberg STP LLC, and SS&C Technologies, Inc. See *infra* notes 53–54 (citing the exemption orders for each).

<sup>53</sup> See Exchange Act Release No. 34-76514 (Nov. 24, 2015) 80 FR 75387 (Dec. 1, 2015) (“BSTP and SS&C exemption”); Exchange Act Release No. 34-44188 (Apr. 17, 2001), 66 FR 20494 (Apr. 23, 2001); see also Exchange Act Release No. 34-39829 (Apr. 6, 1998), 63 FR 17943 (Apr. 13, 1998) (providing interpretive guidance and requesting comment on the confirmation and affirmation of securities trades and matching).

<sup>54</sup> See Exchange Act Release No. 34-39643 (February 11, 1998), 63 FR 8232 (Feb. 18, 1998), as modified by Exchange Act Release No. 34-43775 (Dec. 28, 2000), 66 FR 819 (Jan. 4, 2001); Exchange Act Release No. 34-38328 (Feb. 24, 1997), 62 FR 9225 (Feb. 28, 1997).

agencies in Section 17A(b) of the Exchange Act to entities providing certain services, now sometimes referred to as post-trade processing services, for security-based swaps (“SBS exemption order”).<sup>55</sup> To date, six entities providing a range of such post-trade processing services are relying upon the SBS exemption order. The Commission stated that the exemptive order was necessary because the Dodd-Frank Act had expanded the definition of “security” to include security-based swaps, and therefore entities performing the functions of a clearing agency with respect to security-based swaps would be required to register under Section 17A(b)(1) of the Exchange Act upon the effective date of Title VII.<sup>56</sup> Those functions, as described by the Commission in the SBS exemption order, generally constitute certain collateral management, trade matching, and tear up or compression functions.<sup>57</sup>

## **II. Proposed Amendments under Rule 17Ad-22**

The Commission adopted Rule 17Ad-22(e) to strengthen the substantive regulation of clearing agencies, promote the safe and reliable operation of covered clearing agencies, and improve efficiency, transparency, and access to covered clearing agencies. Rule 17Ad-22(e)

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<sup>55</sup> See Exchange Act Release No. 34-64796 (July 1, 2011), 76 FR 39963 (July 7, 2011).

<sup>56</sup> In addition, as part of its consideration of whether future rulemaking for post-trade processing clearing agencies would be appropriate, the Commission noted that it may consider whether to apply rules to clearing agencies engaged in PCS activities identified in the Clearing Supervision Act. See Clearing Agency Standards adopting release, *supra* note 31, at 66228. In particular, the Clearing Supervision Act identifies the following as PCS activities: (i) calculation and communication of unsettled financial transactions between counterparties; (ii) netting of transactions; (iii) provision and maintenance of trade, contract, or instrument information; (iv) management of risks and activities associated with continuing financial transactions; (v) transmittal and storage of payment instructions; (vi) movement of funds; (vii) final settlement of financial transactions; and (viii) other similar functions that the FSOC may determine. See 12 U.S.C. 5462(7); see also *supra* note 30 and accompanying text.

<sup>57</sup> An expanded explanation of these different functions can be found in the SBS exemption order. See SBS exemption order, *supra* note 55, at 39964.

includes requirements for covered clearing agencies intended to address the activity and risks that their size, operation, and importance pose to the U.S. securities markets, the risks inherent in the products they clear, and the goals of both the Exchange Act and the Dodd-Frank Act. Of particular note, the requirements in Rule 17Ad-22(e) that address policies and procedures for transparency, governance, financial risk management, and operational risk management help ensure that covered clearing agencies are robust and stable.<sup>58</sup>

The Commission is proposing to expand the coverage of Rule 17Ad-22(e) so that all registered clearing agencies performing the functions of a CCP, CSD, or SSS would be subject to Rule 17Ad-22(e). To facilitate this amendment, the Commission is proposing in Part II.B a definition of “securities settlement system” and in Part II.C to amend the definition of “central securities depository services.” In addition, the Commission also is proposing in Part II.D to amend the definition of “sensitivity analysis” to expand its coverage, so that the policies and procedures of all covered clearing agencies that are CCPs provide for a sensitivity analysis that considers the most volatile relevant periods, where practical, that have been experienced by the markets served by the covered clearing agency. In Part II.E, the Commission seeks comment on each of the proposed amendments.

#### **A. Definition of “Covered Clearing Agency”**

Rule 17Ad-22(a)(5) currently defines a covered clearing agency as a registered clearing agency that: (i) has been designated as systemically important by the FSOC and for which the Commission is the supervisory agency under the Clearing Supervision Act (“designated clearing agency”); or (ii) provides CCP services for security-based swaps or is determined by the

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<sup>58</sup> See CCA Standards adopting release, supra note 7, at 475–477, 463, 464–471, 474; see also supra note 34 and accompanying text.

Commission to be involved in activities with a more complex risk profile (“complex risk profile clearing agency”), for which the CFTC is not the supervisory agency under the Clearing Supervision Act.<sup>59</sup> In the CCA Standards proposing release, the Commission sought comment on whether the scope of Rule 17Ad-22(e) was appropriate and whether the definition of “covered clearing agency” was appropriate and sufficiently clear given the requirements proposed.<sup>60</sup>

In the CCA Standards adopting release, the Commission took an important first step to establish coverage of the enhanced requirements in Rule 17Ad-22(e) over an initial group of registered clearing agencies. In light of the comments received on the CCA Standards proposing release, the Commission is now proposing to amend the definition of a “covered clearing agency” to broaden this coverage so that it encompasses all registered clearing agencies performing the functions of a CCP, CSD, or SSS. These functions are critical to the U.S. securities markets and the broader U.S. financial system and implicate the types of activities and risks that Rule 17Ad-22(e) is designed to address. Specifically, the Commission proposes that the definition of “covered clearing agency” be amended to mean a registered clearing agency that provides the services of a CCP, CSD, or SSS.

The Commission preliminarily believes that the proposed amendment to the “covered clearing agency” definition, which takes into account the specific functions performed by registered clearing agencies, would lead to greater regulatory consistency among all registered clearing agencies that perform these critical functions. Additionally, by focusing on functions rather than designation as systemically important, activities with a more complex risk profile, or the presence of another regulator, the proposed definition of “covered clearing agency” would

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<sup>59</sup> See 17 CFR 240.17Ad-22(a)(5).

<sup>60</sup> See *id.* at 29516–17.

ensure that all clearing agencies performing these critical functions are subject to enhanced requirements that address the particular services provided by and risks inherent in these critical functions.

### **1. Critical Functions Common among CCPs, CSDs, and SSSs**

Although the definition of “clearing agency” in the Exchange Act is broad, there are certain activities which, by virtue of their significance to the U.S. financial system generally, and the national system for clearance and settlement in particular, support the application of enhanced requirements. Among these are those clearing agency activities that, at a general level, concern the concentration and management of risk and the potential transmission of systemic risk. Registered clearing agencies that provide CCP, CSD, or SSS services perform common functions that implicate the concentration and management of risk and the resulting systemic risk concerns. The Commission therefore believes that it is appropriate to propose to expand the definition of “covered clearing agency” to subject all such registered clearing agencies to Rule 17Ad-22(e) because Rule 17Ad-22(e) includes enhanced requirements that help mitigate the systemic risk concerns raised by these activities, such as a requirement for policies and procedures regarding a framework for the comprehensive management of such risk and requirements for policies and procedures that address, among other things, financial and general business risk management, settlement risks, and transparency.<sup>61</sup>

Financial risk management is an essential aspect of the role that each of these registered clearing agencies provides for the U.S. securities markets, both for their own participants and participants in the broader U.S. financial system. Establishing requirements for policies and procedures governing such risk management practices is a cornerstone of Rule 17Ad-22(e). For

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<sup>61</sup> See 17 CFR 240.17Ad-22(e)(3)–(10), (15), (23).

example, with respect to credit risk, Rule 17Ad-22(e)(4) requires that each covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes.<sup>62</sup> With respect to liquidity risk, Rule 17Ad-22(e)(7) requires that each covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by the covered clearing agency, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis and its use of intraday liquidity.<sup>63</sup> Rule 17Ad-22(e)(5) and (6) also include enhanced requirements for policies and procedures to manage collateral and maintain a risk-based margin, with particular requirements that help to ensure resilient stress testing of a covered clearing agency's financial resources.<sup>64</sup>

General business risk is another potential risk that these types of registered clearing agencies, as entities that concentrate risk, must manage, and Rule 17Ad-22(e) includes enhanced requirements for policies and procedures that manage general business risk. Specifically, Rule 17Ad-22(e)(3) requires policies and procedures that provide for a comprehensive risk management framework that addresses a variety of risks, including both financial risk and

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<sup>62</sup> See 17 CFR 240.17Ad-22(e)(3). While Rule 17Ad-22(d) also includes some requirements for policies and procedures related to credit risk, Rule 17Ad-22(e) includes enhanced requirements related to, among other things, stress testing.

<sup>63</sup> See 17 CFR 240.17Ad-22(e)(7). Rule 17Ad-22(d) does not include requirements for policies and procedures related to the management of liquidity risk.

<sup>64</sup> See 17 CFR 240.17Ad-22(e)(5), (6).

general business risk.<sup>65</sup> Rule 17Ad-22(e)(15) further requires that each covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to identify, monitor, and manage the covered clearing agency's general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that the covered clearing agency can continue operations as a going concern if those losses materialize.<sup>66</sup>

Other requirements in Rule 17Ad-22(e) flow from the management of these risks as well.

Notably, Rule 17Ad-22(e)(3) requires policies and procedures reasonably designed to ensure that a covered clearing agency establishes plans for the recovery and orderly wind-down of the covered clearing agency necessitated by credit losses, liquidity shortfalls, losses from general business risk, or any other losses.<sup>67</sup> Rule 17Ad-22(e)(15) complements this requirement with requirements for policies and procedures reasonably designed to provide for holding liquid net assets funded by equity equal to the greater of either six months of its current operating expenses or the amount determined by the board of directors to be sufficient to ensure a recovery or orderly wind-down of critical operations and services of the covered clearing agency, as contemplated by the plans established under Rule 17Ad-22(e)(3).<sup>68</sup> The Commission preliminarily believes that a registered clearing agency that provides CCP, CSD, or SSS services should be subject to enhanced requirements for maintaining policies and procedures that manage business risk and provide for recovery and wind-down plans. These enhanced business risk

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<sup>65</sup> See 17 CFR 240.17Ad-22(e)(3). Rule 17Ad-22(d) does not include comparable requirements.

<sup>66</sup> See 17 CFR 240.17Ad-22(e)(15). Rule 17Ad-22(d) does not include requirements for policies and procedures related to the management of business risk.

<sup>67</sup> See 17 CFR 240.17Ad-22(e)(3)(ii).

<sup>68</sup> See 17 CFR 240.17Ad-22(e)(15)(ii).

requirements would benefit not only the clearing agency but also participants and the public.

Likewise, recovery and wind-down plans help ensure that CCPs, CSDs, SSSs, and policymakers can plan for and mitigate the potential systemic consequences of a wind-down or failure.

Facilitating settlement and mitigating settlement risks is another essential role played by these registered clearing agencies, CSDs and SSSs in particular, and another important component of Rule 17Ad-22(e) is enhanced requirements for policies and procedures governing settlement. For example, Rule 17Ad-22(e) includes requirements directed to settlement finality, physical delivery, and money settlements.<sup>69</sup> Importantly, it also includes rules with enhanced requirements for depository functions and settlement systems.<sup>70</sup>

Providing transparency to the markets is another essential role that these registered clearing agencies facilitate in the markets they serve by each maintaining a set of rules and procedures that govern their participants, their clearance and settlement services, and their risk management framework. Each registered clearing agency that provides CCP, CSD, or SSS services has rules that, while they may vary according to the characteristics of the markets they serve, generally govern how they clear transactions or trades submitted by participants, calculate whether and how much each participant owes in margin or to the clearing or participant fund on either a gross or net basis, receive securities from participants that owe securities, deliver securities to participants that are owed securities, collect payments from participants that owe

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<sup>69</sup> See 17 CFR 240.17Ad-22(e)(8), (9), (10).

<sup>70</sup> See 17 CFR 240.17Ad-22(e)(11). Rule 17Ad-22(d)(10) also includes requirements for policies and procedures related to the immobilization or dematerialization of securities certificates and the transfer of them by book entry, but does not include requirements for, among other things, policies and procedures relating to ensuring the integrity of securities issues, safeguarding the rights of securities issuers and holders, preventing the unauthorized creation or deletion of securities, or conducting periodic and at least daily reconciliation of securities issues. See 17 CFR 240.17Ad-22(d)(10).

money, and pay participants that are owed money. Rule 17Ad-22(e)(23)(iv) also requires a covered clearing agency to have policies and procedures that provide for a comprehensive public disclosure of its material rules, policies, and procedures regarding the requirements in Rule 17Ad-22(e).<sup>71</sup> Increased transparency helps market participants manage their risks, thereby reducing systemic risk concerns across the U.S. financial system.

Each of the above roles, common across the registered clearing agencies that provide CCP, CSD, and SSS services, is addressed by the enhanced requirements in Rule 17Ad-22(e), and therefore the Commission believes that expanding the definition of “covered clearing agency” to include those registered clearing agencies that are integral in either performing these functions or managing these risks, as appropriate, will help to further strengthen the national system for clearance and settlement and help to further mitigate risk to the broader U.S. financial system.

## **2. Critical Functions Specific to CCPs, CSDs, or SSSs**

In addition to the critical roles common across CCPs, CSDs, and SSSs, each such clearing agency also performs unique functions that support expanded coverage of the “covered clearing agency” definition and, through it, application of Rule 17Ad-22(e) to such clearing agencies because, as discussed further below, Rule 17Ad-22(e) also includes enhanced requirements with respect to these functions.

First, with respect to CCPs, the Commission is proposing that the definition of “covered clearing agency” be expanded so that CCPs would be subject to Rule 17Ad-22(e) in all circumstances. The Commission has, on previous occasions, noted that increasing reliance by

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<sup>71</sup> See 17 CFR 240.17Ad-22(e)(23)(iv). No comparable requirement exists in Rule 17Ad-22(d).

market participants on CCPs supports the application of enhanced regulatory requirements that address the risks posed by such activity.<sup>72</sup> For example, market participants may rely on CCPs because clearing and settling a high volume of financial transactions multilaterally through a CCP can allow for greater efficiency and lower costs than settling bilaterally.<sup>73</sup> In addition, CCPs are often able to manage risks for their participants related to the clearing and settling of financial transactions more effectively, and, in some cases, reduce certain risks such as the risk that a purchaser of a security will not receive the security or that a seller of a security will not receive payment for the security.<sup>74</sup> CCPs have also become increasingly important given the mandated central clearing of certain swaps and security-based swaps that is required by the Dodd-Frank Act.<sup>75</sup>

CCPs confer certain benefits to the markets in which they operate, but can also pose substantial risk not only to individual market participants but also to the broader financial system, due in part to the fact that central clearing concentrates risk. Disruption to such functions, or failure on the part of the clearing agency to meet its obligations, could, result in significant costs to the clearing agency itself and its members and create a potential source of contagion affecting other market participants or the broader U.S. financial system.<sup>76</sup> As a result,

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<sup>72</sup> See CCA Standards adopting release, supra note 7, at 257–264; Clearing Agency Standards adopting release, supra note 31, at 66264–65 (noting, among other things, that the effectiveness of a CCP’s risk controls and the adequacy of its financial resources are critical aspects of the infrastructure of the market it serves).

<sup>73</sup> See, e.g., Risk Management Supervision Report, supra note 29, at 8.

<sup>74</sup> See, e.g., id. at 8.

<sup>75</sup> See, e.g., id. at 3.

<sup>76</sup> See generally Darrell Duffie, Ada Li & Theo Lubke, Policy Perspectives on OTC Derivatives Market Infrastructure, at 9 (Fed. Reserve Bank N.Y. Staff Reps., Mar. 2010),

proper management of the risks associated with central clearing is necessary to ensure the stability of the U.S. securities markets and the broader U.S. financial system. Each CCP determines how best to manage its credit and liquidity risks, consistent with its regulatory framework and as appropriate for the products it clears and the market it serves. For example, participants must meet membership requirements to join a CCP. Each CCP determines who meets its membership criteria and continues to monitor its membership to ensure that the members continue to meet these criteria. Similarly, each CCP is responsible for determining its own margin models and ensuring that each member meets its obligations under the margin models. When the Commission adopted Rule 17Ad-22(e), it sought to impose enhanced requirements to an initial group of registered clearing agencies that concentrated risk because

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available at [http://www.newyorkfed.org/research/staff\\_reports/sr424.pdf](http://www.newyorkfed.org/research/staff_reports/sr424.pdf) (“If a CCP is successful in clearing a large quantity of derivatives trades, the CCP is itself a systemically important financial institution. The failure of a CCP could suddenly expose many major market participants to losses. Any such failure, moreover, is likely to have been triggered by the failure of one or more large clearing members, and therefore to occur during a period of extreme market fragility.”); Craig Pirrong, *The Inefficiency of Clearing Mandates*, Policy Analysis, No. 655, at 11–14, 16–17, 24–26 (2010), available at <http://www.cato.org/pubs/pas/PA665.pdf>, at 11–14, 16–17, 24–26 (stating, among other things, that “CCPs are concentrated points of potential failure that can create their own systemic risks,” that “[a]t most, creation of CCPs changes the topology of the network of connections among firms, but it does not eliminate these connections,” that clearing may lead speculators and hedgers to take larger positions, that a CCP’s failure to effectively price counterparty risks may lead to moral hazard and adverse selection problems, that the main effect of clearing would be to “redistribute losses consequent to a bankruptcy or run,” and that clearing entities have failed or come close to failing in the past, including in connection with the 1987 market break); Manmohan Singh, *Making OTC Derivatives Safe—A Fresh Look*, at 5–11 (IMF Working Paper, Mar. 2011), available at <http://www.imf.org/external/pubs/ft/wp/2011/wp1166.pdf> (addressing factors that could lead central counterparties to be “risk nodes” that may threaten systemic disruption); Domanski, Dietrich, Leonardo Gambacorta, and Cristina Picillo. “Central clearing: trends and current issues.” *BIS Quarterly Review* December (2015), available at [https://www.bis.org/publ/qtrpdf/r\\_qt1512g.pdf](https://www.bis.org/publ/qtrpdf/r_qt1512g.pdf) (describing links between CCP financial risk management and systemic risk); Wendt, Froukelien, *Central counterparties: addressing their too important to fail nature* (2015), available at <http://papers.ssrn.com/sol3/Delivery.cfm/wp1521.pdf?abstractid=2568596&mirid=1&type=2> (assessing the potential channels for contagion arising from CCP interconnectedness).

they were either designated systemically important or engaged in activities with a more complex risk profile. Now, the Commission believes it is appropriate to propose to expand the coverage of the “covered clearing agency” definition to include all CCPs because, as described above, CCP operations generally concentrate risk and can also act as a transfer mechanism for risk, and Rule 17Ad-22(e) includes enhanced requirements that help mitigate the risks that CCP functions carry. In particular, Rule 17Ad-22(e) includes requirements for the management of credit and liquidity risk, the development of recovery and wind-down plans, and tiered participation arrangements,<sup>77</sup> and the Commission believes that applying these requirements to all CCPs will help further mitigate systemic risk to the U.S. financial system.

Second, the Commission is similarly proposing that a clearing agency providing CSD services also be a covered clearing agency. The Commission has noted on previous occasions the importance of CSDs to the U.S. securities markets. For example, the Commission has noted that CSDs are critical elements of the national system for clearance and settlement,<sup>78</sup> and that the establishment of consistent standards for CCP and CSD operations is an important goal that underpinned the enactment of Section 17A of the Exchange Act.<sup>79</sup> CSDs play a key role in modern financial markets, where, for many issuers, transactions in securities often involve no transfer of physical certificates.<sup>80</sup> Such paperless trading generally improves transactional efficiency but for such benefits to accrue, market participants must have confidence that CSDs

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<sup>77</sup> See 17 CFR 240.17Ad-22(e)(4), (7), (19).

<sup>78</sup> See BSTP and SS&C exemption, supra note 53, at 75398 (noting that a CSD is “a critical element of the national system for clearance and settlement”).

<sup>79</sup> See Clearing Agency Standards adopting release, supra note 34, at 66273.

<sup>80</sup> See CCA Standards proposing release, supra note 31, at 29603.

can correctly account for the number of securities in their custody and for the book entries that allocate securities across participant accounts. The Commission therefore is proposing that CSDs also be subject to Rule 17Ad-22(e) in all circumstances because of the important role they play in the national system for clearance and settlement of securities. Rule 17Ad-22(e)(11) established enhanced requirements specific to CSDs. Rule 17Ad-22(e)(11)(i) requires a covered clearing agency that provides central securities depository (“CSD”) services to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain securities in an immobilized or dematerialized form for their transfer by book entry, ensure the integrity of securities issues, and minimize and manage the risks associated with the safekeeping and transfer of securities. Rule 17Ad-22(e)(11)(ii) requires a covered clearing agency that provides CSD services to establish, implement, maintain and enforce written policies and procedures reasonably designed to implement internal auditing and other controls to safeguard the rights of securities issuers and holders, prevent the unauthorized creation or deletion of securities, and conduct periodic and at least daily reconciliation of securities issues it maintains. Finally, Rule 17Ad-22(e)(11)(iii) requires a covered clearing agency that provides CSD services to establish, implement, maintain and enforce written policies and procedures reasonably designed to protect assets against custody risk through appropriate rules and procedures consistent with relevant laws, rules, and regulations in jurisdictions where it operates.<sup>81</sup> In addition, Rule 17Ad-22(e) generally strengthens the substantive regulations of clearing agencies through, among other things, requirements for the comprehensive management of risk and the development of recovery and wind-down plans, which are equally important to

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<sup>81</sup> See CCA Standards adopting release, supra note 7, at 472.

CSDs.<sup>82</sup> Therefore, the Commission believes that applying Rule 17Ad-22(e) to all clearing agencies providing CSD services will further help mitigate risk to the U.S. financial system.

Lastly, while in the U.S. securities markets the functions of an SSS are typically performed by a registered clearing agency that also provides CSD services, the Commission has also noted that clearing agencies provide a broad range of services in connection with the settlement of securities transactions.<sup>83</sup> For example, the Commission has previously noted that clearing agencies “provide differing clusters of services for their participants.”<sup>84</sup> In particular, “[c]learing corporations generally receive trade data respecting exchanges or [over-the-counter] trades between broker-dealers and compare, account for and settle the netted securities transactions.”<sup>85</sup> Over the years, the Commission has registered a number of entities as clearing agencies that provide a variety of securities settlement services. These services include facilitating the settlement of transactions executed by specialists on an exchange,<sup>86</sup> providing clearance and settlement services for mortgage-backed securities transactions,<sup>87</sup> and facilitating

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<sup>82</sup> See id. at 91–105 (describing the requirements under Rule 17Ad-22(e)(3)).

<sup>83</sup> See Exchange Act Release No. 34-20221 (Sept. 23, 1983), 48 FR 45167, 45169 & n.32 (Oct. 3, 1983) (in describing the accounting processes that generate securities settlement obligations, distinguishing NSCC’s “continuous net settlement” system from a “daily balance order” system); Exchange Act Release No. 34-21335 (Sept. 20, 1984), 49 FR 37879, 37879 (Sept. 26, 1984) (in describing the functions performed by the Boston Stock Exchange Clearing Corporation (“BSECC”), noting that BSECC transmits data to NSCC for processing and collects and pays members’ daily settlement obligations at NSCC and DTC);

<sup>84</sup> See 48 FR at 45169.

<sup>85</sup> See id. (citations omitted).

<sup>86</sup> See id. at 45173–77 (approving the registration of the Stock Clearing Corporation of Philadelphia subject to conditions).

<sup>87</sup> See Exchange Act Release No. 34-24046 (Feb. 2, 1987), 52 FR 4218 (Feb. 10, 1987) (order granting registration as a clearing agency to MBS Clearing Corporation).

the clearance and settlement of cross-border transactions.<sup>88</sup> These SSSs play a vital role in fostering the proper functioning of financial markets, but if they are not effectively managed they have the potential to act as transmission channels for financial shocks, particularly on days of market stress.

The Commission also believes that a clearing agency providing SSS services can raise credit, market, and operational risk concerns.<sup>89</sup> The Commission preliminarily believes that these functions, whether performed independently or consolidated with other clearing agency functions in a single registered clearing agency, support application of the enhanced standards in Rule 17Ad-22(e).<sup>90</sup> In recent years, the Commission has adopted requirements for the policies and procedures of certain clearing agencies under Rule 17Ad-22 to help achieve delivery versus payment and eliminate principal risk,<sup>91</sup> both of which relate to the provision of SSS services. The Commission adopted Rule 17Ad-22(e) to strengthen the substantive regulations applicable to clearing agencies to address, among other things, credit, market, and operational risk.

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<sup>88</sup> See Exchange Act Release No. 34-26812 (May 12, 1989), 54 FR 21691 (May 19, 1989) (order approving temporary registration as a clearing agency of the International Securities Clearing Corporation).

<sup>89</sup> The Commission notes that, currently, no registered clearing agency provides only SSS services in the United States. Nonetheless, the Commission preliminarily believes that SSSs, because they are financial market infrastructures that provide centralized services similar to CCPs and CSDs, can also serve as potential transmission mechanisms for systemic risk and should therefore also be subject to the same requirements as CCPs and CSDs. In this regard, the Commission notes that Rule 17Ad-22(e)(12) includes requirements specific to settlement systems. See CCA Standards adopting release, *supra* note 7, at 472.

<sup>90</sup> See generally Report of the Senate Committee on Banking, Housing & Urban Affairs, S. Rep. No. 94-75, at 5, 91 (recognizing book-entry transfer as one of three basic clearing agency functions before consolidating it, along with clearing and the transfer of record ownership, into a single definition of “clearing agency” in the Exchange Act).

<sup>91</sup> See 17 CFR 240.17Ad-22(d)(13), (e)(12).

Because SSS operations present these types of risk, the Commission is proposing to apply Rule 17Ad-22(e) to all entities performing these SSS functions.

### **3. Increasing Scrutiny of CCP, CSD, and SSS Functions**

In response to the CCA Standards proposing release, the Commission received a number of comments on the proposed scope of the definition of covered clearing agency asking the Commission to expand the scope of the covered clearing agency definition and therefore the coverage of Rule 17Ad-22(e).<sup>92</sup> Specifically, one commenter endorsed efforts to promote financial stability through the application of heightened standards for covered clearing agencies, particularly those that provide CCP services for security-based swaps and other derivatives, noting that the mandatory clearing of OTC derivatives introduced following the 2008 financial crisis has heightened the need for enhanced standards for CCPs.<sup>93</sup> A second commenter suggested that the Commission apply Rule 17Ad-22(e) to all clearing agencies to reduce the risk of failure and the problems such a failure would cause for investors, citing the size of the derivatives markets, and the potential for disruption and systemic risk that these markets may have on covered clearing agencies.<sup>94</sup> A third commenter recommended that any provision of the proposed rules that reflects best practices should be applied across all clearing agencies.<sup>95</sup> Each of these comments supports an approach under which registered clearing agencies are subject to the enhanced standards in Rule 17Ad-22(e) where they perform critical clearing agency functions that concentrate risk and could serve as mechanisms for the transfer of systemic risk.

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<sup>92</sup> See CCA Standards adopting release, supra note 7, at 53–65.

<sup>93</sup> See The Clearing House at 1.

<sup>94</sup> See CFA Institute at 2.

<sup>95</sup> See DTCC at 4.

Consistent with these comments, the proposed application of Rule 17Ad-22(e) to all registered clearing agencies that provide CCP, CSD, and SSS services would strengthen the Commission’s substantive regulation of clearing agencies by imposing enhanced requirements for risk management policies and procedures that help mitigate systemic risk.

In contrast to the above commenters, one commenter endorsed the Commission’s adopted definition of “covered clearing agency” and supported not applying Rule 17Ad-22(e) to registered clearing agencies that were dually registered with the CFTC and SEC, where the CFTC is the supervisory authority under the Clearing Supervision Act.<sup>96</sup> The commenter also believed that subjecting a dually registered clearing agency to requirements under Rule 17Ad-22(e) and the CFTC’s regime would result in duplicative regulation.<sup>97</sup> The Commission preliminarily believes that, as discussed in Part II.A.4 below, although the proposed amendment to the definition of “covered clearing agency” would subject some dually registered clearing agencies to similar regulations under the Commission’s and CFTC’s comparable regimes, expanding the definition to include dually registered clearing agencies is nonetheless appropriate.

#### **4. Expanded Coverage under the Definition of “Covered Clearing Agency”**

The proposed amendment to the definition of “covered clearing agency” would differ in two ways from the existing definition of “covered clearing agency.” First, it would no longer reference whether a clearing agency has been designated systemically important by the FSOC and for which the Commission is the supervisory agency under the Clearing Supervision Act. Second, it would remove references to clearing agencies that provide CCP services for security-based swaps or are involved in activities the Commission determines to have a more complex

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<sup>96</sup> See CME at 2.

<sup>97</sup> See id.

risk profile, unless the CFTC is the supervisory agency under the Clearing Supervision Act. Amending the definition of “covered clearing agency” in this way would replace these two categories of clearing agencies with clearing agencies providing the services of a CCP, CSD, or SSS and thereby expand the range of entities that fall within the definition of “covered clearing agency.” Accordingly, under the proposed amendment to the definition, whether a registered clearing agency is a SIFMU or dually registered with the Commission and the CFTC would no longer be relevant to application of the “covered clearing agency” definition or Rule 17Ad-22(e).

Thus, the potential for registered clearing agencies to be subject to Rule 17Ad-22(e) would increase under the proposed amendment. In particular, under the proposed amendment to the definition, the narrower set of complex risk profile clearing agencies for which the CFTC is not the supervisory agency would be replaced with the full universe of registered clearing agencies that provide CCP, CSD, or SSS services. In light of the discussion above regarding the critical functions common among and specific to CCPs, CSDs, and SSSs, the Commission preliminarily believes that such an expansion is appropriate in order to help further mitigate systemic risk to the U.S. financial system.

Preliminarily, the Commission believes that such an approach is appropriate even though it may subject clearing agencies that are dually registered with the Commission and CFTC to similar requirements in some instances. In this regard, the Commission first notes that the staff has consulted with the CFTC, FRB, and FSOC in the development of these rules to, in part, avoid unnecessarily duplicative or inconsistent regulation with respect to clearing agencies that are dually registered in the United States. With respect to such clearing agencies—as well as clearing agencies regulated by authorities in other jurisdictions—the Commission is nonetheless mindful, pursuant to the comprehensive framework for regulating swaps and security-based

swaps established in Title VII, that the SEC has been given regulatory authority over security-based swaps.<sup>98</sup> CCPs that clear security-based swaps present risks to the securities markets that must be subject to appropriate risk management. As noted in the CCA Standards adopting release, the Commission’s intent with respect to Rule 17Ad-22(e) was, in part, to take an incremental step under Rule 17Ad-22 to ensure that these risks are appropriately managed consistent with the purposes of the Exchange Act, the Clearing Supervision Act, and Title VII of the Dodd-Frank Act.<sup>99</sup> The Commission believes that the proposed amendments to the definition of “covered clearing agency” represent another incremental step to help ensure that these risks are appropriately managed consistent with each of the above statutes. The Commission has, through Rule 17Ad-22(e) sought to apply requirements commensurate and appropriate to the risk posed by the clearing agency functions and activities specific to covered clearing agencies as they exist in, and serve, the U.S. securities markets. The Commission acknowledges that other rules and regulations may apply to a covered clearing agency that are similar in scope or purpose to Rule 17Ad-22(e). However, the presence of similar regulations does not negate the Commission’s obligation to ensure that risk in the U.S. securities markets is appropriately managed consistent with the purposes of the Exchange Act, the Clearing Supervision Act, and Title VII of the Dodd-Frank Act. Further, because Rule 17Ad-22(e) and other comparable

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<sup>98</sup> This dual framework for the regulation of CCPs for swaps and security-based swaps by the Commission and the CFTC was recently recognized by the European Commission in its equivalence decision for the CFTC. The European Commission has indicated that it will conduct a separate equivalence analysis for CCPs clearing securities and security-based swaps. See Commission Implementing Decision (EU) 2016/377 of 15 March 2016 on the equivalence of the regulatory framework of the United States of America for central counterparties that are authorised and supervised by the CFTC to the requirements of Regulation (EU) No 648/2012 of the European Parliament and of the Council, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32016D0377>.

<sup>99</sup> See CCA Standards adopting release, supra note 7, at 45.

regulations—including those of the CFTC—are consistent with the same international standards,<sup>100</sup> the potential for inconsistent regulation is low.

Further, in the CCA Standards adopting release, the Commission addressed comments regarding the risk of duplicative regulation that may result for clearing agencies dually registered with the Commission and the CFTC,<sup>101</sup> and noted that the Commission has previously addressed concerns about duplication in the rule filing process by streamlining the process under Rule 19b-4 for dually registered clearing agencies.<sup>102</sup> Specifically, for rule filings that primarily concern the clearing operations of a registered clearing agency that do not pertain to securities clearing operations but only to clearing of products under the authority of the CFTC, the Commission made a policy decision to provide a streamlined process for such rule filings to become effective upon filing with the Commission, without pre-effective notice and opportunity for comment.<sup>103</sup>

Finally, with respect to the proposed removal of designated clearing agencies from the “covered clearing agency” definition, the Commission notes that each designated clearing agency under Title VIII provides either CCP or CSD services and, therefore, would remain a covered clearing agency under the proposed amendment to the definition of “covered clearing agency.”<sup>104</sup> Moreover, the proposed shift to a function-oriented definition of “covered clearing agency” would not cause any of the registered clearing agencies that currently fall within the

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<sup>100</sup> See CCA Standards adopting release, supra note 7, at 45.

<sup>101</sup> See id. at 44–46.

<sup>102</sup> See Exchange Act Release No. 34-69284 (Apr. 3, 2013), 78 FR 21046 (Apr. 9, 2013).

<sup>103</sup> See id. at 21047.

<sup>104</sup> See supra note 50.

definition to be excluded. DTC, FICC, ICEEU, NSCC, and OCC all perform CCP, CSD, and/or SSS services.

The proposed amendment to the definition would expand the scope of covered clearing agencies by one additional clearing agency, ICC. Although ICC is a designated SIFMU and provides CCP services for security-based swaps, the CFTC is its supervisory agency, so it is not a covered clearing agency under the adopted definition.

### **B. Definition of “Securities Settlement System”**

To facilitate the proposed amendment to the definition of “covered clearing agency,” the Commission is also proposing to define “securities settlement system” to mean a clearing agency that enables securities to be transferred and settled by book entry according to a set of predetermined multilateral rules. The Commission understands that this is the generally accepted meaning of the term.<sup>105</sup> The Commission preliminarily believes that this definition appropriately captures the critical functions performed by SSSs described above, including the role that SSSs have in concentrating and managing risk on behalf of their participants. The proposed definition would, among other things, include a clearing agency that facilitates the settlement of transactions executed by specialists on an exchange, provides clearance and settlement services for mortgage-backed securities transactions, or facilitates the clearance and settlement of cross-border transactions.<sup>106</sup>

### **C. Definition of “Central Securities Depository”**

Consistent with the proposed amendment to the definition of “covered clearing agency,” and to improve consistency with both the definition of “central counterparty” in Rule 17Ad-

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<sup>105</sup> See supra note 6.

<sup>106</sup> See supra notes 83–88.

22(a)(2) and the proposed definition of “securities settlement system,” the Commission is proposing to amend the definition of “central securities depository services” in Rule 17Ad-22(a)(3). Rule 17Ad-22(a)(3) as adopted defines “central securities depository services” to mean services of a clearing agency that is a securities depository as described in Section 3(a)(23)(A) of the Exchange Act. The Commission is proposing to amend Rule 17Ad-22(a)(3) so that it would instead define “central securities depository” to mean a clearing agency that is a securities depository as described in Section 3(a)(23)(A) of the Exchange Act.

This modification would not alter the meaning of Rule 17Ad-22(a)(3) other than to improve consistency with (i) the definition of “central counterparty” and its use throughout Rule 17Ad-22, and (ii) the proposed definition of “securities settlement system” and its proposed use under Rule 17Ad-22. The Commission preliminarily believes that this proposed modification is therefore appropriate so that the definition of “covered clearing agency” is workable.

#### **D. Definition of “Sensitivity Analysis”**

The Commission is also proposing to amend the definition of “sensitivity analysis” under Rule 17Ad-22 to remove the reference to “a covered clearing agency involved in activities with a more complex risk profile” from paragraph (ii). Pursuant to the proposed amendment, all covered clearing agencies that are CCPs, rather than just those involved in activities with a more complex risk profile, as part of developing and maintaining policies and procedures for performing sensitivity analysis pursuant to Rule 17Ad-22(e)(6), would need to consider the most volatile relevant periods, where practical, that have been experienced by the markets served by the clearing agency.

Under the existing definition of “sensitivity analysis,” the Commission applies the requirements for policies and procedures regarding volatile relevant periods only to covered

clearing agencies that are complex risk profile clearing agencies. While this approach applies the requirements related to sensitivity analysis to CCPs that clear security-based swaps, it does not apply the requirements to other clearing agencies that provide CCP services. Under the Commission's proposed amendment to the "sensitivity analysis" definition, these requirements for policies and procedures would apply to all covered clearing agencies that are CCPs. The Commission believes that policies and procedures for considering the most volatile relevant periods, where practical, that have been experienced by the markets served by a covered clearing agency promote sound risk management and help mitigate systemic risk. The Commission therefore preliminarily believes that expanding the coverage of this requirement to all CCPs will help mitigate risks to the U.S. financial system. In light of the Commission's proposal to expand the coverage of the "covered clearing agency" definition to all CCPs, the Commission preliminarily believes it is important to also require that any currently registered CCP or CCP that may register with the Commission in the future be subject to the same requirement to help mitigate risks to the U.S. financial system. Based on its supervisory experience, the Commission preliminarily believes that all active CCPs currently registered with the Commission have policies and procedures for sensitivity analysis though they may vary in their application.

In addition, in order to improve consistency within the definition of sensitivity analysis, the Commission is proposing to separate the two elements that appear in current paragraph (i) into two separate paragraphs and renumber the existing paragraphs accordingly. Thus, "sensitivity analysis" would mean an analysis that involves analyzing the sensitivity of a model to its assumptions, parameters, and inputs that (i) considers the impact on the model of both moderate and extreme changes in a wide range of inputs, parameters, and assumptions, including correlations of price movements or returns if relevant, which reflect a variety of historical and

hypothetical market conditions; (ii) uses actual portfolios and, where applicable, hypothetical portfolios that reflect the characteristics of proprietary positions and customer positions; (iii) considers the most volatile relevant periods, where practical, that have been experienced by the markets served by the clearing agency; and (iv) tests the sensitivity of the model to stressed market conditions, including the market conditions that may ensue after the default of a member and other extreme but plausible conditions as defined in a covered clearing agency's risk policies. This proposed modification would not alter the meaning or application of the definition of "sensitivity analysis," but is designed to improve clarity regarding the number of discrete elements contained in the definition.

#### **E. Request for Comments**

The Commission requests comment on all aspects of the proposed amendments to the definitions of "covered clearing agency," "central securities depository," and "sensitivity analysis" and the proposed definition of "securities settlement system," including whether the definitions are sufficiently clear and, if not, how they should be changed. In addition, the Commission requests comment on the following specific issues. In all cases, responses should be supported by detailed explanation and analysis and, where possible, empirical evidence.

- In describing the functions or services of a covered clearing agency as those of a CCP, CSD, or SSS, has the Commission's proposal appropriately classified the functions/services of a covered clearing agency? Are there other clearing agency functions or services that the Commission should consider including in the definition of "covered clearing agency?" If so, explain why these functions or services should be included and how these functions relate to the policy goals and requirements in Rule 17Ad-22(e). In addition, please explain whether any of the clearing agency functions

included in the proposed definition of “covered clearing agency” should be excluded and why such an exclusion is appropriate.

- Will the proposed approach to expanding the definition of “covered clearing agency” result in duplicative costs for CCPs, CSDs, and SSSs? If so, what are these costs?
- Should any of the requirements under Rule 17Ad-22(e) be altered as they relate to the new entities under the proposed expansion of the “covered clearing agency” definition?

Please explain.

- In referencing a securities depository as described in Section 3(a)(23)(A) of the Exchange Act, does the proposed definition of “central securities depository” sufficiently describe the functions of a CSD? Why or why not? What other functions, if any, should be included in the definition of “central securities depository?”
- The definition of “central securities depository” would continue to appear in Rule 17Ad-22(d)(14).<sup>107</sup> However, as a result of the proposed amendment to the “covered clearing agency” definition, a registered clearing agency that performs CSD services would be a covered clearing agency subject to Rule 17Ad-22(e) and would not be subject to the requirements in Rule 17Ad-22(d). Accordingly, should the Commission modify Rule 17Ad-22(d)(14) in light of the proposed amendments? If so, how should the Commission

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<sup>107</sup> Rule 17Ad-22(d)(14) requires a registered clearing agency other than a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to institute risk controls, including collateral requirements and limits to cover the clearing agency’s credit exposure to each participant family exposure fully, that ensure timely settlement in the event that the participant with the largest payment obligation is unable to settle when the clearing agency provides CSD services and extends intraday credit to participants. See 17 CFR 240.17Ad-22(d)(14).

apply Rule 17Ad-22(d)(14) to a registered clearing agency that is not a covered clearing agency?

- Do commenters agree with the proposed definition of “securities settlement system?” Should there be another definition? If so, why? Does the definition sufficiently describe the functions of an SSS? Is it sufficiently clear what “according to a set of predetermined multilateral rules” means? Please provide examples of SSS activities.
- In light of the proposed amendment to the definition of “sensitivity analysis,” would a covered clearing agency have to make changes to its policies and procedures for conducting sensitivity analysis to comply with the new definition? If so, explain the current policies and procedures of covered clearing agencies relevant to conducting sensitivity analysis and how they would need to be changed. The Commission also requests information regarding the anticipated costs of any such changes to policies and procedures. The Commission also requests information regarding the potential benefits.

### **III. Economic Analysis**

The Commission is sensitive to the economic consequences and effects of the proposed amendments, including their benefits and costs. Under Section 3(f) of the Exchange Act, whenever the Commission engages in rulemaking under the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, it must consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.<sup>108</sup> Further, as noted above, Section 17A of the Exchange Act directs the Commission, when using its authority to facilitate the establishment of a national

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<sup>108</sup> See 15 U.S.C. 78c(f).

system for clearance and settlement of securities transactions, to have due regard for the public interest, the protection of investors, the safeguarding of securities and funds, and maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents.<sup>109</sup> Section 23(a)(2) of the Exchange Act also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>110</sup>

The proposed amendments to three definitions in Rule 17Ad-22(a) would generally expand the scope of registered clearing agencies subject to Rule 17Ad-22(e). The Commission is proposing to amend the definition of “covered clearing agency” in Rule 17Ad-22(a)(5) by focusing directly on clearing agency functions. Thus the amended definition of “covered clearing agency” covers all clearing agencies that provide the services of a CCP, CSD, or SSS. The Commission is also proposing a conforming amendment to the definition of “central securities depository services” in Rule 17Ad-22(a)(3), and the Commission is proposing to amend the definition of “sensitivity analysis” in Rule 17Ad-22(a)(17). As discussed in more detail below, the Commission preliminarily believes the proposed amendments to Rule 17Ad-22(a) would cause one additional registered clearing agency to fall within the definition of “covered clearing agency” and become subject to requirements of Rule 17Ad-22(e).

#### **A. Economic Background**

The Commission believes that the proposed amendments would support improvements in risk management at registered clearing agencies not currently subject to Rule 17Ad-22(e) as

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<sup>109</sup> See supra Part I.A.1.

<sup>110</sup> See 15 U.S.C. 78w(a)(2).

adopted with respect to systemic risk, as well as with respect to legal, credit, liquidity, general business, custody, investment, and operational risk.

As noted in the CCA Standards adopting release, registered clearing agencies have become an essential part of the infrastructure of the U.S. securities markets.<sup>111</sup> While central clearing generally benefits the markets in which it is available, clearing agencies can pose substantial risk to the financial system as a whole, due in part to the fact that central clearing concentrates risk in the clearing agency. Disruption to a clearing agency's operations, or failure on the part of a clearing agency to meet its obligations, could therefore serve as a potential source of contagion, resulting in significant costs not only to the clearing agency itself or its members but also to other market participants or the broader U.S. financial system.<sup>112</sup> As a

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<sup>111</sup> See CCA Standards adopting release, *supra* note 7, at 257.

<sup>112</sup> See generally Dietrich Domanski, Leonardo Gambacorta, and Cristina Picillo, Central Clearing: Trends and Current Issues, BIS Quarterly Review (Dec. 2015), available at [https://www.bis.org/publ/qtrpdf/r\\_qt1512g.pdf](https://www.bis.org/publ/qtrpdf/r_qt1512g.pdf) (describing links between CCP financial risk management and systemic risk); Darrell Duffie, Ada Li & Theo Lubke, Policy Perspectives on OTC Derivatives Market Infrastructure, at 9 (Fed. Reserve Bank N.Y. Staff Reps., Mar. 2010), available at [http://www.newyorkfed.org/research/staff\\_reports/sr424.pdf](http://www.newyorkfed.org/research/staff_reports/sr424.pdf) (“If a CCP is successful in clearing a large quantity of derivatives trades, the CCP is itself a systemically important financial institution. The failure of a CCP could suddenly expose many major market participants to losses. Any such failure, moreover, is likely to have been triggered by the failure of one or more large clearing members, and therefore to occur during a period of extreme market fragility.”); Pirrong, The Inefficiency of Clearing Mandates, Policy Analysis, No. 655, at 11–14, 16–17, 24–26 (2010), available at <http://www.cato.org/pubs/pas/PA665.pdf>, at 11–14, 16–17, 24–26 (stating, among other things, that “CCPs are concentrated points of potential failure that can create their own systemic risks,” that “[a]t most, creation of CCPs changes the topology of the network of connections among firms, but it does not eliminate these connections,” that clearing may lead speculators and hedgers to take larger positions, that a CCP’s failure to effectively price counterparty risks may lead to moral hazard and adverse selection problems, that the main effect of clearing would be to “redistribute losses consequent to a bankruptcy or run,” and that clearing entities have failed or come close to failing in the past, including in connection with the 1987 market break); Froukelien Wendt, Central Counterparties: Addressing Their Too Important to Fail Nature (IMF Working Paper, Jan. 2015), available at <http://papers.ssrn.com/sol3/Delivery.cfm/wp1521.pdf> (assessing the potential channels for contagion arising from CCP interconnectedness); Manmohan Singh, Making OTC Derivatives

result, proper management of the risks associated with central clearing is necessary to ensure the stability of the U.S. securities markets and the broader U.S. financial system. The mandate in Title VII of the Dodd-Frank Act for central clearing of security-based swaps, wherever possible and appropriate, further reinforces this need.<sup>113</sup> When a clearing agency provides CCP services, central clearing replaces bilateral counterparty exposures with exposures against the clearing agency. Consequently, a move from voluntary clearing to mandatory clearing of security-based swaps, holding the volume of security-based swap transactions constant, would increase economic exposures against clearing agencies that centrally clear security-based swaps. Increased exposures in turn raise the possibility that these clearing agencies may serve as a transmission mechanism for systemic events.

As the Commission discussed in the CCA Standards adopting release, clearing agencies have incentives to implement a risk management framework that can effectively manage the risks posed by central clearing.<sup>114</sup> First, the ongoing viability of a clearing agency depends on its reputation and the confidence that market participants have in its services. Clearing agencies therefore have an incentive to reduce the likelihood that a member default or operational outage would disrupt settlement of a particular transaction or set of transactions. Second, some clearing agencies operate as member-owned utilities and mutualize default risk across their members, and thus non-defaulting participants are subject to losses that occur above the defaulter's margin and clearing fund. Clearing agencies that operate under such models thus have an economic interest

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Safe—A Fresh Look, at 5–11 (IMF Working Paper, Mar. 2011), available at <http://www.imf.org/external/pubs/ft/wp/2011/wp1166.pdf> (addressing factors that could lead central counterparties to be “risk nodes” that may threaten systemic disruption).

<sup>113</sup> See supra Part I.A.2.

<sup>114</sup> See CCA Standards adopting release, supra note 7, at 259–260.

in sound risk management to reduce the expected level of losses that must be mutualized. Other clearing agencies are publicly traded and therefore could have different incentives because non-member-owners have a lower economic stake in the clearing agency than member-owners under a mutualized structure.

Such an ownership structure could increase the incentive for owners, particularly those that are non-members, to take risks, though these incentives may be tempered by rules of the clearing agency that are consistent with Section 17A(b)(3)(C) of the Exchange Act, which requires that the clearing agency's rules assure fair representation of its shareholders and participants in the selection of the clearing agency's directors and administration of its affairs.<sup>115</sup>

Nevertheless, incentives for sound risk management may be tempered by pressures to reduce costs and maximize profits that are distinct from goals set forth in governing statutes.<sup>116</sup> This tension may result in a clearing agency making decisions that result in tradeoffs between the costs and benefits of risk management that may not fully reflect the costs and benefits that accrue to other financial market participants as a result of its decisions. For example, because the current market to provide central clearing is characterized by high barriers to entry and limited competition,<sup>117</sup> the market power exercised by clearing agencies in the markets they serve may reduce incentives to invest in risk management systems.<sup>118</sup> Further, even if clearing agencies do internalize costs that they impose on their clearing members, they may fail to internalize the

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<sup>115</sup> See 15 U.S.C. 78q-1(b)(3)(C).

<sup>116</sup> See supra Parts I.A.1 and 2 (describing the requirements under the Exchange Act and the Dodd-Frank Act).

<sup>117</sup> See CCA Standards proposing release, supra note 31, at 29576.

<sup>118</sup> See infra Part III.C.1.c (discussing the effect on competition).

consequences of their risk management decisions on other entities within the financial system that are connected to them through relationships with their clearing members.<sup>119</sup> Such a failure represents a financial network externality imposed by clearing agencies on the broader financial system and suggests that financial stability, as a public good, may be under-produced in equilibrium.

## **B. Baseline**

In order to perform its analysis of the likely economic effects of the proposed amendments to Rule 17Ad-22(a), the Commission is using an economic baseline that considers the current market for clearance and settlement services as it exists at the time of this proposal. As discussed above,<sup>120</sup> the Commission preliminarily believes that the proposed amendment to the definition of “covered clearing agency” will likely result in one additional registered clearing agency, ICC, becoming subject to the requirements in Rule 17Ad-22(e). Further, as discussed below, the Commission preliminarily believes that the proposed amendments potentially affect ICEEU even though the amendment to the definition of “covered clearing agency” will not change ICEEU’s current status as a covered clearing agency.<sup>121</sup> The Commission’s baseline therefore includes the two entities in the market for clearance and settlement services – ICC and ICEEU – that the Commission believes would be affected by the proposed amendments. In addition to current market practices at these entities, the baseline includes rules adopted by the Commission, including rules adopted in the CCA Standards adopting release, as well as rules

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<sup>119</sup> See Daron Acemoglu, Asuman Ozdaglar & Alireza Tahbaz-Salehi, Systemic Risk and Stability in Financial Networks (NBER Working Paper No. 18727, Jan. 2013), available at <http://www.nber.org/papers/w18727>.

<sup>120</sup> See supra Part II.A.4.

<sup>121</sup> See infra Part III.C.1.c.

adopted by other regulators, including those in other jurisdictions to the extent that these rules affect the cost structure, business and market practices of the above-mentioned entities. The following section discusses the elements of the baseline that are relevant for the economic analysis of the proposed amendments.

Pursuant to the adoption of amendments to Rule 17Ad-22,<sup>122</sup> five registered clearing agencies—DTC, FICC, ICEEU, NSCC and OCC—currently meet the definition of “covered clearing agency.” Table 1 below provides basic membership statistics for the two clearing agencies—ICC and ICEEU—that the Commission preliminarily believes would be affected by the proposed amendments to Rule 17Ad-22(a).

**Table 1.** Membership statistics for ICE Clear Credit & ICE Clear Europe.<sup>123</sup>

		Number
	Clear Credit Members	30
ICE	Clear Europe Members	80
-	Clear Europe Members that clear CDS	21

To further assess the economic effects of the proposed amendments to Rule 17Ad-22(a), including possible effects on efficiency, competition, and capital formation, the Commission is also considering as part of the baseline (i) the current regulatory framework for registered clearing agencies, and (ii) the current practices of the entities that would be affected by the proposed amendments to Rule 17Ad-22(a). Each is discussed further below.

<sup>122</sup> See CCA Standards adopting release, *supra* note 7, at 458–459.

<sup>123</sup> Membership statistics are taken from the websites of each of the listed clearing agencies as of March 2016. ICE, ICE Clear Credit Participants, [available at https://www.theice.com/clear-credit/participants](https://www.theice.com/clear-credit/participants); ICE, ICE Clear Europe Membership, [available at https://www.theice.com/clear-europe/membership](https://www.theice.com/clear-europe/membership).

## 1. Regulatory Framework for Registered Clearing Agencies

As previously discussed, the current regulatory framework for registered clearing agencies begins with Section 17A of the Exchange Act, which directs the Commission to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of securities transactions and provides for the registration of clearing agencies.<sup>124</sup> Section 19 of the Exchange Act sets forth the general registration requirements for clearing agencies as SROs, their responsibility as SROs to file proposed rule changes with the Commission for review and approval, and, in general, the provisions relating to Commission oversight of SROs.<sup>125</sup> Titles VII and VIII of the Dodd-Frank Act have expanded the Commission's role with respect to the regulation of central clearing. Specifically, Title VII amended Section 17A of the Exchange Act by adding new paragraphs (g) through (j), which provide the Commission with authority to adopt rules governing security-based swap clearing agencies.<sup>126</sup> The Clearing Supervision Act, adopted in Title VIII, provides for enhanced regulation of SIFMUs and, more generally, for enhanced coordination among the Commission, CFTC, and FRB by facilitating examinations and information sharing.<sup>127</sup> As noted above, on July 18, 2012, the FSOC designated as SIFMUs five registered clearing agencies.<sup>128</sup>

In 2012, the Commission adopted Rule 17Ad-22 under the Exchange Act to strengthen the substantive regulation of registered clearing agencies, promote the safe and reliable operation

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<sup>124</sup> See supra Part I.A.1.

<sup>125</sup> See supra notes 16–18 and accompanying text.

<sup>126</sup> See supra note 22 and accompanying text.

<sup>127</sup> See supra notes 23–30 and accompanying text.

<sup>128</sup> See supra note 50.

of registered clearing agencies, and improve efficiency, transparency, and access to registered clearing agencies.<sup>129</sup> In its economic analysis of the Clearing Agency Standards release, the Commission noted that the economic characteristics of clearing agencies, including economies of scale, barriers to entry, and the particulars of their legal mandates, may limit competition and confer market power on such clearing agencies, which may lead to lower levels of service, higher prices, or under-investment in risk management systems.<sup>130</sup> To address these potential market failures, Rule 17Ad-22 was adopted to strengthen the substantive regulation of clearing agencies, promote the safe and reliable operation of clearing agencies, improve efficiency, transparency, and access to clearing agencies, and promote consistency with international standards.<sup>131</sup>

Today, the Commission adopted amendments to Rule 17Ad-22 and new Rule 17Ab2-2. Rule 17Ad-22(a)(5) provides the definition of “covered clearing agency,” and Rule 17Ad-22(e) establishes standards for the operation and governance of registered clearing agencies that meet the definition of a covered clearing agency. Rule 17Ab2-2 provides a process by which the Commission may determine or rescind past determinations about, whether a covered clearing agency is systemically important in multiple jurisdictions, and whether any of the activities of a clearing agency providing CCP services, including clearing agencies registered with the Commission for the purpose of clearing security-based swaps, have a more complex risk profile.<sup>132</sup>

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<sup>129</sup> See supra note 31 and accompanying text.

<sup>130</sup> See Clearing Agency Standards adopting release, supra note 31, at 66263.

<sup>131</sup> See id. at 66225–26, 66263–64.

<sup>132</sup> See CCA Standards adopting release, supra note 7, at 456–477.

Finally, efforts by the CFTC to adopt rules that are consistent with the PFMI are also relevant to the economic analysis of the proposed amendments to Rule 17Ad-22(a).<sup>133</sup> The CFTC has issued rules for derivatives clearing organizations and systemically important derivatives clearing organizations (“SIDCOs”) which it indicated are intended to be consistent with the PFMI.<sup>134</sup> ICC, the registered clearing agency that the Commission anticipates will fall into the revised covered clearing agency definition, is a clearing agency registered with the Commission that is also supervised by the CFTC as a SIDCO under subpart C of Part 39 of the Commodity Exchange Act.

## **2. Current Practices**

Current industry practices are a critical element of the economic baseline for registered clearing agencies. Registered clearing agencies must operate in compliance with Rule 17Ad-22, though they may vary in the particular ways they achieve such compliance. Some variation in practices across registered clearing agencies derives from the products they clear and the markets they serve.

As discussed above,<sup>135</sup> the Commission preliminarily believes that the proposed revision to Rule 17Ad-22(a) will likely result in one additional registered clearing agency, ICE Clear Credit, falling within the definition of covered clearing agency. Further, the Commission preliminarily believes that the proposed amendments may affect ICE Clear Europe (ICEEU) even though these amendments will not change ICEEU’s current status as a covered clearing

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<sup>133</sup> See id. at 272.

<sup>134</sup> See Derivatives Clearing Organizations and International Standards, Final Rule, 78 FR 72477 (Dec. 2, 2013).

<sup>135</sup> See Part II.A.4.

agency.<sup>136</sup> An overview of the current practices of these entities is set forth below and includes discussion of clearing agency policies and procedures regarding general organization and risk management, including the management of legal, credit, liquidity, business, custody, investment, and operational risk. This discussion is intended solely for the purpose of analyzing the economic effects of the proposed amendments and is based on the Commission's general understanding of current practices as of the date of this proposal, informed by information published by registered clearing agencies, as well as the Commission's experience supervising registered clearing agencies.

### **a. General Organization**

#### **i. Legal Risk**

Legal risk is the risk that a registered clearing agency's rules, policies, or procedures may not be enforceable and concerns, among other things, its contracts, the rights of members, netting arrangements, discharge of obligations, and settlement finality. Cross-border activities of a registered clearing agency may also present elements of legal risk.

Rule 17Ad-22(d)(1) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a well-founded, transparent, and enforceable legal framework for each aspect of its activities in all relevant jurisdictions.<sup>137</sup> Each registered clearing agency makes a large portion of these policies and procedures available to members and participants. In addition, each also publishes their rule

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<sup>136</sup> See infra Part III.C.1.c.

<sup>137</sup> See 17 CFR 240.17Ad-22(d)(1); Clearing Agency Standards adopting release, supra note 31, at 66245–46.

books and other key procedures publicly in order to promote the transparency of their legal framework.<sup>138</sup>

## **ii. Governance**

Rule 17Ad-22(d)(8) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to have governance arrangements that are clear and transparent to fulfill the public interest requirements in Section 17A of the Exchange Act applicable to clearing agencies, to support the objectives of owners and participants, and to promote the effectiveness of the clearing agency's risk management procedures.<sup>139</sup> Important elements of a registered clearing agency's governance arrangements include its ownership structure; its charter, bylaws, and charters for committees of its board and management committees; its rules, policies, and procedures; the composition and role of its board, including the structure and role of board committees; reporting lines between management and the board; and the processes that provide for management accountability with respect to the registered clearing agency's performance.

Each registered clearing agency has a board that governs its operations and supervises senior management. Each registered clearing agency also has an independent audit committee of the board and has established a board committee or committee of members tasked with overseeing the clearing agency's risk management functions.

## **iii. Amended Framework for the Comprehensive Management of Risks**

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<sup>138</sup> The rule book of each registered clearing agency, as well as select policies and procedures, are publicly available on each registered clearing agency's website.

<sup>139</sup> See 17 CFR 240.17Ad-22(d)(8); see also Clearing Agency Standards adopting release, supra note 31, at 66251–52.

Rules 17Ad-22(b) and (d) require registered clearing agencies to establish, implement, maintain and enforce written policies and procedures reasonably designed to measure and mitigate credit exposures, identify operational risks, evaluate risks arising in connection with cross-border and domestic links for the purpose of clearing or settling trades, achieve DVP settlement, and implement risk controls to cover the clearing agency's credit exposures to participants.<sup>140</sup> Rule 17Ad-22(d)(4) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to establish business continuity plans setting forth procedures for the recovery of operations in the event of a disruption.<sup>141</sup> Rule 17Ad-22(d)(11) further requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to make key aspects of the clearing agency's default procedures publicly available and establish default procedures that ensure that the clearing agency can take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a participant default.<sup>142</sup>

In addition to meeting these requirements, the Commission understands that registered clearing agencies also specify actions to be taken when their resources are insufficient to cover

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<sup>140</sup> See 17 CFR 240.17Ad-22(b) and (d); see also Clearing Agency Standards adopting release, supra note 31.

<sup>141</sup> See 17 CFR 240.17Ad-22(d)(4); see also Clearing Agency Standards adopting release, supra note 31, at 66248–49.

<sup>142</sup> See 17 CFR 240.17Ad-22(d)(11).

losses faced by the registered clearing agency.<sup>143</sup> These actions may include assessment rights on clearing members, forced allocation, and contract termination.

### **b. Financial Risk Management**

Registered clearing agencies that provide CCP services have a variety of options available to mitigate the financial risks to which they are exposed. While the manner in which a CCP chooses to mitigate these financial risks depends on the precise nature of the CCP's obligations, a common set of procedures have been implemented by many CCPs to manage credit and liquidity risks. Broadly, these procedures enable CCPs to manage their risks by reducing the likelihood of member defaults, limiting potential losses and liquidity pressure in the event of a member default, implementing mechanisms that allocate losses across members, and providing adequate resources to cover losses and meet payment obligations as required.

Registered clearing agencies that provide CCP services must be able to effectively measure their credit exposures in order to properly manage those exposures. A CCP faces the risk that its exposure to a member can change as a result of a change in prices, positions, or both. CCPs can ascertain current credit exposures to each member by, in some cases, marking each member's outstanding contracts to current market prices and, to the extent permitted by their rules and supported by law, by netting any gains against any losses. Rule 17Ad-22 includes certain requirements related to financial risk management by CCPs, including requirements to measure credit exposures to members and to use margin requirements to limit these exposures. These requirements are general in nature and provide registered clearing agencies flexibility to

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<sup>143</sup> See David Elliot, Central Counterparty Loss-Allocation Rules, at tbl. 1A (Bank of England Financial Stability Paper No. 20, Apr. 2013), available at [http://www.bankofengland.co.uk/research/Documents/fspapers/fs\\_paper20.pdf](http://www.bankofengland.co.uk/research/Documents/fspapers/fs_paper20.pdf) (noting the loss-allocation rules applied at the end of a clearing agency waterfall).

measure credit risk and set margin. Within the bounds of Rule 17Ad-22, CCPs may employ models and choose parameters that they conclude are appropriate to the markets they serve.

The current practices of registered clearing agencies that provide CCP services generally include the following procedures: (1) measuring credit exposures at least once a day; (2) setting margin coverage at a 99% confidence level over some set period; (3) using risk-based models; (4) establishing a fund that mutualizes losses of defaults by one or more participants that exceed margin coverage; (5) maintaining sufficient financial resources to withstand the default of at least the largest participant family,<sup>144</sup> and (6), in the case of security-based swap transactions, maintaining enough financial resources to be able to withstand the default of their two largest participant families.<sup>145</sup>

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<sup>144</sup> See, e.g., IMF, Publication of Financial Sector Assessment Program Documentation—Detailed Assessment of Observance of the National Securities Clearing Corporation’s Observance of the CPSS-IOSCO Recommendations for Central Counterparties, at 10 (May 2010), available at <http://www.imf.org/external/pubs/ft/scr/2010/cr10129.pdf> (assessing NSCC’s observance of Recommendation 5 from the RCCP that a CCP should maintain sufficient financial resources to withstand, at a minimum, the default of a participant to which it has the largest exposure in extreme but plausible market conditions; also noting that NSCC began evaluating itself against this standard in 2009 and has backtesting results to support that it maintained sufficient liquidity to cover the failure of the largest affiliated family 99.98% of the time during the period from January through April 2009); IMF, Publication of Financial Sector Assessment Program Documentation—Detailed Assessment of Observance of the Fixed Income Clearing Corporation – Government Securities Division’s Observance of the CPSS-IOSCO Recommendations for Central Counterparties, at 9–10 (2010), available at <http://www.imf.org/external/pubs/ft/scr/2010/cr10130.pdf> (finding that FICC’s Government Securities Division observed the requirement to maintain enough financial resources to meet the default of its largest participant in extreme but plausible market conditions).

<sup>145</sup> See, e.g., CFTC-SEC Staff Roundtable on Clearing of Credit Default Swaps, at 123 (Oct. 2010), available at [http://www.cftc.gov/ucm/groups/public/@swaps/documents/dsubmission/dfsubmission7\\_102210-transcrip.pdf](http://www.cftc.gov/ucm/groups/public/@swaps/documents/dsubmission/dfsubmission7_102210-transcrip.pdf) (Stan Ivanov of ICE stating, “[A]t ICE we look at two simultaneous defaults of the two biggest losers upon extreme conditions . . . .”); see also ICE, CDS Client Clearing Overview, at 8 (Aug. 2013), available at [https://www.theice.com/publicdocs/clear\\_credit/ICE\\_Clear\\_Credit\\_Client\\_Clearing\\_Overview.pdf](https://www.theice.com/publicdocs/clear_credit/ICE_Clear_Credit_Client_Clearing_Overview.pdf) (noting that the guaranty fund covers the simultaneous default of the two largest clearing

### **i. Credit Risk**

Rule 17Ad-22(b)(1) requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to measure their credit exposures at least once per day.<sup>146</sup> Several CCPs have policies and procedures designed to require measuring credit exposures multiple times per day.

Rule 17Ad-22(b)(3) requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient financial resources to withstand, at a minimum, a default by the participant family to which it has the largest exposure in extreme but plausible market conditions.<sup>147</sup> It further requires CCPs for security-based swaps to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain additional financial resources sufficient to withstand, at a minimum, a default by the two participant families to which it has the largest exposures in extreme but plausible market conditions, in its capacity as a CCP for security-based swaps.<sup>148</sup> Accordingly, the Commission notes that Rule 17Ad-22(b)(3) imposes a “cover two” requirement on CCPs for security-based swaps in order to protect such CCPs from the extreme jump-to-default risk and nonlinear payoffs associated with the nature of the financial products they clear and the participants in the markets they serve. Meanwhile, CCPs that clear

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members); CME Rulebook, Ch. 8H, Rule 8H07, available at <http://www.cmegroup.com/rulebook/CME/I/8H/8H.pdf>.

<sup>146</sup> See 17 CFR 240.17Ad-22(b)(1).

<sup>147</sup> See 17 CFR 240.17Ad-22(b)(2).

<sup>148</sup> See id.

products other than security-based swaps are subject to a “cover one” requirement.<sup>149</sup> Rule 17Ad-22(b)(3) also states that such policies and procedures may provide that additional financial resources be maintained by the CCP in combined or separately maintained funds.<sup>150</sup>

Under existing rules, CCPs collect contributions from their members for the purpose of establishing guaranty or clearing funds to mutualize losses under extreme but plausible market conditions. Currently, the guaranty funds or clearing funds consist of liquid assets and their sizes vary depending on a number of factors, including the products the CCP clears and the characteristics of CCP members. In particular, the guaranty funds for CCPs that clear security-based swaps are relatively larger, as measured by the size of the fund as a percentage of the total and largest exposures, than the guaranty or clearing funds maintained by CCPs for other financial instruments. CCPs generally take the liquidity of collateral into account when determining member obligations. Applying haircuts to assets posted as margin, among other things, mitigates the liquidity risk associated with selling margin assets in the event of a participant default.

ICC recently modified its policies and procedures related to stress testing frameworks indicating that the modifications were designed to ensure that it meets regulatory requirements under Rule 17Ad-22(b)(3).<sup>151</sup>

## **ii. Collateral and Margin**

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<sup>149</sup> See CCA Standards adopting release, supra note 7, at 105–112 (discussing the requirements for “cover one” and “cover two”).

<sup>150</sup> See id.

<sup>151</sup> See Self-Regulatory Organizations; ICE Clear Credit LLC; Notice of Filing of Amendment 1 and Order Approving Proposed Rule Change, as modified by Amendment 1 Thereto, to Update and Formalize the ICC Stress Testing Framework, Exchange Act Release No. 34-77982 (June. 2, 2016).

Rule 17Ad-22(b)(2) requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to use margin requirements to limit their exposures to participants.<sup>152</sup> This margin can also be used to reduce a CCP's losses in the event of a participant default.

Registered clearing agencies that provide CCP services take positions as substituted counterparties once their trade guarantee goes into effect. Therefore, if a counterparty whose obligations the registered clearing agency has guaranteed defaults, the covered clearing agency may face market risk, which can take one of two forms. First, a covered clearing agency is subject to the risk of movement in the market prices of the defaulting member's open positions. Where a seller defaults and fails to deliver a security, the covered clearing agency may need to step into the market to buy the security in order to complete settlement and deliver the security to the buyer. Similarly, where a buyer defaults, the covered clearing agency may need to meet payment obligations to the seller. Thus, in the interval between when a member defaults and when the covered clearing agency must meet its obligations as a substituted counterparty in order to complete settlement, market price movements expose the covered clearing agency to market risk. Second, the covered clearing agency may need to liquidate non-cash margin collateral posted by the defaulting member. The covered clearing agency is therefore exposed to the risk that erosion in market prices of the collateral posted by the defaulting member could result in the covered clearing agency having insufficient financial resources to cover the losses in the defaulting member's open positions.

To manage their exposure to market risk resulting from fulfilling a defaulting member's obligations, registered clearing agencies compute margin requirements using inputs such as

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<sup>152</sup> See 17 CFR 240.17Ad-22(b)(2).

portfolio size, volatility, and sensitivity to various risk factors that are likely to influence security prices. Moreover, since the size of price movements is, in part, a function of time, registered clearing agencies may limit their exposure to market risk by marking participant positions to market daily and, in some cases, more frequently. CCPs also use similar factors to determine haircuts applied to assets posted by members in satisfaction of margin requirements. To manage market risk associated with collateral liquidation, CCPs consider the current prices of assets posted as collateral and price volatility, asset liquidity, and the correlation of collateral assets and a member's portfolio of open positions. Further, because CCPs need to value their margin assets in times of financial stress, their rulebooks may include features such as market-maker domination charges that increase clearing fund obligations regarding open positions of members in securities in which the member serves as a dominant market maker. The reasoning behind this charge is that, should a member default, liquidity in products in which the member makes markets may fall, leaving these positions more difficult to liquidate for non-defaulting participants.

Rule 17Ab-22(b)(2) also requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for risk-based models and parameters to set margin requirements.<sup>153</sup> The generally recognized standard for such models and parameters is, under normal market conditions, price movements that produce changes in exposures that are expected to breach margin requirements or other risk controls only 1% of the time (i.e., at a 99% confidence interval) over a designated time horizon.<sup>154</sup> Currently, CCPs use margin models to ensure

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<sup>153</sup> See id.

<sup>154</sup> See 17 CFR 240.17Ad-22(a)(4).

coverage at a single-tailed 99% confidence interval. Losses beyond this level are typically covered by the CCP's guaranty fund. This standard comports with existing international standards for bank capital requirements, which require banks to measure market risks at a 99% confidence interval when determining regulatory capital requirements.<sup>155</sup>

Rule 17Ad-22(b)(2) also requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to review such margin requirements and the related risk-based models and parameters at least monthly.<sup>156</sup> CCPs are accordingly required to establish a model validation process that evaluates the adequacy of margin models, parameters, and assumptions. Additionally, CCPs are required to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for an annual model validation consisting of evaluating the

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<sup>155</sup> See BCBS, International Convergence of Capital Measurement and Capital Standards: A Amended Framework (June 2004), available at <http://www.bis.org/publ/bcbs107.pdf>; see also Darryll Hendricks & Beverly Hirtle, New Capital Rule Signals Supervisory Shift (Secondary Mortgage Mkts, Sept. 1998), available at [http://www.freddiemac.com/finance/smm/july98/pdfs/hen\\_hirt.pdf](http://www.freddiemac.com/finance/smm/july98/pdfs/hen_hirt.pdf).

Prior to this standard, banks measured value-at-risk using a range of confidence intervals from 90–99%. See BCBS, An Internal Model-Based Approach to Market Risk Capital Requirements, at 12 (Apr. 1995), available at <http://www.bis.org/publ/bcbs17.pdf>. When determining the minimum quantitative standards for calculating risk measurements, the BCBS noted then the importance of specifying “a common and relatively conservative confidence level,” choosing the 99% confidence interval over other less conservative measures. See *id.*

Since its adoption in 1998, the standard has become a generally recognized practice of banks to quantify credit risk as the worst expected loss that a portfolio might incur over an appropriate time horizon at a 99% confidence interval. See Kenji Nishiguchi, Hiroshi Kawai & Takanori Sazaki, Capital Allocation and Bank Management Based on the Quantification of Credit Risk, at 83 (FRBNY Econ. Policy Rev., Oct. 1998), available at <http://www.newyorkfed.org/research/epr/98v04n3/9810nish.pdf>; Jeff Aziz & Narat Charupat, Calculating Credit Exposure and Credit Loss: A Case Study, at 34 (Sept. 1998), available at <http://www.bis.org/bcbs/ca/alrequse98.pdf>.

<sup>156</sup> See 17 CFR 240.17Ad-22(b)(2).

performance of the CCPs' margin models and the related parameters and assumptions associated with such models by a qualified person who is free from influence from the persons responsible for the development or operation of the models being validated.<sup>157</sup>

To meet resource requirements under Rule 17Ad-22(b)(3),<sup>158</sup> ICC recently adjusted its risk calculations and models to account for accumulation of wrong-way risk at the portfolio level.<sup>159</sup>

### **iii. Liquidity Risk**

In addition to credit risk and the aforementioned market risk, registered clearing agencies also face liquidity or funding risk. Currently, covered clearing agencies have varying degrees of formality with respect to their standards and practices relating to liquidity shortfalls. To complete the settlement process, registered clearing agencies that employ netting rely on incoming payments from participants in net debit positions in order to make payments to participants in net credit positions. If a participant does not have sufficient funds or securities in the form required to fulfill a payment obligation immediately when due (even though it may be able to pay at some future time), or if a settlement bank is unable to make an incoming payment on behalf of a participant, a registered clearing agency may face a funding shortfall. Such funding shortfalls may occur due to a lack of financial resources necessary to meet delivery or payment obligations, however even registered clearing agencies that do hold sufficient financial

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<sup>157</sup> See 17 CFR 240.17Ad-22(b)(4).

<sup>158</sup> See Self-Regulatory Organizations; ICE Clear Credit LLC; Notice of Filing of Proposed Rule Change, Exchange Act Release No. 34-75119 (June 8, 2015) at note 7.

<sup>159</sup> See Self-Regulatory Organizations; ICE Clear Credit LLC; Notice of Filing of Amendments No. 1 and 2 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendments No. 1 and 2, to Revise the ICC Risk Management Framework, Exchange Act Release No. 34-75887 (Sept. 10, 2015).

resources to meet their obligations may not carry those in the form required for delivery or payments to participants.

A registered clearing agency that provides CCP services may hold additional financial resources to cover potential funding shortfalls in the form of collateral. As noted above, CCPs may take the liquidity of collateral into account when determining member obligations. Applying haircuts to illiquid assets posted as margin mitigates the liquidity risk associated with selling margin assets in the event of participant default. Some registered CCPs also arrange for liquidity provision from other financial institutions using lines of credit. Additionally, some registered clearing agencies enter into prearranged funding agreements with their members pursuant to their rules. For example, members of one registered clearing agency are obligated to enter into repurchase agreements against securities that would have been delivered to a defaulting member.

ICC has disclosed a liquidity management program that includes stress testing of liquidity requirements to meet settlement obligations over a range of different horizons under extreme but plausible market conditions.<sup>160</sup> ICC also reports that its liquidity resources include cash, U.S. Treasury securities, and committed repurchase agreements.<sup>161</sup>

### **c. Settlement**

Rule 17Ad-22(d)(5) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to employ money settlement arrangements that eliminate or strictly limit the clearing agency's settlement bank

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<sup>160</sup> See ICE Clear Credit Disclosure Framework, note 145 supra, at 18.

<sup>161</sup> See id.

risks and require funds transfers to the clearing agency to be final when effected.<sup>162</sup> Rule 17Ad-22(d)(12) further requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that final settlement occurs no later than the end of the settlement day.<sup>163</sup> Accordingly, for example, certain registered clearing agencies have policies and procedures that provide for final settlement of securities transfers no later than the end of the day of the transaction. Rule 17Ad-22(d)(15) also requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to state to its participants the clearing agency's obligations with respect to physical deliveries and identify and manage the risks from these obligations.<sup>164</sup>

#### **d. CSDs and Exchange-of-Value Settlement Systems**

##### **i. CSDs**

Rule 17Ad-22(d)(10) requires a registered clearing agency that provides CSD services to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain securities in an immobilized or dematerialized form for transfer by book entry to the greatest extent possible. Currently, some securities, such as mutual fund securities and government securities, are issued primarily or solely on a dematerialized basis. Dematerialized shares do not exist as physical certificates but are held in book entry form in the name of the owner (which, where the master security holder file is not maintained on paper due to the use of technology, is also referred to as electronic custody). Other types of securities may be issued in

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<sup>162</sup> See 17 CFR 240.17Ad-22(d)(5).

<sup>163</sup> See 17 CFR 240.17Ad-22(d)(12).

<sup>164</sup> See 17 CFR 240.17Ad-22(d)(15).

the form of one or more physical security certificates, which could be held by the CSD to facilitate immobilization. Alternatively, securities may be held by the beneficial owner in record name, in the form of book-entry positions, where the issuer offers the ability for a security holder to hold through the direct registration system. Whether immobilization occurs at the CSD or through direct registration depends on what is provided for by the issuer.

When a trade occurs, the depository's accounting system credits one participant account and debits another participant account. Transactions between counterparties in dematerialized shares are recorded by the registrar responsible for maintaining the paper or electronic register of security holders, such as by a transfer agent, and reflected in customer accounts.

Registered CSDs currently reconcile ownership positions in securities against CSD ownership positions on the security holders list daily, mitigating the risk of unauthorized creation or deletion of shares.

## **ii. Exchange-of-Value Settlement Systems**

Rule 17Ad-22(d)(13) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to eliminate principal risk by linking securities transfers to funds transfers in a way that achieves delivery versus payment,<sup>165</sup> which serves to link obligations by conditioning the final settlement of one upon the final settlement of the other. One registered clearing agency, for example, operates a Model 2 DVP system that provides for gross securities transfers during the day followed by an end-of-day net funds settlement. Under the rules governing the clearing agency's system, the delivering party in a DVP transaction is assured that it will be paid for the securities once they are credited

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<sup>165</sup> See 17 CFR 240.17Ad-22(d)(13); see also Clearing Agency Standards adopting release, *supra* note 31, at 66256.

to the receiving party's securities account. DVP eliminates the risk that a buyer would lose the purchase price of a security purchased from a defaulting seller or that a seller would lose the sold security without receiving payment for a security acquired by a defaulting buyer.

For example, one registered clearing agency has rules governing its continuous net settlement ("CNS") system, under which it becomes the counterparty for settlement purposes at the point its trade guarantee attaches, thereby assuming the obligation of its members that are receiving securities to receive and pay for those securities, and the obligation of members that are delivering securities to make the delivery. Unless the clearing agency has invoked its default rules, it is not obligated to make those deliveries until it receives from members with delivery obligations deliveries of such securities; rather, deliveries that come into CNS ordinarily are promptly redelivered to parties that are entitled to receive them through an allocation algorithm. Members are obligated to take and pay for securities allocated to them in the CNS process. These rules also provide mechanisms to allow receiving members a right to receive high priority in the allocation of deliveries, and also permit a member to buy-in long positions that have not been delivered to it by the close of business on the scheduled settlement date.

#### **e. Default Management**

##### **i. Participant-Default Rules and Procedures**

Rule 17Ad-22(d)(11) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to make key aspects of its default procedures publicly available and establish default procedures that ensure it can take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a participant default. The rules of registered clearing agencies typically state what constitutes a default, identify whether the board or a committee of the board may make that

determination, and describe what steps the clearing agency may take to protect itself and its members. In this regard, registered clearing agencies typically attempt, among other things, to hedge and liquidate a defaulting member's positions. Rules of registered clearing agencies also include information about the allocation of losses across available financial resources. The registered clearing agency the Commission anticipates will fall within the definition of covered clearing agency as a result of the proposed amendments conduct testing of its default procedures at least annually, including participation by clearing members.

## **ii. Segregation and Portability**

No rule under the Exchange Act currently requires a registered clearing agency through its written policies and procedures to enable the portability of positions of a member's customers and the collateral provided in connection therewith. Additionally, no rule under the Exchange Act currently requires a registered clearing agency through its written policies and procedures to protect the positions of a member's customers from the default or insolvency of the member.<sup>166</sup>

ICC maintains rules and procedures that facilitate the segregation and portability of positions of a clearing member's customers and the collateral provided to it with respect to those positions.<sup>167</sup> ICC's rules are designed to comply with the CFTC's requirements addressing custody, segregation, and investment of customer margin provided in respect of cleared swaps.

ICC thus segregates customer funds pursuant to the "legally segregated, operationally

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<sup>166</sup> See CCA Standards adopting release, supra note 7, at 189–193 (discussing existing rules applicable to registered broker-dealers that address customer security positions and funds in cash securities and listed option markets, thereby promoting segregation and portability at the broker-dealer level).

<sup>167</sup> See ICE Clear Credit Disclosure Framework, supra note 145, at 26.

commingled” (“LSOC”) model found under Part 22 of the CFTC Regulations.<sup>168</sup> Under the LSOC model if a customer defaults, ICC may apply clearing member funds and defaulting customer funds to cover losses, but may not use collateral provided by non-defaulting customers. Additionally, under ICC rules, each clearing member that carries customer positions must, upon request of a customer, transfer or novate that customer’s position to one or more other clearing members designated by the customer, subject to the consent of the transferee; satisfaction by the customer of any margin requirements imposed by the transferor on any positions remaining at the transferor; and the completion of all required transfer documentation.<sup>169</sup>

## **f. General Business and Operational Risk Management**

### **i. General Business Risk**

Business risk refers to the risks and potential losses arising from a registered clearing agency’s administration and operation as a business enterprise that are neither related to member default nor separately covered by financial resources designated to mitigate credit or liquidity risk. While Rule 17Ad-22 sets forth requirements for registered clearing agencies to identify, monitor, and mitigate or eliminate a broad array of risks through written policies and procedures, no rule under the Exchange Act expressly requires a registered clearing agency through its written policies and procedures to identify, monitor, and manage general business risk or to meet a capital requirement. Registered clearing agencies currently have certain internal controls in place to mitigate business risk. Some clearing agencies, for instance, have policies and procedures that identify an auditor who is responsible for examining accounts, records, and transactions, as well as other duties prescribed in the audit program. Other registered clearing

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<sup>168</sup> See id.

<sup>169</sup> See id.

agencies allow members to collectively audit the books of the clearing agency on an annual basis, at their own expense.

ICC maintains financial resources that, pursuant to regulation as a SIDCO by the CFTC,<sup>170</sup> are sufficient to cover twelve months of operating costs.<sup>171</sup> ICC has publicly stated its belief that an orderly wind-down of its business would take between six and twelve months.<sup>172</sup>

## **ii. Custody and Investment Risks**

Registered clearing agencies face default risk from commercial banks that they use to effect money transfers among participants, to hold overnight deposits, and to safeguard collateral. Rule 17Ad-22(d)(3) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to (i) hold assets in a manner that minimizes risk of loss or delay in its access to them; and (ii) invest assets in instruments with minimal credit, market, and liquidity risks.<sup>173</sup> Registered clearing agencies currently seek to minimize the risk of loss or delay in access by holding assets that are highly liquid (e.g., cash, U.S. Treasury securities, or securities issued by a U.S. government agency) and by engaging banks to custody the assets and facilitate settlement. Typically, registered clearing agencies take steps to ensure that assets held in custody are protected from claims from the custodian's creditors using trust accounts or equivalent arrangements. Additionally, designated clearing agencies may have access to credit at a Federal Reserve Bank or other relevant central

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<sup>170</sup> See 17 CFR 39.39(d).

<sup>171</sup> See ICE Clear Credit Disclosure Framework, supra note 145, at 27.

<sup>172</sup> See id.

<sup>173</sup> See 17 CFR 240.17Ad-22(d)(3).

bank, to the extent such services are not already available as the result of other laws and regulations.<sup>174</sup>

ICC's Treasury Operations Policies and Procedures provide for the use of a Federal Reserve Account, the use of a committed repurchase facility and outside investment managers to invest guarantee fund and margin cash.<sup>175</sup>

### **iii. Operational Risk**

Operational risk refers to a broad category of potential losses arising from deficiencies in internal processes, personnel, and information technology. Registered clearing agencies face operational risk from both internal and external sources, including human error, system failures, security breaches, and natural or man-made disasters. Rule 17Ad-22(d)(4) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify sources of operational risk and to minimize those risks through the development of appropriate systems, controls and procedures.<sup>176</sup> It also requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to (i) implement systems that are reliable and secure, and have adequate, scalable capacity; and (ii) have business continuity plans that allow for timely recovery of operations and fulfillment of a clearing agency's obligations.<sup>177</sup>

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<sup>174</sup> See CCA Standards adopting release, supra note 7, at 159 (discussing the requirements under Rule 17Ad-22(e)(7)(iii)).

<sup>175</sup> See "Self-Regulatory Organizations; ICE Clear Credit LLC; Order Approving Proposed Rule Change to Revise the ICC Treasury Operations Policies and Procedures" Exchange Act Release No. 34-74456 (Mar. 6, 2015).

<sup>176</sup> See 17 CFR 240.17Ad-22(d)(4).

<sup>177</sup> See id.

As a result, registered clearing agencies have developed and currently maintain plans to ensure the safeguarding of securities and funds, the integrity of automated data processing systems, and the recovery of securities, funds, or data under a variety of loss or destruction scenarios.<sup>178</sup> These plans may include turning operations over to a secondary site that is located a sufficient distance from the primary location to ensure a distinct geographic risk profile. In addition, registered clearing agencies generally maintain an internal audit department to review the adequacy of their internal controls, procedures, and records with respect to operational risks. Some registered clearing agencies also engage independent accountants to perform an annual study and evaluation of the internal controls relating to their operations.<sup>179</sup>

The Commission adopted Regulation SCI in November 2014, in part, to reduce the occurrence of systems issues, and enhance resiliency when systems problems do occur at certain SROs, such as registered clearing agencies. In particular, Regulation SCI requires that clearance and settlement systems be designed to accomplish end-of-day settlement on the day of a wide-scale disruption. Accordingly, Regulation SCI requires registered clearing agencies to have policies and procedures in place for business continuity as well as disaster recovery plans that include maintaining sufficiently resilient and geographically diverse backup and recovery capabilities that are reasonably designed to achieve two-hour resumption of critical SCI systems following a wide-scale disruption.<sup>180</sup>

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<sup>178</sup> Many of these practices had been previously developed pursuant to other Commission requirements. See CCA Standards adopting release, supra note 7, at 19–21, 181–182, 294–295 (discussing related requirements under Regulation SCI).

<sup>179</sup> See, e.g., NSCC, Assessment of Compliance with the CPSS/IOSCO Recommendations for Central Counterparties (Nov. 2011), available at <http://www.dtcc.com/legal/policy-and-compliance.aspx>.

<sup>180</sup> See 17 CFR 242.1001(a)(2).

## **g. Access**

### **i. Access and Participation Requirements**

Rule 17Ad-22(b)(5) requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide the opportunity for a person that does not perform any dealer or security-based swap dealer services to obtain membership on fair and reasonable terms at the clearing agency to clear securities for itself or on behalf of other persons.<sup>181</sup> Rule 17Ad-22(b)(6) requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to have membership standards that do not require participants to maintain a portfolio of any minimum size or a minimum transaction volume.<sup>182</sup> Rule 17Ad-22(b)(7) requires a registered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide a person that maintains net capital equal or greater than \$50 million with the ability to obtain membership at the clearing agency, provided such persons are able to comply with reasonable membership standards, with higher net capital requirements permissible subject to Commission approval.<sup>183</sup>

In addition, Rule 17Ad-22(d)(2) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency, have procedures in place to monitor

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<sup>181</sup> See 17 CFR 240.17Ad-22(b)(5).

<sup>182</sup> See 17 CFR 240.17Ad-22(b)(6).

<sup>183</sup> See 17 CFR 240.17Ad-22(b)(7).

that participation requirements are met on an ongoing basis, and have participation requirements that are objective and publicly disclosed, and permit fair and open access.<sup>184</sup> Typically, a registered clearing agency's rulebook requires applicants for membership to provide certain financial and operational information prior to being admitted as a member and on an ongoing basis as a condition of continuing membership. Registered clearing agencies review this information to ensure that the applicant has the operational capability to meet the other demands of interfacing with the clearing agency. In particular, registered clearing agencies typically require that an applicant demonstrate that it has adequate personnel capable of handling transactions with the clearing agency and adequate physical facilities, books and records, and procedures to fulfill its anticipated commitments to, and to meet the operational requirements of, the clearing agency and other members with necessary promptness and accuracy. As a result, an applicant needs to demonstrate that it has adequate personnel capable of handling transactions with the clearing agency and adequate physical facilities, books and records, and procedures to conform to conditions or requirements in these areas that the clearing agency reasonably may deem necessary for its protection. Registered clearing agencies have published these requirements on their websites.

Registered clearing agencies use an ongoing monitoring process to help them understand relevant changes in the financial condition of their members and to mitigate credit risk exposure of the clearing agency to its members. The risk management staff analyzes financial statements filed with regulators, as well as information obtained from other SROs and gathered from various financial publications, so that the clearing agency may evaluate, for instance, whether

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<sup>184</sup> See 17 CFR 240.17Ad-22(d)(2).

members maintain sufficient financial resources and robust operational capacity to meet their obligations as participants in the clearing agency pursuant to existing Rule 17Ad-22(d)(2)(i).

Table 1 contains membership statistics for the registered clearing agencies likely to be affected by the proposed rule amendment.<sup>185</sup> Current membership generally reflects features of cleared markets. The decision to become a clearing member depends on the products being cleared, the structure of these asset markets as well as the current state of regulation for cleared markets.

## **ii. Tiered Participation Arrangements**

Tiered participation arrangements occur when clearing members (direct participants) provide access to clearing services to third parties (indirect participants). No rule under the Exchange Act currently requires a registered clearing agency through its written policies and procedures to identify, monitor, and manage material risks arising from tiered participation arrangements. The Commission understands, however, that certain registered clearing agencies have policies and procedures currently in place in order to identify, monitor, or manage such arrangements. Specifically, such clearing agencies rely on information gathered from, and distributed by, direct participants in order to manage these tiered participation arrangements. For example, under some covered clearing agencies' rules, direct participants generally have the responsibility to indicate to the clearing agency whether a transaction submitted for clearing represents a proprietary or customer position. Such rules further require direct participants to calculate, and notify the clearing agency of the value of, each customer's collateral. Direct participants also communicate with indirect participants regarding the clearing agency's margin and other requirements.

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<sup>185</sup> See supra Part III.B.

ICC does not currently have tiered participation arrangements.<sup>186</sup>

### **iii. Links**

Rule 17Ad-22(d)(7) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to evaluate the potential sources of risks that can arise when the clearing agency establishes links either cross-border or domestically to clear or settle trades, and ensure that the risks are managed prudently on an ongoing basis.<sup>187</sup>

Each registered clearing agency is linked to other clearing organizations, trading platforms, and service providers. For instance, a link between U.S. and Canadian clearing agencies allows U.S. members to clear and settle valued securities transactions with participants of a Canadian securities depository. The link is designed to facilitate cross-border transactions by allowing members to use a single depository interface for U.S. and Canadian dollar transactions and eliminate the need for split inventories.<sup>188</sup> Registered clearing agencies that provide CCP services currently establish links to allow members to realize collateral and other operational efficiencies. ICC does not offer inter-operability links with other CCPs.

### **h. Efficiency**

#### **i. Efficiency and Effectiveness**

Rule 17Ad-22(d)(6) requires a registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to require the clearing

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<sup>186</sup> See ICE Clear Credit Disclosure Framework, supra note 145, at 32.

<sup>187</sup> See 17 CFR 240.17Ad-22(d)(7).

<sup>188</sup> See Exchange Act Release No. 34-52784 (Nov. 16, 2005), 71 FR 70902 (Nov. 23, 2005); Exchange Act Release No. 34-55239 (Feb. 5, 2007), 72 FR 6797 (Feb. 13, 2007).

agency to be cost-effective in meeting the requirements of participants while maintaining safe and secure operations.<sup>189</sup> Registered clearing agencies have procedures to control costs and to regularly review pricing levels against operating costs. These clearing agencies may use a formal budgeting process to control expenditures, and may review pricing levels against their costs of operation during the annual budget process. Registered clearing agencies also analyze workflows in order to make recommendations to improve their operating efficiency.

## **ii. Communication Procedures and Standards**

Although no rule under the Exchange Act expressly requires a registered clearing agency through its written policies and procedures to use or accommodate relevant internationally accepted communication procedures and standards, the Commission believes that registered clearing agencies already use these standards. Registered clearing agencies typically rely on electronic communication with market participants, including members. For example, some registered clearing agencies have rules in place stating that clearing members must retrieve instructions, notices, reports, data, and other items and information from the clearing agency through electronic data retrieval systems. Some registered clearing agencies have the ability to rely on signatures transmitted, recorded, or stored through electronic, optical, or similar means. Other clearing agencies have policies and procedures that provide for certain emergency meetings using telephonic or other electronic notice.

## **i. Transparency**

Transparency requirements and disclosures by registered clearing agencies serve to limit the size of potential information asymmetries between registered clearing agencies, their members, and market participants. Rule 17Ad-22(d)(9) requires a registered clearing agency to

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<sup>189</sup> See 17 CFR 240.17Ad-22(d)(6).

establish, implement, maintain and enforce written policies and procedures reasonably designed to provide market participants with sufficient information for them to identify and evaluate risks and costs associated with using the clearing agency's services.<sup>190</sup> Information regarding the operations and services of each registered clearing agency can be viewed publicly either on the clearing agency's website or a website maintained by an affiliate of the clearing agency. Because registered clearing agencies are SROs,<sup>191</sup> they must file with the Commission any proposed rule or any proposed change, in addition to, or deletion from its rules, and the Commission reviews all proposed rule changes and publishes them for comment.<sup>192</sup>

Besides providing market participants with information on the risks and costs associated with their services, registered clearing agencies regularly provide information to their members to assist them in managing their risk exposures and potential funding obligations. Some of these disclosures may be common to all members—such as information about the composition of clearing fund assets—while other disclosures that concern particular positions or obligations may only be made to individual members.

As required by CFTC regulations,<sup>193</sup> ICC completes and publicly discloses its responses to the Disclosure Framework for Financial Market Infrastructures published by the CPMI-IOSCO. Besides a principle-by-principle narrative disclosure describing the registered clearing agency's approach to observing the PFMI, the public disclosure also includes an executive summary, a summary of major changes since the last update of the disclosure, and a general

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<sup>190</sup> See 17 CFR 240.17Ad-22(d)(9).

<sup>191</sup> See supra Part I.A.1.

<sup>192</sup> See supra notes 17–18.

<sup>193</sup> See 17 CFR 39.37.

background on the registered clearing agency that includes descriptions of the registered clearing agency and the markets it serves, the registered clearing agency's general organization, legal and regulatory framework, and systems design and operations.<sup>194</sup>

### **C. Consideration of Benefits, Costs, and the Effect on Competition, Efficiency, and Capital Formation**

The discussion below sets forth the potential economic effects stemming from the proposed amendments to Rule 17Ad-22(a) and considers the effects of the rules on efficiency, competition, and capital formation. The aggregate economic effects arising from the proposed amendments arise from two sources, the proposed amendments' likely effects on existing registered clearing agencies and the proposed amendments' likely effects on clearing agencies that may register with the Commission in the future. In this section, we consider the potential benefits, costs, and likely effects on efficiency, competition, and capital formation that may arise from these two sources separately. As discussed below, the Commission acknowledges that, when viewed in isolation, the economic effects related to existing registered clearing agencies are likely to be low in magnitude. Nevertheless, when taken together with the economic effects related to future registrants, the Commission preliminarily believes that the economic effects of the proposed amendments could be substantial, particularly insofar as they subject future registrants that are CCPs, CSDs, and SSSs, and are thus likely to play critical roles in the clearance and settlement system, to the enhanced requirements in Rule 17Ad-22(e).

#### **1. Economic Effects Related to Registered Clearing Agencies**

As noted above, the Commission anticipates that, as a result of the proposed amendments to Rule 17Ad-22(a), one additional registered clearing agency, ICC, would meet the definition of

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<sup>194</sup> See ICE Clear Credit Disclosure Framework, *supra* note 145, at 2.

covered clearing agency. The Commission preliminarily believes that the addition of ICC as a covered clearing agency will incrementally extend the systemic benefits of risk management discussed in the CCA Standards adopting release. These benefits consist of improved financial stability,<sup>195</sup> a reduction in the ambiguity associated with holding cleared assets in the presence of credit and settlement risk, and a reduction in market fragmentation arising from different requirements across regulatory regimes.<sup>196</sup> The Commission preliminarily believes that the extension of these benefits will likely be incremental and only appear to the extent that the proposed amendments would result in changes to ICC policies and procedures because, as mentioned above, ICC is also regulated as a SIDCO by the CFTC<sup>197</sup> and because Rule 17Ad-22(e) is consistent with comparable regulatory provisions adopted by the CFTC.<sup>198</sup> The following section attempts to estimate particular benefits that could accrue to ICC and its members as a result of ICC being more likely to qualify as a QCCP under the proposed rules.<sup>199</sup> The sections that follow also discuss the costs and the effect on efficiency, competition and capital formation of ICC becoming a covered clearing agency.

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<sup>195</sup> See CCA Standards adopting release, supra note 7, at 376-380.

<sup>196</sup> See CCA Standards adopting release, supra note 7, at 302-317.

<sup>197</sup> See supra Part III.B.1.

<sup>198</sup> See infra Part III.C.1.b.

<sup>199</sup> The BCBS capital framework, as well as the rules adopted by the FRB and Office of the Comptroller of the Currency consistent with that framework, applies lower risk weights of two or four percent to indirect exposures of banks to QCCPs. See Capital Requirements for Bank Exposures to Central Counterparties (Apr. 2014), available at <http://www.bis.org/publ/bcbs282.pdf> (“BCBS capital framework”); See also Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule, 76 FR 62017, 62099 (Oct. 11, 2013), at 62103.

### **a. Benefits**

Pursuant to the proposed amendments ICC will be more likely to qualify as a QCCP with respect to cleared security-based swap transactions in non-U.S. jurisdictions that have adopted the BCBS capital framework's QCCP definition. Under the BCBS capital framework, a QCCP is defined as an entity operating as a CCP that 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. Because Rule 17Ad-22(e) is consistent with the PFMI, the Commission preliminarily believes that foreign bank clearing members as well as foreign banks clearing indirectly through clearing members of ICC may benefit from its qualification as a QCCP. In particular ICC's qualification as a QCCP would result in its foreign bank clearing members and foreign bank indirect participants facing lower capital requirements with respect to cleared security-based swap transactions because, under the BCBS capital framework, capital requirements for bank exposures to QCCPs are lower than capital requirements for bank exposures to non-qualifying CCPs for these products. Moreover, ICC's non-U.S. bank clearing members may experience lower capital requirements with respect to cleared security-based swap transactions relative to the baseline in which foreign banking regulators do not determine ICC to be a QCCP.<sup>200</sup>

The BCBS capital framework affects capital requirements for bank exposures to central counterparties in two important ways. The first relates to trade exposures, defined under the BCBS capital framework as the current and potential future exposure of a clearing member or indirect participant in a CCP arising from OTC derivatives, exchange-traded derivatives

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<sup>200</sup> The Commission notes that benefits to bank clearing members may be contingent upon regulators in other jurisdictions taking action to recognize the QCCP status of the registered clearing agency that will become a covered clearing agency due to the proposed amendments.

transactions, and securities financing transactions. If these exposures are held against a QCCP, they will be assigned a risk weight of 2%. In contrast, exposures against non-qualifying CCPs do not receive lower capital requirements relative to bilateral exposures and are assigned risk weights between 20% and 100%, depending on counterparty credit risk. Second, the BCBS capital framework imposes a cap on risk weights applied to default fund contributions, limiting risk-weighted assets (subject to a 1250% risk weight) to a cap of 20% of a clearing member's trade exposures against a QCCP. This is in contrast to treatment of exposures against non-qualifying CCPs, which are uncapped and subject to a 1250% risk weight. Because QCCP status generally impacts capital treatment, any benefits of ICC attaining QCCP status will likely accrue at least in part, to its foreign clearing members or its foreign indirect participants subject to the BCBS capital framework with respect to their cleared security-based swap transactions.<sup>201</sup> As a result of lower risk weights applied to exposures and a cap on capital requirements against default fund obligations, ICC's qualification as a QCCP may, for those of its clearing members that are subject to the BCBS capital framework, lead to an improved capital position relative to bank members of non-QCCPs with respect to their cleared security-based swap transactions. This may lower funding costs for bank members of QCCPs.

In quantifying the benefits of achieving QCCP status, the Commission based its estimate on publicly available information with regard to ICC. To estimate the upper bound for the potential benefits accruing to bank clearing members at ICC as a result of its QCCP status, the Commission identified a sample of 15 bank clearing members at ICC and, for each bank, collected information about total assets, risk weighted assets, net income and tier one capital

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<sup>201</sup> For a discussion of the effects of QCCP status on competition between bank and non-bank clearing members, see CCA Standards adopting release, supra note 7, at 317–322.

ratio at the holding company level for 2015.<sup>202</sup> The Commission then allocated trade exposures and default fund exposures across the sample of bank clearing members based on the level of risk-weighted assets.<sup>203</sup> The Commission measured the impact on risk-weighted assets for non-U.S. bank clearing members under two different capital treatment regimes. The first regime is in the absence of QCCP status, assuming a 100% risk weight applied to trade exposures and 1250% risk weight applied to default fund exposures for non-U.S. members. In the second regime, ICC obtains QCCP status, and banks are allowed to apply a 2% risk weight to trade exposures and a 1250% risk weight to default fund exposures up to a total exposure cap of 20% of trade exposures.<sup>204</sup> If ICC is determined to be a QCCP, then the increase in risk weighted assets will

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<sup>202</sup> The Commission used the set of entities it identified as banks on ICC's member list, available at <https://www.theice.com/clear-credit/participants>. For U.S. bank holding companies, 2015 total assets, risk weighted assets, net income, and tier 1 capital ratios were collected from Y-9C reports available at the National Information Center, <https://www.ffiec.gov/nicpubweb/nicweb/nichome.aspx>. For non-U.S. bank holding companies, Commission staff obtained corresponding data from financial statements and supplementary financial materials posted to bank websites. Where necessary, values were converted back to U.S. dollars at December 31, 2015 exchange rates obtained from the Federal Reserve, <http://www.federalreserve.gov/releases/h10/hist/>.

<sup>203</sup> For example, one bank in the sample, with 5.06% of total risk-weighted assets, was assigned 5.06% of the total trade and default fund exposures while another bank in the sample, with 3.51% of total risk weighted assets, was assigned 3.51% of these exposures. Because trade exposures of ICC members against ICC are nonpublic, the Commission used the balance of ICC margin deposits and deposits in lieu of margin held at ICC, \$14.2 billion, as a proxy for trade exposures. ICC's 2015 clearing fund deposits were valued at \$1.56 billion. See ICC, 2015 Annual Report, available at [https://www.theice.com/publicdocs/regulatory\\_filings/ICE\\_Clear\\_Credit\\_Financial\\_Statements\\_2014\\_2015.pdf](https://www.theice.com/publicdocs/regulatory_filings/ICE_Clear_Credit_Financial_Statements_2014_2015.pdf)

<sup>204</sup> The BCBS capital framework allows banks to compute default fund exposures in two ways. Method 1 involves computing capital requirements for each member proportional to its share of an aggregate capital requirement for all clearing members in a scenario where to average clearing members default. The Commission currently lacks data necessary to compute default fund exposures under this approach, instead we use Method 2, which caps overall exposure to a QCCP at 20% of trade exposures. See BCBS capital framework, *supra* note 199, Annex 4, paras. 121–25 (outlining two methods for computing default fund exposures).

be smaller in magnitude, implying a smaller adjustment at lower cost. The Commission estimates that benefits associated with ICC obtaining QCCP status stemming from lower capital requirements against trade exposures to QCCPs as a result of the adopted rules to have an upper bound of \$12.9 million per year, or approximately 0.01% of the total 2015 net income reported by bank clearing members at ICC.<sup>205</sup>

The Commission's analysis is limited in several respects and relies on several assumptions about the nature of trade exposures to ICC. First, a limitation of our proxy for trade exposures and our use of ICC's clearing fund is that the account balances include deposits by bank clearing members, who would experience lower capital requirements under the BCBS capital framework, and non-bank clearing members who would not. As a result, the Commission assumes, for the purposes of establishing an upper bound for the benefits to market participants that are associated with QCCP status for ICC under the adopted rules, that the balance of both ICC's margin account and ICC's default fund are attributable only to bank clearing members. Additionally, we assume an extreme case where, in the absence of QCCP status, trade exposures against a CCP would be assigned a 100% risk weight, causing the largest possible shock to risk-weighted assets for affected banks.

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<sup>205</sup> The Commission first quantified the benefits related to ICC's attaining QCCP status for ICC's bank clearing members and bank indirect participants with respect to all reported exposures. Over the period March 2009 through August 2016 the gross notional value of security-based swap transactions cleared by ICE Clear Credit comprised 9% of the total value of all CDS transactions cleared (see: <https://www.theice.com/clear-credit>). Based on this information the Commission arrived at the benefits to ICC's bank clearing members and bank indirect participants from ICC's attaining QCCP status with respect to security-based swap transactions by multiplying the total benefits by 0.09.

Lower capital requirements on trade exposures to ICC would produce effects in the real economy only under certain conditions. First, agency problems, taxes, or other capital market imperfections could result in banks targeting a particular capital structure. Second, capital constraints on bank clearing members subject to the BCBS capital framework must bind so that higher capital requirements on bank clearing members subject to the BCBS capital framework in the absence of QCCP status would cause these banks to exceed capital constraints if they chose to redistribute capital to shareholders or invest capital in projects with returns that exceed their cost of capital in the absence of QCCP status for ICC for security-based swap clearing. Using publicly available data, however, it is not currently possible to determine whether capital constraints will bind for bank clearing members when rules applying the BCBS capital framework come into force, so to estimate an upper bound for the effects of QCCP status on bank clearing members we assume that tier one capital constraints for all bank clearing members of ICC would bind in an environment with zero weight placed on bank exposures to CCPs.<sup>206</sup>

For the purposes of quantifying potential benefits from QCCP status, the Commission has also assumed that banks choose to adjust to new capital requirements by deleveraging. In particular, the Commission assumed that banks would respond by reducing risk-weighted assets equally across all risk classes until they reach the minimum tier one capital ratio under the Basel

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<sup>206</sup> The Commission notes that, at present, no bank in its sample of bank clearing members of ICC is bound by capital requirements under the BCBS capital framework. For U.S. bank holding companies tier 1 capital ratios were collected from Y-9C reports available at the National Information Center, <https://www.ffiec.gov/nicpubweb/nicweb/nichome.aspx>. For non-U.S. bank holding companies, Commission staff obtained corresponding data from financial statements and supplementary financial materials posted to bank websites. The Commission used data from 2013–2016 for its sample of U.S. bank clearing members, and from 2012–2015 for non-U.S. bank clearing members and assumed no bank-specific countercyclical capital buffers for these banks. This suggests a minimum tier 1 capital ratio of 10.5%, exceeding the BCBS capital framework’s minimum by 2.0%.

framework of 8.5%. We measure the ongoing costs to each non-U.S. bank by multiplying the implied change in total assets by each bank's return on assets, estimated using up to 12 years of annual financial statement data.<sup>207</sup>

The BCBS capital framework for exposures to CCPs yields additional benefits for QCCPs that the Commission is currently unable to quantify due to lack of data concerning client clearing arrangements by banks. For client exposures to clearing members, the BCBS capital framework allows participants to reflect the shorter close-out period of cleared transactions in their capitalized exposures. The BCBS capital framework's treatment of exposures to CCPs also applies to client exposures to CCPs through clearing members. This may increase the likelihood that bank clients of bank clearing members that are subject to the BCBS capital framework share some of the benefits of QCCP status.

Furthermore, the fact that the BCBS capital framework applies to bank clearing members may have important implications for competition and concentration. While Rule 17Ad-22(e) may extend lower capital requirements against exposures to QCCPs to the QCCP's non-U.S. bank clearing members, the benefits of QCCP status will still be limited to bank clearing members. However, the costs associated with compliance with Rule 17Ad-22(e) may be borne by all clearing members, regardless of whether or not they are supervised as banks. A potential consequence of this allocation of costs and benefits may be a "crowding out" of members of QCCPs that are not banks and that will not experience benefits with respect to the BCBS capital framework. This may result in an unintended consequence of an increased concentration of clearing activity among ICC's bank clearing members. This increased concentration could mean

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<sup>207</sup> This data has been taken from Compustat. Due to data limitations, for certain banks a shorter window was used for this calculation. The minimum sample window was nine years.

that each of the remaining clearing members becomes more important from the standpoint of systemic risk transmission since, for example, clearing agencies would have fewer non-defaulting members to take on defaulting members' portfolios, and clearing agencies that rely on clearing members to participate in default auctions would hold auctions with fewer participants.

The Commission preliminarily believes that the benefits of ICC attaining QCCP status may depend on whether foreign bank clearing members of ICC are currently able to shift their clearing business from ICC to alternative clearing agencies that serve similar markets. In this regard, the Commission notes that ICC and ICEEU have several overlapping members and ICC clears all the contracts that ICEEU clears. Thus in a situation where ICEEU is a QCCP while ICC is not, common foreign bank members of the two agencies may obtain many of the benefits of ICC having QCCP status by moving their clearing business to ICEEU.

However, under such a scenario, the benefits of ICC having QCCP status for security-based swaps would not be fully realized for a number of reasons. First, not all clearing members of ICC are also clearing members of ICEEU. These members will not be able to move their clearing business to ICEEU. Second, ICEEU only clears a subset of the contracts that ICC does. Thus even common foreign bank members of ICC and ICEEU may not be able to move their entire clearing business from ICC to ICEEU. The Commission therefore preliminarily believes that the extent to which foreign bank clearing members of ICC could obtain QCCP benefits by moving their clearing business from ICC to ICEEU is limited.

#### **b. Costs**

As noted above, ICC is a SIDCO that is also regulated by the CFTC. Based on its consultation and coordination with other regulators, the Commission believes Rule 17Ad-22(e) is consistent and comparable, where possible and appropriate, with the rules and policy statements adopted by the FRB and the rules adopted by the CFTC, as each of the three rule sets are

intended to be consistent with the headline principles in the PFMI. The Commission's rules differ from those requirements adopted by the CFTC and FRB in terms of the specific portions of the key considerations and explanatory text in the PFMI that are, or are not, referenced or emphasized.

Because of the abovementioned similarities between the CFTC's regulatory regime for SIDCOs and Rule 17Ad-22(e), the Commission preliminarily believes that, at the time of this proposal, ICC's policies and procedures are already likely to be in compliance with many of the requirements in Rule 17Ad-22(e). The Commission further notes that ICC's principle-by-principle summary narrative disclosure suggests that it would be unlikely to need to make significant changes to its operations, policies, and procedures in order to comply with Rule 17Ad-22(e).<sup>208</sup>

In light of the abovementioned similarity between the CFTC's regulatory regime for SIDCOs and Rule 17Ad-22(e), the Commission preliminarily believes the economic costs that ICC will bear as a result of the proposed amendments will be related to the establishment, implementation and maintenance of certain policies and procedures under Rule 17Ad-22(e). We preliminarily estimate these costs will at most include one-time costs of approximately \$667,917<sup>209</sup> and annual costs of approximately \$146,249.<sup>210</sup>

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<sup>208</sup> See ICE Clear Credit Disclosure Framework, *supra* note 145.

<sup>209</sup> Calculated as ((Assistant General Counsel for 440 hours at \$440 per hour) + (Chief Compliance Officer for 146 hours at \$501 per hour) + (Chief Financial Officer for 50 hours at \$501 per hour) + (Compliance Attorney for 377 hours at \$345 per hour) + (Computer Operations Department Manager for 344 hours at \$416 per hour) + (Financial Analyst for 70 hours at \$259 per hour) + (Senior Business Analyst for 85 hours at \$259 per hour) + (Senior Programmer for 75 hours at \$313 dollars per hour) + (Senior Risk Management Specialist for 114 hours at \$338 per hour)) = \$667,917.

### c. Effects on Efficiency, Competition, and Capital Formation

The proposed amendments do not alter the covered clearing agency status of DTC, FICC, NSCC and OCC. The Commission preliminarily believes that the proposed amendments will not change the behavior of market participants associated with these entities and will therefore not generate any economic benefits or costs for these entities. Further, even though the proposed amendments do not alter the covered clearing agency status of ICEEU, the Commission preliminarily believes that they are likely to generate economic effects for this entity. This is because ICC clears all security-based transactions that are cleared by ICEEU. Because the proposed amendments are likely to result in uniform regulatory requirements for similar risks at both clearing agencies, they could potentially cause business to shift from ICEEU to ICC. This could translate into a loss of economies of scale for ICEEU which, in turn, would result in higher clearing fees and higher transaction costs in cleared products.

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<sup>210</sup> Calculated as ((Administrative Assistant for 20 hours at \$76 per hour) + (Compliance Attorney for 279 hours at \$345 per hour) + (Computer Operations Department Manager for 12 hours at \$416 per hour) + (Risk Management Specialist for 183 hours at \$188 per hour) + (Senior Business Analyst for 22 hours at \$259 per hour) + (Senior Risk Management Specialist for 10 hours at \$338 per hour)) = \$146,249 per year. To monetize the internal costs the Commission staff used data from the SIFMA publications, Management and Professional Earnings in the Security Industry—2013, and Office Salaries in the Securities Industry—2013, modified by the Commission staff to account for an 1800 hour work-year and multiplied by 5.35 (professionals) or 2.93 (office) to account for bonuses, firm size, employee benefits and overhead. These figures have been adjusted for inflation using data published by the Bureau of Labor Statistics. Commission staff also estimated an hourly rate for a Chief Financial Officer. The website [www.salary.com](http://www.salary.com) reports that median CFO annual salaries in 2016 were \$306,789. A Grant Thornton LLP survey estimated that in 2016 public company CFOs will receive an average annual salary of \$303,975. Using an approximate midpoint of these two estimates of \$305,000 per year, and dividing by an 1800-hour work year and multiplying by the 5.35 factor which normally is used to include benefits but here is used as an approximation to offset the fact that New York salaries are typically higher than the rest of the country, the result is \$906 per hour.

## **2. Economic Effects Related to Future Registrants**

Besides affecting the application of Rule 17Ad-22 to the existing set of registered clearing agencies, the proposed amendments to Rule 17Ad-22 would, if adopted, affect the regulation of clearing agencies that register with the Commission in the future. In particular, under the proposed revision to Rule 17Ad-22(a)(5), any clearing agency that provides the services of a CCP, CSD, or SSS would be a covered clearing agency. This means that covered clearing agencies would no longer be limited to those that have been designated as systemically important by the FSOC or are involved in activities that meet the definition of activities with a complex risk profile, nor would clearing agencies for which the CFTC is the supervisory agency under the Clearing Supervision Act be excluded.

Because the Commission is unable to predict with any precision the number of clearing agencies likely to register in the future, much less the number that are likely to be CCPs, CSDs, or SSSs, it is unable to quantify the aggregate economic effects that would flow as a result of the effect of the proposed amendments to Rule 17Ad-22(a) on future registrants. The Commission notes, however, that it preliminarily believes that the proposed amendments would generally increase the likelihood Rule 17Ad-22(e) would apply to a new registrant. Where possible, the Commission has attempted to estimate the benefits and costs it would expect the proposed amendments to Rule 17Ad-22(a) to have on a single new registrant.

### **a. Benefits**

The Commission preliminarily believes that a benefit of the proposed amendments may be that they reduce the costs that potential entrants into the market for clearance and settlement services could expect to face to determine whether they would face regulation as covered clearing agencies. Under the proposed amendments, any registered clearing agency that expects to provide the services of a CCP, CSD, or SSS would also expect to be subject to Rule 17Ad-

22(e) without requiring additional information about FSOC designation or a Commission determination that its activities have a more complex risk profile. To the extent that this reduces the need for potential entrants that engage in those services to assess whether they are likely to be regulated as covered clearing agencies, the proposed amendments could reduce the costs associated with registration. The Commission preliminarily believes that a reasonable estimate of cost reduction a single registrant is likely to experience is \$3,382, attributable to reduced legal expenses associated with determining whether or not the registrant will also be regulated as a covered clearing agency.<sup>211</sup>

In the absence of the proposed amendments, without designation by the FSOC or a Commission determination, a registered clearing agency would be subject to Rule 17Ad-22(d). The proposed amendments increase the likelihood that new entrants into the market for clearance and settlement services would be subject to Rule 17Ad-22(e). Generally, to the extent that the requirements under Rule 17Ad-22(e) impose higher risk management standards on potential entrant CCPs, CSDs, and SSSs than they would impose on themselves while subject to Rule 17Ad-22(d), the Commission preliminarily believes the proposed amendments to Rule 17Ad-22(a) may improve financial stability. As discussed in the CCA Standards adopting release, some of this increased stability may come as a result of lower activity as Rule 17Ad-22(e) causes participants of these new entrants to internalize a greater proportion of the costs that their activity imposes on the financial system, reducing the costs of default, conditional on a default event occurring.<sup>212</sup> Increased stability may also come as a result of the higher risk management

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<sup>211</sup> The Commission calculated this reduction in costs as ((Assistant General Counsel for 2 hours at \$440 per hour) + (Compliance Attorney for 3 hours at \$300 per hour) + (Outside Counsel for 5 hours at \$400 per hour) = \$3,382.

<sup>212</sup> See CCA Standards adopting release, supra note 7, at 380.

standards at potential entrants effectively lowering the probability that either the entrant clearing agencies or their members default.

### **b. Costs**

In the absence of the proposed amendments, without designation by the FSOC or a Commission determination, a registered clearing agency would be subject to Rule 17Ad-22(d). To the extent that requirements under Rule 17Ad-22(e) would impose additional costs on potential entrants who would otherwise be regulated under Rule 17Ad-22(d), the Commission believes that the proposed amendments may impose additional costs on potential entrants.

In the CCA Standards adopting release,<sup>213</sup> the Commission estimated specific costs that registered clearing agencies would bear related to holding sufficient qualifying liquid resources under Rule 17Ad-22(e)(7). These estimates depended on information about the current operation of registered clearing agencies that are subject to Rule 17Ad-22(e) and so the Commission is unable to provide precise estimates of costs associated with these requirements that potential entrants may bear as a result of the proposed amendments to Rule 17Ad-22(a). However if a potential entrant resembles the average covered clearing agency, the Commission would expect compliance with Rule 17Ad-22(e)(7) to cost the entrant between \$24 million and \$40 million.<sup>214</sup> In addition, the Commission estimates the startup compliance costs associated with policies and procedures for a potential entrant that is not a CSD to be substantially similar to the costs

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<sup>213</sup> See id. at 346.

<sup>214</sup> To arrive at this range, the Commission divided the maximum and minimum costs associated with compliance estimated in the CCA Standards adopting release by 5 covered clearing agencies. See id.

estimated in the CCA Standards adopting release, \$608,578.<sup>215</sup> Furthermore, Rules 17Ad-22(e)(3), (4), (6), (7), (15) and (21) all include elements of review by either a covered clearing agency's board or its management on an ongoing basis. The Commission estimates the cost of ongoing review for these adopted rules at approximately \$39,376 per year for a potential entrant, as estimated in the CCA Standards adopting release.<sup>216</sup>

### **c. Effects on Efficiency, Competition, and Capital Formation**

The Commission preliminarily believes there are unlikely to be substantial direct effects on efficiency and capital formation from the proposed amendments' impact on potential entrants. The Commission acknowledges, however, that there are potential effects on competition that may arise from how the proposed amendments would affect the regulatory treatment of registered clearing agencies and the barriers to entry into the market for services provided by CCPs, CSDs, and SSSs.

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<sup>215</sup> The total initial cost for an entrant that is not a CSD and does engage in activities with a more complex risk profile was calculated as follows: ((Assistant General Counsel for 428 hours at \$467 per hour) + (Compliance Attorney for 365 hours at \$310 per hour) + (Administrative Assistant for 2 hours at \$72 per hour) + (Computer Operations Department Manager for 300 hours at \$361 per hour) + (Senior Business Analyst for 85 hours at \$245 per hour) + (Senior Risk Management Specialist for 114 hours at \$249 per hour) + (Chief Compliance Office for 102 hours at \$441 per hour) + (Senior Programmer for 53 hours at \$282 per hour) + (Chief Financial Officer for 50 hours at \$892 per hour) + (Financial Analyst for 70 hours at \$245 per hour)) = \$592,215. Because only Rule 17Ad-22(e)(11) applies solely to CSDs and many of the other parts of Rule 17Ad-22(e) do not apply to CSDs, the Commission believes the initial cost of an entrant that is a CSD would be lower.

<sup>216</sup> To estimate the cost of board review, the Commission used a recent report by Bloomberg stating that the average director works 250 hours and earns \$251,000, resulting in an estimated \$1000 per hour for board review. As a proxy for the cost of management review, the Commission is estimating \$461 per hour, based upon the Director of Compliance cost data from the SIFMA table, see infra note 778. The Commission estimates the total cost of review for each clearing agency as follows: ((Board Review for 32 hours at \$1000 per hour) + (Management Review for 16 hours at \$461 per hour)) = \$39,376. The Commission requests comment on this estimate.

The proposed amendments would likely result in more consistent regulatory treatment of firms that provide similar services to securities markets. By imposing Rule 17Ad-22(e) on all CCPs, CSDs, and SSSs, regardless of FSOC designation or their engagement in activities with a more complex risk profile, the proposed amendments to Rule 17Ad-22(a) would mitigate the risk that registered clearing agencies with similar businesses would be subject to substantially different regulatory regimes. The Commission preliminarily believes that more uniform treatment under the proposed amendments may provide a more level playing field for CCPs, CSDs, and SSSs. By contrast, in the absence of the proposed amendments, an entrant CCP, CSD, or SSS, that did not engage in activity with a more complex risk profile could initially receive a competitive advantage by being regulated under 17Ad-22(d) until becoming a designated clearing agency because they may internalize less of the risk they pose to the financial system.

On the other hand, as discussed in the CCA Standards adopting release, costs resulting from regulation under Rule 17Ad-22(e) as a result of the proposed amendments to Rule 17Ad-22(a) may have the effect of raising already high barriers to entry.<sup>217</sup> As the potential entry of new clearing agencies becomes more remote, existing clearing agencies may be able to reduce service quality, restrict the supply of services, or increase fees above marginal cost in an effort to earn economic rents from participants in cleared markets.<sup>218</sup>

### **3. Alternatives**

As an alternative to the proposed approach, the Commission considered alternative definitions of “covered clearing agency.” Specifically, the Commission considered more limited

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<sup>217</sup> See CCA Standards adopting release, supra note 7, at 317–318.

<sup>218</sup> See, e.g., Clearing Agency Standards adopting release, supra note 31, at 66263 n.481.

definitions that would not have included CSDs or SSSs along with CCPs within the definition. An alternative approach that included only CCPs within the definition of “covered clearing agency” would still include ICC in the set of covered clearing agencies. The Commission preliminarily believes that such an approach compares unfavorably to the proposed approach because, as discussed in Parts II.A.1 and 2, CSDs perform a critical role in the U.S. securities settlement markets by helping to reduce risk and by providing transparency to the markets and, hence, it is appropriate to apply enhanced requirements under Rule 17Ad-22(e) to CSDs.

Similarly, the Commission could have proposed to exclude SSSs from the definition of covered clearing agency. This would have no effect on the set of registered entities that would be covered clearing agencies and no effect on the immediate economic effects of the proposed amendments. However, this could potentially mean that an entrant clearing agency that solely performs the functions of an SSS would be subject only to Rule 17Ad-22(d). As above, the Commission preliminarily believes that it is appropriate to apply enhanced requirements under Rule 17Ad-22(e) to SSSs because of the critical role they play in the national system for clearance and settlement.

#### **IV. Paperwork Reduction Act**

The Paperwork Reduction Act of 1995 (“PRA”) imposes certain requirements on federal agencies in connection with the conducting or sponsoring of any “collection of information.”<sup>219</sup> An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. Further, 44 U.S.C. 3507(a) provides that, before adopting or revising a collection of information requirement, an agency must, among other things, publish notice in the Federal Register stating that the agency has

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<sup>219</sup> See 44 U.S.C. 3501 *et seq.*; 44 U.S.C. 3502(3).

submitted the proposed collection of information to the Office of Management and Budget (“OMB”) and setting forth certain required information, including (i) a title for the collection of information; (ii) a summary of the collection of information; (iii) a brief description of the need for the information and the proposed use of the information; (iv) a description of the likely respondents and proposed frequency of response to the collection of information; (v) an estimate of the paperwork burden that shall result from the collection of information; and (vi) notice that comments may be submitted to the agency and director of OMB.<sup>220</sup>

Certain provisions of Rule 17Ad-22(e) impose collection of information requirements under the PRA. The Commission submitted these collections of information to the OMB for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. Because the Commission is proposing to revise the respondents under Rule 17Ad-22(e) to account for the proposed amendment to the definition of “covered clearing agency” and related amendments, the Commission will use the same title and control number: “Clearing Agency Standards for Operation and Governance,” OMB Control No. 3235-0695.

## **A. Summary of Collection of Information and Use of Information<sup>221</sup>**

### **1. Rule 17Ad-22(e)(1)**

Rule 17Ad-22(e)(1) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a well-founded,

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<sup>220</sup> See 44 U.S.C. 3507(a)(1)(D); see also 5 CFR 1320.5(a)(1)(iv).

<sup>221</sup> In addition to the discussion of the purposes of the collections of information set forth in Part IV.A, the Commission notes that the policies and procedures would also be used by the Commission as part of its ongoing efforts to monitor and enforce compliance with the federal securities laws through, among other things, examinations and inspections.

clear, transparent and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.<sup>222</sup>

The purpose of this collection of information is to reduce the potential for legal risk at covered clearing agencies, such as the risk that participants face legal uncertainty due to a lack of clarity or completeness regarding conflicts with applicable laws.

## **2. Rule 17Ad-22(e)(2)**

Rules 17Ad-22(e)(2)(i) through (iii) require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent, clearly prioritize the safety and efficiency of the covered clearing agency, and support the public interest requirements of Section 17A of the Exchange Act, and the objectives of owners and participants. Rules 17Ad-22(e)(2)(iv) and (v) require a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to establish that the board of directors and senior management have appropriate experience and skills to discharge their duties and responsibilities and to specify clear and direct lines of responsibility. Rule 17Ad-22(e)(2)(vi) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to consider the interests of participants' customers, securities issuers and holders, and other relevant stakeholders of the clearing agency.<sup>223</sup>

The purpose of this collection of information is to prioritize the safety and efficiency of covered clearing agencies, to help ensure that each covered clearing agency's governance

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<sup>222</sup> See 17 CFR 240.17Ad-22(e)(1); CCA Standards adopting release, supra note 7, at 463.

<sup>223</sup> See 17 CFR 240.17Ad-22(e)(2); CCA Standards adopting release, supra note 7, at 463.

arrangements consider the interests of relevant stakeholders, to promote the establishment of boards of directors at covered clearing agencies that are composed of qualified members with clear and direct lines of responsibility, and to promote accountability of the board of directors and senior management.

### **3. Rule 17Ad-22(e)(3)**

Rule 17Ad-22(e)(3) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, general business, investment, custody, and other risks that arise in or are borne by the covered clearing agency. Rule 17Ad-22(e)(3)(i) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for risk management policies, procedures, and systems designed to identify, measure, monitor, and manage the range of risks that arise in or are borne by the covered clearing agency, and subject them to review on a specified periodic basis and approval by the board of directors annually. Rule 17Ad-22(e)(3)(ii) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure it establishes plans for the recovery and orderly wind-down of the covered clearing agency necessitated by credit losses, liquidity shortfalls, losses from general business risk, or any other losses. Rule 17Ad-22(e)(iii) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide risk management and internal audit personnel with sufficient authority, resources, independence from management, and access to the board of directors. Rule 17Ad-22(e)(3)(iv) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide

risk management and internal audit personnel with oversight by and a direct reporting line to a risk management committee and an independent audit committee of the board of directors, respectively. Rule 17A-22(e)(3)(v) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for an independent audit committee.<sup>224</sup>

The purpose of this information collection is to enhance each covered clearing agency's ability to identify, monitor, and manage the risks that covered clearing agencies face, including by subjecting the relevant policies and procedures to regular review, and to facilitate an orderly recovery and wind-down process in the event that a covered clearing agency is unable to continue operating as a going concern.

#### **4. Rule 17Ad-22(e)(4)**

Rule 17Ad-22(e)(4) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those exposures arising from its payment, clearing, and settlement processes.

Rule 17Ad-22(e)(4)(i) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. Rule 17Ad-22(e)(4)(ii) requires a covered clearing agency that provides CCP services, and that is “systemically important in multiple jurisdictions” or “a clearing agency involved in activities with a more complex risk profile,” to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain additional financial

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<sup>224</sup> See 17 CFR 240.17Ad-22(e)(3); CCA Standards adopting release, supra note 7, at 464.

resources, to the extent not already maintained pursuant to Rule 17Ad-22(e)(4)(i), at a minimum level necessary to enable it to cover a wide range of foreseeable stress scenarios, including but not limited to the default of the two participant families that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions. Meanwhile, Rule 17Ad-22(e)(4)(iii) requires a covered clearing agency that is not subject to Rule 17Ad-22(e)(4)(ii) to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain additional financial resources, to the extent not already maintained pursuant to Rule 17Ad-22(e)(4)(i), at the minimum to enable it to cover a wide range of foreseeable stress scenarios, including the default of the participant family that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions. Rule 17Ad-22(e)(4)(iv) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to include prefunded financial resources, exclusive of assessments for additional guaranty fund contributions or other resources that are not prefunded, when calculating the financial resources available to meet the standards under Rules 17Ad-22(e)(4)(i) through (iii), as applicable. Rule 17Ad-22(e)(4)(v) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain the financial resources required under proposed Rules 17Ad-22(e)(4)(ii) and (iii), as applicable, in combined or separately maintained clearing or guaranty funds.

Rule 17Ad-22(e)(4)(vi) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to test the sufficiency of its total financial resources available to meet the minimum financial resource requirements under Rules 17Ad-22(e)(4)(i) through (iii), as applicable, by conducting stress testing of its total

financial resources at least once each day using standard predetermined parameters and assumptions. Rule 17Ad-22(e)(4)(vi) also requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to conduct a comprehensive analysis on at least a monthly basis of the existing stress testing scenarios, models, and underlying parameters and assumptions, and consider modifications to ensure they are appropriate for determining the covered clearing agency's required level of default protection in light of current market conditions. When the products cleared or markets served by a covered clearing agency display high volatility or become less liquid, or when the size or concentration of positions held by the entity's participants increases significantly, the proposed rule would require a covered clearing agency to have policies and procedures for conducting comprehensive analyses of stress testing scenarios, models, and underlying parameters and assumptions more frequently than monthly. Rule 17Ad-22(e)(4)(vi) also requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for the reporting of the results of this analysis to the appropriate decision makers at the covered clearing agency, including its risk management committee or board of directors, and to require the use of the results to evaluate the adequacy of and to adjust its margin methodology, model parameters, and any other relevant aspects of its credit risk management policies and procedures, in supporting compliance with the minimum financial resources requirements in Rules 17Ad-22(e)(4)(i) through (iii), as applicable.

Rule 17Ad-22(e)(4)(vii) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to require a model validation for its credit risk models not less than annually or more frequently as may be contemplated by the covered clearing agency's risk management policies and procedures.

Rule 17Ad-22(e)(4)(viii) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to address allocation of credit losses the covered clearing agency may face if its collateral and other resources are insufficient to fully cover its credit exposures, including the repayment of any funds the covered clearing agency may borrow from liquidity providers.

Rule 17Ad-22(e)(4)(ix) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to describe the covered clearing agency's process to replenish any financial resources it may use following a default or other event in which use of such resources is contemplated.<sup>225</sup>

The purpose of this information collection is to identify and limit credit exposures to participants and to satisfy all of its settlement obligations in the event of a participant default, to address the allocation of credit losses if collateral and other resources are insufficient to fully cover its credit exposures following a participant default, and to describe the covered clearing agency's process to replenish financial resources following such a default.

#### **5. Rule 17Ad-22(e)(5)**

Rule 17Ad-22(e)(5) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to limit the assets it accepts as collateral to those with low credit, liquidity, and market risks, and also require policies that set and enforce appropriately conservative haircuts and concentration limits if the covered clearing agency requires collateral to manage its own or its participants' credit exposures. In addition, Rule 17Ad-22(e)(5) requires a covered clearing agency to establish, implement, maintain and

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<sup>225</sup> See 17 CFR 240.17Ad-22(e)(4); CCA Standards adopting release, supra note 7, at 464–466.

enforce written policies and procedures reasonably designed to include a not-less-than-annual review of the sufficiency of a covered clearing agency's collateral haircuts and concentration limits.<sup>226</sup>

The purpose of the information collection is to enable a covered clearing agency to be able to maintain sufficient collateral by using appropriately conservative haircuts and concentration limits.

#### **6. Rule 17Ad-22(e)(6)**

Rule 17Ad-22(e)(6) requires a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that is monitored by management on an ongoing basis and regularly reviewed, tested, and verified.

Rule 17Ad-22(e)(6)(i) requires a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to result in a margin system that, at a minimum, considers and produces margin levels commensurate with the risks and particular attributes of each relevant product, portfolio, and market. Rule 17Ad-22(e)(6)(ii) requires a covered clearing agency that provides CCP services to establish implement, maintain and enforce written policies and procedures reasonably designed to ensure that the margin system would mark participant positions to market and collect margin, including variation margin or equivalent charges if relevant, at least daily, and include the authority and operational capacity to make intraday margin calls in defined circumstances. Rule 17Ad-22(e)(6)(iii) requires a covered clearing agency that provides CCP services to establish,

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<sup>226</sup> See 17 CFR 240.17Ad-22(e)(5); CCA Standards adopting release, supra note 7, at 466–467.

implement, maintain and enforce written policies and procedures reasonably designed to calculate margin sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default. Rule 17Ad-22(e)(6)(iv) requires a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that it uses reliable sources of timely price data and uses procedures and sound valuation models for addressing circumstances in which pricing data are not readily available or reliable. Rule 17Ad-22(e)(6)(v) requires a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure the use of an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products.

Rule 17Ad-22(e)(6)(vi) requires a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to establish a risk-based margin system that is monitored by management on an ongoing basis. Rule 17Ad-22(e)(6)(vi) also requires a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to regularly review, test, and verify its risk-based margin system by conducting backtests of its margin model at least once each day using standard predetermined parameters and assumptions. Rule 17Ad-22(e)(6)(vi) also requires a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to regularly review, test, and verify its risk-based margin system by conducting a sensitivity analysis of its margin model and a review of its parameters and assumptions for backtesting on at least a monthly basis, and considering modifications to ensure the backtesting practices are

appropriate for determining the adequacy of the covered clearing agency's margin resources. Rule 17Ad-22(e)(6)(vi) also requires a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to regularly review, test, and verify its risk-based margin system by conducting a sensitivity analysis of its margin model and a review of its parameters and assumptions for backtesting more frequently than monthly during periods of time when the products cleared or markets served display high volatility or become less liquid, and when the size or concentration of positions held by the covered clearing agency's participants increases or decreases significantly. Rule 17Ad-22(e)(6)(vi) also requires a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to regularly review, test, and verify its risk-based margin system by reporting the results of its analyses above to appropriate decision makers at the covered clearing agency, including but not limited to, its risk management committee or board of directors, and using these results to evaluate the adequacy of and adjust its margin methodology, model parameters, and any other relevant aspects of its credit risk management framework.

Finally, Rule 17Ad-22(e)(6)(vii) requires a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to requires a model validation for the covered clearing agency's margin system and related models to be performed not less than annually, or more frequently as may be contemplated by the covered clearing agency's risk management framework established pursuant to Rule 17Ad-22(e)(3).<sup>227</sup>

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<sup>227</sup> See 17 CFR 240.17Ad-22(e)(6); CCA Standards adopting release, supra note 7, at 467–468.

The purpose of the information collection is to enable a covered clearing agency to be able to collect sufficient margin subject to regular sensitivity analysis, monthly backtesting, and an annual model validation.

#### **7. Rule 17Ad-22(e)(7)**

Rule 17Ad-22(e)(7) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by it, by meeting, at a minimum, the ten requirements specified in the rule.

Rule 17Ad-22(e)(7)(i) requires that a covered clearing agency's policies and procedures be reasonably designed to ensure that it maintains sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that includes the default of the participant family that would generate the largest aggregate payment obligation for it in extreme but plausible market conditions.

Rule 17Ad-22(e)(7)(ii) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that it holds qualifying liquid resources sufficient to meet the minimum liquidity resource requirement in each relevant currency for which the covered clearing agency has payment obligations owed to clearing members.

Rule 17Ad-22(e)(7)(iii) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure it uses accounts and services at a Federal Reserve Bank, pursuant to Section 806(a) of the Clearing Supervision Act, or other relevant central bank, when available and where determined to be

practical by the board of directors of the covered clearing agency, to enhance its management of liquidity risk.

Rule 17Ad-22(e)(7)(iv) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure it undertakes due diligence to confirm that it has a reasonable basis to believe each of its liquidity providers, whether or not such liquidity provider is a clearing member, has sufficient information to understand and manage the liquidity provider's liquidity risks, and the capacity to perform as required under its commitments to provide liquidity.

Rule 17Ad-22(e)(7)(v) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that the covered clearing agency maintains and, on at least an annual basis, tests with each liquidity provider, to the extent practicable, its procedures and operational capacity for accessing each type of relevant liquidity resource.

Rule 17Ad-22(e)(7)(vi)(A) through (C) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to determine the amount and regularly test the sufficiency of the liquid resources held for purposes of meeting the minimum liquid resource requirement of Rule 17Ad-22(e)(7)(i) by (A) conducting stress testing of its liquidity resources at least once each day using standard and predetermined parameters and assumptions; (B) conducting a comprehensive analysis of the existing stress testing scenarios, models, and underlying parameters and assumptions used in evaluating liquidity needs and resources, and considering modifications to ensure they are appropriate for determining the covered clearing agency's identified liquidity needs and resources in light of current and evolving market conditions at least once each month; and (C)

conducting a comprehensive analysis of the existing stress testing scenarios, models, and underlying parameters and assumptions used in evaluating liquidity needs and resources more frequently when products cleared or markets served display high volatility or become less liquid, when the size or concentration of positions held by participants increases significantly, or in other circumstances described in the covered clearing agency's policies and procedures. Rule 17Ad-22(e)(7)(vi)(D) also requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to result in reporting the results of the analyses performed under Rules 17Ad-22(e)(7)(vi)(B) and (C) to appropriate decision makers, including the risk management committee or board of directors, at the covered clearing agency for use in evaluating the adequacy of and adjusting its liquidity risk management framework.

Rule 17Ad-22(e)(7)(vii) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to result in performing an annual or more frequent model validation of its liquidity risk models.

Rule 17Ad-22(e)(7)(viii) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to address foreseeable liquidity shortfalls that would not be covered by its liquid resources and seek to avoid unwinding, revoking, or delaying the same-day settlement of payment obligations.

Rule 17Ad-22(e)(7)(ix) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to describe its process for replenishing any liquid resources that it may employ during a stress event.

Rule 17Ad-22(e)(7)(x) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that it, at

least once a year, evaluates the feasibility of maintaining sufficient liquid resources at a minimum in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of foreseeable stress scenarios that includes, but is not limited to, the default of the two participant families that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions if the covered clearing agency provides CCP services and is either systemically important in multiple jurisdictions or a clearing agency involved in activities with a more complex risk profile.<sup>228</sup>

The purpose of this information collection is to identify and limit liquidity risk so that a covered clearing agency can satisfy its settlement obligations on an ongoing and timely basis by holding a sufficient amount of qualifying liquid resources and performing regular stress testing of its liquid resources. It is also to help ensure that a covered clearing agency addresses foreseeable liquidity shortfalls and can replenish any liquid resources that it may employ in a stress event. It is also to help ensure that a covered clearing agency manages the risks posed by its liquidity providers.

#### **8. Rule 17Ad-22(e)(8)**

Rule 17Ad-22(e)(8) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to define the point at which settlement is final to be no later than the end of the day on which the payment or obligation is due and, where necessary or appropriate, either intraday or in real time.<sup>229</sup>

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<sup>228</sup> See 17 CFR 240.17Ad-22(e)(7); CCA Standards adopting release, supra note 7, at 468–471.

<sup>229</sup> See 17 CFR 240.17Ad-22(e)(8); CCA Standards adopting release, supra note 7, at 471.

The purpose of this information collection is to promote consistent standards of timing and reliability in the settlement process.

**9. Rule 17Ad-22(e)(9)**

Rule 17Ad-22(e)(9) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to conduct its money settlements in central bank money, where available and determined to be practical by the board of directors of the covered clearing agency, and minimizes and manages credit and liquidity risk arising from conducting its money settlements in commercial bank money if central bank money is not used by the covered clearing agency.<sup>230</sup>

The purpose of this information collection is to promote reliability in a covered clearing agency's settlement operations.

**10. Rule 17Ad-22(e)(10)**

Rule 17Ad-22(e)(10) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to establish and maintain transparent written standards that state its obligations with respect to the delivery of physical instruments and operational practices that identify, monitor, and manage the risk associated with such physical deliveries.<sup>231</sup>

The purpose of this information collection is to provide a covered clearing agency's participants with the information necessary to evaluate the risks and costs associated with participation in the covered clearing agency.

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<sup>230</sup> See 17 CFR 240.17Ad-22(e)(9); CCA Standards adopting release, supra note 7, at 471.

<sup>231</sup> See 17 CFR 240.17Ad-22(e)(10); CCA Standards adopting release, supra note 7, at 472.

### **11. Rule 17Ad-22(e)(11)**

Rule 17Ad-22(e)(11)(i) requires a covered clearing agency that provides CSD services to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain securities in an immobilized or dematerialized form for their transfer by book entry, ensure the integrity of securities issues, and minimize and manage the risks associated with the safekeeping and transfer of securities. Rule 17Ad-22(e)(11)(ii) requires a covered clearing agency that provides CSD services to establish, implement, maintain and enforce written policies and procedures reasonably designed to implement internal auditing and other controls to safeguard the rights of securities issuers and holders and prevent the unauthorized creation or deletion of securities, and conduct periodic and at least daily reconciliation of securities issues it maintains. Rule 17Ad-22(e)(11)(iii) requires a covered clearing agency that provides CSD services to establish, implement, maintain and enforce written policies and procedures reasonably designed to protect assets against custody risk through appropriate rules and procedures consistent with relevant laws, rules, and regulations in jurisdictions where it operates.<sup>232</sup>

The purpose of this information collection is to reduce securities transfer processing costs and the risks associated with securities settlement and custody, as well as increase the speed and efficiency of the settlement process.

### **12. Rule 17Ad-22(e)(12)**

Rule 17Ad-22(e)(12) requires a covered clearing agency, for transactions that involve the settlement of two linked obligations, to establish, implement, maintain and enforce written policies and procedures reasonably designed to eliminate principal risk by conditioning the final

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<sup>232</sup> See 17 CFR 240.17Ad-22(e)(11); CCA Standards adopting release, supra note 7, at 472.

settlement of one obligation upon the final settlement of the other, regardless of whether the covered clearing agency settles on a gross or net basis and when finality occurs.<sup>233</sup>

The purpose of this information collection is to promote the elimination of principal risk in transactions with linked obligations.

### **13. Rule 17Ad-22(e)(13)**

Rule 17Ad-22(e)(13) requires a covered clearing agencies providing CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations by, at a minimum, requiring the covered clearing agency's participants and, when practicable, other stakeholders to participate in the testing and review of its default procedures, including any close-out procedures, at least annually and following material changes thereto.<sup>234</sup>

The purpose of this information collection is to facilitate the functioning of a covered clearing agency in the event that a participant fails to meet its obligations, as well as limit the extent to which a participant's failure can spread to other participants or the covered clearing agency itself.

### **14. Rule 17Ad-22(e)(14)**

Rule 17Ad-22(e)(14) requires a covered clearing agency that is a security-based swap clearing agency or a complex risk profile clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to enable the segregation and

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<sup>233</sup> See 17 CFR 240.17Ad-22(e)(12); CCA Standards adopting release, supra note 7, at 472.

<sup>234</sup> See 17 CFR 240.17Ad-22(e)(13); CCA Standards adopting release, supra note 7, at 472–473.

portability of positions of a member's customers and the collateral provided to the covered clearing agency with respect to those positions, and effectively protect such positions and related collateral from the default or insolvency of that member.<sup>235</sup>

The purpose of this information collection is to facilitate the safe and effective holding and transfer of customers' positions and collateral in the event of a participant's default or insolvency.

### **15. Rule 17Ad-22(e)(15)**

Rule 17Ad-22(e)(15) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed 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 covered clearing agency can continue operations and services as a going concern if those losses materialize. Rule 17Ad-22(e)(15)(i) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to determine the amount of liquid net assets funded by equity based upon its general business risk profile and the length of time required to achieve a recovery or orderly wind-down, as appropriate, of its critical operations and services if such action is taken. Rule 17Ad-22(e)(15)(ii) requires a clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for holding liquid net assets funded by equity equal to the greater of either six months of its current operating expenses or the amount determined by the board of directors to be sufficient to ensure a recovery or orderly wind-down of critical operations and services of the covered clearing agency, as

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<sup>235</sup> See 17 CFR 240.17Ad-22(e)(14); CCA Standards adopting release, supra note 7, at 473–474.

contemplated by the plans established under Rule 17Ad-22(e)(3)(ii). Rule 17Ad-22(e)(15)(ii) also requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for monitoring its business operations and reducing the likelihood of losses. Rule 17Ad-22(e)(15)(iii) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for maintaining a viable plan, approved by the board of directors and updated at least annually, for raising additional equity should its equity fall close to or below the amount required by the rule, as discussed above.<sup>236</sup>

The purpose of this information collection is to mitigate the potential impairment of a covered clearing agency as a result of a decline in revenues or increase in expenses.

#### **16. Rule 17Ad-22(e)(16)**

Rule 17Ad-22(e)(16) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to safeguard its own and its participants' assets and minimize the risk of loss and delay in access to these assets. Rule 17Ad-22(e)(16) also requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to invest such assets in instruments with minimal credit, market, and liquidity risks.<sup>237</sup>

#### **17. Rule 17Ad-22(e)(17)**

Rule 17Ad-22(e)(17) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to manage the covered clearing agency's operational risk. Rule 17Ad-22(e)(17)(i) requires a covered clearing agency to

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<sup>236</sup> See 17 CFR 240.17Ad-22(e)(15); CCA Standards adopting release, supra note 7, at 474.

<sup>237</sup> See 17 CFR 240.17Ad-22(e)(16); CCA Standards adopting release, supra note 7, at 474.

establish, implement, maintain and enforce written policies and procedures reasonably designed to identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures, and controls. Rule 17Ad-22(e)(17)(ii) requires a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to ensure that systems have a high degree of security, resiliency, operational reliability, and adequate, scalable capacity. Finally, Rule 17Ad-22(e)(17)(iii) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a business continuity plan that addresses events posing a significant risk of disrupting operations.<sup>238</sup>

The purpose of this information collection is to limit operational disruptions that may impede the proper functioning of a covered clearing agency.

#### **18. Rule 17Ad-22(e)(18)**

Rule 17Ad-22(e)(18) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to establish objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access by direct and, where relevant, indirect participants and other FMUs. Rule 17Ad-22(e)(18) also requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency and to monitor compliance with participation requirements on an ongoing basis.<sup>239</sup>

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<sup>238</sup> See 17 CFR 240.17Ad-22(e)(17); CCA Standards adopting release, supra note 7, at 474.

<sup>239</sup> See 17 CFR 240.17Ad-22(e)(18); CCA Standards adopting release, supra note 7, at 474.

The purpose of this information collection is to enable a covered clearing agency to ensure that only entities with sufficient financial and operational capacity are direct participants in the covered clearing agency, while still ensuring that all qualified persons can access a covered clearing agency's services. The purpose of this information collection is also to enable a covered clearing agency to monitor that participation requirements are met on an ongoing basis and to identify a participant experiencing financial difficulties before the participant fails to meet its settlement obligations.

**19. Rule 17Ad-22(e)(19)**

Rule 17Ad-22(e)(19) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage the material risks to the covered clearing agency arising from arrangements in which firms that are indirect participants in the covered clearing agency rely on the services provided by direct participants in the covered clearing agency to access the covered clearing agency's payment, clearing, or settlement facilities. In addition, Rule 17Ad-22(e)(19) also requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to regularly review the material risks to the covered clearing agency arising from such tiered participation arrangements.<sup>240</sup>

The purpose of this information collection is to enable a covered clearing agency to identify and manage risks posed by non-member entities, such as the customers of clearing members.

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<sup>240</sup> See 17 CFR 240.17Ad-22(e)(19); CCA Standards adopting release, supra note 7, at 474.

## **20. Rule 17Ad-22(e)(20)**

Rule 17Ad-22(e)(20) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage risks related to any link with one or more other clearing agencies, FMUs, or trading markets.<sup>241</sup>

The purpose of this information collection is to enable a covered clearing agency to identify and manage risks posed by linkages to other entities, such as other clearing agencies, FMUs, or trading markets.

## **21. Rule 17Ad-22(e)(21)**

Rule 17Ad-22(e)(21) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to require the covered clearing agency to be efficient and effective in meeting the requirements of its participants and the markets it serves. Additionally, the rule requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to have the management of a covered clearing agency regularly review the efficiency and effectiveness of the covered clearing agency's (i) clearing and settlement arrangement; (ii) operating structure, including risk management policies, procedures, and systems; (iii) scope of products cleared or settled; and (iv) use of technology and communications procedures.<sup>242</sup>

The purpose of this information collection is to ensure that the services provided by a covered clearing agency do not become inefficient and to promote the sound operation of a covered clearing agency.

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<sup>241</sup> See 17 CFR 240.17Ad-22(e)(20); CCA Standards adopting release, supra note 7, at 475.

<sup>242</sup> See 17 CFR 240.17Ad-22(e)(21); CCA Standards adopting release, supra note 7, at 475.

## **22. Rule 17Ad-22(e)(22)**

Rule 17Ad-22(e)(22) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to use, or at a minimum, accommodate, relevant internationally accepted communication procedures and standards in order to facilitate efficient payment, clearing, and settlement.<sup>243</sup>

The purpose of this information collection is to ensure the prompt and accurate clearance and settlement of securities transactions by enabling participants to communicate with a clearing agency in a timely, reliable, and accurate manner.

## **23. Rule 17Ad-22(e)(23)**

Rule 17Ad-22(e)(23) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to (i) publicly disclose all relevant rules and material procedures, including key aspects of its default rules and procedures; (ii) provide sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the covered clearing agency; and (iii) publicly disclose relevant basic data on transaction volume and values.

Rule 17Ad-22(e)(23)(iv) requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain clear and comprehensive rules and procedures that provide for a comprehensive public disclosure that describes the covered clearing agency's material rules, policies, and procedures regarding its legal, governance, risk management, and operating framework, accurate in all material respects at the time of publication, including (i) a general background of the covered clearing agency, including its function and the market it serves, basic data and performance statistics on its

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<sup>243</sup> See 17 CFR 240.17Ad-22(e)(22); CCA Standards adopting release, supra note 7, at 475.

services and operations, such as basic volume and value statistics by product type, average aggregate intraday exposures to its participants, and statistics on the covered clearing agency's operational reliability, and a description of its general organization, legal and regulatory framework, and system design and operations; (ii) a standard-by-standard summary narrative for each applicable standard set forth in Rules 17Ad-22(e)(1) through (23) with sufficient detail and context to enable the reader to understand its approach to controlling the risks and addressing the requirements in each standard; (iii) a summary of material changes since the last update of the disclosure; and (iv) an executive summary of the key points regarding each. Rule 17Ad-22(e)(23)(v) also requires a covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure the comprehensive public disclosure required under Rule 17Ad-22(e)(23)(iv) is updated not less than every two years, or more frequently following changes to its system or the environment in which it operates to the extent necessary, to ensure statements previously provided remain accurate in all material respects.

The purpose of this information collection is to ensure that participants and prospective participants in a covered clearing agency are provided with a complete picture of the covered clearing agency's operations and risk management so that they can understand the risks and responsibilities of participation in the covered clearing agency.

#### **24. Rule 17Ad-22(c)(1)**

Rule 17Ad-22(c)(1) requires that, each fiscal quarter (based on calculations made as of the last business day of the clearing agency's fiscal quarter) or at any time upon Commission request, a registered clearing agency that performs CCP services shall calculate and maintain a record, in accordance with Rule 17a-1 under the Exchange Act, of the financial and qualifying

liquid resources necessary to meet the requirements, as applicable, of Rules 17Ad-22(b)(3), (e)(4), and (e)(7), and sufficient documentation to explain the methodology it uses to compute such financial resources or qualifying liquid resources requirement.

The purpose of the collection of information is to enable the Commission to monitor the financial resources of registered clearing agencies that provide CCP services.

## **B. Respondents**

The requirements in Rule 17Ad-22(e) impose a PRA burden on covered clearing agencies. Under the adopted definition of “covered clearing agency,” Rule 17Ad-22(e) applies to five registered clearing agencies, including four registered clearing agencies that provide CCP services and one registered clearing agency that provides CSD and SSS services. In the CCA Standards adopting release, the Commission estimated that two additional entities might seek to register with the Commission. Accordingly, the Commission estimated that the majority of the requirements under Rule 17Ad-22(e) would have seven respondents, of which (i) six would be CCPs and one would be a CSD and (ii) two would be security-based swap clearing agencies. The Commission further clarified that Rule 17Ad-22(e)(6) would only have six respondents because it only applies to CCPs, Rule 17Ad-22(e)(11) would only have one respondent because it only applies to CSDs, and Rule 17Ad-22(e)(14) would only have two respondents because it only applies to security-based swap clearing agencies.

Under the proposed amendment to the definition of “covered clearing agency” described above, Rule 17Ad-22(e) would instead apply to six registered clearing agencies, including five registered clearing agencies that provide CCP services and one registered clearing agency that

provides CSD and SSS services.<sup>244</sup> The Commission continues to believe that two additional entities might seek to register with the Commission. Accordingly, the Commission preliminarily estimates that, under the proposed amendment to the definition of “covered clearing agency” described above, a majority of the requirements under Rule 17Ad-22(e) would have eight respondents, of which (i) seven would be CCPs and one would be a CSD and (ii) two would be security-based swap clearing agencies. The Commission also notes that Rule 17Ad-22(e)(6) would now have seven respondents because it only applies to CCPs, Rule 17Ad-22(e)(11) would continue to only have one respondent because it only applies to CSDs, and Rule 17Ad-22(e)(14) would continue to only have two respondents because it only applies to security-based swap clearing agencies.

The PRA analysis for seven of the eight respondents appears in the CCA Standards adopting release. Below, the Commission provides a PRA analysis for the one remaining respondent that would be subject to Rule 17Ad-22(e) under the proposed amendment to the definition of “covered clearing agency,” therefore reflecting the incremental annual reporting and recordkeeping burdens resulting from the proposed amendment to the definition of “covered clearing agency.” In addition, because the one remaining respondent provides CCP services and does not provide CSD services, the analysis does not include Rule 17Ad-22(e)(11).

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<sup>244</sup> See supra Part III.B and accompanying text. The additional registered clearing agency that provides CCP services and that would be subject to Rule 17Ad-22(e) under the proposed amendment to the definition of “covered clearing agency” is currently a registered clearing agency subject to Rule 17Ad-22(d).

### **C. Total Annual Reporting and Recordkeeping Burdens**

As described in the CCA Standards adopting release,<sup>245</sup> the Commission continues to believe that the information collected pursuant to Rule 17Ad-22(e) reflects, to a degree, existing policies and procedures at covered clearing agencies, but in some instances a covered clearing agency will be required to develop new policies and procedures. Thus, when a covered clearing agency reviews and updates its policies and procedures pursuant to Rule 17Ad-22(e), the Commission believes that the PRA burden may vary across the requirements under Rule 17Ad-22(e), depending on the complexity of the requirement in question and the extent to which a covered clearing agency already has policies and procedures consistent with the requirement. As a general matter, the portions of Rule 17Ad-22(e) for which the Commission expects a higher PRA burden are those provisions including requirements not comparable to any existing requirements under Rule 17Ad-22(d). Where the requirements do not reflect existing practices or the normal course of a covered clearing agency's activity, the PRA burden may entail, in addition to ongoing burdens, initial one-time burdens to develop new policies and procedures.

Consistent with the CCA Standards adopting release, the Commission continues to believe that Rules 17Ad-22(e)(1), (8) through (10), (12), (14), (16), and (22) contain requirements either substantially similar to those in Rule 17Ad-22(d) or reflect current practices at covered clearing agencies. The Commission believes that a covered clearing agency may need to make only limited changes to its policies and procedures pursuant to the requirements in these rules. For example, a covered clearing agency may need to conduct a comparison of its existing policies and procedures against each rule to confirm that its policies and procedures are consistent with the requirements therein.

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<sup>245</sup> See CCA Standards adopting release, supra note 7, at 416–418.

The Commission also continues to believe that Rules 17Ad-22(e)(2), (3), (5), (11), (13), (17), (18), (20), and (21) contain provisions that are similar to those in Rule 17Ad-22(d) but would also impose additional requirements not found in Rule 17Ad-22(d). The Commission believes that a covered clearing agency may need to make changes to update its policies and procedures pursuant to the requirements in these rules. For example, a covered clearing agency may need to review and amend its existing rules, policies, and procedures but may not need to develop, design, or implement new operations or practices pursuant to these rules.

For Rules 17Ad-22(e)(4), (6), (7), (15), (19), and (23), for which no comparable pre-existing requirements under Rule 17Ad-22 have been identified, the Commission continues to believe that a covered clearing agency may need to make more extensive changes to its policies and procedures, may need to implement new policies and procedures, and may need to take other steps pursuant to the requirements in these rules. For example, a covered clearing agency may need to develop, design, and implement new operations and practices. In these cases, the PRA burden is greater since these requirements may not reflect established practices or the normal course of a covered clearing agency's activities. Further, the PRA burden for these rules may entail both initial one-time burdens, such as create new policies and procedures, as well as ongoing burdens, such as requirements to make certain disclosures or perform certain types of review, on a periodic basis.

### **1. Rule 17Ad-22(e)(1)**

Rule 17Ad-22(e)(1) contains substantially similar provisions to Rule 17Ad-22(d)(1).<sup>246</sup> The Commission therefore expects that a respondent clearing agency has written rules, policies, and procedures substantially similar to the requirements in the rule and that the PRA burden

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<sup>246</sup> See 17 CFR 240.17Ad-22(d)(1), (e)(1).

would include the incremental burdens of reviewing current policies and procedures and revising them, where appropriate, pursuant to the rule. Accordingly, based on the similar provisions and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(1),<sup>247</sup> the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of approximately 8 hours to review and revise existing policies and procedures.<sup>248</sup>

Rule 17Ad-22(e)(1) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>249</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(1) would impose an aggregate annual burden on a respondent clearing agency of 3 hours.<sup>250</sup>

## **2. Rule 17Ad-22(e)(2)**

Rule 17Ad-22(e)(2) contains similar provisions to Rule 17Ad-22(d)(8) but also adds additional requirements that do not appear in Rule 17Ad-22(d).<sup>251</sup> The Commission therefore expects that a respondent clearing agency may have written rules, policies, and procedures

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<sup>247</sup> See CCA Standards adopting release, supra note 7, at 418–419; Clearing Agency Standards adopting release, supra note 31, at 66260.

<sup>248</sup> This figure was calculated as follows: ((Assistant General Counsel for 2 hours) + (Compliance Attorney for 6 hours)) = 8 hours x 1 respondent clearing agency = 8 hours.

<sup>249</sup> See CCA Standards adopting release, supra note 7, at 419; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>250</sup> This figure was calculated as follows: (Compliance Attorney for 3 hours) x 1 respondent clearing agency = 3 hours.

<sup>251</sup> See 17 CFR 204.17Ad-22(d)(8), (e)(2).

similar to the requirements in the rule and that the PRA burden includes the incremental burdens of reviewing and revising current policies and procedures and creating new policies and procedures, as necessary, pursuant to the rule. Accordingly, based on the similar provisions and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(8),<sup>252</sup> the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of approximately 22 hours to review and revise existing policies and procedures and to create new policies and procedures, as necessary.<sup>253</sup>

Rule 17Ad-22(e)(2) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>254</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(2) would impose an aggregate annual burden on a respondent clearing agency of 4 hours.<sup>255</sup>

### **3. Rule 17Ad-22(e)(3)**

While Rule 17Ad-22(d) requires registered clearing agencies to have policies and procedures to manage certain risks,<sup>256</sup> Rule 17Ad-22(e)(3) requires a comprehensive framework

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<sup>252</sup> See CCA Standards adopting release, supra note 7, at 420; Clearing Agency Standards adopting release, supra note 31, at 66260.

<sup>253</sup> This figure was calculated as follows: ((Assistant General Counsel for 24 hours) + (Compliance Attorney for 10 hours)) = 22 hours x 1 respondent clearing agency = 22 hours.

<sup>254</sup> See CCA Standards adopting release, supra note 7, at 421; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>255</sup> This figure was calculated as follows: (Compliance Attorney for 4 hours) x 1 respondent clearing agency = 4 hours.

<sup>256</sup> See 17 CFR 240.17Ad-22(d), (e)(3).

for risk management, under which policies and procedures for risk management are designed holistically, are consistent with each other, and work effectively together. Accordingly, the PRA burden requires a respondent clearing agency to revise its written rules, policies, and procedures to include, among other things, periodic review and plans for the recovery and orderly wind-down of the covered clearing agency. As a result, the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of 57 hours to review and revise existing policies and procedures and to create new policies and procedures, as necessary.<sup>257</sup>

Rule 17Ad-22(e)(3) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures created in response to the rule and activities related to facilitating a periodic review of the risk management framework. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>258</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(3) would impose an aggregate annual burden on a respondent clearing agency of 49 hours.<sup>259</sup> The Commission notes that the estimated ongoing burden for Rule 17Ad-22(e)(3) is similar to the initial one-time burden because the rule includes a specific requirement that policies and procedures for

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<sup>257</sup> This figure was calculated as follows: ((Assistant General Counsel for 25 hours) + (Compliance Attorney for 18 hours) + (Senior Risk Management Specialist for 7 hours) + (Computer Operations Manager for 7 hours)) = 57 hours x 1 respondent clearing agency = 57 hours.

<sup>258</sup> See CCA Standards adopting release, supra note 7, at 422–423; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>259</sup> This figure was calculated as follows: ((Compliance Attorney for 8 hours) + (Administrative Assistant for 3 hours) + (Senior Business Analyst for 5 hours) + (Risk Management Specialist for 33 hours)) = 49 hours x 1 respondent clearing agency = 49 hours.

comprehensive risk management include review on a specified periodic basis and approval by the board of directors annually.

#### **4. Rule 17Ad-22(e)(4)**

The Commission has previously estimated that the PRA burdens for Rule 17Ad-22(e)(4) are more significant than in other cases under Rule 17Ad-22(e) and may require a respondent clearing agency to make substantial changes to its written rules, policies, and procedures pursuant to the rule.<sup>260</sup> In addition, Rule 17Ad-22(e)(4) will require a respondent clearing agency to make one-time systems adjustments so that it has the capability to test the sufficiency of its financial resources and to perform an annual model validation. As a result, the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of 200 hours to review and revise existing policies and procedures and to create new policies and procedures, as necessary.<sup>261</sup>

Rule 17Ad-22(e)(4) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures developed in response to the rule and ongoing activities with respect to testing the sufficiency of its financial resources and performing the annual model validation. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>262</sup> the Commission preliminarily estimates that the ongoing activities required

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<sup>260</sup> See Clearing Agency Standards adopting release, supra note 7, at 423.

<sup>261</sup> This figure was calculated as follows: ((Assistant General Counsel for 60 hours) + (Compliance Attorney for 40 hours) + (Senior Risk Management Specialist for 30 hours) + (Computer Operations Manager for 45 hours) + (Chief Compliance Officer for 15 hours) + (Senior Programmer for 10 hours)) = 200 hours x 1 respondent clearing agency = 200 hours.

<sup>262</sup> See CCA Standards adopting release, supra note 7, at 424–425; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

by Rule 17Ad-22(e)(4) would impose an aggregate annual burden on a respondent clearing agency of 60 hours.<sup>263</sup>

### **5. Rule 17Ad-22(e)(5)**

Rule 17Ad-22(e)(5) contains similar provisions to Rule 17Ad-22(d)(3).<sup>264</sup> The Commission therefore expects that a respondent clearing agency has written rules, policies, and procedures substantially similar to the requirements in the rule and that the PRA burden includes the incremental burdens of reviewing current policies and procedures and revising them, where appropriate, pursuant to the rule. For example, a respondent clearing agency may need to develop new policies and procedures for an annual review of the sufficiency of its collateral haircuts and concentration limits. Accordingly, based on the similar policies and procedures requirements in and the Commission's previous corresponding burden estimates for Rule 17Ad-22(d)(3),<sup>265</sup> the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of approximately 42 hours to review and review existing policies and procedures and to create new policies and procedures, as necessary.<sup>266</sup>

Rule 17Ad-22(e)(5) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to the written policies

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<sup>263</sup> This figure was calculated as follows: ((Compliance Attorney for 24 hours) + (Administrative Assistant for 3 hours) + (Senior Business Analyst for 3 hours) + (Risk Management Specialist for 30 hours)) = 60 hours x 1 respondent clearing agency = 60 hours.

<sup>264</sup> See 17 CFR 240.17Ad-22(d)(3), (e)(5).

<sup>265</sup> See CCA Standards adopting release, supra note 7, at 425–426; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>266</sup> This figure was calculated as follows: ((Assistant General Counsel for 16 hours) + (Compliance Attorney for 12 hours) + (Senior Risk Management Specialist for 7 hours) + (Computer Operations Manager for 7 hours)) = 42 hours x 1 respondent clearing agency = 42 hours.

and procedures created in response to the rule and also requires an annual review of collateral haircuts and concentration limits. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>267</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(5) would impose an aggregate annual burden on a respondent clearing agency of 36 hours.<sup>268</sup> The Commission notes that the estimated ongoing burden for Rule 17Ad-22(e)(5) is similar to the initial one-time burden because the rule requires policies and procedures for a not-less-than-annual review of the sufficiency of a covered clearing agency's collateral haircuts and concentration limits.

#### **6. Rule 17Ad-22(e)(6)**

The Commission has previously estimated that the PRA burdens for Rule 17Ad-22(e)(6) are more significant than in other cases under Rule 17Ad-22(e) and may require a respondent clearing agency to make substantial changes to its written rules, policies, and procedures pursuant to the rule.<sup>269</sup> For example, Rule 17Ad-22(e)(6) requires one-time systems adjustments to perform daily backtesting and monthly (or more frequent) sensitivity analyses. As a result, the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of 180 hours to review and revise existing policies and procedures and to create new policies and procedures, as necessary.<sup>270</sup>

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<sup>267</sup> See CCA Standards adopting release, supra note 7, at 426; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>268</sup> This figure was calculated as follows: ((Compliance Attorney for 6 hours) + (Risk Management Specialist for 30 hours)) = 36 hours x 1 respondent clearing agency = 36 hours.

<sup>269</sup> See CCA Standards adopting release, supra note 7, at 427.

<sup>270</sup> This figure was calculated as follows: ((Assistant General Counsel for 50 hours) + (Compliance Attorney for 40 hours) + (Senior Risk Management Specialist for 25 hours) +

Rule 17Ad-22(e)(6) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to the written policies and procedures created in response to the rule and activities associated with daily backtesting, monthly (or more frequent) sensitivity analyses, and annual model validation. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>271</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(6) would impose an aggregate annual burden on a respondent clearing agency of 60 hours.<sup>272</sup>

### **7. Rule 17Ad-22(e)(7)**

The Commission estimates that the PRA burdens for Rule 17Ad-22(e)(7) are more significant than in other cases under Rule 17Ad-22(e) and may require a respondent clearing agency to make substantial changes to its written rules, policies, and procedures pursuant to the rule.<sup>273</sup> For example, Rule 17Ad-22(e)(7) requires one-time systems adjustments to test the sufficiency of its liquid resources, test its access to liquidity providers, and perform an annual model validation. As a result, the Commission preliminarily estimates that a respondent clearing

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(Computer Operations Manager for 40 hours) + (Chief Compliance Officer for 15 hours) + (Senior Programmer for 10 hours)) = 180 hours x 1 respondent clearing agency = 180 hours.

<sup>271</sup> See CCA Standards adopting release, supra note 7, at 427–428; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>272</sup> This figure was calculated as follows: ((Compliance Attorney for 24 hours) + (Administrative Assistant for 3 hours) + (Senior Business Analyst for 3 hours) + (Risk Management Specialist for 30 hours)) = 60 hours x 1 respondent clearing agency = 60 hours.

<sup>273</sup> See CCA Standards adopting release, supra note 7, at 428.

agency would incur an aggregate one-time burden of 330 hours to review and revise existing policies and procedures.<sup>274</sup>

Rule 17Ad-22(e)(7) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to policies and procedures created in response to the rule as well as activities related to testing the sufficiency of its liquidity resources, testing access to its liquidity providers, and performing an annual model validation. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>275</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(7) would impose an aggregate annual burden on a respondent clearing agency of 128 hours.<sup>276</sup>

#### **8. Rule 17Ad-22(e)(8)**

Rule 17Ad-22(e)(8) contains substantially similar provisions to Rule 17Ad-22(d)(12).<sup>277</sup> The Commission therefore expects that a respondent clearing agency has written rules, policies, and procedures substantially similar to the requirements in the rule and that the PRA burden includes the incremental burdens of reviewing current policies and procedures and revising them,

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<sup>274</sup> This figure was calculated as follows: ((Assistant General Counsel for 95 hours) + (Compliance Attorney for 85 hours) + (Senior Risk Management Specialist for 45 hours) + (Computer Operations Manager for 60 hours) + (Chief Compliance Officer for 30 hours) + (Senior Programmer for 15 hours)) = 330 hours x 1 respondent clearing agency = 330 hours.

<sup>275</sup> See CCA Standards adopting release, supra note 7, at 429; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>276</sup> This figure was calculated as follows: ((Compliance Attorney for 48 hours) + (Administrative Assistant for 5 hours) + (Senior Business Analyst for 5 hours) + (Risk Management Specialist for 60 hours) + (Senior Risk Management Specialist for 10 hours)) = 128 hours x 1 respondent clearing agency = 128 hours.

<sup>277</sup> See 17 CFR 240.17Ad-22(d)(12), (e)(8).

where appropriate, pursuant to the rule. Accordingly, based on the similar provisions and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(12),<sup>278</sup> the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of approximately 12 hours to review and revise existing policies and procedures.<sup>279</sup>

Rule 17Ad-22(e)(8) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>280</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(8) would impose an aggregate annual burden on a respondent clearing agency of approximately 5 hours.<sup>281</sup>

### **9. Rule 17Ad-22(e)(9)**

Rule 17Ad-22(e)(9) contains substantially similar provisions to Rule 17Ad-22(d)(5).<sup>282</sup> The Commission therefore expects that a respondent clearing agency has written rules, policies, and procedures substantially similar to the requirements in the rule and that the PRA burden includes the incremental burdens of reviewing current policies and procedures and revising them,

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<sup>278</sup> See Clearing Agency Standards adopting release, supra note 31, at 66260.

<sup>279</sup> This figure was calculated as follows: ((Assistant General Counsel for 2 hours) + (Compliance Attorney for 6 hours) + (Senior Business Analyst for 2 hours) + (Computer Operations Manager for 2 hours)) = 12 hours x 1 respondent clearing agency = 12 hours.

<sup>280</sup> See CCA Standards adopting release, supra note 7, at 429–430; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>281</sup> This figure was calculated as follows: (Compliance Attorney for 5 hours) x 1 respondent clearing agency = 5 hours.

<sup>282</sup> See 17 CFR 240.17Ad-22(d)(5), (e)(9).

where appropriate, pursuant to the rule. Accordingly, based on the similar provisions and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(5),<sup>283</sup> the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of approximately 12 hours to review and revise existing policies and procedures.<sup>284</sup>

Rule 17Ad-22(e)(9) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>285</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(9) would impose an aggregate annual burden on a respondent clearing agency of approximately 5 hours.<sup>286</sup>

#### **10. Rule 17Ad-22(e)(10)**

Rule 17Ad-22(e)(10) contains substantially similar provisions to Rule 17Ad-22(d)(15).<sup>287</sup> The Commission therefore expects that a respondent clearing agency has written rules, policies, and procedures substantially similar to the requirements in the rule and that the PRA burden

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<sup>283</sup> See CCA Standards adopting release, supra note 7, at 431; Clearing Agency Standards adopting release, supra note 31, at 66260.

<sup>284</sup> This figure was calculated as follows: ((Assistant General Counsel for 2 hours) + (Compliance Attorney for 6 hours) + (Senior Business Analyst for 2 hours) + (Computer Operations Manager for 2 hours)) = 12 hours x 1 respondent clearing agency = 12 hours.

<sup>285</sup> See CCA Standards adopting release, supra note 7, at 431; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>286</sup> This figure was calculated as follows: (Compliance Attorney for 5 hours) x 1 respondent clearing agency = 5 hours.

<sup>287</sup> See 17 CFR 240.17Ad-22(d)(15), (e)(10).

includes the incremental burdens of reviewing current policies and procedures and revising them, where appropriate, pursuant to the rule. Accordingly, based on the similar provisions and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(15),<sup>288</sup> the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of approximately 12 hours to review and revise existing policies and procedures.<sup>289</sup>

Rule 17Ad-22(e)(10) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>290</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e) (10) would impose an aggregate annual burden on a respondent clearing agency of approximately 5 hours.<sup>291</sup>

#### **11. Rule 17Ad-22(e)(12)**

Rule 17Ad-22(e)(12) contains substantially similar provisions to Rule 17Ad-22(d)(13).<sup>292</sup> The Commission therefore expects that a respondent clearing agency has written rules, policies,

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<sup>288</sup> See CCA Standards adopting release, supra note 7, at 432; Clearing Agency Standards adopting release, supra note 31, at 66260.

<sup>289</sup> This figure was calculated as follows: ((Assistant General Counsel for 2 hours) + (Compliance Attorney for 6 hours) + (Senior Business Analyst for 2 hours) + (Computer Operations Manager for 2 hours)) = 12 hours x 1 respondent clearing agency = 12 hours.

<sup>290</sup> See CCA Standards adopting release, supra note 7, at 432–433; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>291</sup> This figure was calculated as follows: (Compliance Attorney for 5 hours) x 1 respondent clearing agency = 5 hours.

<sup>292</sup> See 17 CFR 240.17Ad-22(d)(13), (e)(12).

and procedures substantially similar to the requirements in the rule and that the PRA burden includes the incremental burdens of reviewing current policies and procedures and revising them, where appropriate, pursuant to the rule. Accordingly, based on the similar provisions and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(13),<sup>293</sup> the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of approximately 12 hours to review and revise existing policies and procedures.<sup>294</sup>

Rule 17Ad-22(e)(12) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>295</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(12) would impose an aggregate annual burden on a respondent clearing agency of approximately 5 hours.<sup>296</sup>

## **12. Rule 17Ad-22(e)(13)**

Rule 17Ad-22(e)(13) requires a respondent clearing agency to have written policies and procedures reasonably designed to address participant default and ensure that the clearing agency

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<sup>293</sup> See CCA Standards adopting release, supra note 7, at 434–435; Clearing Agency Standards adopting release, supra note 31, at 66260.

<sup>294</sup> This figure was calculated as follows: ((Assistant General Counsel for 2 hours) + (Compliance Attorney for 6 hours) + (Senior Business Analyst for 2 hours) + (Computer Operations Manager for 2 hours)) = 12 hours x 1 respondent clearing agency = 12 hours.

<sup>295</sup> See CCA Standards adopting release, supra note 7, at 435; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>296</sup> This figure was calculated as follows: (Compliance Attorney for 5 hours) x 1 respondent clearing agency = 5 hours.

can contain losses and liquidity demands and continue to meet its obligations. Rule 17Ad-22(e)(13) contains similar provisions to Rule 17Ad-22(d)(11) but also imposes additional requirements that do not appear in Rule 17Ad-22.<sup>297</sup> The Commission therefore expects that a respondent clearing agency may have written rules, policies, and procedures similar to some requirements in the rule and that the PRA burden includes the incremental burdens of reviewing and revising existing policies and procedures pursuant to Rule 17Ad-22(e)(13) and creating new policies and procedures, as necessary. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(11),<sup>298</sup> the Commission preliminarily believes that a respondent clearing agency would incur an aggregate one-time burden of approximately 60 hours to review and revise existing policies and procedures and to create new policies and procedures, as necessary.<sup>299</sup>

Rule 17Ad-22(e)(13) also imposes ongoing burdens on a respondent clearing agency. The rule requires policies and procedures for the annual review and testing of a clearing agency's default policies and procedures. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>300</sup> the Commission

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<sup>297</sup> See 17 CFT 240.17Ad-22(d)(11), (e)(13).

<sup>298</sup> See CCA Standards adopting release, supra note 7, at 436–437; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>299</sup> This figure was calculated as follows: ((Assistant General Counsel for 20 hours) + (Compliance Attorney for 16 hours) + (Senior Business Analyst for 12 hours) + (Computer Operations Manager for 12 hours)) = 60 hours x 1 respondent clearing agency = 60 hours.

<sup>300</sup> See CCA Standards adopting release, supra note 7, at 437; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(13) would impose an aggregate annual burden on a respondent clearing agency of approximately 9 hours.<sup>301</sup>

### **13. Rule 17Ad-22(e)(14)**

With respect to Rule 17Ad-22(e)(14), a respondent clearing agency is a registered clearing agency that provides CCP services for security-based swaps. Such clearing agencies generally have written policies and procedures regarding the segregation and portability of customer positions and collateral as a result of applicable rules and regulations notwithstanding Rule 17Ad-22.<sup>302</sup> The Commission therefore expects that a respondent clearing agency has written rules, policies, and procedures substantially similar to the requirements in the rule and that the PRA burden includes the incremental burdens of reviewing current policies and procedures and revising them, where appropriate, pursuant to the rule. Accordingly, the Commission estimates that Rule 17Ad-22(e)(14) imposes on respondent clearing agencies an aggregate one-time burden of 36 hours to review and revise existing policies and procedures.<sup>303</sup>

Rule 17Ad-22(e)(14) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing

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<sup>301</sup> This figure was calculated as follows: (Compliance Attorney for 9 hours) x 1 respondent clearing agency = 9 hours.

<sup>302</sup> See, e.g., 77 FR 6336 (Feb. 7, 2012) (CFTC adopting rules imposing LSOC on DCOs for cleared swaps). Because the respondent clearing agency is subject to the CFTC's segregation and portability requirements for cleared swaps, the Commission has previously expected that the burden imposed by Rule 17Ad-22(e)(14) will be limited. See CCA Standards adopting release, supra note 7, at 438.

<sup>303</sup> This figure was calculated as follows: ((Assistant General Counsel for 12 hours) + (Compliance Attorney for 10 hours) + (Computer Operations Manager for 7 hours) + (Senior Business Analyst for 7 hours)) = 36 hours x 1 respondent clearing agency that provides CCP services = 36 hours.

monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>304</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(14) would impose an aggregate annual burden on a respondent clearing agency of approximately 6 hours.<sup>305</sup>

#### **14. Rule 17Ad-22(e)(15)**

Because Rule 17Ad-22(d) does not include requirements related to general business risk, the Commission estimates that the PRA burdens for Rule 17Ad-22(e)(15) are more significant than in other cases under Rule 17Ad-22(e) and may require a respondent clearing agency to make substantial changes to its written rules, policies, and procedures pursuant to the rule.<sup>306</sup> The Commission preliminarily estimates that Rule 17Ad-22(e)(15) would impose an aggregate one-time burden on a respondent clearing agency of 210 hours to review and revise existing policies and procedures and to create new policies and procedures, as necessary.<sup>307</sup>

Rule 17Ad-22(e)(15) also imposes ongoing burdens on a respondent clearing agency. Rule 17Ad-22(e)(15) requires a respondent clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain a viable plan, approved by its board of directors and updated at least annually, for raising additional equity in the event that the covered clearing agency's liquid net assets fall below the level required by the

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<sup>304</sup> See CCA Standards adopting release, supra note 7, at 438–439; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>305</sup> This figure was calculated as follows: (Compliance Attorney for 6 hours) x 1 respondent clearing agency = 6 hours.

<sup>306</sup> See 17 CFR 240.17Ad-22(d), (e)(15).

<sup>307</sup> This figure was calculated as follows: ((Assistant General Counsel for 40 hours) + (Compliance Attorney for 30 hours) + (Computer Operations Manager for 10 hours) + (Senior Business Analyst for 10 hours) + (Financial Analyst for 70 hours) + (Chief Financial Officer for 50 hours)) = 210 hours x 1 respondent clearing agency = 210 hours.

rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>308</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(15) would impose an aggregate annual burden on a respondent clearing agency of 48 hours.<sup>309</sup>

### **15. Rule 17Ad-22(e)(16)**

Rule 17Ad-22(e)(16) contains substantially similar provisions to Rule 17Ad-22(d)(3).<sup>310</sup> The Commission therefore expects that a respondent clearing agency has written rules, policies, and procedures substantially similar to the requirements in the rule and that the PRA burden includes the incremental burdens of reviewing current policies and procedures and revising them, where appropriate, pursuant to the rule. Accordingly, based on the similar provisions and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(3),<sup>311</sup> the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of approximately 20 hours to review and revise existing policies and procedures.<sup>312</sup>

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<sup>308</sup> See CCA Standards adopting release, supra note 7, at 439–440; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>309</sup> This figure was calculated as follows: ((Compliance Attorney for 42 hours) + (Administrative Assistant for 3 hours) + (Senior Business Analyst for 3 hours)) = 48 hours x 1 respondent clearing agency = 48 hours.

<sup>310</sup> See 17 CFR 240.17Ad-22(d)(3), (e)(16).

<sup>311</sup> See CCA Standards adopting release, supra note 7, at 440; Clearing Agency Standards adopting release, supra note 31, at 66260.

<sup>312</sup> This figure was calculated as follows: ((Assistant General Counsel for 4 hours) + (Compliance Attorney for 8 hours) + (Senior Business Analyst for 4 hours) + (Computer Operations Manager for 4 hours)) = 20 hours x 1 respondent clearing agency = 20 hours.

Rule 17Ad-22(e)(16) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>313</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(16) would impose an aggregate annual burden on a respondent clearing agency of 6 hours.<sup>314</sup>

#### **16. Rule 17Ad-22(e)(17)**

Rule 17Ad-22(e)(17) contains similar provisions to Rule 17Ad-22(d)(4) but also imposes additional requirements that do not appear in Rule 17Ad-22.<sup>315</sup> The Commission therefore expects that a respondent clearing agency may have written rules, policies, and procedures similar to the requirements in the rule and that the PRA burden includes the incremental burdens of reviewing and revising current policies and procedures and creating new policies and procedures, as necessary, pursuant to the rule. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(4),<sup>316</sup> the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of 28 hours to review and

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<sup>313</sup> See CCA Standards adopting release, supra note 7, at 441; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>314</sup> This figure was calculated as follows: (Compliance Attorney for 6 hours) x 1 respondent clearing agency = 6 hours.

<sup>315</sup> See 17 CFR 240.17Ad-22(d)(4), (e)(17).

<sup>316</sup> See CCA Standards adopting release, supra note 7, at 442; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

revise existing policies and procedures and to create new policies and procedures, as necessary.<sup>317</sup>

Rule 17Ad-22(e)(17) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>318</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(17) would impose an aggregate annual burden on a respondent clearing agency of 6 hours.<sup>319</sup>

#### **17. Rule 17Ad-22(e)(18)**

Rule 17Ad-22(e)(18) contains similar provisions to Rules 17Ad-22(b)(5) through (7) and (d)(2).<sup>320</sup> The Commission therefore expects that a respondent clearing agency may have written rules, policies, and procedures similar to the requirements in the rule and that the PRA burden includes the incremental burdens of reviewing and revising current policies and procedures and creating new policies and procedures, as necessary, pursuant to the rule. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates

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<sup>317</sup> This figure was calculated as follows: ((Assistant General Counsel for 4 hours) + (Compliance Attorney for 8 hours) + (Computer Operations Manager for 6 hours) + (Senior Business Analyst for 4 hours) + (Chief Compliance Officer for 4 hours) + (Senior Programmer for 2 hours)) = 28 hours x 1 respondent clearing agency = 28 hours.

<sup>318</sup> See CCA Standards adopting release, supra note 7, at 442; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>319</sup> This figure was calculated as follows: (Compliance Attorney for 6 hours) x 1 respondent clearing agency = 6 hours.

<sup>320</sup> See 17 CFR 240.17Ad-22(b)(5)–(7), (d)(2), (e)(18).

previously made by the Commission for Rules 17Ad-22(b)(5) through (7) and (d)(2),<sup>321</sup> the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of 44 hours to review and revise existing policies and procedures and to create new policies and procedures, as necessary.<sup>322</sup>

Rule 17Ad-22(e)(18) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>323</sup> the Commission preliminarily estimates that the ongoing activities required by the rule would impose an aggregate annual burden on a respondent clearing agency of 7 hours.<sup>324</sup>

#### **18. Rule 17Ad-22(e)(19)**

Tiered participation arrangements are not addressed by Rule 17Ad-22(d). The Commission therefore expects that a respondent clearing agency may need to create policies and procedures pursuant to Rule 17Ad-22(e)(19).<sup>325</sup> The Commission estimates that Rule 17Ad-22(e)(19) imposes an aggregate one-time burden on respondent clearing agencies of 44 hours to

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<sup>321</sup> See CCA Standards adopting release, supra note 7, at 443; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>322</sup> This figure was calculated as follows: ((Assistant General Counsel for 10 hours) + (Compliance Attorney for 7 hours) + Computer Operations Manager for 15 hours) + (Senior Business Analyst for 5 hours) + (Chief Compliance Officer for 5 hours) + (Senior Programmer for 2 hours)) = 44 hours x 1 respondent clearing agency = 44 hours.

<sup>323</sup> See CCA Standards adopting release, supra note 7, at 443–444; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>324</sup> This figure was calculated as follows: (Compliance Attorney for 7 hours) x 1 respondent clearing agency = 7 hours.

<sup>325</sup> See 17 CFR 240.17Ad-22(d), (e)(19).

review and revise existing policies and procedures and to create new policies and procedures, as necessary.<sup>326</sup>

Rule 17Ad-22(e)(19) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>327</sup> the Commission preliminarily estimates that the ongoing activities required by the rule would impose an annual aggregate burden on a respondent clearing agency of 7 hours.<sup>328</sup>

### **19. Rule 17Ad-22(e)(20)**

Rule 17Ad-22(e)(20) contains similar provisions to Rule 17Ad-22(d)(7) but also adds additional requirements that do not appear in Rule 17Ad-22(d).<sup>329</sup> The Commission therefore expects that a respondent clearing agency may have written rules, policies, and procedures similar to the requirements in the rule and that the PRA burden includes the incremental burdens of reviewing and revising current policies and procedures and creating new policies and procedures, as necessary, pursuant to the rule. Accordingly, based on the similar policies and

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<sup>326</sup> This figure was calculated as follows: ((Assistant General Counsel for 10 hours) + (Compliance Attorney for 7 hours) + (Computer Operations Manager for 15 hours) + (Senior Business Analyst for 5 hours) + (Chief Compliance Officer for 5 hours) + (Senior Programmer for 2 hours)) = 44 hours x 1 respondent clearing agency = 44 hours.

<sup>327</sup> See CCA Standards adopting release, supra note 7, at 444–445; Clearing Agency Standards adopting release, supra note 31, at 66260.

<sup>328</sup> This figure was calculated as follows: (Compliance Attorney for 7 hours) x 1 respondent clearing agency = 7 hours.

<sup>329</sup> See 17 CFR 240.17Ad-22(d)(7), (e)(20).

procedures requirements and compliance burdens associated with Rule 17Ad-22(d)(7),<sup>330</sup> the Commission preliminarily believes that a respondent clearing agency would incur an aggregate one-time burden of approximately 44 hours to review and revise existing policies and procedures.<sup>331</sup>

Rule 17Ad-22(e)(20) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>332</sup> the Commission preliminarily estimates that the ongoing activities required by the rule would impose an aggregate annual burden on a respondent clearing agency of 7 hours.<sup>333</sup>

## **20. Rule 17Ad-22(e)(21)**

Rule 17Ad-22(e)(21) contains similar provisions to Rule 17Ad-22(d)(6) but also adds additional requirements that do not appear in Rule 17Ad-22(d).<sup>334</sup> The Commission therefore expects that a respondent clearing agency may have written rules, policies, and procedures similar to the requirements in the rule and that the PRA burden includes the incremental burdens

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<sup>330</sup> See CCA Standards adopting release, supra note 7, at 445; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>331</sup> This figure was calculated as follows: ((Assistant General Counsel for 10 hours) + (Compliance Attorney for 7 hours) + (Senior Business Analyst for 5 hours) + (Computer Operations Manager for 15 hours) + (Chief Compliance Officer for 5 hours) + (Senior Programmer for 2 hours) = 44 hours x 1 respondent clearing agency = 44 hours.

<sup>332</sup> See CCA Standards adopting release, supra note 7, at 446; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>333</sup> This figure was calculated as follows: (Compliance Attorney for 7 hours) x 1 respondent clearing agency = 7 hours.

<sup>334</sup> See 17 CFR 240.17Ad-22(d)(6), (e)(21).

of reviewing and revising current policies and procedures and creating new policies and procedures, as necessary, pursuant to the rule. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(6),<sup>335</sup> the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of approximately 32 hours to review and revise existing policies and procedures.<sup>336</sup>

Rule 17Ad-22(e)(21) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>337</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(21) would impose an aggregate annual burden on a respondent clearing agency of 11 hours.<sup>338</sup>

## **21. Rule 17Ad-22(e)(22)**

Although Rule 17Ad-22(d) does not include any requirements with provisions similar to Rule 17Ad-22(e)(22), the Commission understands that covered clearing agencies currently use the relevant internationally accepted communication procedures and standards and therefore

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<sup>335</sup> See CCA Standards adopting release, supra note 7, at 447; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>336</sup> This figure was calculated as follows: ((Assistant General Counsel for 10 hours) + (Compliance Attorney for 7 hours) + (Senior Business Analyst for 5 hours) + (Computer Operations Manager for 10 hours)) = 32 hours x 1 respondent clearing agency = 32 hours.

<sup>337</sup> See CCA Standards adopting release, supra note 7, at 447; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>338</sup> This figure was calculated as follows: ((Compliance Attorney for 5 hours) + (Administrative Assistant for 3 hours) + (Senior Business Analyst for 3 hours) = 11 hours x 1 respondent clearing agency = 11 hours.

expects that a respondent clearing agency may need to make only limited changes to its policies and procedures under the rule.<sup>339</sup> Accordingly, the Commission preliminarily estimates that Rule 17Ad-22(e)(22) would impose an aggregate one-time burden on a respondent clearing agency of 24 hours to review and revise existing policies and procedures.<sup>340</sup>

Rule 17Ad-22(e)(22) also imposes ongoing burdens on a respondent clearing agency. It requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>341</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(22) would impose an aggregate annual burden on a respondent clearing agency of 5 hours.<sup>342</sup>

## **22. Rule 17Ad-22(e)(23)**

Rule 17Ad-22(e)(23) contains similar requirements to Rule 17Ad-22(d)(9) but also imposes substantial new requirements.<sup>343</sup> The Commission therefore expects that, although a respondent clearing agency may have written rules, policies and procedures similar to those required by some provisions under the rule, a respondent clearing agency will need to create new

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<sup>339</sup> See 17 CFR 240.17Ad-22(d), (e)(22).

<sup>340</sup> This figure was calculated as follows: ((Assistant General Counsel for 2 hours) + (Compliance Attorney for 6 hours) + (Computer Operations Manager for 7 hours) + (Senior Business Analyst for 2 hours) + (Chief Compliance Officer for 5 hours) + (Senior Programmer for 2 hours)) = 24 hours x 1 respondent clearing agency = 24 hours.

<sup>341</sup> See CCA Standards adopting release, supra note 7, at 448; Clearing Agency Standards adopting release, supra note 31, at 66260.

<sup>342</sup> This figure was calculated as follows: (Compliance Attorney for 5 hours) x 1 respondent clearing agency = 5 hours.

<sup>343</sup> See 17 CFR 240.17Ad-22(d)(9), (e)(23).

policies and procedures to address the other provisions. Accordingly, based on the similar policies and procedures requirements and the corresponding burden estimates previously made by the Commission for Rule 17Ad-22(d)(9),<sup>344</sup> the Commission preliminarily estimates that a respondent clearing agency would incur an aggregate one-time burden of 138 hours to review and revise existing policies and procedures and to create policies and procedures, as necessary.<sup>345</sup>

Rule 17Ad-22(e)(23) also imposes ongoing burdens on a respondent clearing agency. The rule requires ongoing monitoring and compliance activities with respect to its policies and procedures under the rule. Based on the Commission's previous estimates for ongoing monitoring and compliance burdens with respect to Rule 17Ad-22,<sup>346</sup> the Commission preliminarily estimates that the ongoing activities required by Rule 17Ad-22(e)(23) would impose an aggregate annual burden on a respondent clearing agency of 34 hours.<sup>347</sup>

### **23. Total Burden for Rule 17Ad-22(e)**

The Commission preliminarily estimates that the aggregate initial burden for a new respondent clearing agency under Rule 17Ad-22(e) would be 1,567 hours. The aggregate ongoing burden for a new respondent clearing agency under Rule 17Ad-22(e) would be 502

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<sup>344</sup> See CCA Standards adopting release, supra note 7, at 449; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>345</sup> This figure was calculated as follows: ((Assistant General Counsel for 38 hours) + (Compliance Attorney for 24 hours) + (Computer Operations Manager for 32 hours) + (Senior Business Analyst for 18 hours) + (Chief Compliance Officer for 18 hours) + (Senior Programmer for 8 hours)) = 138 hours x 1 respondent clearing agency = 138 hours.

<sup>346</sup> See CCA Standards adopting release, supra note 7, at 449–450; Clearing Agency Standards adopting release, supra note 31, at 66260–63.

<sup>347</sup> This figure was calculated as follows: (Compliance Attorney for 34 hours) x 1 respondent clearing agency = 34 hours.

hours. Further, the Commission preliminarily estimates that, under Rule 17Ad-22(e) and the proposed amendment to the definition of “covered clearing agency,” all respondent clearing agencies would incur an aggregate initial burden of 12,343 hours under Rule 17Ad-22(e) and an aggregate ongoing burden of 4,039 hours.

#### **24. Total Burden for Rule 17Ad-22(c)(1)**

With respect to Rule 17Ad-22(c)(1), a respondent clearing agency is a registered clearing agency that provides CCP services. In the CCA Standards adopting release the Commission estimated that respondent clearing agencies would incur both initial and ongoing burdens under Rule 17Ad-22(c)(1). Specifically, the Commission estimated that Rule 17Ad-22(c)(1) would impose on a respondent clearing agency a one-time burden of 110 hours.<sup>348</sup> The Commission preliminarily believes that this estimate remains correct and that a respondent clearing agency would incur an aggregate one-time burden of 110 hours to perform adjustments needed to synthesize and format existing information in a manner sufficient to explain the methodology used to meet the requirements of Rule 17Ad-22(c)(1).<sup>349</sup>

In addition, the Commission estimated that Rule 17Ad-22(c)(1) would impose ongoing burdens on a respondent clearing agency of three hours per respondent clearing agency.<sup>350</sup> The Commission preliminarily believes that this estimate remains correct and that the ongoing

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<sup>348</sup> See CCA Standards adopting release, supra note 7, at 452–453. This figure was calculated as follows: ((Chief Compliance Officer at 44 hours) + (Computer Operations Department Manager at 44 hours) + (Senior Programmer at 22 hours)) = 110 hours.

<sup>349</sup> This figure was calculated as follows: ((Chief Compliance Officer at 44 hours) + (Computer Operations Department Manager at 44 hours) + (Senior Programmer at 22 hours)) = 110 hours x 1 respondent clearing agency = 110 hours.

<sup>350</sup> This figure was calculated as follows: ((Compliance Attorney at 1 hour) + (Computer Operations Department Manager at 2 hours)) = 3 hours per quarter × 4 quarters per year = 12 hours.

activities required by Rule 17Ad-22(c)(1) would impose an aggregate annual burden on respondent clearing agencies of 120 hours to perform adjustments needed to synthesize and format existing information in a manner sufficient to explain the methodology used to meet the requirements of the rule.<sup>351</sup>

#### **D. Collection of Information is Mandatory**

The collection of information requirements for Rule 17Ad-22(c)(1) and (e) are mandatory.

#### **E. Confidentiality**

The Commission preliminarily expects that the policies and procedures developed pursuant to Rule 17Ad-22(e) would be communicated to the participants, as applicable, of each respondent clearing agency and, as applicable, the public. A respondent clearing agency would be required to preserve such policies and procedures in accordance with, and for the periods specified in, Rules 17a-1 and 17a-4(e)(7) under the Exchange Act.<sup>352</sup> To the extent that the Commission receives confidential information pursuant to this collection of information, such information would be kept confidential subject to the provisions of applicable law.<sup>353</sup>

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<sup>351</sup> This figure was calculated as follows: ((Compliance Attorney at 2 hours) + (Computer Operations Department Manager at 3 hours)) = 5 hours per quarter × 4 quarters per year = 20 hours x 1 respondent clearing agency = 20 hours.

<sup>352</sup> See 17 CFR 240.17a-1 and 17a-4(e)(7).

<sup>353</sup> See, e.g., 5 U.S.C. 552. Exemption 4 of the Freedom of Information Act provides an exemption for trade secrets and commercial or financial information obtained from a person and privileged or confidential. See 5 U.S.C. 552(b)(4). Exemption 8 of the Freedom of Information Act provides an exemption for matters that are contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions. See 5 U.S.C. 552(b)(8).

## **F. Request for Comments**

The Commission invites comments on all of the above estimates. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission requests comment in order to (a) evaluate whether the collection of information is necessary for the proper performance of our functions, including whether the information will have practical utility; (b) evaluate the accuracy of our estimates of the burden of the collection of information; (c) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; (d) evaluate whether there are ways to minimize the burden of the collection of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and (e) determine whether there are cost savings associated with the collection of information that have not been identified in this proposal.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-1090, with reference to File Number S7-23-16. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File Number S7-23-16, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street, N.E., Washington, DC 20549-2736. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it by [INSERT DATE THAT IS 30 DAYS FROM THE DATE OF PUBLICATION IN THE FEDERAL REGISTER].

## **V. Small Business Regulatory Enforcement Fairness Act**

Under the Small Business Regulatory Enforcement Fairness Act of 1996, a rule is considered “major” where, if adopted, it results or is likely to result in (i) an annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease); (ii) a major increase in costs or prices for consumers or individual industries; or (iii) significant adverse effect on competition, investment, or innovation.<sup>354</sup> The Commission requests comment on the potential impact of the proposed amendments to Rule 17Ad-22 on the economy on an annual basis, any potential increase in costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

## **VI. Regulatory Flexibility Act Certification**

The Regulatory Flexibility Act (“RFA”) requires the Commission, in promulgating rules, to consider the impact of those rules on small entities.<sup>355</sup> Section 603(a) of the Administrative Procedure Act,<sup>356</sup> as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules to determine the impact of such rulemaking on “small entities.”<sup>357</sup> Section 605(b) of the RFA states that this requirement shall not apply to

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<sup>354</sup> Pub. L. 104-121, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

<sup>355</sup> See 5 U.S.C. 601 et seq.

<sup>356</sup> 5 U.S.C. 603(a).

<sup>357</sup> Section 601(b) of the RFA permits agencies to formulate their own definitions of “small entities.” See 5 U.S.C. 601(b). The Commission has adopted definitions for the term “small entity” for the purposes of rulemaking in accordance with the RFA. These definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10.

any proposed rule which, if adopted, would not have a significant impact on a substantial number of small entities.<sup>358</sup>

#### **A. Registered Clearing Agencies**

The proposed amendments to Rule 17Ad-22 would apply to registered clearing agencies that are CCPs, CSDs, or SSSs. For the purposes of Commission rulemaking and as applicable to the amendments to Rule 17Ad-22, a small entity includes, when used with reference to a clearing agency, a clearing agency that (i) compared, cleared, and settled less than \$500 million in securities transactions during the preceding fiscal year, (ii) had less than \$200 million of funds and securities in its custody or control at all times during the preceding fiscal year (or at any time that it has been in business, if shorter), and (iii) is not affiliated with any person (other than a natural person) that is not a small business or small organization.<sup>359</sup>

Based on the Commission's existing information about the clearing agencies currently registered with the Commission,<sup>360</sup> the Commission preliminarily believes that all such registered clearing agencies exceed the thresholds defining "small entities" set out above. While other clearing agencies may emerge and seek to register as clearing agencies with the

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<sup>358</sup> See 5 U.S.C. 605(b).

<sup>359</sup> See 17 CFR 240.0-10(d).

<sup>360</sup> In 2015, DTCC processed \$1.508 quadrillion in financial transactions. Within DTCC, DTC settled \$112.3 trillion of securities and held securities valued at \$45.4 trillion, NSCC processed an average daily value of \$976.6 billion in equity securities, and FICC cleared \$917.1 trillion of transactions in government securities and \$48.2 trillion of transactions in agency mortgage-backed securities. See DTCC, 2015 Annual Report, available at <http://www.dtcc.com/annuals/2015/index.php>. OCC cleared more than 4.1 billion contracts and held margin of \$98.3 billion at the end of 2015. See OCC, 2015 Annual Report, available at <http://www.theocc.com/components/docs/about/annual-reports/occ-2015-annual-report.pdf>. In addition, Intercontinental Exchange ("ICE") averaged daily trade volume of 9.3 million and revenues of \$3.3 billion in 2015. See ICE at a glance, available at [https://www.theice.com/publicdocs/ICE\\_at\\_a\\_glance.pdf](https://www.theice.com/publicdocs/ICE_at_a_glance.pdf).

Commission, the Commission preliminarily does not believe that any such entities would be “small entities” as defined in Exchange Act Rule 0-10.<sup>361</sup> Accordingly, the Commission preliminarily believes that any such registered clearing agencies will exceed the thresholds for “small entities” set forth in Exchange Act Rule 0-10.

### **B. Certification**

For the reasons described above, the Commission certifies that the proposed amendments to Rule 17Ad-22 would not have a significant economic impact on a substantial number of small entities for purposes of the RFA. The Commission requests comment regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities, including clearing agencies and counterparties to security and security-based swap transactions, and provide empirical data to support the extent of the impact.

## **VII. Statutory Authority and Text of Proposed Amendments to Rule 17Ad-22**

Pursuant to the Exchange Act, particularly Section 17A thereof, 15 U.S.C. 78q-1, and Section 805 of the Clearing Supervision Act, 12 U.S.C. 5464, the Commission proposes to amend Rule 17Ad-22.

### **List of Subjects in 17 CFR Part 240**

Reporting and recordkeeping requirements, Securities.

### **Text of Proposed Amendment**

In accordance with the foregoing, title 17, chapter II of the Code of Federal Regulations is proposed to be amended as follows:

## **PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE**

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<sup>361</sup> See 17 CFR 240.0-10(d). The Commission based this determination on its review of public sources of financial information about registered clearing agencies.

1. The general authority citation for Part 240 and the sectional authority for § 240.17Ad-22 continues to read, as revised elsewhere in this issue of the Federal Register, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 *et. seq.*; and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; Pub. L. 111-203, 939A, 124 Stat. 1376 (2010); and Pub. L. 112-106, sec. 503 and 602, 126 Stat. 326 (2012), unless otherwise noted.

\* \* \* \* \*

Section 240.17Ad-22 is also issued under 12 U.S.C. 5461 et seq.

\* \* \* \* \*

2. Further amend § 240.17Ad-22(a) as published elsewhere in this issue of the Federal Register by revising paragraphs (3), (5), (15), (16), (17), (18), (19), and (20).

**§ 240.17Ad-22 Standards for clearing agencies.**

(a) Definitions. For purposes of this section:

\* \* \* \* \*

(3) Central securities depository means a clearing agency that is a securities depository as described in Section 3(a)(23)(A) of the Act (15 U.S.C. 78c(a)(23)(A)).

\* \* \* \* \*

(5) Covered clearing agency means a registered clearing agency that provides the services of a central counterparty, central securities depository, or securities settlement system.

\* \* \* \* \*

(15) Securities settlement system means a clearing agency that enables securities to be transferred and settled by book entry according to a set of predetermined multilateral rules.

(16) Security-based swap means a security-based swap as defined in Section 3(a)(68) of the Act (15 U.S.C. 78c(a)(68)).

(17) Sensitivity analysis means an analysis that involves analyzing the sensitivity of a model to its assumptions, parameters, and inputs that:

(i) Considers the impact on the model of both moderate and extreme changes in a wide range of inputs, parameters, and assumptions, including correlations of price movements or returns if relevant, which reflect a variety of historical and hypothetical market conditions.

(ii) Uses actual portfolios and, where applicable, hypothetical portfolios that reflect the characteristics of proprietary positions and customer positions;

(iii) Considers the most volatile relevant periods, where practical, that have been experienced by the markets served by the clearing agency; and

(iv) Tests the sensitivity of the model to stressed market conditions, including the market conditions that may ensue after the default of a member and other extreme but plausible conditions as defined in a covered clearing agency's risk policies.

(18) Stress testing means the estimation of credit or liquidity exposures that would result from the realization of potential stress scenarios, such as extreme price changes, multiple defaults, or changes in other valuation inputs and assumptions.

(19) Systemically important in multiple jurisdictions means, with respect to a covered clearing agency, a covered clearing agency that has been determined by the Commission to be systemically important in more than one jurisdiction pursuant to §240.17Ab2-2.

(20) Transparent means, for the purposes of paragraphs (e)(1), (2), and (10) of this section, to the extent consistent with other statutory and Commission requirements on confidentiality and disclosure, that documentation required under paragraphs (e)(1), (2), and (10) is disclosed to the Commission and, as appropriate, to other relevant authorities, to clearing members and to customers of clearing members, to the owners of the covered clearing agency, and to the public.

By the Commission.

Date: September 28, 2016.

Brent J. Fields  
Secretary