



441 G St. N.W.
Washington, DC 20548

B-325340

December 17, 2013

The Honorable Debbie Stabenow
Chairwoman
The Honorable Thad Cochran
Ranking Member
Committee on Agriculture, Nutrition, and Forestry
United States Senate

The Honorable Frank D. Lucas
Chairman
The Honorable Collin C. Peterson
Ranking Member
Committee on Agriculture
House of Representatives

Subject: *Commodity Futures Trading Commission: Derivatives Clearing Organizations and International Standards*

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Commodity Futures Trading Commission (Commission) entitled "Derivatives Clearing Organizations and International Standards" (RIN: 3038-AE06). We received the rule on November 15, 2013. It was published in the *Federal Register* as a final rule on December 2, 2013. 78 Fed. Reg. 72,476.

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

This rule is effective December 31, 2013, except for the amendments to 17 C.F.R. §§ 39.31 and 140.94, which are effective December 13, 2013, and the amendments to 190.09, which are

effective December 2, 2013. The Congressional Review Act (CRA) requires a 60-day delay in the effective date of a major rule from the date of publication in the *Federal Register* or receipt of the rule by Congress, whichever is later. 5 U.S.C. § 801(a)(3)(A). However, notwithstanding the 60-day delay requirement, any rule that an agency for good cause finds that notice and public procedures are impractical, unnecessary, or contrary to the public interest is to take effect when the promulgating agency so determines. §§ 553(d)(3), 808(2). For the regulations in this final rule, the Commission has determined that good cause exists to waive the CRA effective date requirement and make the regulations effective in less than 60 days.

Enclosed is our assessment of the Commission's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. Our review of the procedural steps taken indicates that the Commission complied with the applicable requirements.

If you have any questions about this report or wish to contact GAO officials responsible for the evaluation work relating to the subject matter of the rule, please contact Shirley A. Jones, Assistant General Counsel, at (202) 512-8156.

signed

Robert J. Cramer
Managing Associate General Counsel

Enclosure

cc: Melissa D. Jurgens
Secretary of the Commission
Commodity Futures Trading Commission

REPORT UNDER 5 U.S.C. § 801(a)(2)(A) ON A MAJOR RULE
ISSUED BY THE
COMMODITY FUTURES TRADING COMMISSION
ENTITLED
"DERIVATIVES CLEARING ORGANIZATIONS
AND INTERNATIONAL STANDARDS"
(RIN: 3038-AE06)

(i) Cost-benefit analysis

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

The Commission requested quantitative data or specific cost estimates associated with the proposed regulations but commenters, other than CME Group Inc., did not provide this information. The Commission states that commenters did address the costs and benefits of the proposed rule in qualitative terms. As noted in the cost-benefit discussion in the proposal, the Commission recognizes that the regulations in this final rulemaking are comprehensive and that, compared against the status quo (the DCO regulatory framework set forth in Subparts A and B of part 39 of the Commission's regulations), these regulations may impose important costs on SIDCOs and Subpart C DCOs depending, in particular, on the SIDCO's or Subpart C DCO's current financial and liquid resources, and risk management framework. In particular, the Commission explains that these regulations may require SIDCOs and Subpart C DCOs to undertake a comprehensive review and analysis of their current policies, procedures, and systems in order to determine where it may be necessary to design and implement additional or alternative policies, procedures, and systems. The Commission states that such costs are likely to increase operational, administrative, and compliance costs for SIDCOs or Subpart C DCOs.

In addition to the costs for SIDCOs and Subpart C DCOs, the Commission has considered the costs these regulations may impose upon market participants and the public. To the extent costs increase, the Commission notes that higher trading prices for market participants (i.e., increased clearing fees, guaranty fund contributions, margin fees, etc.) may discourage market participation and result in decreased liquidity and reduced price discovery. However, the Commission has also considered the costs to market participants and the public if the regulations in this final rulemaking are not adopted. Significantly, without these regulations to ensure that SIDCOs operate under certain enhanced risk management standards, in a manner consistent with internationally accepted standards, the Commission believes that the security of the U.S. financial markets would be at a greater risk relative to international markets. According to the Commission, this could affect the attractiveness of the U.S. financial markets subject to the Commission's jurisdiction as compared to foreign competitors. Moreover, the Commission notes that SIDCOs and DCOs that wish to opt-into the enhanced regulatory framework would not have the opportunity to gain qualified central counterparty (QCCP) status, thereby putting

them at a significant competitive disadvantage in the global financial markets which, again, would be to the detriment of their clearing members and their customers.

The final rule holds SIDCOs and Subpart C DCOs to enhanced regulatory standards, which are designed to promote the financial strength, operational integrity, security, and reliability of these organizations and to reduce the likelihood of their disruption or failure. According to the Commission, this, in turn, increases the overall stability of the U.S. financial markets. The Commission states that as the PFMI note, financial market infrastructures (FMIs), including CCPs (i.e., DCOs), play a critical role in fostering financial stability, and this is particularly the case with respect to SIDCOs. The Financial Stability Oversight Council (Council) has determined that the failure of or a disruption to the functioning of a SIDCO could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system. Thus, the Commission believes that the final rule offers a substantial benefit vis-à-vis the status quo. In addition, the Commission notes that the regulations adopted in this final rulemaking are consistent with the international standards set forth in the PFMI and address the remaining divergences between part 39 of the Commission's regulations and the PFMI. According to the Commission, these regulations will help ensure that SIDCOs and Subpart C DCOs are held to international standards in order to provide them with the opportunity to gain QCCP status. As discussed above, attaining QCCP status will provide clearing members that are banks, as well as banks that are customers of clearing members, with the benefit of complying with less onerous capital requirements, pursuant to the Basel CCP Capital Requirements, than if the SIDCO or Subpart C DCO were not a QCCP. In turn, the Commission believes that this may increase a SIDCO's or Subpart C DCO's competitiveness vis-à-vis non-U.S. clearing organizations that demonstrate compliance with international standards and are QCCPs.

(ii) Agency actions relevant to the Regulatory Flexibility Act (RFA), 5 U.S.C. §§ 603-605, 607, and 609

The Commission states that the rules adopted herein will only affect DCOs. The Commission has previously established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its regulations on small entities in accordance with the RFA. The Commission has previously determined that DCOs are not small entities for the purpose of the RFA. Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. § 605(b) that the rules adopted herein will not have a significant economic impact on a substantial number of small entities. The Chairman made the same certification in the proposed rulemaking, and the Commission did not receive any comments on the RFA.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

As an independent regulatory agency, the Commission is not subject to title II of the Act.

(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act (APA), 5 U.S.C. §§ 551 et seq.

The APA generally requires that the rules promulgated by an agency not be made effective less than 30 days after publication in the *Federal Register*, except for, inter alia, interpretative rules, and statements of policy and as otherwise provided by the agency for good cause found. The Commission finds that good cause exists under APA to make revised regulation 190.09,

regulation 39.31, and regulation 140.94 effective on the dates set forth by the Commission. The Commission states that the effective date for the remaining regulations is December 31, 2013, in accordance with the APA.

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

The Commission also concludes that good cause exists to waive the 30-day effective date for regulation 39.31 because a 30-day effective date would cause public financial harm by constraining the ability of certain DCOs to compete with other CCPs, particularly in global markets, which in turn, may substantially increase costs for market participants that transact in over-the-counter and exchange traded derivatives. Moreover, as discussed above, regulation 39.31 does not impose any requirements on regulated entities or alter the status quo in any way; rather it is a permissive provision that gives DCOs that have not been designated as systemically important by the Council the opportunity to opt-into and become subject to the provisions of an enhanced regulatory scheme that is otherwise only applicable to SIDCOs. Compliance with this enhanced regulatory scheme as well as existing Commission regulations is necessary for such DCOs to be subject to standards that are consistent with the PFMI, and thus enable them to gain QCCP status. Attaining QCCP status will increase a DCO's ability to compete in the global financial markets by allowing such DCO to offer lower capital charges to banks (including their subsidiaries and affiliates) that clear derivative transactions with the DCO banks that transact with the U.S. DCOs that do not have QCCP status will be charged substantially higher capital charges which they may pass along to their bank customers. In order to benefit from QCCP status by December 31, 2013, the Commission must receive a DCO's election form, as set out in regulation 39.31, by December 13, 2013. This date is necessary to allow the Commission a review period to stay, deny, or permit the election by December 31, 2013. For those DCOs that wish to gain QCCP status by December 31, 2013, an effective date beyond December 13, 2013, would delay the election process and cause financial harm by adversely impacting the ability of these DCOs to compete with CCPs that have attained QCCP status by the end of 2013. Therefore, the Commission has determined that good cause exists to make regulation 39.31 effective as of December 13, 2013.

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

Paperwork Reduction Act (PRA), 44 U.S.C. §§ 3501-3520

The Commission states that this rulemaking contains recordkeeping and reporting requirements that are collections of information within "ten or more persons," which triggers PRA compliance, has been deemed to apply to "[a]ny recordkeeping, reporting, or disclosure requirement

contained in a rule of general applicability.” 5 C.F.R. § 1320.3(c)(4). The Commission states that the final rule amends existing Office of Management and Budget (OMB) control number 3038–0081, titled “General Regulations and Derivatives Clearing Organizations.” Therefore, the Commission has submitted this notice of final rulemaking along with supporting documentation for OMB’s review in accordance with 44 U.S.C. § 3507(d) and 5 C.F.R. § 1320.11.

Statutory authorization for the rule

The Commission states that the final rule is authorized by section 5b(c)(2) of the Commodity Exchange Act, as amended by the section 725(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Executive Order No. 12,866 (Regulatory Planning and Review)

As an independent regulatory agency, the Commission is not subject to the review requirements of the Order.

Executive Order No. 13,132 (Federalism)

As an independent regulatory agency, the Commission is not subject to the review requirements of the Order.