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October 25, 2016

The Honorable Richard Shelby
Chairman
The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Jeb Hensarling
Chairman
The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
House of Representatives

Subject: *Securities and Exchange Commission: Standards for Covered Clearing Agencies*

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Securities and Exchange Commission (Commission) entitled “Standards for Covered Clearing Agencies” (RIN: 3235-AL48). We received the rule on September 29, 2016. It was published in the *Federal Register* as a final rule on October 13, 2016. 81 Fed. Reg. 70,786.

The final rule adopts amendments to Rule 17Ad-22 and adds new Rule 17Ab2-2 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). Among other things, the final rule establishes enhanced standards for the operation and governance of those clearing agencies registered with the Commission (registered clearing agencies) that meet the definition of covered clearing agency.

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: Robert W. Errett
Deputy Secretary
Securities and Exchange Commission

REPORT UNDER 5 U.S.C. § 801(a)(2)(A) ON A MAJOR RULE
ISSUED BY THE
SECURITIES AND EXCHANGE COMMISSION
ENTITLED
“STANDARDS FOR COVERED CLEARING AGENCIES”
(RIN: 3235-AL48)

(i) Cost-benefit analysis

The Securities and Exchange Commission (Commission) presented an analysis of the economic effects of this rule, including costs and benefits. The Commission noted that it has attempted to quantify the costs and benefits anticipated to flow from the amendments to Rule 17Ad-22 and Rule 17Ab2-2. In the Standards for Covered Clearing Agencies proposing release (Covered Clearing Agencies Standards proposing release), the Commission requested comment on all aspects of the economic analysis of the proposed rules, including their benefits and costs, as well as any effect the proposed rules may have on competition, efficiency, and capital formation, and encouraged commenters to provide data and analysis to help further quantify or estimate the potential benefits and costs of the proposed rules. Although it states that it did not receive comments specifically directed at the economic analysis, the Commission said that it has considered received comments and found that certain data needed to quantify the costs and benefits associated with the rules remains unavailable.

According to the Commission, the amendments to Rule 17Ad-22 and Rule 17Ab2-2 would impose certain costs on covered clearing agencies. If a covered clearing agency is required to recruit new directors, the Commission estimates a cost per director of \$73,912. The Commission estimates costs associated with liquidity resources under Rules 17Ad-22(e)(7) and (a)(15) would likely fall between \$122 million and \$204 million per year across all covered clearing agencies. The Commission states that it believes that startup costs related to financial risk management systems for existing covered clearing agencies, related to new testing and model validation requirements to be between \$5 million to \$25 million. The Commission also estimated a lower bound on ongoing costs related to these requirements of \$1 million per year. If covered clearing agencies were to hire external consultants for the purposes of performing model validation required under Rules 17Ad-22(e)(4) and (7) through policies and procedures, the Commission estimated the ongoing cost associated with hiring such consultants would be about \$4,509,120 in the aggregate. In addition, the Commission states that 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 estimated the cost of ongoing review for these adopted rules at approximately \$39,376 per year. The Commission also states that the rules would also impose certain implementation burdens and related costs on covered clearing agencies. These costs generally include assessment costs to determine compliance with the adopted rules and costs related to new policies and procedures and updates to existing policies and procedures required by the rules. The Commission estimated the burdens of these implementation requirements for covered clearing agencies in the final rule. According to the Commission, for a new entrant into the set of covered clearing agencies from the set of registered clearing agencies, it estimates the startup compliance costs associated with policies and procedures to be \$592,215, and compliance costs associated with the determinations process under Rule 17Ab2-2 to be \$7,764. The Commission stated that based on its supervisory experience, it believes that in many cases registered clearing agencies

are already in compliance with many of the requirements included in the rules, so this cost represents an upper bound on upfront costs. Conditioned on its current understanding of current market practice at covered clearing agencies, the Commission estimates that the total costs across all existing covered clearing agencies will be \$4,268,075. The Commission further estimates that in the aggregate existing covered clearing agencies would be subject to ongoing costs associated with the rule in the amount of approximately \$926,603 per year.

A benefit of the rules that the Commission states that it was able to quantify is the impact of qualifying central counterparty (QCCP) status of Office of the Comptroller of the Currency (OCC) to non-U.S. bank clearing members at OCC. This benefit comes as a result of lower capital requirements against exposures to QCCPs relative to non-qualifying central counterparties (CCPs). The Commission provided an estimate of the upper bound of this benefit, \$1.2 billion per year, or 0.73 percent of the aggregate 2015 net income reported by bank clearing members at OCC. The Commission states that it believes that the actual benefits flowing from QCCP status would likely be higher due to benefits for foreign bank members of Fixed Income Clearing Corporation and Intercontinental Exchange Clear Europe, in addition to the benefits described with respect to OCC. The Commission believes that the rules will result in an increase in financial stability insofar as they result in minimum standards at covered clearing agencies that are higher than those standards implied by current practices at covered clearing agencies. Some of this increased stability may come as a result of lower activity as the adopted rules cause participants 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. According to the Commission, increased stability may also come as a result of higher risk management standards at covered clearing agencies that effectively lower the probability that either covered clearing agencies or their members default.

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

The Commission certified that this final rule will not have a significant economic effect on a substantial number of small entities.

(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 the Act.

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

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

On March 26, 2014, the Commission published a proposed rule. 79 Fed. Reg. 16,865. On May 22, 2014, the Commission published a correction and republished the proposed rule. 79 Fed. Reg. 29,507. The Commission received 17 comment letters in response to the proposed rule, to which it responded to in the final rule. Commenters included market participants from across the financial industry, including registered clearing agencies, non-U.S. clearing agencies, non-profit groups, various entities participating in or representing professionals who provide investment or asset management services, participants in the derivatives markets, an association of banks representing clearing participants and members of certain central counterparty services, and members of the general public.

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

The Commission determined that this final rule imposes 25 new information collection requirements under the Act and provided summaries of them in the final rule. The Commission submitted them to the Office of Management and Budget (OMB) for review. Because the Commission is revising the collection of information under Rule 17Ad-22 to account for new Rule 17Ad-22(e), the Commission will use the same title and control number: "Clearing Agency Standards for Operation and Governance," OMB Control No. 3235-0695. Since Rule 17Ab2-2 contains a new collection of information requirement, the title and control number are "Determinations Affecting Covered Clearing Agencies," OMB Control No. 3235-0728. The Commission provided notice of PRA estimates in the Covered Clearing Agencies Standards proposing release and received no comments in response. The Commission further noted 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.

Statutory authorization for the rule

The Commission promulgated this final rule under the authority of the Securities Exchange Act of 1934 and, particularly, section 17A thereof, 15 U.S.C. 78q-1, and pursuant to section 805 of the Clearing Supervision Act, 12 U.S.C. 5464, the Commission is adopting amendments to Rule 17Ad-22 and new Rule 17Ab2-2.

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

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

Executive Order No. 13,132 (Federalism)

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