

U.S. Regulatory Landscape For Financial Market Infrastructures

Payment System Policy and Oversight Course
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Presentation Agenda

- ▶ The major players
 - Commodities Futures Trading Commission (CFTC)
 - Securities and Exchange Commission (SEC)
 - The Federal Reserve
- ▶ The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd–Frank Act)
- ▶ Title VIII of the Dodd–Frank Act
 - Key Provisions

CFTC and SEC

- ▶ **Commodities Futures Trading Commission (CFTC)**
 - U.S. government agency responsible for regulating the U.S. derivatives markets (futures and options), including the infrastructure supporting those markets
 - Swap Execution Facilities (SEFs)
 - Derivatives clearing organizations (DCOs)
 - Central counterparties for instruments regulated by the CFTC, e.g., commodities, financial futures, options on futures, OTC swaps that are not “security-based” swaps regulated by the SEC

- ▶ **Securities and Exchange Commission (SEC)**
 - U.S. government agency responsible for regulating the U.S. securities markets and certain derivatives on securities, including infrastructure supporting those markets
 - Securities Exchanges
 - Clearing Agencies (CAs) – broad definition, including inter alia:
 - Central Securities Depositories
 - Securities Settlement Systems
 - Central counterparties for securities, options on securities, security-based swaps

Federal Reserve

- ▶ U.S. central bank responsible for conducting U.S. monetary policy, supervising certain banking institutions, maintaining financial stability, and providing financial services, including payment services.
- ▶ The FR Board provides direct supervision and oversight of certain private-sector financial market infrastructures (FMIs)
 - Authority under banking laws to supervise FMIs chartered by the FR (e.g., Continuous Linked Settlement (CLS) Bank), or that are state-chartered banks that are members of the FRS (e.g., Depository Trust Company (DTC))
 - Authority under Title VIII to supervise designated FMUs that are payments systems whether banks or non-banks (e.g., Clearinghouse Interbank Payment System (CHIPS); or designated FMUs not otherwise regulated by the SEC or CFTC)
- ▶ The FR Board provides direct supervision and oversight of all financial services provided by Federal Reserve Banks
 - Services include cash, check, Automated Clearinghouse, Fedwire Funds, Fedwire Securities, and National Settlement Service
 - Note: The FR Board requires the Reserve Banks' Fedwire Services to meet or exceed the standards set forth in the Principles for Financial Market Infrastructures (PFMIs)

Dodd–Frank Act

- ▶ Title I – Financial Stability
 - Establishment of the Financial Stability Oversight Council (FSOC)
- ▶ Title VII – Wall Street Transparency and Accountability
 - Mandatory clearing of standardized swaps
 - Provides CFTC and SEC authority to regulate over-the-counter (OTC) derivatives market, and infrastructure supporting those markets
 - Enhanced regulatory standards for clearing systems
- ▶ Title VIII – Payment, Clearing and Settlement Supervision
 - Title VIII “concept” is that relevant regulators retain their primary regulatory authority over existing DFMUs but with stronger standards and supervisory processes
 - Additionally, the Fed plays an enhanced overarching role in order to address systemic risk, provide consistency, and strengthen supervision of DFMUs
 - Note: FMUs include payment systems, central securities depositories, securities settlement systems, and central counterparties. Unlike the term FMI, the term FMU by law excludes trade repositories. Designated FMUs are FMUs designated as systemically important by FSOC.

Title VIII: Key Provisions

- ▶ Title VIII has six key provision
 1. Designation of systemic importance
 2. Standards for designated financial market utilities (DFMUs) and financial institutions engaged in designated payment, clearing, and settlement activities
 3. Examination and enforcement
 4. Review of material changes to a DFMU's rules, procedures, or operations
 5. Regulators' requests for information, reports, or records
 6. DFMU access to Federal Reserve Bank accounts and payment services

Designation of Systemic Importance

- ▶ “Systemically important” is defined as a situation where the failure of or a disruption to the functioning of an FMU or PCS activity 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 US financial system.
- ▶ FSOC is responsible for designating FMUs or PCS activities as systemically important, considering specific factors provided under Title VIII
 - Aggregate monetary value of transactions processed
 - Aggregate exposures to counterparties
 - Relationships, interdependences, or other interactions among FMUs or PCS activities
 - Effect that a failure or disruption of a FMU or PCS activity would have on critical markets, financial institutions, or the broader financial system
 - Any other factor the FSOC deems appropriate

Risk Management Standards

- ▶ The FR Board/CFTC/SEC are authorized to prescribe risk-management standards for a DFMU under their supervision, taking into account relevant international standards and existing prudential requirements
 - Regulation HH contains the FR Board's implementation of the PFMI for DFMUs where it is the primary regulator ("Supervisory Agency") under Title VIII (currently CLS and CHIPS)
 - The Board's Payment System Risk (PSR) policy statement has also been revised to incorporate the PFMI; the PSR policy applies to the Fedwire Services, urges other relevant regulators to adopt the PFMI, and is the policy statement applicable to international cooperative oversight activities
 - The CFTC has adopted final regulations incorporating the PFMI
 - The SEC has proposed regulations adopting the PFMI, but not yet finalized them
- ▶ The FR Board may determine that the CFTC or SEC standards are insufficient to mitigate or prevent significant risk to financial markets or to US financial stability and submit its written determination to the relevant agency and the FSOC
 - If the relevant agency rejects the FR Board's determination, the FSOC may require the CFTC or SEC to prescribe enhanced standards upon a two-thirds vote.

Examination and Enforcement

- ▶ For purposes of carrying out the provisions of Title VIII, the statute generally defines the “supervisory agency” (SA) for a DFMU as the Federal agency with primary jurisdiction over a DFMU under Federal banking, securities, or commodity futures laws.
 - The FR Board is the SA for any remaining DFMUs (e.g., payment systems without a banking license) when no financial regulator has primary jurisdiction
- ▶ The relevant Supervisory Agency for each DFMU will examine and enforce the provisions of Title VIII
 - DFMUs must be examined at least annually
 - CFTC/SEC must consult with the FR Board on examination planning
 - In practice, the Fed regularly consults with the CFTC and SEC on their respective examinations of DFMUs
 - The FR Board is authorized but not required to participate in examinations of DFMUs regulated by CFTC/SEC
 - In practice, the FR Board regularly participates in these examinations

Relevant Supervisory Agency for each DFMU

	Federal Reserve	CFTC	SEC
CHIPS	X		
CLS	X		
CME		X	
DTC			X*
FICC			X
ICE Clear Credit		X	
NSCC			X
OCC			X

*The Federal Reserve also supervises DTC as a state-member bank. DTC is also supervised by the New York State Banking Department.

Review of Material DFMU Changes

- ▶ A DFMU is required to provide 60-day advance notice to its Supervisory Agency of any proposed change to its rules, procedures or operations that could materially affect its risks
- ▶ The proposed change is not allowed if the Supervisory Agency objects to the change
- ▶ CFTC and SEC must copy to and consult with the FR Board on advance notices received from their regulated DFMUs

Regulators' Requests for Information, Reports, or Records

- ▶ The FR Board or the FSOC may require any DFMU to provide reports or data to assess:
 - Safety and soundness of the DFMU
 - Systemic risk posed by the DFMU
- ▶ The FSOC and the FR Board must coordinate with the relevant Supervisory Agency or appropriate financial regulator before requesting material information from or imposing reporting or recordkeeping requirements on DFMUs
 - Provision is intended to reduce “paperwork” burden on the DFMUs

Access to FR Accounts and Payment Services

- ▶ The FR Board may establish an account and provide payment services to a DFMU subject to the Fed's rules, orders, standards, or guidelines
 - Regulation HH contains the FR Board's requirements