

## TITLE VIII: Payment, Clearing, and Settlement Supervision

Title VIII provides a specific framework for mitigating systemic risk and promoting uniform risk-management standards for systemically important financial market utilities and systemically important payment, clearing, and settlement activities conducted by financial institutions. It may be cited as the “Payment, Clearing, and Settlement Supervision Act of 2010.” **Sec. 801 (p. 436).**

### A. Purpose

The Act’s findings and purpose discuss that the proper functioning of the financial markets is dependent upon “safe and efficient arrangements for the clearing and settlement of payment, securities, and other financial transactions.” **Sec. 802(a)(1) (p. 436).** Payment, clearing, or settlement activities may reduce risk, but to do so must be well-designed and operate in a sound manner. **Sec. 802(a)(2) (p. 436).** Thus, enhancements to the regulation and supervision of “systemically important financial market utilities” (“Utilities”) and “systemically important payment, clearing, and settlement activities” (“Activities”) are necessary for four primary reasons:

- i. To provide consistency;
  - ii. To promote robust risk management and safety and soundness;
  - iii. To reduce systemic risks; and
  - iv. To support the stability of the broader financial system.
- Sec. 802(a)(4) (p. 436).**

To these ends, the Act authorizes the Fed to promote uniform standards for the management of risks by systemically important financial market utilities, and for the conduct of systemically important payment, clearing, and settlement activities by financial institutions. **Sec. 802(b)(1) (p. 436).** It provides the Fed an enhanced role in the supervision of uniform risk management standards for “systemically important financial market utilities” and “systemically important payment, clearing, and settlement activities.” **Sec. 802(b)(2) and (4) (p. 436).** Finally, it strengthens the liquidity of systemically important financial market utilities. **Sec. 802(b)(3) (p. 436).**

### B. Scope of Regulatory Authority

Broad categories of financial entities and activities are subject to enhanced Fed authority under the Act. Activities subject to regulation include “a payment, clearing, or settlement activity that the Council has designated as systemically important under § 804.” **Sec. 803(2) (p. 437).** Further, “financial institutions” include all depository institutions, branches, or agencies of foreign banks, organizations operating under Sections 25 or 25A of the FR Act, credit unions, brokers and dealers, investment companies, insurance companies, investment advisors, future commission merchants, commodity trading advisors, commodity pool operators, and any company engaged in activities that are financial in nature under Section 4 of the BHC

Act. **Sec. 803(5)(A) (p. 437).**

Similarly, “financial market utility” refers to any person who manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions. **Sec. 803(6)(A) (p. 438).** The Act defines “payment, clearing, or settlement activity” as an activity carried out by one or more financial institutions to facilitate the completion of financial transactions, not including the offer or sale of securities. **Sec. 803(7)(A) (pp. 438-439).**

“Financial transactions” include fund transfers, securities contracts, contracts of sale of a commodity for future delivery, forward contracts, repurchase agreements, swaps, security-based swaps, swap agreements, security-based swap agreements, foresight language contracts, financial derivatives contracts, and “any similar transaction that the Council determines to be a financial transaction for the purposes of this title.” **Sec. 803(7)(B) (p. 439).**

The Act defines “systemic importance” to mean situations where the risk of significant liquidity or credit problems threaten the stability of the financial system of the United States. **Sec. 803(9) (p. 440).** The Council has the authority to designate those financial market utilities or payment, clearing, or settlement activities that are or are likely to become systemically important. **Sec. 804(a)(1) (p. 440).** The Council must do so on a nondelegable basis and by a vote of not fewer than two-thirds of members then serving. The Council must consider:

- i. The aggregate value of transactions processed by the utility or activity;
  - ii. The exposure of the utility or a financial institution engaged in activities to its counterparties;
  - iii. The relationship, interdependencies, or other interactions of the utility or activity with other utilities or activities;
  - iv. The effect the of failure or disruption to a utility or activity on critical markets, institutions or the broader financial system; and
  - v. Any other factors that the Council deems appropriate.
- Sec. 804(a)(2) (pp. 440-441).**

### C. Consultation and Notice and Opportunity for Hearing

Before making any determination, the Council must consult with the relevant Supervisory Agency and the Fed before making any determination. **Sec. 804(c)(1) (p. 441).** It must provide the financial market utility or financial institution with advance notice (including notice published in the Federal Register), and the financial market utility or institution may request, in writing, a written or oral hearing before a determination may be reached. **Sec. 804(c)(2)(A)-(B) (p. 441).** The Act does include an emergency exception by which the Council may waive the notice requirement by a two-thirds vote and an affirmative vote by the Chairperson where the waiver is necessary to prevent an immediate threat to the financial system. **Sec. 804(c)(3)(A) (p. 441).**

**D. Standards for Systemically Important Financial Market Utilities and Payment, Clearing, or Settlement Activities**

The Act mandates that the Fed prescribe risk management standards, taking into consideration relevant international standards and existing prudential requirements governing operations related to payment, clearing, and settlement activities of utilities, and the conduct of designated activities by financial institutions. **Sec. 805(a)(1)(A)-(B) (p. 442)**. The CFTC and the SEC may each prescribe regulations containing risk management standards but must do so in consultation with the Council and the Fed. **Sec. 805(a)(2) (pp. 442-443)**. The objectives and principles of the standards are to promote robust risk management; promote safety and soundness; reduce systemic risks; and support the stability of the broader financial system. **Sec. 805(b) (pp. 443-444)**. The standards proscribed would regulate such areas as:

- i. Risk management policies and procedures;
- ii. Margin and collateral requirements;
- iii. Participant or counterparty default policies and procedures;
- iv. The ability to complete timely clearing and settlement of financial transactions;
- v. Capital and financial resource requirements for designated financial market utilities; and
- vi. Other areas that are necessary to achieve the stated objectives. **Sec. 805(c) (p. 444)**.

**E. Operations of Designated Financial Market Utilities**

The Fed may authorize a Federal Reserve Bank to establish and maintain an account for a designated financial market utility and provide services to that utility authorized under the FR Act to provide to a depository institution. **Sec. 806(a) (p. 444)**. The Fed may authorize a Federal Reserve Bank to provide a utility discount and borrowing privileges only in unusual or exigent circumstances, upon an affirmative vote of a majority of the Fed then serving, and after consultation with the Secretary, and upon a showing that the utility is unable to secure adequate credit accommodations from other banking institutions. **Sec. 806(b) (p. 445)**. The Fed may pay earnings on balances maintained by or on behalf of the utility, and may exempt a utility from reserve requirements. **Sec. 806(c)-(d) (p. 445)**. A designated financial market utility must provide 60-day advance notice to its Supervisory Agency of any proposed change that could materially affect the nature or level of risks presented by the utility. **Sec. 806(e)(1)(A) (p. 445)**. The Supervisory Agency must notify the utility of any objection regarding the proposed change within 60 days of the date of notice or the date any further information is received, and the utility may not implement a change to which the Agency has an objection, but if the Agency does not object within 60 days the change is allowed. **Sec. 806(e)(1)(E)-(G) (p. 446)**. Before taking any action or completing a review of a change proposed by a utility, the Supervisory Agency must consult with the Fed. **Sec. 806(e)(4) (p. 447)**.

The notice requirement on utilities is subject to an emergency exception. A Utility may implement a change, where notice would normally be required, in an emergency where immediate implementation of the change is necessary for the utility to continue to provide its services in a safe and sound manner. **Sec. 806(e)(2)(A) (p. 446)**. However, the Utility must provide notice of such a change to the Supervisory Agency within 24 hours after implementation, explaining the nature of the emergency and the reason the change was necessary. **Sec. 806(e)(2)(B)-(C) (p. 447)**. The Supervisory Agency may require rescission or modification of the change if it is not consistent with the Act. **Sec. 806(e)(2)(D) (p. 447)**.

#### **F. Examination Of and Enforcement Actions Against Designated Financial Market Utilities**

The Supervisory Agency is required to conduct examinations of a designated Utility at least once annually in order to determine the nature of its operations and risks; the financial and operational risks posed by it to financial institutions, critical markets, or the financial system; the ability of the utility to monitor and control such risks; the safety and soundness of the utility; and the designated utility's compliance with this title and the rules and orders prescribed under this title. **Sec. 807(a) (p. 447)**. If a service integral to the operation of the Utility is performed for the Utility by another entity, the Supervisory Agency may examine to ensure the provision of that service is in compliance with applicable law to the same extent as if the utility were performing the service for its own premises. **Sec. 807(b) (p. 447)**. For purposes of enforcing this provision, the Utility is subject to, and the Supervisory Agency has authority, under the FDI Act in the same manner as if the utility was an insured depository institution. **Sec. 807(c) (p. 448)**. The Supervisory Agency is required to consult with the Fed annually regarding any examinations, and the Fed has the discretion to participate in any examination led by a Supervisory Agency. **Sec. 807(d) (p. 448)**.

After consulting the Council and Supervisory Agency, the Fed may at any time recommend that the agency take enforcement action against the utility in order to prevent or mitigate significant liquidity, credit, operational, or other risks to the financial markets or to the financial stability of the United States. **Sec. 807(e)(1) (p. 448)**. The Agency must consider the Fed's recommendation and submit a response within 60 days. **Sec. 807(e)(2) (p. 448)**. If the Agency rejects the recommendation, the Fed may refer it to the Council for a binding decision on enforcement action. **Sec. 807(e)(3) (p. 448)**.

The Fed may also take enforcement action against a Utility if the Fed has reasonable cause to believe that either an action engaged in or contemplated by the Utility, or the condition of the Utility, poses an imminent risk of substantial harm to financial institutions, markets, or the broader financial system of the United States. **Sec. 807(f)(1) (pp. 448-449)**. The imminent risk of substantial harm precludes the Fed's procedural enforcement requirements. **Sec. 807(f)(1)(B) (p. 449)**. For purposes of enforcement action, the utility is considered subject to the FDI Act as if the utility were an insured depository institution. **Sec. 807(f)(2) (p. 449)**.

#### **G. Examination Of and Enforcement Actions Against Financial Institutions Subject to Standards for Designated Activities**

The appropriate financial regulator is authorized to examine a financial institution with

respect to a designated activity in order to determine: the nature and scope of the activities engaged in by the financial institution; the financial and operational risks of the institution's activities that may pose a risk to the soundness of the financial institution; the financial and operational risks engaged in by the institution that may pose a risk to other institutions, markets, or the broader financial system; the resources and capabilities of the institution to monitor and control risks; and the institution's compliance with this title and other rules and orders.

**Sec. 808(a) (p. 449).** An institution subject to these standards will be subject to the appropriate provisions of the FDI Act as if the institution was an insured depository institution. **Sec. 808(b) (p. 449-450).**

The Fed is required to consult with and provide technical assistance to the financial regulators to ensure the Fed's orders are applied in a consistent and uniform manner. **Sec. 808(c) (p. 450).** The regulator may also request the Fed to enforce rules or titles against a financial institution; the Fed will determine, upon request, whether an action is warranted and if so will enforce compliance. **Sec. 808(d) (p. 450).** The Act also provides back up authority to the Fed to conduct and examination and enforce the provisions of the this title against any institution; however, the title does set limits on the Fed's authority to do so, including that the Fed must have reasonable cause to believe an institution is not in compliance, has notified the financial regulator, requested the regulator to conduct and examination, and obtained the approval of the Council upon an affirmative vote of the majority of the Council. **Sec. 808(e) (pp. 450-452).** For purposes of enforcement, the institution is subject to relevant provisions of the FDI Act, as if it were an insured deposit institution. **Sec. 808(e)(3) (p. 452).**

## H. Requests for Information, Reports, or Records

The Council is authorized to require any Utility, or institution engaged in payment, clearing, or settlement activities, to submit information the Council may need for assessing whether the Utility or institution is systemically important, but only if the Council has reasonable cause to believe that the Utility meets the standards for systemic importance. **Sec. 809(a) (p. 452).** The Council and the Fed may each require a Utility to submit reports or data in frequency and form deemed necessary for the Council or Fed to assess the safety and soundness of the Utility and the systemic risk posed by the Utility's operations. **Sec. 809(b)(1) (p. 452).** The Council or Fed may also require an institution partaking in a designated activity to submit reports or data to the Fed and Council with respect to conduct of the designated activity to assess whether rules and standards under this title appropriately address risks to the financial system presented by the Activity and whether the financial institutions are in compliance with the rules and regulations prescribed under this title. **Sec. 809(b)(2) (pp. 452-453).** The Fed may, upon a majority vote of the Council, prescribe regulations that impose a recordkeeping or reporting requirement on designated clearing entities or institutions engaged in designated activities. **Sec. 809(b)(3) (p. 453).**

However, the Fed and Council must coordinate with other federal supervisory agencies. Before requesting any material information from, or imposing reporting or recordkeeping requirements on, any utility or institutions engaged in payment, clearing, or settlement activities, the Council and Fed must coordinate with the agency or appropriate regulator to determine if the information is available from or may be obtained by the agency; if so, the agency must provide the information within 15 days. **Sec. 809(c)(1) and (d) (p. 453).** A Supervisory Agency,

financial regulator, and the Fed may disclose to each other and the Council copies of its examination report regarding any Utility or institution engaged in designated activities.

**Sec. 809(c)(2) (p. 453).** The Act further permits Supervisory Agencies, federal regulators, and the Fed to notify each other of material concerns about a utility or financial institution, and to share appropriate reports, information, or data relating to such concerns. **Sec. 809(e) (pp. 453-454).**

#### **I. Rulemaking**

The Act gives the Fed, Supervisory Agencies, and the Council authority to prescribe rules and issue orders necessary to administer and carry out the authority granted to them under this Act. **Sec. 810 (p. 454).**

#### **J. Other Authority**

The Act does not divest the regulator, Supervisory Agency, or any other federal or state agency of any authority derived from any other law, except that the standards prescribed by the Fed in Section 805 will supersede any less stringent requirements. **Sec. 811 (p. 454).**

#### **K. Consultation**

The CFTC is required to consult with the Fed prior to exercising certain authorities with respect to any rule of a derivatives clearing organization for which a state of certification has been issued and prior to exercising rulemaking authority under the Wall Street Transparency and Accountability Act of 2010. **Sec. 812(a) (p. 454).** The SEC is required to consult with the Fed prior to exercising certain authorities with respect to any proposed rule change of a clearing agency which has already been granted an extension of time for review, and prior to exercising its rulemaking authority under certain sections of the Exchange Act. **Sec. 812(b) (p. 455).**

#### **L. Common Framework for Designated Clearing Entity Risk Management**

The CFTC and the SEC are required to coordinate with the Fed to jointly develop risk management supervision programs for designating clearing entities. No later than one year after the enactment of this act, the CFTC, the SEC, and the Fed must submit a joint report to the Committee on Banking, Housing, and Urban Affairs, and the Committee on Agriculture, Nutrition, and Forestry of the Senate, and the Committee on Financial Services and the Committee on Agriculture of the House of Representatives. The report must include recommendations for improving consistency for designated clearing entity oversight programs, promoting robust risk management by designated clearing entities, promoting robust risk management oversight by regulators, and improving regulators' ability to monitor the potential effects of a clearing entity's risk management on the U.S. financial system. **Sec. 813 (p. 455).**

#### **M. Effective Date**

This title is effective upon the date of enactment of this Act. **Sec. 814 (p. 455).**