

Supervision of Payment, Clearing and Settlement

The Dodd-Frank Act provides for the supervision of systemically important financial market utilities and payment, clearing and settlement activities conducted by financial institutions. The Board of Governors is given a greater role in supervision of risk management standards for these financial market utilities and has been authorized to promote uniform standards to effect this supervision.

The Act defines a “financial market utility” as “a person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person.”¹ This definition excludes several types of entities. A “payment, clearing or settlement activity” is defined as “any activity carried out by one or more financial institutions to facilitate completion of financial transactions.”²

Designation of Systemic Importance

By vote of no fewer than two-thirds of its members (including an affirmative vote by the Chairperson), the Financial Stability Oversight Council (“Council”) must determine that a financial market utility or payment, clearing or settlement activity is, or is likely to become, systemically important. This determination will take into consideration a number of guidelines provided in the Act, such as:

- aggregate monetary value of transactions processed or carried out;
- aggregate exposure to counterparties;
- relationships, interdependencies or other interactions with other financial market utilities or payment, clearance or settlement activities; and
- effect failure or disruption of the utility or activity would have on critical markets, financial institutions, or the broader financial system.³

In addition to the authority to designate a financial market utility or payment, clearing or settlement activity as systemically important, the Council may also rescind such a designation by a vote of no fewer than two-thirds of its members (including an affirmative vote by the Chairperson). Once the designation of systemic importance is rescinded, the utility or institution conducting the activity is no longer subject to Title VIII of the Act.⁴ A financial market utility that has been determined to be systemically important has been defined in the Act as a “designated financial market utility.”⁵ **See “Key Measures to Address Systemic Risk.”**

The Council is required to consult with the relevant federal agency with primary jurisdiction over the designated financial market utility (the “Supervisory Agency”) and with the Board of Governors prior to either making a determination of systemic importance or rescinding such determination.^{6,7} The financial market utility or financial institution conducting the activity shall be provided with advance notice by the

¹ Act § 803(6).

² Act § 803(7).

³ Act § 804(a)(2).

⁴ Act § 804(b).

⁵ Act § 803(4).

⁶ Act § 803(a)(8).

⁷ Act § 804(c).

Council, published in the Federal Register, and shall be given the opportunity to refute the designation of systemic importance or the rescission of that designation.⁸ These requirements may be waived or modified by the Council if it determines that the waiver or modification is necessary to either prevent or mitigate an immediate threat to the financial system. Notice of the waiver or modification, if effected, and of final determination on designation must be provided by the Council. This notice or final determination will be published in the Federal Register.⁹

Board of Governors Prescription of Risk Management Standards

The Act provides that the Federal Reserve shall prescribe risk management standards in consultation with the Council and the Supervisory Agencies. In prescribing these standards, the Federal Reserve will take into consideration international standards and existing prudential requirements.¹⁰ These risk management standards are to:

- promote robust risk management;
- promote safety and soundness;
- reduce systemic risks; and
- support stability of the broader financial system.¹¹

The standards may address a variety of areas, including:

- risk management policies and procedures;
- margin and collateral requirements;
- participant or counterparty default policies and procedures;
- ability to complete timely clearing and settlement of financial transactions;
- capital and financial resource requirements for designated financial market utilities; and
- other areas that are necessary to achieve the objectives listed above.¹²

The Act provides for the CFTC and the SEC to prescribe regulations, in consultation with the Council and the Board of Governors, that contain risk management standards for those designated clearing entities and financial institutions engaged in designated activities for which each of the CFTC and the SEC is the Supervisory Agency or appropriate financial regulator. These standards may govern the operations related to payment, clearing, and settlement activities of designated clearing entities and conduct of designated activities by such financial institutions.¹³ The Board of Governors is given the authority to determine that the existing prudential requirements of the CFTC and the SEC are insuffi-

⁸ *Id.*

⁹ Act § 804(d).

¹⁰ Act § 805(a).

¹¹ Act § 805(b).

¹² Act § 805(c).

¹³ Act § 805(a)(2)(A).

cient to prevent or mitigate risks to the financial stability of the United States.¹⁴ The CFTC and the SEC are provided the opportunity to object to the Board of Governor’s determination or to submit an explanation to the Board of Governors and the Council describing remediating actions.¹⁵ The Council shall require the CFTC or the SEC to prescribe risk management standards as the Council may determine are necessary in order to address requirements that are determined to be insufficient. The Act does not permit the Council or the Board to take any action or exercise any authority granted to the CFTC or the SEC under section 3C(a) of the Securities Exchange Act of 1934.

Designated Financial Market Utilities – Payment System Access and Examination

The Act provides authority for the Board of Governors to establish and maintain an account for a designated financial market utility and also to provide the services listed in section 11A(b) of the Federal Reserve Act and to provide deposit accounts in “unusual or exigent circumstances.” The Board also may authorize a Federal Reserve bank to provide discount and borrowing privileges to designated financial market utilities in unusual or exigent circumstances. Extension of these privileges requires the affirmative vote of a majority of the Board of Governors.¹⁶ These privileges are available to all designated financial market utilities, not just those that are banks or bank holding companies.¹⁷

Designated financial market utilities are subject to annual examination by the Supervisory Agency. The Supervisory Agency shall consult with the Board of Governors.

¹⁴Act § 805(a)(2)(B).

¹⁵Act § 805(a)(2)(D).

¹⁶Act § 806(a).

¹⁷Act § 806(b).