

# COMMITTEE ON CAPITAL MARKETS REGULATION

May 13, 2011

Lance Auer  
Financial Stability Oversight Council  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

Re: Authority to Designate Financial Market Utilities as Systemically Important, 76 Fed. Reg. 17,047 (RIN 4030-AA01)

Dear Mr. Auer:

The Committee on Capital Markets Regulation (Committee) appreciates the opportunity to comment on the Financial Stability Oversight Council's (Council) Proposed Rules<sup>1</sup> regarding its authority to designate a financial market utility as systemically important under § 804 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).<sup>2</sup>

Since 2005, the Committee has been dedicated to improving the regulation of U.S. capital markets. Our research has provided an independent and empirical foundation for public policy. In May 2009, the Committee released a comprehensive report entitled *The Global Financial Crisis: A Plan for Regulatory Reform*, which contains 57 recommendations for making the U.S. financial regulatory structure more integrated, more effective, and more protective of investors in the wake of the financial crisis of 2008.<sup>3</sup> Since then, the Committee has continued to make recommendations for regulatory reform of major areas of the U.S. financial system.

Our comments focus on the regulation of clearinghouses for systemic risk. Specifically, we think the failure of a large clearinghouse would pose a systemic risk, and that the Commodity Futures Trading Commission (CFTC) and Securities and Exchange Commission (SEC) should implement their rules for clearinghouses only after the Federal Reserve (Fed) has exercised its authority to review those rules.

The Dodd-Frank Act instructs the Council to “designate those financial market utilities...that [it] determines are, or are likely to become, systemically important.”<sup>4</sup> Derivatives clearing organizations and clearing agencies registered with the CFTC and SEC, respectively, are included in this definition and are eligible to be designated as systemically important.<sup>5</sup>

<sup>1</sup> Authority to Designate Financial Market Utilities as Systemically Important, 76 Fed. Reg. 17,047 (proposed Mar. 28, 2011).

<sup>2</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act (hereinafter Dodd-Frank Act), Pub. L. No. 111-203, 124 Stat. 1376, § 804.

<sup>3</sup> COMM. ON CAPITAL MKTS. REG., *THE GLOBAL FINANCIAL CRISIS: A PLAN FOR REGULATORY REFORM* (May 2009), <http://www.capmksreg.org/research.html>.

<sup>4</sup> Dodd-Frank Act § 804(a)(1).

<sup>5</sup> *See id.* § 803(3).

Although centralized clearing reduces systemic risk, the failure of a clearinghouse could itself contribute significantly to systemic risk because it serves as a counterparty in each cleared transaction. The Committee documented these effects in a March 2010 letter it sent to several members of Congress.<sup>6</sup> For this reason, the Council should cast a wide net in designating clearinghouses as systemically important.

Designating clearinghouses as systemically important gives the Fed a major role to play in their regulation. First, the CFTC and SEC must consult with the Council and the Fed when adopting risk management standards for clearinghouses that have been designated by the Council.<sup>7</sup> In addition, the Fed may object to the “existing prudential requirements” of the CFTC or SEC. In that case, the CFTC or SEC has 60 days to respond to the Fed’s objection, after which time the Council may resolve the conflict by voting to require those agencies to adopt regulations it determines are necessary.<sup>8</sup> This significant role for the Fed is wise because of its significant experience and expertise as a risk regulator. Indeed, the Committee has taken the view that the Fed should have the last word on regulating clearing entities for systemic risk.<sup>9</sup>

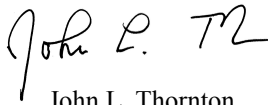
In light of this major role for the Fed, it would be prudent for the Council to make its designations under § 804 and for the Fed to review the proposed or final rules of the SEC and CFTC regarding clearinghouses before those rules take effect. The Council could advise the Commissions to implement their final rules only after such a review has taken place. This review process, including the Fed’s input, should happen promptly, however, in order to avoid unnecessary delay in implementation. This will permit the regulators to begin work now to implement central clearing for the most standard and liquid contracts.

Thank you for considering our comments. Please do not hesitate to contact us at (617) 384-5364 if we can be of any further assistance.

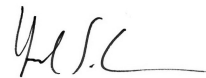
Respectfully submitted,



R. Glenn Hubbard  
Co-CHAIR



John L. Thornton  
Co-CHAIR



Hal S. Scott  
DIRECTOR

<sup>6</sup> Letter from the Comm. on Capital Mkts. Reg. to Christopher Dodd, Chairman, Richard Shelby, Ranking Member, S. Comm. on Banking, Hous. & Urban Affairs and Barney Frank, Chairman, Spencer Bachus, Ranking Member, H. Fin. Servs. Comm. (Mar. 4, 2010), [http://www.capmksreg.org/pdfs/10-Mar-4\\_Committee\\_Derivatives\\_Letter.pdf](http://www.capmksreg.org/pdfs/10-Mar-4_Committee_Derivatives_Letter.pdf).

<sup>7</sup> Dodd-Frank Act, § 805(a)(2)(A).

<sup>8</sup> *See id.* §§ 805(a)(2)(B)–(E).

<sup>9</sup> *See* Letter from the Comm. on Capital Mkts. Reg. to Christopher Dodd, Chairman, Richard Shelby, Ranking Member, S. Comm. On Banking, Hous. & Urban Affairs and Blanche Lincoln, Chairman, Saxby Chambliss, Ranking Member, S. Comm. on Agric., Nutrition & Forestry 4 (Apr. 26, 2010); *see also* Letter from the Comm. on Capital Mkts. Reg. to Gary Gensler, Chairman, Commodity Futures Trading Comm’n (Aug. 25, 2010), [http://www.capmksreg.org/pdfs/2010.09.15\\_Gensler\\_Letter\\_Release.pdf](http://www.capmksreg.org/pdfs/2010.09.15_Gensler_Letter_Release.pdf).