

## [Banking and Finance Law Daily Wrap Up, FINANCIAL STABILITY—Federal Reserve Board proposes rating system for financial market infrastructures, \(Nov. 12, 2015\)](#)

Banking and Finance Law Daily Wrap Up

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The Federal Reserve Board has described a supervisory rating system that it plans to use for financial market infrastructures (FMIs) that it supervises either under the Dodd-Frank Act or the Fed's other supervisory authority. [The rating system](#), to be called ORSOM—for Organization; Risk Management; Settlement; Operational Risk and Information Technology; and Market Support, Access, and Transparency—would function similarly to the CAMELS rating system now used for banking organizations, with a rating of 1 to 5 being assigned for each component and the component ratings then being used to determine an overall composite rating.

According to the Fed, FMIs are multilateral systems that are used to “transfer, clear, settle, or record payments, securities, derivatives, or other financial transactions.” They include payment systems, central securities depositories, securities settlement systems, central counterparties, and trade repositories. FMIs supervised by the Fed under the Dodd-Frank Act are subject to Reg. HH—Designated Financial Market Utilities (12 CFR 234). Other FMIs are operated by state member banks, Edge or agreement corporations, bank holding companies, or Federal Reserve Banks, and these must comply with the Fed's Policy Statement on Payment System Risk (PSR). The Fed proposes that all would be rated under ORSOM.

**Organization.** The organization component has two sub-components: Board and Management Oversight, and Internal Audit. Together, they are intended to address the FMI's objectives and the ability of the FMI's board and management to achieve those objectives. The independence and effectiveness of the company's internal audit function would be a part of that analysis.

**Risk Management.** The consideration of an FMI's risk management would include an analysis of the financial resources available to it to manage losses and liquidity pressures, its ability to meet its obligations should a participant in the system default, its ability to recover or wind down its operations in an orderly manner, and its capital plan. The FMI's management of risks posed by its participants' customers and other FMIs also would be relevant.

**Settlement.** Settlement risk—the risk that settlement will not occur as expected—is a key risk faced by FMIs and their participants, the Fed points out. The Settlement component would look at the tools an FMI uses to ensure settlement takes place and the procedures to be followed if there is a default. The component would consider the FMI's ability to protect the rights of securities issuers and holders and to protect securities issuers that are in its custody. Participant default rules and procedures would be examined as well.

**Operational Risk.** The Operational Risk and Information Technology component would analyze an FMI's systems, procedures, infrastructure, and information security to measure the FMI's operational reliability and ability to support the ongoing functioning of the markets.

**Market Support, Access, and Transparency.** Access to a market may require access to an FMI's services, the Fed says. Also, information about an FMI can give the public and the FMI's participants more confidence in its strength and stability. This component would look at an FMI's participation requirements, monitoring of members, operational efficiency, and rules and procedures disclosures.

**Numerical ratings.** An FMI would receive a rating of 1 to 5 for each component:

- 1—Strong;

- 2—Satisfactory;
- 3—Fair;
- 4—Marginal;
- 5—Unsatisfactory.

The component ratings would be combined into a composite rating, which also would be a rating of 1 through 5. The Fed notes, however, that this would not be done in a formulaic manner, i.e., not by striking an arithmetical average.

Comments on the proposed rating system are due by Jan. 22, 2016.

RegulatoryActivity: DoddFrankAct FinancialStability SecuritiesDerivatives