CME Group

ICE

May 21, 2018

VIA ELECTRONIC SUBMISSION

Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency
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Board of Governors of the Federal Reserve System
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Re: Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for U.S. Global Systemically Important Bank Holding Companies and their Subsidiary Insured Depository Institutions

Dear Sir/Madam:

CME Group Inc. ("CME Group")[1] is the parent of the Chicago Mercantile Exchange Inc. ("CME"). CME is registered with the Commodity Futures Trading Commission ("CFTC") as a derivatives clearing organization ("DCO") and is one of the largest central counterparty ("CCP") clearing services in the world. CME's clearing house division ("CME Clearing") offers clearing and settlement services for exchange-traded futures and options on futures contracts, as well as over-the-counter ("OTC") derivatives transactions, including interest rate swaps ("IRS"). On July 18, 2012, the Financial Stability Oversight Council designated CME as a systemically important financial market utility ("designated FMU") under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

Intercontinental Exchange, Inc. ("ICE") owns and operates seven clearing houses that serve global markets across North America, Europe and Asia. ICE has a successful history of clearing exchange traded and OTC derivatives across a spectrum of asset classes including energy, agriculture and financial products. ICE Clear Credit, a CDS clearing house, is designated as a FMU under Title VIII of the Dodd-Frank Act.

[1] CME Group is the parent company for four designated contract markets: the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX"), the Commodity Exchange, Inc. ("COMEX") and the Chicago Mercantile Exchange Inc. ("CME"). CME is also registered as a derivatives clearing organization under the Commodity Exchange Act ("CEA"). CME is also designated as a systemically important financial market utility under Title VIII of the Dodd-Frank Act.

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CME and ICE appreciate the opportunity to comment on the Board of Governors of the Federal Reserve System ("Board") and the Office of Comptroller of the Currency ("OCC") joint proposed rulemaking ("the proposed rules") that would modify the enhanced supplementary leverage ratio ("eSLR") standards for U.S. bank holding companies which are treated as global systemically important banks ("G-SIBs"). CME and ICE closely follow regulatory reforms that have the potential to impact the centrally cleared ecosystem and incentives to clear more generally. CME and ICE support the goals of the eSLR framework to restrict the build-up of leverage in the banking sector while ensuring the largest and most interconnected banking organizations have adequate capital to maintain financial stability throughout the economic cycle.

It is our understanding that the recalibration of the eSLR leverage buffer to 50 percent of a firm's G-SIB capital surcharge intends to address the systemic risk created where the eSLR serves as a binding constraint and creates incentives for banks to reduce their participation in lower risk, lower return business activities and instead allocate capital to higher risk business activities. We believe the proposed rules are a step in the right direction of reducing systemic risk by reducing the disincentives for central clearing, and other similarly low risk activities. We note that the G-SIB surcharge methodology that is proposed does in fact account for some of the differences in market structure between cleared and uncleared markets, and provides some central clearing incentives. However, the proposed rules do not address the fundamental problem with the eSLR in relation to centrally cleared derivatives markets, the decision to ignore centrally cleared derivatives market structure by failing to provide offsets for segregated, client initial margin.

CME and ICE support the concept of leverage capital limits which are appropriately tailored to foster financial stability. Leverage ratio exposures must accurately reflect the true economic risk. In the case of centrally cleared derivatives, the Futures Commission Merchant (FCM) clearing model in the U.S. must be understood and accounted for in eSLR design. FCMs act as agents for their clients, guaranteeing the performance of the clients to the CCP, assuming any payment obligation that would arise should a client default. To mitigate the risk associated with potential future exposures of these client cleared derivative transactions, initial margin is pledged by the client to the FCM clearing member and then placed in a segregated account whereby client money is held separate from the FCM's own money. The vast majority of this customer initial margin is then passed on to the CCP or clearinghouse where it remains outside ownership and becomes outside the control of the FCM clearing member. By law and regulation, these initial margin resources may only be used to offset the client exposure guaranteed by the FCM. Failing to provide recognition of this segregated client initial margin against client exposures therefore increases rather than decreases systemic risk by incentivizing banks away from lower risk businesses such as client central clearing and into other higher risk businesses.

Below are additional remarks to the specific question as laid out in the Board and OCC proposal.

> **Question 3. What, if any, beneficial or negative consequences for market participants, consumers, and financial stability are likely to result from the proposed calibration? Please provide examples and data where feasible.**

The reduced ability for G-SIB and bank affiliated CCP clearing members to provide client clearing services due to the current eSLR calibration has been widely publicized within the derivatives industry. Many FCMs have left the business over the past few years and a smaller FCM clearing member community adversely impacts the financial markets by concentrating risk while reducing the availability of clearing services to end-users. End-users depend on clearing services to mitigate their business risks and a lack of access to these services results in the increased cost of goods for consumers. The proposed recalibration of the leverage buffer to a floating, risk-based backstop requirement has the potential to create incentives for firms to provide client clearing services depending on how the banks chose to reallocate the capital relieved under the proposed rulemaking. However, a greater incentive would be achieved by providing offsets for segregated client initial margin which would directly incentivize client clearing services which are essential to financial stability and the wider economy, as evidenced during the financial crisis. Client clearing allows a wider group of market participants to hedge their business risk while increasing overall financial stability by applying risk mitigation benefits of central clearing to a larger portion of the financial system.

Unfortunately, if the proposal is adopted in its current form the goal of the Group of 20 nations ("G-20") to incentivize central clearing will not be fully realized because the availability of client clearing will be reduced. This is due to the fact that the proposed rules do not consider the market structure of central clearing, specifically the nature of appropriately segregated customer initial margin as an offset against client derivative exposures. Under the U.S. regulatory framework, FCM clearing members are required to segregate the positions and collateral of their customers from that of their own proprietary positions and collateral.[2] The sole purpose of client collateral is to offset the potential future exposures arising from a given customer's derivatives positions at a CCP, with the vast majority of client collateral required to be passed through from the clearing member to the CCP. To date, these protections have been recognized by policymakers in Europe but ignored by banking regulators elsewhere.

The continued failure of the eSLR standards to recognize the role and use of segregated customer initial margin for centrally cleared derivatives may also increase systemic risk by lowering the probability of successful porting of solvent customers of a defaulting clearing member of a CCP. For background, in the event of a clearing member default, in order to maintain market stability and preserve risk management capabilities for clients by minimizing portfolio liquidation, a CCP will often look to port the solvent customers of the defaulting clearing member. The consequences of the SLR and eSLR are such that during a period of financial stress in which clients may need to be ported to solvent clearing members, a bank-affiliated clearing member cannot consider the fully segregated customer initial margin they would receive by taking on these solvent customers as a means to offset the increased capital required to meet the increased SLR and eSLR requirement. The lack of recognition for segregated customer initial margin offsets under the current standards increases liquidation risk for customer portfolios in the event of a clearing member default because of the risk non-defaulting clearing members will be unable to accept ported customers. In addition, the resulting need to liquidate client positions may cause significant price deterioration in markets as these bank-affiliated clearing members will likely also decline to bid on the portfolio being liquidated, for fear of the punitive capital requirements under the SLR and eSLR. The increased likelihood of forced liquidation during a market stress event can elevate overall systemic risk and exacerbate volatility in an already-stressed market. We note that these problems could be avoided by simply applying the initial margin offset treatment for centrally cleared client derivative exposures.

CME and ICE have long advocated for bank capital reform to recognize central clearing market structures, which provide offsets for client initial margin against cleared derivative exposures. CME and ICE are not alone in its support for the calibration of the SLR to account for the central clearing market structure, this point of view has been widely supported by the financial industry and policymakers in

[2] See 17 C.F.R. §§ 1.20-1.30; 17 C.F.R. §§ 22.2-22.7

both the U.S. and Europe. By way of example, the U.S. Department of Treasury report published in October 2017 specifically calls out the punitive capital treatment the SLR has imposed on FCMs, citing "...higher capital costs, in turn, discourage FCMs from clearing derivatives transactions for clients."[3] This punitive capital treatment goes against the goals laid out by the G-20 to increase the use of central clearing as a means to provide risk mitigation. The U.S. Department of Treasury understands the role initial margin plays in central clearing and "calls for the deduction of initial margin for centrally cleared derivatives from the SLR denominator."[3] Further to this point, the remarks of CFTC Chairman Giancarlo have expressed a similar concern, stating the application of "...the SLR to clearing customer margin reflects a flawed understanding of central counterparty (CCP) clearing."[4]

Furthermore, the House Financial Services Committee passed H.R. 4659 with bipartisan support on March 21, 2018, specifically recognizing this important industry concern.[5] The bill was introduced by Subcommittee Chairman Blaine Luetkemeyer in an effort to increase access to central clearing for market participants who utilize derivatives for hedging business risk. The bill aims to correct the unintended harm it has caused to the cleared derivatives market, bank affiliated clearing members, end-user clients, and ultimately the wider economy. If the bill is enacted it will ensure the U.S. bank-affiliated clearing members are not structurally disadvantaged relative to their foreign counterparts.

If the proposal is adopted in its current form, the ability of U.S. banks to compete with their European counterparts will be degraded. The European Union is in its final stages of adopting legislation that would amend the leverage ratio in the capital requirements regulation ("CRR") to allow for the offset of client initial margin to reduce the exposure measure for derivatives cleared through qualifying CCPs ("QCCPs").[6] While the U.S. legislators have taken strides to amend bank capital regulation to appropriately treat client clearing, more must be done to ensure U.S. banks and financial markets have the ability to compete with offshore market participants.

> **Question 4. What, if any, alternative methods would be more appropriate to determine the level of firm-specific eSLR standards? For example, what other approaches using publicly reported data, such as the systemic risk data collected on the FR Y-15, would be appropriate? Please provide example and data where feasible.**

CME and ICE believe it is important to understand that the impact of bank capital standards extend beyond that of the banking industry, and have widespread effects in the markets which rely on bank-affiliated market participants and agency services such as client central clearing. As mentioned in our response to Question 3, the eSLR's failure to recognize central clearing market structure imposes punitive capital constraints on bank-affiliated clearing members, many of which are G-SIBs, which results

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[3] U.S. Treasury Report, A Financial System that Creates Economic Opportunities: Capital Markets page 136, 138

[4] U.S. CFTC Remarks of Acting Chairman J. Christopher Giancarlo before ISDA 32nd Annual Meeting, May 10th 2017, https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-22

[5] https://financialservices.house.gov/uploadedfiles/bills-115hr4659ih.pdf

[6] Regulation of the European Parliament and the Council amending Regulation (EU) No 575/2013 (the Capital Requirements Regulation or CRR), available at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2016:0850:FIN

in reduced access to centrally cleared markets for end-users. The quantification of systemic risk in the FR Y-15 as defined by the indicators of the G-SIB surcharge must be representative of the actual risks bank-affiliated clearing members pose to centrally cleared markets.

In reviewing the five different indicators of the G-SIB surcharge assessment methodology, it is our understanding that cleared and non-centrally cleared derivative transactions are given separate treatment. This distinction infers that the quantification of systemic risk in separate indicators appropriately accommodates for the differences between cleared and non-cleared derivative products, and the market structures which support them. It is our understanding that the size indicator incorporates centrally cleared derivative transactions. Conversely, non-centrally cleared OTC derivative transactions are also included in both the complexity and interconnectedness indicators of the G-SIB surcharge assessment. CME and ICE appreciates this distinction between centrally cleared and non-centrally cleared derivatives in the indicators which provides for an inherent differentiation in central clearing due to the risk mitigation techniques it employs.

Conclusion

CME and ICE support capital reform that restricts build-up of leverage in the system and appropriately backstops risk-based requirements. While the eSLR recalibration to a risk-based measurement is a move in the right direction due to its incorporation of the G-SIB criteria, it fails to consider the centrally cleared derivative market structure and the exposure reducing nature of appropriately segregated client initial margin. It is crucial that leverage ratio exposures for banks which provide client clearing services reflect the true economic exposure they pose to the financial system. Therefore, CME and ICE encourage the Board and OCC to consider capital reform that more appropriately reflects the structure and financial stability benefits of centrally cleared markets.

CME and ICE would be happy to further discuss and clarify any of the above issues with the Board and OCC. If you have any comments or questions regarding this submission, please feel free to contact Sunil Cutinho, President, CME Clearing at +1 312 634-1592 Sunil.Cutinho@cmegroup.com, or Scott Hill, Chief Financial Officer, Intercontinental Exchange Inc. at scott.hill@theice.com.

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