CME Group

June 13th, 2014

VIA ELECTRONIC MAIL

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW., Suite 3E–218
Mail Stop 9W–11
Washington DC 20219
[Docket ID OCC-2014-0008] [RIN 1557-AD81]

Robert de V. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551
[Regulation Q; Docket No. R-1487] [RIN 7100-AD AD16]

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW.
Washington, DC 20429
[RIN 3064-AE12]

Re: Regulatory Capital Rules: Regulatory Capital, Proposed Revisions to the Supplementary Leverage Ratio

CME Group Inc. ("CME Group")[1] appreciates the opportunity to comment on the rules proposed by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Board"), and the Federal Deposit Insurance Corporation ("FDIC"), together the "Agencies", in regard to the proposed revisions to the supplementary leverage ratio (the "Proposed Rules").

CME Group participated in the comment period process during the Basel Committee on Banking Supervision's ("BCBS") June 2013 consultative document on the revised leverage ratio standard[2], and we

[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") and is deemed registered as a clearing agency under the Securities Exchange Act of 1934 ("Exchange Act") with respect to swaps classified as "security-based swaps", as that term is defined in the CEA and the Exchange Act. CME is also designated as a systemically important financial market utility under Title VII of the Dodd-Frank Act. ("COMEX") and the Chicago Mercantile Exchange Inc. ("CME"). CME is also registered as a derivatives clearing organization under the Commodity Exchange Act ("CEA") and is deemed registered as a clearing agency under the Securities Exchange Act of 1934 ("Exchange Act") with respect to swaps classified as "security-based swaps", as that term is defined in the CEA and the Exchange Act. CME is also designated as a systemically important financial market utility under Title VII of the Dodd-Frank Act.

[2] Basel Committee on Banking Supervision: Revised Basel III leverage ratio framework and disclosure requirements - consultative document; http://www.bis.org/publ/bcbs251.htm

were pleased that many of the outcomes in the final BCBS leverage ratio standard[3] better reflected the operational realities of central clearing. CME Group appreciates that the Proposed Rules are largely in line with the final BCBS standard, and thus have focused on three suggested areas for improvement:

(I) We ask the Agencies to follow the November 2013 Bank of England statement[4] and specifically confirm that Client Initial Margin posted in Cash be considered a fiduciary asset and allowed to be included in the line item "Adjustment for fiduciary assets recognized on balance sheet but excluded from total leverage exposure";

(II) We ask the Agencies to explicitly address how bank entity affiliate derivatives will be captured under the final standard in order to ensure against double-counting of exposures at the consolidated banking group level; and

(III) When calculating the "Add-on amounts for potential future exposure (PFE) for derivatives exposures", we ask the Agencies to adopt the BCBS Standardized Approach for measuring Counterparty Credit Risk exposures[5] ("SA-CCR").

I. Client Initial Margin posted in Cash should be considered a fiduciary asset excluded from total leverage exposure

US Generally Accepted Accounting Principles ("GAAP") and the International Financial Reporting Standards ("IFRS") require firms to include client cash posted for initial margin purposes to be held on balance sheet and contribute to a firms' total assets. Under the US Commodity Futures Trading Commission ("CFTC") Regulation 39.15(b)[6], client funds must be held in segregated accounts from the firm's own funds:

> §39.15 Treatment of funds.
>
> (b) Segregation of funds and assets—(1) Segregation. A derivatives clearing organization shall comply with the applicable segregation requirements of section 4d of the Act and Commission regulations thereunder, or any other applicable Commission regulation or order requiring that customer funds and assets be segregated, set aside, or held in a separate account.

[3] Basel Committee on Banking Supervision: Basel III leverage ratio framework and disclosure requirements; http://www.bis.org/publ/bcbs270.htm

[4] Bank of England Prudential Regulation Authority Supervisory Statement | SS3-13 Capital and leverage ratios for majorUK banks and building societies; http://www.bankofengland.co.uk/pra/Documents/publications/policy/2013/capitalleveragess3-13.pdf

[5] Basel Committee on Banking Supervision: The standardised approach for measuring counterparty credit risk exposures; http://www.bis.org/publ/bcbs279.htm

[6] CFTC Title 17: Commodity and Securities Exchanges; Part 39- Derivatives Clearing Organizations; http://www.ecfr.gov/cgi-bin/text-idx?SID=81b62b4491936e7c007b7ec892a5eecf&node=17:1.0.1.1.32&rgn=div5

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CFTC requirements result in an environment where a client's cash initial margin is segregated from the firm's own funds, but cannot be considered a fiduciary asset due to GAAP and IFRS rules. Because these cash funds cannot be used in any other fashion by the firm, including providing leverage for other business purposes, these client cash funds should be excluded from the total leverage exposure under the final US supplementary leverage ratio standard.

The Bank of England recognized that regulatory impediment in November 2013 when they issued the following statement, and we ask the Agencies also specifically address this issue in their final standard:

> "In relation to derivative trades undertaken by the firm to facilitate customer central clearing through qualifying central counterparties (QCCPs), the CRR exposure measure may be adjusted in the following ways:
>
> a. initial margin received in cash from the client, provided it is segregated from the firm's own cash, does not have to be recognised;"

II. Bank entity affiliate derivative exposures should be explicitly addressed to ensure they are not double-counted under the total leverage exposure calculation

In the US, when the affiliate of a banking entity that is a direct member of a clearinghouse enters into a derivative contract that is to be centrally cleared, that derivative contract is cleared in the house account of the banking entity that is a direct member. This relationship is dictated by CFTC regulation. In the European Union, the rules are slightly different and these affiliates can be cleared in a customer account. No matter the account where the affiliate derivatives are cleared, house or customer, CME Group believes the Agencies should explicitly confirm that this derivative exposure of the banking entities' affiliate should only be counted once in that bank entities supplementary leverage ratio.

CME Group is concerned that under the proposed rules, double-counting could occur if the affiliate leg of the derivative exposure is counted at the affiliate level, and then once again at the consolidated banking group level. CME Group believes the single counting of this leg is consistent with the BCBS text regarding Credit Valuation Adjustment ("CVA") risk capital charges on intercompany transactions, included in the BCBS's December 2012 frequently asked questions document[7]:

> "2e. Other CVA risk capital charge questions
>
> 2e.1 Is an intercompany transaction with a zero risk weight subject to a CVA charge?
>
> As per the group consolidated reporting, no regulatory capital charge (including a CVA charge) applies to intercompany transactions. This should include the relevant CVA hedge that is only with an internal desk; internal hedges are not recognised for regulatory capital purposes because they are eliminated in consolidation.

[7] Basel Committee on Banking Supervision: Basel III counterparty credit risk and exposures to central counterparties - Frequently asked questions (December 2012); http://www.bis.org/publ/bcbs237.htm

> 2e.2 Industry members would like confirmation on a technical note that, as with the downgrade-and-default charge within the Basel II framework, the CVA variability charge associated with affiliate exposures will net out under group consolidated reporting.
>
> See answer to Question 2e.1 above."

This text leads to the logical conclusion that the net, rather than gross, exposure of the banking entity should be included for their supplementary leverage ratio purposes. CME Group believes this treatment warrants explicit definition by the Agencies in the final supplementary leverage ratio rule.

III. "Add-on amounts or potential future exposure (PFE) for derivatives exposures" should be quantified under the BCBS SA-CCR approach, not the Current Exposure Method ("CEM")

The proposed rules from the Agencies call for the potential future exposure ("PFE") of each derivative contract to which the national bank or Federal savings association is a counterparty be sized using a version of the Current Exposure Method ("CEM") approach as defined in the Agencies' Regulatory Capital Rules published in the Federal Register in October 2013[8]. The CEM approach given by the Agencies has its roots in the original Basel Accord of July 1988[9], and is acknowledged by the Basel Committee itself as a poor approach to sizing derivatives transactions[10]:

> "In formulating the SA-CCR, the Basel Committee's main objectives were to devise an approach that is suitable to be applied to a wide variety of derivatives transactions (margined and unmargined, as well as bilateral and cleared); is capable of being implemented simply and easily; addresses known deficiencies of the CEM and the SM; draws on prudential approaches already available in the Basel framework; minimises discretion used by national authorities and banks; and improves the risk sensitivity of the capital framework without creating undue complexity.
>
> The CEM had been criticised for several limitations, in particular that it did not differentiate between margined and unmargined transactions, that the supervisory add-on factor did not sufficiently capture the level of volatilities as observed over recent stress periods, and the recognition of netting benefits was too simplistic and not reflective of economically meaningful relationships between derivatives positions."

Furthermore, the Basel committee acknowledged in their final leverage ratio standard[11] that they are "considering alternatives to the CEM" to calculate derivatives exposures under the leverage ratio standard. CME Group asks that the Agencies and the Basel Committee work together to make a final determination on this important piece of the supplementary leverage ratio standard before any

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[8] Federal Reserve System, Regulatory Capital Rules; http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf

[9] Basel Committee on Banking Supervision: http://www.bis.org/publ/bcbsc111.htm

[10] BCBS 279; page 1

[11] BCBS 270; page 3, footnote 5

regulation is finalized. Appendix I provides an example for the Agencies' review of just one of the deficiencies of the CEM approach versus the more precise SA-CCR approach.

An additional comment specific to the SA-CCR approach and related to our point (II) raised previously; CME Group asks that if the Agencies adopt the SA-CCR approach for sizing derivatives under the supplementary leverage ratio, that they clearly articulate the margin period of risk ("MPOR") a bank should use under the SA-CCR when sizing a bank affiliate entity's derivatives. The reason for this clarification is that under the Basel SA-CCR approach, and under the Basel "Capital Requirement for bank exposures to central counterparties"[12], there is concern in the industry that the US and EU interpretations of these rules could lead to regulatory arbitrage. For background, MPOR, is a key component in determining the amount of margin a counterparty is required to post in order to trade any derivative. Under Basel's final rules, BCBS 279 and 282, there is little clarity around which MPOR a bank affiliate entity should use when calculating their exposures under the SA-CCR approach, and historically the rules for affiliate clearing have been different between the US and EU. For these reasons, CME Group asks the Agencies to include this level of detail in their final supplementary leverage ratio standard if they choose to employ the SA-CCR approach.

To conclude and summarize the current situation, the Agencies under the proposed rules are suggesting that all derivatives exposures be sized under the CEM method, a framework originally developed in 1988 with known deficiencies that are acknowledged by the 27 members of the Basel Committee. This is a poor outcome that can be easily corrected through further communication and coordination between the Agencies and the Basel committee.

CME Group would be happy to provide the Agencies any quantitative information that would help in making a final determination on the proper approach to exposure quantification.

We would be happy to further discuss and clarify any of the above issues with the OCC, the Board, and the FDIC. If you have any comments or questions regarding this submission, please feel free to contact Kim Taylor, President, CME Clearing at +1 312 930-3156 or Kim.Taylor@cmegroup.com.

Sincerely,

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President, CME Clearing
Chicago Mercantile Exchange, Inc.
20 South Wacker Drive
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[12] Basel Committee on Banking Supervision: Capital requirements for bank exposures to central counterparties - final standard (April 2014); http://www.bis.org/publ/bcbs282.htm

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Appendix I - Leverage Exposure example under CEM & SA-CCR approaches

	Eurodollar Contract (3Month Fixed Interest Rate Agreement)		Over-the-Counter Interest Rate Swap	
	2 Year Trade	**5 Year Trade**	**2 Year Trade**	**5 Year Trade**
Notional Amount	100,000,000	100,000,000	100,000,000	100,000,000
Contract Start Date (S_i)	3/1/2016	3/1/2019	6/13/2014	6/13/2014
Contract End Date (E_i)	6/1/2016	6/1/2019	6/1/2016	6/1/2019
Duration of Contract (E_i - S_i)	0.25	0.25	2.0	5.0
CEM Conversion Factor	0.005	0.005	0.005	0.005
Contract Market Value	0	0	0	0
Net-to-Gross Ratio	0%	0%	0%	0%
Margin Period of Risk	5	5	5	5
	Potential Future Exposure Amount for Leverage Ratio			
CEM Approach	**200,000**	**200,000**	**200,000**	**200,000**
SA-CCR Approach	**24,380**	**20,984**	**198,976**	**466,743**

CEM Deficiencies:

(1) CEM uses notional amount without recognition of the actual outstanding duration of a trade

(2) CEM uses the same factor for 2 year and 5 year trades which does not properly reflect the counterparties exposure from the trade