January 16, 2024

VIA ELECTRONIC SUBMISSION
Department of the Treasury – Office of the Comptroller of the Currency
Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation

Re: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity

The Global Association of Central Counterparties ("CCP Global")[1] is the international association for central counterparties ("CCPs"), representing 41 members who operate over 60 individual CCPs across the Americas, EMEA, and the Asia-Pacific region.

CCP Global appreciates the opportunity to respond to the *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity*[2] (the "Basel III Endgame Proposal" or "the Proposal") issued by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System ("the Federal Reserve"), and the Federal Deposit Insurance Corporation (collectively, "the Agencies"). We welcome the Agencies' ongoing efforts to support financial stability, confidence in the financial system, and a banking organizations' resiliency.

CCP Global introductory remarks

The Basel Framework is the full set of standards of the Basel Committee on Banking Supervision, which is the primary global standard setter for the prudential regulation of banks. The Framework sets international standards for a banking organizations' capital adequacy, liquidity, stress testing, and rules aimed at increasing safety and soundness, which are part of an iterative process that culminated with the Basel III requirements that were put in place in the aftermath of the Global Financial Crisis of 2007-08 ("GFC"). The current work undertaken by regulators globally, also colloquially referred to as the Basel III Endgame, is the final step in the implementation of the Basel III Framework. In the aftermath of the GFC, the global leaders have also promoted utilization of central clearing and in some cases, such as with standardized OTC derivative contracts, mandated central clearing as a part of the G20 commitments made in Pittsburgh in 2009. G20 leaders appreciated how well CCPs performed before and during the crisis and the numerous advantages of clearing, which include, among other things:

- increased safety and stability of financial markets;

[1] Previously known as CCP12.
[2] Federal Register / Vol. 88, No. 179 / *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity* (September 2023), available at Link.

- mitigation of systemic and counterparty risk;
- improved risk management;
- centralized default management;
- reduced interconnectedness;
- increased operational efficiency;
- reduction of settlement fails;
- multilateral netting;
- balance sheet netting;
- cost reduction for market participants;
- greater transparency into the market;
- access to a greater number of market participants; and
- customer protection.

These benefits have been appreciated not only by policy makers and regulators but also by market participants, whose use of central clearing, including on a voluntary basis, has been growing steadily. Accordingly, regulators have sought to incentivize central clearing where possible and have implemented rules and regulations to achieve this goal. CCP Global is concerned that the Proposal will have unintended negative consequences for central clearing and contravene these incentives. It is important to note that the CFTC-registered futures commission merchants ("FCMs") engaged in client clearing for swaps are concentrated within a sub-set of FCMs owned by banks or bank holding companies with over 90% of cleared swaps customers margin attributed to the top 10 FCMs.[3] With respect to options markets, three bank-owned broker-dealers are responsible for over 55% of the market.[4] Increasing the capital that these FCMs and broker-dealers must hold may cause some of these entities to decrease or exit clearing, which is a low margin business, in favor of more profitable businesses where the safety of central clearing is not available. This could exacerbate the concentration in the industry, increasing systemic risk and providing less choice at higher cost for market participants accessing centrally cleared markets. Generally, diversity of clearing members supports resiliency of the centrally cleared markets. Alternatively, a concentration of clearing activity in only a few clearing members may increase systemic risk, as it increases the negative impact on the market if one or more of the few defaults. With this in mind, we hope that the Agencies that have issued the Proposal can show a similar level of pragmatism as was seen to some previous proposals when the full ramifications to central clearing were realized by the relevant regulators.[5] A positive example of setting appropriate standards supporting clearing was the single-counterparty credit limits rule[6] which provided exemptions for qualifying central counterparties ("QCCPs") at inception of the rule and provided a logical and important incentive for firms to utilize central clearing.

We would also like to highlight that there are currently a large number of proposed rules that affect CCPs, central clearing, market participants, and the financial markets more broadly. These include the

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[3] E.g., see the presentation for the CFTC MRAC meeting of 11th December, 2023, available at Link, in particular slides 32-33.
[4] Source: OCC internal data.
[5] One example would be the revisions to the leverage ratio rule of 2019; see BCBS, Leverage ratio treatment of client cleared derivatives (June 2019), available at Link.
[6] See Federal Register /Vol. 83, No. 151/Monday, August 6, 2018/Rules and Regulations.

approved rule to move to a T+1 settlement cycle that was issued by the U.S. Securities and Exchange Commission (the "SEC"), the rules to enhance governance at CCPs that were issued independently by the SEC and the Commodity Futures Trading Commission (the "CFTC"), and the rule to enhance risk management in central clearing and facilitate additional central clearing for the U.S. Treasury market that was issued by the SEC. It is in this context that the Agencies have issued this Proposal addressed at midsize and large banking organizations which may disincentivize these organizations from fully participating in central clearing. All of the above-mentioned rules will affect centrally cleared markets and their participants and the Proposal should therefore be discussed and finalized with caution, and an ample time should be spent on an in-depth analysis and broad industry consultations. It does not appear, for example, that the Agencies have consulted with the primary U.S. CCP supervisory authorities, the CFTC and the SEC, regarding this Proposal and the potential effect of the Proposal when combined with the other current proposed[7] and passed rules affecting centrally cleared markets. We urge the authorities to exercise sufficient caution and regulatory coordination in finalizing any aspects of the Proposal to ensure that it does not disincentivize central clearing.

Accordingly, we have made recommendations for several modifications to the Proposal, including those that are detailed below, with the objective of finalising a rule, which will not disincentivize, but rather support, central clearing and the stability of the financial system. We would also recommend that the Agencies conduct a thorough cost-benefit analysis of the Proposal before proceeding with any element that may impact central clearing to avoid any unintended consequences.

CCP Global selected comments to the Basel III Endgame Proposal

- **CVA requirements**

While CCP exposures are exempted from the Credit Valuation Adjustment ("CVA") charges, the Basel III Endgame Proposal would impose CVA charges on bank and bank-affiliated clearing members for client clearing activity, in effect treating a client cleared position as if it were an uncleared OTC transaction. This would ignore the risk management benefits of central clearing that are not available in OTC transactions.[8] CCP Global is of the view that requiring CVA charges on client cleared leg of the activity is duplicative of the credit risk charges banks are already taking on these client exposures. Additionally, as U.S. brokers hold client cleared transactions off the balance sheet, there is no CVA recorded against these transactions and it is not appropriate to hold CVA risk capital there. Requiring CVA charges on top of margin when clearing members are only serving as agent for their customers would further raise the costs of and discourage risk-mitigating hedging for end users. The CVA requirement in the Proposal would also differ from the approach taken in the Basel standards[9], which

[7] In this context, in particular, the parallel proposal by the Federal Reserve – Regulatory Capital Rule: *Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15)* (September 2023), available at Link, should be taken into account.

[8] See Federal Register / Vol. 88, No. 179 /, *op.cit.*, at page 64151: "The proposed definition of a CVA risk covered position would include client-facing derivative transactions and would recognize the potential CVA risk of such exposures through the risk-based requirements for these exposures, as described in sections III.I.3.a and III.I.4 of this Supplementary Information."

[9] SIFMA, "The Federal Reserve Should Remove "Gold-Plating" in the Basel 3 Endgame" (November 2023), available at Link.

do not impose CVA charges on client cleared transactions. We therefore request a modification of the Proposal to not include the client cleared leg in the CVA calculation.

- **Operational risk capital**

The Basel III Endgame Proposal amends the current operational risk capital measure calculated under the Advanced Approach, by switching it to a Standardized Approach. The Standardized Approach includes a "services" component which includes clearing fees, exchange fees, and commission income on a gross basis. This proposed approach would disincentivize central clearing via an unintentional 'tax' in the form of additional capital to cover operational risk. The requirement for additional capital would likely increase the commissions that banks would charge clients, which would further increase gross revenues and consequently require even more operational risk capital (a potential perpetually growing charge). CCP Global recommends that fees and commission income paid for the central clearing of derivatives and relevant securities should not be included in the calculation of the Business Indicator Component or that they should be included only on a net basis.

- **Investment grade designation**

According to the Basel III Endgame Proposal, in order for counterparties to qualify for the lower investment grade designation (65% risk weight vs. default 100% risk weight), they must have issued securities listed on a recognized exchange.[10] Our concern is that requiring counterparty corporations to qualify at the lower risk weighting by having securities listed on a recognized exchange may be inappropriate as it will likely raise costs for entities such as agriculture producers and pension funds to hedge in the derivatives markets via clearing members which are banks or bank-affiliated counterparties. We believe this does not target a well-defined risk and could impact client clearing negatively. The March 2023 banking crisis highlighted the importance of entities proactively risk-managing their interest rate and other market risks and that failure to effectively hedge one's risk, such as through the use of derivatives, can present significant risk, as was the case with the failure of Silicon Valley Bank.[11] We are concerned that certain firms, when faced with decisions to hedge these risks or incur additional costs, may look towards the lower cost option of not hedging, which is a more risky alternative.

- **Cross-Product Netting**

As the Basel III Endgame Proposal eliminates the internal models approach, the ability to utilize the benefits from cross-product netting continues to shrink.[12] Going forward, cross-product netting sets will be excluded from the definition of "netting sets" and a netting set will be limited to a group of

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[10] See Federal Register / Vol. 88, No. 179, *op. cit.*,, at page 64054: "Under the proposal, a banking organization would assign a 65 percent risk weight to a corporate exposure that is both (1) an exposure to a company that is investment grade, and (2) where that company, or a parent that controls that company, has publicly traded securities outstanding."

[11] See, e.g., Board of Governors of the Federal Reserve System, Material Loss Review of Silicon Valley Bank (September 2023), available at Link.

[12] See Federal Register / Vol. 88, No. 179, *op.cit.*, at page 64059: "Compared to the current capital rule, the proposal would exclude cross-product netting sets from the definition of a netting set, as none of the proposed approaches under the revised framework would recognize cross-product netting."

single-product transactions with a single counterparty that are subject to a qualifying master netting agreement and that consist only of one of the following: derivative contracts, repo-style transactions, or eligible margin loans.

Cross-product netting, as has been permitted by Chicago Mercantile Exchange Inc. ("CME") and Fixed Income Clearing Corporation ("FICC") for certain U.S. Treasury related securities and derivatives, and by CME and the Options Clearing Corporation ("OCC") for certain derivatives products, recognizes the offsetting value of positions maintained by a clearing member (or a clearing member and its affiliate) at the cooperating CCPs for margin purposes. Any resulting margin reductions create capital efficiencies for common clearing members. Members are able to utilize products offered by those CCPs to manage a variety of risks (e.g., balance sheet risk) associated with their positions in U.S. Treasuries or derivatives. As noted above regarding the banking crisis, for example, interest rate risk related to U.S. Treasury securities can have significant impacts for a banking organization and, therefore, hedging should be incentivized and not become unduly costly.

The Agencies should continue to promote balance sheet management by banking organizations, by promoting the usage of cross-product netting arrangements to minimize balance sheet risk. The relationships as described above established between certain U.S. CCPs further support the safety and soundness of clearing members (including banks) and markets and therefore cross-product netting relationships such as these should be included in the definition of a "netting set". As stated by the SEC in their September 2023 approval of the CME-FICC cross-margining program enhancements:

> *"Cross-margining programs enhance member liquidity and systemic liquidity both in times of normal trading and in times of market stress by reducing margin requirements for members, which could prove crucial in maintaining member liquidity during periods of market volatility, and enhancing market liquidity as a whole. By enhancing market liquidity, cross-margining arrangements remove impediments to and help perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions.[13]"*

The SEC continued to promote cross-margining amongst Covered Clearing Agencies ("CCAs") that clear Treasury securities in the Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule With Respect to U.S. Treasury Securities that was issued in December 2023, when they said, "…the Commission continues to believe that market participants can benefit from cross-margining arrangements and encourages U.S. Treasury securities CCAs to consider the potential of such benefits."[14]

[13] SEC, Self-Regulatory Organizations; The Fixed Income Clearing Corporation; Order Granting Approval of Proposed Rule Change to Amend and Restate the Cross-Margining Agreement between FICC and CME, available at Link, at page 10.
[14] SEC, Standards for Covered Clearing Agencies for U.S. Treasury Securities and Application of the Broker-Dealer Customer Protection Rule With Respect to U.S. Treasury Securities, available at Link, at p. 135.

About CCP Global

CCP Global is the international association for CCPs, representing 41 members who operate over 60 individual central counterparties (CCPs) across the Americas, EMEA, and the Asia-Pacific region.

CCP Global promotes effective, practical, and appropriate risk management and operational standards for CCPs to ensure the safety and efficiency of the financial markets it represents. CCP Global leads and assesses global regulatory and industry initiatives that concern CCPs to form consensus views, while also actively engaging with regulatory agencies and industry constituents through consultation responses, forum discussions, and position papers.

For more information, please contact the office by e-mail at office@ccp-global.org or through our website by visiting www.ccp-global.org.

CCP Global Members