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Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel, Switzerland

Submitted electronically on bis.org

RE: Comments on the consultative document entitled, "Leverage Ratio Treatment of Client Cleared Derivatives"

Dear Sir or Madam,

The U.S. Chamber of Commerce, Center for Capital Markets Competitiveness ("CCMC") appreciates the opportunity to comment on the Basel Committee on Banking Supervision's ("BCBS") consultative document on "Leverage ratio treatment of client cleared derivatives." CCMC has commented extensively on the Basel III framework and U.S. rules to implement the standards.[1] We believe that appropriate leverage and capital requirements are necessary to reduce the risks that can be created through too much leverage; however, leverage and capital standards that are not

[1] See: letter of June 14, 2011 from the Chamber to Federal Reserve Chairman Ben Bernanke on G-SIFI surcharges; letter of October 22, 2012 from the Chamber to the regulators commenting on the proposed Basel III regulations; letter of September 19, 2013 from the Chamber to the Bank of International Settlements commenting on Revised Basel III leverage ratio framework and disclosure requirements; letter of September 23, 2013 from the Chamber to the regulators on Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and their Subsidiary Insured Depository Institutions; letter of January 31, 2014 on Liquidity Coverage Ratio; letter of February 2, 2015 on Total Loss Absorbing Capacity; April 1, 2015, GSIB Surcharge; and March 27, 2016, Total Loss Absorbing Capacity.

designed in a manner consistent with market structure can have serious, unintended negative consequences.

The current supplementary leverage ratio fails to recognize that client initial margin reduces leverage exposure. That lack of recognition has created a disincentive for central clearing, which is counterproductive to the G20 Leaders' objective of promoting central clearing of standardized derivative contracts. According to data collected by FIA from 14 of the largest clearing members with regard to client cleared derivatives, "the aggregate leverage exposure of the 14 participating firms would be 80 percent higher under SA-CCR without an offset for initial margin than it would be using SA-CCR with an offset." Further, FIA found that "clients that would be most adversely affected by the lack of an offset would be asset managers, insurers, and other end-users that use cleared derivatives to hedge risk."[2]

The European Union recognized these potential negative impacts and have proposed a leverage ratio standard that appropriately accounts for cleared derivatives market structure. Specifically, in discussing its legislative proposal, the European Commission noted, "In order to not disincentive client clearing by institutions, institutions are allowed to reduce the exposure measure by the initial margin received from clients for derivatives cleared through qualifying central counterparties."[3] The Bank of England has also called for the BCBS to allow an offset for initial margin, warning, "Not allowing this initial margin to reduce [potential future exposure] PFE could lead clearing members to raise fees for client clearing of derivatives or withdraw from providing client clearing services." The Bank of England commented on the impact to derivatives end-users, noting, "Allowing client initial margin to reduce the PFE would reduce the capital cost of client clearing to leverage-constrained dealers. This would support the availability and affordability of clearing services to real-

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[2] FIA, Response to Basel Leverage Ratio Consultation Regarding the Proposed Calculation of Centrally Cleared Derivatives Exposures Without Offset for Initial Margin and its Impact on the Client-Clearing Business Model, July 6, 2016

[3] European Commission Face Sheet: Frequently Asked Questions: Capital Requirements (CRR/CRD IV) and resolution framework (BRRD) amendments, November 23, 2016: http://europa.eu/rapid/press-release_MEMO-16-3840_en.htm

economy clients and other financial institutions and help them hedge risks effectively, without compromising the resilience of dealers."[4]

In the U.S., the Department of the Treasury recommended that the leverage ratio be amended to provide offsets for initial margin. In its first report in response to President Trump's Executive Order on Core Principles for Regulating the United States Financial System, Treasury stated "The leverage ratio imposes significant capital requirements on initial margin, which is collected to reduce risk on centrally cleared exposures. Because of the low-margin and high-volume nature of the business of providing clients access to central clearing, high leverage ratio capital charges discourage firms from providing such services."[5] Treasury discussed the impacts further in its second report in response to the Core Principles Executive Order, noting, "These higher capital costs discourage [futures commission merchants] from clearing derivatives transactions for clients."[6]

CFTC Chairman Giancarlo has also discussed the need for an offset for initial margin. Specifically, Giancarlo estimated that providing an offset for initial margin would reduce capital costs for clearing members by as much as 70%, but would only result in a 1% capital reduction at the bank holding company level.[7] Giancarlo added, "Assuming these savings are fully passed on to their customers, these reductions could translate into a three-fold increase in trading activity, especially hedge positions that are carried overnight."

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[4] Bank of England, "Financial Stability Report," July 2016: https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2016/july-2016.pdf

[5] U.S. Department of the Treasury, "A Financial System That Creates Economic Opportunities: Banks and Credit Unions," June 2017: https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf

[6] U.S. Department of the Treasury, "A Financial System that Creates Economic Opportunities: Capital Markets," October 2017: https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf

[7] Remarks of Acting Chairman J. Christopher Giancarlo before International Swaps and Derivatives Association 32nd Annual Meeting, Lisbon, Portugal: "Changing Swaps Trading Liquidity, Market Fragmentation and Regulatory Comity in Post-Reform Global Swaps Market," May 10, 2017: https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-22

CCMC is supportive of each of the BCBS's two proposed alternatives to the current treatment of client cleared derivatives. "Option 2" would allow amounts of cash and non-cash initial margin that are received from the client to offset the potential future exposure of derivatives centrally cleared on the client's behalf. "Option 3" would permit both cash and non-cash forms of initial margin and variation margin received from the client to offset replacement cost and the potential future exposure for client cleared derivatives. "Option 3" appears to more accurately reflect market structure, given that in the cleared derivatives markets both initial margin and variation margin offset client exposure. In addition, as noted by the BCBS, "Option 3" would align with the measurement for risk-based capital requirements, providing consistency to market participants. Therefore, we would prefer "Option 3," however are supportive of both options as they each recognize the exposure reducing effects of client initial margin.

Thank you for the opportunity to comment. We look forward to continuing to work with the BCBS as well as U.S. regulators to ensure capital requirements are appropriately calibrated and prevent unintended, negative consequences.

Sincerely,

Tom Quaadman