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October 20, 2017

Via Electronic Mail

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Amendments to the Banking Organization Systemic Risk Report—FR Y-15 (OMB Control No. 7100-0352)

Ladies and Gentlemen:

The Clearing House Association L.L.C.[1] appreciates the opportunity to comment on the Federal Reserve's proposed amendments to the FR Y-15 report applicable to U.S. global systemically important banks and other bank holding companies with total consolidated assets of $50 billion or more.[2] Although the proposal is presented as mere changes to a reporting form, the revisions are in substance and direct effect significant amendments to the Federal Reserve's G-SIB surcharge rule.[3] As such, they would fundamentally alter the treatment of client clearing activity under that rule by including client clearing notional amounts and exposures in the systemic indicator scores for both the complexity and interconnectedness categories.[4] Because these proposed revisions are both procedurally deficient and substantively inappropriate, we urge the Federal Reserve to withdraw them.

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1 The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly $2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

2 82 Fed. Reg. 40154 (Aug. 24, 2017).

3 12 C.F.R. Part 217, Subpart H.

4 Throughout this letter, "client clearing notional amounts" and "client clearing exposures" refer to notional amounts and exposures associated with transactions in which a clearing member banking organization, acting as an agent, guarantees the performance of a client to a central counterparty ("CCP").

I. The proposal is in substance and direct effect an amendment to the Federal Reserve's G-SIB surcharge rule, and the Federal Reserve's failure to provide empirical analysis and meaningful explanation in support of the proposed revisions is inconsistent with the letter and spirit of the Administrative Procedure Act ("APA").

Under the Federal Reserve's G-SIB surcharge rule, the capital surcharge for a U.S. G-SIB is determined by reference to its applicable systemic indicator scores, including its short-term wholesale funding score for purposes of Method 2. Each systemic indicator score is defined as being the amount "reported by the bank holding company on the FR Y-15."[5] Accordingly, changes to reporting requirements on the FR Y-15 directly affect the systemic indicator scores and resulting capital surcharges for U.S. G-SIBs. Given the G-SIB surcharge rule's dependence on the FR Y-15, the proposed revisions to Item 1 of Schedule D (Complexity) and Items 5(a) and 11(a) of Schedule B (Interconnectedness) of the FR Y-15 would significantly change the nature and scope of transactions reflected in the systemic indicator scores for the notional amount of OTC derivatives in the complexity category and for intra-financial system assets and liabilities in the interconnectedness category.[6] Accordingly, the proposal would amend the U.S. G-SIB surcharge rule by fundamentally changing the treatment of client clearing activity in that rule.

Simply put, this aspect of the proposal is deficient as a matter of administrative law and policy—it is, to use the relevant phrase, *arbitrary and capricious*. Consider, for example, that the proposal:

- Does not state or acknowledge that the impact of the proposed change is to alter the methodology of the G-SIB surcharge rule and thereby the capital requirements applicable to U.S. G-SIBs;
- Provides no rational basis for the proposed change;
- Gives no estimate or assessment of the impact of the proposed change on U.S. G-SIBs' complexity or interconnectedness indicator scores, composite systemic indicator scores, or G-SIB capital surcharges;

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5 *See, e.g.*, 12 C.F.R. §§ 217.401(l) ("*Intra-financial system assets* means total intra-financial system assets, as reported by the bank holding company on the FR Y-15"), (m) ("*Intra-financial system liabilities* means total intra-financial system liabilities, as reported by the bank holding company on the FR Y-15") and (r) ("*Notional amount of over-the-counter (OTC) derivatives* means the total notional amount of OTC derivatives, as reported by the bank holding company on the FR Y-15").

6 For example, the impact of the proposed changes to Schedule D (Complexity) has been estimated to add $46 trillion to U.S. G-SIBs' systemic indicator scores for the notional amount of OTC derivatives. *See* Louie Woodall, *Fed G-Sib plan threatens 50bp jump in FCM capital*, RISK.NET (Sept. 21, 2017) ("The new reporting requirement would result in an estimated $46 trillion of client-cleared notional being factored into the complexity component of the G-Sib calculation for the first time.), *available at* https://www.risk.net/regulation/5333971/fed-g-sib-plan-threatens-50bp-jump-in-fcm-capital. $46 trillion represents approximately 7.6% of the $606 trillion year-end 2015 aggregate global indicator amount for that systemic indicator. *See* Federal Reserve, www.federalreserve.gov/bankinforeg/basel/denominators.htm, *GSIB Framework Denominators* (last accessed October 20, 2017).

- Provides no discussion or analysis of whether the complexity and interconnectedness categories, as revised, would more appropriately asses systemic risk, or why the revised capital surcharge framework resulting from that change would be more appropriately calibrated; and

- Provides no data, analysis or information on which the Federal Reserve relied in formulating the proposal.

Indeed, the *sole* support offered by the Federal Reserve for this significant regulatory change is the conclusory statement that "client clearing activity would be expressly included in the reporting of cleared derivatives in order to capture the systemic risks associated with such activity and better align the treatment of cleared derivatives with the Board's regulatory capital rules."[7] Again, there is no discussion or analysis of (i) what systemic risk is posed by this activity, (ii) how the proposed changes would "capture" that systemic risk, whatever it may be, (iii) how the proposed changes would "better align" with regulatory capital rules, or (iv) why such alignment is desirable. And this is to say nothing of the impact on the G-SIB capital surcharge framework itself, on which the proposal is silent. As a result, the proposal violates one of the fundamental tenets of U.S. administrative law: the "responsibility of the agency to explain the rationale and factual basis for its decision."[8]

The absence of any meaningful explanation of the proposal's basis not only renders the proposed changes arbitrary and capricious, but also makes meaningful public comment on the proposal impossible, as one can only speculate as to the purpose, reasoning, and factual data behind the proposal. This, too, is inconsistent, with the APA, which requires that interested persons be afforded "an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation"[9] and not merely an opportunity to speculate as to an agency's analysis and objectives.[10]

Finally, we note that the proposal's supporting statement also indicates that "[m]any of the proposed changes to the FR Y-15 would correspond to changes made to the [Basel

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7 Federal Reserve, *Supporting Statement for the Banking Organization Systemic Risk Report (FR Y-15; OMB No. 7100-0352)* (the "Supporting Statement") at 5, *available at* https://www.federalreserve.gov/reportforms/formsreview/FR%20Y-15_20170824_OMB%20SS.pdf.

8 *See Bowen* v. *American University Hospital*, 476 U.S. 610, 627 (1986) (plurality opinion).

9 5 U.S.C. § 553(c).

10 Indeed, courts have interpreted APA notice-and-comment procedures to require an agency to reveal for public evaluation "the 'technical studies and data' upon which the agency relies" in its rulemaking. *See, e.g.*, *Chamber of Commerce*, 443 F.3d 890, 899 (D.C. Cir. 2006); *Radio Relay League v. FCC*, 524 F.3d 227, 236 (D.C. Cir. 2008). Where an agency fails to disclose such "studies and data," and an affected party is thereby "prejudiced by the absence of an opportunity" to comment meaningfully, the agency action must be vacated. *Owner-Operator Indep. Drivers Ass'n v. FMCSA*, 494 F.3d 188, 202 (D.C. Cir. 2007); *see also Cal. Wilderness Coal. v. U.S. Dep't of Energy*, 631 F.3d 1072, 1095 (9th Cir. 2011) ("[W]here a regulation is promulgated in violation of the APA and the violation is not harmless, the remedy is to invalidate the regulation."). Public release of this information is mandated by the APA and applicable case law, which generally require—to enhance the public's participation in rulemakings—that the public be provided the "most critical factual material" used by the agency in developing a rulemaking. *See Chamber of Commerce*, 443 F.3d at 900.

Committee on Banking Supervision] data collection" relating to the Basel Committee G-SIB surcharge assessment methodology.[11] Although the proposed revisions to Schedule B would be consistent with the Basel Committee's 2016 year-end reporting instructions, consistency with those instructions is not a sufficient justification for changing the treatment of client clearing activity in the U.S. G-SIB surcharge rule. The Basel Committee had made similar revisions to its reporting instructions for year-end 2016,[12] but those revisions were not subject to the procedural requirements applicable to rulemaking in the U.S. Indeed, the Basel Committee never sought public comment on them. As we have previously noted,[13] it should not (and by law cannot) be the case that the federal banking agencies, including the Federal Reserve, consider themselves obligated to implement regulatory frameworks developed by international bodies before a public administrative process has been conducted in the United States. This is particularly important given the lack of any public process, record or other details regarding how decisions were actually reached by the Basel Committee in adopting revisions to its reporting instructions relating to the treatment of client clearing exposures in the interconnectedness category.

The significant potential impact of the proposed changes to the complexity and interconnectedness categories on the systemic indicator scores and surcharges of U.S. G-SIBs makes it imperative that the Federal Reserve provide transparent and complete details of the underlying rationale, analysis and factual data that support its proposal to fundamentally change the treatment of client clearing activity in its G-SIB surcharge rule. If, notwithstanding the concerns reflected in this letter, the Federal Reserve should decide to continue to pursue revisions to require reporting of client clearing notional amounts and exposures on Schedules D and B of the FR Y-15, administrative law requires that the Federal Reserve first publish data and its analysis regarding the effects of the proposed changes (including the estimated impacts on systemic indicator scores and surcharges), provide a meaningful rationale for the changes, and reopen the proposal for public comment. Anything less would violate both the letter and spirit of the APA.

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[11] Supporting Statement, at 6. This rationale would not apply to the proposed changes to Schedule D (Complexity), which would make the Federal Reserve's FR Y-15 reporting requirements inconsistent with the most recent Basel Committee reporting instructions. The Basel Committee's most recent instructions—for year-end 2016 reporting—also presented changes that would be implemented beginning with 2017 year-end reporting, and none of those pending changes related to the complexity category or client clearing activity. *See* Basel Committee, *Instructions for the end-2016 G-SIB assessment exercise* (Jan. 16, 2017) at para. 119 (OTC derivatives cleared through a central counterparty) and Appendix 6 (indicator changes to be implemented starting with 2017 year-end reporting), *available at* http://www.bis.org/bcbs/gsib/instr_end16_gsib.pdf. Accordingly, the proposed changes to Schedule D (Complexity) would also appear likely to be inconsistent with the Basel Committee's 2017 year-end reporting instructions. If the Basel Committee does revise its reporting instructions to require client clearing notional amounts to be reported in the complexity category, consistency with those instructions would be an insufficient justification for revising Schedule D of the FR Y-15 for the reasons addressed in this paragraph.

[12] *Compare id.* at para. 80 *with* Basel Committee, *Instructions for the end-2015 G-SIB assessment exercise* (Feb. 5, 2015) at para. 78, *available at* http://www.bis.org/bcbs/gsib/instr_end15_gsib.pdf.

[13] The Clearing House, SIFMA, FSR, ABA, IIB and CRE Finance Council, *Comment Letter re: Notice of Proposed Rulemaking – Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements* (Aug. 5, 2016) at 13, *available at* https://www.theclearinghouse.org/-/media/tch/documents/research/articles/2016/08/20160805_joint_trade_nsfr_comment_letter.pdf.

Below, we provide the views of The Clearing House on why the proposal would result in misstating systemic risk as measured by the G-SIB surcharge. Our comments are necessarily incomplete, as we do not know the basis on which the Federal Reserve apparently concluded otherwise, and thus our preemptive criticisms do not substitute for a true notice-and-comment process. And, of course, numerous other potential commenters are likely altogether unaware that the G-SIB surcharge is at issue with what appear to be technical reporting requirements.

II. The proposed change to the treatment of client clearing activities would create disincentives for the central clearing of derivatives, frustrate longstanding policy goals to reduce interconnectedness and complexity in the derivatives markets, and thereby increase system risk.

Increasing systemic indicator scores for the complexity and interconnectedness categories on account of client clearing activity would have adverse effects on U.S. G-SIBs' clearing businesses and may adversely affect the pricing and availability of clearing services, as well as the liquidity and portability of cleared derivatives. Although the impact on clearing businesses would likely be most significant at those U.S. G-SIBs that experienced an increase in their surcharges on account of any changes to the treatment of client clearing activity in the Federal Reserve's G-SIB surcharge rule, all U.S. G-SIB clearing businesses would be adversely affected by the proposal. This is because higher systemic indicator scores attributable to client clearing activity would affect how U.S. G-SIBs allocate capital to their clearing businesses and assess the economic returns of their clearing businesses, irrespective of whether such higher systemic indicator scores directly and immediately cause a higher surcharge. As a result, U.S. G-SIBs with clearing businesses may have economic incentives to reduce client clearing activities or to increase fees for the provision of clearing services because of lower returns on attributed capital. Such incentives could also lead to further concentration in clearing activities and higher capital requirements attributable to client clearing activity could encourage U.S. G-SIBs to exit the clearing business.[14] Likewise, U.S. G-SIBs may become less willing or less able to acquire client clearing positions from other clearing firms, which could reduce the liquidity and portability of cleared derivatives.[15]

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[14] *Cf.* U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities, Banks and Credit Unions*, Report to President Donald J. Trump, Executive Order 13772 on Core Principles for Regulating the United States Financial System (June 2017), (the "Treasury Banking Report") at 51 ("Because of the low-margin and high-volume nature of the business of providing clients access to central clearing, high leverage ratio capital charges [on initial margin] discourage firms from providing such services."), *available at* https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf; U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities, Capital Markets*, Report to President Donald J. Trump, Executive Order 13772 on Core Principles for Regulating the United States Financial System (October 2017) (the "Treasury Capital Markets Report") at 137 ("FCMs have reportedly dropped out of the clearing business due to it being a low-margin business, driven in part by the capital costs"), *available at* https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

[15] "Portability" refers to the ability of a clearing client to transfer its cleared derivative positions to another member of a CCP that provides clearing services. The Treasury Capital Markets Report, at pages 137-138, discusses the negative effects of bank capital requirements on the liquidity and portability of cleared derivatives, noting, in particular, that "remaining FCMs are hesitant to take on new business due to the

Creating disincentives for U.S. G-SIBs to clear transactions would frustrate the longstanding policy goal—reflected in the 2009 G20 derivatives reform agenda[16] and the Dodd-Frank Act[17]—to encourage and increase the central clearing of derivatives in order to reduce systemic risk. For example, the proposal is inconsistent with a Federal Reserve governor's recent statement that global authorities "have a responsibility to ensure that bank capital standards and other policies do not unnecessarily discourage central clearing"[18] and the U.S. Treasury Department's recent recommendation "that regulators properly balance the post-crisis goal of moving more derivatives into central clearing with appropriately tailored and targeted capital requirements."[19] The proposal would also run counter to recent recommendations from U.S. policymakers to reconsider and revise the effects of bank capital requirements on central clearing. For example, one governor has recommended that the calibration of the eSLR be reconsidered from this perspective;[20] the U.S. Treasury Department has recommended adjustments to the calculation of the eSLR and transitioning from the current exposure methodology ("CEM") to a more risk-sensitive approach to measuring counterparty credit exposures in light of the adverse effects of the eSLR and CEM on clearing activities;[21] and CFTC Chairman J. Christopher Giancarlo has described the adverse effects of the eSLR on U.S. G-SIBs' clearing businesses, their clearing customers and the derivatives markets more generally and also recommended revisions to the eSLR to mitigate those effects.[22] Indeed, the proposal would effectively replicate the problems identified with the treatment of client clearing activity in the eSLR and CEM in the G-SIB surcharge rule—in yet another (and very significant) aspect of the capital framework, clearing activities would be unnecessarily discouraged through the

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capital costs" and that "[t]he [current exposure methodology] may be responsible for a corresponding reduction in banks' ability and willingness to facilitate access for their market maker clients who are the primary liquidity providers in these markets."

16 *See* G20, Leaders Statement—the Pittsburgh Summit—September 24-25, 2009 (Sept. 2009) at 9, *available at* http://www.fsb.org/wp-content/uploads/g20_leaders_declaration_pittsburgh_2009.pdf; *see also* Financial Stability Board, *Review of OTC derivative market reforms—Effectiveness and broader effects of the reforms* (June 29, 2017) ("FSB 2017 Review of OTC Derivative Market Reforms") at 7, *available at* http://www.fsb.org/wp-content/uploads/P290617-1.pdf.

17 *See, e.g.*, Commodity Futures Trading Commission, *Clearing Requirement Determination Under Section 2(h) of the CEA*, 77 Fed. Reg. 74284, 74285 (Dec. 12, 2012) (quoting S. Rep. 111-176, at 32 (Apr. 30, 2010) and Letter from Senators Christopher Dodd and Blanche Lincoln to Congressmen Barney Frank and Collin Peterson (June 30, 2010)).

18 Federal Reserve Governor Jerome H. Powell, *Central Clearing and Liquidity*, Speech at the Federal Reserve Bank of Chicago Symposium on Central Clearing, Chicago, Illinois (June 23, 2017), *available at* https://www.federalreserve.gov/newsevents/speech/powell20170623a.htm.

19 Treasury Capital Markets Report at 138.

20 *See id.*; *see also* Webcast of GW Law & Reuters: A Conversation on Financial Regulation, Washington D.C. (Oct. 3, 2017) at 37 minutes, 35 seconds (Governor Powell noting that the Federal Reserve is reviewing and considering revising the eSLR and noting the negative effects of the eSLR on central clearing), *available at* http://www.reuters.tv/l/avJ/2017/09/29/reuters-summit-financial-regulation-in-2017?edition=XW.

21 *See* Treasury Banking Report at 51-52 and 54; Treasury Capital Markets Report at 138.

22 CFTC Chair J. Christopher Giancarlo, *Changing Swaps Trading Liquidity, Market Fragmentation and Regulatory Comity in Post-Reform Global Swaps Markets*, Speech at the International Swaps and Derivatives Association 32nd Annual Meeting, Lisbon, Portugal (May 10, 2017), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-22.

application of capital requirements that do not reflect the actual risks of the underlying activity and that have not been properly calibrated.

The unusual result of the disincentives described above is that the proposal could have the perverse effect of increasing systemic risk. As discussed above, the proposed revisions to the treatment of client clearing activity in the complexity and interconnectedness categories of the Federal Reserve's G-SIB surcharge rule could adversely affect the availability of clearing services and result in reductions in the liquidity and portability of cleared derivatives. In stressed conditions, such changes to the derivatives markets could contribute to the spread of risk throughout the financial system.[23]

Again, we do not know from the proposal whether these adverse effects were considered in formulating the proposed changes to the FR Y-15 or, if they were considered, why they were rejected.

Given the fundamental inconsistency of the proposal with policy initiatives to promote central clearing and reduce systemic risk, we urge the Federal Reserve not to revise Schedule D (Complexity) and Schedule B (Interconnectedness) of the FR Y-15 to require the reporting of client clearing notional amounts and exposures.

III. The proposed change to the treatment of client clearing activities would further exacerbate significant substantive problems in the G-SIB surcharge rule.

As we have previously stated,[24] the Federal Reserve's G-SIB surcharge rule lacks a coherent conceptual foundation, is based on a flawed methodology and has adverse effects on the economy and the competitive position of U.S. G-SIBs. We urge the Federal Reserve not to implement the proposed revisions to Schedule D (Complexity) and Schedule B

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[23] *Cf.* Treasury Capital Markets Report at 138 ("The CEM may be responsible for a corresponding reduction in banks' ability and willingness to facilitate access for their market maker clients who are the primary liquidity providers in these markets. End users face increased risk of being unable to transfer their positions and margin to another FCM if their FCM defaults or exits the business. In a period of market stress, this risk would be exacerbated and could become systemic.")

[24] The Clearing House, *Submission to the U.S. Treasury Department: Aligning the U.S. Bank Regulatory Framework with the Core Principles of Financial Regulation* (May 2, 2017) at 15-17, *available at* https://www.theclearinghouse.org/~/media/TCH/Documents/TCH%20WEEKLY/2017/20170502_TCH_Submission_to_UST_re_Core_Principles_Study.pdf/; The Clearing House, *Comment Letter re: Incorporation of the GSIB Surcharge into CCAR* (June 2, 2016), *available at* https://www.theclearinghouse.org/-/media/action%20line/documents/volume%20vii/20160602_tch_comments_on_%20incorporation_of_gsib_surcharge_into_ccar.pdf; The Clearing House, SIFMA, FSR, *Comment Letter re: Notice of Proposed Rulemaking; Comment Request: Risk-Based Guidelines – Implementation of Capital Requirements for Globally Systemically Important Bank Holding Companies (79 Fed. Reg. 75,473, December 18, 2014)* (Apr. 2, 2015), *available at* https://www.theclearinghouse.org/-/media/files/association%20related%20documents/20150402%20tch%20comment%20letter%20on%20gsib%20surcharge.pdf?la=en; *see also* The Clearing House, *Comment Letter re: Consultative Document – Global systemically important banks – revised assessment framework (March 2017)* (June 27, 2017), *available at* https://www.theclearinghouse.org/-/media/tch/documents/tch%20weekly/2017/20170627_tch_comments_to_bcbs_gsib_revised_assessment framework.pdf.

(Interconnectedness) relating to client clearing activity because the revisions would further exacerbate those problems in a number of ways.

- Central clearing reduces complexity[25] and interconnectedness[26] in the financial system. Through central clearing, transactions *among* market participants are replaced with transactions *between* market participants, on the one hand, and CCPs on the other. The result is simpler, more transparent contractual arrangements within a financial system that is also less interconnected—*i.e.*, less exposed to the risk that "[f]inancial distress at a banking organization may materially raise the likelihood of distress at other firms given the network of contractual obligations throughout the financial system."[27] The liquidity and portability of client clearing positions further mitigate the potential systemic impact of the failure of a U.S. G-SIB with a clearing business. If such a U.S. G-SIB were to fail, its clients could transfer their cleared derivatives positions to other clearing firms or liquidate their positions.; indeed, this is what occurred when Lehman Brothers failed.[28] Although central clearing mitigates the risks that the complexity and interconnectedness categories are intended to measure, the proposal would treat client clearing activity as contributing to those risks. In this way the proposal would exacerbate critical flaws in the G-SIB surcharge rule: the lack of a coherent conceptual foundation and insensitivity to risks sought to be addressed.

- The proposed revisions to the treatment of client clearing activity would double count U.S. G-SIBs' cleared derivatives transactions. Under the current instructions, if a G-SIB enters into a derivative transaction, the associated notional amount and exposure is reported once for purposes of both Schedule D (Complexity) and Schedule B (Interconnectedness) irrespective of whether the transaction is cleared or bilateral (*i.e.*, non-cleared). Under the revised instructions, a bilateral transaction would be reported once and count toward U.S. G-SIB surcharges once (*i.e.*, for the U.S. G-SIB executing the transaction), but a transaction executed and cleared by U.S. G-SIBs

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25 FSB 2017 Review of OTC Derivative Market Reforms, at 3-4 ("Greater use of central counterparties (CCPs) is beginning to reduce counterparty credit risks in the financial system by replacing much of the complex and opaque web of ties between market participants that contributed to key markets seizing up during the crisis with simpler and more transparent links between CCPs and their clearing members, supported by robust CCP standards including improved resilience and risk management.").

26 *Id.* at 3 ("Authorities report meaningful progress towards mitigating systemic risk, including risk arising from interconnectedness of financial institutions in OTC derivatives markets. In particular, increasing central clearing is an important component of the reforms to mitigate systemic risk and thereby help end too-big-to-fail for banks, in part by improving their resolvability.").

27 Federal Reserve System, *Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies*, 80 Fed. Reg. 49082, 49095 (Aug. 14, 2015).

28 *See, e.g.*, Dietrich Domanski, Leonardo Gambacorta and Cristina Picillo, *Central Clearing: Trends and Current Issues*, BIS QUARTERLY REVIEW (Dec. 2015) at 65 ("The push towards central clearing is motivated by the experience of the Great Financial Crisis. After the Lehman Brothers default in September 2008, central counterparties continued to function smoothly despite abnormally high market volatility. Within a short time frame, the positions of Lehman clients were either transferred to other, non-defaulting, CCP participants or liquidated.") (citation omitted), *available at* http://www.bis.org/publ/qtrpdf/r_qt1512g.pdf.

would be reported twice and count toward U.S. G-SIB surcharges twice (*i.e.*, for the U.S. G-SIB executing the transaction as well as the U.S. G-SIB clearing the transaction for the counterparty). Put differently, the revised instructions would count cleared transactions twice, in each case treating them as contributing significantly more to U.S. G-SIBs' complexity and interconnectedness scores than bilateral transactions, even though central clearing *reduces* complexity and interconnectedness. The Federal Reserve has offered no analysis or justification for this double counting and treatment, which is inconsistent with the policy rationales underlying central clearing.

- Due to the "cliff effects" resulting from the discontinuous surcharge buckets, even small changes in a U.S. G-SIB's systemic indicator scores can result in the U.S. G-SIB moving up a bucket and being subject to a higher surcharge. Accordingly, the implications of the proposed revisions extend beyond the potential impacts on the clearing businesses of U.S. G-SIBs and the derivative markets—the implications relate to the G-SIB surcharge rule's broader effects on the real economy and capital markets. Continual increases in capital requirements can decrease the availability of credit and have other adverse economic effects,[29] yet there is no indication that the Federal Reserve has considered (or empirically analyzed) these and other potential economic costs associated with the proposal.

- The proposed changes to Schedule D (Complexity) would make the Federal Reserve's FR Y-15 reporting requirements inconsistent with the most recent Basel Committee reporting instructions and appear likely to also be inconsistent with the forthcoming Basel Committee instructions for year-end 2017 reporting.[30] Because Method 1 scores and surcharges are relative measures based on the relationship of a U.S. G-SIB's scores to the denominators consisting of the scores of the world's 75 largest global banking organizations and any other banking organization included in the Basel Committee's sample,[31] absent corresponding changes by the Basel Committee to its reporting instructions, the proposed changes to Schedule D would result in Method 1 scores and surcharges for U.S. G-SIBs that would no longer be comparable to the Basel G-SIB scores and surcharges for non-U.S. G-SIBs. The lack of comparability in what is by design a relative measure would introduce a further flaw into the Federal Reserve's Basel G-SIB surcharge Method 1 framework. Moreover, higher Method 1 scores and surcharges, together with the lack of comparability, would have a negative effect on the competitive position of U.S. G-SIBs.

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29 *See* Treasury Banking Report, at 37 ("an excess of capital and liquidity in the banking system will detract from the flow of consumer and commercial credit and can inhibit economic growth") and 49 ("the continual ratcheting up of capital requirements is not a costless means of making the banking system safer").

30 *See* footnote 11.

31 *See* 12 C.F.R. §§ 217.401(a), 217.403(b) and 217.404.

- The proposed revisions to Schedule B (Complexity) would double count client clearing exposures using a methodology that is insufficiently risk sensitive. Client clearing exposures are already reflected in the size indicator—they must be reported in items 1(a) and (b) of Schedule A (Size).[32] Requiring client clearing exposures to be reported in Schedule B would thus introduce further overlap between categories. In addition, the revisions to Schedule B would measure client clearing exposures using the current exposure methodology, which is insufficiently risk-sensitive and does not recognize the risk-mitigating effects of initial margin in potential future exposure.[33]

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The Clearing House appreciates the opportunity to comment on the proposal. If you have any questions, please contact me by phone at 202.649.4622 or by email at Jeremy.newell@theclearinghouse.org .

Respectfully submitted,

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The Clearing House Association, L.L.C.

cc: Michael Gibson
Mark Van Der Weide
(Board of Governors of the Federal Reserve System)

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[32] *See* Federal Reserve, *Instructions for Preparation of Banking Organization System Risk Report—Reporting Form FR Y-15* (Dec. 2016), at A-1.

[33] If the Federal Reserve revises Schedule B to require reporting of client clearing exposures—which we oppose—it should do so using a more risk-sensitive methodology. Due to its lack of risk sensitivity, we also believe the Federal Reserve should replace the current exposure method with a more risk-sensitive methodology for all FR Y-15 reporting requirements as well as the capital rules more generally.