

October 23rd, 2017

VIA ELECTRONIC SUBMISSION

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Regs.comments@federalreserve.gov

Re: Proposed Agency Information Collection Activities [FR Doc. 2017–17939] [FR Y-15; OMB No. 7100-0352]

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”) and credit default swaps (“CDS”)². 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”).

CME is writing to express concerns to the Board of Governors of the Federal Reserve System (“Board”) regarding the proposed rulemaking (“the proposed rules”): Banking Organization Systemic Risk Report form (“FR Y-15”). The proposed rules, if implemented, will potentially have significant impacts on the size of the global systemically important banks (“G-SIBs”) higher loss absorbency requirement, risk based capital surcharge. Many bank-affiliated clearing members that provide client clearing services to market participants at CME have been designated G-SIB status and are subject to G-SIB risk based capital surcharge requirements. The Board’s proposed rules, specifically those related to client cleared OTC derivative transactions, will directly impact G-SIB clearing members at CME.

This letter outlines CME’s concerns with two of the proposed rules: “expressly including all cleared derivative transactions in Schedule D, item 1” and “specifying how certain cleared derivative transactions are reported in Schedule B, items 5(a) and 11(a).” Chiefly, the proposed rules will make it challenging for those clients’ subject to clearing mandates to find a clearing member to provide clearing

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.

² As announced on September 14, 2017, CME Group announced that it will exit the company’s credit default swaps clearing business by mid-2018. During this transition, CME will continue to provide full clearing services so that participants can continue to manage their risk. For additional information, a copy of the press release can be found here: http://www.cmegroup.com/media-room/press-releases/2017/9/14/cme_group_to_exitotccreditclearingbusinessreturn650mincapitaltoc.html

services and creates a disincentive for clients to voluntarily centrally clear OTC derivatives. In the U.S., client clearing services are provided on an agency basis, meaning the exposure of the derivatives contracts are that of the client rather than the clearing member. Therefore, the clearing member is not principal to the trade. In addition, a U.S. clearing member is required under CFTC rules to collect initial margin from its clients. The initial margin collected from the client is passed on to the clearinghouse to fully collateralize the exposures against potential mark-to-market losses the client may incur on the derivatives. In the event of a clearing member default, the agent relationship helps in porting of clients to a solvent clearing member, in particular, in conjunction with bulk porting and gross customer margin.

The inclusion of OTC client cleared exposures under the complexity and interconnectedness indicators of the G-SIB surcharge calculation will increase the cost and decrease capacity of G-SIB clearing members to provide clearing services on an agency basis to their clients. Ultimately this will create a disincentive to centrally clear OTC derivatives, reduce the amount of transactions brought to central counterparties and potentially undermine the systemic risk mitigation goals of the G-SIB capital surcharge. We caution against the adoption of proposals that could negatively impact the G20 commitments to central clearing without a robust impact assessment that supports the necessity of such a change.

Complexity Indicator: Proposal for revision to include client cleared OTC derivatives ³

In the Board's supporting statement, the Board advises "client clearing activity would be expressly included in the reporting of cleared derivatives in order to capture the systemic risk associated with such activity and better align the treatment of cleared derivatives with the Board's regulatory capital rules."⁴ Recent regulatory framework and industry consensus proves that central clearing mitigates systemic risk, offers greater transparency and provides financial stability to the broader financial system. The inclusion of OTC client clearing activity within the G-SIB calculation complexity indicator will substantially increase capital costs for G-SIB's end users driving them to reassess their client clearing services. As demonstrated by recent regulations, such as the supplementary leverage ratio, increased capital requirements have caused G-SIBs to raise customer fees, limit client business or cause them to exit cleared markets altogether. Increased capital costs in the cleared derivatives market creates further concentration in both G-SIBs who provide clearing services and ultimately the clients of G-SIBs who access cleared markets. Therefore, the G-SIB surcharge risks exacerbating the already negative impacts that Basel III has had on the ability of clients to take advantage of the risk mitigation benefits of central clearing.

Risk management is the foundation with which CCPs operate. As risk managers, CCPs such as CME, have developed dynamic and prudent risk management standards that are applied to all clearing members. Centrally cleared markets are by design managed to limit failures and maintain market stability. By acting as a neutral risk manager and maintaining a matched book (i.e. no market risk), CCPs safeguard the global derivatives markets. The stability of the cleared markets during the past financial crises have proven CCPs expertise in managing risks. This success led policy makers to mandate that the web of

³ CME's comments pertain to OTC client cleared transactions under the complexity indicator of the G-SIB capital surcharge requirement.

⁴ Supporting Statement, page 5 https://www.federalreserve.gov/reportforms/formsreview/FR%20Y-15_20170824_OMB%20SS.pdf

bilateral exposures in liquid, standardized OTC derivatives be transitioned into a transparent, centrally cleared and third-party risk managed environment. The transition has allowed CCPs to increase financial stability by applying their risk management techniques and expertise to the risks taken by market participants that previously existed in opaque, bilateral OTC derivatives markets. Under the proposed rules, the capital costs for G-SIBs for their OTC client cleared exposures will increase which will create a disincentive to centrally clear OTC transactions and thus reduce financial stability.

It is important to note that client exposures are not that of a G-SIB clearing member's exposures. Client exposures are segregated, reset each day through settlement variation and collateralized via initial margin deposits. The collateral held at CCPs such as CME that covers these client exposures is bankruptcy remote from the G-SIB and the CCP itself.

Since the Proposal refers to the complexity indicator, it is important to understand what complexity means for G-SIBs. In establishing complexity as one of the primary components for identifying G-SIB systemic importance, the Board draws a correlation to resolvability. The Board advises, "Resolvability and organizational complexity are important contributors to the potential systemic effects of a GSIB default and the complexity indicators included in the methodology seek to reflect this in a quantifiable way."⁵ OTC client cleared transactions are not determinants of complexity. To identify the systemic risks G-SIB pose to the financial system, the primary focus should be directed towards the nature of firm's resolvability. Historically in the U.S., bulk customer porting of positions and collateral has occurred in advance of the insolvency and/or resolution of the defaulting clearing member and has increased the resilience of the cleared derivatives markets upon a clearing member default.

One of the systemic benefits of the U.S. regulatory regime for cleared derivatives has been the ability to port the positions and collateral of the clients of a defaulting clearing member. In a stressed scenario, the ability of a G-SIB, non-defaulting clearing member to accept ported customers will be negatively impacted by the proposed changes to FR Y-15. Effectively, the Proposal unnecessarily takes customer cleared OTC derivatives exposures into account for the complexity indicator for the potential defaulter (because customers have traditionally been ported) while simultaneously decreasing the likelihood of porting to non-defaulting G-SIB clearing members by increasing the capital costs for supporting those customers.

CME has additional concerns with the supplementary statements regarding the consultation outside of agency. The Board states, "Many of the proposed changes to the FR Y-15 would correspond to changes made to the BCBS data collection."⁶ Specifically, about the complexity indicator, the most recent Basel Committee on Banking Supervision ("BCBS") data collection⁷ does not consider the inclusion of client cleared transactions where a G-SIB guarantees its client's performance to the CCP. BCBS only requires the inclusion of notional amounts associated with the G-SIB clearing member's performance guarantee

⁵ Fed final rule, page 49096

⁶ Supporting Statement, page 6

⁷ *Instructions for the end-2016 G-SIB assessment exercise, January 2017:*
https://www.bis.org/bcbs/gsib/instr_end16_gsib.pdf

of the CCP to the client.⁸ The Board's final G-SIB surcharge requirement maintained this same requirement. With the proposed rules, the Board is now proposing a divergence from the international standard, thereby negatively impacting U.S. G-SIBS and U.S. cleared derivatives markets. This divergence is inappropriate and undermines incentives to centrally clear OTC transactions.

Interconnectedness Indicator: Proposal for revision to include client cleared OTC derivatives⁹

The proposal for changes to the interconnectedness indicator is not detailed enough for readers to understand the specific changes that are required and how they would impact G-SIBs. An integral part of which the interconnectedness indicator represents, is the explicit distinction of whether a transaction creates an asset or liability for the G-SIB. In the U.S. when a G-SIB acts as an agent providing clearing services, the exposures of the client are not assets or liabilities of the G-SIB. Since the client exposures are not assets or liabilities of the G-SIB, it is unclear how these client exposures could be included in the interconnectedness indicator. We believe such inclusion is flawed for the policy reasons covered above but suggest, at a minimum, that further explanation be provided as to how they could be incorporated into the indicator.

Conclusion

The proposed rules create disincentives to centrally clear OTC transactions by increasing the potential G-SIB capital surcharge based on exposures related to client cleared OTC transactions. Such an approach is not consistent with the G20 commitments to central clearing while also failing to reduce systemic risk in a manner consistent with the goals of the G-SIB surcharge construct. Consequently, CME encourages the Board to reject the proposed rules including client cleared OTC derivatives exposures in the G-SIB surcharge. If the Board decides to continue down the path of including client cleared OTC derivatives, at a minimum it should re-issue the Proposal with an impact assessment which clearly demonstrates the risk management benefits of the inclusion of client cleared OTC derivatives.

CME would be happy to further discuss and clarify any of the above issues with the Board. 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 or Sunil.Cutinho@cmegroup.com.

Sincerely,



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⁸ *Instructions for the end-2016 G-SIB assessment exercise, January 2017, page 20*

⁹ CME's comments pertain to OTC client cleared transactions under the interconnectedness indicator of the G-SIB capital surcharge requirement.