The Clearing House
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February 17, 2015

Via Electronic Mail

Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219
Docket D CCC-2014-0025
RIN 1557-AD88

Robert de V. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1502
RIN 7100-AE 24

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN 3064-AE 12

Re: Notice of Proposed Rulemaking—Regulatory Capital Rules: Regulatory Capital, Proposed Revisions Applicable to Banking Organizations Subject to the Advanced Approaches Risk-Based Capital Rule

Ladies and Gentlemen:

The Clearing House Association L.L.C. ("**The Clearing House**")[1] appreciates the opportunity to comment on the notice of proposed rulemaking by the Office of the Comptroller of the

[1] Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively hold more than half of all U.S. deposits and which employ over one million people in the United States and more than two million people worldwide. The Clearing House Association L.L.C is a nonpartisan advocacy organization that represents the interests of its owner banks by developing and promoting policies to support a safe, sound and competitive banking system that serves customers and communities. Its affiliate, The Clearing House Payments Company L.L.C which is regulated as a systemically important financial market utility, owns and operates payments technology infrastructure that provides safe and efficient payment, clearing and settlement services to financial institutions, and leads innovation and thought leadership activities for the next generation of payments. It clears almost $2 trillion each day, representing nearly half of all automated clearing house, funds transfer and check-image payments made in the United States. *See* The Clearing House's web page at www.theclearinghouse.org.

Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (collectively, the "**Agencies**"), entitled *Regulatory Capital Rules: Regulatory Capital, Proposed Revisions Applicable to Banking Organizations Subject to the Advanced Approaches Risk-Based Capital Rule* (the "**Proposal**").[2]

The Clearing House strongly supports the Proposal, and we welcome the Agencies' efforts to clarify and update the final U.S. Basel II-based regulatory capital rules adopted in 2013 (the "**Revised Capital Rules**").[3] We particularly appreciate the clarifications in the Proposal that reflect consideration of our 2014 Basel III Capital Industry FAQs. Moreover, we would encourage the Agencies to continue to refine the Revised Capital Rules in the light of further experience. The Revised Capital Rules are lengthy and inherently complex. The Clearing House believes that an iterative and cooperative process which takes into account issues, observations and questions that arise as Agencies and banking institutions gain further insight from the continued application and implementation of the Revised Capital Rules will only serve to improve the regulatory capital framework.

In this regard, we have set forth below a number of recommendations and suggestions which we believe either flow logically from the Proposal and/or we believe should be implemented in order to resolve certain unaddressed idiosyncrasies in the Revised Capital Rules, including:

- Trade exposures to a central clearing party ("**CCP**") in respect of transactions cleared on behalf of clients where the clearing member does not guarantee the performance of a CCP should be assigned a zero-percent risk weighting, regardless of whether the clearing member is subject to the standardized or advanced approaches capital rules or whether such transactions satisfy the operational requirements of Section 3(a) of the Revised Capital Rules for recognition of "cleared transactions";

- Cross references in Section 32 of the Revised Capital Rules for standardized banking organizations, like those in Section 133 for advanced approaches entities, should be updated to capture all possible risk weightings for collateral posted to a CCP, not just retail and wholesale exposures; and

- The Revised Capital Rules should be amended to allow banking organizations calculating risk weighted assets under the standardized approach to deduct the recognized credit valuation adjustment ("**CVA**") or accounting equivalent from exposure at default ("**EAD**") in order to avoid double counting counterparty credit risk.

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2 79 Fed. Reg. 75455 (Dec. 18, 2014).

3 78 Fed. Reg. 62018 (Oct. 11, 2013).

1. **We appreciate the Agencies' efforts to clarify certain rules applicable to advanced approaches banking organizations and urge the Agencies to make corresponding clarifications for banking organizations subject to the standardized approach.**

The Clearing House understands that the Proposal focuses on the rules applicable to advanced approaches banking organizations. However, we believe the Agencies should take the opportunity offered by this rulemaking to also address the corresponding provisions of the standardized approach of the Revised Capital Rules, as applicable.

The Proposal would allow clearing members subject to the advanced approaches capital rules to assign a zero-percent risk weighting to the trade exposure amount of a cleared transaction when the clearing member (i) does not guarantee the performance of the CCP and (ii) has no payment obligation to the clearing member client in the event of a CCP default.[4] We agree with the Agencies' conclusion that requiring clearing members to include the trade exposure amount of a cleared transaction in credit risk weighted assets will overstate total risk weighted assets and, for that reason, believe the revision set forth in the Proposal as to the advanced approaches should similarly be made with respect to the standardized approach. The preamble to the Revised Capital Rules makes no distinction between standardized and advanced approaches clearing members; therefore, under the Revised Capital Rules, clearing members using the standardized approach would be subject to the distortive calculations that the Proposal seeks to address for advanced approaches banking organizations only. Moreover, we see no logical reason why advanced approaches banking organizations—which must calculate their risk weighted assets under *both* approaches as a result of Section 171[5] of the Dodd-Frank Act—should potentially be negatively affected based solely on the different treatment of these issues with respect to the two approaches where the Agencies have already come to the conclusion that a revision is necessary. For the sake of consistency and completeness we therefore ask the Agencies to also revise the standardized approach to apply a zero-percent risk weight where the clearing member acts as a riskless principal.

The Proposal also clarifies the risk weighting applicable to collateral posted to a CCP, clearing member or custodian for a cleared transaction. As noted in the Proposal Sections 133(b)(4)(ii) and 133(c)(4)(ii) of the Revised Capital Rules state that the appropriate risk weight for such collateral should be calculated in accordance with Section 131, which provides risk weighting of wholesale and retail exposures only. However, as the Agencies acknowledge, collateral is not always limited to wholesale or retail assets. Therefore, to accommodate collateral in the form of a securitization exposure, equity exposure or a covered position, the Proposal would expand the cross reference from simply Section 131

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[4] Proposal at 75458.

[5] *Codified at* 12 U.S.C. § 5371.

to subpart E or subpart F, as applicable, to direct banking organizations to select the correct risk weighting for their relevant collateral.

We support the Agencies' decision to eliminate the potential for misinterpretation and correct the cross references in Sections 133(b)(4)(ii) and 133(c)(4)(ii). Consistent with this revision, we urge the Agencies to take the next, logical step and make parallel changes with respect to the standardized approach to prevent any confusion arising out of those provisions. Accordingly, we request that the cross references in Sections 35(b)(4)(ii) and 35(c)(4)(ii) be revised to cite subpart D or subpart F, as applicable, rather than Section 32.

2. To avoid the double counting of counterparty credit risk, banking organizations should be allowed to deduct CVA from EAD when calculating total risk weighted assets under both the standardized and advanced approaches.

The Proposal would allow advanced approaches banking organizations to reduce the EAD for OTC derivative contracts calculated according to the current exposure methodology ("**CEM**") in Section 132(c) by the CVA recognized on the bank's balance sheet for the purpose of calculating total risk weighted assets. However, the Proposal notes that for the purpose of calculating standardized total risk weighted assets, advanced approaches banks would not be permitted to reduce the EAD calculated according to the CEM because the standardized risk weighted assets calculation does not include the CVA capital requirement calculated in Section 132(e). The rationale provided for disallowing the reduction under the standardized approach, however, does not appear consistent with the total counterparty exposure subject to a potential loss in the event of a default.

The reason for reducing EAD with recognized CVA is to accurately represent the estimated EAD. A component of the exposure amount is the current credit exposure which should reflect the net asset amount, *i.e.*, net of any reserves, as this is the amount that is potentially at risk when the counterparty defaults. As this is true under both the standardized and advanced approaches, the reduction in EAD should be also allowable under both approaches. Otherwise, in the standardized approach banks would double count the impact of CVA by reflecting it in Tier 1 capital through decreases in retained earnings for purposes of the numerator while still treating it as an exposure amount in the RWA denominator.

The absence of a CVA capital requirement in the standardized approach does not alter the fact that incurred CVA constitutes an effective reduction in the bank's exposure amount under both the standardized and advanced approaches. The CVA capital requirement tries to capture the volatility in the incurred CVA charge. It is not a charge for the incurred CVA on the balance sheet, as this has already been reflected in Tier 1 capital through a reduction of retained earnings.

In light of the foregoing, we ask that the Agencies amend the Revised Capital Rules in order to allow banking organizations calculating standardized approach risk weighted assets to reduce EAD by CVA or its equivalent accounting charge. This request is consistent with the international Basel III rules which do not make a distinction between the standardized and internal ratings-based approaches for the purpose of calculating EAD and recognizing incurred CVA losses.[6] Allowing the deduction of CVA from EAD under the standardized approach would not only eliminate accounting redundancies but also more closely align the Revised Capital Rules with international standards.

3. Cleared transactions should be assigned a zero-percent risk weight for non-guarantor clearing members, regardless of whether they satisfy bankruptcy remoteness and portability criteria.

As noted above, the core element required under the Proposal for a clearing member to assign a zero-percent risk weight to the trade exposure amount of a cleared transaction is that the clearing member must have economic exposure to the clearing member client in the event of a CCP default. However, to be eligible for zero-percent risk weighting, a transaction must also qualify as a "cleared transaction," which means that it must meet the requirements of Section 3(a).[7] Section 3(a), in turn, identifies four operational requirements for a cleared transaction: (i) "the offsetting transaction must be identified by the CCP as a transaction for the clearing member client;" (ii) "the collateral supporting the transaction must be held in a manner that prevents the [BANK] from facing any loss due to an event of default . . of either the clearing member or the clearing member's other clients;" (iii) "the [BANK] must conduct sufficient legal review to conclude with a well-founded basis . . that in the event of a legal challenge . . the relevant court and administrative authorities would find the [collateral] arrangements . . to be legal, valid, binding and enforceable under the law of the relevant jurisdictions" (the "**Bankruptcy Remoteness Requirement**") and (iv) "the offsetting transaction with the clearing member must be transferable . . to another clearing member should the clearing member default, become insolvent, or enter receivership, insolvency, liquidation, or similar proceedings" (the "**Portability Requirement**").[8]

The Associations believe that the Bankruptcy Remoteness Requirement and the Portability Requirement are unnecessary where—by definition—the clearing bank, as the Agencies themselves believe, as evidenced by the assigned zero-percent risk weight, has no economic exposure and should therefore be eliminated in such circumstances.

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[6] Basel Committee on Banking Supervision, BASEL III: A GLOBAL REGULATORY FRAMEWORK FOR MORE RESILIENT BANKS AND BANKING SYSTEMS (rev. June 2011), ¶ 105.

[7] Revised Capital Rules at § 2.

[8] Revised Capital Rules at § 3(a).

Furthermore, omitting the Bankruptcy Remoteness Requirement and the Portability Requirement is consistent with other Agency rulemakings and other international implementations of the Basel III framework. For example for purposes of calculating its supplementary leverage ratio, an advanced approaches "clearing member Board regulated institution that does not guarantee the performance of a CCP with respect to a transaction cleared on behalf of a clearing member client may exclude its exposure to the CCP for purposes of determining its total leverage exposures."[9] Similarly, the European Union's Basel III implementation provides for zero exposure to a CCP where a financial intermediary does not guarantee the CCP's performance to the client but does not impose additional requirements.[10] Given this disparity in requirements, clearing members subject to the Revised Capital Rules will be at a competitive disadvantage as compared to their European counterparts.

Moreover satisfaction of these four requirements is not a simple task. For example, in order to safely meet the Bankruptcy Remoteness Requirement, clearing members may need to obtain legal opinions from CCPs to ensure the enforceability of their security agreements. While this is not an issue for some CCPs which provide these opinions on their websites, other CCPs do not publish these opinions, which poses a greater challenge for clearing members seeking to do business while still meeting the Revised Capital Rules' operational requirements. Eliminating such requirement would therefore remove an unnecessary burden.[11]

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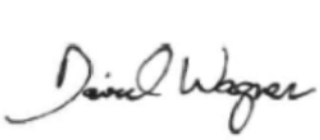
9 12 C.F.R. § 217.10(c)(4)(ii)(I).

10 Regulation (EU) No 575/2013, Article 306(1)(c), *available at:* http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013R0575.

11 We note that clearing member client banking organizations are also burdened by the Portability Requirement and the Bankruptcy Remoteness Requirement and request that the Agencies also consider what actions could be taken to alleviate or lessen such burden.

The Clearing House appreciates the opportunity to provide comments on the Proposal. We greatly appreciate your consideration of our comments and would welcome the opportunity to discuss them further with you at your convenience. If we can facilitate arranging for those discussions, or if you have any questions or need further information, please contact me at (212) 613-9883 (email: david.wagner@theclearinghouse.org).

Respectfully Submitted,



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