CME Group

June 3rd, 2016

VIA ELECTRONIC SUBMISSION

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551
[Docket No. R-1534] [RIN No. 7100 AE-48]

Re: Federal Reserve System Proposed Rule, Single-Counterparty Credit Limits for Large Banking Organizations

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"). 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 would like to express its appreciation to the Board of Governors of the Federal Reserve System ("the Board") for the opportunity to comment on the proposed rulemaking: Single-Counterparty Credit Limits for Large Banking Organizations. CME applauds the Board's proposed rule-making, which recommends an exemption from the single-counterparty credit limits for central counterparties that meet the definition of a qualified central counterparty ("QCCPs"), those that have adopted the Principles for Financial Market Infrastructures ("PFMIs") under Regulation Q.

CME is broadly supportive of the proposed rules by the Board, most specifically of the exemption for exposures to CCPs that satisfy the requirements for the QCCP designation, and recognition of the CCP market structure where CCPs are required to hold collateral in segregated accounts from their own assets and generally at third party custodians. Without the exemption and recognition of market structure, introducing a hard limit for controlling bank exposures to QCCPs would severely curtail the risk mitigating benefits that QCCPs provide. CCPs serve to reduce systemic risk and have always managed their risk to high standards as demonstrated by their stability during the 2008 financial crisis. Such standards have been raised further since 2013, not least due to new regulations on own capital, on

[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.

CCP default fund sizes and on default management procedures, all designed to address large exposure risk. Failing to take into account the unique nature of CCP exposures, and seeking to set hard limits for such exposures, could result in significant unintended consequences, including an increase in overall systemic risk, frustrating the goals of the Dodd-Frank Act.

CCPs are a critical component to the global financial markets and play a crucial role in mitigating risks for all participants in the markets they serve. While CCPs are counterparties to the covered companies under the proposed rules, their structure as a central counterparty, along with their purpose in these markets, is dramatically different from the structure, purpose, and risk profile of the covered companies meant to be addressed under the proposed rules. Unlike the covered companies addressed in this rule, market movements will not impact CCPs directly. The genesis of a CCP default would most likely be the default of multiple major clearing members during a catastrophic market event, where the losses exceed the prefunded financial resources of the CCP. Scenarios that could generate such an event were determined to be extreme and implausible in the European Securities and Markets Authority's ("ESMA") recent stress test of European CCPs,[2] meaning the current resources available to CCPs are sufficient for all extreme but plausible stress scenarios as contemplated by ESMA.

CCPs that meet the QCCP criteria, including CME, are designed to protect against losses caused by at least the two largest clearing members' default before even utilizing their legal authority to call for additional resources. Such additional cash calls generally allow CCPs to withstand the default of their four largest clearing members. Thus, the structure of QCCPs, which are insulated against market risk, coupled with effective risk management tools, are fundamentally different than that of the standard counterparty, which the exposure limitations applied to covered companies under the proposed rules are rightly designed to address.

All market participants share the goal of the proposed single-counterparty credit limit rules, to reduce concentration risk and limit contagion in a time of market crisis; however, applying the same standards to CCP exposures would ignore the ultimate purpose for which CCPs operate. CCPs are unique given the central role they play in the global financial markets as a market risk flat central counterparty with the purpose of significantly mitigating counterparty risk to allow for more efficient global financial markets. QCCPs in particular are qualified for exemption from the proposed rules considering the stringent regulatory standards with which they must comply, which exceed those that were in place during the financial crisis. The Board has proposed exempting QCCPs from any rules establishing single-counterparty credit limits for nonbank financial companies, highlighting their market risk neutral position and stabilizing role in the marketplace. We encourage the Board to make this exemption permanent as proposed and would similarly encourage all jurisdictions to follow the path of the Board and take this same step of providing a permanent exemption for QCCPs exposures consistent with these proposed rules.

We will also provide more direct comments below in response to Questions 16, 37, and 55 of the proposed rules.

> <u>Question 16: With respect to derivative transactions, the Board invites comment on the proposed reliance on the methodologies covered companies are permitted to use under the</u>

[2] "The results show that CCPs' resources were sufficient to cover losses resulting from the default of the top-2 EU-wide CM groups combined with historical and hypothetical market stress scenarios."
https://www.esma.europa.eu/press-news/esma-news/esma-publishes-results-eu-central-counterparties-stress-test

risk-based capital rules. Should covered companies instead be required to use CEM? Should the single-counterparty credit limits rule ultimately require use of SA-CCR or a similar standardized approach to measure a covered company's credit exposure to derivative counterparties?

Regulatory capital requirements for banks that hold derivatives exposures have direct impacts on the markets CME serves, higher requirements lead to higher trading costs and thus can impact market liquidity. CME is not advocating for a broad lowering of the capital requirements for derivatives exposures, we are asking for consistency in the standardized capital requirement approaches and that the requirements for derivatives exposures are appropriately tailored based on market structure. Consistency in the standardized capital requirement approaches is paramount given that these requirements will ultimately impact the financial stability of our markets if different banks are under different standardized approaches.

CCPs act as the buyer to every seller and seller to every buyer and we are able to offer this service through our relationships with our clearing members. CCP clearing members are typically the subsidiary of a larger bank holding company which ultimately must calculate the regulatory capital requirements for the derivatives exposures of the clearing member subsidiary under the rules of the larger bank holding company's home jurisdiction.

Standardized bank regulatory capital requirements for derivatives exposures have historically been calculated under the Current Exposure Method ("CEM"). The CEM approach has existed for decades and is implemented consistently across the globe. CEM faced heavy criticism during the Basel III design process due to its focus on trade notional as its primary measure of riskiness. Additionally, the CEM lacks a delta-adjustment for non-linear contracts, a duration adjustment for liquid listed interest rate derivative products, and has strict limitations on contract netting. As a result of these criticisms, the Basel Committee has introduced a new standardized approach to sizing bank regulatory capital requirements for derivatives exposures; known as the Standardized approach for measuring counterparty credit risk exposures ("SA-CCR").

The SA-CCR approach is designed to be more risk-sensitive while also preventing any undue complexity in the calculation process. Additional risk-sensitivity is achieved in the SA-CCR through a delta-adjustment for non-linear derivatives, and also through a maturity duration adjustment for interest rate derivatives, both absent from the CEM methodology.

The Basel Committee has recommended the SA-CCR to replace the CEM in the capital framework, including in the Basel Committee version of the Board's proposed rules, the Basel Committee on Banking Supervision Standards, Supervisory framework for measuring and controlling large exposures, April 2014. The Basel Committee recommends implementation of the SA-CCR method by Jan 1st 2017 and implementation is progressing in different stages throughout the globe[3].

In the event of a CCP clearing member default, common practice is that the CCP will seek to port the solvent customers of that defaulting clearing member to another solvent clearing member, which again is typically a subsidiary of a larger bank holding company. A key consideration of the solvent clearing member when deciding whether to accept the solvent customers of the defaulting clearing member is

[3] http://www.mas.gov.sg/News-and-Publications/Consultation-Paper/2015/Consultation-Paper-on-Proposed-Amendments-to-MAS-Notice-637-to-Implement-Revisions.aspx

the amount of regulatory capital required to support those customers. If different bank holding companies are subject to starkly different standardized capital requirement approaches because different jurisdictions have adopted different standardized capital requirement approaches, this will lead to undue confusion and complexity during a period of financial stress. CME is an advocate for global consistency in the standardized capital requirement approaches and asks that the Board consider the importance of consistency in the implementation of their final rules.

> <u>Question 37: Should all trade exposures to QCCPs be exempt from the proposed rules? Is the definition of ''QCCP'' sufficiently clear? Should the Board consider exempting any different or additional exposures to QCCPs? Would additional clarification on these issues be appropriate?</u>

CME agrees with the proposed rules to exempt all trade exposures to QCCPs. This will not frustrate the intentions of Title VII of the Dodd-Frank Act and in fact facilitate the usage of central clearing, which is in line with the purposes of the global regulating body Committee on Payments and Market Infrastructures ("CPMI") & the International Organization of Securities Commissions ("IOSCO") when they released the PFMIs to reduce risk and create a safer, more efficient marketplace.

Regarding additional exposures to QCCPs for exemption consideration, CME believes the Board should explicitly exempt any unfunded default fund contributions from the rules, similar to how pre-funded default fund contributions are proposed to be exempted under the rules. This approach would be consistent with the Basel Committee on Banking Supervision Standards, Supervisory framework for measuring and controlling large exposures, April 2014. Furthermore, unfunded default fund contributions deserve the same explicit exemption from the rules because in the event that the funds were provided to the QCCP, they would be done so in a manner consistent with pre-funded default fund contributions and subject to the proposed exemption. Covered companies would benefit from this additional clarification under the final rules, and having additional funds earmarked for the default exempted from the single counterparty credit limits would further the intentions of CPMI-IOSCO and the PFMIs. Therefore we request the Board make this additional exemption in their final rule making.

In the matter of additional clarifications, several market participants have voiced concerns to CME that the proposed rules do not go far enough to clarify that the exemptions would apply through the consolidated banking group and also to any domestic and non-domestic affiliates and subsidiaries of the consolidated banking group which would be subject to the rules. Therefore, CME requests the Board makes more explicit in the final rule that the exemption for QCCPs applies throughout the domestic and non-domestic affiliates and subsidiaries of the consolidated banking group, and that any affiliates or subsidiaries are allowed to look-through to their final QCCP exposures when determining their compliance with the limits under these rules. Often due to regulatory restrictions, a covered company under the rules in the United States will use a non-domestic affiliate when booking a transaction on our markets in order to provide access to our markets for market participants in that respective jurisdiction. Not allowing that non-domestic affiliate to apply the QCCP exemption would conflict with the spirit of the proposed rules to provide an exemption for QCCP exposures more generally, and also frustrate the purposes of Title VII of Dodd-Frank Act and intentions of CPMI-IOSCO.

> <u>Question 55: Would additional exemptions for foreign banking organizations or the U.S. intermediate holding companies of foreign banking organizations be appropriate? Why or why not?</u>

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As noted in our response to Question 37, market participants have voiced concerns to CME that the proposed QCCP exemption does not go into enough detail to confirm that the exemption applies to the non-domestic affiliates of the US intermediate holding companies of the foreign banking organization. CME believes that additional clarification of the exemption to the non-domestic affiliates of the US intermediate holding companies of foreign banking organizations would be appropriate and consistent with the intent of the Rule. We ask this additional clarification be included in the Board's final rules.

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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