CREDIT SUISSE

March 18, 2019

Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, DC 20219
Attention: Legislative and Regulatory Activities Division
Docket ID OCC-2018-0030; RIN 1557-AE44

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Ann E. Misback, Secretary
Docket No. R-1629; RIN 7100-AF22

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Robert E. Feldman, Executive Secretary
RIN 3064-AE80

Re: Credit Suisse Comment on Proposed Standardized Approach for Calculating the Exposure Amount of Derivative Contracts

Ladies and Gentlemen:

Credit Suisse welcomes the opportunity to provide comments on the proposed rule (the "**Proposal**") issued by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (the "**Agencies**") to implement the standardized approach for counterparty credit risk ("**SA-CCR**") as a replacement for the current exposure method ("**CEM**") in the U.S. capital rules.[1]

We appreciate the opportunity to comment on the approach as it relates to Credit Suisse's ability to provide swaps clearing access to our clients[2] and the related considerations around the Supplemental Leverage Ratio (**"SLR"**). Additionally, we echo concerns raised by our clients in the comment letter filed by The Securities Industry and Financial Markets Association's Asset Management Group ("SIFMA AMG") and Managed Funds Association ("MFA"), principally as they relate to the supervisory factors for credit and commodities.

Introduction

We appreciate that in the Proposal, the Agencies acknowledge that they are "sensitive to impediments" that exist in the current rules for clearing firms, like Credit Suisse, to act as a clearing intermediary for our clients. The Agencies specifically requested comments on the consequences of not recognizing client collateral.

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[1] 83 Fed. Reg. 64,660 (December 17, 2018).

[2] While Credit Suisse is writing this letter in its capacity as a clearing provider, we support other comment letters that address concerns with the rule proposal as they relate to Credit Suisse's own access to the market including the joint-letter issued by ISDA, FIA, SIFMA, ABA, and BPI.

We believe that SLR (and by extension, SA-CCR) should recognize the risk mitigating effect of initial margin and variation margin in reducing a banking organization's potential future exposure ("**PFE**") when clearing derivatives for clients. Furthermore, U.S. rules should not include supervisory factors that are more severe than the internationally agreed-upon Basel Committee standards. This will significantly increase costs for end users to hedge in US markets with little to no added benefit to the safety and soundness of U.S. markets. Until these issues are corrected, the SLR and SA-CCR rules will continue to disincentive clearing, thereby harming the ability of end-users to hedge risks and impeding economic growth.[3]

Background

One of the purposes of the SLR is to limit the buildup of capital market risk; however, as adopted the rule has:

- Penalized pension funds, producers, and insurance companies who clear swaps and futures to hedge their market risks.
- Incentivized clearing activities for speculators and high frequency traders;
- Increased market concentration of clearing providers; and,
- Increased the cost of doing business for farmers, ranchers, producers and other end users across the country.

These unintended consequences have the effect of impeding clearing in the derivatives market. This is contrary to stated G-20 goals and to the chief principles of post crisis financial reforms enacted in the United States including those reforms driven at producing more liquidity in the markets.

Of specific concern to us, the SLR incorrectly imposes a capital charge on brokers engaged in client clearing activity. This charge has reduced the already narrow-profit margins of bank-owned client clearing brokers, rendering such activity uneconomical for many firms. In turn, this has led to banking organizations decreased ability to support client clearing exposures, reduced liquidity in this market, and growing concentration of clearing activities. All of these consequences ultimately result in higher costs for end-users.

U.S. market regulators recognize the impediments the SLR places on clearing activities to the detriment of the market as a whole, impacting both end-users and financial institutions. Both former- CFTC Chairman Timothy Massad, and the current CFTC Chairman Christopher Giancarlo have called for the SLR to be amended to take account of this activity, a move that we support – particularly as it applies to client clearing brokerage activity.[4]

In this context, our concerns over the SLR only grow as we look at the proposal to move from CEM to SA-CCR. Under the current proposal, exposure amounts would increase for derivative contracts with clients like asset managers, investment funds, and pension funds. We believe this increase in exposure is a result of SA-CCR's excessive layering of buffers, often times for risks that are already adequately protected for with collateral and capital.

In order to prevent SA-CCR from amplifying the negative effects of the current regulatory regime on clearing intermediaries and the end users we service, SA-CCR should be adopted in a more risk-sensitive and less punitive manner than is set forth in the Proposal. This includes:

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[3] CFTC, Capital Adequacy: Standardized Approach for Calculating the Exposure Amount of Derivative Contracts (February 15, 2019). Available at: https://www.cftc.gov/sites/default/files/2019-02/SA-CCRCommentLetter021519.pdf.

[4] Timothy Massad, Keynote Address before the Institute of International Bankers (March 2, 2015). Available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-13.

- Recognizing the risk mitigating effect of initial margin and variation margin in reducing a banking organization's PFE when clearing derivatives for clients, and

- Reducing and making more granular the Proposal's supervisory factors for certain credit, commodity, and equity asset classes.

1. The SLR should recognize the risk mitigating effect of initial margin and variation margin in reducing a banking organization's PFE when clearing derivatives for clients. Until this is corrected, the rule will continue to hinder the ability of end-users to hedge risks and thereby impede economic growth.

As evidence, CFTC data concludes that there were 171 Future Commission Merchants ("**FCMs**") as of March 2007. Ten years later (May 2017) there were but 54 FCMs left, many of which are inactive or marginally active entities.[5] Further, since the SLR took effect six of the leading clearing brokers have closed their US swaps clearing business: Deutsche Bank, BNY Melon, Nomura, RBS, Jefferies and State Street. Currently, three brokers control more than 50% of all client cleared collateral for swaps combined. The top five banks control approximately 75% of the business.[6]

The SLR requires banks to hold capital against actual exposures to loss. Unfortunately, the current standard does not recognize the collection of customer margin in the clearing process as an offset to these exposures. The SLR incorrectly treats margin collected on a cleared swaps transaction the same as it does for a bilateral (i.e., uncleared) transaction - despite the fact that a cleared transaction does not have the same risk profile as an uncleared one. The risk profile of a cleared swap is significantly lower than that of a bilateral swap, which is precisely the reason regulators sought to incentivize more clearing to begin with.

Unlike a bilateral trade, once a trade is cleared, the clearing broker has no credit exposure to the central clearing party, nor does it have any market exposure in the transaction. The only exposure remaining for the clearing broker is that of the end user to the clearing party. In this transaction, the broker guarantees the performance of the end user's account to the central counterparty clearinghouse ("**CCP**").

Given that client margin is collected for this exact purpose, to insure their performance/credit worthiness on the transaction, it should count, under the SLR, as risk mitigating.[7]

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[5] Brookings Institute, Dwindling Numbers in the Financial Industry by Hester Peirce (May 15, 2017). Available at: https://www.brookings.edu/research/dwindling-numbers-in-the-financial-industry/amp.
[6] Bloomberg, Deutsche Bank to close US OTC clearing business by Noah Buhayar (February 8, 2017). Available at: https://www.bloomberg.com/news/articles/2017-02-09/deutsche-bank-is-said-to-close-u-s-swaps-clearing-business.
[7] This recommendation is consistent with the third option presented by the Bank for International Settlements last year, which has received the support of ISDA, GFMA, and IIF. See BIS's Leverage Ratio Treatment of Client Cleared Derivatives (October 2018). Available at: https://www.bis.org/bcbs/publ/d451.htm.

Recommendation:

Segregated Client Margin Should Offset the Potential Future Exposure of Client Clearing Brokers under the Leverage Ratio Framework/U.S. SLR

I. Client segregated margin shall be deemed to offset the PFE of the clearing broker to such client if:

(i) The clearing broker does not record any particular transaction or portfolio of transactions or the associated collateral as an asset or liability under applicable accounting standards, including, without limitation, the clearing broker cannot invest the collateral for its own purposes;

(ii) The clearing broker exclusively has potential future credit exposure to its clearing client and no potential market exposure for the transaction itself, portfolio thereof, or the associated collateral; and,

(iii) The clearing client has paid or otherwise deposited segregated margin with the CCP in the form of cash or treasury instruments to cover the client's potential future market exposure and the clearing broker's potential future credit exposure to its clearing client.

2. Reduce and make more granular the Proposal's supervisory factors for certain credit and commodity asset classes.

Credit

We agree with the Agencies' decision not to increase the Basel Committee's supervisory factors for indexed credit derivatives. We are, however, concerned that the same treatment was not extended to single-name credit derivatives. We believe the Proposal inappropriately increases the Basel Committee's supervisory factors for single-name credit derivatives through its conversion of external credit ratings into alternative criteria.

The Proposal accounts for only three gradations of issuer credit quality compared to seven in the Basel Committee standard. This reduction would result in higher supervisory factors for the most creditworthy issuers. The Basel Committee's two lowest-risk categories for single-name credit derivatives – AAA- and AA-rated issuers – are assigned a 0.38% supervisory factor, but the Proposal's lowest-risk category ("investment grade") would be assigned a 0.50% supervisory factor. Creditworthy issuers in the United States are no more prone to default than are creditworthy issues in other G-20 jurisdictions, and accordingly, the final U.S. SA-CCR standard should not include a higher supervisory factor for investment grade issuers than the Basel Committee's lowest supervisory factor.

Lastly, in the proposal, the Agencies query whether they should seek alternative criteria that would permit more granularities in the categorization of issuer creditworthiness, consistent with the Dodd-Frank Act's restrictions on the use of external credit ratings. We would encourage the Agencies to conduct this exercise.

Recommendation:

- Recalibrate supervisory factors to be on par with those set forth in the Basel Committee standard, and
- Allow more granular categorization of issuer creditworthiness.

Commodities

We are also concerned with the Proposal to increase the Basel Committee's supervisory factors for oil and gas derivatives by combining those derivatives with the electricity category and assigning the higher Basel supervisory factors for electricity to the entire combined energy category. The stated rationale for this treatment is that SA-CCR does not permit diversification benefits among sub-classes of commodities, and therefore additional commodity sub-classes could reduce the number of derivative contracts across which a banking organization may hedge.[8] SA-CCR should allow the oil and gas and electricity categories to be part of the same hedging set, not to combine them into a single category with a higher supervisory factor.

Recommendation:

- Permit Electricity vs non-Electricity commodities to be part of the same hedging set, and
- Eliminate supervisory factors that are more stringent than internationally-agreed upon Basel Committee standards.

Conclusion

For the reasons stated herein, we urge the Agencies to adopt SA-CCR in a manner that will decrease, rather than increase, exposure values compared to CEM for banking organizations when they offer swap clearing services to clients such as asset managers, investment funds, pension funds and farming co-ops. This can be achieved, in part, by recognizing the risk mitigating effects of initial margin that is posted for client cleared transactions and by recalibrating supervisory add-ons so that they better account for safety measures already in place and better align with global standards.

We also support the proposed implementation and compliance timeframe considerations highlighted in the joint-letter from International Swaps and Derivatives Association ("ISDA), American Bankers Association ("ABA"), Bank Policy Institute ("BPI"), Futures Industry Association ("FIA"), and SIFMA. Institutions should be permitted to adopt SA-CCR upon the issuance of the final rules; however, given the correlation between SA-CCR and aspects of the US implementation of Basel III reforms, aligning the compliance dates of both would allow the industry to take a more methodical approach in both regulatory initiatives. At the very least, we urge the Agencies to reconsider the current implementation timeframe of July 2020 given the numerous practical challenges it poses across the industry.

We appreciate the Agencies' consideration of our comments as it relates to our ability to provide clearing services to our clients. Should you have any questions, please do not hesitate to contact the undersigned at **(202) 626-3326** (margaret.gage@credit-suisse.com). Questions can also be directed to John Dabbs at (212) 325-0460 (john.dabbs@credit-suisse.com) or Peter Ryan at (202) 626-3306 (peter.ryan@credit-suisse.com).

Respectfully submitted,

Maggie Gage
Head of U.S. Public Policy

[8] 83 Fed. Reg. at 64,671 (December 17, 2018).