LCH The Markets' Partner

Via Electronic Submission

February 26, 2019

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

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

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW
Suite 3E-218
Washington, DC 20219

Re: Standardized Approach for Calculation the Exposure Amount of Derivative Contracts (Federal Reserve Docket No. R-1629, RIN 7100-AF22; FDIC RIN 3064-AE80; OCC Docket ID OCC-2018-0030)

Dear Sirs and Madams:

LCH Group ("LCH") welcomes the opportunity to respond to this request for comment from the Board of Governors of the Federal Reserve System ("Board"), Federal Deposition Insurance Corporation ("FDIC"), and the Office of the Comptroller of the Currency ("OCC") (together "Agencies") regarding the Proposed Rule on the Standardized Approach for Calculating the Exposure Amount of Derivative Contracts ("Proposal").[1] This Proposal replaces the Current Exposure Methodology ("CEM") with the Standardized Approach for Counterparty Credit Risk ("SA-CCR") as the methodology for calculating total risk-weighted assets under the capital rule and for the total leverage exposure.

LCH is an international, multi-asset class group of clearing houses, or central counterparties ("CCPs"), that manage risk of many diverse portfolios of cleared derivatives.[2] LCH has supported regulatory reform enhancements to the global structure governing derivatives markets that have resulted in a

[1] 83 FR 64660 (Dec. 17, 2018); https://www.govinfo.gov/content/pkg/FR-2018-12-17/pdf/2018-24924.pdf.

[2] LCH Group clears a broad range of asset classes including securities, exchange-traded derivatives, commodities, foreign exchange derivatives, interest rate swaps, credit default swaps, and euro and sterling denominated bonds and repos. LCH Group Limited is majority owned by the London Stock Exchange Group ("LSEG"), a diversified international exchange group.

comprehensive, stronger, and more robust risk management framework for CCPs, clearing members, and end-users of derivatives.

LCH welcomes the Agencies' Proposal to replace CEM with SA-CCR. LCH has consistently supported the transition to SA-CCR and inclusion of the client initial margin ("IM") offset within the leverage ratio calculation.[3]

In general:

- **LCH supports the replacement of CEM with SA-CCR for the purposes of the supplementary leverage ratio ("SLR"):** SA-CCR is a more risk-sensitive, calibrated methodology that better reflects the current market conventions and regulatory requirements designed to mitigate the risks associated with derivative contracts.
- **LCH supports recognizing client IM in the exposure calculation of SLR:** LCH recognizes SLR's important role in the market but stresses the importance for clearing members ("CM") to be capitalized in line with the risks they bear and not unnecessarily penalized. The segregated IM that a CM collects from its clients and passes to the CCP is risk reducing and should be reflected in the exposure calculation of the SLR.

LCH provides the following specific comments to the Proposal:

Question 16: What concerns do commenters have regarding the proposal to replace the use of CEM with a modified version of SA-CCR, as proposed, for purposes of the supplementary leverage ratio?

LCH is concerned with the proposed floor of 10 business days for the margin period of risk ("MPOR") in respect to client cleared transactions.[4] This increase, from a floor of 5 days, is a significant deviation from the international standards and other jurisdictions. This is likely to disincentivize central clearing by increasing capital costs, which will be passed on to end-users.

Question 17: The agencies invite comment on the recognition of collateral provided by clearing member client banking organizations in connection with a cleared transaction for purposes of the SA–CCR methodology. What are the pros and cons of recognizing such collateral in the calculation of replacement cost and potential future exposure?

LCH agrees CMs that do not collect any collateral from a client should set aside capital against that exposure. However, if the collateral collected is passed to a CCP, it is not reasonable to require the CM to set aside the same amount of capital against that exposure. The recognition of client IM in the SLR appropriately promotes increased postings of collateral, such that CMs and clients seek a balance between capital and collateral costs.

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[3] LCH response to BCBS consultation paper on potential changes to the Leverage Ratio Treatment of client cleared derivatives, 16 Jan 2019, available at https://www.bis.org/bcbs/publ/comments/d451/overview.htm; LCH response to BCBS Revisions to the Basel III Leverage Ratio Framework, 6 July 2016, available at https://www.bis.org/bcbs/publ/comments/d365/lchclearnetgrou.pdf;
Joint Industry letter to FSB, GHOS, and BCBS, Treatment of Cleared Client Initial Margin in the Leverage Ratio, 3 Nov 2016, available at https://fia.org/articles/pan-industry-coalition-urges-international-banking-regulators-revise-leverage-ratio;
LCH response to BCBS 251 - Revisions to the Basel III Leverage Ratio Framework and Disclosure Requirements, 20 Sep 2013, available at https://www.bis.org/publ/bcbs251/lchclearnet.pdf.

[4] 83 FR 64660 at 64677.

Capital requirements that disproportionately constrain client clearing capacity or prohibit new market participants from accessing central clearing services work against the G20 objective to promote central clearing and increases the risk of CMs refusing to accept porting of clients during a default.

Analysis of IM Offset Impact

In October 2018, LCH Ltd's SwapClear[5] service conducted an analysis on the impact of recognizing client IM in the SLR framework, assuming implementation of SA-CCR.

For the top 3 CMs, representing roughly 45% of SwapClear's client cleared notional volume, failure to recognize IM unnecessarily adds 55% more capital. Of this, roughly 75% of the increase is represented by real money client activity because their portfolios are generally more directional. This results in the negative effect from not recognizing client IM disproportionately impacting real money clients.

We acknowledge the Agencies must balance the principles of the SLR framework against the broader G20 goals and systemic risk concerns. As a central player in the cleared derivatives market, LCH believes IM is the front-line defense for risk management in the clearing industry, protecting CMs, clients, and the broader financial markets from counterparty risk. Failure to recognize its risk-reducing effect is contrary to the broader goals of prudential and market regulators to promote an appropriate balance between margin and capital and to ensure a more resilient clearing industry. [6]

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We appreciate the opportunity to respond to this request for comment from the Agencies and look forward to further engaging on this matter. Please do not hesitate to contact us if you have any questions.

Sincerely,

Jonathan Jachym
Head of North America Regulatory Strategy and Government Relations
U.S. Country Head
London Stock Exchange Group

[5] SwapClear is the leading clearing house for interest rate swap derivatives, housed within LCH Ltd.

[6] For the complete set of results and additional details on the reasons LCH supports the recognition of segregated client IM deposited with CMs in the SLR, please see the LSEG response to the BCBS consultation paper on potential changes to the Leverage Ratio Treatment of client cleared derivatives, 16 Jan 2019, available at https://www.bis.org/bcbs/publ/comments/d451/overview.htm.