



January 16, 2024

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

Chief Counsel's Office  
Attention: Comment Processing  
Office of the Comptroller of the Currency  
400 7<sup>th</sup> Street SW, Suite 3E-218  
Washington, DC 20219

James P. Sheesley  
Assistant Executive Secretary  
Attention: Comments/Legal OES (RIN  
3064-AF29)  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street NW  
Washington, DC 20429

**Re: Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15); Docket No. R-1814 and RIN 7100-AG65 (“GSIB Surcharge Proposal”)**

**Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity; Docket No. R-1813, RIN 7100-AG64 (“Basel III Endgame Proposal”), together with the GSIB Surcharge Proposal, the “Proposals”.**

Dear Sir / Madam,

The London Stock Exchange Group (“LSEG”) is pleased to file a response to the request for comment on the Proposals referenced above issued by the Board of Governors of the Federal Reserve System (the Federal Reserve), and jointly by the Federal Reserve, Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency (collectively, the “Agencies”).

LSEG is a leading global financial markets infrastructure and data provider, with significant operations in the United States. We play a vital role in managing risk in the world’s financial system. We are leaders in clearing and trade execution, risk management, capital formation and data and analytics. With our trusted expertise and global scale, we enable the sustainable growth and stability of our customers and their communities and global financial markets.

LSEG has majority ownership of the global central counterparty clearing house group, LCH Group, which has two U.S. licensed central counterparty (CCP) subsidiaries – LCH Ltd (LCH) and LCH SA. Both are leading multi-asset class and international clearing houses, serving major international exchanges and platforms as well as a range of over-the-counter (OTC) markets. We clear a broad range

of asset classes, including securities, exchange-traded derivatives, commodities, Interest Rate Swaps (IRS), foreign exchange (FX) derivatives, credit default swaps and Euro, Sterling and U.S. Dollar denominated bonds and repos.

LCH provides important clearing services to U.S. markets through the provision of OTC derivatives clearing in IRS and FX. LCH's SwapClear service is an essential pillar of the market infrastructure for IRS as it clears over 90% of the IRS market globally, including in USD. We provide clearing services to many important U.S. organizations including all the U.S. Global Systemically Important Banks (GSIBs), U.S. government sponsored enterprises, pension funds, insurance companies, regional banks, asset managers and hedge funds. SwapClear has 127 direct clearing members, including 12 active Futures Commission Merchants (FCMs) who provide clearing broker services to approximately 1,800 U.S. clients and 2,400 non-U.S. clients. LCH is authorized by a network of international official sector agencies in fulfillment of its resulting responsibilities, including in the U.S. as a registered Derivatives Clearing Organization (DCO) with the Commodity Futures Trading Commission (CFTC) since 2001<sup>1</sup>. We are fully compliant with the CFTC's DCO core principles established in Section 5b of the Commodity Exchange Act<sup>2</sup>, and the rules promulgated thereunder and the Dodd-Frank Act.

LSEG commends the Agencies' objective in issuing the Proposals to improve the safety and transparency of the financial markets. We support regulatory enhancements to the global regulatory structure governing derivatives markets that have resulted in a comprehensive and robust risk management framework for CCPs, clearing members, and end users of derivatives. The clearing of OTC derivatives is recognized to have important systemic risk benefits, as reflected in Financial Stability Board's assessment of the G20 recommendations<sup>3</sup> in the immediate aftermath of the 2008 financial crisis. Great progress has been made in implementing these recommendations at a global level. The mandatory clearing requirement<sup>4</sup> was introduced to standardize and reduce counterparty risk associated with OTC derivatives, and, in turn, to reduce the likelihood that they cause or exacerbate instability in the financial system. Accordingly, CCPs have demonstrated resilience to stress events that have threatened financial stability.

With this perspective in mind, we welcome the opportunity to comment on specific elements of the Proposals. We have strong concerns about their impact to the cleared derivatives market as the Proposals would materially alter the existing U.S. framework that governs them. We believe it is of the utmost importance that the use of cleared derivatives is not negatively impacted. As cleared derivatives greatly reduce risk in the financial system, it is imperative that the Proposals do not deter both U.S. and non-U.S. end users from continuing to utilize them to hedge exposures and manage risks for the real economy. Specifically, the Proposals should not increase systemic risk by constraining banks' capacity for offering access to clearing, increase the cost for end users, or by otherwise disincentivizing the use

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<sup>1</sup> LCH SA has been registered with the CFTC since 2013 and with the Securities Exchange Commission as a Clearing Agency since 2017.

<sup>2</sup> 7 USC § 7a-1.

<sup>3</sup> [G20 Leaders Declaration Pittsburgh 2009 \(fsb.org\)](#) and [Implementation and Effects of the G20 Financial Regulatory Reforms: 3rd Annual Report \(fsb.org\)](#)

<sup>4</sup> [2012-18383a.pdf \(cftc.gov\)](#)

of cleared derivatives. Further, under existing regulatory frameworks cleared derivatives are already suitably heavily capitalized in support of managing the attendant risks. Indeed, the Proposals do not demonstrate that capital requirements for cleared derivatives are inadequate or otherwise provide grounds for changing existing capital requirements for cleared derivatives.

## I. The GSIB Surcharge Proposal

### **Amending the complexity indicator to include the notional amount of OTC derivatives cleared under the agency model would lead to increased costs for end users and contravene global policies in favor of clearing**

The most significant adverse impact to cleared derivatives comes from the GSIB Surcharge Proposal's changes to the "complexity" indicator<sup>5</sup>. In the original U.S. GSIB rules<sup>6</sup>, the complexity indicator is intended to capture the systemic risk of a bank's distress or failure arising from that bank's business, structural and operational complexity. The GSIB Surcharge Proposal would require U.S. banks to include the notional amount of OTC derivatives that are cleared by an affiliated FCM on behalf of clients via the agency or FCM model<sup>7</sup>. This would lead to additional and duplicative capital holdings, and we are concerned that as clearing brokers calibrate their service offering to their GSIB score, this would reduce their provision of services and increase the cost of providing such services. Consequently, this could lead to less hedging by end users. These effects would be fundamentally inconsistent with the Pittsburgh G20 commitments and would contravene global policies in favor of clearing.

Agency model activity has been excluded from the complexity indicator to date, and it will remain excluded for non-U.S. GSIBs, in line with the Basel Committee on Banking Supervision (BCBS) agreement. This current arrangement incentivizes the reduction of complexity that is associated with cleared transactions, consistent with the policy objective of a complexity indicator. Further, agency client clearing is already included in the "size" indicator of the GSIB surcharge calculation. Any divergence from international standards would create a competitive disadvantage for U.S. GSIBs that provide client clearing in a "well capitalized"<sup>8</sup> and highly regulated manner. Moreover, given that U.S. GSIBs provide clearing services globally via the agency model for U.S. and non-U.S. clients, applying higher capital charges for U.S. GSIBs may erode the pervasiveness of the agency model and have knock on structural implications to the globally cleared derivatives market. Yet, the Agencies have provided no evidence that a change from the BCBS agreement is warranted.

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<sup>5</sup> Note, other GSIB Surcharge indicators are also impacted, but we believe these to have a lesser impact. For example, a similar proposal exists for the "interconnectedness" indicator which would require U.S. banks to include the guarantee of a client's performance for OTC derivatives they clear on behalf of clients under the U.S. agency model. This would have a smaller impact than the complexity indicator due to clearing brokers receiving initial margin from clients.

<sup>6</sup> [2015-18702.pdf \(govinfo.gov\)](#)

<sup>7</sup> Globally, organizations use two structures to act as a clearing intermediary for their clients, as identified in the GSIB Surcharge Proposal: (i) the principal model; and (ii) the agency model or FCM model.

<sup>8</sup> [The Fed - 3. Leverage in the Financial Sector \(federalreserve.gov\)](#)

Our internal analysis of SwapClear data estimates that the impact of the amendment to the complexity indicator alone would increase the GSIB score of a large FCM by approximately 16bps<sup>9</sup>. Given the proposal to tighten Method 2 GSIB score bands to 20bps, this increase would equate to 80% of a given band. Consequently, it would likely move the bank into a higher Method 2 capital surcharge bucket for the bank's entire activity (total risk-weighted assets), which will already be higher under the Basel III Endgame Proposal.

Similar changes to the GSIB's complexity indicator were proposed and rejected by the Federal Reserve in 2018<sup>10</sup> as they did not believe it was appropriate to treat the client leg of a cleared transaction in the agency model as more complex than a simple credit exposure. Additionally, concerns were mitigated with the expansion in availability and overall use of the agency model, with the Federal Reserve suggesting the need to revisit this treatment if the principal model became more common.

Since 2018, SwapClear's outstanding notional under the agency model has more than doubled and its U.S. GSIBs clear approximately \$44trn (as of Q4, 2023) under this model. Further, the agency model is the dominant method of clearing and the relative share of the principal model at SwapClear has fallen. The international success and importance of the agency model is evident as more than 80% of SwapClear's client cleared OTC derivatives use this model, and 55% of clients (by number of clients) under this model are domiciled inside the U.S. Given the same reasoning as in 2018 remains true, OTC derivative transactions cleared under the agency model should not be added into the complexity indicator.

Therefore, as central clearing reduces complexity, the continued relevance of the Federal Reserve's prior reasoning supporting agency clearing, and the materiality of the GSIB Surcharge Proposal, we recommend that the notional amount of OTC derivatives cleared on behalf of clients under the agency model continue to be excluded from the GSIB complexity indicator for reporting U.S. banking organizations.

**The GSIB Surcharge Proposal should not disincentivize porting of positions as it reduces systemic risk through efficient default management and risk management**

LSEG has related concerns with the GSIB Surcharge Proposal's impact on the willingness of clearing brokers to accept new client positions as part of a client porting transaction. Porting is key to clients' risk management and is used by CCPs and by clients in business-as-usual (BAU) and stress event portfolio management to facilitate the movement of positions and margin from one clearing broker to another.

Porting is particularly important during times of market stress and is a vital process to allow clients to port positions away from clearing brokers who may come under distress, or may wish to exit, allowing for trade continuity. Moreover, the use of porting is central to CCP default management processes where

<sup>9</sup> The analysis only includes the impact from the complexity indicator. Impact from other indicators would further add to this estimate.

<sup>10</sup> Agency Information Collection Activities: Announcement of Board Approval Under Delegated Authority and Submission to OMB, 83 Fed. Reg. 31,144 (July 3, 2018).

in the event of a clearing broker default, CCPs reduce risk in the overall financial system by porting client positions to other clearing brokers that are financially sound. The process was well utilized by clients during the withdrawal of Credit Suisse from FCM clearing. During this period SwapClear clients ported approximately 250% more positions in 2022 as compared to 2021. Porting continues to be well utilized. In 2023, SwapClear clients ported approximately 84,000 extra positions, an increase of 30% as compared to 2022.

Therefore, as the GSIB Surcharge Proposal would significantly increase clearing brokers' capital requirements, we are greatly concerned it will reduce the willingness of clearing brokers to accept new client positions and facilitate client porting. This could be the case not only in BAU, but also in stress and default scenarios, which would exacerbate systemic risk concerns given its importance during these times. The challenge on constrained clearing broker capacity and its impact of porting likelihood has been flagged in prior industry advocacy<sup>11</sup> and we urge for it to be considered when finalizing the proposed rule.

## **II. The Basel III Endgame Proposal**

The Basel III Endgame Proposal would have additional specific adverse impacts to cleared derivatives. While these impacts are secondary to the reservations expressed above, they should be addressed to prevent increased capital charges for banks providing clearing intermediary services and from negatively impacting the use of cleared derivatives.

### **The Credit Valuation Adjustment (CVA) risk capital calculation should not include client cleared transactions**

The Basel III Endgame Proposal would continue to include derivatives exposures arising from client clearing in the capital requirements capturing CVA risk. This would lead to overcapitalization from inappropriate risk capture and duplicative charges. CVA aims to reflect counterparty credit risk in the valuation of an OTC derivative contract. As U.S. clearing brokers hold client cleared transactions off the balance sheet, there is no CVA recorded against these transactions, so it is not appropriate to hold CVA risk capital against this. Although U.S. clearing brokers guarantee the performance of their clients, this risk is fully captured through the counterparty credit risk default capital charge and reduced through initial margin, and as a result this risk should not need to also be captured via a CVA risk capital. Furthermore, EU and U.K. regulation excludes CVA risk for client cleared transactions and the U.S. Proposal's divergence from these regulations would create a further disadvantage for U.S. clearing brokers clearing for U.S. and non-U.S. clients. Therefore, we recommend an exclusion of client clearing exposures when capitalizing for CVA risk under the Basel III Endgame Proposal.

### **The operational risk capital calculation should not include client clearing related fees**

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<sup>11</sup> [Addressing-Porting-Challenges.pdf \(isda.org\)](https://www.isda.org/Addressing-Porting-Challenges.pdf)

The Basel III Endgame Proposal would amend the operational risk capital calculation to only use the “standardized approach”. This impacts U.S. banks’ cleared derivatives activities by the inclusion of fee (and commission) based activities that would be captured on a gross basis in the services component. In the context of client clearing for both U.S. and non-U.S. clients, clearing brokers charge fees for providing a clearing broker service and often also charge pass-through fees as an intermediary where they collect fees from clients that are levied by (and paid onwards to) CCPs. We would recommend all client clearing related fees to be excluded in the prescribed approach to ensure that end user costs are not increased and clearing disincentivized. Nonetheless, if client clearing related fees are not excluded, we would recommend these to be reported on a net basis to more accurately reflect the risk.

### Conclusion

LSEG appreciates the opportunity to submit our comments on the Proposals. We strongly support regulatory work to maintain the safety and soundness of financial markets. We respectfully request that our concerns on the impact to cleared derivatives are considered in the interests of that objective and to prevent adverse impacts arising from the Proposals. We also recommend that the Agencies conduct a thorough cost benefit analysis of the Proposals before proceeding given their impact to cleared derivative transactions. We stand ready to support and contribute further to this important initiative.

If you have any questions, please contact Claire O’Dea, LSEG Government Relations and Regulatory Strategy at [Claire.ODea@lseg.com](mailto:Claire.ODea@lseg.com).

Sincerely,



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