

**Meeting Between Staff of the Federal Reserve Board, Federal Deposit
Insurance Corporation, and Office of the Comptroller of the Currency
and the Futures Industry Association
June 11, 2019**

Participants: Norah Barger, David Lynch, Michael Pykhtin, Elizabeth MacDonald, Mark Handzlik, Noah Cuttler, and Mark Buresh (Federal Reserve Board)

Guowei Zhang and Ron Shimabukuro (Office of the Comptroller of the Currency)

Irina Leonova, Catherine Wood, and Michael Phillips (Federal Deposit Insurance Corporation)

Jacqueline Mesa (Futures Industry Association); Mariam Rafi (Citigroup); Jeffrey Gore (Wells Fargo); Alistair Webster (JP Morgan Chase); Alicia Crighton (Goldman Sachs); Sean Downey and Anne Gray (CME Group); Laura Harper (Managed Funds Association); Kevin McClear (ICE); Randy Benjenk (Covington & Burling)

Summary: Staff of the Federal Reserve Board, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (collectively, the agencies) met with representatives of the Futures Industry Association and member organizations to discuss the interagency notice of proposed rulemaking on the Standardized Approach for Calculating the Exposure Amount of Derivative Contracts (SA-CCR). The Futures Industry Association recommended certain adjustments to the SA-CCR proposal, as described in the attached materials. Points of particular emphasis included the recognition of collateral for cleared transactions and the rules for netting economically similar settled-to-market and collateralized-to-market derivatives.

Attachment

Discussion of U.S. SA-CCR Proposal with CME, FIA, ICE, MFA

June 11, 2019



MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry

Agenda

- General concerns with U.S. SA-CCR proposal
- Recognition of initial margin in RWA and leverage exposure calculations
- MPOR for client clearing transactions
- 1.4X alpha multiplier
- Supervisory factors for commodities, credit, and equity
- Netting sets

General Concerns with Proposal

- Post-crisis rules raising capital requirements for derivatives activities have disincentivized the activity, thereby reducing market liquidity, imposing barriers to access derivatives, and increasing systemic risk
- U.S. SA-CCR proposal may exacerbate rather than alleviate this problem
 - Industry QIS shows that in comparison to CEM—
 - Standardized RWAs for counterparty credit risk defaults would increase by 30 percent
 - Commodities RWAs would increase by 70 percent
 - “Top of the house” SLR and eSLR would decrease by 3 basis points (with much greater impact at business line level)
 - CFTC staff empirical analysis shows SA-CCR’s conservatism and variability across portfolios
 - Preamble acknowledges that “exposure amounts would increase for derivative contracts with . . . asset managers, investment funds, and pension funds”

Recognition of IM in RWA Calculation

- **SA-CCR Proposal:** Would include an exponential PFE formula and a 5 percent PFE floor that result in only partial recognition of IM
- **Issues:**
 - Understates economic effect of IM
 - Disregards CCP rules that require enough IM to cover loss with 99 percent confidence level
 - Treats IM more conservatively than CEM
- **Request:** Provide closer to dollar-for-dollar recognition of margin (subject to haircuts); and, at a minimum, adjust the floor downward to 1 percent

Recognition of IM in Leverage Exposure Calculation

- **SA-CCR Proposal:** Would not recognize effect of IM in calculating total leverage exposure
- **Issues:**
 - Inconsistent with G20 mandate
 - Ignores economic effect of IM
 - Creates disincentives to clear that—
 - cause market exits in clearing, thus increasing concentration
 - harm end users (see DAT Report and SIFMA AMG survey)
 - impair portability in times of stress, increasing systemic risk
 - More punitive for U.S. banks than European leverage ratio, which gives appropriate recognition of IM in client clearing
- **Request:** Recognize exposure-reducing effect of cash and non-cash IM and VM on PFE and RC in client cleared transactions

MPOR for Client Clearing Transactions

- **SA-CCR Proposal:** Would assign same 10 day minimum MPOR to bilateral and client clearing transactions
- **Issues:**
 - Disincentivizes clearing
 - Inconsistent with G20 commitment that “Non-centrally cleared contracts should be subject to higher capital requirements”
 - Prevents netting of exposures that legally and economically are compressed
- **Request:** Assign 5 day minimum MPOR to client clearing transactions

1.4X Alpha Multiplier

- **SA-CCR Proposal:** Would apply a 1.4X alpha factor to RC and PFE
- **Issues:**
 - Based on flawed premises
 - Proposal states that standardized approach should not produce lower exposure amounts than a modelled approach, but in U.S., this can and does happen
 - Proposal states that alpha multiplier instills conservatism, but SA-CCR does this elsewhere through supervisory factors calibrated to reflect “stress volatilities observed during financial crisis”
 - Causes deviation from book value of on-balance sheet assets
- **Request:** Eliminate or recalibrate alpha factor; at very least, do not apply alpha factor to RC in SLR and CCR RWA

Supervisory Factors

- Commodities
 - **Issue:** Oil & gas combined with electricity and assigned electricity's higher supervisory factor
 - **Request:** Revert to Basel's supervisory factors for oil/gas and electricity
- Credit
 - **Issues:**
 - Three gradations of credit quality are too blunt
 - Investment grade issuers subject to higher supervisory factor than Basel
 - **Request:** Provide more categories based on probability of default, and adjust the supervisory factors to correspond with Basel's supervisory factors
- Equities
 - **Issue:** Insufficient granularity
 - **Request:** Distinguish between investment and non-investment grade issuers; issuers in advanced vs. emerging economies; publicly-traded and private; large cap and small cap

Netting Sets

- **SA-CCR Proposal:** Would disallow netting between trades under the same QMNA, because of either (i) different margining mechanisms, or (ii) different MPORs
- **Issues:**
 - Ignores legally enforceable netting arrangements
 - Prevents netting of settled-to-market (STM) trades with collateralized-to-market (CTM) trades
- **Request:** Allow all trades subject the same QMNA to be part of the same netting set, including at least netting of CTM and STM exchange traded instruments, and (ii) CTM and STM OTC cleared derivatives

Any questions?