

WFE response to notice of proposed rulemaking on Standardized Approach for Calculating the Exposure Amount of Derivatives Contracts

**FAO: Office of the Comptroller of the Currency; Federal Reserve System; Federal Deposit Insurance Commission
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We welcome the opportunity to respond to US authorities' notice of proposed rulemaking on Standardized Approach for Calculating the Exposure Amount of Derivatives Contracts.

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent over 200 market infrastructure offerings, spread across the Asia-Pacific region (~37%), EMEA (~43%) and the Americas (~21%). This includes over 50 distinct CCP clearing services, with everything from local entities in emerging markets to stand-alone CCPs based in major financial centres.¹

With extensive experience of developing and enforcing high standards of conduct, WFE members support an orderly, secure, fair and transparent environment for investors; for companies that raise capital; and for all who deal with financial risk. We seek outcomes that maximise the common good, consumer confidence and economic growth. And we engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in an internationally integrated financial system.

Authorities and market infrastructures concur on the necessity of a policy framework that allows for accessible, competitive and vibrant derivatives markets that also ensures the soundness of banks (including the prevention of excessive leverage). We believe that major jurisdictions should move in an expeditious and coordinated way to implement SA-CCR with segregated client margin collateral being permitted to reduce the leverage exposure measure under the Leverage Ratio. We therefore welcome jurisdictions moving to SA-CCR and urge the authorities to act to address the well-known challenges related to the leverage ratio treatment of client cleared derivatives (i.e. by permitting offsets for segregated client margin collateral under the Leverage Ratio). These challenges have been raised in numerous forums and by a diverse set of market stakeholders, including through academic work – including from [central banks](#) and [derivatives markets authorities](#) – and in the [findings of the Derivatives Assessment Team \(DAT\)](#).

As the WFE described in its response to the DAT:

- The failure of the current leverage-ratio calculation to recognise the exposure-reducing impact of segregated client margin collateral has reduced access to hedging products for end-users, potentially increasing risk in the system;
- It is striking at a time when the absolute and relative amounts of centrally cleared business have increased that the number of client-clearing operations has moved in the opposite direction;
- There is a risk that post-default porting will not be available to clients because it would not satisfy return on capital metrics of clearing members' parent organisations.

The reduction in client clearing services providers notably increases concentration risk and reduces access to clearing services for end users. The WFE collected data from six CCPs regarding the number of client clearing service providers active at their CCP in 2008 and 2018. These spanned the geographies of the WFE (i.e. 2 Americas, 3 EMEA, 1 Asia-Pacific) and included both large and small CCPs. Excepting one newly formed CCP (APAC CCP 1), four of the remaining five (Americas CCP 1, Americas CCP 2, EMEA CCP 1 and EMEA CCP2) saw the numbers of client clearing service providers remain flat or decline. EMEA CCP 3 had an overall rise in the number of client clearing services providers, though this was significantly less than the rise in entities clearing on their own account. The CFTC's data finds a decline in the client clearing service providers in the US over the period (from 139 to 64). Our belief that the lack of recognition of initial margin has contributed to this decline is substantiated by the DAT:

"Analysis of quantitative and qualitative survey data and market outreach suggest that the treatment of initial margin in the leverage ratio can be a disincentive for client clearing service providers to offer or expand client clearing."²

We believe that major jurisdictions should move in an expeditious and coordinated way to implement SA-CCR with segregated client margin collateral being permitted to reduce the leverage exposure measure under the Leverage Ratio. The solutions

¹ The WFE membership list [can be found here](#).

² Financial Stability Board, [Incentives to centrally clear over-the-counter \(OTC\) derivatives](#), November 2019.

proposed (Options 2 and 3) by the BCBS in their recent consultation would bring policy coherence to the Leverage Ratio, aligning the position of offsets for client-cleared derivatives with the position of securities financing transactions.³ These reforms would ameliorate the risk management challenges described above, while keeping intact the important improvements made to the prudential regime for banks under Basel III. We also note that a coordinated implementation of SA-CCR should include a focus on consistent terminology as well as a careful understanding of the differing structural features between types of listed derivatives that will be implicated by SA-CCR.

Within clearing member units of banks, the proposed changes would reduce client-related leverage ratio exposures substantially, calibrating the capital charge to more accurately capture the leverage implied by these transactions. Nevertheless, at the group level, the biggest banks clearing at CCPs will only be able to reduce their Tier 1 capital buffers by 1 per cent. Just as internal model approvals apply at the level of individual desks within banking organisations, banking supervisors will still be able to supervise and stress-test the leverage taken in client-clearing on a case-by-case basis.

Given the DAT's finding that even fewer organisations are likely to offer client-clearing in the future if reforms are not enacted, it is of utmost urgency that the US and international authorities act now to reform the leverage ratio and recognise the risk-reducing impact of margin. We urge authorities to monitor whatever changes are made to the leverage ratio on an on-going basis for their impact on client clearing services provision, particularly regarding concentration of client clearing services provision and other barriers to client clearing that may become apparent.

³ "The final standard [relating to securities financing transactions] now allows limited netting with the same counterparty to reduce the leverage ratio's exposure measure, where specific conditions are met." Basel Committee on Banking Supervision, [Basel III leverage ratio framework and disclosure requirements](#), January 2014.