

May 11, 2017
Via Electronic Mail
Financial Stability Board
fsb@fsb.org

Re: Proposed Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms

CME Group Inc. appreciates the opportunity to provide comments on the Financial Stability Board's ("FSB") Proposed Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms dated April 11, 2017.

Chicago Mercantile Exchange Inc.'s clearing house division ("CME Clearing") offers clearing and settlement services for exchange-traded and over-the-counter ("OTC") derivatives. CME Clearing is registered with the Commodity Futures Trading Commission ("CFTC") as a derivatives clearing organization ("DCO"), has been deemed a systemically important financial market utility by the Financial Stability Oversight Council ("FSOC"), and is a recognized third country central counterparty ("CCP") under the European Market Infrastructure Regulations ("EMIR").

CME Group supports the efforts of the FSB to define a standardised and replicable framework for evaluating regulatory developments. This is a crucial step to review both the efficacy of on-going regulatory progress as well as any unintended consequences. The G20 reforms have significantly improved the safety and security of financial markets, however we are aware that unintended consequences can arise even after the thoughtful processes that have led to implementation of many of the core reforms.

We appreciate the FSB's open and transparent process to developing a framework to assess the impact of these reforms. We look forward to working with the relevant stakeholders as the framework takes shape and evaluations begin.

Please find responses to the specific questions below.

Discussion Questions

1. Do you have any comments or suggestions on the main elements of the evaluation framework (e.g. are there other elements that should be considered for inclusion in the framework)?

With regards to the evaluation framework, we suggest that the FSB require that a diverse set of standard-setting bodies ("SSBs"), as well as other market stakeholders, including market regulators, are involved in the evaluation process. Specifically, we believe it is important to ensure the SSBs that are engaged in performing the assessments be drawn from a broader group than just the SSB(s) that led the design and implementation of the reform, as appropriate for the assessment under consideration. This is necessary to guarantee that a broad cross-section of expertise is included in the evaluation group which is sufficiently independent from the design and implementation of the reform being assessed. Consistent with the intentions outlined in the proposed framework, this approach will allow for the outcomes of the G20 financial reforms to effectively be assessed individually and holistically by allowing the SSBs to evaluate how a given reform interacts with other reforms. In particular, the SSBs would be able to efficiently identify the impacts a given reform has on areas of the marketplace for which it was not necessarily designed to directly impact. Additionally, broader stakeholder involvement in the process is important to ensure widespread industry awareness and support, and to ensure that the standards are fit for purpose and the cost-

benefit analysis is accurate and comprehensive. Particularly as the FSB seeks to work within the appropriate SSBs' existing governance arrangements, drawing from a diverse set of SSBs will ensure a comprehensive approach to governance.

6. Do you have comments or suggestions on how to address the challenges of defining and measuring social benefits and costs, especially when they do not follow directly from private benefits and costs?

Especially in the case of CCPs, we believe that social benefits and costs closely align to the private benefits and costs of end users and market participants. Central clearing is commonly understood to reduce the probability and severity of financial crises. This ability of CCPs to increase overall financial stability in the market was recognised by global leaders and the regulatory community in the G20 commitment of 2009 to mandate central clearing for certain over-the-counter products. The G20 commitment recognised the systemic risk reduction provided by CCPs, and the social benefits such as systemic risk reduction to overall financial stability must continue to be considered in evaluating costs and benefits of financial reform.

Where regulatory requirements inappropriately result in a higher private cost to end users of central clearing, reducing participation and thus undermining the social benefits of increased financial stability. For example, a recent survey conducted by SIFMA AMG asked market participants about the impacts of the Supplemental Leverage Ratio ("SLR") on the availability and costs for their members to obtain clearing services. This survey found that many market participants had been negatively affected by these rules:¹

- 50% of Participants were asked to increase Clearing fees for Futures, Options, Interest Rate Swaps, FX Swaps, Credit Swaps
- 58% of Futures Users were asked re-route execution business to their clearer to avoid larger clearing fees, 50% for Options Users
- Portion of Participants asked to agree to Outstanding Positions Caps: 33% Futures, 30% Options, 50% of Interest Rate Swaps
- Portion of Participants whose clearing relationships were terminated involuntarily: 30% Interest Rate Swaps, 25% FX swaps, and 18% Credit Default Swaps.

This illustrates the significant hurdle the leverage ratio capital requirements create for market participants seeking access to cleared services, as clearing members are required to capitalise client positions as if they were held on the clearing member's own book, without regard to the exposure reducing impacts of client initial margin. By taking a wider view in evaluating these regulations, the FSB will be able to consider the impact beyond the banks and larger financial firms. The analysis should incorporate the ultimate effects on all market participants, including the end users who suffered losses during the 2008 financial crisis – the very parties that reforms were meant to protect. This issue has been raised by several market participants and industry leaders since it was introduced and as the full impacts became known.²

In some ways, this consideration of end users and specific market needs has already been taken by the Basel Committee for Banking Supervision ("BCBS") in their treatment of securities financing transactions ("SFT"). The Basel III Leverage Ratio stipulates that where the bank is acting as an agent for SFT, the bank exposure takes the agent relationship into account. For example, when the bank is acting on behalf of their customers in an SFT, the bank can capitalize against a net exposure that is

¹ <http://www.sifma.org/comment-letters/2016/sifma-amg-submits-comments-to-the-basel-committee-on-banking-supervision-on-revisions-to-the-basel-iii-leverage-ratio-framework/>

² <https://www.cmegroup.com/education/files/letter-to-the-bank-of-england.pdf>

offset by the collateral posted as part of the SFT transaction. This relationship is nearly identical to the clearing member/client relationships at derivatives CCPs, yet the SLR does not allow the clearing member to offset the client collateral against the exposure of their clients' transactions. We encourage the FSB to consider examples like these, where equivalent relationships are treated differently by the same regulation, in their evaluations.

The leverage ratio construct for centrally cleared derivatives imposes a private cost on end-users, which ultimately reduces the social benefit of central clearing as fewer participants can access cleared markets. This lack of ability to access central clearing undermines the ability of end-users to manage their business risk. In addition, the leverage ratio risks reducing the number of firms offering client clearing. This reduction in clearing firm participation is particularly problematic in a clearing member default where there will be fewer firms available to absorb defaulted positions and client accounts.

We appreciate the FSB's efforts to analyse the efficacy and impact of regulatory reforms. We believe there is a need to evaluate the negative impact of private costs on the intended social benefits where private costs disincentivise risk reducing behaviour such as central clearing, resulting in higher social costs. Where regulatory reform unintentionally increases the probability or severity of a financial crisis, the balance of costs and benefits has fallen out of alignment and requires further analysis.

9. Do you have views on lessons – in terms of methods and approaches – that can be learned from evaluations in other policy areas, or from existing national or regional evaluation frameworks?

Whilst a broad review of regulatory reform is rare, we have observed evaluations which offer insights into how to develop a framework for such work going forward. One example provides a meaningful lesson: the October 2014 study commissioned by OTC DAT, a group formed by a conglomeration of global regulatory bodies including the FSB, BCBS, CGFS, IOSCO, and CPMI.³ This study ultimately concluded that market participants did have incentives to participate in central clearing. However, the study notably excluded the impact of a variety of regulations, including the Leverage Ratio, Liquidity Coverage Ratio, and the CPMI-IOSCO Principles for Financial Market Infrastructure ("PFMIs"). These omissions led OTC DAT to mistakenly conclude that regulatory reforms appropriately incentivized the use of central clearing. Unfortunately, this conclusion directly contradicts the views a majority of market participants.

Market participants do not consider the impact of central clearing in a vacuum; the sophisticated financial firms that are active in these markets evaluate the full impact of all their costs, including regulatory burdens. As such, it is critically important to consider the entirety of the reforms when assessing the benefits and costs of regulations. It alarms us that past studies have been done, with conclusions presented to the G20, which did not consider the full programme of regulatory reforms holistically.

A global view must be taken when analysing the impact to market participants and we would encourage the FSB to take a similarly holistic view in their evaluation of financial regulatory reform.

10. Do you have suggestions on information sharing arrangements (publication of results, repository of evaluations, and data availability, particularly as it pertains to replicability)?

CME highlights the importance of maintaining confidential information in an appropriately secure manner, even between and across regulatory bodies. As the central hub for a variety of confidential

³ <http://www.bis.org/publ/othp21.pdf>

data, including specific clearing participant positions, CCPs are uniquely positioned to offer a comprehensive view of market activity. Many regulators have identified CCPs as a useful source of this data and have compelled reporting for analysis at an international level. Then, as now, we encourage regulators to ensure that data sharing between markets is performed by the primary regulator of the CCP. It should not be up to the market participant – CCP or otherwise – to provide confidential information to entities beyond their primary regulation, with whom they maintain the appropriate protections that allow for transmission of such data. This maintains the chain of confidentiality via existing, secure data sharing arrangements and ensures that the onus of responsibility for securing confidential information remains with the appropriate party at each stage of any data sharing process.

With regards to the publication of results, where such reporting may make use of or refer to the data received by market participants, confidentiality of the users is critical to ensuring the reports do not have unintended consequences for market participants. We've seen recent attempts to summarise market data as part of industry-wide stress testing that successfully report on overall market resilience whilst anonymising the names of the participants of the report.⁴ This allows the audience to understand the implications of the report without participants suffering unnecessary and potentially inappropriate consequences. This also prevents the inadvertent publication of confidential information, such as the size of positions at major market participants. This approach should be followed in any public report that contains or refers to such market data.

11. How can the FSB and SSBs best engage with external stakeholders (e.g. financial services providers, various kinds of end-users, and academics) in their evaluation work (going beyond public consultations)?

We agree with the FSB that public consultation, whilst an effective and efficient tool to garner feedback, may not be sufficient for every topic. As further engagements are considered, we encourage the FSB to ensure the inclusion of a wide variety of external stakeholders representing all impacted parties. We imagine this would include at the very least a cross section of end-users, banks, and market infrastructures. We have observed such engagement from the FSB in recent consultations regarding the CCP industry and are encouraged by the broad scope of stakeholders included in these discussions.

Going forward, we encourage the FSB to consider the way that the composition and governance of the FSB may improve external stakeholder engagement. With the FSB's primary mission being the promotion of financial stability, we believe it important that the membership composition is driven by the relative size of the member jurisdictions financial markets. Entities most likely to be subject to FSB policy-making generally originate from those jurisdictions with the largest financial markets.

Ensuring sufficient representation from the regulators in those markets where large global financial institutions are domiciled provides a natural engagement and feedback mechanism with impacted institutions through their primary regulatory relationship. In that vein, we believe adding the U.S. Commodity Futures Trading Commission to the FSB would improve external stakeholder engagement in its evaluation work by providing a natural conduit to engagement with the participants and operators of the largest exchange traded derivatives markets globally. This

⁴ In publishing the results of their industry wide CCP stress test, both ESMA and the CFTC have provided overall results without specifying the results of individual CCPs:

<https://www.esma.europa.eu/press-news/esma-news/esma-publishes-results-eu-central-counterparties-stress-test>

<http://www.cftc.gov/PressRoom/PressReleases/pr7483-16>

addition would have the added benefit of more closely aligning respective financial market size of jurisdictions with representation in the FSB policy-making process.

12. Do you have comments or suggestions on which individual reforms or interacting set(s) of reforms should be initially considered for evaluation as a matter of priority?

CME Group suggests that priority should be placed on regulatory reforms that have created disincentives for central clearing and thus limited the risk reducing benefits of clearing on markets. This unintended consequence of some international standards has inadvertently created incentives that contradict the G20 commitment to central clearing.

As mentioned above, we, along with many industry leaders, believe that the Leverage Ratio calculation which does not recognise client margins to offset client positions at their clearing members creates disincentives to the social beneficial activity of central clearing. This type of regulation should be at the forefront of any evaluation, as the impacts have already been felt by users who are less able to access cleared services. The potential risk will only worsen if markets experience a stress event which will be exacerbated by the concentration of client clearing.

Conclusion

CME Group appreciates the opportunity to comment on the FSB's consultation on the development of its evaluation framework. We are encouraged by the FSB's launch of an open and transparent process in designing this framework and we are eager to continue engagement with the Board on these important issues.

If any comments or questions regarding this submission arise, please feel free to contact myself or Sean Downey, Executive Director, CME Clearing at +1 (312) 930-8167 and sean.downey@cmegroup.com.

Sincerely,



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