January 16, 2019

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2, CH-4002
Basel, Switzerland

Re: FIA Comment on Consultative Document: Leverage Ratio Treatment of Client Cleared Derivatives

Dear Sirs and Madams:

The Futures Industry Association ("FIA")[1] appreciates the opportunity to comment on the Basel Committee on Banking Supervision's Consultative Document on the leverage ratio's treatment of client cleared derivatives (the "Consultation"), and applauds the Basel Committee for recognizing that a reevaluation of such treatment is necessary.[2]

FIA strongly supports the adoption of a limited and targeted revision to the leverage ratio denominator to allow cash and non-cash forms of initial margin and variation margin to offset a clearing member bank's potential future exposure ("PFE") and replacement cost ("RC") in a client cleared derivative transaction, as proposed in Option 3 of the Consultation. Recognition of the exposure-reducing effect of initial margin within the leverage ratio is critical for the long-term health of the cleared derivatives ecosystem.

As the international standard-setting bodies' Derivatives Assessment Team recently concluded in its final report, in language agreed to by the Basel Committee, "the treatment of initial margin in the leverage ratio can be a disincentive for client clearing service providers to offer or expand client clearing" and "this might translate into higher costs for clients and a reduced availability of clearing services."[3] Clearing also has not decreased systemic risk to the extent it should, because there are fewer clearing members available to take on a book of positions from a failing clearing member as a result of the leverage ratio, and because the banks remaining in the market would be particularly unwilling to do so in times of system-wide stress, when their capital ratios are depressed. These results are flatly inconsistent with the Pittsburgh

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[1] FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry.

[2] Basel Committee on Banking Supervision, Consultative Document: Leverage Ratio Treatment of Client Cleared Derivatives (Oct. 2018), *available at* https://www.bis.org/bcbs/publ/d451.pdf.

[3] *See* Derivatives Assessment Team, Incentives to Centrally Clear Over-the-Counter (OTC) Derivatives: A Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms – Final Report, at pp. 4, 67 (Nov. 19, 2018), *available at* http://www.fsb.org/2018/11/incentives-to-centrally-clear-over-the-coupnter-otc-derivatives-2/ (hereinafter, the "DAT Report").

G20 Leaders' mandate to the Basel Committee and other standard-setting bodies to promote central clearing of derivatives, including by implementing lower capital requirements for cleared derivatives, in order to increase financial stability.

As discussed in greater detail in Part I of this letter, a targeted revision to the leverage ratio framework solely to address cleared derivatives exposures is therefore warranted by concrete and robust empirical evidence; would meet the G20 Leaders' policy objectives of strengthening the resilience of the banking system and promoting central clearing of standardized derivative contracts; and would facilitate clearing without creating systemic risk. Part II describes why Option 3 of the Consultation would be more consistent with global policymakers' goals than Option 2. Part III discusses why the Basel Committee should not adopt segregation criteria as a condition to recognition of margin. Finally, Part IV sets forth reasons why the Basel Committee should rescind its new conditions for a bank that provides clearing services as a "higher level client" in a multi-level client structure not to recognize exposure to the clearing member upstream in the clearing chain.

I. The Basel Committee Should Adopt a Targeted and Limited Revision to the Leverage Ratio's Treatment of Client Cleared Derivatives to More Meaningfully Recognize the Exposure-Reducing Effect of Margin

A. Concrete and Robust Empirical Evidence Warrants a Targeted and Limited Revision to the Leverage Ratio's Treatment of Client Cleared Derivatives to More Meaningfully Recognize the Exposure-Reducing Effect of Margin

Years of mounting evidence clearly shows that the leverage ratio has driven some banks out of the client clearing business, reduced clearing capacity and availability, increased prices, and depressed liquidity:

- ***Clearing Member Experiences.*** According to the DAT Report, 64.7 percent of client clearing service providers have found the leverage ratio to have a significant negative impact on their ability to offer client clearing services, and 88.2 percent reported a negative impact.[4] A 2016 FIA study of clearing member data found that clearing for asset manager, insurance company, and sovereign clients creates disproportionately higher leverage exposure due to the leverage ratio's failure to include an offset for initial margin.[5]

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[4] *See* DAT Report at p. 22.

[5] *See* FIA Response to Basel Leverage Ratio Consultation Regarding the Proposed Calculation of Centrally Cleared Derivatives Exposures Without Offset for Initial Margin and its Impact on the Client-Clearing Business Model (July 6, 2016), *available at* https://fia.org/sites/default/files/2016-07-06_FIA_Comment_Letter_Basel_Committee_Leverage_Ratio.pdf.

- ***End User Experiences.*** End users have reported struggling to access cleared derivatives and/or facing higher prices.[6] Their data suggests that the leverage ratio's failure to recognize the exposure-reducing effect of initial margin is a direct cause of these effects. In a particularly stark example, one of the biggest traders on oil derivatives exchanges recently suspended operations after being directed by its clearing member to sharply reduce its positions as a result of the leverage ratio capital charges associated with its trades.[7]

- ***Reduced Number of Transactions.*** The Bank of England, using data from UK central counterparties ("CCPs"), found in 2018 that the leverage ratio has disincentivized banks from engaging in client clearing. As the UK implemented the leverage ratio, and the leverage ratio became reportable, banks that were constrained by the leverage ratio reported greater declines in the number of daily transactions and the number of clients than banks that were not constrained by the leverage ratio.[8]

- ***Market Exits.*** Since the introduction of the leverage ratio, several banks have stopped clearing derivatives for clients in some or all markets.[9] In many cases, these banks specifically cited the leverage ratio as the reason that they exited the market. New entrants have not filled the void. According to the DAT Report, the notional amount of clearing in the U.S., UK, and Japan that passes through the top five clearing members now exceeds 80 percent for interest rate swaps.[10] In the United States, data from the U.S. Commodity Futures Trading Commission ("CFTC") shows that the number of firms

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6 *See* Securities Industry and Financial Markets Association Asset Management Group, Response to Consultative DAT Report on Incentives to Centrally Clear OTC Derivatives, at pp. 5–7 (Sept. 7, 2018), *available at* http://www.fsb.org/wp-content/uploads/SIFMA-Asset-Management-Group.pdf.

7 *See* Bloomberg, Top Oil Market-Maker Closes After 'Damaging' Regulatory Changes (June 27, 2018), *available at* https://www.bloomberg.com/news/articles/2018-06-27/top-oil-market-maker-closes-after-damaging-regulatory-changes.

8 *See* Bank of England: The Impact of the Leverage Ratio on Client Clearing, Staff Working Paper No. 735 (June 15, 2018), *available at* https://www.bankofengland.co.uk/working-paper/2018/the-impact-of-the-leverage-ratio-on-client-clearing.

9 *See* Deutsche Bank Walks Away From US Swaps Clearing, Financial Times (Feb. 9, 2017), *available at* https://www.ft.com/content/2392bc42-ee47-11e6-930f-061b01e23655; Nomura Exits Swaps Clearing for US and European Customers, Financial Times (May 12, 2015), *available at* https://www.ft.com/content/e1883676-f896-11e4-be00-00144feab7de; State Street Exiting Swaps Clearing Business, Citing New Rules, Bloomberg (Dec. 4, 2014), *available at* https://www.bloomberg.com/news/articles/2014-12-04/state-street-exiting-swaps-clearing-business-citing-new-rules; RBS to Wind Down Swaps Clearing Units, Reuters (May 19, 2014), *available at* http://uk.reuters.com/article/uk-rbs-primeservices-divestiture-idUKKBN0DY0PU20140519; BNY Mellon Closes U.S. Derivatives Clearing Business, Pension & Investments (Dec. 20, 2013), *available at* http://www.pionline.com/article/20131210/ONLINE/131219993/bny-mellon-closes-us-derivatives-clearing-business.

10 DAT Report at p. 21.

> providing clearing services in the United States has fallen from 84 at the beginning of 2008 to 55 at the beginning of 2018, partly due to service closures and partly due to consolidations.[11] These market exits are all the more remarkable given that over the same timeframe, policymakers implemented clearing mandates globally that have increased the aggregate volume of clearing.

Based on this evidence and the results of surveying market participants, the Derivatives Assessment Team concluded that "the leverage ratio can constrain the client clearing business, and so affect the willingness of individual firms to provide access to centrally cleared OTC derivatives markets, particularly to large directional clients."[12]

These effects are likely to become even more pronounced in the future, for two reasons. First, some member jurisdictions have yet to implement the leverage ratio buffer that the Basel Committee adopted in December 2017. Once implemented, the buffer will increase the leverage ratio for global systemically important banks ("G-SIBs") and thereby make the leverage ratio more likely to be a binding constraint for some G-SIBs. Second, in the United States, the Board of Governors of the Federal Reserve System will be implementing a "stress capital buffer" that will effectively add the G-SIB surcharge as a post-stress test minimum capital ratio. The G-SIB surcharge incorporates the denominator of the leverage ratio – total leverage exposure – in its denominator. As the DAT Report stated, "[t]o the extent that the leverage ratio has an impact [on incentives to clear derivatives], this carries over into the G-SIB methodology."[13] Thus, if not revised, the leverage ratio denominator's flawed methodology will even disincentivize some banks for which *risk-based* capital requirements are the binding constraint from clearing derivatives. Of course, a bank need not be constrained by the leverage ratio or the G-SIB surcharge to be disincentivized from clearing. As the DAT Report recognized, "for purposes of their own internal management, firms may allocate capital requirements at the business unit level," which "means that while a constraint might not bind at the group level, it may do so when a bank applies it at a more granular level."[14]

In sum, the evidence shows that the leverage ratio's current overstatement of exposure arising out cleared derivatives transactions has had, and will continue to have, harmful effects in cleared derivatives markets. A revision to the leverage ratio denominator to more accurately reflect banks' actual economic exposure from clearing is therefore warranted.

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11 DAT Report at p. 22.

12 DAT Report at p. 5.

13 DAT Report at p. 69.

14 DAT Report at p. 64.

B. A Targeted and Limited Revision to the Leverage Ratio's Treatment of Client Cleared Derivatives to More Meaningfully Recognize the Exposure-Reducing Effect of Margin Would Strengthen the Resilience of the Banking System

Central clearing is designed to reduce systemic risk by facilitating the transfer (or "port") of the positions of a defaulting clearing member's clients to other, financially sound clearing members in a simple and rapid manner, with the goal of preserving the end-users' positions while protecting any collateral pledged. Porting reduces clients' exposure to counterparty default losses, which strengthens the resilience of the banking system by:

- discouraging clients from participating in destabilizing runs on banks;
- reducing the cascade of defaults that can result from clients incurring losses or going unhedged; and
- limiting losses to banks that are themselves clients.

The current leverage ratio treatment of client clearing impedes the porting function, thereby increasing risk to the financial and banking systems. Porting depends on the presence of a number of clearing members with capacity and willingness to take on additional clients from a failing clearing member in a rapid manner. But as the DAT Report acknowledged, as a result of the leverage ratio, "other providers may be unwilling to take on additional business, leaving some of the affected clients without access to OTC derivatives clearing."[15] Current levels of concentration in the provision of clearing services "could amplify the consequences of the failure or withdrawal of a major provider" because there are fewer remaining clearing members that might be available and willing to step in and acquire a book of cleared derivatives.[16]

These issues will be exacerbated in times of market stress. If banks' capital declines to levels that make the leverage ratio a truly binding limit, the ability of such banks to purchase portfolios of cleared derivatives from other clearing members – including distressed banks – will be severely constrained. This is the case because "a clearing service provider must have sufficient 'head room' in its regulatory metrics before accepting [clients that wish to port in], and additional client clearing business must offer an acceptable return on the required capital thus deployed."[17] Moreover, as the levels of margin required by CCPs increase in times of stress, leverage ratio capital costs attributable to margin on a bank's balance sheet will correspondingly increase, aggravating the constraint on portfolio purchases. Such constraints on providing liquidity to stressed markets would accelerate downward price pressure at exactly the wrong moment, thereby increasing risk to the system and to banks specifically. Ad hoc capital relief

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15 DAT Report at p. 54.

16 DAT Report at p. 3.

17 DAT Report at p. 67.

provided by supervisors once the stress materialized would be insufficient to mitigate these risks. Porting is only effective when it occurs rapidly.

Additionally, due to the leverage ratio, market participants now find it difficult to access or afford cleared derivatives to hedge their business or investment risk.[18] End users' risks are more likely to go unhedged, which increases risk overall in financial and non-financial markets and to end users' bank counterparties.

A revision to the leverage ratio to decrease the overall leverage exposure resulting from derivatives clearing would make it easier for banks to acquire the positions of a failing clearing member, and would promote access to clearing overall. Such a revision would therefore decrease systemic risk and risk to the banking sector in multiple ways.

C. A Targeted and Limited Revision to the Leverage Ratio's Treatment of Client Cleared Derivatives to More Meaningfully Recognize the Exposure-Reducing Effect of Margin Would Facilitate Clearing Without Creating Systemic Risk

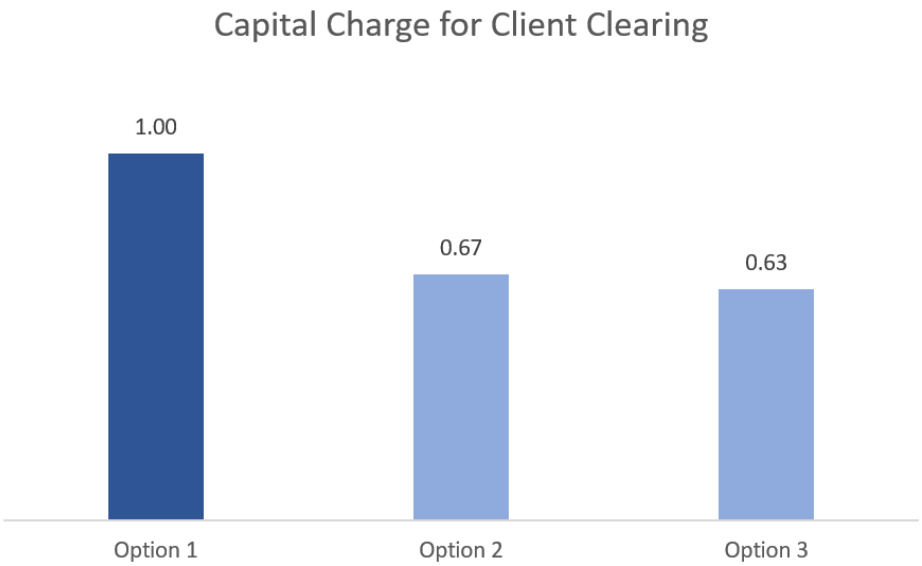
Industry data commissioned to discern the quantitative impact of the Consultation's options show that Option 3 and Option 2 would have the following effects compared to Option 1:

- Banks' leverage ratio exposure arising out of client clearing transactions would decrease.
- Changes to banks' overall leverage ratios would be negligible, even if banks materially increased their levels of client clearing.

Eleven banks, including G-SIBs and other internationally active banks that clear derivatives, participated in the industry study, and reported data on their client clearing portfolios as of June 30, 2018. Figure 1 shows the aggregate impact of the options on participating banks' leverage exposure attributable to client clearing activity.

[18] *See* n. 6, above.

Figure 1: Impact of Consultation's Options on Leverage Exposure for Client Cleared Transactions



Stated differently, Option 1 results in 59 percent more leverage exposure for client clearing than Option 3, and 49 percent more leverage exposure than Option 2

Decreasing leverage exposure at the transaction- or business line-level, as Options 2 and 3 would do, should reduce disincentives for banks to engage in client clearing. When a requirement such as the leverage ratio requires much more capital to support a low-return business like derivatives clearing than is warranted by the risk-adjusted returns of the business, a bank is less likely to allocate capital to engage in the business. A bank will generally use its balance sheet to fund businesses that can meet the bank's overall return-on-equity ("ROE") targets. The more capital that the bank must maintain to support a business, the greater income from the business needs to be to meet a given ROE. For a low-return activity, the bank's incentives are to raise prices, scale back the activity, or both. By contrast, when a capital requirement is calibrated to reflect actual economic exposure from a business, it becomes easier for a bank to engage in the activity and satisfy ROE targets without raising prices.

At the same time, data from the eleven participating banks show that a revision to the leverage ratio that more meaningfully recognizes the exposure-reducing effect of margin would not weaken banks' *overall* capital positions. Options 2 and 3 would cause banks' aggregate leverage ratios to increase by just 2.0 and 2.2 basis points, respectively, compared to Option 1, given the size of banks' balance sheets and client cleared portfolios as of June 30, 2018.

Even if banks materially increased their client clearing activity, Options 2 and 3 would have a negligible effect on their overall capital levels. For instance, if banks increased their client clearing exposures by 100 percent, their leverage ratios would increase by just 4.0 basis points under Option 2, and 4.4 basis points under Option 3. Option 2 and Option 3 thus would not undermine safety and soundness.

II. Option 3 Would Best Promote Uniformity and Further the G20 Goals

Option 3 of the Consultation is the same methodology that the Basel Committee has adopted within risk-based capital requirements. Using this methodology in the leverage ratio context would be a more transparent and simple way to implement an offset than Option 2. If the Basel Committee adopts Option 3, banks and regulators will only need to implement a single set of requirements and calculation methods for client cleared derivatives for regulatory capital purposes, and supervisors, investors, and counterparties will have a better understanding of banks' exposure levels.

Moreover, Option 2 is less conceptually coherent than Option 3, in three ways:

- First, there is no conceptual reason to limit the effect of initial margin to the calculation of PFE, as Option 2 would do. As a matter of a bank's actual economic exposure, initial margin reduces PFE and RC alike. Option 3 recognizes this economic reality by permitting initial margin to offset RC.

- Second, there is also no conceptual reason to limit an offset for margin within the PFE calculation to initial margin, as Option 2 would do. As a matter of a bank's actual economic exposure, excess variation margin reduces PFE as well as RC. Option 3 recognizes this economic reality by not distinguishing between the forms of margin that can offset PFE.

- Third, Option 2 would follow accounting rules in *some* respects, such as its lack of recognition for non-cash variation margin received from a client. It would then follow risk-based capital rules in *other* respects, such as implementing the 1.4X alpha multiplier associated with the Standardized Approach to Counterparty Credit Risk ("SA-CCR"). Option 2 therefore appears to selectively adopt the most conservative elements of various approaches in order to achieve an artificially high exposure measure.

In addition, Option 3 would make clearing more accessible and affordable for certain end users. Some types of clients, including pension funds and insurance funds, tend to have greater amounts of highly liquid securities than cash. Option 3, unlike Option 2, allows recognition of non-cash variation margin received from a client. As such, Option 3 would ensure that there is no capital-driven disincentive for a bank to offer clearing services to a client based on the leverage ratio effect of the type of margin that the client is able to provide.

Finally, compared to Option 2, Option 3 would result in marginally lower leverage exposure for client clearing transactions – a difference of 4 percent.[19] This modest transaction-level difference in leverage exposure can be helpful in removing disincentives for banks to engage in client clearing. Yet Option 3 would result in almost no change to banks' overall

[19] *See* Part I.C., above.

leverage ratios compared to Option 2 – with the difference being just 0.2 basis points.[20] Accordingly, Option 3 would be no less consistent with safety and soundness than Option 2.

III. The Basel Committee Should Not Adopt Segregation Criteria As a Condition to Recognition of Margin

We support the adoption of Option 3 of the Consultation without the imposition of segregation criteria for margin that offsets exposure under the leverage ratio. As a threshold matter, we note that segregation primarily is designed to protect clients from banks' default, rather than the reverse. While there are good reasons for jurisdictions to implement protections that minimize clients' exposures to banks, the leverage ratio is designed to capture *banks'* exposures, including to their clients.

In the past, the Basel Committee has expressed some concern that a bank can use margin to leverage itself.[21] However, the vast majority of initial margin in a cleared derivative transaction is held by the CCP and is unavailable for reinvestment by the bank. Additionally, with respect to the limited amount of initial margin held by the bank, the on-balance sheet component of the leverage ratio otherwise accounts for the possibility of reinvestment:

- ***Reinvestment Rights Create On-Balance Sheet Exposure.*** In certain limited circumstances, applicable law permits a bank acting as clearing member to reinvest client margin in highly liquid, ultrasafe assets such as the highest-rated sovereign debt. The bank will often remit a portion of the income from reinvestment of margin to the client that provided the margin, which reduces the client's opportunity cost of clearing and makes clearing more affordable. Importantly, when the bank *can* reinvest cash margin, and when it *does* reinvest non-cash margin, the margin is generally counted as an on-balance sheet exposure of the bank under the leverage ratio denominator. Such treatment effectively reverses any offset that the Basel Committee may adopt to recognize the exposure-reducing effect of initial margin.

- ***Relinquishing Reinvestment Rights Can Remove On-Balance Sheet Exposure.*** Some banks have been able to move cash initial margin off their balance sheets under applicable accounting rules by, among other things, passing back to the client the interest paid on client balances held at a CCP, broker, or third party bank. The client incurs all principal risk. In these circumstances, the clearing member bank is not using the margin to "leverage itself" in any sense.

Accordingly, to the extent that the Basel Committee remains concerned about the possibility of a bank reinvesting initial margin, despite the extremely limited degree of reinvestment that is permitted by law, the leverage ratio already accounts for this possibility by

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[20] *Id.*

[21] *See, e.g.*, Basel Committee on Banking Supervision, Basel III: Finalising Post-Crisis Reforms, at p. 146 (Dec. 2017), *available at* https://www.bis.org/bcbs/publ/d424.htm.

counting reinvestment-related exposures. It is not necessary to impose segregation criteria to address this concern.

In addition, the risk-based version of SA-CCR does not include segregation criteria. The Basel Committee has not expressed any reason why the risk-based and leverage capital rules should differ in this respect. As discussed above in Part II of this letter, subtle differences between the calculations of risk-weighted assets and leverage exposure could prove confusing for counterparties and investors. It would be far more simple for the Basel Committee, domestic supervisors, and banks to adopt SA-CCR's treatment of margin than to incorporate additional complex requirements. Such an approach of adopting SA-CCR's treatment of margin in the leverage ratio would fulfill the Basel Committee's stated goal to "strike an appropriate balance between the complementary goals of risk sensitivity, simplicity and comparability."[22]

Further, we are concerned that any segregation criteria that the Basel Committee would adopt would necessarily impose a one-size-fits-all standard, which would be inappropriate for several reasons. Segregation rules vary widely among jurisdictions. Segregation rules in the United States and the UK, for example, are expressed in very different ways, even though they are both highly protective. In Europe, clients have their choice of several different segregation models, rather than a single standard. These differences among jurisdictions are due to the fact that segregation regimes rest on a foundation of idiosyncratic common law and statutory frameworks relating to enforceability, insolvency, and customer protection. Additionally, segregation rules are dynamic, rather than static. They frequently evolve to reflect changes in CCP rulebooks, standard contractual arrangements, customer protection regulations, and case law. Given the jurisdiction-specific approaches to segregation, the Basel Committee should leave its member jurisdictions free to determine whether to impose segregation criteria in connection with an offset to leverage exposure for client margin and, if so, what those criteria should be.

Finally, the Basel Committee has not imposed segregation criteria in connection with the offset it adopted in paragraph 53 of the leverage ratio for collateral a bank receives in a securities financing transaction. In keeping with this precedent, the Basel Committee should not impose segregation criteria in connection with revisions to the leverage ratio's treatment of derivatives clearing to recognize initial margin.

IV. The Basel Committee Should Rescind the Leverage Ratio's Conditions for a "Higher Level Client" to Avoid Recognizing Exposures to the Clearing Member Upstream in a Multi-Level Client Structure

Paragraph 41 of the leverage ratio provides that where a bank acting as clearing member, based on the contractual arrangements with the client, is not obligated to reimburse the client for any losses suffered in the event that a QCCP defaults, the bank need not recognize the resulting trade exposures to the QCCP in the leverage ratio exposure measure. This general rule rightly

[22] *See* Basel Committee on Banking Supervision, Discussion Paper: The Regulatory Framework: Balancing Risk Sensitivity, Simplicity, and Comparability (July 2013), *available at* https://www.bis.org/publ/bcbs258.htm.

recognizes that in the "riskless principal" or "financial intermediary" clearing model that is common in Europe and a number of other jurisdictions, the bank can effectively eliminate its liability to its client (downstream in the clearing chain) if the CCP (upstream in the clearing chain) fails to perform.

In its December 2017 revisions to the leverage ratio, the Basel Committee abrogated this general rule for longer clearing chains where the bank acts as a "higher level client" between the clearing member (upstream in the clearing chain) and the ultimate client (downstream in the clearing chain). In such a structure, the bank can now only avoid recognizing an exposure to the clearing member upstream if it satisfies a number of additional conditions. In other words, under paragraph 41, for the bank to avoid incurring leverage ratio exposure to the entity upstream in the clearing chain, it is no longer sufficient for the bank to be contractually relieved from its obligation to the client downstream if the entity upstream defaults.

This new exception and the conditions associated with it are inappropriate for several reasons. First, contractual arrangements relieving the bank from its obligation to its client downstream in the event of a default by the clearing member upstream are sufficient to eliminate the bank's actual economic exposure to the clearing member, just as they are sufficient for a bank acting as clearing member in a three-party clearing chain to eliminate its actual economic exposure to the CCP. The Basel Committee has not justified the difference in treatment of multi-level client structures. To prevent an artificial "double count" of the leverage exposure of the bank serving as the higher level client, the bank should not be required to include exposure arising out of client transactions in its exposure to the clearing member, provided that the lower level client has limited recourse to the bank in the event of the clearing member default, which would be consistent with the requirements for a simple clearing chain consisting of the CCP, the clearing member, and the client.

Second, the new conditions address risk of loss and not the value of exposure, the latter of which is at the core of the leverage ratio calculation. Indeed, the conditions originally appeared in the risk-based capital framework, where they serve as conditions for a bank client to apply a lower risk weighting to transactions with a clearing member than would otherwise apply. The Basel Committee has not presented any reasons why a test to apply *lower risk-weighting* to an exposure to a clearing member would be an appropriate test for whether such exposure *exists*. To our knowledge, no other area in the leverage ratio imports risk weighting concepts in this manner.

Third, the condition addressing the effectiveness of porting depends on the robustness of local insolvency regimes, and even where porting is legally recognized and effective in the event of a higher level client default, porting may not take place for operational reasons (*e.g.*, the clearing member will likely not know the identity of lower level clients in a net omnibus account in the riskless principal clearing model). While this may have relevance to the risk weighting that the bank applies to its trade exposure to the clearing member, it does not have any impact on the value of the bank's exposure, which is key in the leverage ratio context.

Finally, the conditions include unclear terms, such as the requirement that legal arrangements will "prevent any losses" to the bank serving as a higher level client. "Prevent any

losses" is not a defined term in the Basel capital framework. We believe that the phrase means that an insolvency of the clearing member and/or one of its other clients would not diminish the bank's positions and assets at the CCP. Should the conditions of paragraph 41 remain in the leverage ratio framework, it is important for the Basel Committee to clarify standards such as "prevent any losses" to enable banks to meet them.[23]

While we understand that the Consultation has not expressly sought comment on this issue, we respectfully ask the Basel Committee to reconsider and rescind the conditions it adopted in December 2017 for multi-level client structures to prevent possible double-counting of exposures arising out of client transactions. In this regard, we note that the conditions appear in Annex 2 of the Consultation, which is presented for public comment.

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We look forward to engaging with the Basel Committee on the matters discussed in this letter. Please contact Jacqueline Mesa, Senior Vice President of Global Policy at FIA, if you have any questions.

Respectfully Submitted,

Walt L. Lukken
President and Chief Executive Officer
Futures Industry Association

[23] Similarly, the requirement that offsetting transactions with an insolvent CM are "highly likely" to continue to be indirectly transacted through the QCCP is unclear and would benefit from clarification.