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

Submitted via http://www.bis.org/bcbs/commentupload.htm

6 July 2016

Dear Sir or Madam,

The Basel III Leverage Ratio: Detrimental Impact on End Users

The Alternative Investment Management Association ("AIMA"), the Commodities Markets Council ("CMC"), the Investment Association ("IA"), the Managed Funds Association ("MFA") and the Asset Management Group ("AMG") of the Securities Industry and Financial Markets Association ("SIFMA") (collectively: the "Associations"; "we") welcome the opportunity to comment on the Basel Committee on Banking Supervision's ("BCBS") Consultative Document[1] on Revisions to the Basel III leverage ratio framework, as published in April 2016.

Collectively, we represent a broad range of end users, including asset managers, manufacturers, and commercial and industrial entities. Many of our members are active participants in both over-the-counter ("OTC") and exchange-trade derivatives markets and clear transactions through a broad range of central counterparties ("CCP" or "Clearing House").

We strongly support central clearing, which contributes to safer, more resilient derivatives markets. The demand for clearing services has increased significantly in recent years and will continue to increase as further entities become subject to clearing mandates as regulators finalize their rules.

It is, therefore, vital to ensure that end users are able to access central clearing on reasonable commercial terms. In this regard, we have significant concerns that the approach being pursued by the BCBS when it comes

[1] *See* http://www.bis.org/bcbs/publ/d365.pdf. Referred to in this submission as "the Consultative Document".

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to the leverage ratio will make it more costly – and in some cases impossible – for end users to access central clearing.[2]

Specifically, we are concerned that the standardized approach for measuring counterparty credit risk exposures ("SA-CCR") as set out in the Consultative Document does not allow any offsetting of a clearing member's potential future exposure with the initial margin ("IM") posted by its central clearing clients.

We do not be believe that this approach is justified, given that client IM serves to reduce the exposure that arises for a clearing member by virtue of its guaranteeing its client's performance to the CCP and is a fundamental component of rules that seek to ensure that CCPs are financially sound. This IM cannot be used by the clearing member for any other purpose and does not enable it to lever its positions. Penalizing clearing members by not allowing the offset of client IM in the calculation of their position vis-à-vis the leverage ratio will make it more costly for them to provide clearing services, to the ultimate detriment of their clients.

Segregated IM is also important in times of financial stress. Historically, CCPs have been able to successfully port customers of failing clearing members to new clearing members in order for these customers to maintain their open positions and avoid disruption from volatile market conditions. This is at least in part due to the exposure-reducing benefits provided by CCP IM which is ported along with customer positions during a default. If this porting leads to a significant increase in capital costs for non-defaulting clearing members (without a related offset), the ability of non-defaulting clearing members to take on new customer positions will be greatly constrained, particularly in times of stress. Clearing Members have historically been willing to take on customers from failing clearing members because segregated margin plainly reduced the actual economic exposures involved in doing so.

Clearing members being unable to accept the porting of non-defaulting customers during a clearing member default will ultimately result in mass liquidations of customer positions. Not only would this negatively impact the customers being liquidated, but the liquidations are likely to exacerbate volatility at the worst possible moment. This increased volatility could lead to additional defaults perpetuating the cycle of stress and reducing market participants' ability to withstand such stressful events. The negative impact to systemic financial stability of such a situation would be significant.

We appreciate that the BCBS's position is driven by the principle that "banks must not take account of physical or financial collateral, guarantees or other credit risk mitigation techniques to reduce the [leverage ratio] exposure measure".[3] However, the BCBS has rightly not adopted this approach for variation margin ("VM"), on the basis that this is a pre-settlement payment.[4] The same logic could also be applied to IM, which in effect serves as a pre-settlement payment in respect of the potential default of the client.

In conclusion, many of our members have already experienced an increase in clearing costs. Some have experienced the termination of a clearing relationship by their clearing broker, while overall central clearing is becoming more costly and more difficult to access. We therefore strongly caution against any measure that could further undermine the ability of the end user community to access the benefits of central clearing, and ask the BCBS to revise the leverage ratio standard to allow an offset of client initial margin against a firm's potential future exposure under SA-CCR. This would also foster a more consistent regulatory framework that recognizes the value of segregated IM in the context of client clearing.

We would be happy to discuss our concerns with you further.

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[2] Some of the individual signatories to this letter are writing separately to the BCBS to provide further quantitative data in support of these concerns. We note, in particular, data collected by SIFMA's AMG. *See* http://www.sifma.org/issues/item.aspx?id=8589961201.

[3] Consultative Document, p.2.

[4] BCBS, "Basel III leverage ratio framework and disclosure requirements", January 2014, p.270. *See* http://www.bis.org/publ/bcbs270.pdf.

Yours truly,

/s/

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Deputy CEO, Global Head of Government Affairs
AIMA

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Gregg Doud
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/s/

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About the Associations

Alternative Investment Management Association

AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 1,600 corporate members in over 50 countries. AIMA works closely with its members to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes, and sound practice guides.

Commodities Markets Council

CMC is a trade association that brings together exchanges and their industry counterparts. Its members include commercial end-users that utilize the futures and swaps markets for agriculture, energy, metal, and soft commodities. Its industry member firms also include regular users and members of swap execution facilities (each, a “SEF”) as well as designated contract markets (each, a “DCM”), such as the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Minneapolis Grain Exchange, NASDAQ Futures, and the New York Mercantile Exchange. Along with these market participants, CMC members also include regulated derivatives exchanges.

The Investment Association

The Investment Association represents the UK asset management industry. Our members manage over £5 trillion in the UK of assets on behalf of UK, European and international clients, both retail and institutional. Collectively, our members make up the second-largest asset management industry in the world.

Managed Funds Association

Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

Securities and Industry and Financial Markets Association

SIFMA's Asset Management Group (SIFMA AMG) members represent U.S. asset management firms whose combined global assets under management exceed $34 trillion.

The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.