October 11, 2017

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Proposed Agency Information Collection Activities (FR Doc. 2017–17939)

Dear Ms. Misback:

The Futures Industry Association ("FIA") and the International Swaps and Derivatives Association ("ISDA")[1] are writing to express our deep concerns with the proposed changes (the "Proposal") by the Board of Governors of the Federal Reserve System ("Board") to the mandatory Banking Organization Systemic Risk Report form ("FR Y-15") that would affect the treatment of client-cleared over-the-counter ("OTC") derivatives transactions for purposes of the capital surcharge (the "G-SIB Surcharge") imposed on U.S. global systemically important banking organizations ("G-SIBs").

The Proposal is a major policy change that could increase G-SIB Surcharge capital requirements by over ten billion dollars in the aggregate unless G-SIBs exited or scaled back their OTC derivatives central clearing businesses.[2] It could have a profoundly negative impact on end users and cleared derivative markets, and increase systemic risk. Yet, the Board describes the Proposal in a single sentence of a Federal Register notice of proposed informational collection activities,[3] describes the reasons for the Proposal in two sentences of a Supporting Statement,[4] and does not acknowledge the Proposal's effect on G-SIBs' capital requirements.

Since the inception of the G-SIB Surcharge rule, its "Complexity" and "Interconnectedness" indicators have not included transactions in which a clearing member G-SIB, acting as agent for a client's OTC derivative trade, guarantees the client's performance to a central counterparty ("CCP") but does not guarantee the CCP's performance to the client. These exclusions make good sense. Central clearing makes the derivatives markets less complex, results in fewer parties being exposed to or interconnected with G-SIBs, and generally promotes systemic stability. The

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1 See the Annex to this letter for a description of FIA and ISDA.

2 As discussed below, the Proposal could cause a number of G-SIBs to move up one capital "bucket" of the G-SIB Surcharge on a pro forma basis.

3 *See* 82 Fed. Reg. 40,154 (Aug. 24, 2017).

4 *See* Supporting Statement for the Banking Organization Systemic Risk Report (FR Y-15; OMB No. 7100-0352), p. 5, *available at* https://www.federalreserve.gov/reportforms/formsreview/FR%20Y-15_20170824_OMB%20SS.pdf (hereinafter, "Supporting Statement").

Board now proposes to add these transactions to the calculation of the G-SIB Surcharge through revisions to the FR Y-15 reporting form instructions.

FIA and ISDA believe these changes are entirely unwarranted and would increase risk in the U.S. financial system; we therefore strongly urge the Board not to adopt the Proposal. FIA and ISDA also strongly believe the Board should not make major policy changes of this nature through revisions to an information reporting form, without an adequate explanation of the rationale for the changes and no description of their potential impact on G-SIBs, end users, the cleared derivatives markets, or systemic stability. At a minimum, the Board should re-issue the Proposal through a transparent rulemaking process that satisfies all of the applicable requirements of administrative law for changes of this nature.

Part I of this letter discusses why the Proposal is unwarranted and should not be adopted. Part II describes the history of the G-SIB Surcharge's treatment of agent transactions in which a clearing member guarantees its client's performance to a CCP, but not the CCP's performance to the client. Part III discusses why the Proposal is deficient in its current form, and at a minimum, should not be adopted unless the Board releases a notice of proposed rulemaking with a reasonable explanation of the reasons for and impact of the proposed changes.

I. The Board Should Not Adopt the Proposal

A. Central Clearing Reduces Complexity, and Interconnectedness, and Overall Systemic Risk

Global regulators have cited central clearing as a key element to financial reform because it greatly reduces risk in the system. Since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the industry has made considerable progress on implementing regulatory and structural changes to the OTC derivatives markets. Today, an overwhelming majority of OTC derivative products are centrally cleared through regulated clearinghouses and a growing number of derivatives are traded on regulated exchanges, bringing more transparency and oversight to these markets than ever before, and substantially reducing their complexity.

Central clearing helps to mitigate systemic risk and provides transparency by replacing the complex web of bilateral ties between market participants with a more transparent CCP system. The Board has described the Interconnectedness indicator as capturing the likelihood that "financial distress at a G-SIB may materially raise the likelihood of distress at other firms."[5] Central clearing through a CCP greatly reduces the universe of counterparties that are exposed to a clearing member G-SIB as compared to bilateral derivative arrangements, and thus plainly results in the G-SIB being less interconnected with other firms.[6] Moreover, any

[5] 79 Fed. Reg. 75,473, 75,485 (Dec. 18, 2014).

[6] *See* Froukelien Wendt, Central Counterparties: Addressing their Too Important to Fail Nature, IMF Working Paper, p. 6 (Jan. 2015), *available at* https://www.imf.org/external/pubs/ft/wp/2015/wp1521.pdf ("The establishment of a CCP reduces the interconnectedness of banks. A CCP guarantees the performance of open positions despite the failure of

interconnectedness that results from the mutualization of losses in the central clearing model is substantially curtailed by a waterfall of risk mitigants that include robust amounts of initial margin,[7] pre-funded default fund contributions, CCP capital, and other safeguards. This waterfall structure greatly reduces the probability that other clearing members would suffer losses due to a clearing member G-SIB's default, as well as the potential impact of any such losses. Accordingly, a CCP can endure "truly extreme" losses without clearing members being required to make additional contributions to the CCP.[8]

Central clearing also reduces systemic risk overall by facilitating the transfer (or "port") of the positions of a distressed clearing member G-SIB's clients to other, financially sound clearing members in a simple and rapid manner.[9]

For these reasons, treating derivatives clearing as equivalent to entering into bilateral derivatives, as the Proposal would do, would be an overly blunt way of measuring systemic risk that would not recognize meaningful differences between those activities. In this regard, we note that any systemic risk resulting from a clearing member G-SIB's guarantee of its client's obligation to a CCP is already captured in the G-SIB Surcharge through the "Size" indicator.

B. The Proposal Would Disincentivize Clearing and Increase Risk in the System

Despite the substantial progress that the industry has made in moving OTC derivatives to central clearing, the unintended consequences and costs of a range of capital and liquidity rules are having an adverse impact on the health of the markets and make it more challenging for market participants to access cleared products. For this reason, Governor Jerome H. Powell recently stated that global regulators "have a responsibility to ensure that bank capital standards and other policies do not unnecessarily discourage central clearing."[10] Likewise, the U.S. Department of the Treasury has recommended that "regulators properly balance the post-crisis goal of moving more derivatives into central clearing with appropriately tailored and targeted capital

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one of the clearing members. In that sense a CCP that is well designed and capitalized insulates counterparties from one another. In its role of firewall a CCP can be considered a prudential tool to reduce the interconnectedness among banks.").

7 *See, e.g.*, 17 C.F.R. § 39.13(g)(2)(iii) (requiring CCPs to establish initial margin requirements sufficient to cover their potential future exposures to clearing members over a specified liquidation time with an established confidence level of 99 percent).

8 *See* CME Group, Balancing CCP and Member Contributions with Exposures, at p. 4 (Aug. 18, 2017), *available at* http://www.cmegroup.com/education/balancing-ccp-and-member-contributions-with-exposures.html.

9 *See* Dietrich Domanski, Leonardo Gambacorta, and Cristina Picillo, Central Clearing: Trends and Current Issues, Bank for International Settlements Quarterly Review, p. 61 (Dec. 6, 2015), *available at* http://www.bis.org/publ/qtrpdf/r_qt1512g.htm.

10 Federal Reserve Board Governor Jerome H. Powell, Central Clearing and Liquidity, Speech at the Federal Reserve Bank of Chicago Symposium on Central Clearing, Chicago, Illinois (June 23, 2017), *available at* https://www.federalreserve.gov/newsevents/speech/powell20170623a.htm.

requirements."[11] The Proposal would flatly contradict Governor Powell's statement and Treasury's recommendation and exacerbate these problems.

Inclusion of cleared derivatives in the Complexity and Interconnectedness indicators of the G-SIB Surcharge could substantially increase the capital requirements for G-SIBs that provide client clearing services. Specifically, we believe the proposed changes could very well result in the G-SIB Surcharge scores of a number of FIA and ISDA members increasing by one bucket on a pro forma basis, which would require those members to maintain additional capital of 0.5% of risk-weighted assets beyond the surcharges already in place. Because the Proposal would take effect so soon – as of the December 31, 2017 reporting date – G-SIBs would have very little practical ability to manage their G-SIB Surcharge scores to avoid moving up to a higher capital bucket.

Derivatives clearing is fundamentally a low-risk, low-return business. The substantial and disproportionate capital burden that the Proposal would impose – together with other requirements such as the Supplementary Leverage Ratio – would make it much more difficult for G-SIBs to earn a sufficient return on equity to make the business of client clearing economically viable.[12]

Some derivatives clearing members could respond to these disincentives by exiting the market entirely. Some clearing members may be less likely to take on new clients for derivatives clearing, or could respond to the higher costs of capital by dropping clients whose trades would have the largest impacts on the revised Complexity and Interconnectedness indicators – those that trade large notional values of OTC derivatives or are "financial institutions" under the capital rules.

Significant increases in clearing members' required capital could also significantly increase costs for end users, including pension funds and businesses across a wide variety of industries that rely on derivatives for risk management purposes, including agricultural businesses and manufacturers. As a result of higher costs and reduced access to cleared derivatives, market participants may be less willing or able to hedge their underlying risks, which would increase overall risk.

In addition, the liquidity and portability of cleared derivatives markets could be significantly impaired, which would substantially increase systemic risk. That is, in times of market stress, when G-SIBs' capital may decline to levels that make their G-SIB Surcharges effectively a binding constraint, the ability of such G-SIBs to purchase portfolios of cleared derivatives from

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[11] United States Department of the Treasury, A Financial System That Creates Economic Opportunities: Capital Markets, at p. 215 (Oct. 8, 2017), *available at* https://www.treasury.gov/press-center/press-releases/Pages/sm0173.aspx.

[12] *See* United States Department of the Treasury, A Financial System That Creates Economic Opportunities: Banks and Credit Unions, at p. 51 (June 12, 2017), *available at* https://www.treasury.gov/press-center/press-releases/Pages/sm0106.aspx ("Because of the low-margin and high-volume nature of the business of providing clients access to central clearing, high leverage ratio capital charges discourage firms from providing such services.") (hereinafter, the "Treasury Report").

other clearing members – including distressed banks – would be severely constrained. G-SIBs would seek to avoid the substantial increased capital requirements associated with acquiring new portfolios. Such a constraint on providing liquidity to stressed markets would accelerate downward price pressure at exactly the wrong moment, thereby undermining a key risk mitigating feature of cleared derivatives and increasing risk to the system.

The consequences outlined above are inconsistent with global policies designed to enhance the appropriate use of centrally cleared derivatives. The Pittsburgh G20 commitments of 2009 established a clear policy that mandatory clearing of certain derivatives is essential to improving risk management and promoting financial stability. The Dodd-Frank Act translated this policy into binding requirements in the United States. This policy and set of requirements are built on the assumptions that there will be an adequate number of clearing members that are able to, and remain willing to, provide clients access to clearinghouses, and that as a result, clearing members will significantly increase the number of clients for which they provide clearing services. We fear these assumptions would prove to be incorrect if the Board adopted the Proposal.

C. The Proposal Would Place U.S. Banking Organizations at a Competitive Disadvantage

The Proposal would create an inconsistency between the U.S. G-SIB Surcharge and the internationally-agreed standard. The Basel Committee on Banking Supervision's latest reporting instructions for the international G-SIB Surcharge assessment exclude from the Complexity indicator cleared derivative transactions in which a clearing member G-SIB, acting as agent, does not guarantee the performance of a CCP to its client.[13] By proposing to "gold-plate" the international standard by including such transactions within the Complexity indicator of the U.S. G-SIB Surcharge, the Proposal would needlessly place U.S. G-SIBs at a disadvantage to their competitors based abroad.

II. Since Its Inception, the G-SIB Surcharge Has Not Included Client-Cleared OTC Derivative Transactions Where the Clearing Member G-SIB Does Not Guarantee Its Client's Performance

The Board adopted the relevant exclusions for client-cleared derivative transactions as part of a widely publicized, transparent G-SIB Surcharge rulemaking process. As proposed and ultimately finalized, the G-SIB Surcharge rule includes measurements of certain OTC derivative exposures within two indicators: the Complexity indicator and, to the extent such derivatives created "intra-financial system assets" or "intra-financial system liabilities," the Interconnectedness indicator. The rule defines the relevant indicators and sub-indicators by reference to items on the FR Y-15 reporting form.

When the Board invited comment on its proposed rule in December 2014, the scope of OTC derivatives to be counted for these purposes was reasonably understood to exclude a transaction in which a clearing member G-SIB, acting as agent for a client's trade, guarantees the client's

[13] Basel Committee on Banking Supervision, Instructions for the end-2016 G-SIB assessment exercise, at p. 20 (Jan. 16, 2017), *available at* https://www.bis.org/bcbs/gsib/instr_end16_gsib.pdf.

performance to CCP but does not guarantee the CCP's performance to the client. This is the case for a number of reasons:

- With respect to the Complexity indicator, the Basel Committee stated in the very first G-SIB Surcharge consultative document and final standard in 2011 that "[t]he focus here is on the amount of OTC derivatives that are not cleared through a central counterparty. The greater the number of non-centrally cleared OTC derivatives a bank enters into, the more complex a bank's activities."[14]

- The preamble to the Board's proposed G-SIB Surcharge rule stated that "OTC derivatives activity [for purposes of the Complexity indicator] would be the aggregate notional amount of the *bank holding company*'s OTC derivative transactions that are cleared through a central counterparty or settled bilaterally,"[15] a statement that modestly expanded the internationally-agreed Complexity indicator to include centrally-cleared OTC derivative transactions in which the G-SIB is the client.

- The FR Y-15 reporting instructions that were in place at the time the Board invited comment on the proposed G-SIB Surcharge rule included a cross-reference to the FR Y-9C Glossary entry for "derivative contracts."[16] The glossary entry, in turn, solely described derivatives that a bank holding company enters into as principal.[17]

- The Basel Committee G-SIB assessment reporting instructions released during the comment period of the U.S. G-SIB Surcharge proposal stated that OTC derivative transactions for purposes of the Complexity indicator "[d]o not include cleared derivative transactions (ie transactions where the bank provides clearing services for clients executing trades via an exchange or with a CCP) where the bank is not a direct counterparty in the contract" other than "[i]n cases where a clearing member bank, acting

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[14] Basel Committee on Banking Supervision, Consultative Document, Global systemically important banks: Assessment methodology and the additional loss absorbency requirement at p. 9 (July 2011), *available at* https://www.bis.org/publ/bcbs201.pdf; Basel Committee on Banking Supervision, Global systemically important banks: assessment methodology and the additional loss absorbency requirement, Rules text, p. 9 (Nov. 2011), *available at* https://www.bis.org/publ/bcbs207.pdf.

[15] 79 Fed. Reg. 75,473, 75,486 (Dec. 18, 2014).

[16] Board of Governors of the Federal Reserve System, Instructions for Preparation of Banking Organization Systemic Risk Report, Reporting Form FR Y-15, at p. D-1 (Dec. 2013), *available at* https://www.federalreserve.gov/reportforms/forms/FR_Y-1520131231_i.pdf.

[17] Board of Governors of the Federal Reserve System, Instructions for the Preparation of Consolidated Financial Statements for Holding Companies, Reporting Form FR Y-9C, at p. GL-26 (Dec. 2014), *available at* https://www.federalreserve.gov/reportforms/forms/FR_Y-9C20141231_i.pdf. ("Derivative Contracts: Holding companies commonly use derivative instruments for managing (positioning or hedging) their exposure to market risk (including interest rate risk and foreign exchange risk), cash flow risk, and other risks in their operations and for trading . . . . ASC Topic 815 requires all derivatives to be recognized on the balance sheet as either assets or liabilities at their fair value.").

> as an agent, guarantees the performance of a CCP to a client."[18] Likewise, for purposes of the Interconnectedness indicator, the Basel Committee instructions in place provided that client-cleared OTC derivative transactions only create intra-financial system assets and liabilities where the clearing member G-SIB guarantees the performance of the CCP to the client.[19]

The Board unequivocally confirmed this understanding in the set of updated FR Y-15 reporting instructions it released in connection with issuing the final G-SIB Surcharge rule. The FR Y-15 instructions stated that OTC derivative transactions for purposes of the Complexity indicator "[d]o not include cleared derivative transactions (i.e., transactions where the bank provides clearing services for clients executing trades via an exchange or with a CCP) where the bank is not a direct counterparty in the contract," except where the clearing member G-SIB "guarantees the performance of a CCP to a client."[20] Similarly, with respect to intra-financial system assets and liabilities, the instructions provided that the clearing member G-SIB was to include client-cleared OTC derivative transactions only where the G-SIB guarantees the performance of the CCP to the client.[21] The Board reaffirmed this treatment each time it amended the FR Y-15 instructions without revising these statements – in June 2016, September 2016, December 2016, and March 2017.

The text of the G-SIB Surcharge rule does not dictate a different result. With respect to the Complexity indicator, the rule text defines "notional amount of an OTC derivative" as "the total notional amount of OTC derivatives, *as reported by the bank holding company on the FR Y-15*,"[22] a definition that would be unnecessary if the FR Y-15 form required the reporting of all "OTC derivatives" rather than a subset thereof.[23] With respect to the Interconnectedness indicator, a clearing member generally does not record on its balance sheet agency transactions in which it has guaranteed the performance of its client to a CCP.[24] Thus, as a matter of plain

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[18] Basel Committee on Banking Supervision, Instructions for the end-2015 G-SIB assessment exercise, p. 18 (Feb. 5, 2015), *available at* https://www.bis.org/bcbs/gsib/instr_end15_gsib.pdf.

[19] *Id.* at pp. 13-14.

[20] Board of Governors of the Federal Reserve System, Instructions for Preparation of Banking Organization Systemic Risk Report, Reporting Form FR Y-15, at p. D-1 (Dec. 2015), *available at* https://www.federalreserve.gov/reportforms/forms/FR_Y-1520151231_i.pdf.

[21] *Id.* at p. B-3.

[22] 12 C.F.R. § 217.401(r) (emphasis added).

[23] Indeed, the Board also excludes cleared derivatives initiated through an exchange from the Complexity indicator based on this authority. *See* Board of Governors of the Federal Reserve System, Instructions for Preparation of Banking Organization Systemic Risk Report, Reporting Form FR Y-15, at p. B-3 (Dec. 2016), *available at* https://www.federalreserve.gov/reportforms/forms/FR_Y-1520170331_i.pdf.

[24] Under U.S. generally accepted accounting principles ("GAAP"), cash initial margin attributable to client-cleared derivative transactions may be recorded on the clearing member's balance sheet.

language and GAAP accounting, such transactions do not create intra-financial system "assets" and "liabilities" and need not be included in those sub-indicators.

As a result, the G-SIB Surcharge today excludes client-cleared derivative transactions from the Complexity and Interconnectedness indicators where the clearing member G-SIB does not guarantee its client's performance to the CCP. Public comments on the G-SIB Surcharge rule were premised on these exclusions forming part of the G-SIB Surcharge. And G-SIBs have carefully managed their balance sheets and activities in light of these exclusions.

III. At a Minimum, the Board Should Re-Issue the Proposal in a Notice of Proposed Rulemaking That Includes a Reasonable Explanation and Impact Assessment

In contrast to the visible and transparent process by which it adopted the G-SIB Surcharge rule, including the exclusions for client cleared derivatives, the Board now proposes to include those transactions through a notice of information collection activities. Notably, neither the Federal Register notice nor the Supporting Statement acknowledges that the Proposal would have an effect on the calculation of the G-SIB Surcharge.

In relevant part, the Federal Register notice instead describes the Proposal in the following sentence: "The FR Y-15 would be revised by . . . (3) expressly including all cleared derivative transactions in Schedule D, item 1; (4) specifying how certain cleared derivatives transactions are reported in Schedule B, items 5(a) and 11(a) . . . ." The Board's Supporting Statement states the reasons for the Proposal in the following sentence: "Under the proposal, client clearing activity would be expressly included in the reporting of cleared derivatives in order to capture the systemic risks associated with such activity and better align the treatment of cleared derivatives with the Board's regulatory capital rules." The Supporting Statement also states that "[m]any of the proposed changes to the FR Y-15 would correspond to changes made to the BCBS data collection." While it is not explicit, we assume the Board intended for this statement to describe the proposed changes to the treatment of OTC derivatives.

A. The Board's Proffered Reasons for the Proposal Do Not Support Its Implementation

While the Supporting Statement provides that inclusion of client clearing would "capture the systemic risks associated with such activity," the Board has not presented any evidence demonstrating that acting as a clearing member presents systemic risk. Further, to the extent that clearing derivatives presents systemic risk, the Board has not demonstrated that such risk should be counted in the same manner as the systemic risk resulting from entering into bilateral derivatives, as the Proposal would do. The Board also has not established that the Size indicator, which includes exposure arising from a clearing member G-SIB's guarantee of its client's obligation to a CCP, does not adequately capture any systemic risk arising from such a transaction. And the Board has not acknowledged or addressed the reasons why the Proposal would be likely to *increase* systemic risk, as described in Part I of this letter.

The Board's statement that the Proposal would better align the treatment of cleared derivatives in the FR Y-15 form with the Board's regulatory capital rules also does not justify adopting the Proposal. The G-SIB Surcharge – a measurement of *systemic* risk – need not and should not

align in all respects with the generally applicable regulatory capital rules that capture *firm-specific* risks. Indeed, the definition of "notional amount of an OTC derivative" expressly contemplates that the G-SIB Surcharge would not include all OTC derivatives as defined in the capital rules within the Complexity indicator, as discussed above in Part II of this letter. Similarly, the intra-financial system assets and liabilities sub-indicators do not require inclusion of client-cleared derivatives conducted on an agency basis in the Interconnectedness indicator.

Finally, the Board's goal of aligning the FR Y-15 form with the Basel Committee's international G-SIB Surcharge reporting form is inconsistent with the Proposal. As discussed above, the Basel Committee's latest reporting form does *not* include in the Complexity indicator client cleared derivative transactions where the clearing member G-SIB acts as agent and does not guarantee the CCP's performance. With respect to the Interconnectedness indicator, the Basel Committee revised the reporting form for the international G-SIB assessment standard in January 2017 to include within intra-financial system assets and liabilities client-cleared derivatives where the clearing member G-SIB guarantees its client's performance to the CCP. However, the Basel Committee did not publically consult on this change prior to finalizing it. Nor did the Basel Committee provide any reasons for the change. The fact that the Board seeks to align the FR Y-15 form with the Basel Committee's form does not mean that it should implement such significant changes without undertaking a transparent public comment process to assess their full impact prior to implementation.

B. The Public Cannot Meaningfully Understand the Proposal Nor Comment on It Without a Reasonable Explanation and Impact Assessment

Neither the Federal Register notice nor the Supporting Statement acknowledges or discusses the Proposal's broader public policy implications, including the impact on the capital requirements of clearing member G-SIBs, incentives for G-SIBs to clear derivatives, and other issues.

The Board's Supporting Statement assesses the impact of the Proposal based solely on the costs of reporting, and thereby concludes that G-SIBs' costs are "not expected to change with the proposed revisions."[25] By presenting the Proposal as simply a change to an information collection form, the Board's impact assessment does not state the real costs of the Proposal, which are the significant costs that could result from counting client-cleared derivative transactions in the Complexity and Interconnectedness indicators of the G-SIB Surcharge. Imposing billions of dollars of new G-SIB Surcharge capital requirements for G-SIBs' client clearing activities would cause negative consequences to G-SIBs, their clients, cleared derivatives markets, and systemic stability. The Board should therefore assess the full impact of the Proposal – including its cumulative impact when considered alongside other requirements such as the Supplementary Leverage Ratio – before adopting it.

Without the Board providing a reasonable explanation of the reasons for the Proposal, and consideration of its economic impacts, it is not possible for the public to provide meaningful comment on the Proposal. The Board should take these steps before implementing the Proposal.

[25] Supporting Statement, p. 6.

FIA and ISDA also respectfully believe that the Proposal would benefit from the Board consulting with the Commodity Futures Trading Commission, which has specialized expertise in derivatives and the stated mission of fostering open, transparent, competitive, and financially sound markets to avoid systemic risk;[26] and the Financial Stability Oversight Council, which has a mandate to identify systemic risk and respond to threats to systemic stability, was specifically intended to serve as a forum for facilitating information-sharing among member agencies in rulemakings,[27] and has a working group focused on whether prudential regulations constrain market liquidity.[28] Such consultation would be consistent with Treasury's June 2017 report on regulatory reform, which described the "need for enhanced policy coordination among federal financial regulatory agencies."[29]

C. Administrative Law *Requires* the Board to Provide a Reasonable Explanation and Impact Assessment of the Proposal in a Notice and Comment Rulemaking

Not only would it yield a better, more fully-vetted rule if the Board provided a reasonable explanation of the Proposal and its economic impacts, such a process would help remedy the Proposal's legal deficiencies. Under the Administrative Procedure Act ("APA"), a federal agency seeking to promulgate or amend a "rule" that is not an "interpretative rule" is required to go through notice-and-comment procedures,[30] which include satisfying the requirements to not be arbitrary or capricious agency action.[31] "Rules" subject to the APA notice-and-comment requirements include any "agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy."[32] A statement has "general applicability" if it "has a substantial impact on [a] regulated industry," or on a class of that industry.[33] A statement has "future effect" if it has prospective effect.[34]

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[26] *See* Commodity Futures Trading Commission, Agency Financial Report, Fiscal Year 2016, *available at* http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/2016afr.pdf.

[27] 12 U.S.C. § 5322(a)(1), (a)(2)(E).

[28] Bloomberg, Wall Street Says Rules Pose Risk of Another Crisis, and Trump Regulators Agree (June 7, 2017), *available at* https://www.bloomberg.com/news/articles/2017-06-07/wall-street-says-rules-risk-next-crisis-trump-regulators-agree.

[29] Treasury Report at p. 11.

[30] 5 U.S.C. § 553(b). *See also* 5 U.S.C. § 551(5) (defining "rule making" as "agency process for formulating, amending, or repealing a rule").

[31] 5 U.S.C. § 706(2)(A).

[32] 5 U.S.C. § 551(4).

[33] Phillips Petroleum Co. v. Johnson, 22 F.3d 616, 620 (5th Cir. 1994) (quotation omitted); Natural Res. Def. Council v. EPA, 966 F.2d 1292, 1309 (9th Cir. 1992).

[34] *E.g.*, Citizens to Save Spencer County v. EPA, 600 F.2d 844, 879–80 (D.C. Cir. 1979).

The Proposal is subject to the APA's notice-and-comment procedures because it both is a "rule" itself and would effectively amend the G-SIB Surcharge rule. The G-SIB Surcharge would have a substantial impact on G-SIBs and their clients on a prospective basis. Moreover, the Proposal is not an "interpretative rule," for the following reasons:

- Agency action that "effectively amends" an existing legislative rule is itself a legislative rule, not an interpretative rule.[35] The Proposal would "effectively amend" the G-SIB Surcharge rule because the G-SIB Surcharge rule incorporates sub-indicators of the FR Y-15 form by reference. As a result, the Proposal's material revisions to the FR Y-15 instructions would constitute material amendments to the G-SIB Surcharge rule itself.

- An agency may not include in a rule an "open-ended" provision that reserves its authority to establish conditions outside the bounds of the APA's notice-and comment rulemaking requirements.[36] That is, the Board may not take advantage of the fact that the G-SIB Surcharge rule cross-references the FR Y-15 reporting form in order to effectively amend the rule through revisions to the form's instructions that do not independently satisfy the APA's requirements. To do so would allow the agency to "grant itself a valid exemption to the APA for all future regulations, and be free of APA's troublesome rulemaking procedures forever after, simply by announcing its independence in a general rule."[37]

- The Proposal does not "merely clarify or explain existing law or regulations,"[38] because it (1) makes changes that are incorporated by reference into the G-SIB Surcharge rule, and (2) sets forth an entirely different meaning of the Complexity and Interconnectedness indicators than those that are currently set forth in the existing FR Y-15 instructions.[39]

- The Proposal's nature as a "legislative rule is recognizable by virtue of its binding effect."[40] The Proposal has binding effect because it imposes "rights and obligations" on G-SIBs to comply with a different G-SIB Surcharge requirement, and does not "leave[] the agency . . . free to exercise discretion" in the calculation of G-SIB Surcharge scores.[41]

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35 American Mining Congress v. Mine Safety and Health Administration, 995 F.2d 1106, 1112 (D.C. Cir. 1993).

36 United States v. Picciotto, 875 F.2d 345 (D.C. Cir. 1989).

37 *Id.*

38 Alcaraz v. Block, 746 F.2d 593, 613 (D.C. Cir. 1984) (quoting Powderly v. Schweiker, 704 F.2d 1092, 1098 (9th Cir. 1983)).

39 *See* Batterton v. Marshall, 648 F.2d 694, 705 (D.C. Cir. 1980) (holding that change in Department of Labor's methodology for calculating employment statistics required notice-and-comment rulemaking because such methodology was a "critical factor in an otherwise inflexible statutory formula for allocating monies").

40 State of Alaska v. U.S. Dep't of Transp., 868 F.2d 441, 445 (D.C. Cir. 1989).

41 *Id.*

As a "rule" subject to the notice-and-comment procedures of the APA, the Proposal must include "either the terms or substance of the proposed rule or a description of the subjects and issues involved."[42] In its current form, the Proposal does neither. The Proposal does not state that it would change G-SIBs' scores for purposes of the G-SIB Surcharge, which are the "terms" and "substance" of the proposed changes. The Proposal does not describe how it would raise capital requirements for G-SIBs, affect G-SIBs' incentives to clear derivatives, and substantially impact systemic risk, which are the "subjects and issues involved" in making such changes.

In addition, the Proposal must satisfy the standards to avoid being arbitrary or capricious agency action under the APA. Accordingly, the Board must offer findings and analysis to justify the choices it has made, and "cogently explain why it has exercised its discretion in a given manner."[43] The Proposal would be deficient if the Board "entirely failed to consider an important aspect of the problem" or "offered an explanation for its decision that runs counter to the evidence before the agency."[44] The Board has a "statutory obligation to determine as best it can the economic implications of the rule it has proposed."[45] And the Board must "consider significant alternatives to the course it ultimately chooses."[46] Here, the Board has failed to justify or cogently explain the Proposal; "entirely failed to consider" the impact of the Proposal on G-SIBs, end users, derivatives markets, and systemic stability; provided no evidence; not fulfilled its obligation to determine the economic impacts of the Proposal; and not identified any alternatives to the Proposal.

Finally, because the Proposal is a "rule" under the APA, the Board must also comply with other associated requirements to adopt it, including:

- ***APA Requirements for Changing Policy.*** An agency action that amends an existing rule will survive "arbitrary and capricious" review under the APA only if: (i) the agency shows that it is aware it has changed its policy; and (ii) the agency shows "good reasons" for the new policy.[47] An "unexplained inconsistency in agency policy is a reason for holding an interpretation to be an arbitrary and capricious change from agency practice."[48] The Board's Proposal does not satisfy these requirements in its current form. The Proposal would amend the G-SIB Surcharge rule, but does not demonstrate any awareness that it would have such an effect.

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42 5 U.S.C. § 553(b)(3).

43 Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 48 (1983).

44 *Id.* at 43.

45 Chamber of Commerce of U.S. v. Sec. & Exch. Comm'n, 412 F.3d 133, 143 (D.C. Cir. 2005).

46 Allied Local & Reg'l Mfrs. Caucus v. EPA, 215 F.3d 61, 80 (D.C. Cir. 2000).

47 F.C.C. v. Fox Television Stations, Inc., 556 U.S. 502, 515 (2009).

48 Encino Motorcars, LLC v. Navarro, 136 S. Ct. 2117, 2126 (2016) (internal quotations omitted).

- ***Regulatory Flexibility Act.*** The Board must comply with the requirements of the Regulatory Flexibility Act, including preparing an Initial Regulatory Flexibility Analysis (IRFA) and Final Regulatory Flexibility Analysis (FRFA) describing the Proposal's impacts on small entities.[49]

- ***Effective Date of Any Final Rule.*** Under the APA, the effective date of any final rule adopting the Proposal may not be earlier than 30 days after the publication of the final rule in the Federal Register.[50] That is, the Proposal could not take effect for the December 31, 2017 reporting date unless a final rule were published in the Federal Register by December 1, 2017 or earlier. (And in all events, any final rule would need to be preceded by a proposed rule satisfying the requirements described in this Part III.C.)

- ***Congressional Review Act.*** The Board must submit the Proposal, if adopted, to the Congress and the Comptroller General for review and potential disapproval under the Congressional Review Act.[51] The Board is also required to identify the Proposal as a "major rule" under the Congressional Review Act, because it would have an annual effect on the economy of more than $100 million; would be likely to have significant adverse impacts on competition and investment; and would have significant adverse impacts on the ability of United States-based enterprises to compete with foreign-based enterprises.[52]

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49 5 U.S.C. §§ 603, 604.

50 5 U.S.C. § 553(d).

51 5 U.S.C. §§ 804(a)(1)(A)(ii), 801(a)(1)(A).

52 5 U.S.C. § 804(2).

We look forward to engaging with the Board on the matters discussed in this letter. Please contact Jacqueline Mesa, Senior Vice President of Global Policy at FIA, at 202-466-5460, or Christopher Young, Head of U.S. Public Policy at ISDA, at 202-683-9339, if you have any questions.

Respectfully Submitted,

Walt L. Lukken
President and Chief Executive Officer
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Scott O'Malia
Chief Executive Officer
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cc: Shagufta Ahmed, Office of Information and Regulatory Affairs, Office of Management and Budget

Annex - Descriptions of the Associations

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. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members play a critical role in the reduction of systemic risk in global financial markets.

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 875 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.