

**Meeting Between Staff of the Federal Reserve Board and Representatives of  
the Futures Industry Association  
July 17, 2024**

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Kyle Glenn, Walt Lukken, and Jacqueline Mesa (Futures Industry Association); Tom Gillis, Jeffrey Hall, and Roger Rice (Wells Fargo); Michael Formichelli, Sarah Lantz, Andrew Nash, Denise Pieck, Jason Swankoski, and Daniel Wiebicke (Morgan Stanely); Helen Gordon and Deborah Toennies (JP Morgan); Zachary Koh, Thomas Treadwell, and Harry Yang (Citigroup); Joseph Hwang and Avijit Praveer (Goldman Sachs); Noah Cuttler (Barclays); Damian Kudelka, Edward Mayfield, and Bengt Redlinger (Bank of America)

**Summary:** Staff of the Federal Reserve Board met with representatives of the Futures Industry Association (FIA) regarding topics including the agencies' Basel III endgame notice of proposed rulemaking. FIA representatives raised concerns with the proposal, including several articulated in the FIA's comment letter, with emphasis on its impact on derivatives clearing activities and potential impacts to the functioning of the U.S. Treasury market.

Attachment



**Bank Capital Framework:  
Interplay with UST Clearing**

Presentation to the U.S. Banking Agencies

July 2024



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# Executive Summary

- **Client Clearing – Capital Constraints.** FIA and its member firms have raised comments about the interplay of the Endgame proposal with FCM client clearing models for derivatives.<sup>1</sup>
  - As a general matter, an FCM's guarantee of its (derivative) client's performance to the CCP results in the FCM's Parent BHC recognizing Credit Risk RWAs to the FCM client
  - The inclusion of this activity in the CVA and operational risk charge under the Endgame proposal and the inclusion of OTC cleared transactions in 'complexity' and 'interconnectedness' under the GSIB proposal can result in constraints on market capacity
  - In addition, the Parent BHC may face SLR pressures from balance sheet gross-ups and PFE add-ons
- **UST Clearing Final Rule.** The SEC adopted a U.S. Treasury securities (UST) secondary market clearing final rule in December 2023<sup>2</sup> after the Banking Agencies had proposed the Basel Endgame package in July 2023.
  - The UST clearing final rule applies directly to Covered Clearing Agencies (CCAs) – of which there is currently only one, the Fixed Income Clearing Corporation (FICC) – and requires CCAs to impose a UST clearing mandate on CCA member firms
  - Broadly speaking, the clearing mandate applies to CCA members firms' UST repo transactions and UST cash transactions, subject to certain exemptions
  - The UST clearing final rule requires CCAs to develop rules to implement the UST clearing mandate, which is an ongoing process with FICC and would require additional rulemakings by any future CCAs
  - The SEC's final rule requires CCAs to impose a UST cash clearing mandate by YE 2025 and a UST repo clearing mandate by mid-2026
- **Interplay of Bank Capital Rules with the UST Clearing Mandate.** The July 2023 Endgame capital proposal did not consider the role of banking organizations in facilitating UST clearing at CCAs.
  - We believe these issues should be directly addressed in any future steps taken to advance the rulemaking.
  - As summarized in this presentation, the UST clearing issues are both similar to and distinct from FCM derivatives clearing issues and require further examination.
  - Another complication is that, unlike U.S. FCM derivatives clearing practice, there are a range of clearing models that might support UST clearing at FICC (or other future CCAs), complicating BHC-level analysis of capital implications.

Note 1: See Comment Letter from Futures Industry Association, Jan. 16, 2024 ([here](#)).

Note 2: 89 Fed. Reg. 2714 (Jan. 16, 2024) ([here](#)).



# UST Clearing: What Are The Bank Capital Issues?

- **UST Clearing – Capital Constraints.** U.S. banking organizations facilitating UST client clearing may do so through bank, broker-dealer/FCM or other subsidiaries that are CCA members. Imposition of a UST clearing mandate raises both similarities with and differences from prior FCM-centered issues highlighted for derivatives clearing.
  - Similarities
    - In connection with UST repo clearing facilitation, Parent BHC recognizes Credit Risk RWAs to the B-D/bank client in connection with the B-D/bank's guarantee of client performance
    - Balance sheet gross-ups may result from UST (repo or cash) clearing facilitation, in particular from cash initial margin exchange
    - Revenue-based Ops Risk charges may not accurately capture operational risks
  - Differences
    - UST repo and cash securities clearing does not result in SA-CCR or CVA charges. UST repo would instead be subject to the collateral haircuts approach
    - Cash securities clearing is T+1 settlement and thus does not give rise to Credit Risk RWAs
    - Unlike FCM practice, a B-D/bank is not required by the CCA to collect regulatory initial margin from its UST clearing clients – initial margin collection from clients is a commercial decision
- **Mixed Product Portfolios.** A client may have a mix of derivatives (e.g. futures and cleared swaps), UST repo and/or UST cash security positions for clearing. In these situations, the full range of client clearing issues (derivatives and UST repo/cash) is relevant
  - Neither existing U.S. bank capital rules nor proposed Endgame standards specifically contemplate facilitation of clearing in such mixed product client portfolios, even though one set of products (e.g., UST repo) can be a risk offset to the other (e.g., UST futures)
  - The inability to net cross product diverges with UK and EU as they maintain application of cross product netting under IMM
- **Multiple potential UST clearing models.** It is expected that FICC will have two models, the "Sponsored" model, which has been in place for several years, and the "Agency" model, which is still in development. Actually, other CCPs may seek to become CCAs in order to clear UST transactions. Each new CCA likely will have its own model whose structure differs from that of other CCAs' models. These clearing model variants may lead to different constraints or frictions.
- **Endgame.** While some of these issues would arise under the current capital framework, the Endgame proposal did not consider the impacts of the SEC's UST clearing final rule, adopted in December 2023, so raising these issues now is timely.

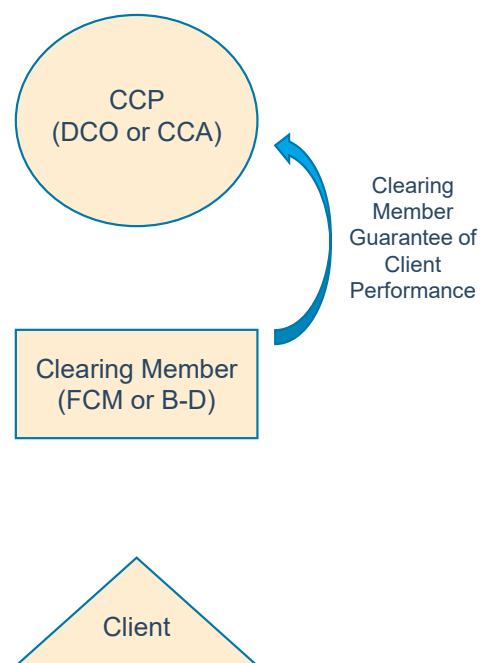
\*See, e.g., Reuters, Mar. 12, 2024, "CME Group bids to enter US Treasuries clearing business" ([here](#)); Reuters, Mar. 13, 2024 ("LCH looking at clearing US Treasuries, competition set to increase" ([here](#)), Bloomberg, Jun. 24, 2024, "ICE Aims to Clear US Treasuries as Market Regulation Expands" ([here](#)).



# Variations in UST Clearing Models

- **Diversity of Potential Clearing Models.** While “sponsored, done-with” clearing has existed for years at FICC, the introduction of an SEC clearing mandate, related rule changes at FICC, and the prospect of new clearinghouses registering as Covered Clearing Agencies (CCA) raises the prospect of a range of potential UST clearing models.
  - Sponsored, Done-With: The existing marketplace for clearing UST repo is largely based on the “sponsored, done-with” model at FICC. In this model, a Clearing Member “sponsors” the repo client (i.e., any margin on the Client’s cleared position is calculated on a gross basis with respect to that position) and the Clearing Member also executes the original repo that is then submitted for clearing by both parties (“done-with”).
  - Done-Away: FICC’s expectation is that the Agency model (below) will better accommodate “done-away” clearing where the Clearing Member provides a standalone clearing service for the Client without separately executing the underlying repo trade with the Client.
  - Agency vs Sponsored: FICC rules also contemplate an “Agency” clearing model in which a FICC clearing member clears repos for its client (which does not become a FICC member). The Agency model is designed to replicate the trade structure of the FCM model.
  - B-D vs Bank Facilitation: Both banks and broker-dealers are Clearing Members at FICC. A broker-dealer Clearing Member is required to apply Exchange Act Rule 15c3-3 to margin received from clients in connection with clearing at FICC (and may, in some circumstances, recognize an offsetting debit when client collateral is delivered to FICC). Bank clearing members are not subject to these requirements.
- **Potential for Multiple CCAs.** While there is currently only one CCA (FICC), several other clearinghouses have signaled that they may create CCAs. Each CCA’s rulebook and product offerings may be variable, adding another layer of complexity to planning for the 2025/2026 go-live dates.
- **Uncertainty; Future Development.** These clearing model variations – which can be combined in different permutations – are still being evaluated by the industry and by clients for future use as the UST clearing mandate approaches. In practice, there may be a range of potential clearing models (e.g., Sponsored, Done-With, Broker-Dealer as well as Agent, Done-Away, Bank) that develop over time as market participants organize for anticipated increases in clearing flows.
  - It appears unlikely that the market will converge on a single UST clearing model, at least in the foreseeable future – the capital rules should accommodate a range of potential models.

# Client Clearing Models



- Client clearing models – whether for futures/swaps, repo or cash securities – raise variations of the same core model in which the Clearing Member guarantees the performance of the client to the clearinghouse
- As a result, while the particular flows are distinct, in each case the Clearing Member’s Parent BHC faces RWA, Tier 1 Leverage and SLR impacts from its guarantee of Client performance to the clearinghouse
- This illustration focuses on the UST repo/cash securities “done away” model in which the Clearing Member is not executing a transaction with the Client and is, instead, only facilitating the Client’s clearing access, which is analogous to an FCM’s role in derivatives client clearing
- FICC contemplated “Agency” and “Sponsored” UST clearing models, and other CCAs’ models, will likely raise distinct accounting and margining considerations

Parent BHC Impacts Under Endgame Proposal	Derivatives	UST Repo	UST Cash Securities
Credit Risk: SA-CCR	X		
Credit Risk: CVA	X*		
Credit Risk: RST Guarantee (Collateral Haircuts)		X	
Ops Risk	X	X	X
Balance Sheet Gross-Ups from Collateral Movement	X	X	X
G-SIB Complexity and Interconnectedness	X**	X***	

\* House trades not subject to CVA  
 \*\* Only included for OTC cleared  
 \*\*\* Included in interconnectedness only



# Credit Risk: RST Guarantee

## RWA Mechanics

- Guarantee of sponsored member's performance on Treasury repo results in repo-style transaction for Standardized as well as under ERBA
- Exposure calculated based on collateral haircut approach (E-C) plus conservatively calibrated supervisory volatility haircuts
  - The Endgame proposal opens the E-C CHA formula for comment in ERBA
- Applicable risk weights for certain counterparties contingent on public listing requirement under B3EG
- Additional RWA arising from capped contingent liquidity facilities or default fund contributions

## SLR Mechanics

- Any on balance sheet asset arising from the guarantee of sponsored member's performance on Treasury repo included in the SLR (with US GAAP netting contingent on the model pursued)
- Additional counterparty credit risk add-on for repo-style transactions of (E-C)
  - The Endgame proposal opens the E-C CHA formula for comment in ERBA (as applied in the SLR)

## Ops Risk

- **Services BI.** Conceptually, UST client clearing raises the same Ops Risk frictions as derivatives client clearing – revenue is a poor metric of operational risk
  - Revenues received by the B-D/BHC will, in practice, be utilized in part to offset clearing expenses
  - While FICC's Sponsored model exists today, the anticipated growth in UST clearing volumes (both repo and cash clearing) makes it difficult to predict how revenues trends will change over time





# Balance Sheet Gross-Ups

- **CCA-Mandated Margin.** CCAs impose margin requirements for clearing both UST cash and UST repo transactions. The SEC's and FICC's frameworks do not require Clearing Members to collect CCA-mandated initial margin from clients, making it a commercial decision whether the Clearing Member will absorb the cost of margining on behalf of UST clearing clients.
  - Where clients provide margin in support of their UST cleared positions through a B-D Clearing Member, the SEC included an amendment in its December 2023 final rule to permit a B-D to use initial margin collected from client to post to FICC to meet FICC's margin class in respect to client transactions instead of B-D's own funds as required previously due to segregation requirements of margin associated with client transactions.
  - However, the B-D (or bank's) role as a Clearing Member intermediary may result in balance sheet gross-ups from cash margin transfers.
- **Excess Margin.** Clearing Members may require margin in excess of CCA-mandated requirements in some cases. Where such excess margin is received in the form of cash it will increase the Clearing Member's balance sheet, adding SLR pressures.
- **Range of potential UST clearing models.** Unlike the FCM/derivatives clearing model, which is well-established in U.S. law, regulation and market practice, the UST repo/securities clearing model is still in development and will likely have a range of variants – as such, clearing model variants may lead to different constraints or frictions.
  - In particular, there is near-term focus on the Accounting (balance sheet) treatment FICC's "Agent" clearing model
- **Endgame.** While some of these issues would arise under the current capital framework, the Endgame proposal did not consider the impacts of the SEC's UST clearing final rule, adopted in December 2023, so raising these issues now is timely.
- **Questions/Focus Areas.** Topics that are being considered by industry participants:
  - The accounting treatment that may apply to different structures (e.g., the FICC Agent model) and whether that will lead to balance sheet inefficiencies
  - Netting enforceability in different structures, including for both accounting and regulatory purposes
  - The commercial practicalities of a pure "done-away" clearing model
  - Whether the expanded Exchange Act Rule 15c3-3 debit treatment can be efficiently applied in practice

# Mixed Product Portfolios

- **Derivatives and Repo Clearing.** In some cases, a market participant may seek to clear a mix of derivatives, e.g., UST futures and repos, e.g., UST repos.
  - This scenario was highlighted by the DTCC/FICC comment letter on the Endgame proposal (Comment Letter from Depository Trust & Clearing Corporation, Jan. 16, 2024 ([here](#)))
  - The DTCC/FICC letter observes that applying qualifying cross-product master netting agreement (QCPMNA) treatment to the combined futures/repo exposure would permit the Clearing Member BHC to apply an exposure that more accurately reflects the aggregate risk profile and margining practices of the combined portfolio
  - The industry is in the process of analyzing how this could be achieved within the construct of a standardized exposure calculation
- **Illustrative example:**



RWA without any Initial Margin / Haircut on the repo		Actual Counterparty Credit Risk Exposure	
		Scenario: 2Y Treasury Yield Up	Scenario: 2Y Treasury Yield Down
Long Future (bank's perspective)	EAD = $1.4 * (RC + PFE) = 1.4 * (0 + \$404k) = \$565k$ RWA = $100% * \$565k = \$565k$	Exposure to the client decreases given bank loses on the future long position	Exposure to the client increases given bank gains on the future long position
Reverse Repo (bank's perspective)	EAD = $(E - C + HC * C) = \$3.1MM$ RWA = $100% * \$3.1MM = \$3.1MM$	Exposure to the client increases given treasury collateral value decreases	Exposure to the client decreases given treasury collateral value increases
Combined	RWA = \$3.7MM > The RWA on the combined portfolio is higher than even the standalone RWAs of repos and futures despite that the actual counterparty credit risk exposure is lower > Based on the CME-FICC cross-product margin methodology for house trades reduction could be between 85 - 90% for such a portfolio	> Any exposure change is mitigated given that decrease from the future is offset by increase from repo > The combined exposure is less than the standalone (future / repo) would be	> Any exposure change is mitigated given that increase from the future is offset by decrease from repo > The combined exposure is less than the standalone (future / repo) would be



# Endgame Questions

- **Evolving Topic.** Banking organizations and their clients are still considering a range of implementation issues in the UST clearing final rule. As such, we welcome an ongoing dialogue. The potential list of questions may evolve as the model details are revealed.
- **Bank Capital and UST Markets.** While the UST clearing final rule is a new development, it should be viewed in the broader context of banking organizations' roles as UST market intermediaries and liquidity providers.
  - Banking Agency principals have commented on the need to consider, in connection with Endgame, whether bank capital rules support UST market functioning<sup>1</sup>
  - 2020/2021 UST SLR relief provided valuable insights on banks' roles supporting UST market functioning
  - UST market issuance trends highlight the importance of marketplace intermediaries<sup>2</sup>
- **Potential Questions for Endgame.**
  1. What adjustments should be made to the Credit Risk framework to account for an anticipated increase in, and risk profile of, banking organization-guaranteed UST repo clearing for clients?
  2. What adjustments should be made to the SLR to account for an anticipated increase in, and risk profile of, banking organization-guaranteed UST repo clearing for clients?
  3. What new mechanisms are needed in the Endgame rules to capture banking organizations' exposures associated with client clearing cross-margining practices across cleared derivatives, e.g. UST futures and cleared repos, e.g. UST repo?
  4. How can the proposed Services Component Operational Risk standards be revised to address anticipated increases in revenues associated with banking organizations' UST client clearing volumes?
  5. What Endgame standards apply in a comparable manner to comparable risk profiles when banking organizations facilitate UST client clearing in different forms (e.g., Agent vs Sponsored models, "Done With" vs "Done Away," etc.)

Note 1: See, e.g., Gov. Michelle W. Bowman, "The Consequences of Bank Capital Reform," Jun. 26, 2024 ([here](#)) (The Banking Agencies should "review[ ] the impact of capital requirements, including leverage ratio requirements, on U.S. Treasury market intermediation and liquidity").

Note 2: See, e.g., Congressional Budget Office, "The 2023 Long-Term Budget Outlook," Jun. 28, 2023, p. 5 ([here](#)) ("[I]n CBO's projections, federal deficits are large by historical standards: From 2023 to 2053, deficits average 7.3 percent of GDP, more than double their average over the past half-century. And deficits are projected to grow almost every year over the next three decades, reaching 10.0 percent of GDP in 2053.")

The image features a stylized logo for 'FIA' centered against a background of overlapping geometric shapes. The background consists of several large, semi-transparent polygons in shades of light green, light blue, and a vibrant cyan. The 'F' is a solid dark grey block letter. The 'I' is a solid dark grey block letter. The 'A' is a stylized, overlapping shape composed of a light green triangle on the left and a cyan triangle on the right, with a horizontal cyan bar across its middle. The overall aesthetic is modern and geometric.

**FIA**