



FedFin Client Report

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House Agriculture Looks to Expand Fed Access to CCPs, Alter SLR

Client Report: **FMU11**

Executive Summary

In this report, we assess today's House Agriculture Committee hearing on the regulatory framework for clearinghouses and their challenges if one of their members fail. That this session was convened at the full committee level without a near-term threat or pending bill specifically on CCPs points to the battle now under way over CCP systemic regulation and risk. The House-passed reform legislation repeals Dodd-Frank's Title VIII and thus ends FRB authority over CCPs and certain rights for CCPs that came with these rules. Chairman Conaway (R-TX) and four witnesses pushed for allowing all CCPs to deposit funds with the Fed and for access to the discount window in certain scenarios. As FedFin noted in our prior report, we do not expect any final reform legislation simply to repeal the Dodd-Frank systemic regime for CCPs, but we also think significant changes will be made to it once Treasury recommendations are released for this critical sector. Following recent statements from FRB Gov. Powell, Ranking Member Peterson (D-MN) took aim at the treatment of initial and variation margins in the calibration of the SLR and witnesses suggested initial margins should be deducted. FinServ committee member Rep. David Scott (D-GA) expressed concern over a possible breakdown in the global equivalency regime which witnesses noted could be effected not only by new European CCP standards, but also by possible U.S. repeal of OLA. Democratic Reps. Scott, Kuster (D-NH), and Plaskett (D-VI) defended OLA in part due to fears of CCP negative externalities, but FRB-Chicago Senior Policy Advisor Steigerwald countered that OLA would never be needed for CCPs because internal resilience protocols if combined with discount-window access ensure ongoing operation.

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Analysis

Opening Statements

While Chairman Conaway said a failure of a major clearinghouse would be unprecedented, he argued that any such failure would be both cataclysmic and possible. He applauded work by CCPs to plan for an unlikely failure but noted that factors outside their control such as the availability of liquidity, the calculation of the SLR, and economic stability affect the implementation of their recovery plans. He also argued that Congress needs to identify the objectives of government intervention in resolution and how limits on regulatory actions could result in another bailout.

Ranking Member Peterson stressed the importance of addressing potential CCP failure before it occurred and argued that Title VII of Dodd-Frank made the financial system safer.

Testimony

Robert Steigerwald, a senior policy advisor at the FRB-Chicago, pushed for granting clearing houses central bank account services and emergency liquidity access. Although he made clear that he presented his own views, his testimony surely reflects the thinking of many at the Federal Reserve. Mr. Steigerwald argued that CCPs are dependent on “time-critical” liquidity and that their private sector liquidity arrangements may be unreliable in a crisis. Therefore, if CCP resources for default management are held at a central bank, these will be immediately available in a crisis and will help secure emergency liquidity from the FRB.

Scott Hill, testifying on behalf of Intercontinental Exchange, argued that CCPs mitigate default risk and help manage systemic risk. He applauded existing mandates on clearing obligations for certain swaps and argued these reduce risk over a broader array of capital markets. He also argued for CCPs to be allowed to deposit cash in FRB accounts and for CCP access to the discount window in order to convert Treasuries into cash. Additionally, Mr. Hill attacked the proposed Basel III SLR for considering customer margins as risk enhancing and for treating cleared transactions with initial margin the same as bilateral trades. Finally, Mr. Hill argued that, if regulatory intervention is necessary in resolution, then the CFTC should oversee CCP resolution due to their experience and expertise.

Jerrod Salzman, testifying on behalf of CME Group, gave an overview of CCP waterfall procedures in the case of a clearinghouse member failure. He stated that, when a CCP receives potential default resources from clearing members, the safest place to deposit them is at the FRB.

John Dabbs, Global Head of Prime Derivatives for Credit Suisse, said that the post-crisis reforms have mitigated risk to CCPs and across the financial system. He pushed for all CCPs to meet Cover Two standards and for access to FRB accounts. He also pushed for systemically important CCPs to have access to the Fed's discount window on a secured basis to convert U.S. sovereign debt into cash. He praised the Treasury report's recommendations (see Client Report **CAPITAL216**) regarding treatment of posted margins in the calculation of the SLR.

Amias Gerety, Special Advisor at QED Investors and Former Treasury Assistant Secretary, argued that Dodd-Frank has made the financial system and derivatives market safer. He also defended OLA, saying that any purported budget savings from its elimination are illusory.

Q&A

- **CCP Access to Fed Accounts and Emergency Liquidity:** Chairman Conaway said that it is clear allowing CCPs access to FRB account services and, in limited circumstances, eligibility for discount-window lending when secured by Treasuries does not put taxpayers at risk. Rep. O'Halleran (D-AR) argued that the FRB is an essential backstop for CCPs in crisis situations. Rep. Thompson (R-PA) was skeptical, noting that some believe providing account services to systemic CCPs creates moral hazard by implying that the CCP will be bailed out. Rep. Austin Scott (R-GA) asked why market-based solutions cannot address liquidity issues and Mr. Steigerwald responded that the private sector will hoard liquidity in a crisis.
- **SLR Calculation:** Ranking Member Peterson argued that the Basel standards on SLR treatment of initial and variation margin are "wrong." Mr. Steigerwald said the SLR would almost certainly hinder the transfer of assets from an insolvent clearing house member to a solvent one and Mr. Dabbs argued that initial margins should be deductible.
- **Equivalency:** Rep. David Scott asked if new European standards for CCPs will affect the equivalency status currently granted to U.S. CCPs operating in the EU. Mr. Hill said the new standards grant the Europeans a lot of discretion so it is too early to say. Building off their equivalency discussion, Mr. Salzman noted that repeal of Title II of Dodd-Frank is concerning since European equivalency determinations are dependent on the existence of OLA.

- CCP Designations: Rep. Austin Scott questioned whether CCPs should be treated differently based on systemic designations. Rep. Plaskett defended the importance of FSOC's designation authority.
- OLA: Democrats, including Reps. David Scott, Kuster, and Plaskett, pressed the witnesses on how repealing OLA could be damaging. While Mr. Gerety argued bankruptcy alone would be insufficient in a crisis, Mr. Steigerwald said that tools to ensure matched books ensure recoverability without resort to OLA.
- Cybersecurity: Reps. Marshall (R-KS) and Soto (D-FL) pressed the witnesses on the steps taken to protect clearinghouse systems from cyber threats. Mr. Hill said that this is a top priority for CCPs, which have undertaken a number of steps to enhance cybersecurity.