



ASX Limited  
ABN 98 008 624 691  
20 Bridge Street  
Sydney NSW 2000  
PO Box H224  
Australia Square  
NSW 1215

Telephone 61 2 9227 0000  
[www.asx.com.au](http://www.asx.com.au)

4 February 2011

Secretariat of the Basel Committee on Banking Supervision  
Bank for International Settlements  
CH-4002 Basel  
Switzerland

### **Capitalisation of bank exposures to central counterparties**

Dear Basel Secretariat,

ASX Group (ASX) would like to thank the Basel Committee on Banking Supervision (BCBS) for the opportunity to respond to *Consultative Document: Capitalisation of bank exposures to central counterparties*.

Given the short period between consultation document release and the deadline for comments, we are only able to provide our initial views on the proposals put forward. We would be grateful for the opportunity to comment in the future in more depth on the proposal specifics. In particular, it will be important to review the consultation once the CPSS-IOSCO Principles have been published given the central role that they play in determining a Qualifying CCP and their wider financial stability requirements. ASX looks forward to working closely with the BCBS, national regulators and market users in further reviewing and finalising the proposal.

#### About ASX Group

The ASX Group is a provider of multi asset class exchange services. It operates Australia's main equities and derivatives exchange markets and the post-trade processing services in which transactions executed on those markets are cleared and settled.

ASX currently operates two Central Counterparties (CCPs) – ASX Clear and ASX Clear (Futures). ASX Clear provides CCP services for a range of financial products traded on the ASX market, including cash equities, pooled investment products, warrants, certain interest rate products and equity and commodity-related derivatives. ASX Clear (Futures) provides CCP services for derivatives traded on the ASX24 market, including futures and options on interest rate, equity, energy and commodity products.

ASX's CCPs are licensed entities regulated by Australia's corporate regulator and central bank. The CCPs must comply with the obligations arising from their clearing and settlement facility licences, granted by the Australian Government, including those arising from the Financial Stability Standard for Central Counterparties determined by Australia's central bank, the Reserve Bank of Australia (RBA).

#### Comments on the Consultation Proposal

*1. ASX agrees that the counterparty risk weightings for Qualifying CCPs should be significantly lower than bi-lateral OTC exposures*

CCPs, such as ASX Clear and ASX Clear (Futures), place great importance on maintaining excellent risk management processes. ASX fully supports the BCBS intention to capitalise bank exposures to a potential CCP default at a much lower rate than bilateral transactions between other counterparties.

---

Indeed, should BCBS be able to put in place an appropriate hypothetical CCP capital calculation, ASX suggests that the 2% counterparty risk weighting be reduced for those Qualifying CCPs with significant default resources relative to their hypothetical capital. Such a move would appropriately recognise CCPs with the highest risk management standards.

## *2. Existing Over-the-Counter (OTC) risk methodologies do not accurately quantify CCP risks*

The consultation document relies heavily on an existing OTC methodology to capitalise bank exposures to CCPs. While this methodology may be appropriate on a bilateral basis for non standard OTC exposures, given the standard CCP risk protections (such as daily margining), CCP risk exposures are significantly different to OTC risk exposures. As a result, ASX considers that the current methodology would not accurately estimate CCP risks and therefore banking entity exposures to CCPs.

ASX believes that the methodology outlined in the Consultation Document has a number of material failings for assessing a CCP's hypothetical capital in respect of its futures, options and cash market exposures:

- The transparency of the methodology's application is inadequate and likely to generate significant divergence of interpretation. This has been reflected in the confusion surrounding the details of the impact study.
- CCP netting capabilities and default loss collateral offset rights, in part determined by house and client account structures, are not correctly reflected in the proposed approach. Under the Current Exposure Method (CEM) for OTC products, it appears that CCPs are only able to recognise partial netting for 60% of total exposures. We consider that this approach is arbitrary and does not fully recognise the large number of positions which CCPs have a clear legal right to net.. ASX believes that CCPs should be given more discretion to determine, along with their national regulators, appropriate contract netting procedures.
- By equating option notional values to the underlying futures contract notionals, risks may be significantly over or under estimated.
- No account is taken of cash market risks and potentially also collateral and default fund contributions held in respect of joint derivative and cash market obligations.
- The add-on factors imposed under the CEM should be more granular, in line with standard CCP stress testing measures. The maximum exposure a Clearing Member will have to a CCP is limited by end of day variation margin calls<sup>1</sup> to a very short period before a defaulter's exposure is extinguished by the CCP. In the CCP context, therefore, it is inappropriate to impose higher requirements on longer maturity products as the length of the close out period is not tied to the maturity of the instrument.

## *3. Hypothetical CCP capital should be derived from existing CCP stress testing models*

CCPs are currently subject to stringent regulatory requirements that, in the case of Australia, also meet the CPSS-IOSCO Recommendations for CCPs. These standards, for example, impose requirements on CCPs in areas such as margining, financial resources, default procedures and participant requirements. Integral to these regulatory requirements are robust and transparent stress testing models periodically reviewed by regulatory authorities.

Given the limitations of the proposed BCBS approach, ASX proposes that a preferable solution would be to derive hypothetical CCP capital from the results of the existing models. This would significantly improve the accuracy of the calculation and avoid unnecessary duplication. Such an approach may be regarded as the equivalent of the internal risk model approach operated by many banks for capital adequacy purposes under Basel II. ASX is keen to explore further such an alternative with the BCBS.

---

<sup>1</sup> This exposure is even less where robust intraday processes are in place.



ASX considers that the potential daily stress testing result (currently the default of the largest Clearing Participant), as required by IOSCO, would be a more appropriate way of determining CCP capital adequacy. Any methodology adopted should also be capable of recognising that ASX's CCPs operate an additional margin regime where additional margin is called from any Clearing Participant where daily stress test exposures exceed predefined limits which are based on the CCP's liquid capital.

*4. Data collection and transmission would be inefficient, potentially error prone and may be prevented by privacy legislation*

It appears, based on the current proposals, that each CCP will need to obtain multiple cross border regulatory Memorandums of Understanding (MoUs) in order to share information on banking Clearing Participants with the banks' home supervisors. Although ASX is keen to assist banking regulators to quantify bank exposures to CCPs, ASX believes that this information would be better sourced directly from CCP regulators and centrally from banks. Moreover, in some cases national privacy laws may obstruct a CCP's ability to share data and therefore make it unable to satisfy the other key test for a 'Qualifying CCP'. In addition, the current proposal could impose a significant administrative burden for regulators and CCPs alike if a large number of overseas regulators wish to clarify data submissions.

ASX is seeking further clarity from the BCBS on the required frequency of recalculation for the hypothetical CCP capital and capital requirements on default fund contributions. As CCP exposures are constantly changing, it is expected that data provision will be frequent. This will impose a significant administrative burden on CCPs, banks and regulators.

*5. Further clarity is required on the scope of the application of this proposal*

The consultation document does not explicitly outline which entities will be subject to the proposal outlined in the Consultation Document. ASX would appreciate further clarity on whether the BCBS intention is to limit these requirements to entities holding a banking licence or if they are intended to apply to non-bank subsidiaries of a banking entity or even to a non-bank subsidiary of a non-bank parent entity that has other bank subsidiaries. Other potential issues could include whether joint venture Clearing Members with bank and non-bank parents will be caught under these proposals. In such cases, ASX would appreciate further detail on any ownership thresholds the BCBS expects to apply.

*6. Further calibration of CCP contingent and uncapped levy powers is needed*

Currently there is no standard default waterfall model used across CCPs. Default arrangements often involve several tiers of CCP and Clearing Member capital either pre-funded or in the form of contingent calls. The proposal appears to assume that CCPs' default resources have at most three tiers with one tier supplied by Clearing Member contributions – this is insufficiently robust for some CCPs. It is unclear how the proposed rules will work where there is a more complex default waterfall methodology in use. For example, the proposal does not appear to consider the splitting of Clearing Member contributions to the fund into the second and fourth tiers of the CCP's default resources. This is likely to occur in the future on ASX Clear (Futures).

ASX believes that the uniform application of the 1.2 exposure scalar is inappropriate. Additional Clearing Member obligations are outlined in the CCP's Rulebook and could be more accurately used to estimate the risk of additional funds being called to fund a shortfall arising from another Clearing Member's failure to pay. ASX therefore believes that any assessment of additional capital should be made on a case by case basis depending on the commitment of the Clearing Member to further support the CCP as stipulated in the CCP Rulebook.

Should the BCBS reaffirm the need to use the scalar as currently proposed, the approach should be expanded to include circumstances where Clearing Members do not either pre-fund or supply contingent resources to the CCP as they logically remain equally at risk to an additional unspecified call.

Both ASX CCPs have contingent default funding commitments placed on Clearing Members. Although these contingent funding processes are capped and there are detailed processes to work out default loss

apportionment, it is impossible to forecast the actual call on Clearing Members before default losses are realised. The methodology should reflect an estimate of the likely call rather than the theoretical maximum, as for many Clearing Members this may vary significantly.

*7. Proposed BCBS implementation timetable is inappropriate*

ASX is concerned that the proposed BCBS implementation timetable cannot be achieved whilst ensuring the quality of the solution. ASX considers that the September 2011 scheduled finalisation of the CCP related rule provisions is too early given the significant review period for the associated CPSS-IOSCO Principles. In addition, it appears that national implementation by January 2013 may be too optimistic given the need to address the current complex data calculation and the establishment of numerous international information sharing arrangements across different jurisdictions.

*8. Potential for volatile bank capital requirements*

The current BCBS proposal will, in some circumstances, create very volatile capital requirements for bank Clearing Members. This will occur where a CCP's hypothetical capital is very similar to the CCP's own funds and financial resources. In such instances the capital requirement on default fund contributions could switch from a capital factor of 1.6 to 100 per cent. Such a movement could be due to either movement in bank or non-bank Clearing Member exposures. This will be particularly important if CCPs and banks are required to regularly calculate individual capital requirements on default fund contributions. ASX recommends that BCBS explore a means of alleviating such volatility.

*9. Clarification of "bankruptcy remote" assets*

ASX welcomes the inclusion of the concept of 'bankruptcy remote' assets in the proposal. However, ASX wishes to see further detailed guidance over its definition to avoid inconsistency of application.

ASX would like to thank the BCBS for the opportunity to comment on this consultation document. We would be happy to discuss any of these issues with BCBS staff. If you have any comments or questions, please contact Joshua Everson at [joshua.everson@asx.com.au](mailto:joshua.everson@asx.com.au) or phone: +612 9227 0233.

Yours sincerely



**Alan Bardwell**  
**Chief Risk Officer**