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

Dear Sir/Madam:

Re: CBA[1] Comments on the Basel Committee's consultative document *"Capitalisation of bank exposures to central counterparties"*

Thank you for the opportunity to comment on the Basel Committee's consultative document entitled *Capitalisation of bank exposures to central counterparties*. We understand that the Basel Committee's goal is to establish risk-sensitive capital requirements for exposures to central counterparties (CCPs) given the G-20 efforts to encourage that more derivatives business be conducted through central counterparties. We also understand that this is intended to incent banks to deal with CCPs that are subject to the Committee on Payment and Settlement Systems (CPSS) and International Organization of Securities Commissions (IOSCO) standards.

For your consideration, below is a summary of our key concerns with regards to the Basel Committee's consultative document. Additional detailed discussion on specific paragraphs is included in the attached.

Methodology to Calculate CCP Exposure

We are concerned with the requirement to use the current exposure method (CEM) to determine a bank's exposure to CCPs, since it lacks sophistication and is not risk sensitive. Add-on factors are not calibrated to market volatility. In addition, the treatment of netting in CEM is rudimentary, and is particularly problematic for the very large netting sets that will typically exist for the trades done with a CCP. We believe that the CEM netting rules put an effective floor on netting that is not appropriate for a CCP.

To determine a bank's trade-related exposure to a CCP, we recommend that the use of the Internal Model Method (IMM) be permitted for those banks with approved models since it is more risk sensitive. We believe that the IMM is a more appropriate method to calculate a bank's capitalization of trade-related exposure to CCPs since it can be calibrated to market volatility and better captures both netting and collateral effects.

[1] The Canadian Bankers Association works on behalf of 51 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 263,400 employees to advocate for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy.

Also, while we understand the need to use a consistent methodology across CCPs in determining their default fund exposure, we believe that the CEM formula should be amended to make netting rules more risk appropriate (in particular for the factor in the expression relating to A_{net} to A_{gross})[2].

Incentives of CCP Capital Regime

We currently do not have all the relevant information we need to properly quantify the expected capital treatment for a CCP. In order to evaluate the proposal, we believe more information about assumptions is required (e.g. capital treatment of (a) collateral, (b) exposure to CCP, (c) initial and variation margin, and (d) contribution to default funds). Subsequent to the Basel subcommittee's review of the data and subject to the approval of participants, we expect that the quantitative impact study (QIS) results and the related qualitative comments will provide valuable information, which will allow for a more appropriate impact analysis of the proposed capital requirements. We therefore request that the QIS results be made available on a summary basis to provide some direction so that banks can perform a more fulsome assessment.

We also request further clarification on the application of the 2% risk weighting and would appreciate an example of a calculation, including all of the components to which it applies. We recommend that, where the variation margin is legally considered a settlement against the derivative transaction, the two can be netted together and not separately attract the 2% risk weight.

Qualifying Criteria for CCPs

There is a risk that if a CCP is disqualified for the lighter capital requirements, the capital requirements for all member banks could jump materially at the same time. This could be a significant systemic risk since a large number of FI's may then be in the position of having to simultaneously raise capital or unwind trades. We recommend that a process be put in place to allow for orderly disqualification of a CCP over a period of time.

Level Playing Field

To have the desired outcome of encouraging the use of CCPs on a global basis, it is critical that the final policy recommendations be materially adopted by all members of the G20 concurrently. A significant concern for Canadian banks is asymmetric implementation of these proposals in terms of timing and degree of adoption, since this would result in an unlevel playing field for capital market businesses. We believe that the standards should not be adopted unless consistent implementation can be guaranteed across jurisdictions.

We thank you for taking our comments into consideration and would be pleased to discuss these issues further at your convenience.

Sincerely,

Attachment: Detailed Comments

cc: OSFI (Brad Shinn, Richard Gresser, Patrick Tobin)

[2] Treatment of potential exposure for off-balance- sheet items, Basel Committee, April 1995, page 5.

CBA comments on the Basel Committee's Consultative Document: *Capitalisation of bank exposures to central counterparties*

CBA Members' Comments and Requests for Clarification
OVERALL COMMENTS

Incentives of CCP Capital Regime

The approach is straightforward and, at least in concept, quite reasonable. However, it is difficult to comment on the appropriateness of the default fund capital methodology without knowing the data that will drive the results. We request further clarification on the application of the 2% risk weighting and would appreciate an example of a calculation, including all of the components to which it applies.

In this respect, will the Basel Committee share the results of the CCP QIS to provide context and information on the magnitude of the proposed rules? To assess the overall capital treatment and incentives of the CCP capital regime over bilateral arrangements, we would appreciate a summary of the aggregate QIS results to provide information about assumptions (subject to the Basel subcommittee's review and the approval of participants).

We request clarification on the following issues:

- How are trade-related exposure amounts to the CCP determined? Who calculates this and using what methodology? We recommend that the use of the Internal Model Method (IMM) should be allowed for those banks with approved models since it is more risk sensitive.
- How does collateral to a CCP get treated? We believe that collateral posted should be netted against the MTM liability to the CCP. We believe it is appropriate to offset collateral against the MTM liability and, therefore, recommend that only collateral in excess of liabilities should attract capital.
- Who calculates the capital requirement for the default fund? We need further clarification on the capital impact to clearing members. We recommend that CCPs use an amended CEM calculation for the default fund so that netting rules are more risk appropriate (in particular, for the factor in the expression relating to A_{net} to A_{gross}).
- How much capital does the initial margin attract? Is this risk-weighted at 2% as well? Is it treated as a contribution to the default fund or equity? We recommend that, where the variation margin is legally considered a settlement against the derivative transaction, the two should be netted together and not separately attract the 2% risk weight.

CBA Members' Comments and Requests for Clarification	
Audit and Control on CCP's Calculation of Hypothetical Capital We question if the CCP is best positioned in terms of being the source of information to make the calculation of hypothetical capital. We believe that their expertise and infrastructure should be examined before concluding that they can perform the calculation. We have concerns about whether this information will be accessible in a timely fashion for banks to perform their capital calculations. We recommend that national regulators put in place a level of audit and control for CCPs to assure that they maintain the same level of data quality that is required of all deposits taking institutions.	
III. PROPOSED REFORMS (Pages 2 - 6)	
Indirect Access (para 9(i) and Annex para 112) Our concern is that not all CCP's may have a process to ensure that indirect members are covered in the event of the member default (i.e. portability in the event of a default of the direct clearer). Making recognition of indirect interaction with a CCP contingent on this condition may render the provision inoperative in practice and remove the very incentive the regulators are trying to design. We recommend that this default portability requirement be reconsidered by the regulators in light of their potential to decrease the incentive of trading on a CCP. We also recommend that a direct clearer need not hold capital for the transactions of an indirect clearer if the indirect clearer maintains the capital requirements for its exposure to the CCP for their trades (including collateral requirements). Additional clarity would also be appreciated on the requirement for bankruptcy remoteness. Specifically, under what circumstances, if any, should a non-defaulting indirect clearer experience losses related to combined failure of its clearing member and the clearing member's other clients.	