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Zurich, 2 February 2011

Capitalization of bank exposures to central counterparties
Comments on consultative document issued in December 2010

Dear Sir/Madam

SIX Securities Services and its affiliated central counterparty, SIX x-clear Ltd welcome the opportunity to provide comments on the consultative paper on the capitalization of bank exposures to central counterparties issued by the Basel Committee.

The revised provisions could have an impact on both market participants using CCP services and the CCP service providers. Considering the fact that the various instruments and asset classes cleared by CCPs are very different in terms of latent market risk, it is important to clarify the scope of the proposal. Our comments in the annex to this letter focus on the range of application and possible impact on market participants.

We hope that these comments are useful. If you have any questions about this letter, please contact our risk control department: XCRC.group@sisclear.com.

Yours sincerely

SIX Securities Services

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1. Scope of asset classes and transactions types

Annex A of the consultative document stipulates that *"exposures to central counterparties arising from OTC derivatives, exchange-traded derivatives and SFTs transactions will be subject to the counterparty credit risk treatment laid out in paragraphs 106 to 120"*.

We understand that trade exposure and default fund contributions related to the following transaction types are out of scope of the regulatory capital rules on the capitalization of exposures to CCPs:
OTC spot transactions and on-exchange spot transactions with or without instant settlement in equity products, fixed income products/convertibles, exchange-traded funds and commodities, investment funds, as well as exchange-traded repurchase agreements, exchange-traded reverse repurchase agreements and exchange-traded securities lending and borrowing as long as the individual contracts can be terminated immediately and the close out can be effected in the same way as for spot markets.

In contrast, we believe that trade exposure and default fund contributions related to the following transactions are proposed to be within the scope of the regulatory capital rules on the capitalization of exposures to CCPs:
Derivatives including contracts for difference and future contracts, repurchase agreements, reverse repurchase agreements, and security lending and borrowing.

It should be emphasized that instruments commonly used for repo and securities lending and borrowing transactions, such as equities, bonds and cash, bear a similar latent market risk to positions resulting from spot transactions in these instruments. Therefore, in our opinion, trade exposure and default fund contributions related to SFTs which are not implying any leverage should not have the same risk weighting as exposures related to OTC derivatives.

We are seeking clarification as to on which instruments and transactions types the regulatory capital rules on the capitalization of exposures to CCPs will be applied.

2. Collateralized exposure to central counterparties

In most clearing models, the trading parties using CCP services are obliged to post collateral in favor of the CCP, but do not receive securities from the CCP in return. The soundness of the CCP is the trading parties' main security in such a scenario.

A competitive clearing model, in which multiple CCPs clear transactions of the same trading platform, involves inter-CCP transactions, which result in trade exposures between the CCPs. Observing CPSS-IOSCO recommendations, a CCP usually gets collateral from the counter CCP to mitigate the latent market risk resulting from unsettled inter-CCP transactions.

CCPs with bank or securities dealer status are usually subject to the Basel II/III framework. We suggest that collateralized trade exposures between one CCP and another qualified CCP be made exempt from the new capitalization rules (i.e. the risk weighting of 0% will remain in place).

3. Impact on market participants and systemic stability

It is not yet known how national regulators will implement the framework of Basel III. This means that the future capital requirements for transactions not cleared by a CCP cannot be exactly quantified at this stage. In any case, it must be ensured that there are no dysfunctional incentives:

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- The use of CCPs by trading participants should not lead to higher capital requirements than under bilateral contracts.
- Strong defense lines and conservative collateral requirements of a CCP should not prevent market participants from using a CCP, and competition at risk management level among CCPs is to be avoided. In this respect, it is questionable whether capital requirements for posted collateral are supportive of financial stability.
- Arbitrage based on different national regulatory requirements must be avoided