

Sent by e-mail to: [baselcommittee@bis.org](mailto:baselcommittee@bis.org)

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

4 February 2011

Dear Secretariat,

We welcome the opportunity to provide our comments on the Basel Committee on Banking Supervision's ("BCBS") consultative document "Capitalisation of bank exposures to central counterparties" (BCBS 190). The central counterparties ("CCPs") are going to play an increasingly significant role in the financial markets, and it is crucial to make sure that the initiatives taken to enhance their role and use are carefully considered and evaluated.

In our attached response we highlight issues that we believe to be particularly important, but we also support the joint trade associations (ISDA, BBA, IIF and AFME) response, which covers a broader range of issues in more detail.

We believe in particular that great care must be taken to address the specific risks arising from the expanded use of central counterparties. These include increase in concentration risk, the systemic impact in the event of a CCP failing, and the subsequent steps that would have to be taken during resolution. Introduction of a capital charge on banks' exposures to CCPs warrants consideration, but any capital charge will need to be considered in the context of the multiple related initiatives that are currently being progressed by regulators both globally and regionally. These are complex issues, which require further analysis and consideration. We urge BCBS to take the time necessary to develop a robust framework that truly results in enhanced robustness of the financial markets.

We will be pleased to engage in further a dialogue with regulators and other market participants on the development of a well thought out framework for CCPs.

Yours faithfully,



Lenny Feder  
*Group Head, Financial Markets*

## **Standard Chartered Bank response to the Basel Committee on Banking Supervision (BCBS) Consultative Document**

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

#### High level observations

There are multiple regulatory reform initiatives that affect commercial activity in OTC derivatives. The Dodd-Frank Act in the US, the proposed European Union regulations on OTC derivatives, central counterparties (CCPs) and trade repositories, and the changes in counterparty credit risk rules, already introduced as part of the Basel III package issued in December 2010, will combine to impact the way the markets operate with respect to the use of CCPs.

It is essential that the aggregate impact of these initiatives is carefully considered, and that their subsequent implementation be introduced in a coordinated manner. The BCBS consultation paper recognises in generic terms that these initiatives exist, but there is no indication of whether or how their aggregate system-wide implications would be assessed. Some of the behavioural consequences will only emerge over time as secondary consequences and we believe that a significant systemic risk may result from the uncoordinated introduction of regulations that affect the same activities.

We appreciate that increased use of CCPs has merits, but this will result in risks that were earlier distributed across several banks being concentrated on a few CCPs. Any failure on the part of these CCPs, even though less likely than the failure of a single bank, would have far reaching “domino” effects which are likely to be far worse than the failure of any single bank. Further, there will be a natural tension between having only a few CCPs and creating thereby too much concentration risk, or allowing for the introduction of a larger number of them, which may give rise to competition among CCPs. We cannot rule out the possibility that such a situation potentially leads to competitive distortions among CCPs on operating parameters like margin requirements and/or rigour in the statistical models used by the CCPs for various measurements. Further, in order to manage this risk concentration, the International Organization of Securities Commissions’ oversight over CCPs might have to be expanded to include newer elements (e.g., model validation may henceforth become a constituent of the process of determining what is a Qualifying CCP); it is advisable to build in adequate time and effort required for such resourcing, into the roll-out plan.

We agree with the comments in the joint trade associations’ letter concerning the need for robust regulation and oversight of CCPs and the requirement for a systemic risk overseer that has the authority to allow access to emergency liquidity. Risk will become concentrated in CCPs to such an extent that access to adequate emergency liquidity should be a prerequisite for both the initial and subsequent renewal of approval of CCPs. In some cases it may be appropriate for such liquidity to be assured at more than just a domestic level. Setting up international liquidity support would support the necessary international oversight of the regulatory framework for the CCPs’ prudential supervision.

The insolvency regime applicable to a CCP should also be considered with regard to its approval. Special protections in respect of the enforceability of cleared contracts after the insolvency (or similar state) of a Clearing Member and/or the CCP should be required. Early intervention powers for regulators triggered by management failings at any CCP should be established in order to secure recovery before that CCP is forced to take more serious steps to avoid default on its obligations.

These conditions for initial and continuing approval should also be considered with regard to permitting the interoperability of any two CCPs

Partially arising from the need to evaluate the current initiatives comprehensively, but also considering that the BCBS proposals will require substantial changes to current market practices and will have systems implications that will need an adequate lead time for implementation, we finally consider the timeline proposed by the BCBS as being too aggressive and not allowing for all the operational requirements to be met.

### Comments on BCBS specific questions

#### 1. The CEM calculation

*Section III 9 (a) -- page 3*

This pertains to the allocation of responsibility for the calculation of capitalisation of CCP exposures.

***“The Committee invites comments on whether CCPs, CCP overseers, clearing members, transaction repositories or other sources of information and expertise are best equipped to assemble and manage the necessary information and to complete this calculation. Further, verification of such calculations will also be essential (e.g. bank supervisors will need to confirm that banks have correctly calculated their exposures to, and capital requirements in respect of, CCPs). As such, the Committee invites comments on how such verification and related quality control can be assured”.***

Generally, there seems to be a competencies mismatch in this situation, in the sense that Clearing Members would have the expertise to use the Current Exposure Method (“CEM”) to calculate capital requirement but would not have the complete transactional data, whereas the CCP would have the transactional data but not necessarily the expertise to use CEM.

Should the task of computing the calculation be given to the Clearing Members, this may result in CCP providing data to banks that may breach confidentiality, while the banks’ calculations would have to be verified.

As such, we are of the opinion that it is the CCP which is best equipped to calculate the capitalisation level. Assigning this task to a third party may prima facie appear to be a solution to the confidentiality problem but it creates a new problem in that now the calculations are to be done by an entity which has neither the data nor the CEM expertise. So, it worsens the “mismatch” problem mentioned above. The verification of calculations would also become more onerous because an additional intermediary layer for requesting information and sending replies will be created. We also believe that in-house calculation by the CCP is important from the point of view of enabling the CCP to capture “early warning signals”.

## 2. Method for CCPs DFE and HC

### *Section III 9 (g) – page 4*

This pertains to the formulas laid down by the BIS to calculate Default Fund Exposure and Hypothetical Capital.

*“The Committee specifically invites comments on other practicable, simple and supervisable methods for calculating such exposure or hypothetical capital and on adjustments to CEM that could improve its utility as a proxy for CCP exposures to its members.”*

The methodology does not distinguish between a strong and a weak CM; it uses a uniform risk weight of 20% based on the Standardised Approach. In our view, a differentiation should be made between CMs on the basis of their credit profile and their operational robustness. In other words, higher risk weights should be required for weaker CMs. We suggest adoption of the Basel Standardised approach of relying on ratings to determine risk weights rather than a simplified 20% across the board.

## 3. Bankruptcy remoteness of collateral and Indirect Access

### *Section III 9 (d) – page 4*

*“...where collateral posted by a bank in connection with trades with a compliant CCP has been segregated and is remote from the bankruptcy of the firm holding the collateral, no counterparty credit risk capital charge is required as a result of the bank posting such collateral.”*

### *Section III 9 (i) – page 6*

This section stipulates that when a non-CM bank takes a position on the CCP via a CM, then the non-CM bank is entitled to assign a 2% Risk Weight to the exposure only if *“any assets of the non-member bank related to such trade are segregated and bankruptcy remote from the clearing member; and (ii) the non-member bank is legally ensured that another CCP member will take over such trade if the original clearing member counterparty cannot perform”*.

Specific guidelines need to be defined on what constitutes “segregation” in both the case of a CM’s direct collateral holdings and those of non-CM banks as many banks are likely to use a ‘hybrid’ model of some direct exposure to CCPs as a CM and access to others via a third party CM. This model will only be viable if there is a realistic and easily implemented method for a bank to apply a consistent capital treatment to its exposure between direct CCP membership or access via a third party.

For both direct and indirect access, bankruptcy laws differ from jurisdiction to jurisdiction. While it is not practical to harmonise these laws, we are of the view that more detailed guidelines from BIS would be helpful by way of setting some minimum criteria for legal documentation.

#### 4. Interplay between rising exposure to CCPs and the Large Exposures Rules

Finally, we would like to draw the BIS attention to the interplay between the existing Large Exposures regime under European legislation and the likelihood that, after transitioning from OTC to CCP, banks would accumulate significant exposures to CCPs. In order to facilitate banks’ transition to CCPs, we are of the view that exposures to Qualifying CCPs would need to be exempted from the constraints imposed by the Large Exposures Rules. Without such exemption, banks may be forced to distribute their trades among a disproportionate number of CCPs, increasing the amount of operational risk and most likely having to resort to CCPs of potentially lower standards.