POSITION PAPER

WSBI-ESBG comments on the 'Capitalisation of bank exposures to central counterparties' (BCBS 190)

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The World Savings Banks Institute (WSBI) and the European Savings Banks Group (ESBG) welcome the opportunity to provide a response to the Basel Committee on Banking Supervision (BCBS)' consultative document on the **'Capitalisation of bank exposures to central counterparties (CCPs)'** in context of the new Basel III rules (BCBS 190).

General Remarks:

- In general WSBI-ESBG agrees with the idea that banks should maintain sufficient capital for exposures to central counterparties (CCPs). Thus we appreciate the efforts of the BCBS, as well those taken in various individual jurisdictions, for example, the European Union to improve derivative regulation and create more incentives to encourage central counterparty clearing, as decided on at the G-20 level.

- WSBI-ESBG would, however, like to draw attention to the fact that various jurisdictions have already undertaken own initiatives concerning central counterparties along the lines of the G-20 objectives. For example, in the European Union, the European Commission tabled its proposal in September 2010 for a 'Regulation on OTC derivatives, central counterparties and trade repositories[1], which purports to ensure that by the end of 2012, all standardised OTC derivatives contracts will be centrally cleared. In WSBI-ESBG's view, the EU initiative in particular already fulfils the objectives of the G-20 to a considerable extent. In addition similar developments are also taking place in the United States. Thus the BCBS should recognise such developments when deriving the final Basel III capital adequacy rules text.

- WSBI-ESBG has doubts as to whether decisions or determinations which are made by the CCP itself should indirectly be incentivised by banking regulation, as banks may ultimately only have a very limited influence on CCPs' decisions regarding their own capital and organisation. Rather, sufficient capital adequacy of CCPs should be achieved through direct qualitative and quantitative capital requirements and the prudential supervision of CCPs.

- WSBI-ESBG welcomes the Basel Committee's intention to conduct an impact study on the effect of these specific changes on bank capitalisation. However, we need to raise awareness that the real impact of such changes can only be assessed with great difficultly, as in various jurisdictions the current status-quo in this area is bound to change as a result of ongoing regulatory developments at the level of the jurisdiction. For instance in the EU, there is no clarity yet on the future rules for CCPs and clearing of OTC derivatives – yet they are likely to have an effect on current CCPs' structures and, especially, on their default funds. Thus

[1] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52010PC0484:EN:NOT

the truly materialising impact of the proposal (particularly with regard to default fund capital requirements) is, for the time being, very hard to predict.

Specific comments:

- **Concerning the definition of a CCP (consultative paper p. 3 para. a and Annex A, para. 113, 114, 117 and 118):**

In Annex A of the consultative paper, a CCP is defined as being a licensed CCP provided that the CCP is *'based and prudentially supervised in a jurisdiction where the supervisor substantially enforces the CPSS/IOSCO Principles for Financial Market Infrastructures on an ongoing basis'*.

In WSBI-ESBG's view, given the aforementioned initiatives that have already been taken in this regard at the level of individual jurisdictions (such as the EU), the definition of what qualifies as a licensed CCP should allow for necessary flexibility in relation to the circumstances in an individual jurisdiction, as well as to ensure international consistency. In the European Union, for example, the new European Markets and Securities Authority (ESMA)[2] will play a role in the authorisation and supervision of CCPs. Against this background, CPSS, IOSCO, national and supranational regulators should work closely together – in the EU, credit institutions should be able to trust, that a CCP, which is authorised and supervised according to the forthcoming regulation, also adheres to the CPSS/IOSCO standards.

- **Central Counterparties - discretion of bank supervisors (Annex A, para. 107):**

Paragraph 107 (Annex A) states that regardless of the view of a CCP supervisor, a bank supervisor has the ultimate discretion to determine whether banks subject to its supervision should hold more than the minimum capital requirements arising from dealing with a CCP. WSBI-ESBG does not agree with this approach given the risk of distortions to the international level playing field. We also take the position that in this context the ultimate discretion of the national supervisor is not essential as the regulation will have been agreed upon at the international level.

- **Central Counterparties – treatment of exposures of banks which are not themselves clearing members, but which are clients of clearing member (p. 6, para. 9. i and Annex A, para. 112):**

Para 112 a) and b) lays out under which conditions the 2% risk weight for trade exposures applies to clients of clearing members, where the clearing member operates as an intermediary vis-à-vis a qualifying CCP. In this context, WSBI-ESBG would like to reiterate the role played by a direct regulation of CCPs. This being said, WSBI-ESBG takes the view that the first set of conditions laid

[2] http://register.consilium.europa.eu/pdf/en/10/pe00/pe00042.en10.pdf

out in (a) are sufficient to achieve an effective reduction of default risk. Nevertheless given that there are different segregation models in different jurisdictions, further clarification is required as to which segregation models will remove the additional capital charge.

Furthermore, the conditions outlined in (b) are found to be highly unpractical in reality, as they would entail the ex-ante contractual commitment of additional clearing members to take over the exposures of another (i.e. the 'original') clearing members, in the case of default or insolvency at an uncertain point in the future. Such contracts would be very difficult to determine in reality, and WSBI-ESBG would propose either deleting b) entirely, or if this is not possible, to soften the wording to alternatively read:

112 b) '~~Relevant laws, regulation rules and contractual arrangements ensure that~~ the clients' contracts with the defaulted or insolvent clearing member ~~will~~ ***can*** *be taken over by another clearing member, and thereby continue to be indirectly transacted through the CCP, should the clearing member default or become insolvent".*

In addition, WSBI-ESBG does not see that the absence of para. 112 b) would actually give rise to greater counterparty risk for the indirect member. The reason for this is that even whilst liquidation of the portfolio is not desirable and could result in market-to-market loss, the liquidation proceeds would still be paid out to the indirect client. Therefore WSBI-ESBG does not see any grounds as to why such liquidation would result in additional counterparty risk to the indirect clearing member, as compared to a direct clearing member.

- **<u>Trade Exposures (p. 6, para. 9.c and Annex A, para. 114/119)</u>**:

WSBI-ESBG agrees that the low capital charges for exposures to qualified CCPs should be limited to posted collateral, market-to-market exposures and potential future exposures.

Concerning the specific capital requirement suggested for trade exposures towards qualified CCPs, WSBI-ESBG finds that the BCBS should provide greater conceptual clarity as regards the kind of risk this capital requirement is to cover, i.e. credit risk or operational risk. In fact, credit risk should already be addressed by collateral and the capital charge on the default fund contributions. If it is directed at operational risk, however, there is the risk of double counting given that, unless the AMA method is applied, there is already a specific operational risk charge based on income from different business areas. In addition WSBI-ESBG notes that the 2% risk weight as such has no recognisable empirical basis.

- **<u>Qualifying default fund exposures (p. 4 para. 9g and Annex A, para. 117):</u>**

In relation to the calculation of qualifying default fund exposures, the Basel Committee has called for specific comments on other practicable methods for calculating such exposure or hypothetical capital. In this respect, WSBI-ESBG considers that, alongside the 'waterfall method' prescribed, a possibility could be to adopt a standardised method, i.e. a unique risk weight based on the risk inherent in contributions to default funds.

As regards the waterfall method, WSBI-ESBG would like to point out that this approach relies on input into banks' calculations of capital requirements of exposures towards CCPs, which banks need to receive from CCPs, supervisors or some other counterparty (e.g. trade repositories). Thus in this way banks have to depend on input from a "third party", which may easily cause additional time pressure in the context of banks' delivery of the overall CAD calculations. A related question is at which frequency the necessary third party information will be provided to banks.

All in all, we believe that the relevant supervisor has a role to play in ensuring that a 'qualified' CCPs' default fund should always be at least equal to its hypothetical capital.

About WSBI-ESBG (World Savings Banks Institute – European Savings Banks Group)

WSBI-ESBG – The Global Voice of Savings and Retail Banking

WSBI (World Savings Banks Institute) is one of the largest international banking associations and the only global representative of savings and retail banking. Founded in 1924, it represents savings and retail banks and associations thereof in 90 countries of the world (Asia-Pacific, the Americas, Africa and Europe – via ESBG, the European Savings Banks Group). WSBI works closely with international financial institutions and donor agencies and facilitates the provision of access to financial sectors worldwide – be it in developing or developed regions. At the start of 2009, assets of member banks amounted to almost € 9,000 billion, non-bank loans to € 4,300 billion and non-bank deposits to 4,600 billion. Together the member banks conducted operations through 160,000 outlets.

ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of over € 6.000 billion, non-bank deposits of € 3.100 billion and non-bank loans of € 3.300 billion (all figures on 1 January 2009). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

WSBI and ESBG members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. WSBI and ESBG member banks have reinvested responsibly in their region for many decades and are a distinct benchmark for corporate social responsibility activities throughout Europe and the world.

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