ABN·AMRO Clearing

Memorandum

This memorandum represents the comments of ABN AMRO Clearing Bank N.V., Gustav Mahlerlaan, 10, 1082 PP Amsterdam, The Netherlands, to the consultative document ´Capitalisation of exposures to Central Counterparties´ of the Basel Committee on Banking Supervision of 2 Nov 2011[1].

As a leading clearing bank, ABN AMRO Clearing Bank N.V. welcomes the efforts of the Basel Committee on Banking Supervision to have banks more appropriately capitalise their exposures to CCP and appreciates that the Basel Committee on Banking Supervision has addressed comments[2] of industry stakeholders on its December 2010 proposal[3]. With regard to certain aspects we would like to comment the following:

1. **CEM**: The Current Exposure Method (CEM) is simple, but outdated and does not reflect the risks of the underlying derivatives positions. E.g., for options the exposure is measured as a fixed percentage of the nominal which in most cases is misleading/exaggerating. On the other hand, for some short-term interest rate derivatives the resulting exposure is zero.
   This seems to be partly acknowledged by the consultative document, because CCP may multiply notional amounts for contracts by the absolute value of the option's delta (see 116 (i), p 16 of the consultative document) when calculating the hypothetical capital requirement towards clearing banks. However, this does not seem to be the case for the clearing banks themselves which use the CEM when calculating the trade exposure towards CCP.

2. **Standardised Method**: We welcome that the Standardised Method is an allowed method for clearing banks when calculating their trade exposure towards CCP. However, this has not been yet tested in a quantitative impact study. Furthermore, the calculations depend largely on the allowed netting which remains unclear for clearing banks' exposures towards most CCP.

3. **Netting**: When calculating trade exposure or hypothetical capital requirements, uniform netting standards are of utmost importance. The consultative paper takes this into account when changing the factor in the CEM which controls the amount of netting (rho) and states *"…that for netting agreements employed by CCPs, no standardisation has currently emerged that would be comparable to the level of standardisation with respect to OTC netting agreements for bilateral trading."* We believe that this adjustment is not sufficient given the shortcomings of the CEM. Also, the change of the factor seems to be applicable only to CCP, but not to clearing banks, when taking netting into account calculating their trade exposure to the CCP by means of the CEM. Especially in established centrally cleared markets with high transaction volumes market participants usually have rather well-hedged positions.
   But also for clearing banks using the Standardised Method the possibility of netting remains unclear.
   The time between the finalization of the new rules and their implementation should be long enough for those CCP without any netting rules in their regulations to adopt and implement legally sound close-out netting rules. In this respect, more guidance from the Basel Committee on Banking Supervision as well as from national regulators would be most welcome that would ensure consistent netting rules across CCP and clearing banks.

4. **Timeline and interplay with upcoming CPSS IOSCO Rules:** The document states *'It is expected that all large CCPs will be compliant with these new CPSS-IOSCO principles, since the framework provides incentives to CM (through the capital rules) to deal only with these safer and more robust CCPs.'* In principle, we share this assessment. However, because these new principles[4] are not finalized yet, and because some large CCP have not been declared compliant

[1] http://www.bis.org/publ/bcbs206.pdf , in the further text referred to as 'the consultative document'.

[2] http://www.bis.org/publ/bcbs190/cacomments.htm

[3] http://www.bis.org/publ/bcbs190.pdf

[4] http://www.bis.org/publ/cpss94.pdf

by their national supervisors with regard to the existing CPSS IOSCO Rules[5], we believe that the timeline of 1 Jan 2013 is too ambitious.

5. **Level playing field:** With regard to upcoming regulations it is of utmost importance that a level playing field will be achieved and kept.
   We highly appreciate that the Basel Committee on Banking Supervision and the national supervisors cooperate in setting uniform standards for CCP (such as the CPSS IOSCO standards) which should include also uniform implementation of these standards.
   With respect to a level playing field we would like to draw the attention also to the fact that many CCP do not require their clearing members to be banks as long as they fulfil the membership standards set by the CCP. A capital requirement only for clearing banks would give an advantage to non-bank clearing members because these would be able to offer their services at a lower cost. Thus potentially more exposure could eventually be transferred to less capitalized firms.

6. **Transparency of capital calculations:** We would advocate a system in which the capital calculations of CCP which are input for the calculations of clearing banks are made transparent to the respective clearing banks as far as possible.

We would like to suggest the following:

A Capping QCCP exposure at the value as if the CCP was non-QCCP

Potentially the capital requirement of a clearing bank vs. a QCCP (i.e. CCP compliant to CPSS IOSCO rules) can be higher than the capital requirement if the CCP was a non-QCCP, due to the potential high exposure stemming from contributions to the default fund when the factor by which the prefunded default fund contributions are to be multiplied to calculate the resulting capital requirement is much larger than 1. This could even mean that it could be cheaper the respective trades OTC, i.e. non-centrally, which seems absurd for QCCP trades.
Thus we would suggest capping the capital requirement vs. a QCCP at the analogous value for a non-QCCP.

B Adjusting the CEM for clearing banks' trade exposure towards CCP

We propose to adjust the CEM for clearing banks using it when calculating the trade exposure towards CCP in the same way as the consultative documents proposes for the calculations of the hypothetical capital requirements of CCP towards their clearing members, i.e.:

- Multiplying notional amounts for contracts by the absolute value of the option's delta (see 116 (i), p 16 of the consultative document) when calculating the trade exposure.
- Change the factor in the CEM which controls the amount of netting (rho) in the same way as for CCP when they calculate their hypothetical capital requirement (see p 16 first paragraph of the consultative document). We also propose to change the formula by using the factors 0.0 and 1.0 instead of 0.3 and 0.7 as proposed in the consultative document, for trade exposure calculations by clearing banks using CEM as well as for hypothetical capital requirement calculations by CCP.

C Extension of Timeline

We strongly believe that the time between the publication of the new rules and the proposed date of implementation, 1 Jan 2013, is too short for these reasons:

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[5] http://www.bis.org/publ/cpss64.pdf

Firstly, the proposed capital rules in their current form will increase the costs of existing central clearing considerably. Thus their implementation will have a substantial and potentially disruptive impact on well-established centrally cleared financial markets and their respective CCP which have overall functioned well and have shown their resilience during market upheavals experienced during the past years. The timeframe should be long enough for market participants of these well-functioning markets and their CCP to adapt.
Secondly, the timeframe seems rather short also when considering other upcoming regulations with impact on central clearing to be implemented simultaneously.
Thirdly, a different timeframe could give time to improve exposure calculation methods.
Fourthly, more time is needed to establish more uniform netting standards.