

The Clearing Corporation of India Ltd, Mumbai
Response to Document on Capitalisation of Bank Exposures to central counterparties, November '11

We refer to the November 2011 Consultative Document on %Capitalisation of Bank Exposures to central counterparties+published on the BIS website.

We operate in India as a CCP for OTC financial market products since 2002 as an authorized Payment & Settlement System Service Provider authorized by Reserve Bank of India, the central bank of India. We presently provide CCP clearing for mainly institutional trades in Government Securities, Foreign Exchange . both spot market and forward trades, trades in domestic money market through our own product Collateralised Borrowing & Lending Obligation (CBLO). We are also in the process of offering CCP settlement of Indian rupee denominated trades in Interest Rate Swaps by using the trade warehouse on such swaps created by us.

We had submitted our response to the earlier document of December 10 and are encouraged to observe that many of the suggestions made in our response to the document have been duly considered and a second consultation period has been announced. The current document has placed certain clear principles in setting capital requirements for various exposures of Clearing Participants on a Central Counter-party (CCP) and also in respect of trades of clients of the Clearing Participants. We congratulate the Basel Committee for achieving significant progress on this vexatious issue within such a short time.

Being a CCP offering clearing exclusively in OTC markets where netting efficiency and costs of margin and capital play very important roles in the decision making of the clearing participants in using or otherwise of the CCP services, we however are concerned on whether some of the approach being laid down will come in the way of incentivizing the market players to use the services of CCPs. There is also some worry as to whether there will be level playing field even among various CCPs.

Our submissions, in this regard, therefore, are as under:

(a) For exposures on Default Fund contribution to a Qualified CCP under some circumstances (i.e. when $K_{ccp} < DF_{ccp}$, for the amount of shortfall) and to Non-Qualified CCP under all circumstances, 1250% is being suggested as the appropriate Risk Weight. When we view the number as against 0% Risk weight currently for an exposure on a CCP (and even 100% in case of exposures to a non-bank counter-party of good credit standing), 1250% is unreasonably high. It would be reasonable to set the Risk Weight at 100%.

(b) Further, as per Annex 4, Section 1 A, the certification of a CCP as that of a QCCP rests with the supervisor of the CCP in the jurisdiction it operates. It is inferred that i) where a CCP operates in more than one jurisdiction, the certification given by the parent regulator shall prevail; ii) where a bank that operates in more than one jurisdiction provides for risk weight on its trade related exposures in a country to the regional QCCP as appropriate, such risk weight shall also be applied by the bank for computation of capital requirements at global level . in other words, the certification of a CCP by its regulator shall not be questioned by the other regulators. A clarification to this effect would avoid confusion.

(c) A CCP is certified as a QCCP or otherwise by its regulator that ~~substantially~~ enforces the CPSS . IOSCO Principles for FMIs. It is presumed that the regulator shall enjoy some degree of discretion in deciding how much is ~~substantial~~. In other words, does the extent of compliance with the principles have to be 100% or can it, say, be 90%, with the 10% being considered and weighed by the Regulator as not rendering the financial system more vulnerable. Given the vast difference in capital requirements between a qualified and non-qualified CCPs, such discretion becomes relevant and important. A clarification in this regard would be helpful,

(d) The Annexure to the Consultation Paper, in 2nd para of Page 12, mentions that the trade exposures are *to be calculated in accordance with Annex 4 using the IMM, CEM or Standardised method, as consistently applied by such bank to such an exposure in the ordinary course of business*. It occurs to us that unless the Clearing Member concerned is using IMM, full netting of trade related exposures will not become available for computation of Potential Future Exposures. This approach will be discriminatory against some Clearing members who, for various reasons and some may not even be under its control, are not using IMM so far. We therefore feel that the benefit of full netting of exposures be explicitly extended to all categories of Clearing Members.

(e) Exposure on Collaterals placed with CCP: Collaterals are placed by Clearing Members with the CCP towards margins to provide cover for the exposures taken by the CCP on the Clearing Member. If variation margin collection is not entirely in cash, the collaterals placed by a Clearing Member would typically be equal to the sum of (adverse) Mark-to Market value and Potential Future Exposure (for the trades of the Clearing Member). While collaterals placed towards Potential Future Exposure can at the most be taken as exposure of the Clearing Member on the CCP, collaterals placed to cover Mark to Market value of the trades should not at all be taken as Clearing Member's exposure on the CCP.

An example will make the position clearer:

Clearing Member	No of Trades	Replacement Cost #	PFE	Exposure due to Trade Positions	Collaterals Placed as Margin with CCP*	Exposure due to Trade Positions & Collaterals
(a)	(b)	(c)	(d)	(e)=(c)+(d)	(f)	(g)
A	2	5	2	7	2	9
B	2	0	2	2	2	4
C	2	-5	2	-3	7	4

From the Clearing Member's perspective

* For simplicity, taken at PFE + Replacement Cost from CCP's perspective

For A and B, the exposures of 9 & 4 respectively will be similar to values to be arrived using the process laid down. However, for C, the laid down process will

arrive at an exposure of 9 (2+7, ignoring replacement cost of -5) as against the actual exposure of 4.

(f) For computing K_{ccp} as per the revised approach under para 116(i), the revised CEM formula still does not take full netting into consideration. It has only changed the weightage to 0.3 & 0.7 as against 0.4 & 0.6 earlier. Apparently, this position is in recognition of the fact of various client positions coming to the CCP through the Clearing Member. If it is so, positions of Self Clearing Members i.e. who do not also settle client positions, should be allowed to be fully netted for arriving at A_{net} .

In our response to the earlier Consultation Document of Dec 2010, we had pointed out that if the banks are required to provide capital on Lines of Credit (lines of Credit) they allow to the CCPs, the availability of LOCs in many jurisdictions will come down drastically. Such an approach can reduce the availability of liquidity (funds) to the CCPs which are critical for the stability of the CCP run Clearing Systems. The new consultation paper is silent on this. We suggest that exposure of Clearing Members or other market entities on CCPs on account of allowing such LOCs be considered to be zero risk due to expected very short tenor of such exposures. At the most, such exposures can be allowed to be treated at par with Trade related exposures of Clearing Members.
