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DTCC

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Via Electronic Mail

Basel Committee on Banking Supervision
c/o Bank for International Settlements
CH-4002 Basel
Switzerland

Re: *Capitalisation of Bank Exposures to Central Counterparties*-Consultative Paper II

Ladies and Gentlemen:

The Depository Trust & Clearing Corporation (DTCC) appreciates the opportunity to provide comments to the November 2011 Consultative Paper (the "Paper") issued by the Basel Committee on Banking Supervision (the "Committee") on the Capitalisation of Bank Exposures to Central Counterparties. This Paper follows the previous consultation on this topic issued in December 2010, where DTCC submitted comments, and a number of quantitative impact studies that have been conducted by the Committee over the past year.

As we noted in our original letter, DTCC recognizes and fully supports the risk mitigation concerns motivating the capitalization proposal. We note that a number of changes have been made in the current draft from what was presented in the December version. These changes include:

- Clarification of the intended scope;
- An adjustment to the netting factor in the Current Exposure Method (CEM) to better reflect the netting benefits arising from a CCP (applicable with respect to derivatives transactions only);
- Other adjustments to the capital requirements formula designed (i) to reflect that clearing member default fund contributions related to a defaulting member will be utilized (along with its margin) before non-defaulting members mutualize any excess loss, (ii) to assume that two average-sized clearing members will default, and (iii) to the extent that a CCP has substantial excess default fund contributions over its hypothetical capital requirement, to provide a reduction of the 1.6% capital requirement (subject to a floor of 0.16%) on a sliding scale by applying a decay factor.

We welcome these clarifications and improvements and recognize that the formula adjustments, in particular, are designed to better reflect the risk presented by participation in the CCP. However, we believe that, in the interests of achieving simplicity and consistency as applied across CCPs, the Committee's proposed formula and calculations, even as revised, still overstate true exposures. We believe that unless further revised they will cause undue capital charges for a CCP's participants and create an inaccurate perception of the actual risks posed by participation in a CPSS-IOSCO-compliant CCP (QCCP).

Even under the modified formula, where a CCP's default fund resources are equal to or greater than its hypothetical capital, the amount of such resources up to the hypothetical capital will be subject to a 100% capital charge (which with an 8% capital ratio equates to an implied risk weighting of 1250%).[1] A further capital charge is applied to default funds that are in excess of the hypothetical capital. DTCC recognizes a decay factor has been introduced to grant a lower capital charge for those CCPs that have large "excess" default funds. However, the decay factor methodology used requires a default fund that is significantly (over 2000 times) larger than the hypothetical capital to achieve the minimum risk weighting (i.e., the 0.16% capital charge).

The application of the 100% capital charge to the amount of default fund resources up to the hypothetical capital requirement, coupled with the capital charge on "excess" default funds, may incent CCPs to reduce their hypothetical capital by increasing initial margin and reducing default funds to achieve lower overall capital charges. A reduction in a CCP's default fund will reduce the available resources to protect against tail risk (as well as an important source of CCP liquidity), while increasing initial margin will add a drain on market liquidity.

Secondly, whilst the netting factor for use with the CEM exposure calculation for derivatives has been adjusted, this calculation and the calculation for Securities Financing Transactions still understate netting benefits by not recognizing normal portfolio offsets among and between assets and asset classes that reduce risk and are reflected in CCPs' more sophisticated margining formulas (including cross- margining arrangements). The combination of these factors results in the formula still significantly overstating the counterparty risk posed by QCCPs.

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[1] As noted in the February response of the European Association of CCP Clearing Houses (EACH), equity in general is not 1250% weighted; a weighting that severe is reserved only for financial institutions where certain additional factors exist (depending upon a bank's ownership percentage of the financial institution), so as to avoid the artificial creation of additional capital in the banking sector. A CCP's default fund does not serve that purpose, and we concur with EACH that a similar weighting would not be appropriate for a CCP's default fund resources.

Finally, however the formula is finalised, we ask that the Committee provide more specific guidance on the individual calculations, and consider including sample calculations for each asset class and netting group. Not only will this provide valuable guidance for the CCPs making the calculations, it will assist in ensuring uniformity in their application across CCPs and jurisdictions.

DTCC appreciates the opportunity to comment on the Paper. Should you wish to discuss these comments further, please contact me at (212) 855-3240 or lthompson@dtcc.com

Regards,

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Overview of DTCC

DTCC, through its wholly-owned subsidiaries, provides clearing, settlement and information services for equities, corporate and municipal bonds, government and mortgage-backed securities, money market instruments and over-the-counter derivatives in the U.S. and globally. Of most relevance to the Paper, in its implications for the risk profiles and capitalization of CCPs, DTCC owns three CCP subsidiaries: National Securities Clearing Corporation (NSCC) and Fixed Income Clearing Corporation (FICC), each a registered clearing agency under the Securities Exchange Act of 1934, as amended and, accordingly, regulated by the Securities and Exchange Commission, and European Central Counterparty Limited (EuroCCP), a U.K.-based CCP and recognized clearing house regulated by the Financial Services Authority.

FICC processes the bulk of all trading in the U.S. fixed-income marketplace, the largest and most liquid financial market in the world. It operates two divisions: the Government Securities Division (GSD), and the Mortgage-Backed Securities Division (MBSD). The GSD is the leading provider of automated trade comparison, netting, settlement and risk management services for transactions in U.S. government securities, clearing original auction purchases of Treasury and agency securities, buy/sell trades and repurchase agreements (repos) in U.S. Treasury bills, notes, bonds, STRIPS, zero-coupon securities and book-entry non-mortgage-backed agency securities, as well as GCF Repos® (General Collateral Finance repurchase agreements) in Treasury, agency and agency mortgage-backed securities.

In addition, DTCC owns a 50% equity interest in New York Portfolio Clearing, LLC (NYPC),[2] which is registered as a Derivatives Clearing Organization by the U.S. Commodity Futures Trading Commission. NYPC currently clears Eurodollar and U.S. Treasury Futures for NYSE Liffe U.S., the U.S. derivatives exchange of NYSE Euronext. NYPC has a cross-margining arrangement with FICC's GSD to provide for cross-margining of GSD's fixed income cash products with their related offsetting NYPC derivative trades in a "single pot".

[2]NYSE Euronext owns the other 50% equity interest.