



FEDERATION
BANCAIRE
FRANCAISE

*Banking supervision
And Accounting issues Unit
The Director*

Paris, November 25th 2011

FBF comments on the BCBS Consultative Document on the capitalisation of bank exposures to central counterparties (BCBS 206)

Dear Sir,

The French Banking Federation (FBF) is the professional body representing the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 430 commercial and cooperative banks. FBF member banks have 40,000 permanent branches in France. They employ 400,000 people, and service 60 million clients.

The FBF supports the objective of a better and more appropriate capitalization of bank exposures to central counterparties (CCPs) and appreciates the opportunity to provide its views on the issues raised in this second consultation document.

French banks welcome the numerous changes that have been made to the initial proposal issued in November 2010. However in order to meet all the objectives set by the G20 in Pittsburgh, some issues should be re-considered.

In this respect, our main concerns are:

- Clearing through a CCP compared to bilateral trading does not lower capital charges.
 - Risk weights of cleared clients' trades exceed those of bilateral trades. This is a disincentive to be a global clearer and could then prevent banks from clearing transactions through CCPs.
 - Capitalisation of default fund contributions is excessively conservative. To be consistent with EMIR and Dodd Frank provisions, the risk weight for default fund should not exceed 400%.

**Mr Wayne BYRES
General Secretary
Secretariat of the Basel Committee
on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland**

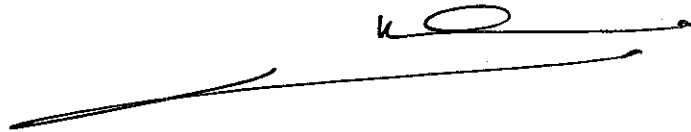
- Exposures to a non-qualifying CCP might be less capitalised than with a qualifying CCP. This again results from the high capitalisation of qualifying CCPs' default fund contributions.
- Imposing the rough CEM method for the CCP's hypothetical capital calculation does not incentivize CCPs to develop more advanced, robust and risk sensitive methods. As an alternative, the internal model method should be authorised for the more sophisticated central counterparties.

In this context, it is unclear whether Global Clearing Services will still be viable. This may become a major barrier to CCP clearing as many banks will choose not to seek central counterparties' membership.

You will find in the annex attached our detailed comments on the issues raised in the consultative document.

We thank you for your consideration of our remarks and remain at your disposal for any questions or additional information you might have.

Yours sincerely,

A handwritten signature in black ink, consisting of a stylized 'J' followed by a horizontal line and a small loop at the end.

Jean-Paul Caudal

French banking Federation detailed comments on BCBS-206

PART I. Capitalisation of default fund contributions

a. Hypothetical Capital

The derivation of hypothetical capital (K_{CCP}) is central in determining the Capital Clearing Members will be charged for their default fund contributions (K_{CM}). In this respect, we appreciate the improvement¹ introduced by the Basel Committee to the initial proposals (BCBS 190) as a response to the industry concerns regarding the overestimation of the hypothetical capital. Nevertheless, we believe that the exposure before risk mitigation (EBRM) will remain, after those amendments, grossly overstated. The EBRM being assessed on a different scale, netting it with the clearing members' initial margins (IM) and default fund pre-funded contributions (DF_{CM}) will leave it virtually unchanged. **In the end, the hypothetical capital not only remains much higher than the economical risks the central counterparties (CCP) endure but it will also be insensitive to the level of initial margins and default fund contributions**². The unintended consequence might be for central counterparties to demand either too low initial margins and default fund contributions as the impact on CMs' Capital requirement will be minimal or, at the other extreme, require huge amounts of initial margins to match an inflated hypothetical capital, making clearing uneconomical.

It is consequently of the uttermost importance to have the EBRM be a commensurate measure of the CCPs' economical risk exposures.

The only way to achieve this is to allow CCPs to use more advanced methods leading to more realistic exposures. The internal model method (IMM) should therefore be authorised for the more sophisticated central counterparties subject to full scale validation by central counterparties' supervisors. In so doing, **we will ensure consistency between the capital exposure for banks and the effective methods used by CCPs to manage their risks.** Moreover, central counterparties will be incentivized to improve their processes and models. The standardised method could be a fall-back approach in case of non adoption of the IMM method.

If the central counterparties were to continue assessing their hypothetical capital with the CEM, we would strongly recommend at least allowing for an even higher proportion of PCE netting in line with the conclusions from the large netting sets analysis.

Whichever the method, **a ten days margin period of risk for derivatives is excessive with regard to the standards of cleared transactions**, in particular for exchange traded derivatives for which a close out period of two days is usually recognised. We believe therefore similar margin periods of risk and in any case not higher than 5 days should be allowed in the internal model method for cleared trades while lower percentages to derive potential future credit exposures should be applied on the current exposure and the standardised methods to reflect those lower margin periods of risk.

¹ In particular, in its second consultative paper, the Basel Committee allows a higher proportion of netting within the CEM method as well as the multiplication of options and swaptions notional amounts by their delta.

² As an example, the parameter C communicated to most QIS participants for one major CCP's default fund contribution illustrates our concerns. Its value, 32, means that for every euro contributed to the default fund, clearing members are charged a Capital of 32 euros (equivalent risk weight of 40,000).

b. Capital for default fund contribution

We note that while seeking to capitalize banks default funds exposures according to a loss waterfall that takes into consideration the size and the quality of the CCPs financial resources as well as their application in the CCP's loss bearing waterfall, the Basel Committee is still imposing a 1250% (and potentially higher) risk weight to the Default Fund contributions.

This is in contradiction with the fact that in the event of a default, it is first the initial margin and subsequently, the default fund contribution of the defaulting clearing member that are used in priority to offset its own default. Only then the CCPs shareholders default fund and finally (or even simultaneously) the default fund contributed by other CCP members are called to off-set the losses.

In addition to this concern, we note that the capital charge for default fund contributions can, in the proposed framework, exceed pre-funded and committed default fund contributions. Hence default fund contributions might be risk weighted well above 1250%.

As demonstrated by the two QIS organised by the Basel Committee, **this can lead to the very counter intuitive situation whereby non-qualifying central counterparties might be assigned less capital than qualifying ones**. Indeed, in the current consultative document, non-qualifying CCPs Capital amounts to 100% of the pre-funded and committed default fund contributions while for qualifying CCPs the Capital can be well over.

With the introduction of EMIR and Dodd Frank (tbc), central counterparties are going to be required to put a cap on the amount clearing members could be called to cover CCPs' losses in the event of a clearing member defaulting. This cap must be reflected in the Basel Committee's proposals and the capital charge for default fund contributions should never exceed the total of the pre-funded and committed contributions be it for qualifying or non qualifying CCPs.

Beyond that and by analogy to the CCPs equity which might be at risk before the mutualised default fund under EMIR or Dodd Frank, we believe the default fund risk weight should not exceed a level comparable to other Basel weightings applied in similar loss positions –based on the existing framework for securitisation, we suggest a 400% weighting³.

c. Reliance on central counterparties' calculations

As the proposed capital charge for default fund contributions relies on central counterparties' calculations, we would like to emphasize the need for ensuring adequate risk management models at CCPs level by mean of an effective CCPs' regulation and oversight. Of particular importance, Clearing Members must be provided with granular enough information to verify the accuracy of the figures provided to them for the calculation of their capital for default fund contributions.

Reliance on central counterparties' calculations might also have dear operational consequences given the short timeframe of regulatory reporting. We would like to have assurance that CCPs will be provided enough time to implement the necessary developments to produce capital figures in compliance with banks regulatory reporting deadlines.

³ Third loss positions in the Basel Rating-based securitisation framework attract a risk weight in the 400% area.

PART II. Capital requirements for clients clearing

a. Cleared versus bilateral risk weighting

We would like to reiterate our overarching concern that centrally cleared trades will be risk weighted more than bilateral trades. This will provide incentives to deal on a bilateral basis in contradiction with the G20 stated objective of encouraging central clearing. Banks will see no benefit in being a Global Clearer, this eventually resulting in a situation where no bank will take on the role of Clearer. As a consequence, **the current proposal may result in clearing services provided by more thinly capitalised FCMs who are not subject to Basel capital rules.** This is by no means likely to make the market safer.

b. Other considerations regarding clients' clearing

Furthermore, regarding clients' exposures we are seeking some clarifications on several aspects:

- Paragraph 110 states that a Clearing Member should capitalise its clients' exposures to CCPs whenever it acts as a financial intermediary. The term "financial intermediary" is not sufficiently clear and we seek confirmation that for clients with whom the clearing member does not guarantee the performance of a central counterparty, i.e. who will be passed on losses incurred from that central counterparty defaulting, the clearing member should not bear a capital charge for those clients' exposures with the CCP. Note that whether the Clearing Member is acting as a principal or an agent is irrelevant with respect to this provision.
- Paragraph 111 seems to suggest that the Clearing Member to Client leg should be capitalised on a bilateral basis (including the charge on CVA) in any circumstances as it is implicitly assumed that the clearing member always guarantee the performance of the client to the CCP. However, in the event that specific procurements exist whereby the clearing member does not provide such guarantee, there should be no capitalisation of the CM to client leg

When the Clearing Member guarantees the performance of his client to the CCP, the Clearing Member is at risk on the client but the capitalisation of this risk should take into account the particular features of the clearing business. In particular, the margin period of risk for client cleared trades must be based on the analysis of exchange and client documentation, and floored at 2 days. Moreover, because CCPs typically calculate initial margin dynamically, banks that can model dynamic IM (and justify their assumptions as part of their model waiver process) should be permitted to do so in their EEPE and stressed EEPE calculations.

Last but not least, we would appreciate some clarification concerning the definition of exchange traded derivatives transactions conducted under a bilateral agreement.

- The European Capital Requirement Regulation ('CRR') proposal published on July 2011 states that no capital charge shall apply to a clearing member offering portability to other clearing members' clients (Article 296, §6). However, the Basel Committee 2nd consultative document stays silent on this issue. We would like confirmation from the Basel Committee that portability shall not trigger additional capital charges for the Clearing Member.

- Overall, we would welcome a synthesis table setting out the Regulators' intention with regard to what capital charge applies to whom, against what exposure and in which situation.

PART III. Other considerations

a. Large exposure regime

We would like confirmation that qualifying central counterparties are excluded from the large exposure regime. The exemption of qualifying CCPs is clearly stated in the July 2011 CRR proposal (Article 389, §1j) but does not appear in the new Basel Committee consultative document.

b. Timeline

Considering the short timeframe to finalise the methodology applicable to central counterparties' exposures, the CPSS/IOSCO standards still not finalised, the strain to implement the proposed requirements by both the clearing members and the central counterparties and considering the significant impacts already assessed or still unseen and their possible unintended consequences, we strongly advocate a postponement of its effective implementation .

However, we are supportive to the idea of a parallel evaluation during a predefined period of time starting January 1st, 2013.