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Via Email: baselcommittee@bis.org

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Dear Sir/Madam,

RE: DFSA's response to the "Supervisory framework for measuring and controlling large exposures" consultation

1. We are pleased to submit our response to the Basel Committee's Consultative Document on the "Supervisory framework for measuring and controlling large exposures". We believe that this is a key aspect of prudential supervision and are happy to provide comments and feedback on some key areas.

Scope and level of application

2. We welcome the consultation initiative and the scope of application. We note and understand the difficulties associated with the treatment of Sovereign Exposures and entities connected with Sovereigns, including Public Sector Entities treated as Sovereigns (also set out at paragraphs 97 and 98). While acknowledging the difficulties we are of the view that there are lessons to be learned regarding sovereign risk from the financial crisis and that further consideration should be given to development of a concentration risk regime in this area.

3. Please find below our comments on each of the queries identified in the consultation paper.

Question 1

4. We agree with the proposal to lower the large exposure threshold to 5% of relevant capital resources. However, there is then a conflict with the Basel Core Principle standards which mandates a 10% threshold. If the proposal is accepted, it is suggested that the Basel Core Principles be amended to reflect a 5% threshold for large exposures to achieve consistency across different sets of Basel standards.

Question 2

5. We agree; the proposed criteria appear reasonable.

Question 3

6. We agree with the recommendation that the large exposure limit should be based on the CET1 Capital, as this is the source of capital with greatest loss-absorption capacity on a going-concern basis. It could also be considered to include the Capital Conservation Buffer since it will be the same quality as CET1, and very much has a going concern loss absorption capacity. The need to focus on going concern loss absorption capacity is critical given the objective of the large exposures regime to ensure that a bank can continue to operate as a going concern, after taking into account the maximum loss in the event of a sudden counterparty failure.

7. We are also of the view that T1 Capital is not an appropriate base for this threshold as it includes AT1 Capital which provides more of a gone-concern loss absorption capacity.

Question 4

8. We are of the view that, as a simple backstop measure, large exposures should not be based on internal capital models. Introducing additional complexity to an otherwise straightforward assessment would not appear warranted and would not be in line with the ultimate aim of the large exposure regime as a stopgap measure to limit the maximum amount of loss. This would also not be consistent with approaches adopted by jurisdictions where capital modelling is not utilised to a full extent.

9. We agree with the utilisation of credit risk mitigation (CRM) techniques to reduce exposure values provided those CRM techniques are permitted under Basel capital adequacy measurement standards.

Question 6 – Securities Financing Transactions

10. Similar to our response to Question 4, we agree with the proposal not to use internal models for calculating exposure values for securities financing transactions.

Question 7 – 100% CCF

11. We agree with the proposal to apply a 100% CCF for off-balance sheet commitments. This is consistent with the policy of treating an exposure as the maximum potential loss.

12. There is also an argument to be made regarding off-balance sheet commitments that cannot be drawn to deal with stress by the counterparty (e.g. guarantees, performance bonds, trade finance products which crystallise an exposure only on the occurrence of a specific event). So, it cannot be conclusively said that applying the current CCFs results in an imprudent estimation of exposure values, rather deviation from the current slate of CCFs would result in penalising products and exposures which do not always lead to actual exposures (contingents with a low probability of crystallising into an exposure), Also, these products often cannot be used to drawdown funds at times of

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stress.

13. We believe that the drafting of this section should address the danger of unintended consequences, particularly in a field where the implications of large exposures are relatively less felt, given that the exposures are relatively short-term and self-liquidating. It is always very difficult to define comprehensively all trade finance products and transactions which share the characteristics of those listed in the CP, and so which merit a similar treatment of applying the current CCFs. Due to product innovation and idiosyncratic practices in certain markets, there will always be cases of products which do not fall into these two categories but share the same credit characteristics.

14. An alternative would be to specify that all off-balance sheet commitments which can be used to draw down funds at times of stress or imminent failure should be assigned a CCF of 100% - committed lines of credit, straight L/Cs without underlying trade transactions, inventory or receivables financing lines.

15. Even if the BCBS thinks it wise to go ahead with the current proposal, the words "arising from the movement of goods" should be amended to include a reference to services or "arising from genuine commercial transactions".

Question 8 – Hybrid approach

16. We agree with the proposed approach for banks that apply the comprehensive approach to financial collaterals.

Question 9

17. We have no issues with the proposed approaches.

Question 10 – offsetting long and short positions

18. We have no concerns with the proposed approach. The proposed buckets of seniority need to be clearly defined to avoid misinterpretation or misuse.

Question 11: Interbank exposures

19. We agree with the concept that large exposure limits should be applied to interbank exposures in the same way as they are applied to third party exposures. However, we also note that to impose the standard 25% limit on smaller banks, such as banks operating in emerging markets or subsidiaries of larger banks, may not be operationally practical. It may be preferable to have a limited exemption to a permissible level for smaller banks, for example for banks with CET1 of less than US$ 100 million a higher large exposures limit could apply.

20. We also agree that in order to ensure smooth operation of interbank payment and settlement processes certain exclusions from the concentration risk limits should be permitted.

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Question 12 and 13 – Granularity threshold and additional risks

21. We agree with the fundamental concept and intention of the look through approach (LTA). In order to preclude the possibility of a bank circumventing the concentration risk limits by structuring a fund, securitisation or other vehicle, we suggest incorporating a requirement that LTA must be employed for all vehicles which include even one exposure to a counterparty to which the bank already has a large exposure. Otherwise, a bank can have exposures to a counterparty up to the concentration risk limit, and additional exposures buried in pools or vehicles which meet the threshold test for granularity. Such a move will preclude a breach of the concentration risk limits.

22. We agree with the proposals on additional risks; clear definitions would be welcome in this area to avoid misinterpretation.

Question 14 – CCPs

23. We agree with the recommendation to place concentration risk limits on Q-CCPs and the systemic importance these entities may have.

Proposals for GSIB

24. We agree with the proposal outlined in paragraph 132. This is consistent with the risks associated with G-SIBs from a systemic perspective and the need to mitigate their contagion potential. This will help to restrict concentration of risk within a small group of G-SIBs. This proposal should also be applicable to the group of Domestic SIBs within every jurisdiction.

Yours faithfully,

Peter Smith

Peter Smith
Head of Policy