Standard Chartered

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

Dear Sir or Madam,

28 June 2013

The Standard Chartered Group (the "Group") welcomes the opportunity to provide comment on the Basel Committee on Banking Supervision's ("the Committee") consultative document 'Supervisory framework for measuring and controlling large exposures.'

As an internationally active banking group, we are supportive of the Committee's aim of harmonising regulatory requirements for the measurement, reporting and control of exposures to single counterparties across jurisdictions. However, we believe there are a number of important issues which need to be addressed prior to the large exposures framework being finalised and implemented internationally. We set out below our general views and concerns with the existing proposals, with individual responses to specific aspects of the framework on which the Committee welcomes comment included as Appendix A.

Scope for greater consistency and alignment of regulatory initiatives

The consultation document raises a number of concerns with respect to misalignment and duplication in the response of regulatory bodies to those issues that emerged during the financial crisis.

Such inconsistencies include the duplication of resilience measures introduced by the Financial Stability Board and the Committee for those institutions deemed as Global Systemically Important Banks (G-SIBs); the divergence in the treatment of exposures arising from securitisation structures and collective investment undertakings under the large exposure requirements of the European Banking Authority's Capital Requirements Regulation and the Committee's proposals; and the proposed adoption of limits on exposures to central counterparties and regulatory initiatives (including the European Market Infrastructure Regulation) to incentivise the use of central counterparties.

Such inconsistencies and duplication may hamper the effectiveness of regulatory initiatives, produce unintended consequences for the functioning of credit markets, and result in banks incurring considerable costs in attempts to comply with inconsistent or fluid regulatory expectations.

One specific element of inconsistency in regulatory initiatives that the Group wishes to highlight is the proposal to use Common Equity Tier 1 ("CET1") or Tier 1 ("T1") capital as the base for hard limits on exposures to a single counterparty, or group of connected counterparties. The Basel III framework requires banks to ensure that subordinated debt issuances are loss absorbing and convertible to common equity ('bail-inable'). Therefore, by establishing large exposures limits based on a function of banks' CET1 capital, the Committee is inherently ignoring this loss absorbing capability. Hence, rather than CET1 or T1 capital, the Group advocates the use of

total regulatory capital (plus other issued subordinated debt instruments) as the appropriate basis for determining the maximum amount of lending permitted to counterparties.

Requirements for banks to adopt exposure measurement approaches distinct from those currently used in risk management and regulatory capital reporting

The current proposals require banks to adopt a number of exposure measurement approaches distinct from those currently used in risk management and regulatory capital reporting. These include the treatment of exposures arising from option positions and the adoption of the proposed successor to the Current Exposure Method for exposures arising from OTC derivatives.

We believe that the requirement to use new exposure measurement approaches under the large exposures framework introduces complexity and additional burden for banks that conflicts with the Committee's objective of establishing a consistent, and relatively simple, framework for the management of large exposures. Furthermore, an alignment of the measurement approaches used for large exposure reporting, risk management and capital reporting purposes will ensure that the exposure data reported to national supervisors is produced using established and tested data and reporting systems, and subject to rigorous internal oversight and assurance.

We would welcome the opportunity to provide further comment on the large exposures framework, as the proposals are refined based on the initial round of consultation and the results of the Quantitative Impact Study. Given that the consultation document indicates that the Committee may consider returning to types of concentration risk in future work, particularly in relation to sovereign and intragroup exposures, we would also welcome the opportunity to provide input on any future regulatory proposals developed by the Committee.

Yours sincerely,

Richard Goulding

Richard Goulding
Group Chief Risk Officer

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APPENDIX A - Specific aspects of the Consultation Paper on which the Committee welcomes comment

1. The Committee welcomes views on the proposed definition of large exposures and on the proposal for reporting

The Group is supportive of the Committee's view that the existing risk-based capital standards should be complemented by measures designed to protect banks from large losses resulting from the sudden default of a single counterparty. To support the operation of such measures, the definition of what constitutes a 'large exposure' should be calibrated to provide national supervisors with sufficient warning of those customer groups that are approaching any hard exposure limits.

Relative to existing regulatory requirements, we note that the proposed definition of a large exposure (5% of a bank's eligible capital base) will result in a significant increase in the number of customer groups reported to national supervisors on an ongoing basis.

2. The Committee welcomes views on the criteria proposed for the identification of connected counterparties when they pose a single risk

The Group supports the Committee's proposals to harmonise the measurement and aggregation of exposures under the regulatory large exposures framework, with the aggregation of exposures to those entities which are likely to fail simultaneously, due to relationships of control or economic interdependence, embedded in banks' existing credit risk management processes.

While we acknowledge that the identification of economic interdependence between counterparties will be a subjective consideration, we note that a reliance on qualitative guidance on those connections that may indicate economic interdependence will provide scope for the inconsistent application of the framework across jurisdictions.

3. The Committee welcomes views and quantitative information on whether the limit should be based on Common Equity Tier 1 or Tier 1

Rather than CET1 or T1 capital, the Group advocates the use of total regulatory capital as the appropriate basis for determining the maximum amount of lending permitted to a single counterparty, or group of connected counterparties.

Importantly, total capital includes eligible subordinated debt which under the Basel III framework is required to be 'bail-inable'. In such event, Tier 2 ("T2") capital would be reclassified as CET1. It would be incongruous to require 'bail-in' conditions for such instruments, yet not recognise them within the capital base with which to absorb potential losses. Moreover, in the event that T2 capital

instruments were bailed in, the capital base of the large exposures limit would suddenly exceed that available in benign conditions. There is also a strong argument that other subordinated debt liabilities, not otherwise included in the total capital calculation, should be included on the basis of their loss absorption capabilities, despite their regulatory classification.

Subordinated debt, by definition, is a medium to long-term instrument. It must be issued for a minimum period of 10 years with a call date of not earlier than its fifth anniversary. In comparison, the tenor of most commercial lending is generally far shorter in duration. Accordingly, eligible subordinated debt remains a relatively stable means of loss absorption.

4. **The Committee welcomes views on the extent and nature of the use of internal models (when they have received supervisory approval for being used for Pillar 1 capital requirements purposes) to measure large exposures**

The Group encourages the Committee to recognise internal models, approved by national supervisors for use in the estimation of Pillar 1 regulatory capital requirements, under the large exposures framework.

Acknowledging the concerns of the Committee with respect to model risk, we note that the Committee's intention of 'capturing the maximum possible loss that a bank could incur if a single counterparty, or group of connected counterparties were to fail' will in effect require the use of some forms of models. We highlight that the output of those models, approved for use in the estimation of Pillar 1 capital requirements, will represent the most current estimates of exposure values available to the bank. Furthermore, such models are subject to regulatory scrutiny and rigorous oversight, including independent validation and ongoing performance monitoring.

5. **The Committee welcomes views on the proposal to calculate exposure value of banks' investments in OTC derivatives**

As noted in the attached covering letter, the Group does not support those proposals which require banks to adopt exposure measurement approaches that differ from those currently used in risk management and regulatory capital reporting. Noting that the requirement to use new exposure measurement approaches introduces complexity and additional burden for banks that conflicts with the Committee's objective of establishing a consistent, and relatively simple, framework for the management of large exposures.

Specific to the treatment of OTC derivatives in the large exposures framework, we raise concerns with the focus placed on the, yet to be determined, successor to the Current Exposures Method ("CEM"). Given this focus, we would appreciate the opportunity to provide comment on the use of the approach, once finalised, in the context of the large exposures regime.

7. **The Committee welcomes views on the proposal to generally apply a 100% CCF for "traditional" off-balance sheet commitments**

Given the importance of trade finance facilities in promoting economic activity and development in emerging markets, and the risk mitigants inherent to the structure of such facilities, we support the Committee's proposal to assign lower credit conversion factors in the estimation of exposures arising from trade finance facilities.

As noted in the attached covering letter, the Group does not support those proposals that require banks to adopt exposure measurement approaches that differ from those currently used in risk management and regulatory capital reporting.

8. **The Committee welcomes views on the proposed hybrid approach for banks that apply the "comprehensive approach" to financial collaterals**

Reiterating the themes raised in the attached covering letter, the Group is concerned by the number of proposals that will require banks to adopt exposure measurement approaches that differ from those currently used in risk management and regulatory reporting.

11. **The Committee welcomes comments on the proposal regarding interbank exposures and in particular in which cases specific exemptions would be warranted**

When considering the exemption of short-term interbank exposures from large exposures requirements, the Group highlights the importance of the interbank market to a well functioning and efficient banking system. We welcome the acknowledgment by the Committee that some forms of exposure, arising from client activity, warrant exemption from the large exposures framework to avoid unintended consequences for the smooth functioning of payment and settlement systems, or the implementation of monetary policy.

In the context of the conditions proposed by the Committee for any possible exemptions, to avoid disruptions to the interbank market and liquidity we encourage the Committee at a minimum to facilitate the continued exemption of all forms of short-term interbank exposures relating to money transmission, payment services, clearing, settlement, custody services and correspondent banking from large exposure reporting and limits.

While we acknowledge the systemic risks posed by concentrations in exposures between G-SIBs, the Committee should also consider the aggregate impact of the proposed measures, and the likelihood that the combined impact of the current proposals may result in an increase in other sources of concentration. Specifically, the combination of the proposed imposition of limits on exposures between G-SIBs, the tightening of the capital base for hard large exposure limits, and any changes to the scope of short-term interbank exposures exempt from large exposure limits, will encourage a shift away from interbank placement of surplus funds to increased placements with sovereigns. This in turn could disrupt

local liquidity markets and dampen the effectiveness of government policies to encourage lending within local markets.

12. The Committee welcomes comments on the calibration of the granularity threshold and whether the mandatory application of the look-through approach to the transaction where an underlying exposure may exceed the granularity threshold will raise specific issues

As noted in the attached covering letter, the treatment of exposures arising from securitisation structures and collective investment undertakings is an aspect of the consultation paper where inconsistencies arise with other developing regulatory initiatives.[1] Such inconsistencies raise the concern that European banks will face considerable costs in attempting to comply with inconsistent regulatory expectations throughout the implementation of the European Capital Requirements Regulation and the proposed adoption of the Committee's large exposures framework.

The Group encourages the Committee to increase the granularity threshold for determining where the 'look through approach' must be applied, in order to balance the effectiveness of the proposals and the burden imposed by requiring banks to identify exposures in what are still quite granular portfolios. We also highlight that the 'look through approach' for securitisation structures, as documented in the consultation paper, fails to recognise credit enhancements and hence the disclosure of any exposures based on the underlying assets will overstate potential losses.

14. The Committee welcomes views on the options for the treatment of banks' exposures to Central Counterparties ("CCPs")

While the Group supports centralised clearing, and the use of CCPs, where products are sufficiently standardised to allow for all associated risks to be managed effectively, we believe that regulatory initiatives encouraging the use of CCPs are creating concentration risks.

We do not agree with the establishment of hard limits on exposures to CCPs. As a policy choice, this seems in direct contradiction with the move to impose mandatory clearing and incentivise the use of CCPs via regulatory tools such as higher capital requirements for uncleared trades and the imposition of initial margin.

The Group also disagrees with the proposal to introduce 'soft' reporting limits on exposures to CCPs, as any kind of limit gives the illusion of safety, which would be an inadequate solution to ensuring that exposures to CCPs do not create excessive risks to the bank itself, or the system as a whole.

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[1] Including the European Banking Authority's draft Technical Standards relating to the application of the large exposure requirements under the European Capital Requirements Regulation (EBA/CP/2013/07).

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Rather than imposing limits on exposures to CCPs, whether in the form of 'hard' or 'soft reporting' limits, national supervisors are encouraged to consider the fundamental questions of CCP supervision, risk management and resolution.