ASSOCIATION DES BANQUIERS CANADIENS
CANADIAN BANKERS ASSOCIATION

Box 348, Commerce Court West
199 Bay Street, 30th Floor
Toronto, Ontario, Canada M5L 1G2
www.cba.ca

Marion G. Wrobel
Vice-President
Policy and Operations
Tel: (416) 362-6093 Ext. 277
mwrobel@cba.ca

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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland
baselcommittee@bis.org

Dear Sir/Madam:

Re: CBA[1] Comments on the Basel Committee on Banking Supervision's Consultative Document: Capital treatment of bank exposures to central counterparties

Thank you for the opportunity to comment on the Basel Committee on Banking Supervision's (BCBS) consultative document: Capital treatment of bank exposures to central counterparties. The CBA supports efforts to improve the capital treatment of exposures to Qualifying CCPs (QCCPs) and preserve the incentives for central clearing. While the CBA sees these potential changes as a step forward in achieving the BCBS's objectives, CBA members would first like to review the results of the QIS before providing any final views.

The CBA would like to express its general support for the joint response of the International Swaps and Derivatives Association (ISDA), the Global Financial Markets Association (GFMA), and the Institute of International Finance (IIF) to this consultative document ("joint response"). This CBA response attempts to complement the joint response by highlighting key areas where the CBA is in agreement and supportive of the joint response, but also noting potential impacts on CBA members in the Canadian context.

These comments are set out below.

Application of Cover*

Capital levels should reflect the actual risk of transacting through a CCP and we are concerned that this is currently not the case. Reflecting the risks of transacting through a CCP more accurately should provide the necessary incentives for central clearing. However, it is not clear that the application of Cover* would fulfill this requirement in all cases, as the examples provided

[1] The Canadian Bankers Association works on behalf of 56 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 275,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness. www.cba.ca.

in the joint response illustrate. Capital requirements for default funds should be based on a risk sensitive capital measure. The point is that the overall level of the default fund is secondary in importance to the actual mutualised risk that the bank faces. While Cover* is used to determine a bank's default fund contribution, the actual risk which the bank faces may be greater or less than that amount. We believe that the bank's risk is most accurately captured using $K_{CCP.}$ The proposed Cover 1 or 2 requirements are not a good measure (and potentially excessive), unless these requirements are accurately calibrated to actual risks. Whether NIMM is the most appropriate approach, or whether NIMM should be adapted to CCPs, can be more accurately determined once results from the NIMM and Incentives QIS are available for review.

Risk-Weights of Default Fund

Capital requirements need to be accurately calibrated. As commented on in detail in the joint industry response, if Cover* is used in the reference level calculations, the risk weight is excessive and would need adjustment. If the NIMM based K_{CCP} calculation determines the reference level as suggested above, clearing members would effectively capitalize the same exposures twice, once through default fund contributions at a 100% capital level with an effective 20% risk weight to clearing member counterparties (as evident from a look-through approach) and second through the default charge with a 2-20% risk weight to the CCP. An accurate calibration of the two capital charges needs to be achieved to reflect actual risks, either through a reduction of default fund contributions or through a significant reduction in the default charge (e.g. with a risk weight 2% for CCP capitalization at reference level). If CCPs are properly capitalized through default fund contributions, the risk weight for the default charge portion should be small and primarily capture the cost of moving cleared transactions to another CCP in case of default.

We also note that the proposed risk weight of 20% for determining CCP internal capital may be excessive compared to a bilateral transaction regime and should be adjusted to reflect the CCP's risk management practices, CCP structure, and membership criteria. Also, the alpha parameter in the CCP EAD calculation should be calibrated to reflect the lack of general wrong way risk and the high level of diversification of a CCP. The regulatory assessment which led to the 1.4 value may not be relevant for large diversified entities such as CCP's.

Incentives to CCP for a More Risk Sensitive Approach

When applying NIMM as capital measure for CCPs internally, in the current proposal, no incentives are given to CCPs to measure and manage risk more efficiently as for example in an IMM approach to capital calculations. Not allowing a modelled exposure based risk measure for CCP capital requirements puts central clearing at a disadvantage compared to bilateral transactions under an IMM approach where risks would be modelled and captured more accurately by the transacting parties.

Providing a more accurate measure of capital should provide the necessary incentive for clearing and a clear economic advantage over bilateral transactions, avoiding distortions of the financial system and capital arbitrage from less accurate and risk sensitive approaches.

We thank you for taking our comments into consideration and would be pleased to discuss these issues further at your convenience.

Sincerely,