The Clearing Corporation of India Ltd, Mumbai, India
Response to BCBS 253 : Consultative Document on Capital treatment of bank exposures to central counterparties, June 2013

We refer to the June 2013 Consultative Document on "Capital treatment of bank exposures to central counterparties" published on the BIS website.

2. We operate in India as a CCP for OTC financial market products since 2002 as an authorized Payment & Settlement System Service Provider authorized by Reserve Bank of India, the central bank of India. We presently provide CCP clearing for mainly institutional trades in Government Securities, Foreign Exchange – both spot and forward trades in Rupee/US Dollars, trades in domestic money market through our own product Collateralised Borrowing & Lending Obligation (CBLO). We are also in the process of offering CCP clearing of Indian rupee denominated trades in Interest Rate Swaps by using a trade data warehouse for such swaps created by us in Aug 2007.

3. We had submitted our responses to the earlier consultative documents of December '10 and November '11 and are encouraged to observe that some of the suggestions made in our responses to the documents have been duly considered and BCBS Risk Measurement Group has now suggested a modified proposal which brings issues in clearer focus. The current document has also provided clear reasoning for the suggested approaches. We also observe that QIS is being carried out to guard against any unintended consequences. We congratulate the Basel Committee for achieving significant progress on this vexatious issue within such a short time.

4. Being a CCP offering clearing exclusively in OTC markets where netting efficiency and costs of margin and capital play very important roles in the decision making of the clearing participants in using or otherwise of the CCP services, we however are concerned on whether some of the proposed approaches will come in the way of incentivizing the market players to use the services of CCPs. There is also some worry in our mind as to whether there will be level playing field even among various CCPs.

5. Our submissions, on the issues considered in the consultative document, therefore, are as under:

a) For exposures on Default Fund contribution to a Qualified CCP, 1250% is being suggested as the Risk Weight. In our view, this is a gross over-estimation of the risk associated with QCCP default funds and will work to disincentivize centrally cleared derivatives.

CCP default funds have seldom been used. These are by definition resources for contingencies and exist to cover tail risk associated with the default of a clearing member whose initial margin and contribution to the Default Fund turns out to be insufficient to cover losses before the liquidation of its portfolio. We therefore request the BCBS to re-evaluate their approach on risk weighting the default fund, to bring it more in line with assets that reflect the same near-zero default risk, thus incentivizing central clearing.

b) The tranche approach seems to be a better approach for capitalizing default fund exposures of clearing members, as it is more risk sensitive accounting for the resources of the CCP. In case of CCP having adequate internal resources to support loss due to default of clearing member, this approach ensures relatively lower capital burden on the clearing members thus facilitating the objective of promoting adequate resources with the CCP .

(c) We also observe that under both the proposed approaches, A (Ratio Approach) and B (Tranche Approach), modifications have been suggested to account for commitments to top up default funds. This will lead to increased capital requirements for clearing members. This approach would also create serious disincentive in the way of getting additional default fund resources for taking care of extreme event and thus would work against incentivizing better risk management for Central Counterparties. As against the suggested objective of getting Default Fund contributions upfront to the maximum extent in para 14(i) so that any drawdown do not impact solvency of any clearing member, the drawing against commitment of Clearing Members to facilitate more orderly management of a default would be preferable. This would help in preventing CCP from going insolvent and the system going through a resolution process.

We believe that RLDF linked capital requirement computation would create sufficient incentive to have CCPs adequately capitalised except for handling multiple defaults under highly stressed scenario (an extreme tail event).

(d) In regard to the proposal to include DFCover* as a component of Reference Level Default Fund (RLDF), we submit that as DFCover* would be an estimated tail loss under severe hypothetical and historical stress scenarios, it cannot be treated as an indicator of the risk inherent in contributing to the default fund of the CCP.

Risk weight of 1250% on this DFCover* amount would imply assuming loss of the amount with certainty. This is surely an inappropriate assumption and would hugely disincetivize Central Clearing.

Moreover, DFcover* should be taken as reference point only after netting DFccp.

(e) We feel that the Margin Period of Risk should be set at the same level as the holding period allowed for the products by the regulators for the CCPs under PFMI. Moreover, the regulator supervising the CCP should have discretion to fine-tune the factors in case they perceive that the peculiarity of the market demands modulation.

(f) Greater sophistication of the proposed new default fund exposure calculation should reduce 'trade exposures risk'. The existing two per cent risk weighting should therefore be considered as sufficiently prudent.

4. We also understand that QIS being run by BCBS would provide guidance to the suitability of the suggested alternatives. We understand that a very limited number of CCPs are participating in the QIS. Unless the QIS is carried out across various markets, we are apprehensive that the QIS may not adequately identify the issues specific to some markets. We, therefore, request BCBS to carry out another QIS covering all markets after the proposed processes are finalised so that any unintended consequences can be avoided.

5. In our submission in respect of previous consultation of November ’11, we had pointed out two under-noted issues we considered very critical and sought BCBS guidance on those. Our submissions were as under:

(a) Exposure on Collaterals placed with CCP: For OTC clearing, variation margin collection is not always in cash. While collaterals placed towards Potential Future Exposures could be taken as exposures of the Clearing Members on the CCP, collaterals placed to cover Mark to Market values of the trades, if any, should not be taken as such exposures on the CCP.

(b) Lines of Credit from banks to CCPs: if the banks are required to provide capital on Lines of Credit (LOC) they allow to the CCPs, the availability of LOCs in many jurisdictions will come down drastically. Such an approach can reduce the availability of liquidity (funds) to the CCPs which is critical for the stability of the CCP run Clearing Systems. We therefore suggested that the exposures of Clearing Members or other market entities on CCPs on account of allowing such LOCs should be considered as zero risk due to very short tenor of such exposures. At the most, such exposures can be allowed to be treated at par with Trade related exposures of Clearing Members.

While we observe that the issue mentioned in (a) above has been taken care of through the process of computation of NIMM (i.e. V-C as building block takes care of this) and congratulate BCBS for handling this issue in a logically neat manner, there is no clarity given so far on the point mentioned in (b) above. Considering the critical role that the availability of liquidity plays in the success of Centralised Clearing initiative and taking into consideration that the risk element in providing such short term liquidity is very low, a guidance from BCBS on this will be very helpful. Same would also bring in standardization in approaches in various jurisdictions.

6. If any *information/clarification about this submission is needed, please feel free to contact Mr Siddhartha Roy, Chief Risk Officer, The Clearing Corporation of India Ltd., Mumbai, India at +91 22 6154 6411 or via sroy@ccilindia.co.in or Mrs Indrani Rao, Chief Forex Officer, The Clearing Corporation of India Ltd., Mumbai, India at +91 22 6154 6461 or via irao@ccilindia.co.in*

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