

Via E-Mail (BaselCommittee@bis.org)

27th Sept. 2013

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

Dear Committee Members,

Re. BCBS 253 Consultative Document on Capital treatment of bank exposures to central counterparties

1. CCP12*, a global association of 32 major central counterparty organizations, congratulates the Basel Committee on Banking Supervision (BCBS) for coming out with a revised model for assessing capital requirements for exposures to central counterparties which is more risk sensitive and rational in approach. CCP12 was happy to be part of a meeting in June '13 on the subject convened by the Joint Working group where the underlying issues were discussed. It also considers it a privilege to get an opportunity to comment on the Consultative Paper detailing the possibilities.

2. As may be appreciated, the BCBS recent proposals for changes may have significant impact on the avowed G-20 goals of promoting central clearing of OTC derivatives. CCP12 observes with satisfaction the mention in paragraph 16 of the BCBS 253 that "The overall aim of the proposals is to achieve a quantum of total capital that satisfies the resilience and loss absorbency objectives (objective i), without undermining the broader G20 mandate to promote central clearing of OTC derivatives (objective ii), and in particular, therefore, without exceeding the level of capital that would be required if the same trades were executed bilaterally and were not centrally cleared." However, when the document is read with the other consultative documents BCBS 254 on The non-internal model method for capitalising counter-party credit risk exposures and BCBS 251 on Revised Basel III Leverage Ratio framework & disclosure requirements, it gets a feeling that the standards proposed through these consultative documents are possibly somewhat conflicting, can be seen to disincentivize clearing, and as a result, could encourage OTC products to remain in un-cleared status, thus re-enforcing the problems seen in the 2008 crisis for OTC derivatives, and otherwise work against the BCBS's stated policy goal of crafting standards that seek to incentivize clearing of clearable OTC derivatives.

3. In the following sections, CCP12 views are elaborated on the issues identified in the Consultative document:

(i) The BCBS 253 consultation recommends at 1250% risk weight for default fund contributions from clearing member firms. This is a gross over-estimation of the risk associated with QCCP default funds and will work to disincentivize centrally cleared derivatives.

History has proven that CCP default funds are seldom used, less frequently even than AAA rated structured finance securities that can carry risk weights of up to 20 times less¹. Our research has shown that the 1250% risk weight puts QCCP default funds on a similar level with uncollateralized short term financing transactions with unrated counterparties as well as many other examples of high risk securities. QCCP default funds are by definition not high risk securities. QCCP default funds exist to cover tail risk associated with the default of a clearing member whose initial margin is insufficient to cover losses before the liquidation of their portfolio. Financial safeguard packages may vary between the CCP members of CCP12, but none of our default funds carry the risk characteristics implied by the BCBS in applying a 1250% risk weight.

Additionally, we believe that incentives for central clearing from a traditional capital charge perspective will revolve around the following relationship:

<u>Uncleared Capital Costs</u>		<u>Cleared Capital Costs</u>
10 Day MPOR Floor		5 Day MPOR Floor
Margin Costs	>	Margin Costs
CVA VaR		Default Fund

As currently calibrated, we believe the 1250% risk weight on default fund contributions will far outweigh the differential between 5 and 10 day MPOR requirements, as well as any potential CVA VaR charges. Additionally, we note that for CVA VaR charges there already exist many exemptions which can vary by jurisdiction, further diluting incentives to clear from a capital perspective.

CCP 12 therefore asks that the BCBS re-evaluates their approach to 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.

(ii) There is also apprehension that 5 day MPOR floor has not been provided for clearly when computing Supervisory Factor for NIMM based computation of exposure of Clearing members on CCPs & vice versa. CCP12 requests that the Margin Period of Risk should be set at same level as the holding period allowed for the products by the regulators for the CCPs under PFMI. Moreover, regulator supervising the CCP

¹ BCBS 236: Revision to the Basel Securitization Framework ; Table 2 – Illustrative Revised RBA risk weights under hierarchy A(%) ; AAA Senior Tranche security of 5 year maturity carries a risk weight of 58%

should have discretion to fine-tune the factors in case they perceive that the peculiarity of the market demands any modulation.

(iii) In relation to the proposed DFCover* method to determine the capital requirements against CCP default fund contributions, major concerns of CCP12 are that DFCover* is not an appropriate measure on which capital requirements should be based on, since it is a prefunded estimated tail loss calibrated under severe hypothetical and historical stress scenarios, conditioned on the default of the largest or the largest two Clearing Members and thus represents a risk mitigating component within a CCPs risk mutualisation mechanism which distributes losses in extreme but plausible events among its members and is not an indicator of the risk inherent in CCPs business.

Furthermore, it is proposed to apply DFCover* neither assigning a risk weight related to the Clearing Members which have contributed to the fund nor a weighting reflecting the probability that the amount represented by DFCover* has to be drawn. No weighting implies a risk weight of 1250% meaning that DFCover* will have to be drawn with certainty within any given year. Given the strong performance of CCPs in past crisis and the common credit quality of Clearing Members, this is not a valid assumption.

Both facts together show that DFCover* is an inappropriate factor for the aimed purpose, translating into overly conservative capital requirements.

Additionally it is not clear when a CCP will have to apply an amount sufficient to cover the default of the largest or the largest two members as DFCover*. It is not obvious whether this decision is governed by the regulatory requirements established in the jurisdiction where a CCP is located or whether a CCP is allowed to use a cover one model based on the CPSS IOSCO principles for the calculation even so the regulatory requirements established in its home jurisdiction require the application of a cover two model to size the default fund. It is possible that in some jurisdictions CCPs are required to use a cover two model whereas CCPs with the same risk profile in other jurisdictions are required to use a cover one model. That would make capital requirements among CCPs incomparable, leading to an advantage for CCPs which are located in jurisdictions with less stringent requirements which would be a counter intuitive result.

To prevent such uncertainties CCP12 proposes use of the hypothetical capital calculated with NIMM to base capital requirements on a logical and comparable measure and eliminate DF Cover* from the proposal.

(iv) Both the proposed approaches, A (modifying the Ratio Approach) and B (modifying the Tranche Approach) for capturing commitments to top up default funds, will lead to increased capital requirements for clearing members. This approach can create 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, CCP12 believes that 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. In any case, RLDF linked capital requirement computation should create sufficient incentive to have CCPs adequately capitalised except for handling multiple defaults under highly stressed scenario (an extreme tail event).

(v)The greater sophistication of the proposed new default fund exposure calculation should reduce 'trade exposures risk'. The existing two per cent risk weighting for both bank Clearing Members and bank clients of Clearing Members should be considered as sufficiently prudent.

4..While QIS being run by BCBS should provide guidance to the suitability of the suggested alternatives, many of our members are not part of this QIS and they are apprehensive that the QIS may not adequately reflect the state/requirements of the markets served. BCBS should extend the scope of QIS before finalising the approach.

5. CCP12 appreciates your consideration of this submission and looks forward to working with you to advance the steps being taken for safer OTC Derivatives markets.

Sincerely,

Siddhartha Roy
Chairman,
CCP12 – The Global Association of Central Counterparties

Attachments:Annex 1: List of CCP12 Member Organizations

*** About CCP12**

Formed in 2001, CCP12 is a global association of 32 major central counterparty clearing house organisations across Africa, the Americas, Asia, Australia and Europe. CCP12's mission is to collaboratively share information, support development of standards and liaise with regulators, industry groups and global market users to foster dialogue on areas of mutual interest and concern, and to promote best practices in CCP risk management and operations.

For further information/clarification on this submission, please contact the Chair of CCP12, 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

ANNEX 1

List of CCP12 Member Organizations

CCP-12 Member Organization	Geographic Identifier
ASX Limited (ASX)	Australia
BM&F Bovespa (BM&F)	Brazil
Cassa di Compensazione e Garanzia S.p.A. (CC&G)	Italy
Contraparte Central S.A. (CCLV)	Chile
Cámara de Riesgo Central de Contraparte de Colombia S.A. (CRCC)	Colombia
CME Group (CME)	USA
The Clearing Corporation of India Ltd. (CCIL)	India
TMX Group (TMX)	Canada
Depository Trust & Clearing Corporation (DTCC)	USA/UK
Dubai Commodities Clearing Corporation (DCCC)	UAE
Gre Tai Securities Markets (GTSM)	Taiwan
Grupo BMV	Mexico
Eurex Group	Germany
Hong Kong Exchanges & Clearing Ltd (HKEx)	Hong Kong
Indian Clearing Corporation Limited (ICCL)	India
Intercontinental Exchange (ICE)	UK
Krajowy Depozyt Papierów Wartościowych (KDPW)	Poland
Korea Exchange (KRX)	South Korea
LCH Clearnet Group Ltd. (LCH)	UK
Mercado de Valores de Buenos Aires S.A. (Merval)	Argentina
NASDAQ OMX (NASDAQ)	USA/Sweden
National Securities Clearing Corporation Limited (NSCCL)	India
National Clearing Center (NCC)	Russia
The Options Clearing Corporation (OCC)	USA
Johannesburg Stock Exchange (SAFCOM)	South Africa

CCP-12 Member Organization

Shanghai Clearing House (SHCH)

Singapore Exchange Ltd (SGX)

SIX X-clear (SIX)

Taiwan Futures Exchange (Taifex)

Taiwan Stock Exchange (TWSE)

Tel Aviv Stock Exchange (TASE)

Japan Securities Clearing Corporation &
Tokyo Stock Exchange, Inc.**Geographic Identifier**

China

Singapore

Switzerland

Taiwan

Taiwan

Israel

Japan

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