Japan Securities Clearing Corporation

27 September 2013

Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
Sent by e-mail to baselcommittee@bis.org

Re: BCBS 253 Consultative Document - Capital treatment of bank exposures to central counterparties

Dear Committee members,

Japan Securities Clearing Corporation (hereinafter "JSCC") appreciates the opportunity to comment on the Consultative Document "Capital treatment of bank exposures to central counterparties" published on 28 July 2013 by Basel Committee on Banking Supervision.

Among the issues raised in the Document, JSCC would like to submit several comments as follows.

1. Comment on the second question

Q2: What are the pros and cons of using the greater of the minimum Cover* level required by the CPSS-IOSCO PFMIs or the hypothetical level of default resources calculated using NIMM as a model for calculating the relative risk of clearing members contribution to QCCP default funds? Should the Committee consider any adjustments to NIMM to improve its measurement of derivative exposures in the context of CCPs? Would it be better to use only one of these measures, or are there other suitable alternatives?

【JSCC Comment】

The Consultative Document contains statements in multiple sections[1] that base on an assumption that a clearing member may deposit the default fund in excess of minimum level of financial resources required by the CPSS-IOSCO PFMIs. Based on such statements, JSCC

[1] Paragraph 25 *"Applying the capital charge in this way also helps to ensure that the regulatory capital treatment does not materially disincentivise CCPs and their clearing members from maintaining member default funds that exceed the CPSS-IOSCO minimum."*
Paragraph 29 *" if members contribute sufficient default funds to achieve exactly the Cover* requirement, or, if higher, a default fund exactly equal to the hypothetical level of default resources calculated using NIMM"*
Paragraph 30 *"As prefunded default resources are increased above the minimum Cover* level required by the CPSS-IOSCO PFMIs"*

would like to, for good order's sake, confirm if it is the correct understanding that the value to be adopted as DFcover* is not necessarily obtained by applying the calculation logic of default fund requirement which is actually adopted by each CCP, and the calculation of such value using a hypothetical level considered by the authority of each country as appropriate “minimum requirement” under FMI Principles is permitted under the proposed framework.

Regarding this point, in the response to DFcover* column in QIS conducted in association with this Consultation, JSCC presented the value obtained by using JSCC’s prevailing default fund requirement calculation framework as “reference value,” because JSCC could not have an exact idea on what the level or assumption of such “minimum requirement” would be. However, we confirmed that the level of such value significantly deviated from the Kccp (NIMM) which was estimated by us and did not qualify prerequisite in Paragraph 28 of the Consultative Document *“NIMM is not materially lower than Cover* for the CCP*”. (*We would ask BCBS to confirm this point based on the response in QIS.)

From the result of such estimation, if new framework requires to obtain DFcover* by applying the default fund calculation logic actually adopted by each CCP, there is a concern that clearing members are imposed of excessive capital charge, which leads to outcome against the Mandate of the Pittsburgh Summit, i.e., facilitation of use of CCP by banks. We ask BCBS to recognize such potential risk.

Moreover, as stated in Box A of the Consultative Document, if DFcover* is defined as the amount satisfying the “minimum requirement” for the purpose of PFMI, it is considered necessary for securing level playing field across the markets of each jurisdiction that (i) the “minimum requirement” for a judgment, by the authorities in each jurisdiction, of compliance by each CCP under the PFMI framework is presented in a form that would enable clear-cut numerical calculation by CCPs, and (ii) recognition of the level of such “minimum requirement” be standardized among authorities of the countries.

While it could be more appropriate that such issue is discussed at not BCBS but CPSS-IOSCO, if there is no unified metrical perception about the assumption relating to the description of “*wide range of potential stress scenarios*” “*in extreme but plausible market conditions*” in the PFMI[2] (e.g. assumption of price volatility, etc. for calibrating tail risk amount) among the authorities, JSCC thinks it would be practically difficult to ensure level playing field. Furthermore, it should be noted that the framework on which each regulatory authority and CCP have to seek the “minimum requirement” of PFMI might be a disincentive for CCPs to improve their risk management system.

Therefore, until the above two conditions be shared among authorities of the countries (through discussion, etc. at CPSS-IOSCO), we consider that utilization of CCP internal model should be considered carefully in order to, among other things, eliminate potential gaming. In fact, it might be worth considering using only NIMM as a transitional measure.

[2] Principle 4: Credit risk, Key considerations 4, etc.

2. Comment on the third question

Q3: What risk weights / capital charges would best achieve, or appropriately balance, the objectives set out in Section II.C? In particular, how would possibly lower values ensure that clearing members are capable of absorbing losses in times of stress without the drawing down of the default funds threatening the viability of the non-defaulting members who have contributed to them? How would the proposed 1250% risk weight affect incentives to use central counterparty clearing?

【JSCC Comment】

The Consultative Document proposes that, in the segment where the appropriation of default fund contribution by surviving clearing members is highly likely, the capital charge of 100% of such contribution is to apply so that loss absorbency can be ensured without damage to the financial strength of contributing surviving clearing member. Based on the concept of applying the capital charge corresponding to the risk level, however, in the case where RLDF is derived from DFcover*, risk weight of 1250% on an assumption of damage to the entire amount of the RLDF seems to be excessively conservative.

In addition, since the proposed risk weight of 1250% is the same level as applied to default fund contributions to a non-qualifying CCP, there is concern that such a high risk weight would create a result adverse to the Mandate of the Pittsburgh Summit i.e., facilitation of use of CCP by banks.

JSCC considers it reasonable to set the risk weight applicable to the amount of RLDF derived from DFcover* at the level determined taking into consideration the probability of actual occurrence of bearing in the amount of RLDF (risk level).

JSCC considers that this concept is consistent with the approach taken when calculating the multiplier in NIMM positioned as a floor to RLDF (i.e. larger the amount of excess collateral/in-the-money amount of mark-to-market value of transactions is, smaller the EAD).

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