JOHANNESBURG STOCK EXCHANGE

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Secretariat of the Basel Committee on Banking Supervision

Bank for International Settlements
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"Capital treatment of bank exposures to central counterparties"

We refer to the above consultative document's revised version, released in July 2013 and welcome the opportunity to communicate our views on the proposed changes to the interim rules for the capital treatment of banks' exposure to qualifying central counterparties (QCCPs).

Safcom[1], which is licensed in South Africa as a clearing house by the Registrar of Securities Services under the Financial Markets Act No. 19 of 2012, is a wholly owned subsidiary of the Johannesburg Stock Exchange (JSE). It is in this capacity that the JSE submits its comments, as follows.

Capital treatment of banks' contributions to QCCP default funds: options for change

Q1: Which of these two proposed methodological approaches best satisfies the objectives which the capital treatment seeks to achieve and why?

A1: In the JSE's opinion the Ratio Approach satisfies the objectives of the capital treatment better than the Tranches Approach, as it provides a more direct and transparent benefit to systemic risk reduction (through higher CCP contributions that are to be accessed first) without penalizing a growing default fund. The Ratio Approach, given its simplicity, is easier to explain and implement.

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?

A2: The JSE only sees benefits in using RLDF = max{DF^{cover^*}, K_{CCP}(NIMM)}, as it incorporates CCPs own estimates of default fund size (in line with CPSS-IOSCO requirements), whilst providing a floor to the fund

[1] Safcom achieved CPSS-IOSCO compliance in December 2012.

size, which is calculated on the basis of the regulatory requirements. In our view, the latter ought to ensure that the incentive for CCPs to adopt artificially low estimates of default fund size is removed.

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?

A3: The JSE is of the opinion that a risk weight of 1250% is not appropriate as it equates contributions to the default fund as below investment grade risk. The probability of using the funds in the default fund is lower as a result of the entry criteria imposed on clearing members; in addition, the waterfall approach ensures recourse to other funds ahead of non-defaulting members' contributions. The imposition of this risk weight suggests that the various levels of protection afforded by initial margin, the defaulting member's and the CCPs respective contributions to the default fund have not been taken into account adequately. As an unintended consequence, contributions to default funds could be lowered, increasing the risk in the CCP.

Capital treatment of banks' trade exposures to QCCPs: options for change

(A) A risk sensitive approach

Q4: The Committee invites comments on this potential risk sensitive approach to capitalizing trade exposures to CCPs.

A4: The new risk sensitive approach is intuitive; the JSE prefers the calculation using RLDF instead of DF^{cover^*}, to ensure a regulatory floor is imposed on the default size requirement upon which capital is charged.

(B) Treatment of posted initial margin

Q5: Do you consider it appropriate to treat initial margin, where a QCCP has legally enforceable rules that make initial margin a senior claim to variation margin in the event of losses in excess of default resources, differently from other trade exposures by retaining a fixed 2% risk weight on initial margin posted in a non-insolvency remote manner?

A5: The JSE supports recognition of the legal environment and contractual arrangements in place that make initial margin a senior claim to variation margin and initial margin that is not posted in an insolvency remote manner. A fixed risk weight for these arrangements is supported.

Capital treatment of commitments to top up default funds

Q6: Do the proposed approaches to capture commitments to top up default funds in the capital treatment of exposures to QCCPs satisfy the objectives which the capital treatment seeks to achieve? Are there ways in which the proposed capital treatment of commitments could be improved? Is the proposed α value of 0.5 appropriate?

A6: Capital required to support a possible top-up of the default fund should be treated with the associated probability of such an event occurring, and the applicable capital charge calculated accordingly. The JSE

supports the calculation method proposed and recognizes that where there is no commitment to top up a default fund, all things being equal, a bank's capital requirement in respect of exposures to that CCP should be higher than if there were a real commitment to top up.

We trust our input will be of assistance in finalizing the capital treatment of bank exposures to QCCPs. Please do not hesitate to contact us for further clarity on any of the above.

Yours Faithfully

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