The Clearing Corporation of India Ltd, Mumbai, India
Response to BCBS 254: Consultative Document on The non-internal model method for capitalising counter-party credit risk exposures, June 2013 (revised 25th July 2013)

We refer to the June 2013 (July ’13 revision) Consultative Document on “*The non-internal model method for capitalising counter-party credit risk exposures*“ 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. As the Regulator in the Indian market has so far not allowed banks to move to IMM approach, Current Exposure Method(CEM) approach would have been the guiding process for assessing capital requirements of the Clearing members for their exposures on Central Counterparties with effect from early 2014 (when Basel III would have come into effect). The deficiencies of both CEM and Standardised Method (SM) are well known and have also been listed in the consultative document. We therefore applaud BCBS and its Risk Measurement Group for taking timely action in fine tuning the exposure computation method. We are also aware that Single Entity Exposure limits of the Clearing Members based on CEM method are already creating hurdles in respect of Clearing Members’ dealing with the CCPs in some jurisdictions. An appropriate counter-party exposure computation methodology would therefore significantly facilitate the avowed objective of encouraging Centralised Clearing of OTC derivative products.

4. In this context, it is also pertinent to draw attention to the reported large scale inappropriate usage of IMM approach. While BCBS is seized of this issue, it may therefore be a better idea to bring even those carrying out IMM approach for their risk assessment under NIMM for capitalizing credit risk exposures on counter-parties. This will bring uniform treatment across jurisdictions and will bring level playing field between clearing members clearing through various CCPs.

5. Our submissions, on the questions posed in the consultative document, are as under:

Q1. *Should the Basel Committee replace the CEM and SM with the NIMM in all areas of the capital framework? What are the benefits and drawbacks of using the NIMM in each of these areas?*

CCIL: The proposed NIMM should be applied to the capitalization of CCP exposures, leverage ratio and large exposures.

NIMM is expected to throw up a more reasonable exposure value as it would apparently allow netting to a greater degree under most circumstances. Moreover, it will also allow offset between negative replacement costs and PFE under certain circumstances and thus should be more risk sensitive.

In respect of each of the above mentioned areas, advantages would be as under:

a) Capitalisation of CCP Exposures: Clearing Participants/Members having negative replacement cost would in most cases have to post variation margin on such trades to the CCP. They would also post initial margin to cover PFE . For clearing of OTC market products, variation margin exchange is not so orderly as in case of exchange traded products. Thus, if NIMM is not applicable for assessing exposures on centrally cleared trades whereas the same becomes available on bilateral transactions, it will disincentivise Central Clearing.
b) More appropriate assessment of exposures on cleared trades is also very critical for leverage ratio computation. Using NIMM should be of help.
c) Of late, the issue of large exposures (i.e. exposure on Central Counterparties) is becoming very critical in moving products into CCP clearing. Limited netting using current exposure method is coming in the way of market participants' availing CCP services. NIMM should rectify the position to some extent.

Q2. *Is the proposed approach of retaining the general structure of the CEM with respect to replacement cost and the potential future exposure add-on appropriate? Is the division of the broad asset classes appropriate?*

CCIL: The approach of retaining the general structure of the CEM is appropriate for vast majority of market participants who cannot shift to IMM model for various limitations at their end. The broad asset classes as proposed are appropriate except that limited offsets between currency pairs should be allowed.

Moreover, for complex products, a process should be designed where the same should be accounted for under all relevant risk factors (instead of the process suggested in para 44)

Q3. *Are there specific product types that are not adequately captured in the outlined categories?*

CCIL: All product types are broadly covered.

Q4. *Does the above approach reflect the replacement cost of margined transactions? Are there any other collateral mechanics that the Basel Committee should consider?*

CCIL: In case of OTC market CCPs, variation margining process is not so streamlined as in case of exchange traded products. Residual positive MTM value of trades in the accounts of the clearing participants are sometime allowed to be set off against initial &

other form of margins. Such residual positive MTM value against a Central Counterparty should be considered collateral under NIMM approach from the perspective of CCPs.

Q5. *Of the options under consideration for recognising offset across hedging sets, which treatment is preferred? What number of maturity buckets is appropriate to consider?*

CCIL: The Approach 1 with partial offsetting across maturity buckets seems an appropriate approach. The number of maturity buckets seems appropriate.

Q6. *Is the proposed approach of using a different methodology for determining the add-on for each asset class appropriate? Is each proposed add-on methodology for each asset class effective at capturing the main risk driver of that asset class?*

CCIL: The proposed approach for determining the add-ons seems appropriate.

Q7. *Are the proposed minimum time risk horizons for each transaction category (unmargined, non-centrally cleared, centrally cleared) appropriate? Should the Basel Committee consider factors other than the IMM for determining the appropriate time risk horizon for the NIMM (eg harmonising with other international or national legislation)?*

CCIL: Minimum time risk horizon for trades in CCP Clearing 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 any modulation.

Q8*. Do the suggested formula and 5% floor appropriately recognise the benefits of over-collateralisation*?

CCIL: The formula & floor looks appropriate.

Q9. *Is the proposed approach to aggregate across asset classes appropriate?*

CCIL: Offset should be provided across interest rate and foreign exchange derivatives, at the minimum. Moreover, for foreign exchange exposures, bucketing of exposures like Interest Rate swaps should be considered (logic that foreign exchange exposures are short term is not really valid and even if it is so, those with very short maturity will not get caught by the change)

Q10. *Are there any risk factors that should be included in their own category or accounted for in another manner?*

CCIL: For complex products, a process should be designed where the same should be accounted for under all relevant risk factors (instead of the process suggested in para 44)

Q11. *Is the proposal to introduce the multiplier in order to allow reduction of the PFE add-on in the IMM shortcut method appropriate?*
CCIL: Yes, this looks appropriate.

6. We congratulate BCBS for taking this timely step to streamline the method of computation of credit risk exposures on counterparties. We also understand that QIS is also being run by BCBS which would provide guidance to the suitability of the suggested alternatives. We however understand that a very limited number of CCPs are participating in the QIS. In this backdrop, we are apprehensive that the QIS may not adequately identify the issues specific to some markets. We request BCBS to consider the QIS result from this perspective..

7 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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