

5 July 2016

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

Dear Sirs,

**FEEDBACK ON THE BASEL COMMITTEE ON BANKING SUPERVISION'S CONSULTATIVE DOCUMENT
ON REVISIONS TO THE BASEL III LEVERAGE RATIO FRAMEWORK**

1. We refer to the consultative document on the revisions to the Basel III leverage ratio framework issued by the Basel Committee on Banking Supervision ("BCBS") in April 2016.
2. We welcome the opportunity to submit our comments on the proposed changes to the leverage ratio framework. Our response to the consultative document is enclosed.
3. If you require further clarification, please do not hesitate to contact Mr Jerome Amon (Email: jerome.amon@sgx.com) or Ms Yelizaveta Marchenko (Email: yelizaveta.marchenko@sgx.com).

Yours sincerely,

A handwritten signature in black ink, appearing to read "Christer Rydberg", with a stylized, cursive script.

CHRISTER RYDBERG
HEAD, RISK POLICY
SINGAPORE EXCHANGE

CONSULTATIVE DOCUMENT ON REVISIONS TO THE BASEL III LEVERAGE RATIO FRAMEWORK

SGX Comments

1. INTRODUCTION

- 1.1 Singapore Exchange Limited ("SGX") welcomes the opportunity to submit its comments on the Basel Committee on Banking Supervision's ("BCBS") consultative document issued in April 2016 in relation to the revisions of the Basel III leverage ratio framework.
- 1.2 SGX operates two clearing house entities in Singapore, namely the Singapore Exchange Derivatives Clearing Limited ("SGX-DC") and The Central Depository (Pte) Limited ("CDP"). SGX-DC provides clearing services for exchange-traded derivatives contracts and over-the-counter commodities and financial derivatives contracts. CDP provides clearing services for securities. The two clearing house entities are regulated by the Monetary Authority of Singapore as approved clearing houses under the Securities and Futures Act of Singapore.
- 1.3 SGX is supportive of the introduction of a leverage ratio as a mean to ensure financial stability but has been attentive on the impact this could have on the clearing industry. Since the initial publication of the leverage ratio framework in January 2014, several market participants and central counterparties ("CCPs"), including SGX, have raised concerns regarding the definition of derivative exposures and its adverse effects on the provision of client clearing services by financial institutions and market making activity. SGX is of the view that the proposed revision to the Basel III leverage ratio framework alleviates some of the concerns, but certain issues remain, as detailed in our comments below.

2. COMMENTS ON DERIVATIVE EXPOSURES

SGX supports the replacement of the Current Exposure Method ("CEM") by the Standardized Approach for measuring Counterparty Credit Risk ("SA-CCR") for the calculation of derivative exposures. The CEM, which treats indifferently margined and unmargined trades and has limited recognition of netting benefits, was not an appropriate measure of the exposure for centrally cleared derivative transactions. While the SA-CCR methodology addresses some of the shortcomings and represents a great improvement over the CEM, SGX notes that some issues remain when it comes to calculation of client clearing exposures, in particular with respect to the treatment of collateral received and the calibration of the Margin Period of Risk.

2.1 Treatment of collateral received

SGX notes that the BCBS maintained its position on collateral and reaffirmed that collateral received “reduces counterparty exposure but can also increase the economic resources at the disposal of the bank, as the bank can use the collateral to leverage itself”. As a result, the original SA-CCR Method has been modified with the application of a fixed multiplier of 1, effectively restricting the possibility for collateral received and/or negative Mark-to-Market to reduce derivative exposures.

SGX would like to reiterate its views that aforementioned rationale is not justified in the context of client clearing where margin collateral is required to be segregated and is generally not at the disposal of the bank for reinvestment. At the very least, the BCBS should allow collateral that is passed-on to the CCP to reduce the exposure via the multiplier.

2.2 Calibration of Margin Period of Risk for the Maturity Factor

Under the SA-CCR method, exposures are multiplied by a maturity factor that is based on a five-day Margin Period of Risk (“MPOR”) for centrally cleared derivative transactions. As it stands, the five-day MPOR applies indistinctively to Exchange Traded or OTC derivatives. While the five-day MPOR may appear reasonable for OTC derivatives, it is unduly conservative in the case of highly liquid Exchange Traded derivatives (“ETDs”). In comparison, SGX, as for other international CCPs, generally use a one or two days close-out period as a basis to determine initial margin requirements for ETDs. This close-out period is in line with CPMI-IOSCO Principles for Financial Market Infrastructures and has been validated by national regulators. Moreover, CCPs close-out period takes into account larger and more complex portfolio than what Clearing Members would face in case of a client’s default.

In light of the above, SGX urges the BCBS to consider applying a shorter Margin Period of Risk of two days for ETDs, in line with international practice and regulator’s requirements. Combined with a 5 days MPOR for OTC Derivatives, this would also be consistent with the G20 objective to have standardized OTC derivative contracts being traded on exchanges or electronic trading platforms.

3. **COMMENTS ON ON-BALANCE SHEET EXPOSURES**

3.1 Exclusion of Cash collateral received from on-balance sheet exposure

SGX understands that Clearing Members providing client clearing services may record client’s cash collateral received as either on- or off-balance item, depending on their accounting framework and internal policy. When recorded as on-balance sheet, cash collateral is counted as exposure in the leverage ratio denominator.

On the other hand, accounting standards generally allows securities collateral to be recorded off-balance sheet and hence not to be included in leverage exposure.

Considering cash collateral pledged to CCP as an exposure goes against other regulatory efforts to encourage centralized clearing. It changes dynamics in the market place with some groups of clients becoming increasingly un-profitable, potentially leading to unintended consequences. Most importantly, the difference in accounting treatments as highlighted above lead to several issues:

- It promotes usage of securities collateral instead of cash collateral, thus creating operational and potential liquidity risk. Regulators shall also consider other unintended consequences of this discrepancy like increasing costs of certain collateral type due to large demand and second order effects on financial markets and price formation.
- It creates unlevel playing field between financial institutions with different accounting treatments. In that respect, SGX has noted recent initiatives from some market participants to derecognize client's cash collateral (i.e. switching from on-balance sheet to off-balance sheet), in a move that was implicitly aiming at reducing leverage exposure.
- For Financial institutions that continue to record cash collateral as on-balance sheet asset, the collateral not only does not reduce derivative exposures, but on contrary is added to the exposure. Exposure is hence double counted, which is not only counter-intuitive but also discourages affected institutions to call additional collateral from risky counterparties.

Issues above were previously highlighted to the BCBS by Industry participants but SGX noted that the BCBS did not provide clarifications on this matter in the revised framework.

SGX urges BCBS to clarify that client's cash collateral, in particular when posted to the CCP, should not be counted as exposure, irrespective of the accounting treatment adopted by the firm.

4. CONCLUSION

- 4.1 SGX would like to thank again the BCBS for the opportunity to participate in the consultation process. We look forward to being involved in future public consultations.