A. Introduction

Deutsche Börse Group (DBG) welcomes the opportunity to comment on BCBS consultative document “Capital floors: the design of a framework based on standardised approaches” (d306) issued on 22 December 2014.

DBG is operating in the area of financial markets along the complete chain of trading, clearing, settlement and custody for securities, derivatives and other financial instruments and as such mainly active with regulated Financial Market Infrastructure providers.

Among others, Clearstream Banking S.A., Luxembourg (CBL) and Clearstream Banking AG, Frankfurt/Main (CBF), who act as (I)CSD\(^1\) as well as Eurex Clearing AG (ECAG) as the leading European Central Counterparty (CCP), are also credit institutions (hereinafter “institutions”) and therefore within the scope of the European Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) which transpose i.a. the Basel III rules into European law. Clearstream subgroup is supervised on a consolidated level as a financial holding group.

However, those group entities are in scope of the banking supervision and therefore Basel III rules although they are offering only limited banking activities ancillary to their function as Financial Market Infrastructure (FMI). In order to operate as a FMI and in line with the dedicated regulatory framework (e.g. CPSS-IOSCO principles for financial market infrastructures as of April 2012) as well as generally recognised business practices, the business model of our group entities is risk averse, does not include a trading book / proprietary trading, allows loan business only in connection with clearing, settlement and custody activities for very short durations and in general only to other banks and dedicated public sector entities (PSE) and in general on a collateralised basis. The business models lead to the fact that the main risk category is operational risk while credit risk is less important and market risk coming from small open currency positions is marginal. Since inception which goes back to 1949, none of our companies has faced any credit loss despite a number of market stress situations and as such, loan loss provisions are irrelevant for our group companies.

Our response to the consultation below is reflecting the dedicated business of our group entities.

\(^1\) (International) Central Securities Depository
The document at hand contains a management summary in part B and responses to the stated questions in part C.
B. Management Summary

In general, we support the approach of the BCBS to balancing risk sensitivity, simplicity and comparability as presented in the BCBS discussion paper in July 2013. However, as per our response to that mentioned consultation, the approach going forward also need to take into account the need to have a stable environment to the extent possible\(^2\). With the introduction of the Basel II framework in 2004, there was an international consensus between regulators and the financial industry that the previous Basel I framework fulfilled simplicity and comparability but was lacking to some extent risk sensitivity\(^3\). The introduction of internal models was one element of the Basel II framework which was supposed to lead to more risk sensitivity. As at the time, there was no history of the impact of internal models available and as it was also intended not to increase the overall levels of capital on average (but to honour less risky businesses while requesting higher capital for more risky businesses), the Basel I floor was introduced as an interim measure to (a) gain some experience with the internal models and calibrate the parameters within the internal models over time and (b) continue to use existing methodology in order to avoid the implementation of an additional base line approach.

While the executive summary and the introduction of the consultation papers confirms the above mentioned facts, the proposed framework in our view fails to follow the own BCBS guidelines.

We clearly acknowledge the results unveiled by recent research i.a. by the BCBS on variation of capital ratios across banks based on different models mainly in the credit (but also market) risk area and we also accept therefore the need for action leaving aside the element of stability over time of the model. However, the Committee should come back to the roots of the Basel II framework and calibrate within the internal approaches rather than pushing to replace the interim Basel I floor (which by the way was supposed to disappear a while ago) by requiring model banks also to calculate the standardised approaches. As at the time the decision was right to continue to use the Basel I rules as they were already in use and therefore nothing new was to be implemented, institutions using advanced approaches should not be penalised by being forced to introduce the standardised methods on top. In the past, especially the systemically important institutions have been more or less forced to use the internal approaches as that has been considered being more adequate to reflect their

\(^2\) See our response to BCBS #258: http://www.bis.org/publ/bcbs258/deutschebrsegro.pdf

\(^3\) See i.a. introduction of the Basel II framework
business in a risk sensitive manner. We do not understand why all model banks are now pushed to use the standardised methods on top.

We acknowledge the efforts made by the BCBS especially during the last two years to reduce options and national discretions in the standardised methods (also we want to remind for the necessary principle of stability of the methods over time), there is still a lot of choice left and most likely will also be left after the review cycles currently performed by the BCBS on the standardised methods. As such, there is no such thing than one (unique) standardised approach which applies everywhere. This is in particular true for credit risk. As such, we doubt (beside our more generic criticism to the proposed approach) that – especially for credit risk – the standardised approach would be a proper basis for a unique floor.

Instead of setting floors to the however defined standard approaches, the BCBS should rather look to the model components of the internal approaches and adjust elements therein if deemed necessary.

On top of this, it is rather strange that the BCBS consultation on the review of the standardised method for credit risk, which is running in parallel to this consultation, is gathering for some harmonisation of the standardised and the internal rating based approaches and is showing a tendency to use the details from the IRB. Moreover, the same consultation is – in line with the general criticism on the reliance on external ratings – proposing alternative measures which are coming closer to internal model information although still derived form external sources (it is to be noted that we also disagree to a large extent to the BCBS proposals in this regards).

In addition to this, the consultation paper seems to take for granted that the leverage ratio is a binding limit under pillar I. We strongly object to this as the leverage ratio is not appropriately calibrated at all and especially is not capable to handle dedicated low risk business models like the one of our group companies. We doubt that even a differentiated leverage ratio taking the different risk profiles of certain businesses into account is an appropriate measure to be incorporate in pillar I. Contrary we see some benefits of the leverage ratio as a pillar II tool.

Likewise, we also see no real benefit in any floor based on standardised approaches if in general the model based approaches are seen as being superior with regards to risk sensitivity. The floor approach in our mind is especially neither needed nor appropriate for the capital charge on operational risk. To our knowledge, there is also no empirical evidence available in this regards – different form credit and also market risk. We therefore strongly oppose an introduction of a floor for operational risk (we
have to say, that in our case the capital charge is anyway substantially higher than under the simpler approaches). The additional (though in the case of operational risk limited) efforts do not justify the introduction of a floor. In any case, the introduction of the floor should grant the institutions the right to return to the standardised methods without any different justification than the introduction of the floor! Finally in this regards, as operational risk has not been part of the Basel I framework explicitly, this is an additional argument not to introduce a floor for operational risk capital charge.

The proposed approach of the BCBS is in total adding complexity (not following the target of simplicity), is going away from risk sensitivity, is only reaching to a very limited extent more comparability (as there is no unique standardised approach and the floor will only capture some exposures) and is not in line with our requested principle of stability over time. As such, the approach fails to reach the own principles of BCBS and consequently should not be followed further.

Overall, we clearly favour to end the Basel I floor as it is becoming increasingly outdated and is not following current developments to capture additional risks (e.g. CVA charge, exposures towards CCPs, etc.). Furthermore, we clearly oppose the introduction of any floor based on the standardised approaches (especially for operational risk) as it is adding substantially implementation and running costs without demonstrating its benefits. Finally, we urge the BCBS to refine the internal methods especially the IRB (refine and / or set (new / revised) floors, caps, exposure classes, haircuts, etc.) to reach the target of more comparability by far better and in line with the original ideas of Basel II as well as the own principles of the BCBS.
C. Responses to the questions for consultation

1. Assuming the respective floors were calibrated to achieve the same level of required capital, what are your views on the relative merits of a risk category-based floors and an aggregate RWA-based floor? What are your views on a floor based on exposure class?

As stated in section B of the paper, we oppose to the proposed framework in its entirety. Having said this, we nevertheless want to express our views below in case the BCBS is going to implement a floor based solution as proposed despite our strong concerns.

Beside the two options discussed for risk category-based floors or an aggregate RWA-based floor, we also see the option to introduce risk category-based floors but allow for netting of excess / shortfalls across the risk categories. Especially in cases where an institution is not using internal / model based approaches for all three categories of risk the aggregate RWA-based floor does not make sense. As such, we see a model which adds up any excess / shortfall per risk category where relevant to be superior to a model including (in any case) all risk categories.

Judging the three models as described above or even the more detailed model on the level of exposure classes from our perspective is only possible in conjunction with the results of respective parameters after calibration based on a quantitative impact study (QIS). Once more, the reference to exposure classes clearly indicates that the approach may – if at all – only fit to credit risk (and to some extent maybe market risk) and should not be applied to operational risk at all. Following the guiding principle on simplicity, we see the approach based on exposure classes as less favourable compared to an approach on risk categories. Furthermore, any approach chosen needs to reflect properly the situation for institutions which use the internal / model based approach only for some risk categories.

In general, we doubt the usefulness of a QIS as this would already require model banks to implement the standardised approaches. As the parameters are not yet available, we kindly ask the BCBS – if the approach is followed further – to perform an additional consultation once a QIS has been performed and results are included in the revised proposal.
2. What are your views on the relative merits of the two options for adjusting for differences in the treatment of provisioning for credit risk?

As explained in section A of this paper, our group companies do not face the topic of loan loss provisions. As such, we have no comments to this question.

3. Do you have any other comments regarding the design of the capital floor?

The term risk weighted assets (RWA) is used in the context of credit risk. Capital charges for market risk and operational risk are multiplied by 12.5 in order to make them comparable with the risk weighted assets on the basis of an 8% capital charge. Further elements are added (settlement risk, CVA charge, etc.) and in the end the minimum levels of capital required are derived. We kindly ask the BCBS to consider a rephrasing of its terminology and use the term “RWA" in the future only for the purpose of credit risk. The total of the risk exposures per risk category should than be referred to as “Total Risk Exposures". As such, any reference to RWA would be clearly referring to credit risk only.

Beside this, we have no further comment on top of the general criticism and proposals made in section B of this paper.

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We hope our comments are seen as a useful contribution to the discussion and are taken into account in the further work on the topic to reach more comparability across different banks while not leaving aside simplicity, risk sensitivity and stability over time.

Eschborn

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