A. Introduction

Deutsche Börse Group (DBG) welcomes the opportunity to comment on BCBS consultative document "Revision to the Standardised Approach for credit risk" – second consultative document - issued in December 2015.

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), which act as (I)CSD[1] as well as Eurex Clearing AG as the leading European Central Counterparty (CCP), are also credit institutions and are 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 the banking activities of the group companies are limited / tailored to their underlying activities. DBG has commented the first consultative document and raised substantial concerns about the proposals made therein[2].

Quite a few of our concerns have been taken up with the second consultative document. Nevertheless, some of our concerns remain and new elements which do not seem to be appropriate are now included in the proposal. We focus our responses below on the topics affecting our dedicated business model. Moreover we raise comments for a variety of dedicated items which in our view need to be adjusted. In addition, we raise comments related to unclear provisions or specific topics where we have a different view.

The document at hand contains a management summary in part B, comments on the consultative document in part C and detailed comments on the draft wording in the revised framework in part D.

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[1] (International) Central Securities Depository

[2] See http://www.bis.org/bcbs/publ/comments/d307/deutscheborsegr.pdf

B. Management Summary

The BCBS strengthened the capital framework and the overall ruleset for banks already with the introduction of the Basel III framework. The BCBS is performing or has finalised a variety of reviews with regard to capital regimes, e.g. fundamental review of the trading book, TLAC holdings, capital floors, revisions to the securitisation framework, operational risk requirements, interest rate risk in the banking book, etc. For the foreseeable future many other initiatives, e.g. the treatment of exposures towards sovereigns and central banks, replacement of the current exposure method by the non-internal model method, etc. are already announced to be on the agenda. While we understand that every single initiative might have it's justification we urge the BCBS to summarize these initiatives in a "Basel IV" framework. In this process the interaction of these initiatives should be assessed and cumulative capital requirements calibrated. Otherwise capital requirements are geared up heavily as several capital requirements depend on other capital regimes. The variety of initiatives to cover risks via capital requirements might appear appropriate on an isolated basis but their accumulation leads to a situation that banks are heavily restricted on their ability to grant loans to the real economy.

Parallel to this consultation the treatment of TLAC holdings was discussed. That consultation includes possible future treatments of subordinated debt and certain equity holdings which are not aligned with the proposals the BCBS made in this consultative document. This is a very good example to stress the need for a comprehensive and holistic consultation on all proposed changes as a revised "Basel IV" framework. Both regimes must be closely aligned in order to have a suitable framework[3].

Having said this, we notice strong improvements in this second consultation paper compared to the first consultation on the revision of the standardised approach for credit risk. In the first consultative document issued in December 2014 the BCBS proposed to remove the rating based approach to derive risk weights for banks' exposures. Instead balance sheet related ratios, e.g. the capital ratio, the ratio of non-performing assets (for exposures towards banks) or leverage and revenue (for

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[3] See our comments in the consultative document: http://deutsche-boerse.com/dbg/dispatch/en/binary/gdb_content_pool/imported_files/public_files/10_downloads/11_about_us/Public_Affairs/Position_paper/GDB_Position_paper_to_BCBS_342_TLAC_holdings_1_0.pdf

exposures towards corporates) were brought up. We expressed our strong concerns to skip the usage of credit ratings for the standardised approach for credit risk due to a variety of reasons. The conduct of a second consultative document in order to honour the strong industry concerns is highly appreciated, in particular the general acceptance of ratings for deriving risk weights in jurisdictions that allow those ratings for regulatory purposes.

Coming to some of our key concerns with regards to the current proposal, we continue to be sceptical on the right balance between risk sensitivity and simplicity. Furthermore, we have strong concerns related to the availability of certain required information and the severe consequences resulting from that. We continue to doubt that an adjustment of the Standardised Approach towards the IRB for off-balance sheet positions is appropriate.

Summing up, we still see room for a less complex and a more simple solution being still risk sensitive enough and in particular we see the need to better calibrate the overall capital requirements and abstain from unjustified mark ups.

Finally, we are missing a usability test as a lot of the elements may be a good idea in theory but lack any potential for practical implementation due to missing data and missing processing possibilities.

C. Specific comments on the consultative document

Balancing Simplicity and risk sensitivity

We strongly support the BCBS approach to balance out simplicity and risk sensitivity. However, we disagree that this has been reached in a sufficient manner with the proposal. Not only is the proposal getting less simple and more complex than the current framework but we also do not see really risk sensitivity being reached. In line with the general BCBS guiding principles as formulated in the discussion paper "The regulatory framework: balancing risk sensitivity, simplicity and comparability"[4] we want to point out that stability over time is also needed[5]. As such, we urge the BCBS once more to consider carefully whether amendments in the framework are necessary for the currently discussed topic but also more in general. In line with our former statements on other BCBS consultations we urge the BCBS not to overpower banks with regard to capital requirements and their management.

Continue the rating based approach and disagreement on proposed alternatives

As mentioned in part B we highly appreciate the intention of the BCBS to continue the rating based approach for jurisdictions in which the usage of ratings is permitted. In that line, we disagree to break up the link between banks and their sovereigns completely. While we clearly understand the rationale behind the BCBS proposal, we raise concerns on the proposed treatment for exposures towards small banks especially in the savings banks and co-operative banks area but also related to banks being parts of (even systemically important) groups which do not have a rating (at least not an own one) as they do not need it. Access to the capital market may not be needed directly. We clearly reject the proposed treatment as requested data may not be readily available (neither in an appropriate timeframe nor in an appropriate technical manner). Therefore the introduction of a back stop solution using the sovereign rating as a basis still seems to be an option that should be allowed from our perspective in case no rating is available.

Exposures towards unrated banks' and for exposures of banks incorporated in jurisdictions that do not allow the use of external ratings for regulatory purposes

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[4] See http://www.bis.org/publ/bcbs258.htm

[5] See our response to the consultation under: http://www.bis.org/publ/bcbs258/deutschebrsegro.pdf

Grades A, B and C are introduced by the BCBS proposal. If minimum regulatory requirements are exceeded a risk weight of 50% is assigned. One of those requirements is leverage. In a variety of consultations we expressed our strong concerns about the concept of the leverage ratio, in particular if the mandatory leverage ratio is not taking the business model into account. The solvency regime is based on risk sensitivity taking into account the riskiness of the assets. Mixing this approach with a back-stop regime like the leverage ratio (or at least should be although for many low risk / high volume banks it might become the primary regulatory constraint) is not sound.

In order to derive the CSRA Grades for unrated credit institution counterparties in the BCBS proposal, the data capturing effort is very high (but not risk sensitive as the captured data is outdated once it is available) and the envisaged "minimum requirements" are vague. A lot of those requirements are no limits as they may be either underrun for some time or they are not binding for the time being. As such, like in the case of the rating substitutes in the first consultative proposal, the new parameters in our mind do not pass the use test. Even if audited financial statements are available, a detailed auditor's opinion is not public. As such, it is also not shared with counterparties and therefore it cannot be assumed to be publically or in a credit relationship available.

In case, despite our concerns, minimum regulatory ratios continue to be considered as the appropriate metrics, we propose to use the solvency ratios as the sole trigger to allocate exposures to Grades A, B or C.

In our view the BCBS proposal is also vague and misleading with regards of the treatment of capital buffers in this regard. For the allocation to Grade B if at all a shortcoming of the total buffer requirement may be the appropriate measure. However, there cannot be a shortfall related to only one buffer as capital is held in total and not related to certain buffer captions. As such, the wording on page 5 of the consultative document in this regard lacks clarity.

Materiality Threshold required

Based on the proposal of the consultative document, the categorisation of counterparties based on external ratings or into Grades A to C based on a due diligence is to be done regardless of the size of the exposure. For unrated exposures we feel this to be inappropriate as we did not detect a materiality threshold in the proposal to exclude minor exposures from the necessity to perform a due diligence. Therefore, we propose to assign exposures below 100,000 EUR equivalence to Grade B of the proposal and do not oblige to perform a due diligence in exchange for a missing due diligence. Further, the question occurs whether a due diligence must be performed on an on-going basis or whether it must be performed only e.g. once a year. We clearly favour an annual assessment only, which however is not risk sensitive and demonstrates our concerns on the approach as such.

OECD country ratings for High Income Countries

Related to the use of OECD country ratings we do want to make the BCBS aware that the OECD is not issuing country ratings any longer for High Income Countries. As such, current mappings of OECD country ratings fail for such countries. The BCBS therefore needs to clarify throughout its framework how to deal with such countries and should make their treatment equal to a country risk qualification of 0.

Short-term interbank exposures

We positively take note of the BCBS view on the preferential treatment of short-term interbank exposures in order to secure market liquidity in interbank markets. However, the BCBS has not incorporated so far a similar preferential treatment in its published large exposure rules which is by far more critical for the well functioning of money markets. As such, we clearly urge the BCBS to introduce a substantial relief for short-term interbank exposures in the large exposure regime. In our view, all overnight interbank exposures should be treated preferential in the large exposure regime and be exempted from limits. Other short term exposures up to three months original maturity should also get a preferential treatment there.

Not enhancing disclosure requirements further

The BCBS is considering asking for further enhancements of the disclosure requirements. We clearly express our concerns on this proposal. In the recent past those requirements have been vastly increased, in quantity, quality and granularity. The level of detail has reached a complexity that makes it very hard, maybe impossible to retrieve meaningful information from banks' disclosures (not to talk on the non-existing possibility to compare across banks already now). The level of disclosure requirements should be focused on key figures and other relevant information for the public.

In particular, the BCBS is proposing to disclose information about banks' credit assessment approach. This is clearly rejected as the counterparties may use this information to anticipate and dilute the credit assessment process.

Exposures to corporates

We agree to the approach for corporate exposures and welcome the changes compared to the first consultative document.

Subordinated debt, equity and other capital instruments

We clearly agree to the proposal made. That proposed treatment of subordinated debt should be in alignment with the capital treatment of TLAC holdings, discussed in BCBS d342. So far, the TLAC proposal and the proposed credit risk framework do not match. A capital treatment must be consistent, otherwise it cannot be ensured that banks are compliant with both regimes. Consequently, (i) the TLAC holding rules should be included in the capital framework as proposed in Annex I and (ii) the rules for the capital requirements on TLAC-holdings – if deemed necessary – should follow the proposal as made in this consultative document.

Risk weight add-on for exposures with currency mismatch

Corporate portfolio exposures with currency mismatch shall receive risk weight add-ons of 50% according to the BCBS proposal. We ask the BCBS to specify how a match can be identified in order to skip the 50% add-on. While the applicability of such treatment on corporate exposures in general seems to be reasonable we reject the proposal as it is too vague, neither practicable nor manageable and results in higher complexity without any prove of appropriate calibration. We reject the identification of unhedged exposures on exposure level as it is not practicable. Corporates may hedge exposures on a macro level with different counterparties but such information is not available to the individual banks. If at all, an add-on for corporates will be introduced it should be generic and should be related to particular currencies (e.g. currencies which are not in scope of the general business activities of the corporate). In this context the determination of exposures is difficult or even impossible in any case and the BCBS should develop feasible, practicable and reasonable criteria which:

1. are accurately balancing simplicity and risk sensitivity and
2. are associated with additional efforts that are reasonable.

In summary it seems to be more adequate to skip the requirements for corporate exposures.

Unconditionally cancellable commitments (UCC)

We highly appreciate the definition of those commitments as "…any contractual arrangement accepted by the client whereby the bank <u>is committed to extend credit</u>, purchase assets or issue credit substitutes" in paragraph 64 of the proposed framework which is reducing the threat of possible misinterpretations. As such, any credit line granted which is unconditionally cancellable at any time, in itself is not a commitment (as the bank is not obliged to pay if the cancelation clause is drawn) and therefore cannot be a UCC. However, as we believe this is not the intention of the BCBS we reject the proposed increase of the credit conversion factor from 0% to a range of 10% to 20%. Especially for interbank commitments such increase results in possibly drying-up interbank liquidity markets which would for sure lead to a destabilisation of the financial system.

Exposures to multilateral development banks (MDBs)

The identification of MDBs that are categorised in ECA risk score 0 must be performed by the BCBS and afterwards published on the BCBS homepage. Furthermore, OECD risk classification should be allowed to derive the risk weights of MDBs.

Credit risk mitigation framework

With regards to the credit risk mitigation framework we in general agree to the proposal made, nevertheless, we have some comments/requests for amendments:

- **<u>SFTs:</u>** The current treatment of collateralisation in securities financing transactions (SFTs) must be continued in the sense that the exposure minus collaterals (under consideration of haircuts) must be covered by own funds. In case the collateralisation exceeds the exposure no capital requirements shall occur. We agree to the proposed treatment of SFTs in paragraphs 124 to 165 of the proposal concerning the credit risk mitigation techniques if not mentioned otherwise in part D.
- **<u>Collateral eligibility:</u>** In the current and proposed framework certain substitutions of ratings are not allowed which are eligible for exposures in the credit risk framework e.g.:

- In the current credit risk framework substitution of missing rating information on an instrument level by rating information on a programme or issuer level is allowed[6];
- In addition the current credit risk framework allows the usage (substitution) of the sovereign or central government rating for local governments/regional governments etc. under certain conditions[7].

As for some debt instruments ratings are available only on programme level rather than a single issue level or even available for the issuer as such we urge the Committee to allow the substitution for the purpose of the CRM framework in the same manner as it is allowed for the general credit risk framework. Moreover, with regards to local/regional governments which fulfil the conditions mentioned above we propose to the Committee to allow the usage of the rating of the central government for regional / local governments etc. in line with the general credit risk framework.

Revised methodology for repo-style transactions

The methodology for repo-styled transactions in paragraph 2.1 appears to be overly complex. In particular, the second element of the formula raises our concern (add-on for potential future exposure). Instead of imposing a capital charge on those SFTs we propose to impose a clearing obligation with daily margining. Therefore the credit risk of future price movements is reduced.

[6] See paragraph 99 of the Basel II framework

[7] See paragraph 58 and footnote 23 of the Basel II framework

D. Detailed comments on the draft wording in the revised framework

- In paragraph 6 the treatment of high income countries should be clarified in the course of the review of exposures to sovereigns. A sentence may be inserted prior to the last sentence, e.g. as follows:
  "High Income OECD and High Income Euro Area Countries are considered to be equal with ECA risk score 0 for the purpose of determining the risk weight";[8]
- In paragraph 10 we appreciate the specified definition of MDBs;
- In paragraph 11 it should be made clear that it is the **Committee** which evaluates and determines MDBs being eligible for a 0% risk weight. The Committee should be obliged to publish the classification. Therefore sentence 2 and 3 should be rephrased as follows:
  "The Committee will continue to evaluate and determine the eligibility on a case by case basis taking the following criteria into account. The Committee publishes a list of current eligible MDBs and announces changes to this list. The eligibility criteria for MDBs risk-weighted at 0% are:"

  Currently, criterion (i) only refers to rating agencies' ratings. However, also the OECD is publishing multilateral and regional institutions risk classifications which should be taken into account. As such, criterion (i) should be rephrased as follows:
  "very high-quality long-term issuer ratings, i.e. a majority of an MDB's external ratings must be AAA or where the OECD multilateral and regional institutions risk classification is 0"

[8] With regards to the usage of the terms „High Income OECD Countries" and "High Income Euro Area Countries" and their treatment for risk classification purposes we refer to the OECD Arrangement on officially supported Export Credits
http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?doclanguage=en&cote=tad/pg(

- In paragraph 12 the usage of OECD multilateral and regional institutions risk classifications should also be allowed. A sentence 3 should be added:
  "Alternatively the risk weight may be determined based on the OECD multilateral and regional institutions risk classifications (ECA risk scores) as shown below."

External rating of counterparties	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-	Unrated
ECA risk score	0-1	2	3	4-6	7	Unrated
"Base" risk weight	20%	50%	50%	100%	150%	50%

- For paragraph 14 and 15 we repeat our general concerns on the due diligence requirements. However, in case the due diligence approach is implemented a materiality threshold should be included in case the exposure is below 100,000 EUR equivalence. In this case we propose to assign such an exposure to Grade B of the proposal in order to waive the due diligence requirements. Further, the question occurs whether a due diligence must be performed on an on-going basis or whether it must be performed only e.g. once a year, as described in part C of our response;

- According to paragraph 21 a counterparty classified into Grad A must exceed the published minimum regulatory requirements and buffers established by its national supervisors. We propose to change the wording from exceeding the published minimum regulatory requirements to meet the published minimum regulatory requirements to be aligned with paragraph 24;

- In paragraph 27 a possible trigger for the classification as Grade C is the existence of adverse audit opinion. We want to mention that those adverse opinions are not publicly available. The simple "not-existence" of such adverse opinion in the public sphere does not necessarily mean that such adverse opinion doesn't exist. Possibly the Committee targets for the overall auditor's statement to the audited financial statements which is more broadly published than the full auditor's report. If that is the case then to our best knowledge the appropriate terminology to be used would be "qualified auditor's opinion" as defined in the International Standards on Auditing ISA 705. The reference should be included in the final standard in order to clarify what is meant and have a common and well know definition;

- The proposal intents to assign the exposure to Grade C in case regulatory ratios are breached. From our perspective this is only acceptable for a breach of the capital ratio. In case the LCR of even the not yet binding NSFR is breached we consider the grading to B appropriate as those ratios may be temporary breached, contrary to the capital ratio. That fact is already recognised by the Committee in the proposal itself.
  Nevertheless, we want to mention our concerns that the capital ratio is a point in time measure, a breach may already be solved in the moment of reporting such breach. In addition, volatile business models must be adequately considered as well. Therefore, we ask for a clear statement for what regulatory ratios a breach might lead to a negative classification to Grade B or C instead of a generic statement "published minimum regulatory requirements and buffers (…)".
- In paragraph 32 we propose to add the following in order to ease the operational burden for banks related to the due diligence of counterparties:
  "If the exposure per counterparty is below the equivalent of 100,000.00 EUR a due diligence is not mandatory. Instead banks may apply a risk weight in accordance with Grade B."
- The treatment of subordinated debt in paragraph 42 to 44 must be closely aligned with the currently discussed and consulted TLAC holding regime. We refer to our comments and proposal made, see footnote 2. We strongly support the proposed treatment as presented in the current consultation. TLAC holdings need to be included in the final text of the revised capital framework. Chapter 7 as proposed in Annex I of the current consultation paper therefore should be rephrased to "Subordinated debt, equity, TLAC holdings and other capital instruments";
- The add-on risk weight to corporate exposures with currency mismatch in paragraph 62 is rejected. Such approach would increase complexity without really reaching risk sensitivity. We refer to our comments in part C;

- We welcome the clarification of the definition of commitment in paragraph 64. Therefore we clearly understand that in cases where the bank has legally the option to cancel any time and unconditionally a credit line this facility is not considered as commitment and therefore is not in scope of UCCs (unconditionally cancellable commitments) as a facility which is not defined as a commitment can also not be a UCC. Regardless of this possible wording topic, and in combination with paragraph 69 we clearly agree that no CCF should be introduced to interbank credit lines which are unconditionally cancellable at any time. As such, it needs to be crystal clear that paragraph 66 does not apply to such lines. We also oppose to apply paragraph 66 i.e. a CCF of 50% to 75% to lines being unconditionally cancellable at any time towards corporates in case our interpretation stated above is not followed by the Committee. If the Committee continues to have the idea to set a CCF above 0% to UCCs due to possible factual impossibility to cancel that should be limited to corporates and private/retail counterparties and a CCF should not be higher than 10%;
- In the third bullet of paragraph 65 a 100% CCF is demanded for the lending of banks' securities or the posting of securities as collaterals by banks. This is strongly rejected as such treatment would represent a double counting of these exposures for solvency purposes without necessity. Such approach would severely harm the repo and securities lending market as well as the market for secured lending. Collateralised transactions result in significantly lower risks, a penalty for such transactions contradicts the political intention to stabilise financial markets and reduce credit risk in the financial system;
- The generic application of a 100% CCF for any unsettled exposure in paragraph 73 is clearly rejected. In a delivery-versus-payment (DvP) an unsettled transaction does not impose any credit risk. As such the related CCF should be 0%;
- Regarding the attempt to prevent cherry picking in paragraph 87 we ask the Committee to specify that ECAIs used for pillar I capital ratio calculation purposes should be used within internal risk management considerations but there is no requirement to incorporate external ratings in the internal risk management / risk controlling calculations. They may only be used as a back stop / back testing basis. In addition, as there may be small portfolios where the usage of ECAIs

both from a risk perspective and economic perspective is not reasonable, an exceptional treatment should be included by adding an additional sentence to paragraph 87:

"Nevertheless, banks are allowed not to use the chosen ECAIs and the ratings for non material types of claims. Such types of claims are exposure classes which account for less than 5% of the average quarter end values of the last four quarters and never exceeded 6% at any quarter end."

- For paragraph 92 we see the necessity to tackle this problem via a waterfall system. First the treatment must be defined if an issuer rating exists. If such rating exists the rating should be used. In case no issuer rating exists an issue rating may be taken into account.

  Regardless of the generic approach we come to the conclusion that such approach is hardly feasible, highly complex and implementation almost impossible. We propose to find a more practical approach that is not imposing overwhelming efforts required on banks. The proposed approach may be highly risk sensitive, but fails when it is implemented and is not feasible. Same is the case for paragraphs 95, 97 and 98;

- In paragraph 118 the simple approach foresees the possibility to substitute the risk weight of the counterparty with the risk weight of the collateral for the collateralised portion of the exposure, generally subject to a 20% floor. This is rejected as the collateralisation with high quality assets, e.g. German sovereign bonds, are heavily damaged without necessity. The approach is not risk sensitive and a reasonable justification cannot be identified. In addition, there has been no quantitative assessment underlining the proposal made;

- In this regard we want to raise the attention of the Committee to the substitution of issuer ratings in case no particular issue rating is available. We ask the Committee to include another paragraph in order to cover this topic:

  "For a debt security received as collateral a bank may use the rating of the issuer itself or a programme rating in case no specific issue rating is available. In particular the rating of the central governments may be used if issued debt instruments of those central governments are unrated, e.g. short term instruments." In paragraph 130 it is stated that where a bank is acting as an agent in a repo-style transaction it must apply a 100% CCF for the guarantees provided.

We consider the assumption of a 100% default as over-prudent and not justified. This lacks on risk sensitivity. In addition, we wonder why this issue is not covered in paragraph 11 instead;

- We propose to include Central Securities Depositories (CSDs) in the list of entities that core market participants may include at the discretion of the national supervisors in paragraph 136.

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We hope that our comments given are useful in the further process and are taken up going forward. We are happy to discuss any question related to the comments made.

Eschborn

11 March 2016

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