ISDA Safe, Efficient Markets | gfma GLOBAL FINANCIAL MARKETS ASSOCIATION | IIF INSTITUTE OF INTERNATIONAL FINANCE

27 September 2013

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2, CH-4002 Basel, SWITZERLAND

Sent by email to: baselcommittee@bis.org

Re: Joint Associations' Response to the BCBS Consultative Document: The Non-Internal Model Method for Capitalising Counterparty Credit Risk Exposures

This letter contains the response of the International Swaps and Derivatives Association, Inc[1] ('ISDA'), the Institute of International Finance[2] ('IIF'), and the Global Financial Markets Association[3] ('GFMA', together 'the Associations'), to the Basel Committee on Banking Supervision ('BCBS') Consultative Document *"The non-internal model method for capitalising counterparty credit risk exposures"* (NIMM) dated June 2013.

The Associations very much appreciate the opportunity to comment on the proposed NIMM, to meet with the BCBS in Washington in June 2013, and to further discuss with the Federal Reserve in August 2013. We found these meetings to be constructive and they have assisted the industry in formulating its response in a focused and constructive way.

The Associations welcome the BCBS's consultative document as a significant step in addressing many of the long standing concerns regarding the Current Exposure Method ('CEM'). As an alternative to CEM, it is clear that NIMM has the potential to perform better as a measure of exposure. However, there are certain products and circumstances where we are concerned that NIMM does not appropriately recognize the reality of some collateral and netting arrangements thus resulting in disproportionately high levels of exposure. We have detailed our specific concerns, with examples, in the attached documentation and provided suggestions on how to address our concerns and improve the risk sensitivity of NIMM.

[1] Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 60 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

[2] The Institute of International Finance, Inc. (IIF) is a global association created in 1983 in response to the international debt crisis. The IIF has evolved to meet the changing needs of the international financial community. The IIF's purpose is to support the financial industry in prudently managing risks, including sovereign risk; in disseminating sound practices and standards; and in advocating regulatory, financial, and economic policies in the broad interest of members and foster global financial stability. Members include the world's largest commercial banks and investment banks, as well as a growing number of insurance companies and investment management firms. Among the IIF's Associate members are multinational corporations, consultancies and law firms, trading companies, export credit agencies, and multilateral agencies. All of the major markets are represented and participation from the leading financial institutions in emerging market countries is also increasing steadily. Today the IIF has more than 450 members headquartered in more than 70 countries. For more information, please visit www.iif.com.

[3] The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, please visit www.gfma.org.

Preliminary analyses have shown that it will not be possible to differentiate these issues from those of overly conservative calibration using the multiple quantitative impact studies. We therefore suggest that additional time be allotted by the BCBS to further evaluate NIMM and perform additional empirical testing on real portfolios. The Associations' members are ready and willing to engage further on this.

Additionally, NIMM uses a more complex formula as compared to the CEM formula, and is not necessarily a suitable framework for all organisations engaged in derivatives transactions, particularly banking organisations with less complex derivatives portfolios, that are used mainly for hedging activities. We propose that each jurisdiction should allow institutions flexibility in determining the method that is best suited for the complexity of their portfolio by permitting banks to apply a simplified version of NIMM (e.g. with reduced recognition of netting and other exposure-reducing effects), subject to supervisory review. As is the case today, supervisors would maintain the ability to mandate the use of a particular measurement method.

The Associations understand that the optional use of the a simplified version of NIMM may reduce slightly the ability to compare portfolios across organizations, which is not necessarily consistent with the goal of comparability as discussed in the BCBS discussion paper *"The regulatory framework: balancing risk sensitivity, simplicity and comparability"* (July 2013). However, we respectfully emphasize that there are instances where a simplified version of NIMM is more reasonable from cost-benefit perspectives taking into account differences in business models and transaction attributes among financial institutions.

Finally, we note that our comments and suggestions are based on the use of NIMM in the calculation of risk based capital for counterparty credit exposures and do not necessarily take into the account the issues that may arise if NIMM is used to calculate exposures under other applications, such as the supplemental leverage ratio and the Basel large exposures proposal. If the Basel Committee chooses to use NIMM in any other context we strongly urge the Committee to consult the industry on such use and to conduct quantitative impact studies prior to implementing NIMM in any other context.

We stress again that we are broadly in agreement with the direction of the BCBS NIMM proposals for risk based capital purposes and believe that the points set out in the attached Paper complement the proposed framework and help improve the calibration of the proposals. We do however, strongly suggest that additional time be allotted by the Committee to further evaluate NIMM and perform additional empirical testing on real portfolios. The Associations' members are ready and willing to engage further on this.

We do sincerely believe that you will find our comments and inputs helpful.

Yours faithfully,

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