

# Deutsche Börse Group Response

to BCBS consultative document d436

## **‘Revisions to the minimum capital requirements for market risk’**

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Contact: Ralph Kowitz  
Telephone: +49 (0) 69 211 - 16330  
Telefax: +49 (0) 69 211 - 13315  
Email: [ralph.kowitz@deutsche-boerse.com](mailto:ralph.kowitz@deutsche-boerse.com)

## A. Introduction

Deutsche Börse Group (DBG) welcomes the opportunity to comment on BCBS consultative document on 'Revisions to the minimum capital requirements for market risk' published on 22 March 2018.

DBG operates in the area of financial markets along the complete chain of trading, clearing, settlement and custody for securities, derivatives and other financial instruments and acts as such as a provider of highly regulated financial market infrastructures (FMIs).

Deutsche Börse AG as the parent company of the group operates the Frankfurter stock exchange, one of the largest regulated markets in Europe. In addition, several other products and services of DBG such as market data, indices, CSD and CCP services are in summary supporting financial stability and transparency of financial markets. With its business activities DBG contributes to the overall political aim as outlined i.a. at the Pittsburgh summit in 2009, throughout the regulatory initiatives of FSB, the Basel Committee, CPMI as well as IOSCO and other international fora.

Among others, Clearstream Banking S.A., Luxembourg and Clearstream Banking AG, Frankfurt/Main, acting as (I)CSD<sup>1</sup>, as well as Eurex Clearing AG as a leading European Central Counterparty (CCP), are authorised as credit institutions within the scope of the European Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) which transposed i.a. the Basel III rules into European law. Clearstream subgroup is supervised on a consolidated level as a financial holding group.

However, all our group entities in scope of CRD/CRR and therefore Basel III rules are offering limited banking activities ancillary to their function as financial market infrastructure. 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 and grants loan only in connection with clearing, settlement and custody activities for very short durations (and in general on a collateralised basis without intended financial leverage). None of our entities is performing proprietary trading in order to gain trading profits, they are purchasing securities only for intended long-term investments and are entering into a few derivatives positions for limited hedging purposes only. Any arising market risk comprises almost only foreign exchange risk but in general solely to a very limited extent.

Cash received out of the functions of our companies is based on the sole discretion of the clients<sup>2</sup>. It is invested with low credit risk and to a large degree without maturity transformation. For the CCP business collateral taken is the consequence of the general political preference for CCP cleared business especially for financial derivatives. Those collaterals and our capital are invested to a large extend into sovereign debt instruments with highest liquidity and credit quality. These instruments are held with the intention to hold them until they mature. Only instruments listed on an exchange provide the required level of liquidity in order to generate funds quickly if needed. As a consequence of proper organisational set-up, we clearly distinguish between (i) trading activities and related controls and (ii) the management of any investments which is performed via a trading desk.

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<sup>1</sup> (International) Central Securities Depository;

<sup>2</sup> Margin/collateral requirements may be fulfilled by either cash or securities up to the discretion of the client.

The document at hand contains our general remarks to the revised market risk framework (Part B) as well as specific comments on the consultative paper and on open issues (Part C).

## B. General comments

We appreciate that the BCBS keeps the discussion on market risk with all stakeholders ongoing and consequently is taking action to adjust the market risk framework as published in January 2014. We regard the resulting postponement of the implementation of the revised rules as a logical consequence and clearly welcome this approach. As such, we regard a thorough setup of the rules with a timely delay as being superior to implementing rules quicker that contain identified substantial weaknesses.

Based on our business we are hardly impacted by the rules on market risk capital charge and as such do not comment in details on those. However, our group companies are covered by the current Basel rules as well as by the proposed adjustments on certain organisational aspects and the trading book/banking book boundary. We in general refer back to our comments we have made in the previous consultative procedures<sup>3</sup> and the topics raised at that time. Regarding our organisational comments, we clearly welcome the amendment that instruments that are managed/acquired via a trading desk are not assigned to the trading book by default anymore. As proper governance arrangements require a trading desk also for liquidity management in the banking book, the linkage of trading desk and trading book was not appropriate. As such, we appreciate that the BCBS has deleted this point in paragraph 13.

The amendments made to the allocation of items to the trading book and banking book respectively by type of instrument or activity are only minor. We still see the need for **substantial** adjustments. Also our comments regarding the treatment of securities lending transactions are neither considered in the Basel standard nor in the current proposal. Therefore, we comment in more detail in Part C on the following topics:

- a) Definition of the trading book/banking book boundary by type of instrument/activity and
- b) Treatment of securities lending transactions in the market risk framework.

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<sup>3</sup> DBG Statement on BCBS 219: <https://www.bis.org/publ/bcbs219/deutscheboersegro.pdf>;  
DBG Statement on BCBS 265: <https://www.bis.org/publ/bcbs265/deutscheboersegroup.pdf>;

## C. Specific comments and open issues

### a) Definition of trading book/banking book boundary by type of instrument/activity

The market risk framework as published in January 2014 redefines the trading book/banking book boundary. In order to assign a financial instrument to the trading book or to the banking book it focuses more on the characteristics of the respective financial instrument than on the bank's intent of gaining short-term profits. The targeted rules led to allocations of financial instruments that penalised transparent instruments transacted on highly regulated and transparent markets compared to less transparent, mainly OTC traded instruments. This contradicts the general aims of the overarching regulatory principles.

In general, the main criterion for assigning instruments to the trading book or to the banking book should be the underlying intention of the trade to generate short-term profits or not. As such, we see allocating transactions depending on the underlying instrument or the type of (possible) trading venue to one of both books critical. Nevertheless, we understand that for some instruments no active market and/or related market value is present. Under these circumstances, a direct assignment of these positions to the banking book may be justifiable as a reasonable approach (paragraph 15). In these cases, the presumption of a missing trading intent seems to be meaningful. Nonetheless, the resulting capital requirements of these positions should be appropriate and reasonably sufficient conservative. The market risk of these less liquid instruments is most likely higher than those that have a regulated market and frequently updated price quotes. The capital treatment in any case should not structurally prefer and incentivise less liquid instruments compared to instruments that follow the regulatory intended path of being listed/traded on regulated markets or being centrally cleared.

In contrast, we do not support allocating certain instruments to the trading book automatically without considering the trading intent. As such, we continue to oppose paragraphs 13 and 16 of the Basel standard also as amended by the consultative paper.

The previously said is especially true for listed equities and equity investments in funds:

- **Listed equities** cannot be considered as (highly) liquid solely relying on the fact that these instruments are listed on an regulated exchange.
  - The criterion 'listed' does not give any evidence that the respective instrument is 'liquid' as well, even though it can be assumed that this is most likely the case when they are listed in an index as the related demand should be present (assuming a 'normal' trading volume).
  - In case listed equities are reasonably considered as liquid due to an regulated market, regularly updated price quotes and related demand, this circumstance does not imply a trading intent per-se as well. For example, a strategic participation in a listed company by holding more than 10% of the company's equity would lead to a direct assignment to the trading book. The allocation of strategic investments to the trading book without any intention to trade in the foreseeable future cannot be intended by the BCBS. The resulting consequences are neither reasonable nor appropriate.

Listed equities should not be treated more conservative than unlisted equities for the purpose of regulatory capital charge.

- Regarding **equity investments in funds**, we also see room for improvement of the underlying criteria to assign these exposures per default to one of both books. One of the criteria for the allocation of equity investments in funds (paragraph 15a) to the trading book is whether a look-through in a fund is possible or not<sup>4</sup>. In case the look-through is feasible, also according to the revised wording of the consultative paper, the investment shall be assigned to the trading book and therefore higher operational and capital requirements are associated compared to an equity investment into a fund where no look-through is possible. Thus, the treatment of less transparent funds is considered in principle as being more favourable which contradicts the general regulatory approach to foster trading via regulated markets and overall transparency. In contrast, we value such investments as being more risky or at least of the same level of risk and this should be reflected at least with same operational and capital requirements. From our point of view, the look-through approach seems not to be an adequate criterion to assign funds to the respective book at all.

In this context, we additionally ask the Committee to clarify what is meant by 'equity' investment in a fund and what look-through comprises of. In case of the equity investment, we understand it is targeted for investment in funds with underlying investments in (listed or un-listed) equities.<sup>5</sup> Related to the look-through approach, we wonder if only effective look-through is targeted for or whether also a mandate-based approach would be covered. If both categories are included, we wonder how a credit institution with good risk management practises could invest in such vehicle at all as the institution would not know where it invests in. If only the effective look-through would be taken into account, 'cherry picking' would be made possible.

- **Investments** of accumulated funds in investment funds or in listed equities **in order to cover future pension and similar obligations** have to be treated appropriately. In case such or similar investments are done according to the accounting standard in the books of the bank, clearly no trading intent can be assumed. Consequently, the allocation of such investments by type of the instrument to the trading book is inappropriate. We therefore once more ask the Basel Committee to reconsider its approach in a fundamental manner.

## b) Treatment of securities lending transactions in the market risk framework

Also the revised proposal in our view seems not to be appropriate with regard to positions on securities lending transactions. At least some clarifications are needed. In general, we do not see any market risk resulting from securities lending transactions as borrowed securities has to be returned regardless

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<sup>4</sup> The additional criterion of necessary daily price quotes in our view makes sense in line with our argument given in the second paragraph of Section C of this paper. However, we rather prefer to formalise it in paragraph 15 as a criterion to allocate all funds not delivering daily valuation.

<sup>5</sup> This brings the additional complexity that direct investment in unlisted equities is classified in the banking book while indirect investments via a fund with look-through possibilities contrary to that would mandatory classify for the trading book (daily price quotes assumed as well).

of market price fluctuations during the loan period. In principle, the lender is showing the lent securities on his balance sheet and is bearing market risk out of this position. However, depending on the accounting standard, a de-recognition might take place. In such cases, the market risk of the underlying securities needs to be captured in case the securities are part of the trading book.

Moreover, securities lending transactions performed in order to increase settlement efficiency should not be part of the trading book at all. Furthermore, any business conducted as an agent to arrange securities lending between two other parties, e.g. in the form a third party agent model, should neither be allocated to the trading book. This should include models where the 'agent' formally acts as principal in a matched principal broking transaction.

Thus, we again kindly ask the Committee to clarify the position on securities lending transactions.

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We are at your disposal to discuss the issues raised and proposals made if deemed useful.

Faithfully,

Jürgen Hillen

Ralph Kowitz