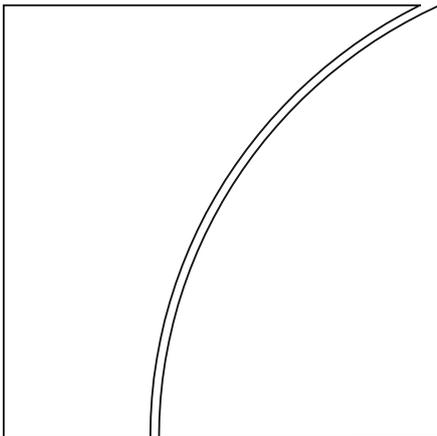


# Basel Committee on Banking Supervision



## Frequently asked questions on Basel III monitoring

5 March 2015



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# Frequently asked questions on Basel III monitoring

## 1. Introduction

This document provides answers to technical and interpretive questions raised by supervisors and banks during the Committee's Basel III monitoring. **The document intends to facilitate the completion of the monitoring questionnaire and is not to be construed as an official interpretation of other documents published by the Committee.**

Paragraph numbers given in the remainder of this document usually refer to *Basel III: A global regulatory framework for more resilient banks and banking systems* ("the Basel III standards"), the *Basel III leverage ratio framework and disclosure requirements* ("the Basel III leverage ratio framework"), *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* ("the Basel III LCR standards") and *Basel III: The Net Stable Funding Ratio* ("the Basel III NSFR standards").<sup>1</sup>

In addition to the guidance for completing the monitoring template contained in this document, the Committee has published frequently asked questions as its official response to questions of interpretation relating to certain aspects of the Basel III standards. **Therefore, banks should also take into account the frequently asked questions on capital, counterparty credit risk and the leverage ratio published by the Committee.**<sup>2</sup>

Questions which have been added since the previous version of the FAQs are shaded yellow; questions which have been revised (other than updated cell references) are shaded red.

## 2. General

1. Cell F21 in the "Requirements" worksheet asks for the amount of sovereign exposures in the trading book. Should this be the gross, long-only, or net market value positions?

**Answer:** Banks should report the gross positions to sovereign exposures in the trading book. For example, a bank with a \$100 long position for sovereign A and a \$20 short position for sovereign B should report \$120 as its sovereign exposures.

(added 17 February 2015)

2. Banks should report securitisation RWA under the revised hierarchy of approaches in rows 16 to 19 of the "Floors" worksheet. Should the changes from the proposed *Revisions to the standardised approach for credit risk* be reflected in the RWA figures when calculating the revised approaches for securitisations, as set out in the December 2014 *Revisions to the*

<sup>1</sup> Basel Committee on Banking Supervision, *Basel III: A global regulatory framework for more resilient banks and banking systems (revised June 2011)*, June 2011, [www.bis.org/publ/bcbs189.htm](http://www.bis.org/publ/bcbs189.htm); Basel Committee on Banking Supervision, *Basel III leverage ratio framework and disclosure requirements*, January 2014, [www.bis.org/publ/bcbs270.htm](http://www.bis.org/publ/bcbs270.htm); Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools*, January 2013, [www.bis.org/publ/bcbs238.htm](http://www.bis.org/publ/bcbs238.htm); Basel Committee on Banking Supervision, *Basel III: The Net Stable Funding Ratio*, October 2014, [www.bis.org/bcbs/publ/d295.htm](http://www.bis.org/bcbs/publ/d295.htm).

<sup>2</sup> Basel Committee on Banking Supervision, *Basel III definition of capital – Frequently asked questions*, December 2011, [www.bis.org/publ/bcbs211.htm](http://www.bis.org/publ/bcbs211.htm); Basel Committee on Banking Supervision, *Basel III counterparty credit risk – Frequently asked questions*, December 2012, [www.bis.org/publ/bcbs237.htm](http://www.bis.org/publ/bcbs237.htm); Basel Committee on Banking Supervision, *Frequently asked questions on the Basel III leverage ratio framework*, [www.bis.org/publ/bcbs293.htm](http://www.bis.org/publ/bcbs293.htm).

*securitisation framework (eg the SEC-SA)?* This is also relevant for row 17 when applying caps for securitisation positions.

**Answer:** In principle, it would have been desirable to use the proposed revised standardised approach for credit risk when calculating the SEC-SA in the revised securitisation framework. However, given the likely data limitations at this stage, banks should apply the existing standardised approach for credit risk when calculating the capital charge under the SEC-SA of the revised securitisation framework.

(added 5 March 2015)

### 3. Definition of capital

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### 4. Leverage ratio

1. Items deducted from the capital measure that must symmetrically be deducted from the Basel III leverage ratio exposure measure are only those that are on the asset side of the balance sheet. There should not be any liability item deducted from the Basel III leverage ratio exposure measure.

**Answer:** Yes.

2. How should the Basel III leverage ratio exposure be measured? Shall the accounting treatment be used?

**Answer:** The Basel III leverage ratio exposure measure for the leverage ratio should generally follow the accounting value, coupled with the following adjustments for non-derivative exposures and non-securities financing transactions (non-SFTs): (i) net of specific provisions and valuation adjustments; (ii) do not reduce on-balance sheet exposures for physical or financial collateral, guarantees or credit risk mitigation purchased; and (iii) no netting of loans and deposits. Moreover, for derivative exposures the effect of netting according to the Basel II framework should be considered, while for SFTs netting of cash receivables with cash payables may only be recognised subject to the strict criteria set out in paragraph 33(i) of the Basel III leverage ratio framework. Please also refer to the Basel III leverage ratio framework for more details on how to calculate the exposure measure.

3. It is not obvious whether the Basel III leverage ratio will be affected by insurance activities.

**Answer:** See paragraphs 8, 9 and 16 of the Basel III leverage ratio framework.

4. Can the Committee confirm that cross-product netting is not permitted under the Basel III leverage ratio exposure measure, and that the 40/60 rule embodied within paragraph 96 (iv) of Annex 4 of the Basel II framework applies to the allowable netting of the CEM add-on?

**Answer:** Yes.

5. Given that the restriction on counterparty credit risk due to hedging of financial institution investments has been removed in the definition of capital, does this also apply in the context of the Basel III leverage ratio even though in general it does not recognise credit risk mitigation?

**Answer:** In the context of the Basel III leverage ratio, the capital measure follows the criteria laid down in the Basel III standards for the definition of capital. This applies also to the hedging of investments in the capital of banking, financial and insurance entities.

In order to ensure that the capital and exposure measures are measured consistently, investments in the capital of banking, financial and insurance entities are excluded from the Basel III leverage ratio exposure measure for the same amount deducted from capital.

In any case, it must be noted that physical or financial collateral, guarantees or credit risk mitigation purchased are not allowed to reduce the on-balance sheet exposures. This implies that no effects other than those described above should occur from the hedging of exposures that are included in the Basel III leverage ratio.

6. What is meant by credit risk mitigation? Any collateral pledged to us should be available, however, any hedges with counterparty risk will be hard to identify.

**Answer:** This requirement asks for delivery of gross positions for on-balance sheet exposures, ie guarantees, financial collateral or other risk mitigants are not allowed to reduce the on-balance sheet exposures. However, cash variation margin *received* associated with derivative transactions and fulfilling the criteria in paragraph 25 of the Basel III leverage ratio framework may be viewed as a form of pre-settlement and hence not considered as a credit risk mitigant for the purpose of the Basel III leverage ratio.

7. Should the "Off-balance sheet exposures: notional x regulatory CCF" area in panel C of the "Leverage Ratio" worksheet include the EAD amount resulting from the derivative transactions?

**Answer:** No, derivative transactions should only be included in columns D and J.

8. In cell D77 of the "Leverage Ratio" worksheet, should we only provide the amount resulting from the netting agreements or should we also include cash collaterals?

**Answer:** Cell D77 should only include (i) the amount resulting from the netting, with the effects of collateral to be included in cell D79; and (ii) the gross value of derivatives that are treated off-balance sheet and therefore included in column E (and K) of panel A where applicable; following the relevant accounting frameworks.

9. We assume row 12 also includes all other derivatives (ie all except credit derivatives). Is this correct?

**Answer:** Yes.

10. We seek confirmation that the standards do not allow the netting of loans and deposits?

**Answer:** This is correct.

11. Can banks subject to a national GAAP exclude fiduciary assets from the total exposures measure of the Basel III leverage ratio under any circumstance, and if so under what circumstances?

**Answer:** Yes. According to paragraph 15 and footnote 4 of the Basel III leverage ratio framework, where a national GAAP recognises on-balance sheet fiduciary assets, these assets can be excluded from the Basel III leverage ratio total exposures measure provided the assets meet the criteria in IAS 39 for de-recognition and, where applicable, IFRS 10 for de-consolidation. When disclosing the Basel III leverage ratio, banks should additionally disclose the extent of such de-recognised fiduciary items.

An example is the accounting for promotional programs for housing modernisation and energy conservation under German GAAP, where a state-owned bank provides loans via the bank in question acting as fiduciary (where the funding is completely provided by the state-owned bank, the administered funds cause neither credit risk nor liquidity risk for the bank in question, and the liability of the bank in question is limited to duly performing its obligations as a provider of funds management services). These loans are recognised on the balance sheet under German GAAP whereas they are not under IFRS.

12. Should the shortfall of the stock of provisions to expected losses (note paragraph 73 of Basel III) be deducted from the exposure measure of the Basel III leverage ratio?

**Answer:** See paragraph 16 of the Basel III leverage ratio framework.

13. A bank is applying national GAAP for their financial reporting, where certain derivative instruments are not recognised on the balance sheet. How should these derivatives be treated when calculating the exposure measure for the Basel III leverage ratio?

**Answer:** See paragraph 19 and footnote 6 of the Basel III leverage ratio framework.

## 5. Liquidity

### 5.1 General

1. It is cumbersome and time consuming to obtain data for rows 103 to 107 and 132 to 136 of the "LCR" worksheet ("additional deposit categories with higher run-off rates as specified by supervisor"). Since the weight is set to 0%, what is the significance of collecting these data? How should these amounts be reported on the "NSFR" worksheet?

**Answer:** The parameters (ie the run-off rates applied for the purpose of calculating the LCR) for additional retail and small business deposit categories with higher run-off rates are specified by national supervisors, who are required to provide the specifications for these items. If a national supervisor has not yet decided what parameters to apply to these deposit categories, a 0% factor is automatically used for the calculation of the LCR.

Amounts reported in lines 103 to 107 and 132 to 136 of the "LCR" worksheet should be reflected in the amount reported in cell C11 on the "NSFR" worksheet.

2. Section 2.2 of the instructions states: "Where information is not available, the corresponding cell should be left empty. No text such as "na" should be entered in these cells. However, leaving a cell empty could trigger exclusion from some or all of the analyses if the respective item is required."

We would like to know which information is considered absolutely necessary to be reported so as not to be excluded from the most relevant analysis. At the moment, and given the short time to fill in the templates, we find it difficult to provide some of the breakdowns (eg operational deposits, distinction between non-transactional accounts with and without established relations and credit lines/ liquidity lines).

**Answer:** All relevant breakdowns on the templates should be filled in on a "best- efforts" basis. Leaving a relevant row blank may distort the end result and may trigger exclusion from the analyses. Furthermore the LCR calculation may not produce a result in cell H443 (the LCR percentage) if any required cells are left blank. If cells are not applicable, then they are known to be zero and thus a zero value should be entered in such cells.

## 5.2 LCR

3. What is meant by “if the collateral received is re-used and tied up for 30 days or longer to cover short positions” in the treatment of reverse repos maturing within 30 days?

**Answer:** The LCR framework assumes that a reverse repo can only roll off if the collateral received on the reverse repo is available or will become available within 30 days to be returned to the counterparty on the reverse repo.

The bank may choose from the following options concerning the collateral received on reverse repos maturing within 30 days:

- (a) The bank could retain the collateral which would thereby be available for return when the reverse repo matures. In this case, the collateral may be included in the stock of high-quality liquid assets (if it satisfies the qualifying criteria) and repo transactions may roll-off in which case an inflow may be taken into account. The reverse repos should then be reported in lines 276 to 289.
- (b) The bank could sell the collateral to another party, in which case the bank would take a short position (it has sold assets it does not own outright). The collateral then cannot be included in the stock of high-quality liquid assets. In this case, per paragraph 147 of the Basel III LCR standards, there is no need to report an outflow for the bank’s short position, but the reverse repo cannot roll-off either, so there will not be an inflow of the cash extended in the reverse repo (ie it is assumed that the reverse repo will be rolled over to cover the bank’s short position). The reverse repos should then be reported in lines 291 to 296.
- (c) The bank could rehypothecate the collateral in a repo transaction. The collateral cannot then be included in the stock of high-quality liquid assets.
  - If the repo transaction matures within 30 days, resulting in an outflow, the collateral may return within 30 days and the reverse repo could unroll resulting in an inflow (unless the collateral consists of Level 1 assets, in which case the reverse repo is assumed to roll-over in full). The reverse repos should then be reported in lines 276 to 289.
  - If the repo transaction matures beyond the 30-day horizon, the collateral will not return within 30 days and the reverse repo is assumed to continue to roll-over in full and not generate any inflows. The reverse repos should then be reported in lines 291 to 296.

### 5.2.1 Stock of highly liquid assets

4. Section 6.1.1 of the instructions states “All assets ... should be under the control of the function charged with managing the liquidity of the bank”. Can unencumbered high-quality trading assets qualify for the stock of liquid assets if internal procedures exist such that these trading assets would be put under the control of the liquidity risk management function in times of stress?

**Answer:** Assets qualifying for the stock of liquid assets should meet all of the operational requirements noted in paragraphs 31 to 40 of the Basel III LCR standards at all times (not just in times of stress) including:

- (a) The stock should be under the control of the function charged with managing the liquidity of the bank (eg the treasurer), meaning the function has the continuous authority, and legal and operational capability, to monetise any asset in the stock (paragraph 33 of the Basel III LCR standards);

(b) Control must be evidenced either by maintaining assets in a separate pool managed by the function with the sole intent for use as a source of contingent funds, or by demonstrating that the function can monetise the asset at any point in the 30 day stressed period and that the proceeds of doing so are available to the function throughout the 30 day stressed period without directly conflicting with a stated business or risk management strategy (paragraph 33 of the Basel III LCR standards).

5. Can assets that otherwise qualify for the stock of high-quality liquid assets but that are used to hedge structural interest rate risk be included as eligible high-quality liquid assets in the buffer?

**Answer:** Yes, so long as the assets meet the other operational requirements (eg within the control of the treasury function, etc).

6. Can rated loans be included in the stock of liquid assets?

**Answer:** No, only securities can be included.

7. How should assets be distinguished among lines 57 and 60?

**Answer:** First report any assets qualifying for line 57 in that line. Then, report any assets not yet reported in line 57 that qualify for line 60. The important consideration is that assets should not be double-counted in this section.

8. How should unencumbered assets that are held in a pool at a major electronic collateral management system be treated?

**Answer:** Assets available to fund gaps between inflows and outflow from day 1 and that meet all the other operational requirements are eligible for the stock of high-quality liquid assets. To decide which assets in the pool should be considered encumbered and unencumbered, please refer to the "definition of unencumbered" provided in Section 6.1.1 of the instructions.

9. Do assets pledged with the central bank (eg for RTGS purposes) qualify as high-quality liquid assets?

**Answer:** The unused portion of the collateral that has been pre-positioned or deposited with, or pledged to, a central bank or a public sector entity (PSE) but that has not been used to generate liquidity can be counted as part of the stock of liquid assets in accordance with paragraph 31 of the Basel III LCR standards.

10. Assume a bank uses the GC pooling market as offered by Eurex in Germany and receives collateral consisting of a basket of fixed income securities where, for example, roughly 40% of these securities are highly rated government securities that would, on their own, qualify for the stock of liquid assets. The remaining part (60%) consists of securities (mainly covered bonds) issued by financials. The bank will receive this collateral as "full transfer of title" so these securities will initially be part of their liquid asset pool. How should this be treated in the LCR stock of high-quality liquid assets?

**Answer:** If the highly rated government securities cannot separately be sold or used in a repo transaction, the weight that should be applied in the LCR should correspond to the asset that receives the lowest weight within the framework. For example, if the basket of securities includes only government securities that would be Level 1 eligible and covered bonds that would be Level 2A eligible, the entire basket of securities would be considered as Level 2A assets. If any part of the basket of securities relates to assets that are ineligible for the stock of high-quality liquid assets, the entire basket should receive a 0% weight and thus be excluded from the stock.

11. Where the cap on Level 2 assets or the cap on Level 2B assets is binding for a bank (meaning that certain otherwise eligible assets are excluded from the stock of high-quality liquid assets),

can the inflows on these excluded assets count in the denominator of the LCR as inflows (falling within the next 30 calendar days)?

**Answer:** No, Level 2A or Level 2B assets that are excluded from the stock of high-quality liquid assets because of the caps should remain reported in panel Ab (if Level 2A) or panel Ac (if Level 2B) and not be reported as inflows. However, assets that are excluded from the stock of high-quality liquid assets because they do not meet the operational requirements and are not reported in panel Ab (if Level 2A) or panel Ac (if Level 2B) can be included as inflows.

## 5.2.2 Cash outflows

12. Do “transactional accounts” in row 85 include “current accounts” from retail customers?

**Answer:** Yes, if the retail customers use these current accounts for regular transactions and they have, for instance, their salaries automatically deposited to these accounts.

13. Regarding a relationship account “where the customer has another relationship with the bank”, does this include a situation where the customer has more than one product apart from a “non-transactional account” (eg more than just one savings account)?

**Answer:** Yes, the term “relationship” in this context refers to the customer having other products (ie loans, other deposit accounts) that makes it less likely that the customer will withdraw the deposits were the LCR stress scenario to unfold.

14. Row 60: The stock of high-quality liquid assets should not be designated to cover operational costs (such as rents and salaries): Does this effectively mean that 30-day expected operational costs are treated as an outflow?

**Answer:** No, the expected operational expenses are not included in outflows and the means held to pay them are not reflected in the stock of high-quality liquid assets.

15. Regarding “notes, bonds and other debt securities issued by the bank are included in this category regardless of the holder, unless the bond is sold exclusively in the retail market and held in retail accounts (including small business customers treated as retail),” can such bonds be treated as retail or small business customer deposits if they have been sold to a primary bank and from the primary bank then sold to retail customers or small business customers?

**Answer:** No, if such bonds are sold to a primary bank, they cannot exclusively be sold to retail and small business customers and would therefore not qualify for treatment as retail or small business customer deposits.

16. Given the short time frame provided to fill in the templates, the basic difficulty will be combining different databases (eg commercial and financial information) to determine the portion of the deposits that qualify for operational purposes.

**Answer:** Banks are requested to distinguish between operational and other deposits on a best-efforts basis.

17. In rows 202 and 209, are the counterparties BIS, IMF, ECB and European Community treated the same as domestic sovereigns, multilateral development banks or domestic PSEs with a 20% risk-weight, or do they fall into the category “other counterparties”?

**Answer:** Only transactions with specific domestic counterparties should be included in lines 202 and 209. The institutions listed in the question are not domestic but international counterparties.

18. Regarding unsecured wholesale funding run-offs, does “where the market expects certain liabilities to be redeemed before their legal final maturity date” (paragraph 86 of the Basel III LCR standards) mean that where the counterpart expects a liability to be redeemed with

applying established methods of financial mathematics, then this liability should be modelled with early termination in the LCR?

**Answer:** Yes, banks and supervisors should assume such behaviour for the purpose of the LCR and include these liabilities as outflows. Also, for funding with options exercisable at the bank's discretion, supervisors should take into account reputational factors that may limit a bank's ability to not exercise the option. This could reflect a case where a bank may imply that it is under liquidity stress if it did not exercise an option on its own funding.

19. Regarding Section 6.1.2 of the instructions on credit and liquidity lines: the definition of "general working capital facilities" suggests that facilities without an explicit function that can be used for various products (money market for short-term business, loans for longer-time business) should be defined as credit facilities. Is that correct?

**Answer:** General working capital facilities for corporate entities (eg revolving credit facilities in place for general corporate and/or working capital purposes) will not be classified as liquidity facilities but as credit facilities.

20. Suppose a transactional retail deposit holds €90k. €40k is fully insured by an effective deposit insurance scheme, €20k is partly insured (eg for 95%) and €30k is not insured. Which amount may be treated as 'stable'?

**Answer:** Only the amount that is fully insured can be treated as stable. So in the example, €40k may be treated as stable deposits. The other €50k are only partly insured or not insured and should therefore be reported as less stable.

21. Suppose a non-operational deposit provided by a non-financial corporate holds €125k. The deposit insurance scheme in the jurisdiction where the deposit is placed meets the requirements for an effective deposit insurance scheme, providing full insurance on deposit amounts up to and including €100k. How should this deposit be treated?

**Answer:** The non-operational deposit does not meet the eligibility requirements for the 20% run-off factor as the entire amount of the deposit (ie €125k) is not fully covered by the effective deposit insurance scheme (given the deposit insurance limit is €100k). This deposit should not be reported in line 157, rather it should be reported in line 158 (and assigned a 40% run-off factor).

22. How should balances in savings accounts which can be withdrawn at any time be treated? Should we assume such accounts mature within 30 days?

**Answer:** These should be treated similarly to demand deposits if the bank allows depositors to withdraw such balances without applying a significant penalty that is materially greater than the loss of interest.

23. In paragraph 114 of the Basel III LCR standards, it is assumed for secured funding transactions that involve Level 1 assets that no reduction in funding availability against these assets is assumed to occur due to their high-quality nature. For Level 2A assets, for example, a 15% reduction in funding availability will be assigned to maturing secured funding transactions backed by these assets and conducted with counterparties other than the bank's domestic central bank. Under this assumption, if a bank engaged in a \$100 repo transaction backed by a Level 2A asset with a counterparty other than the bank's domestic central bank, only \$85 would be assumed to roll over. Is the \$15 that is assumed not to roll over eligible for the stock of high-quality liquid assets, subject to the appropriate haircut?

**Answer:** No. The \$15 represents a loss of funding and is taken into account as a cash outflow (the denominator of the ratio) as a result of the 15% weighting in line 195, rather than be incorporated in the stock of liquid assets.

24. The Basel III monitoring instructions state that “the amount of a commitment to be treated as a liquidity facility is the amount of the currently outstanding debt issued by the customer (or proportionate share, if a syndicated facility) maturing within a 30 day period that is backstopped by the facility. The portion of a liquidity facility that is backing debt that does not mature within the 30-day window is excluded from the scope of the definition of a facility. Any additional capacity of the facility (ie the remaining commitment) would be treated as a committed credit facility and should be reported as such.” Please clarify how the supporting lines are included in the LCR calculation.

**Answer:** When short-term debt, such as commercial paper, has a liquidity line as support, only the portions of the line that are supporting issued and outstanding debt that matures within 30 days and that which, in addition, could be used within the 30-day timeframe (ie the available, unused capacity) are to be included in the LCR calculation.

For example, assume \$75 of debt is currently outstanding, of which \$50 is due within 30 days and the remaining \$25 balance is due beyond 30 days. This paper is backed by a \$120 liquidity facility. The amount of the facility to be included in the LCR calculation as a liquidity facility is \$50. The \$45 in available, unused capacity (calculated as the total line of \$120 less the \$75 in outstanding debt) would be prescribed the credit facility draw rate associated with the counterparty type to which the facility is provided. The \$25 of debt due outside the 30-day window would not be included in the LCR calculation (since that \$25 is funded by debt that could not come due within the 30 days hence no resulting bank outflow could occur within the LCR horizon).

### 5.2.3 Cash inflows

25. According to the instructions to rows 302 to 305, interest payments should be reported as part of contractual inflows. However, interest payments are an element that is currently not observed in this kind of reporting, and retrieving data on this will be challenging given the timeframe and current IT set-up.

**Answer:** We recognise that there are many complications facing institutions in this early monitoring stage, particularly related to IT changes to collect and populate the Basel III monitoring template. For purposes of the exercise, institutions are requested to provide data on a best-efforts basis.

26. What is the purpose for row 324 regarding the cap on cash inflows compared to cash outflows?

**Answer:** Row 324 calculates the maximum amount of cash inflows – ie 75% of cash outflows – to be taken into account in the quantification of net cash outflows, in line with paragraph 144 of the Basel III LCR standards. A cap on total inflows is introduced to prevent banks from relying solely on anticipated inflows to meet their outflows and also to ensure that a minimum amount of liquid assets is held by the bank (ie a minimum of 25% of cash outflows). Row 323 of the worksheet includes the amount of cash inflows before application of the cap, whereas row 325 of the worksheet includes the amount of cash inflows after application of the cap. In cases where the cap on inflows is binding, row 325 will be less than row 323 (and will equal row 324), whereas in cases where the cap on inflows is not binding, row 325 will be equal to row 323.

27. According to paragraphs 171 and 172 of the Basel III LCR standards, when consolidating the LCR, the excess of buffer on an entity can be counted on consolidated LCR only when assets are transferable. Does the liquidity transfer depend on the type of asset (cash, sovereign bonds, corporate bonds, ...) or does it depend only on characteristics related to the reporting entities (incorporation country, ...) and in that case the whole excess is treated in the same way (and no different restrictions are applied according to the product type)?

**Answer:** When considering whether excess liquidity on a legal entity basis can be included in a firm's consolidated LCR, the firm should consider the provisions outlined in paragraphs 36 to 37 and 171 to 172 of the Basel III LCR standards. In particular it should demonstrate that:

- these excess liquidity buffers are freely available in times of stress for the consolidated firm to use;
- the firm has all liquidity transfer restriction to the extent applicable, captured and accounted for in their assessment of available excess liquidity;
- the convertibility of currency, from the local jurisdiction in which the excess liquidity buffer resides, exists to meet the liquidity needs at the consolidated level and that this convertibility is available during a time of crisis;
- an asset, not in the form of cash, can be converted and transferred to the consolidated firm during a time of crisis.

### 5.3 NSFR

28. Where the template provides encumbrance terms greater than one year for assets with maturities less than one year, such as in row 150, is it simultaneously possible to have securities with maturities less than one year that are encumbered for greater than one year?

**Answer:** It is technically possible to encumber assets for longer than their maturity. For example, a bank may transact a one-year repo against a basket of securities and pledge a security that matures in six months. The bank would therefore be required to replace matured covered assets. The same effect could occur in securitisations of revolving assets, such as credit card receivables. If a bank does not undertake this type of activity then it has nothing to report.

29. Regarding secured borrowing in lines 43 through 47, are repos, collateral lending and covered bonds included in this field?

**Answer:** Yes, the definition of secured borrowing is the same as that used in the LCR: it defines secured funding as "those liabilities and general obligations that are collateralised by legal rights to specifically designated assets owned by the borrowing institution in the case of bankruptcy, insolvency, liquidation or resolution".

30. Regarding Section 6.2 and in particular Section 6.2.2, of the instructions, please provide additional guidance on how we should treat encumbrances that result from reasons other than pledging or secured funding transactions (ie tied positions).

**Answer:** Encumbrance should be treated in the same manner regardless of the reason.

31. Where should data for insurance companies, investment companies, etc be reported?

**Answer:** Data for these entities should be reported in rows 32 and 47 as they are funding from "other legal entities".

32. In what row should the market value of financial instruments be reported? Are the reported figures supposed to be net figures?

**Answer:** Assuming that “financial instruments” means derivatives, they should be reported as outlined in Section 6.2.2 of the instructions.

33. Concerning reverse repos, the instructions say they should be treated as secured cash loans.

- In which line(s) should they be reported? As loans depending on the counterparty? If so, this treatment does not seem to agree with paragraph 32 of the Basel III NSFR standards (if the bank will receive cash, then the RSF of the transaction would be 0%).

**Answer:** Reverse repos should be reported as cash loans according to counterparty. Paragraph 32 is only applicable to assets on balance sheet. Most accounting standards do not result in such assets being recorded on a bank’s balance sheet.

- What distinction is made for the different underlying assets (Level 1, Level 2A, Level 2B, others)?

**Answer:** Secured loans to financial institutions where such loans are secured against Level 1 assets (and where the bank has the ability to freely rehypothecate the received collateral for the life of the loan) are reported separately from such loans secured by other collateral. See reporting instructions for additional detail.

- What maturity should be considered for RSF, the maturity corresponding to the reverse repo or that of the underlying security?

**Answer:** The maturity of the reverse repo (secured loan).

- If the asset received in the reverse repo has been sold or re-hypothecated (thereby creating a short position), how should it be reported?

**Answer:** The loan should be reported in the applicable RSF category according to its maturity, and then it should also be reported as encumbered for the period of encumbrance in the relevant sub-lines of that category. For more information refer to Section 6.2.2 of the Basel III monitoring instructions.

34. How are assets excluded from Level 1 and Level 2 in the LCR because they do not meet the operational requirements (line 60 of the “LCR” worksheet) treated in the NSFR?

**Answer:** The operational requirements which apply to the LCR are not relevant in the NSFR.

35. The current definition of line 251 (all other assets not included in the above categories) could potentially generate misleading results. A more granular approach would be beneficial for a better understanding and a more accurate reporting of balances.

**Answer:** Firms can provide to their national supervisors explanatory notes detailing significant exposures in this category upon request.

36. Rows 163 to 168 refer to “residential mortgages of any maturity that would qualify for the 35% or lower risk weight under the Basel II standardised approach for credit risk”. Among the “encumbered” classification, it would be useful for analysis purposes to insert a specific sub-category (“of which”) with the self-securitisations.

**Answer:** As this type of encumbrance is not treated differently from other types, no distinction is made in the template. Assets encumbered in self-issued or synthetic (own-name) securitisations should only be reported as encumbered if the securities have been encumbered outside of the reporting entity. For example, if the securities being held by the institution have not been pledged and are still available to raise funding, then the underlying assets can be reported as unencumbered.

37. Concerning derivatives liabilities/assets in lines 49 and 213, is there a reporting distinction for differences in maturity?

**Answer:** No distinction is made for maturity.

38. Should the time buckets fit the generally binding accounting standards and include the upper bound ( $\leq 6$  months,  $> 6$  months and  $\leq 12$  months etc)?

**Answer:** The standard is measured at one year or greater, and the semi-annual buckets were calibrated accordingly.

39. What is the applicable RSF for a plain vanilla reverse repo on a Level 1 asset? Is it 100% as we have to look at the long-term claim which is on the balance sheet or 5% for the collateral held unencumbered? In the first case, is there any liquidity value considered in the NSFR for the Level 1 asset?

**Answer:** For the purpose of the Basel III monitoring exercise, a reverse repo of any asset for longer than one year is 100%. Therefore, no liquidity value is assigned to the borrowed asset.

40. Some mortgages and loans are only partially secured and are therefore separated into secured and unsecured portions with different risk weights under Basel II. How should these portions be treated in the NSFR template?

**Answer:** Only the portion of the loan with the appropriate risk weight should be reported. The separate portion at a different risk weight should be reported in the row to which it relates. For purposes of Basel III monitoring reporting, institutions can assume that the secured portion of the loan applies to the longest dated ( $>$  one year) part of the loan, so long as it remains encumbered for that entire period.

41. Where are "short" selling transactions reported in the NSFR template?

**Answer:** Where collateral borrowed through a reverse repo has been sold or rehypothecated in a repo or similar transaction in which the firm intends to repurchase the collateral, the resulting cash inflows and outflows are assumed to offset and therefore should not be reported. In such cases the initial reverse repo loan should be reported as encumbered in the applicable RSF category according to the counterparty of the initial reverse repo loan and the term of encumbrance of the initial reverse repo loan.

42. Net known derivatives (payable or receivables) should be reported in the LCR as well as the NSFR. It is clear that any known (ie non-contingent) cash flow that will take place within 30 days on derivative positions should be included on a net basis (different lines if payable or receivable). However, should FX spot transactions (spot outright (an exchange between two currencies) and not forward contracts) be taken into account? If they should be included in "net known derivatives", are they treated the same if they have same day settlement or if settled with two-day lag (T+2)?

**Answer:** Known cash flows related to FX spot transactions should be included in the net known derivatives payable/receivable lines of the LCR template, regardless of the settlement date (providing it is within the 30-day period).

43. How should the portion of amortising loans that comes due within one year be reported on the NSFR template?

**Answer:** Per paragraph 26 of the Basel III NSFR standards, "for amortising loans, the portion that comes due within the one-year horizon can be treated in the 'less than a year' residual maturity category". Where possible, banks should allocate the amortising portion across the maturity time buckets on the NSFR worksheet.

## 6. Trading book

### 6.1 General issues

1. For the purpose of the QIS, are foreign exchange (FX) and commodity risks in the banking book to be included in the market risk capital charges for the trading book?

**Answer:** Yes. All FX and commodity risks should be included.

(added 17 February 2015)

2. Are all market risk hedges for counterparty credit risk, including for Credit Valuation Adjustments (CVA), excluded for the purpose of the trading book QIS?

**Answer:** Banks should apply the current Basel Committee standards.

(added 5 March 2015)

3. How should the distinction between investment grade and high yield credits be made across the standardised and internal models approaches? For example, in the computation of credit spread risk for the revised standardised approach (Annex 4, page 192) and in the determination of liquidity horizons for the internal models approach (page 213), do banks have the discretion to make this distinction based on internal rating, agency rating or market implied rating (ie via credit spreads)?

**Answer:** For the purpose of the QIS, banks have the discretion to distinguish between investment grade and high yield credits based on internal rating, agency rating or market implied rating (ie via credit spreads).

(added 5 March 2015)

4. The glossary in Annex 4 (page 244) makes reference to the "SMM". Is this meant to be the revised standardised approach?

**Answer:** Yes.

(added 5 March 2015)

5. Does paragraph 14 (Annex 4, page 173) take priority over paragraph 22 (page 175)?

**Answer:** No. Paragraph 14 is not intended to take priority over paragraph 22. Paragraph 22 is a requirement, not a presumption. An exemption to this paragraph is only possible in cases where there is a specific reference in the revised standards which would allow for it.

(added 5 March 2015)

6. Does paragraph 14 (Annex 4, page 173) take priority over paragraph 15?

**Answer:** No. Paragraph 14 is not intended to take priority over paragraph 15. The instruments described in paragraph 15 do not meet the requirements of paragraph 14 in order to be presumed to be in the trading book.

(added 5 March 2015)

7. In paragraph 22 (Annex 4, page 175), is there a common definition for "retail and SME credit" that banks should use?

**Answer:** Yes. For the definition of "retail and SME credit", please refer to paragraph 231 of the Basel II framework.

(added 5 March 2015)

8. With regard to the exclusion of certain currency risk positions in paragraph 6 (Annex 4, pages 171 and 172), the maximum exclusion is limited to investments in “affiliated but not consolidated entities” and “consolidated subsidiaries” denominated in foreign currencies. Can a bank include investments in branches denominated in foreign currencies in the maximum exclusion?

**Answer:** No. Branches are not capitalised separately so they should not be included in the calculation of the maximum exclusion.

(added 5 March 2015)

## 6.2 The revised internal models approach

1. Section 7.1 (page 115) states: “The “TB IMA” worksheet should be filled in by participating banks in the trading book exercise with approval to use the internal model approach (IMA). Data provided in this worksheet should only be based on the share of a participating bank’s non-securitisation trading book that has received IMA approval.” According to the proposed market risk framework, IMA approval will be granted on a desk-by-desk basis, while in the current market risk framework, IMA approval can be granted for specific risk factor categories. Consider a bank which has a trading desk exposed to specific interest rate risk and FX risk. This bank does not have IMA approval for calculating capital charges for specific interest rate risk, but has IMA approval for FX risk. Should the bank include or exclude this trading desk for the purpose of filling in the “TB IMA” worksheet?

**Answer:** For panel A of the “TB IMA” worksheet, the bank should include this trading desk. Where according to the bank’s approval status some risks of a trading desk are capitalised under the current standardised measurement method, column G may be completed using the bank’s internal sVaR measure rather than the regulatory sVaR measure. Separately, panel B of the “TB IMA” worksheet should be completed based on the risk factors for which the bank *currently* has IMA approval (ie the proposal of IMA approval on a desk-by-desk basis need not be considered).

(added 17 February 2015)

2. In Annex 4, paragraph 171(k) (page 213), the liquidity horizons for different risk factor categories are set out. For FX rates, a distinction is made between “liquid currency pairs” and “other currency pairs”. Two of the currency pairs that are deemed to be “liquid currency pairs” are USD/EUR and USD/SEK (footnote 22). Does this imply that EUR/SEK could be treated as a liquid currency pair?

**Answer:** No. EUR/SEK should be treated under the “FX rate - other currency pairs” category.

(added 17 February 2015)

3. In Annex 4, paragraph 171(k) (page 213), is it confirmed that for the interest rate risk factor category, EUR, USD, GBP, AUD, JPY, SEK, CAD and the domestic currency of the participating bank should be subject to a 10 day liquidity horizon?

**Answer:** Yes.

(added 17 February 2015)

4. In Annex 4, paragraph 171(k) (page 212), the third bullet states: “...on a desk-by-desk basis  $n$  can be increased relative to the values in the table below (ie the liquidity horizon specified below can be treated as a floor).” For correlated risk factors within a trading desk, is it mandatory to take the longer liquidity horizon as the floor?

**Answer:** No. Please carefully review the phrasing of the third bullet under paragraph 171(k).

(added 17 February 2015)

5. In Annex 4, paragraph 173(c) (page 215), it is stated that “...To be considered modellable, a risk factor should have at least 24 observations per year (measured over the period used to calibrate the current expected shortfall model) with a maximum period of one month between two consecutive observations”. Are risk factors derived from modellable risk factors considered to be modellable? For example,

Risk factors derived from pricing inputs:

- Constant maturity yields at specific tenor points “derived” (via curve fitting/ bootstrapping exercise) from a set of bond prices;
- Implied volatility at specific tenor/maturity/moneyness on a volatility surface that is calibrated from a set of option prices;
- Volatility skew risk factor from a calibrated volatility surface;
- Calibrated correlation for a basket implied from prices of the basket and basket constituents; or
- Option adjusted spreads implied from prices of mortgages and interest rate curves.

Risk factors derived as part of the ES modelling process:

- A statistical factor model for the common movements of a number of yields or spreads derived from a principle component analysis on a set of bond yields or credit spreads that are derived from “real” prices of actual transactions;
- Benchmark factors and residual;
- Factor hierarchy in commodity prices capturing locations and grades;
- Market model (index) of equity prices.

**Answer:** For the purpose of the QIS, banks may treat risk factors derived from other modellable risk factors (such as those in the examples in the question) as modellable. Any “real” price that is observed for a transaction should be counted as an observation for *all* of the risk factors concerned (ie to all risk factors which are used to model the risk of the instrument that is bought, sold or generated through the transaction as part of the overall portfolio). For example, if a bank buys an option that is mapped to eight combinations of tenor, maturity, and moneyness, this transaction will be counted as an observation for each of the eight implied volatilities and for each for the risk factors used for modelling the risk of the underlying of the option.

(added 17 February 2015)

6. In panel A of the “TB IMA” worksheet, please confirm how the 100 most material trading desks should be defined.

**Answer:** Column F of panel A should only be filled in with the stylised names of regulatory trading desks that should meet the key elements of a trading desk as defined in Annex 4, Appendix A (pages 225–226).

(added 5 March 2015)

7. In panel B of the "TB IMA" worksheet, what should be reported under "revised model" (column C) and "current model" (column D)?

**Answer:** The "revised model" is automatically populated from the "TB general" worksheet, hence no data should be entered in this column. The "current model" column should include VaR plus sVaR (without applying the multiplier of 3) under the current IMA capital framework. As stated in Section 7.5.2 of the instructions (page 124), the migration component of the IRC model should be included in row 110 for "Credit spread risk: non-securitisations" and the default component of the IRC should be included in row 111 for "Default risk: non-securitisations".

(added 5 March 2015)

8. Please confirm what information is to be inputted into row 4 of the "TB IMA P&L" worksheet.

**Answer:** Row 4 of the "TB IMA P&L" worksheet should be filled in with the date for each day of data that are included in rows 8 to 107.

(added 5 March 2015)

9. Please confirm that panel C of the "TB IMA P&L" worksheet should include delta and vega risk factors only for the sensitivities based approach (ie the revised standardised approach).

**Answer:** Yes.

(added 5 March 2015)

10. With reference to paragraph 171(k) in Annex 4 (page 212), if a bank can assign a longer liquidity horizon than the prescribed liquidity horizon floor on a desk level, how should this assignment take place? As an example, could this bank assign SPX to a 20-day (instead of 10-day) horizon and keep EURO STOXX at a 10-day horizon within one trading desk? Or should the bank set all equity large cap to either a 10-day or 20-day horizon?

**Answer:** The liquidity horizon floor applies at the risk factor level within a risk asset class. If a 20-day liquidity horizon is applied to SPX for a particular trading desk, this horizon applies to all instruments exposed to SPX at this trading desk. For EURO STOXX, the bank could still apply a 10-day liquidity horizon at the same trading desk.

(added 5 March 2015)

11. With reference to paragraph 171(c) in Annex 4 (page 209), is footnote 21 (page 210) still relevant?

**Answer:** Footnote 21 is no longer relevant to paragraph 171(c).

(added 5 March 2015)

12. With reference to paragraph 171(k) in Annex 4 (pages 212–213):

- (i) Please confirm that the liquidity horizon for “credit spread volatility risk factors” would have the same liquidity horizon as the “Credit (other)” category?
- (ii) Please clarify the liquidity horizon equity dividend risk factors can take on the horizon of the underlying equity price.
- (iii) Is there any currency dependency for the Interest rate – ATM volatility and FX volatility categories?
- (iv) Please confirm that the liquidity horizon for Recovery Rates risk factors can take on the horizon of the underlying credit spread (ie a bond with recovery risk would not split the credit risk and recovery rate risk into two different liquidity horizons)?
- (v) On which liquidity horizon should mono-currency basis risk and cross-currency basis risk be assigned?

**Answer:** With regard to:

- (i) Yes.
- (ii) No. In this example the liquidity horizon would fall under equity (other) at 120 days.
- (iii) No.
- (iv) Yes, but only for the purpose of the QIS.
- (v) These risk factors should both be assigned to FX (other) at 60 days.

(added 5 March 2015)

13. In paragraph 171(k) (page 213), is footnote 22 incorrectly tagged to “FX rate – other currency pairs”?

**Answer:** Yes. Footnote 22 should instead be tagged to “FX rate – liquid currency pairs”.

(added 5 March 2015)

14. With regard to paragraph 171(c), can banks use approximations to decompose their ES approach by risk class?

**Answer:** For the purpose of the QIS only, approximations may be reported where firms do not have systems available to perform the requisite decomposition of their ES.

(added 5 March 2015)

15. Based on footnote 25 (Annex 4, page 215), if a risk factor is replaced by proxying with another risk factor plus an idiosyncratic add-on (to capture the basis risk between the two risk factors), would the add-on be treated as a non-modellable risk factor (NMRF)? Would all such idiosyncratic add-ons be capitalised separately without any diversification benefit?

**Answer:** Yes, the idiosyncratic add-on would be treated as a NMRF and all such add-ons must be capitalised separately without any diversification benefit.

(added 5 March 2015)

16. Under paragraph 173(c) (Annex 4, page 215), would industry consensus pricing (eg from Markit) be considered as a modellable risk factor?

**Answer:** Industry consensus pricing must satisfy the same “real price” criteria as other pricing data. It cannot be treated as a “real” price unless the requirements in paragraph 173(c) are satisfied. For the purpose of the QIS, banks can use data derived from consensus pricing only if such data are deemed to satisfy the requirements in paragraph 173(c).

(added 5 March 2015)

17. With regard to the Incremental Default Risk (IDR) model in paragraph 176 (Annex 4, pages 218–220), what does the term “incremental” refer to specifically?

**Answer:** The term “incremental” in the Incremental Default Risk (IDR) model refers to the IDR being an incremental, separate, requirement to the internal Expected Shortfall (ES) model. No offsetting permitted between the internal IDR model and the internal ES model.

(added 5 March 2015)

18. Paragraph 176(c) (Annex 4, page 218) states that commodity and FX instruments as well as instruments subject to capital charges under the standardised approach are out of scope of the Incremental Default Risk (IDR) model. Does this mean that interest rate swaps, for example, are in the scope of the IDR model even though they have no issuer and hence no issuer default risk?

**Answer:** No, interest rate swaps are not in scope of the IDR model, unless their reference rate is subject to default risk. Only positions that are subject to default risk are in scope of the IDR model. As stated in paragraph 176(a), default risk is the risk of direct loss due to an obligor’s default as well as the potential for indirect losses that may arise from a default event.

(added 5 March 2015)

19. Paragraph 176(t) (Annex 4, page 220) would require banks to use loss-given-default (LGD) from the current Basel II internal ratings-based approach (IRB) for credit risk. If national supervisory authorities apply constraints to IRB LGDs (eg floors), should these be taken into account for the purpose of the LGD in the Incremental Default Risk (IDR) model?

**Answer:** Yes. Where a bank has an approved LGD estimate used in its IRB approach, including any requirements on that estimate from the national supervisory authority, it should use that LGD estimate as the LGD in the IDR model.

(added 5 March 2015)

20. Paragraph 176(b) and 176(i) (Annex 4, pages 218 and 219) would require correlations for default risk to be based on a period of stress. Paragraph 176(b) states that correlations must be “estimated over a 10-year time horizon and be based on a 1-year liquidity horizon”, while paragraph 176(i) states that correlations between defaults among obligors “should be calibrated over a period of at least 10 years” and “must be measured over a liquidity horizon of one year”. What is the period that should be used for calibrating correlations in the IDR model?

**Answer:** As defined in paragraph 176(b), correlations for the IDR model should be calibrated based on a minimum of 10 years of data which includes a stress period for the portfolio.

(added 5 March 2015)

21. In paragraph 180 (Annex 4, page 221), can the capital measure for non-modellable risk factors within model-eligible trading desks (SES) be computed across all model eligible desks for each specific non-modellable risk factor, or does this need to be calculated on a desk-by-desk basis?

**Answer:** SES should be calculated across all model eligible desks for each specific non-modellable risk factor.

(added 5 March 2015)

### 6.3 The revised standardised approach

1. In Annex 4, paragraph 63 (page 187), please provide additional clarity for how banks should define "residual maturity" of *the underlying of an option* with vega risk exposure to general interest rate risk (GIRR), ~~credit spread risk (CSR) and/or the commodity risk asset class~~. Consider a bank which transacts in a swaption comprising a one-year call option on a three-year interest rate swap. What is the "residual maturity" of this swaption?

**Answer:** In the above example, the "residual maturity" of the swaption is three years, regardless of whether the bank is the buyer or seller of the call option.

(added 17 February 2015, updated 5 March 2015)

2. With regard to the preamble included in Annex 4 (pages 181–183), please provide more clarity on the treatment described in Section I: "In the vega risk context...".

**Answer:** Please note that in the vega risk context, Section I relates not just to indices, but to all "options where all instruments have sensitivities for delta risk of the same sign". This also includes certain basket options. Section I deals specifically with options on multiple underlyings. Options where all underlying instruments have sensitivities for delta risk are of the same sign (eg indices) are to be decomposed with respect to their vega risk. The instruction to decompose these option into constituent vega risk positions each of which corresponds to a single delta risk factor has to be read in conjunction with Section II of the preamble. Please see the following examples:

*Example 1:* The vega of an option on a basket of two equities is decomposed into distinct constituent vega risk positions for each of the underlying equities. The decomposition is made according to the risk weight that applies to the respective equity according to para 54 (b). The dimensions moneyness and maturity of the vega risk positions are determined according to the moneyness and maturity of the option.

*Example 2:* The vega of an option on a basket of two CDSs with different issuers is decomposed into distinct constituent vega risk positions for each of the underlying names. The decomposition is made according to the parallel shift of the respective credit spread curve according to paragraph 56(a) in Annex 4 (page 184). The dimensions moneyness and maturity of the vega risk positions are determined according to the moneyness and maturity of the option.

(added 5 March 2015)

3. With regard to the preamble in Annex 4 (pages 181–183), please clarify the computation steps of the vega risk framework in Section III: “Further clarification on vega risk computation”, and provide banks with the parameters  $\alpha$  and  $\beta$  (Annex 4, page 183). Would there be a less computationally intensive way to capture vega risk?

**Answer:** Within the preamble in Annex 4, Section “III: Further clarification on vega risk computation” (page 182) is to be replaced in full with the following text:

[For the purpose of the QIS, two approaches for computing vega risk can be used: (i) the “full vega risk computation” and (ii) the “reduced vega risk computation”.

### “Full vega risk computation”

Several vega risk positions are specified based on the term and moneyness structure of implicit volatilities. Specifically, vega risk positions are computed for each node of the ATM volatility matrix (cube for GIRR) along two dimensions (three dimensions for GIRR):

- *The maturity of the option:* Relevant tenor(s) as specified in the delta risk context for General Interest Rate Risk – 0.25 years, 0.5 years, 1 year, 2 years, 3 years, 5 years, 10 years, 15 years, 20 years and 30 years.
- *For GIRR vega risk only – the residual maturity of the underlying of the option at the exercise date of option:* Relevant tenor(s) as specified in the delta risk context for General Interest Rate Risk – 0.25 years, 0.5 years, 1 year, 2 years, 3 years, 5 years, 10 years, 15 years, 20 years and 30 years.
- *Smile risk:* Relevant moneyness risk factors – 80% ATM, ATM (100%) and 120% ATM.

Any option that does not lie precisely on one of these nodes must be mapped by the bank to the nearest nodes. For example, an equity option that is 90% ATM with maturity 1.5 years must be mapped to the 80% ATM and ATM (100%) nodes for the maturities 1 year and 2 years.

For the purpose of the QIS, the correlation  $\rho_{kl}$  between vega risk exposures should be computed as follows:  $\rho_{kl} = \rho_{T_k T_l}^{(all\ asset\ classes)} \cdot \rho_{T'_k T'_l}^{(GIRR\ only)} \cdot \rho_{M_k M_l}$

With:

- $\rho_{T_k T_l}^{(all\ asset\ classes)} = e^{-\alpha |T_k - T_l|}$ , with  $T_k$  the maturity of the option related to vega risk factor  $k$  and  $T_l$  the maturity of the option related to vega risk factor  $l$ ;
- $\rho_{T'_k T'_l}^{(GIRR\ only)} = e^{-\alpha |T'_k - T'_l|}$ , with  $T'_k$  the maturity of the underlying instrument of the option related to vega risk factor  $k$  and  $T'_l$  the maturity of the underlying instrument of the option related to vega risk factor  $l$ ; and
- $\rho_{M_k M_l} = e^{-\beta |M_k - M_l|}$ , with  $M_k$  the moneyness related to vega risk factor  $k$  and  $M_l$  related to vega risk factor  $l$ , expressed as a percentage of the spot price of the option.

Several values of  $\alpha$  and  $\beta$  will be tested during the QIS. These values are set as follows:

- Scenario (a):  $\alpha = 0.01$  and  $\beta = 0.25$ ;
- Scenario (b):  $\alpha = 0.05$  and  $\beta = 1$ ; and
- Scenario (c):  $\alpha = 0.1$  and  $\beta = 5$ .

In the “TB SBA” worksheet, banks should report  $Kb$  values for vega risk of each bucket based on computations using scenario (a):  $\alpha = 0.01$  and  $\beta = 0.25$ .

The total vega risk capital charge for each risk asset class should be reported separately for scenarios (a), (b) and (c) in the "TB SBA" worksheet.

### "Reduced vega risk computation"

For banks which are not able to aggregate data to capture smile risk/ATM volatilities, an alternative approach may be used for the QIS.

Vega risk positions are computed along one dimension (two dimensions for GIRR):

- *The maturity of the option:* Relevant tenor(s) as specified in the delta risk context for General Interest Rate Risk – 0.25 years, 0.5 years, 1 year, 2 years, 3 years, 5 years, 10 years, 15 years, 20 years and 30 years.
- *For GIRR vega risk only – the residual maturity of the underlying of the option:* Relevant tenor(s) as specified in the delta risk context for General Interest Rate Risk – 0.25 years, 0.5 years, 1 year, 2 years, 3 years, 5 years, 10 years, 15 years, 20 years and 30 years.

The correlation  $\rho_{kl}$  between vega risk exposures should be computed as follows:

$$\rho_{T_k T_l}^{(all\ asset\ classes)} = e^{-\alpha|T_k - T_l|}$$

- with  $T_k$  the maturity of the option related to vega risk factor  $k$  and  $T_l$  the maturity of the option related to vega risk factor  $l$ ;
- *For GIRR vega risk only:*  $T_k$  may be defined as the discrete mid-point between the two bounds of each maturity band (ie between the maturity of the option and residual maturity of the underlying of the option). For example,  $\rho_{0.25\ to\ 0.5, 1\ to\ 2}^{(all\ asset\ class)} = e^{-\alpha|0.75 - 1.5|}$ .

Several values of  $\alpha$  will be tested during the QIS. These values are set as follows:

- Scenario (a):  $\alpha = 0.01$
- Scenario (b):  $\alpha = 0.05$
- Scenario (c):  $\alpha = 0.1$

In the "TB SBA" worksheet, banks should report  $Kb$  values for vega risk of each bucket based on computations using Scenario (a):  $\alpha = 0.01$ .

The total vega risk capital charge for each risk asset class should be reported separately for scenarios (a), (b) and (c) in the "TB SBA" worksheet.

### Relevant information for the "full" and "reduced" vega risk computations

For the purpose of the QIS:

- The above maturity and moneyness dimensions for vega risk factors relate to properties of the option as an instrument (ie the option as a whole has a particular maturity and moneyness). Yet, apart from these any vega risk factor also has a dimension in terms of the underlying of the option. This dimension is specified in Section II of the preamble (Annex 4, page 181). For example, with respect to an option on a single equity, this underlying dimension is the spot price of the equity. Hence, any vega risk factor for an equity option has three dimensions: maturity and moneyness of the option and underlying equity spot price.
- The correlations above apply between risk factors that are of the same underlying dimension. The correlations between vega risk positions of different underlying dimensions are determined according to the same intra-bucket ( $\rho_{kl}$ ) and across-bucket ( $\gamma_{bc}$ ) correlations that would apply to the delta risk factors that correspond to

their underlying dimensions (eg the correlation between any vega risk factor with underlying dimension "Coca Cola equity price" and any vega risk factor with underlying dimension "Pepsi Cola equity price" will be the same as between the correlation between the Coca Cola share price and the Pepsi Cola share price).

- For GIRR the risk factors above already include a dimension for the residual maturity of the underlying of the option at the exercise date. This implies that for GIRR the above correlations already specify between all vega risk factors for options whose underlying is subject to GIRR of a particular currency. Hence, only the correlation between vega risk factors for options whose underlying is subject to GIRR of two different currencies needs to be specified. The correlation between GIRR options with different currencies as underlying is 0.5 as for delta risk.

The closed-form questions under panel D in the "TB general" worksheet will be used to ask banks whether the "full" or "reduced" vega risk computation method was used. As stated in the instructions, the closed form questions will be circulated to participating banks in due course.]

(added 5 March 2015)

4. Which part of the QIS instructions should banks refer to for the most updated set of vega risk factor definitions?

**Answer:** Please refer to the preamble in Annex 4, Section II (pages 181–182).

(added 5 March 2015)

5. For all asset classes, should correlation scaling (to recognise basis risk) be compounded if there is more than one attribute which differs between two risk exposures? For example, commodity type C2 is identical to commodity type C1 (including signs), and differ only in terms of grade and delivery location. Should the correlation scaling be multiplication by  $(1+x)^2$  or by  $(1+x)$  ?

**Answer:** In the example within the question, the correlation scaling should be multiplication by  $(1+x)$ .

(added 5 March 2015)

6. For the reporting of the breakdown of SBA correlations (QIS instructions, page 120), should the summation for the terms  $\Sigma(1)$  and  $\Sigma(1-x)$  be restricted to run only over terms representing the same tenor point across different curves (for GIRR and CSR)?

The format for reporting the breakdown of the SBA correlation terms is such that detailed information is provided for each off-diagonal term (eg 0.25yr vs 0.5yr, 3yr vs 10yr etc), with additional terms (labelled  $\Sigma(1)$  and  $\Sigma(1-x)$ ) that capture correlations for the on-diagonal tenors for different curves (eg, 0.25yr OIS vs 0.25yr BOR, 3yr OIS vs 3yr BOR). However, the description of  $\Sigma(1)$  and  $\Sigma(1-x)$  on page 120 is such that it could also be construed to capture any off-diagonal terms where the SBA correlation is 1 (eg the 20yr vs 30yr correlation is 1). The implication of this is that some points will be double counted. Please clarify?

**Answer:** Both  $\Sigma(1)$  and  $\Sigma(1-x)$  should only cover terms representing the same tenor point *but across different curves*. There should be no double-counting of tenor points.

(added 5 March 2015)

7. In the definition of vega risk sensitivities for each asset class, given that the industry sometimes uses normal volatilities instead of lognormal volatilities, should the same scalar of 0.55 be used in all instances?

**Answer:** Yes. The 55% scalar should be used in all instances. When a bank uses normal volatilities in its system, it must operate an additional variable change in order to use lognormal volatilities.

(added 5 March 2015)

8. In the definition of  $VR_{ik}$  (ie for vega risk) should  $\sigma_i$  be indexed by  $k$  as well, therefore written  $\sigma_{ik}$ ?

**Answer:** Yes. The correct definition of  $VR_{ik}$  for all asset classes should read as follows:

$$VR_{ik} = 0.55 \cdot \left( \frac{\sqrt{LH}}{\sqrt{10}} \right) \cdot \left( \frac{dV_i}{d\sigma_{ik}} \cdot \sigma_{ik} \right)$$
. Note that options are often (but not always) priced using a

single implied volatility. Yet, even when an option has an underlying that corresponds to a single delta risk factor the option may be mapped to more than one vega risk positions, eg when its tenor lies between two regulatory tenors. Therefore, in the example the option  $i$  is mapped to vega risk position for two distinct risk factors  $k_1$  and  $k_2$ .

(added 5 March 2015)

9. In Annex 4, it is stated that between vega and delta exposures across asset classes, the correlation is set at 1 for same-sign risk positions and -1 for different-sign risk positions. This is equivalent to having no diversification or hedging benefit recognised between vega and delta risk exposures. Is this correct?

**Answer:** Yes. There is no diversification or hedging benefit recognised between vega and delta risks.

(added 5 March 2015)

10. The preamble of Annex 4 (page 181) states that for GIRR curvature and vega risks, all rates (spot and forward) should be floored at zero for computational reasons. Should this same adjustment be applied to credit spread risk?

**Answer:** Yes. The same adjustment should be applied to credit spread risk.

(added 5 March 2015)

11. For GIRR curvature risk, the aggregation across tenors for a given currency has been clarified in the QIS instructions. Can it therefore be assumed that the correlation matrices for "maturity tenors" are redundant for GIRR curvature risk?

**Answer:** Yes. For GIRR curvature risk,  $\sum CVR$  is equal to  $Kb$  for each currency bucket.

(added 5 March 2015)

12. For GIRR and CSR curvature risk factors, does one curve (eg OIS, BOR, Bond, CDS) represent a single risk factor?

**Answer:** As stated in the preamble (Annex 4, page 181), for GIRR only one yield curve should be used as a risk factor for each currency. For CSR: non-securitisations, only one curve should be specified as a risk factor for each name, with no distinction made between a General Electric bond curve and a General Electric CDS curve.

(added 5 March 2015)

13. For GIRR curvature risk, the QIS template gathers only two data points per currency for GIRR (columns IC and ID):  $Kb$  and  $\Sigma CVR$ . This seems legitimate if one ignores inflation, and the two columns should be equal to the unique CVR position obtained by parallel shifts. Does it mean inflation is always ignored for GIRR curvature risk?

**Answer:** Yes, inflation can always be ignored for GIRR curvature risk.

(added 5 March 2015)

14. The risk factor definition for foreign exchange (FX) vega risk and curvature risk is described in the preamble in Annex 4 (page 182) as "currency pairs". This appears to supersede the definition for FX curvature risk described in paragraph 62 (page 187) which begins with "all the exchange rates between the currency in which an instrument is denominated and the reporting currency..." Please clarify the correct definition of FX vega and curvature risks.

**Answer:** For vega risk related to cross currency FX options, please use the definition "currency pairs" (ie of the two relevant currencies of the option), as mentioned in the preamble (page 182). For delta and curvature risk definitions of FX, please use the definition "all the exchange rates between the currency in which an instrument is denominated and the reporting currency..." as fully described in paragraph 62 (Annex 4, page 187).

(added 5 March 2015)

15. If vega risk for FX is defined as "currency pairs", how should panel E, cells O125 to T155 in the "TB SBA" worksheet be filled in, given that each row is defined by currency?

**Answer:** Please refer to the following example for filling in cells O125:T155 in the "TB SBA" worksheet: For a bank with a reporting currency in CAD, data related to

- options with a EUR/CAD pair should be filled in cells O126 to T126.
- options with a AUD/CAD pair should be filled in cells O129 to T129.
- options with all currency pairs that do not reference the CAD (ie the reporting currency of the bank) should be filled in cells O155 to T155.

(added 5 March 2015)

16. In the "TB SBA" worksheet, can it be confirmed that under panel E (foreign exchange risk), cells F155 to N155 and U155 to AC155 are to be left blank? Please also confirm that cells F159 and F161 to F164 ("listed currencies") are to be reported based on computations within cells F125 to AC154 only.

**Answer:** Yes. Cells F155 to N155 and cells U155 to AC155 are to be left blank. Cells F159 and F161 to F164 are to be reported based on computations from cells F125 to AC154 only.

(added 5 March 2015)

17. What should be filled in cells G159 and G161 to G164 ("all currencies")?

**Answer:** These cells should be filled in with corresponding information from cells F159 and F161 to F164 *plus* delta, vega and curvature risk capital charges from all other currencies that are not listed in rows 125 to 155.

(added 5 March 2015)

18. With regard to curvature risk factors, for indices can shocks be applied to all underlying instruments at the same time?

**Answer:** No.

(added 5 March 2015)

19. In paragraph 68 (Annex 4, page 188), sensitivities for equity risk factors are expressed as 1% relative variation of the equity risk factor. This definition fits for equity spot prices in our bank's system but not for dividend forecasts and repos. Can an alternative definition be set out for equity dividend forecasts and repos that is different from equity spot price?

**Answer:** For the QIS all equity risk factor sensitivities are subject to the definition in paragraph 68. For a given equity name/issuer, there should be no double-counting between spot price, dividend forecasts and repo price. For instance, dividend forecasts for an equity name/issuer should not be included as a risk factor if this is fully captured in the spot price.

(added 5 March 2015)

20. With regard to equity risk correlations, basis risk recognition appears to be applicable in both same and different names in the example on page 164 (Annex 3 of the instructions), while the text on page 197 (Annex 4) indicates that basis risk should be recognised between two risk factors related only by the same name. Which is correct?

**Answer:** The basis risk recognition for equity risk as defined on page 197 (Annex 4) is correct. All risk factor and correlation definitions implied in Annex 3 are superseded by Annex 4.

(added 5 March 2015)

21. Where should "healthcare" be mapped in the buckets for equity risk in paragraph 106 (Annex 4, page 196)?

**Answer:** "Healthcare" should be mapped to buckets 1 and 5 in the table within paragraph 106.

(added 5 March 2015)

22. In Annex 3 (page 164 and 167), please clarify if the following elements within the correlation examples are correct?

(i) Equity (page 164): Are  $\Sigma(rho+)^2$  and  $\Sigma(rho-)^2$  incorrectly specified?

(ii) Foreign exchange (page 167): Does the "Rho" column for delta risk, within buckets, contain any errors?

**Answer:** On (i), yes.  $\Sigma(rho+)^2$  should be in the last row for Equity {Different Name; Same Sign; Rho = 9.02%}, while  $\Sigma(rho-)^2$  should be in the second to last row {Different Name; Different Sign; Rho = 2.25%}.

On (ii), yes. The "Rho" column for foreign exchange should read from top to bottom: {Netting; Netting; 95%; 90%; 70%; 65%; 85%; 80%}.

(added 5 March 2015)

23. In the "TB SBA" worksheet, should the following cells be left blank?

(i) Cells K62 ( $\Sigma rho+$ ) and L62 ( $\Sigma rho+(1+x)$ )

(ii) Cells K86 ( $\Sigma rho+$ ) and L86 ( $\Sigma rho+(1+x)$ )

**Answer:** Yes.

(added 5 March 2015)

## 7. Standardised approach to credit risk

1. We would like to seek clarification on column O (NPL amount) of the “BB SA General” worksheet. For off-balance sheet items, should the reporting bank populate the EAD or EAD pre-CCF as the NPL amount?

**Answer:** In the *Instructions for Basel III monitoring*, revised 13 February 2015, a clarification was included regarding the NPL amount to be included in column O: “Non-performing loans (NPL) (column O) should represent the losses for each portfolio experienced during the last reporting year.” Therefore, EAD pre or post-CCF would not be the correct measure. Banks should input the losses for that portfolio for the year ended 31 December 2014 (an income statement measure) in that column.

(added 17 February 2015)

2. The QIS template, under retail exposures, option C (row 1271 of the worksheet “BB SA general”), refers to using “maturity” as one of the drivers. As this term is not defined in the completion instructions, could you please clarify if “maturity” is intended to mean contractual or residual maturity?

**Answer:** Residual maturity should be provided.

(added 17 February 2015)

3. In answering the asset class specific information, if there is no data satisfying the definitions of rows, should a bank report “0” or keep those rows blank? For example, if a bank cannot check the CET1 ratio or net NPA ratio of all bank exposures and it reports the data of bank exposures to the panel for exposures for which obligor’s disclosure is insufficient, should the rows regarding bank exposures be kept blank or filled with 0? In many other worksheets, yellow cells must be filled with data, even if it is 0.

**Answer:** If the bank does not have information to report the requested breakdowns, it should leave the cell blank. The bank should only report “zero” where it knows that the exposure is nil. Please refer to Section 2.2 of the Basel III monitoring instructions. Note that banks must try to calculate the risk drivers for their counterparty banks, even if they can only calculate CET1 and net NPA for a subset of their bank counterparties. Banks are also encouraged to proxy the risk drivers if possible. Although the QIS is complex, banks should avoid defaulting to the highest risk weight.

(added 5 March 2015)

4. In the case of the exposures secured by residential real estate and by commercial real estate, are there any rows in which a bank can report data when it cannot check either or LTV or DSC (or any other risk driver). What should a bank do in such a case? Should a bank not report any data regarding the exposures secured by residential real estate or commercial real estate if it cannot check the relevant risk drivers?

**Answer:** If the bank knows the LTV ratio but not the DSC, then for the applicable LTV ratio (eg 20% to 30%, 30% to 40%), they should report the exposure in the “DSC > 50%” and “currency of main income” row.

If the bank does not know LTV, it should leave the breakdown panel blank (particularly panels D and E2). However, the real estate exposures should be included in the summary information on the whole portfolio section and a risk weight of 100% should be applied.

(added 5 March 2015)

5. For calculating DSC as a risk driver, the consultative document says that the income netted with tax should be used. If a bank can obtain only the gross income and cannot calculate the net

income, can the bank use the gross income instead of the net income for this QIS? Or should the bank keep these cells blank?

**Answer:** The bank should try to proxy the income after taxes. In case it is not possible, it could report based on gross income. In any case, the bank should submit a word file explaining the data that it has submitted.

(added 5 March 2015)

## 8. TLAC

1. TLAC term sheet section 21 sets four criteria for determining material subsidiaries. Can you please confirm that criterion c means the 5% of the denominator of the Basel III leverage ratio?

**Answer:** Yes, the 5% threshold is based on the Basel III leverage ratio.

(added 5 March 2015)

2. Please clarify what is meant by "location of issuance" in the TLAC location worksheet.

**Answer:** Please fill in the table based on the location of the infrastructure chosen for the settlement of the liabilities. For example, a bond issued by a UK G-SIB, listed in Switzerland under New York law, denominated in USD and settled at the US DTCC should be reported in the column "US". Euro-bonds settled at Euroclear / Clearstream should be reported in the "EU (excl UK)" total column, even if issued by a UK firm. The "of which EU home country" should only include issuances settled at the infrastructure in the home country of the resolution entity filling in this template. If the settlement system is not known, please use the jurisdiction of the governing law.

(added 5 March 2015)