

Secretariat of the Basel Committee on Banking Supervision,
Bank for International Settlements,
CH-4002 Basel
Switzerland

16 April 2010

Dear Sirs,

STRENGTHENING THE RESILIENCE OF THE BANKING SECTOR

Barclays Bank PLC ("Barclays") welcomes the Basel Committee's consultation paper "Strengthening the resilience of the banking sector" and we acknowledge the critical importance of the issues the paper raises.

1. *Executive Summary*

- 1.1. We support the direction of prudential reform outlined by the G20 and taken forward by the Committee in this paper. As we have indicated in response to earlier consultations, we agree with the principle that prudential capital standards for the banking sector needed to be raised. Consequently, we (and our peers) have pre-empted the anticipated change by increasing our capital ratios during 2008 and 2009, thereby providing a substantial capital buffer against the risk of further stress, whilst also lowering our leverage and improving our liquidity position. Armed with this enhanced capital buffer, authorities have the time to both analyse in depth the optimal absolute level of capital that the system should hold and to thereby calibrate the aggregate impact of the changes proposed as well as articulate a vision for the desired end state that the reforms are trying to achieve.
- 1.2. The analysis and vision need to consider the conflicting objectives of limiting banking risk, maintaining the supply of credit to the economy at an acceptable price and ensuring banks are sufficiently profitable to continue to attract the necessary supply of capital from private investors to meet the new level. We fully support the Quantitative Impact Study which will provide an input in to this analysis. Further inputs are also required to cover other changes, such as funding of deposit insurance schemes, which would impact bank profitability. Completion of this important analysis prior to finalising the new requirements will mitigate the risk that implementation negatively impacts the economic recovery.
- 1.3. We have also been undertaking detailed work over the last three months to better understand the likely impact of the aggregate reform package. It is clear from the analysis that the impact of the proposed capital and liquidity reforms will be severe – particularly in context of other proposals such as Resolution Levy.
- 1.4. We also support the regulators desire to ensure individual risk types are capitalised commensurate with the level of risk on a consistent basis. We believe Basel 2, where

implemented successfully, achieved this consistent risk based approach for a number of products and risk types; although we accept that the market disruption has highlighted aspects that could be improved. The Committee's paper and earlier changes to market risk requirements all contribute to this objective.

- 1.5. However, given the materiality and international nature of the changes proposed to risks types, it is critical that the level playing field is maintained. Consequently, we recommend authorities reach international consensus on both the changes required and the pace of implementation rather than proceeding unilaterally ahead of such consensus and needing to reverse later (which may be politically challenging) if international consensus proves to be different. Reaching consensus first has limited risk to the banking system given the enhanced capital levels already in place, but will have the benefit of limiting potential arbitrage between jurisdictions whilst protecting individual economies from unfair competition.
- 1.6. In terms of the specific elements of the current consultation, we are particularly concerned re:
 - counterparty risk – where the proposals will significantly overstate capital requirements;
 - minority interests – where the treatment is asymmetric; and
 - leverage ratios as a concept within Pillar 1
- 1.7. This letter discusses the above points in more detail below. We have also made more specific observations and comments on the detail within the consultation paper in an appendix to this letter.

2. *The importance of international co-ordination and consistent implementation*

- 2.1. Barclays welcomes and supports the development of harmonised global standards. We believe that it is important that national and regional supervisors resist the temptation to anticipate the development of international standards and where they have anticipated these that they swiftly come into line with global standards once they are agreed.
- 2.2. It is also important that prudential regulation does not become, or is not perceived to be, the source of competitive distortion. While we understand that the Capital Accord is not legally binding and the Committee has no enforcement mechanism, we do think it is important that national implementation of the revised Accord is reviewed by the Basel Committee, perhaps through its Standards Implementation Group, and that differences in interpretation and implementation are discussed and – it is to be hoped – minimised or eliminated. Even before the implementation of the trading book amendments issued in July 2009 and the proposals in this consultation, there is significant variation in how the leading economies have implemented the Accord, the introduction of Basel II being the clearest example.

3. *The proposed amendments to counterparty risk will significantly overstate capital requirements*

- 3.1. The proposed changes to the counterparty risk regime will significantly overstate the Committee's aim of increasing capital requirements for counterparty risk. We believe that the mandated scope of the credit valuation adjustment (CVA) capital charge is significantly broader than the CVA charges that yielded income volatility during the crisis. Whilst we are still quantifying the impact of the CVA charges and will be submitting them in the QIS, we believe that the levels of capital required will be multiples of the potential and realised losses arising from CVA in the financial statements.
- 3.2. CVA as defined for capital and accounting should be aligned where possible. If the CVA methodology is substantially different for accounting and for regulatory capital purposes this will create conflicting incentives and difficulties that will need to be thought through and

managed. The main areas where these approaches diverge are credit spread assumptions and exposure calculations.

- 3.3. We further believe that the approach taken to CVA should be more refined and, as drafted, does not reflect the way that CVA is calculated and managed in banks. We believe that CVA should be capitalised in a trading book integrated VaR framework with diversification against other risk factors and hedges of both a market risk and credit risk nature. The appendix to this letter provides more detail on our proposals.
- 3.4. Another area of concern is introduction of stressed Effective EPE as an additional measure of general wrong-way risk. For a number of reasons, we believe that EPE based on stressed inputs may not produce the intended benefits and may even increase overall risk.
 - Where the stressed charge dominates, the use test may be weakened, as it is unlikely to be adopted for credit sanctioning purposes. Credit risk management already considers tail values on a client by client basis.
 - It will become harder for firms to manage exposures; undertaking additional trades to offset risk based on current market factors could potentially increase the exposure of a stressed EPE basis due to differences in correlations. Furthermore, clients are unlikely to be willing to post initial margin against stress volatility instead of current or market implied volatilities.
- 3.5. We would emphasize that the main (and most credible) tool to demonstrate EPE validity is back-testing, on which a regulatory approach is of course still in development. We consider that materiality of the use of a stressed EPE should be reviewed, once a) results of the QIS are known and b) a back-testing framework is published.

4. The treatment of Minority Interests is asymmetric

- 4.1. We believe that the proposed treatment to exclude ordinary equity minority interests emanating from operating entities is inappropriate. An asymmetry in the consolidated capital calculation would result from excluding equity minority interests in operating subsidiaries from consolidated capital resources whilst including all the risk weighted assets and capital deductions of the subsidiary.
- 4.2. Whilst we appreciate the Committee's desire to ensure fungibility of capital, we consider that the consolidated capital calculation is not the appropriate method to achieve this. Fungibility (or lack thereof) is already regulated in the UK through the implementation of a solus capital regime. This requires that all regulated entities within groups, including the parent bank, must be adequately capitalised for the risks that the entity is exposed to. Those risks may be either external to the group or intra-group exposures to other subsidiaries.
- 4.3. The existing Basel framework contemplates solus capital requirements. However the success of the regime has been diluted by the impact of national discretions which permit a parent bank to avoid its solo requirements where the group is adequately capitalised. This discretion effectively allows a parent bank to be potentially undercapitalised and therefore reliant on capital repatriations from subsidiaries in order to meet the parent's risks.
- 4.4. There are a number of macro economic and risk sharing benefits gained from equity minority interests. These include joint ventures that are used to capture the combined strengths of multiple organisations for mutual economic benefit and access to other geographical equity markets potentially not otherwise open to the parent company. Excluding equity minority interests from core capital jeopardises these benefits. We understand that the Committee may be concerned over potential arbitrage of its rules. However we believe that the proposed

minority interest deduction could effectively close off legitimate business strategies for large, cross-border firms.

5. *At most the Leverage Ratio should be a Pillar 2 consideration*

- 5.1. Barclays has strong reservations about introducing a leverage ratio. The existence of such a ratio in certain jurisdictions did not prevent the crisis. Indeed, in encouraging an originate-and-distribute model for high quality assets like mortgages which are treated in the leverage ratio on the same basis as assets of lesser quality, it can be argued that the leverage ratio was a contributor to the crisis. Barclays believes that the prime focus of regulators should remain on risk based measures of capital adequacy.
- 5.2. If, nevertheless, regulators continue to believe that the leverage ratio is a useful tool, then Barclays believes that the ratio must be both carefully defined and consistently applied if it is to fulfil the potential it may have to assist regulators identify and prevent extreme behaviour. The most significant barrier to this is accounting treatment and we welcome the Basel Committee's acknowledgement that accounting differences will need to be adjusted for.
- 5.3. We also have strong reservations about the use of "gross" leverage ratios for any purpose. Focusing on the grossed up balance sheet will discourage activity that is either appropriately risk managed or that provides important risk management and funding tools for banks and their clients. It also means that supervisors will not be focused on the sources of risk. Barclays strongly urges the Committee to permit the netting of positions that do not reflect risk taking.
- 5.4. We also do not believe that a regulatory leverage ratio should become a constraint under Pillar 1, particularly if the chosen ratio restricts activity that does not reflect the risk associated with leverage as a result of the proposal to disallow netting. Incorporating the leverage ratio in Pillar 1 would put in place a binding constraint that is unlikely to be universally applicable across all banking structures and business models and across different banking businesses. There is a risk that this will lead to unnecessarily higher pricing for lower risk lending, for example retail mortgages, as banks will need to set aside more capital to avoid breaching the ratio.
- 5.5. If a leverage ratio is introduced, we propose that regulators take it into consideration when undertaking their Supervisory Review under Pillar 2. Pillar 2 allows the regulator to consider all relevant factors, including the structure of the business, governance and risk mitigation in place when seeking to meet its objective of managing excessive leverage in the system.
- 5.6. Barclays would favour the use of Tier 1 capital as the measure of capital to be used in calculating leverage ratios. This definition is the most appropriate as it represents the buffer that is most readily available in the event of distress. It also has the advantage of wide usage and of precedent, for example, Tier 1 capital is currently used in the United States for the calculation of the leverage ratio.

6. *The overall impact of proposals on the real economy need to be fully considered*

- 6.1. As the UK FSA has noted in a preliminary discussion of the issue of the cumulative impact of the various regulatory reform proposals, the scale of the proposed changes is greater than any included in its sample period¹.
- 6.2. Barclays is acutely conscious of the complexity and interconnected nature of these proposals and is concerned by the potential for unintended consequences for banks and for the wider

¹ FSA DP09/4 *Turner Review Conference Discussion Paper, A regulatory response to the global banking crisis: systemically important banks and assessing the cumulative impact*, Annex 2 para A2.11

economy. We therefore support the quantitative impact study that is being run by the Basel Committee in respect of the combined regulatory proposals.

- 6.3. It is important that the QIS analysis goes beyond an assessment of the first round impact on bank capital and liquidity to consider how banks will respond to these changes and what impact this will have on the wider economy. The QIS will not capture all the requirements and demands that are likely to affect banks in 2012 and beyond. These are likely to vary between jurisdictions, but may include exit from and repayment of various support mechanisms and repayment of disbursements by and funding of deposit insurance schemes.
- 6.4. We recommend that international regulators take the time to properly analyse the QIS data, including the assumptions upon which it is based, in order to reach a global agreement on the:
- Appropriate calibration of required levels of capital in the system
 - Appropriate transition periods for the introduction of the new regime.

7. *Calibration remains uncertain, but needs to be clear*

- 7.1. In reaching agreement it is essential that policy makers find a balance between:
- Strengthening the system's resilience to shocks
 - Maintaining the ability of the banking system to support the retail and commercial activities of our customers and clients, including the delivery of affordable credit and sustainable growth to the wider economy
 - The availability of adequate private supply of capital to the system at an appropriate price
 - The need for banks to be sufficiently profitable to continue to attract support from private investors
- 7.2. There is no clarity as yet on what the target level of capital is for the new regime either at the system or individual bank level, other than it should be more than that held before the crisis. This issue needs considerable thought and debate, as well as inevitably being a reflection of what is politically and economically possible.
- 7.3. The output of the QIS will be an important input into this decision. However, the calibration issue is sufficiently important that the Committee should consult further on its expectations for total capital before finalising its decision either on what the level of capital should be or the approach to setting detailed requirements for categories of risk.

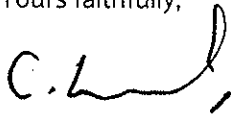
8. *Transition needs to be carefully managed*

- 8.1. Whatever the shape of the final regime, Barclays is concerned that there should be an appropriate, clear and consistent understanding of how transition to the new regime should take place, with a clear prioritisation of the actions to be undertaken and with suitable transitional periods. Given the other changes impacting banks, they may not be in a position to implement the Committee's proposals when they come into force at the end of 2012 without restricting the flow of credit to the wider economy.
- 8.2. We have seen already the tendency for market analysts to seek to anticipate the capital requirements that might result from the revised Capital Accord. It is clear that this has the capability to move markets significantly. There is a danger that, unless suitably long transition periods are established, the market for capital instruments may immediately factor the new rules into market prices and crystallise the negative unintended consequences for the wider economy of a premature tightening of banks' capacity to take on risk.

9. *Closing Comment*

- 9.1. In summary, Barclays supports the Committee's objectives to strengthen the capital regime for banks, but remains concerned over some of the detail which we have described above and in our appendix. We are particularly keen that regulators ensure a consistent international approach to implementation and timing is applied after having concluded on the optimal level of capital in the system considering the conflicting objectives of a secure banking system, supply of capital and resulting pricing and supply of credit.
- 9.2. We hope that our response is of assistance to the Basel Committee in the further development of its work, and we of course stand ready to discuss these with the Committee if that would be of assistance. We look forward to working with the Basel Committee to attain our common objective of a soundly capitalised and well-managed banking sector.

Yours faithfully,

A handwritten signature in black ink, appearing to be 'C. L. L.' with a stylized flourish at the end.

Appendix

A. CAPITAL RESOURCES

1. Tier 1 Non-Equity Capital

1.1 Innovative Hybrid Capital

We recognise that the prevailing perception amongst European national bank regulators is that throughout the credit crisis hybrid Tier 1 capital instruments have not absorbed losses to the extent that they should have, notwithstanding the significant amount of Core Tier 1 capital generated through buybacks and exchanges of hybrid Tier 1 and, to a lesser extent, the cancellation or suspension of periodic payments on certain hybrid Tier 1 capital issues.²

However, we submit that innovative hybrid Tier 1 capital has generally exhibited loss absorption capability comparable to that of non-innovative hybrid capital. The primary distinction between the two classes of capital is that innovative hybrid Tier 1 capital includes instruments that contain a coupon step-up or another moderate incentive for the issuer to redeem the instrument. Although empirical evidence is limited, several innovative hybrid issues that became callable in 2009 and 2010 were not redeemed by the issuer.

Furthermore, any prudential concerns about the permanence of a hybrid instrument that contains a step-up and call should be addressed by the robust redemption conditions contained in proposed criteria 5 and 6 for Tier 1 Additional Going-Concern Capital ("T1 AGCC").

Finally, we note that both CEBS and the UK FSA have assessed step-ups as part of the CRD II amendments and have concluded that they are not inconsistent with the requirement that Tier 1 capital be permanent.

We therefore suggest that step-ups in innovative hybrid issues have not demonstrably undermined the loss absorption capability of the issues, and we are of the opinion that the T1 AGCC criteria will significantly improve the quality of hybrid capital instruments irrespective of whether or not the instruments feature a step-up.

1.2 Tier 1 AGCC Criteria

1.2.1 International consistency

We understand that some countries domestic laws permit the design of Tier 1 AGCC securities that comply with Basel requirements (for example, France). However it is very unclear whether other banking institutions in Europe and the US will be able to design a security that would comply with the Tier 1 AGCC criteria without significant legislative changes. Any revised standards in non-equity forms of Tier 1 capital should not permit competitive advantage of one jurisdiction versus another on the basis of differences in domestic tax and accounting standards. We note in this regard that US banks have continued to issue in Trust Preferred format since the publication of the Basel paper. It is unclear to us what, if anything, has been agreed regarding grandfathering of these securities.

² Barclays Capital estimates that repurchases and exchanges of outstanding hybrid Tier 1 and Upper and Lower Tier 2 capital instruments have generated the pre-tax equivalent of approximately €26 billion of Core Tier 1 capital for European financial institutions.

1.2.2 Dividend/Coupon Discretion

Proposed criterion 7 is silent with respect to provisions that permit an issuer of a T1 AGCC instrument to settle periodic payments by delivering ordinary shares, in lieu of cash, to holders (a so-called “Alternative Coupon Satisfaction Mechanism” or “ACSM”).

ACSMs are beneficial to issuers because they allow the issuer to absorb losses by issuing shares, rather than paying cash, and they can result in a lower cost of capital for the issuer by appealing to investors’ sensitivities and, in certain jurisdictions, by rendering periodic payments tax-deductible for the issuer.

Certain regulators have reservations that ACSM provisions may raise prudential concerns, such as the potential accumulation of unpaid periodic payments and the potentially destabilising effects of dilution at a time of financial distress for the issuer. CEBS and the UK FSA have considered ACSMs as part of the CRD II amendments. CEBS’ Implementation Guidelines for Hybrid Capital Instruments impose useful conditions on ACSM provisions that fully address such prudential concerns.

We would therefore recommend that the Basel Committee consider explicitly permitting the use of ACSM provisions, subject to adherence to the conditions stipulated by CEBS.

1.2.3 Special Purpose Vehicles

The requirement in proposed criterion 14 for the proceeds of an issuance by a special purpose vehicle to be immediately available to an operating entity in the consolidated group, “in a form which meets or exceeds all of the other eligibility criteria for T1 AGCC,” seems unnecessary.

We would submit that, to the extent that i) an SPV issuance satisfies the T1 AGCC criteria, and ii) an SPV issuance can be designed to function in the same way as a direct issuance, the inter-company arrangements between the SPV and the operating company should not be relevant. The contested language would effectively preclude any SPV issuance and we do not believe this is the intended consequence of the Committee’s drafting.

1.2.4 Tax Treatment of T1 AGCC Instruments

We agree with the European Commission Services’ recommendation that tax treatment should not be included in the eligibility criteria for T1 AGCC. We would welcome a similar statement from the Basel Committee. We believe that this will help to promote a level-playing field, as tax regimes vary across jurisdictions. We believe that the revised definition of T1 AGCC will ensure that such instruments constitute high quality capital and that tax treatment is not relevant to loss absorption capability.

1.2.5 Principal Loss Absorption in T1 AGCC

CEBS’ requirement for hybrid capital instruments to absorb losses by converting into ordinary equity or through a reduction in principal has been a source of ambiguity for some time. Based on Criterion 10, we presume that Criterion 11 requires that only T1 AGCC instruments that are classified as liabilities for national insolvency law need contain additional loss absorbency provisions. If correct, we welcome this clarification and believe that it is appropriate.

We do not see the need for a T1 AGCC instrument that otherwise meets the T1 AGCC criteria to contain incremental principal loss absorbency because the instrument would permit the issuer to absorb losses by suspending payments of interest and deferring principal indefinitely.

Furthermore, a requirement for a conversion or write-down provision may give rise to various practical issues:

- T1 AGCC instruments in certain jurisdictions may not be treated as debt for tax purposes;
- Write-down mechanisms may potentially create volatility in the bank's P&L by giving rise to taxable gains and losses in certain jurisdictions.
- A write-down/write-up mechanism may not be recognised under IFRS.
- Conversion provisions may be hampered by annual pre-emption limits for new issued shares, as well as a requirement for the issuer to obtain AGM/EGM approval
- Certain fixed income funds may be unable to buy equity instruments or instruments that could convert into equity

In instances where a T1 AGCC instrument is classified as a liability for insolvency law purposes, it should be possible to identify one or more triggers that could be expected to closely track the financial health of the firm and therefore support the firm's creditors in times of stress. An objective, pre-defined trigger would have the benefit of removing any perception of moral hazard and may result in lower capital costs for the issuer if investors are able to evaluate the likelihood of a trigger breach. However, we recommend that the supervisor also retain the ability to cause an instrument that is classified as a liability for insolvency law purposes to be written-down or convert into Core Tier 1 elements in the event that a severe financial stress threatening the viability of the issuer as a going concern occurs so suddenly that pre-determined triggers have not been breached.

1.2.6 Grandfathering and other Timing Considerations

It is important that issuers and investors have clarity on the grandfathering arrangements for hybrid instruments issued prior to the Basel III implementation date to ensure a smooth transition and reduce the likelihood of a build-up of supply that might prove disruptive to the market. The conflicting timetables proposed by Europe and the Basel Committee have resulted in considerable market uncertainty on this important issue.

We also note that it is difficult to comment on proposed definitions for distinct elements of the capital structure without clarity on how much capital will be required (a) across the system as a whole (b) for individual firms and (c) at each level of the capital structure of individual firms. We understand that the Basel Committee will be considering QIS 5 impact data to inform final decision making on these vital questions. We hope that the Committee will be in a position to give initial feedback on the QIS data following its July meeting and will be able to issue either definitive guidance or a clear further work plan following its September meeting at the latest. We would encourage the Committee to be open and transparent in its dialogue with firms, and in its communication with the market as a whole, to ensure a smooth, globally consistent transition to the new regime.

2. Tier 2 Capital

We have no significant concerns with the criteria for inclusion in Tier 2 capital. Our comments on the following topics apply *mutatis mutandis* to non-equity Tier 1 and Tier 2 capital:

- Grandfathering
- Calibration of required levels of capital in the system and in individual firms
- Indirect issuance using SPVs

We note that there is no reference to the gearing restraints placed on Tier 2 and Lower Tier 2 capital. These constraints will clearly need to be defined.

3. Deductions

3.1 Pension Fund assets and liabilities

The current treatment of defined benefit pension fund assets and liabilities in capital resources is not consistent on an international basis due to accounting and national regulatory differences. Recognising accounting liabilities as proposed would reduce some of the current inconsistencies across banks.

However, fully recognising accounting liabilities as proposed will result in pro-cyclical volatility in capital resources as pension fund liabilities are volatile and increase in times of stress. Capital resources will become more difficult to manage and increasing pro-cyclicality is not consistent with the Basel Committee's objectives.

In addition, the Committee's proposal does not encourage full funding of pension schemes as any excess funding resulting in a pension asset will be deducted from capital. A pension asset would facilitate a break up of the bank in a resolution situation, reflecting lower future contribution requirements. We would recommend a consistent approach to both assets and liabilities.

The UK FSA has a prudential filter that bases the regulatory capital impact of pension fund assets and liabilities on anticipated bank contributions to reduce pension fund deficit rather than a measure of the liability at a point in time. We support this approach which gives a more through-the-cycle treatment consistent with the treatment of other risks and the Committee's proposals on cyclicalities.

We recommend that the Basel Committee proposes a prudential filter for Pillar 1 that replaces any accounting liability with a deduction from capital for the cumulative excess funding, over and above annual service costs, agreed with pension fund Trustees for reducing a liability. This approach eliminates point in time volatility as agreements with Trustees will take a long term view of the funding required to reduce a pension liability.

To ensure consistent application, clarity should be provided on the calculation of excess funding, the time horizon considered for the excess funding, the application of discount rates and the tax treatment. If regulators consider that the Pillar 1 regulatory treatment is not sufficient, then Pillar 2 is available to increase a bank's capital requirements.

The treatment for banks that follow the corridor approach to pension accounting is unclear in the Committee's proposals. Although it is anticipated that IASB will remove the corridor approach at some point, it is recommended that, should the original proposal be adopted, the Basel Committee clarify the treatment for banks that follow the corridor approach to pension accounting.

3.2 Deferred Tax

Deferred tax usually relates only to timing differences between financial reporting and tax returns. An example of this is where an expense is accrued in the accounts for deferred compensation that is paid out after the end of the accounting period where tax relief is only allowable on a paid basis in some tax jurisdictions.

The Basel Committee's consultative document proposes that from the end of 2012, deferred tax assets (DTAs) which rely on future profitability of the bank should be deducted from Core Tier 1 capital, the adjustment being net of any deferred tax liabilities (DTLs), and that DTAs which are not reliant on future profitability should be assigned the relevant sovereign risk weighting.

In our experience all DTAs rely on future profitability and as such all DTAs would be a deduction from Core Tier 1. It is not clear to us whether this is the intention of the Committee.

More clarity is also required on netting. IAS 12 requires that DTAs and DTLs are netted for the same taxable entity if, and only if, they relate to income taxes levied by the same taxation authority and the entity has a legally enforceable right to set off current tax assets and current tax liabilities. The aggregate position across all entities in the bank normally results in an overall DTA and a DTL on the balance sheet and it's not clear if the Committee is recommending further netting of these amounts beyond the netting required under IAS 12.

While we agree with the proposition that it may be appropriate to make a capital adjustment in respect of DTAs for prudential purposes, the calibration of this adjustment must be right in order to ensure a level playing field for all regulated banks and the current proposal does not achieve this. The following points are relevant in relation to an appropriate calibration :

- Long term future profitability is taken into account in recognising DTAs under IAS 12, particularly in relation to DTAs on losses, and the future profit forecasts are reviewed by a bank's auditors in arriving at the DTAs recognised on the balance sheet.
- For entities with DTAs on losses a distinction can be made between those entities whose future profits have inherent trading risk and those entities with secure investments that could be sold to third parties with value for the DTAs.
- A distinction can be made between DTAs relating to future payments that we are not committed to make and DTAs arising for other reasons. For example, accruals for deferred compensation relating to a provisional reward allocation, where the payment is at the ultimate discretion of senior management, and may not be paid in a stress scenario. The release of the deferred compensation provision and the write off of the DTA thereon would be accretive to capital in overall terms and as such these DTAs should be viewed differently from DTAs that are reliant on future profits.

In order to minimise the complexity of the calibration and to ensure a level playing field we recommend an approach used in the US where no adjustment is made for DTAs up to the lesser of (i) DTAs reversing within 12 months and (ii) 10% of Tier 1 capital. We believe that this approach would achieve the regulator's objective of excluding large deferred tax assets.

On a separate point, the Committee's concern appears to be on the uncertainty of future profits to the extent that in a gone concern scenario the DTAs would have less value and as such it may be more appropriate to make any capital adjustment for DTAs to Tier 2 capital rather than Core Tier 1.

3.3 Investments in own shares (treasury stock)

We recognise the Committee's objective to prevent double counting of a bank's capital by deducting for holdings in own shares. This is a familiar principle for UK banks. However, we believe that the proposal to look through holdings of index securities to deduct exposures to own shares is operationally burdensome and does not reflect the true risk position of these securities. Further, while we recognise the desire to prevent capital arbitrage by including certain indirect holdings of own shares in the scope of the proposed deduction, the Committee does not fully articulate the risk it is trying to capture in index linked products. Firms like Barclays enter into index trades to meet specific client demand. Clients may wish to take exposure to a recognised index or to construct an index which creates the desired risk profile. If Barclays stock happens to be a constituent of the index, the firm should not automatically be subject to capital penalties.

Exposures to own shares via index trades create notional positions and do not add anything to a bank's capital base, consequently the rationale for a capital deduction to prevent artificial inflation of the capital base is lost. The risk of such index trades is typically managed through firms' trading books and, as such, will be subject to the more stringent market risk capital requirements prescribed by the Basel Committee in 2009. Overlaying an additional deduction risks overstating capital requirements and the significant operational costs of capturing the deduction would not, in our view, be justified given that the perceived risk should already be captured under the revised Trading Book rules.

3.4 Minority Interests

We believe that the proposed treatment to exclude ordinary equity minority interests emanating from operating entities is inappropriate. An asymmetry in the consolidated capital calculation would result from excluding equity minority interests in operating subsidiaries from consolidated capital resources whilst including all the risk weighted assets and capital deductions of the subsidiary.

Whilst we appreciate the Committee's desire to consider the fungibility of capital, we consider that the consolidated capital calculation is not the appropriate method to achieve this. Fungibility (or lack thereof) is already regulated in the UK through the implementation of a solus capital regime. This requires that all regulated entities, including the parent bank, must be adequately capitalised for the risks that the entity is exposed to. Those risks may be either external to the group or intra-group exposures to other subsidiaries.

The existing Basel framework contemplates solus capital requirements. However the success of the regime has been diluted by the impact of national discretions which permit a parent bank to avoid its solo requirements where the group is adequately capitalised. This discretion effectively allows a parent bank to be potentially undercapitalised and therefore reliant on capital repatriations from subsidiaries in order to meet the parent's risks.

There are a number of macro economic and risk sharing benefits gained from equity minority interests. These include joint ventures that are used to capture the combined strengths of multiple organisations for mutual economic benefit and access to other geographical equity markets potentially not otherwise open to the parent company. Excluding equity minority interests from core capital jeopardises these benefits. We understand that the Committee may be concerned over potential arbitrage of its rules. However we believe that the proposed minority interest deduction could effectively close off legitimate business strategies for large, cross-border firms.

B. COUNTERPARTY RISK

We appreciate the opportunity to comment on the Basel Committee's proposals relating to counterparty credit risk. As noted in our cover letter, while supporting the general direction of travel of the Basel Committee, we believe that these are likely significantly to overshoot the target that the Committee had in mind when drafting these proposals, and that the proposals therefore need to be revisited. We support the proposed incentives to move bi-lateral OTC contracts to central clearing and have been at the forefront of developments in this area.

1. Credit valuation adjustments (CVA)

We understand that the proposals on CVA have been drafted on the basis that approximately two thirds of counterparty risk losses were due to mark to market credit valuation losses rather than counterparty default. We also understand the proposed capital charge is in addition to capital requirements for counterparty credit risk (CCR) based on standardised or IRB approach for credit risk. As a result counterparty risk exposures appear to attract both banking book capital requirements and a punitively calibrated trading book requirement.

We believe that allocating capital (an unexpected loss protection concept) against the risk of raising provisions for non-trading book exposures (an expected loss protection concept) is theoretically weak. The Basel Accord currently gives credit for provisions and valuation adjustments in the EL provision calculation. If the objective is to increase capital charge for derivative positions due to CVA risk it would be more appropriate to deal with counterparty credit risk within the trading book in a manner consistent with its accounting.

We have reviewed the methodology which we understand will be applicable to IMM banks for this purpose; the bond equivalent methodology, and have come to the following observations and conclusions.

- Scope and scale : While we understand the rationale for a CVA capital charge we have observations on its scope and strong reservations on its size, as set out in the proposals:
 - We understand the capital charge will be based on market spreads and applicable to all OTC derivative counterparties, regardless of whether a CVA is calculated for accounting purposes. We note therefore that the scope of the CVA capital charge could be significantly wider than the actual source of volatility in profit and loss. Furthermore, if the CVA methodology is substantially different for accounting and for capital purposes this may create conflicting incentives and difficulties in managing risk as between the accounting and regulatory measures. The regulatory and accounting methodologies could diverge in credit spread assumptions and exposure calculation.
 - While the calibration of the CVA capital charge should be based primarily on the results of the QIS that are due by end of April, several elements allow us to estimate its likely size. Based on these, it appears to us as if the capital charge would result in levels of capital exceeding by high multiples the actual or potential losses arising from CVA. Table 1 below illustrates the potential size with simple examples
 - for an investment grade counterparty whose credit spread has been approximated to an investment grade CDS index (Itraxx Main) the additional capital would be 18 to 88% of exposure (EEPE)
 - for a sub investment grade counterparty whose credit spread has been approximated to a sub investment grade CDS index (Itraxx XOver) the additional capital would be 70% to 351% of exposure (EEPE)

- We think it would make sense to calibrate the CVA capital charge to the actual losses experienced by financial institutions in the 2007-08 period of stress. A thorough review of CVA losses taking into account CVA scope would be a necessary first step to achieve this. In particular CVA losses should exclude ad hoc provisioning and items unrelated to counterparty risk. Furthermore, we believe that CVA losses arising from wrong way risk (such as Monoline exposures) should be separately identified to ensure that future capital requirements to cover these historic risks are not duplicative.

Table 1

| Spread / Source | Duration/ Effective Maturity | 10 Day 99% VaR | Alpha | Annualisation | VaR Multiplier | Stress VaR | Total Multiplier | Capital | RWA |
|-----------------------|------------------------------------|----------------------|-------|---------------|----------------|------------|------------------------------------|------------------------------|-----------------------|
| | A | B | a | b | c | d | $C = a \times b \times c \times d$ | $K \sim A \times B \times C$ | $RWA = K \times 12.5$ |
| IG / Itraxx Main | 1.0 | 0.42% | 1.4 | 5 | 3 | 2 | 42 | 18% | 221% |
| IG / Itraxx Main | 2.5 | 0.42% | 1.4 | 5 | 3 | 2 | 42 | 44% | 551% |
| IG / Itraxx Main | 5.0 | 0.42% | 1.4 | 5 | 3 | 2 | 42 | 88% | 1103% |
| Sub IG / Itraxx Xover | 1.0 | 1.67% | 1.4 | 5 | 3 | 2 | 42 | 70% | 877% |
| Sub IG / Itraxx Xover | 2.5 | 1.67% | 1.4 | 5 | 3 | 2 | 42 | 175% | 2192% |
| Sub IG / Itraxx Xover | 5.0 | 1.67% | 1.4 | 5 | 3 | 2 | 42 | 351% | 4384% |

- Methodology: At Barclays we manage CVA in a trading book framework where CVA (for a defined population of counterparties) is re-valued daily based on market implied parameters, profit and loss volatility is hedged with market instruments and residual risk measured first and foremost with VaR. We welcome regulatory approaches which better align capital standards with internal risk management practices. We see the bond equivalent as an initial step towards a trading book risk approach to CVA. We think however that it falls short of recognising key elements which fall in two broad categories; spread and exposure risk.

Spread risk:

- The bond equivalent approach relies on a proxy measure of CVA sensitivity to credit spreads which assumes a position in risky and riskless bonds. The actual spread risk is from CVA sensitivity to spreads (CV01) which is commonly calculated and used to measure and hedge risks internally. We do not see the benefit of using an alternative measure which will be disconnected from actual sensitivities and risks.
- Spread risk is already reflected in the IMM approach via the maturity adjustment. To isolate the impact of default from spread risk the IMM could be replaced by IRC. Alternatively the effective maturity could be set to one year in the IMM.
- Recognition of hedges is limited to single name CDS and CCDS hedges. Index CDS are used as an effective hedge and often as the only hedge against spread volatility. For example illiquid names CVA may be valued based on index CDS, in which case the corresponding index is a perfect hedge against spread risk. Not only would it make sense to recognise index CDS in the range of possible hedges but also credit swaptions, portfolio tranches and other trading book instruments used to hedge credit spread risk.

Exposure risk:

- When it comes to CVA volatility exposure risk is arguably as important as spread risk. In some instances, for example near default counterparties, it can be much more

important. At Barclays it is being actively hedged using market instruments replicating sensitivities to market factors. Under current proposal not only would the market hedges not be recognised but they would also add to the bank VaR as effectively outright positions. We would therefore suggest that the CVA charge reflects risks to other market factors than credit spreads (IR, FX, Commodities, Equities, Indices) as well as offsetting hedges.

- With an accurate reflection of exposure risks in CVA capital charge, the Alpha parameter would be redundant in the calculation of CVA risks.

Based on the above elements we think the starting point for allocating capital to CVA volatility should be an integrated VaR framework capturing CVA and hedges sensitivities to relevant market factors, included but not limited to credit spreads. This framework should be consistent with trading book capital allocation by VaR for other asset classes. While this framework would apply to advanced IMM counterparties, others could elect to use a standard market risk framework with CVA sensitivities.

2. Stressed EEPE

The CP sets out suggested changes, to address problems seen in respect of general wrong-way risk (WWR – paras 118 – 122). The concern in respect of this risk is shared by Barclays, even though it has been notably difficult to quantify WWR historically. The opportunity to work with the regulators in ways to assess and capitalise this type of residual risk is welcomed.

The proposal to take the higher of current market factors and stressed market factors is clearly appealing, as it is simple in concept and prevents a benign market environment from unjustifiably and increasingly impacting results, as historic spikes fall out of the time series used..

It is, however, noteworthy that the pillar 2 stress test charge should already take potential wrong-way risks into account through the stress scenarios envisaged and there is, therefore, a risk that a stressed Effective EPE charge – which would be computationally highly intensive – is duplicative.

For a number of reasons, we believe that Effective EPE based on stressed inputs may not produce the intended benefits and may even increase overall risk.

- Where the stressed charge dominates, the use test may be weakened, as it is unlikely to be adopted for credit sanctioning purposes. Credit risk management already considers tail values on a client by client basis.
- It will become harder for firms to manage exposures; undertaking additional trades to offset risk based on current market factors could potentially increase the exposure of a stressed EPE basis due to differences in correlations. Furthermore, clients are unlikely to be willing to post initial margin against stress volatility instead of current or market implied volatilities.
- The proposal to implement stressed EEPE will be more challenging than implementation of stressed VaR, as the Monte-Carlo based calculation is computationally more intensive than a historical simulation based VaR. Having parallel systems for EEPE and stress EEPE or changing parameters (e.g. market data and correlations) may introduce additional operational risk.

Industry would add that the main (and most credible) tool to demonstrate EPE validity is back-testing, on which a regulatory approach is of course still in development. We consider that

materiality of the use of a stressed Effective EPE should be reviewed, once a) results of the QIS are known and b) a back-testing framework is published.

3. Wrong-way risk

We agree that it is appropriate to define wrong way risk more clearly and to ensure that it is handled appropriately in regulatory capital calculations. We are concerned that the proposed text in paragraphs 126 to 134 do not achieve these aims.

We agree that there should be a charge for unmitigated specific wrong way risk (SWWR). However, we believe that the language in paragraph 58 is inappropriate requiring the full notional amount to be taken as the EAD. Generally elsewhere in the Basel Accords the EAD is defined as the maximum loss (paragraph 308 in the existing accord); this is best shown via an example:

Fund A replicates an equity index. It invests unit-holders funds in the constituent equities of the index and approaches a bank to allow a 2 x leveraged return to unit holders by way of an equity swap on the index. The fund provides its holdings of equity as collateral to the swap.

In this case there is no legal relationship between the derivative underlying and the counterparty, however, this is much clearer wrong way risk than the broader definition of general wrong way risk (CWWR) provided.

In the example, the counterparty is likely to be in default at the point that the index has fallen by 50%. Therefore taking an EAD of 100% of the index (i.e. full trade notional) is clearly inappropriate. It would be more appropriate to define EAD as maximum loss rather than trade notional. In this case it would be 50% notional plus a buffer (relating to time to close out).

Economically, a wrong-way financing transaction secured by a marketable collateral and subject to a margining mechanism has a significantly better risk profile than an unsecured loan to the same counterparty, as in many likely scenarios the lending bank (i) would be able to collect margin before the borrower defaults and/or (ii) would be able to recover some value from the collateral once the borrower has defaulted, even if there is a clear correlation between the value of the collateral and the credit of the borrower. Completely disregarding or significantly understating the benefit of risk mitigants such as collateral or margining under wrong-way transactions would be detrimental, in particular because it could create a perverse incentive for firms to waive those mitigating features to placate clients, thereby worsening their risk position.

We agree that SWWR can be the result of poorly constructed transactions. We believe that mitigation can be built into transactions to ensure that the economic consequences of such SWWR can be mitigated. Examples of mitigants would include deleverage triggers in the trade (in our example above the remaining notional on the trade reduces dynamically as MTM moves against the counterparty) or by purchasing appropriate hedges, such as a deep out of the money put on the index from an unrelated and credit worthy counterparty. As currently proposed, the regulatory regime would not recognise such measures and therefore would not provide an incentive for the appropriate mitigation of SWWR

4. Asset value correlation for large financial institutions

The proposed definition of financial firms for the proposed asset value correlation (AVC) multiplier is very broad. For $M = 1\text{yr}$ and $\text{LGD} = 60\%$ this would increase risk weightings by 36% at AAA, 32% at BBB- down to 13% at CCC (i.e. from 10.7% to 14.6% at AAA). We assume that the intention is to apply these risk weights to all exposures to such institutions rather than just counterparty risk exposure, although the consultation paper is not clear on this point. We are also keen to understand the rationale behind the choice of a 1.25 multiplier and how this was calibrated, and would hope that the Basel Committee would be willing to consider evidence from banks to support recalibration of this multiplier.

The increased charge for all financial firms under IRB is in stark contrast to the preferential treatment of banks and other regulated financial firms under the standardised approach to Basel 2. This seems illogical and we would suggest that regulated financial firms be exempted from the AVC multiplier.

5. Central counterparties

We support the proposed treatment of derivatives cleared with a high quality central counterparty (CCPs) and support moves towards more clearing of client business, and have been at the forefront of market moves in this area. The application of a 0% risk weight to cleared trades eliminates an issue in the current regime whereby, under the standardised rules, an unrated CCP may be an ineligible guarantor for banking book exposures or a CCP risk treated on a standardised basis is an ineligible guarantor for an exposure treated under IRB. This has a disincentive on clearing, i.e. if a firm hedges a trade with a bank it gets a regulatory benefit in the banking book, but loses the benefit as soon as the trade is cleared.

We recognise that CCPs should be subject to review and where necessary regulation, and that only strong CCPs should attract a 0% risk weighting. However, we are keen that consideration is given to the need to ensure that reviews of risk management standards do not result in 0% risk weightings being removed from CCPs without there having been a suitable opportunity for the CCP to remedy issues raised or the opportunity for members to move their business to other CCPs.

6. Securitisation securities as collateral

We agree that it is appropriate to apply higher supervisory haircuts to securitisation securities held as collateral. We are, however, concerned that the definition of securitisation in the Accord is very broad and can be interpreted in a broad or narrow manner. Therefore, to provide clarity we would like further guidance in this section regarding scope. For example, such guidance could be in the form that any trades that the reporting firm has originated or sponsored or any bonds with a structured finance or securitisation rating from a relevant ECAI are securitisation collateral.

C. LEVERAGE RATIO

Barclays strongly believes that regulators should principally focus on risk-based measures of capital. In principle we believe that a consistently applied leverage ratio could be a useful measure for regulators to identify extreme behaviour, and as such we support the proposal to introduce the ratio as a "backstop" measure. However, we have strong reservations about

making the leverage ratio an integral part of Pillar 1, particularly if the chosen ratio restricts activity that doesn't reflect the risk associated with leverage through the exclusion of all netting.

It is essential that comparability across businesses and international jurisdictions is achieved. The most significant barrier to this is accounting treatment. In particular, the differences between IFRS and US GAAP would have a material impact on the measurement of the leverage ratio at an international level.

Including derivatives within a leverage ratio would be materially misleading and punitive for banks that use derivatives as a prudent hedge against credit risks. It would be a perverse outcome if risks were not effectively hedged as a result of an inappropriately rudimentary regulatory ratio.

1. A Pillar 1 approach is inappropriate

The leverage ratios already employed in the United States, Canada and Switzerland display a marked divergence in design and definition³. More widely, banks have diverse business models and asset books and operate in a multitude of jurisdictions and where accounting treatments vary.

At the macroprudential level, imperfections in the calibration of regulatory risk weights and an institution-specific focus may present difficulties in identifying the build-up of aggregate leverage across the financial system as a whole.

On the face of it the challenge of setting a single standard applicable across different business models, accounting regimes and jurisdictions makes a simple, non risk-based measure seem attractive. However, this approach is an inappropriate way to ensure that the measure only binds, as intended, during periods of extreme credit expansion.

A Pillar 1 approach is likely to be such a blunt instrument that it is likely to cause the ratio to either bite too early, harming economic growth, or be set so wide that it will allow excessive leverage to build-up.

It is important that whatever approach is adopted takes due account of differences in business models. Banks that invest in high grade corporate debt are very different to those that choose to invest in low grade illiquid securities, but under a Pillar 1-type approach, both could have the same leverage ratio.

A Pillar 1 approach to backstop measures also creates incentives for banks to take greater risks by investing in higher risk assets when the regulatory acceptable bound is approached.

We believe that a Pillar 2 approach is more consistent with the regulatory objective of fully understanding the risks within firms and to discourage excessive risk taking to game the system. Regulators are able to take leverage into consideration when undertaking their supervisory review under Pillar 2. Using this existing process seems, to us, a better option than migrating leverage to a Pillar 1 rule. Pillar 2 allows the regulator to consider all relevant factors, including the structure of the business, governance and risk mitigation in place.

³ United States – Tier 1 capital must be $\geq 3\%$ of on-balance sheet assets for “strong” bank holding companies (BHCs) and $\geq 4\%$ for all other BHCs; Canada – Tier 1 and Tier 2 capital must be $\geq 5\%$ of on balance sheet plus qualifying off balance sheet assets for BHCs; Switzerland – Tier 1 capital must be $\geq 3\%$ of on balance sheet assets less Swiss domestic lending for BHCs and $\geq 4\%$ for individual institutions. This is applicable only to Credit Suisse and UBS (source *The Bank of England*)

2. Capital measure

We believe that a regulatory definition of capital is appropriate for use as the capital measure. While the use of a regulatory capital measure with an accounting based exposure measure provides inconsistency (in principle using accounting measures for the numerator and the denominator may be preferable), a regulatory definition is more likely to provide a harmonised definition of capital.

Of the regulatory measures of capital, we favour the use of Tier 1 for the capital measure. We think that this definition is most appropriate as it represents the buffer that is available to bank counterparties in the event of distress. It also has an advantage in that it is currently applied under the US leverage ratio and is widely used by numerous other institutions.

3. Exposure measure

3.1 Netting should be allowed: We do not agree with the proposal to disallow netting. We question how meaningful the gross leverage ratios will be, particularly for wholesale banks. For many institutions, applying the grossed up balance sheet will dwarf the net balance sheet and wrongly put focus on activity that is appropriately risk managed. Focusing on the gross balance sheet activity may impact on activity that provides valid risk management and funding tools for the business and clients. This may be counter-productive where, for example, credit protection is used to manage risk to capital ratios. Furthermore, banks may not be able to control some movements in gross derivatives due to movements in market prices. However, it is vital that any netting treatment for repos and derivatives is consistently applied across jurisdictions.

3.2 High quality liquid assets: We would support the Committee's decision to exclude highly liquid assets as defined under the proposed international liquidity standard.

3.3 Off-balance sheet items: The Committee proposes that off-balance sheet items should be included using a flat 100% credit conversion factor (including commitments to liquidity facilities, unconditionally cancellable commitments, direct credit substitutes, acceptances, standby letters of credit, trade letters of credit, failed transactions and unsettled securities). This would increase exposure significantly and does not match the balance sheet treatment. It is difficult to assess what the impact of this might be, but again highlights that an unduly simplified approach to measuring leverage is unlikely to provide meaningful insights to macro-prudential regulators about the actual levels of leverage in the system and about real world behaviours.

D. CYCLICALITY

We welcome the focus of the Basel Committee on developing measures to reduce cyclicity in capital requirements and support moves in this direction. In addition to views on specific proposals set out below, we also make the following general observations:

- **International co-ordination:** The Basel Committee is one of a number of bodies addressing aspects of cyclicity. It is important that work is co-ordinated across regulators, accountants and others to ensure the resulting regime is well thought out, non-duplicative and practical operationally.
- **The innovative nature of these proposals:** This is difficult territory. We urge regulators to proceed cautiously and guard against premature responses that may not stand the test of time.

1. Limiting the cyclical of the pillar 1 requirement

1.1 Measuring the cyclical of Basel II

We welcome the Committee's initiative to review the cyclical of the Pillar 1 requirement. We would urge this assessment to be as wide-ranging as possible. Cyclical can potentially be observed more widely than just the impact on capital requirements of a rise in PD as economic circumstances deteriorate. For example, risk sensitive PDs may also have reduced the availability of undrawn credit lines (as firms act to limit the rise in capital requirements) especially as firms may have been keen to prove that such lines were (indeed) unconditionally cancellable and therefore truly merited little/no capital.

1.2 Downturn and long term average PD

We believe the concept of a downturn PD is the wrong way to address pillar 1 cyclical and have a clear preference for an approach that utilises some form of long run average. We have already been working with the FSA to implement scalar methodologies across our businesses. In the case of downturn PD our concerns focus on the impact on the required level of capital and how such a concept would be work in practice.

1.3 Calibration of the capital requirement

Downturn PD's would add extra conservatism to the capital calculation on top of the calibration of the curves - which is already set to allow for extreme events.

- If introduced a downturn PD is likely to be calibrated against the recent crisis which may be an inappropriate assessment of risk and is already captured through stress testing.
- A downturn PD will be hard to measure and for some assets will be determined by the chosen segmentation.
- For many assets a downturn PD concept is at odds with established behaviour whereby in a downturn a small number of exposures see a significant rise in PD but many (high quality) see little (or no) movement in PD. Applying a downturn PD to all assets would be inappropriate.
- The development of a downturn PD concept is at odds with the regulatory commitment to TTC methods.
- A downturn PD has no relevance for business usage undermining the use test. In contrast both Point in Time and Through the Cycle PD can be taken into business decisions. Risk models are forward looking utilising the best information currently available.
- The proposal to undertake the calculation at exposure class level ignores the impact of changing underlying credit quality. A portfolio where underlying credit quality has improved could be penalised by an inappropriate legacy historic PD.

Instead, as noted above, we support the development of long run average PDs in the Pillar 1 calculation.

However, our preference is not to support the Committee's proposal to use average historic PD estimates. Model estimates have been available for a limited historic period and their application at the level of asset class means that any changes in credit quality may not be taken into account e.g. a shift to better quality exposures than in the past. Instead, we believe that regulators should acknowledge that this is an inexact science and that the Basel Committee should urge local regulators to adopt a flexible approach so as to enable the adoption of through the cycle methodologies rather than promote a specific methodology. We believe that there needs to be a recognition that a solution that is directionally correct rather than theoretically pure is often the best that can be achieved, and that in our experience it is unlikely that one methodology is capable of being implemented for all asset classes.

2. Forward looking provisioning

Barclays agrees that we need a joined up approach between regulators and accountants and welcome the stance taken by Basel Committee in this regard. Barclays wishes to see a simplification that does not confuse the objectives of either party. For example, an expected loss approach is relevant for the “good book”, whereas the incurred loss model is entirely appropriate for the “bad book”.

More work can be done on standardising to encourage greater consistency between firms and across products but recognise there is no one size that fits all.

Agreement is needed at a conceptual level as to the objective that is being pursued. It is important to base any approach on existing risk metrics that are used to manage the business on the one hand and measures that are internationally consistent and stable on the other. We should not get caught in theoretical abstracts which are impossible to implement.

We do not believe that it is possible, or even desirable, to mask artificially underlying economic cycle effects in the provisioning results of a firm. This means that it is not possible to eliminate entirely the procyclical effects. The market expects provision levels to change through an economic cycle.

Finally, there needs to be greater focus on international consistency in definitions as well as in implementation, recognising legal and other national differences that need to be accommodated.

3. Building Counter Cyclical Buffers

As part of a set of management approaches, informal planning buffers are a sensible concept for the management of capital. The establishment of capital buffers forms part of our Risk Appetite framework and is reviewed at Board level. Maintenance of these capital buffers is closely monitored by senior management at all times. Regulators already have the ability to discuss our buffer levels with senior management. As a consequence we see little reason to put a formal external framework around this practice and would view this as a very significant change.

We support the consistent international development of Recovery Plans. However no guidance is given as to how recovery plans interact with the proposed capital conservation framework. We do not support the concept of hard-coded actions at specified levels of capital and feel that plans to restore utilised buffers would be best addressed via an informal process of agreement between regulators and banks, taking into consideration Recovery Plans and appropriate management actions.

To the extent that a formal capital buffer process is implemented, we make the following recommendations:

- It is important that capital buffers are driven by firms own stress testing analysis with any subsequent adjustments by the regulator being clear and transparent
- It is important that the framework includes the potential benefits of recovery plans in the calculation
- That the capital buffer is a dynamic concept allowing for changes in business model and economic circumstances

- It is important that the planning buffer is a confidential matter between firm and regulator, not externally disclosed, which is operated flexibly to allow firms the incentive to manage down their risks.

4. Excessive credit growth

Discussions on the use of capital in macro-prudential supervision are at an embryonic stage and we recommend that no firm proposals are put forward until this has been fully debated internationally. The issues that need to be addressed include whether capital related actions are implemented across all entities operating in a given market, including branches of overseas banks, and the ability / practicality to apply such capital charges to new flow rather than existing stock of lending. There are other non-capital related actions that could be more effective at managing macro level concerns and we encourage authorities to consider those at the same time as capital to ensure the full range of solutions are available.