



BNP PARIBAS

Chief Executive Officer

Paris, April 16th, 2010

Sirs,

BNP Paribas appreciates to have the opportunity to convey its views on the BCBS Consultative Paper 164 and 165. We have contributed to many banking association responses and we largely support them. However, we have thought it relevant to bring up to your attention our own comments where they might slightly differ or when we believe some issues deserve a particular focus. Our response should not be then expected to be a comprehensive one but wants to reflect BNP Paribas' full implication, presently and at any stage of the reform process.

We support the general thrust and direction of the BCBS recommendations: the status quo is not an option. The severity of the financial crisis calls clearly for a regulation and supervision reform: the current framework needs improvement, such as tougher capital requirements for market activities, stricter definition of capital and better supervision of liquidity. This is also a unique opportunity to progress towards a highly needed and fair level playing field throughout the world, composed of homogeneous principles and consistent application in all countries. Our concern is not limited to the proposed reform but also encompasses all the BCBS recommendations, in particular the recent amendment to the market risk capital requirements that is supposed to be implemented by the end of year with a very significant impact on market activities.

I would like to take the opportunity to underscore that the stability of the financial system is based on:

1. The expertise and social responsibility of the banks' management,
2. The efficiency and coordinated action of supervisors,
3. The relevance of regulation, monetary policy and consumer protection.

Public Authorities should be right about their priorities. In that respect, the coming attention to corporate governance is very welcome and relevant.

.../...

BANK FOR INTERNATIONAL SETTLEMENTS
The Basel Committee and Banking Supervision

Regarding our answer to the proposed regulation in the Consultative Paper, I would like to highlight our major concerns and objections in order to help promoting the consistent reshaping of the banking industry on sound bases:

- Minority interests: the principle of symmetric treatment has to be retained as minority interests do absorb losses in the subsidiary they are invested in,
- DTAs: deduction should be limited to those resulting from operational losses, ie tax losses carried forward,
- Non netting of short positions on own shares and non consolidated financial institutions involving counterparty risk: this technical mistake is to be corrected as it mixes considerations on counterparty risks and on double counting of capital in the banking sector and would have devastating unintended consequences,
- CVA treatment: the approach is to be totally revised, as counterparty risk is to be apprehended either via the default of the counterpart ("banking book" approach) or via the loss through the CVAs ("trading book approach") and certainly not by adding those two approaches,
- Pro-cyclicality: we do not acknowledge the excessive pro-cyclicality of the capital requirements and do not believe that the market and the supervisors would accept any solvency ratio relaxation in dire times. On the other hand, we strongly support the prospective provisioning concept so long it is also recognized by the accounting standard setters. We do not want two sets of accounts. Moreover, we do already have a specific enhanced solvency ratio minima resulting from the Pillar 2 discussions with our supervisors that protects the bank from unplanned downturns.
- Liquidity: we are supportive of the BCBS "Sound Liquidity Management Principles" fostering strict policies and strong practices based on banks' specificities. Minimal ratios should be based either on standardized metrics or on bank-specific ones designed consistently with the above principles and approved by supervisors. We believe that this kind of approach is the most fruitful and flexible one. Unfortunately, the BCBS proposal retains only the standardized method based on excessively strict and crude assumptions. More specifically:
 - o LCR: the underlying inflows and outflows assumptions must be revised; they should not be harsher than the situation observed in the recent severe crisis. The definition of "high liquid assets" must be consistent with the Central Bank eligibility criteria as the underlying systemic crisis scenario implies necessarily their intervention.
 - o NSFR: the objectives and assumptions of the ratio must be totally reconsidered. No one can assume an absence of banks' reaction for a full year in case of narrowing liquidity. No one should deny the fundamental transformation role of the Industry.
- Leverage ratio: except for its extreme (excessive...) simplicity, this indicator has no clear objective and justification; furthermore it has proven failures or flawed definitions wherever it has been applied, in particular in the USA. Application should therefore be based at most on a Pillar 2 approach.

.../...

- Fragmentation: we are very concerned by the general regulation trend towards national ring fencing and the correlative challenge of the relevance and strength of cross-border banking groups. This move appears to us totally at odds with the globalization of the world economy that has been the basis of economic growth for many years.

It is of the utmost importance to have a careful and transparent analysis of the on going QIS. Indeed, as explained above, recommendations presented in the Consultative Paper, even if obviously well intentioned, are in many cases excessive in their tentative calibration and sometimes ill conceived, a direct consequence of the extremely tight schedule granted to write them. This work and the possible conclusions that could be drawn from it, not only on calibration but also on the relevance of some measures, must be the occasion of a second exchange with the Industry through an additional consultative phase – in autumn potentially - before final recommendations can be issued. Besides, we are very concerned by the cumulative impact of the multiple proposed measures and we really need to ensure that they, both individually and collectively, deliver proportionate benefits to the economy.

Implementation needs to take place therefore over an extended timetable dictated by economic recovery and on a step by step basis. In this way, unforeseen and adverse outcomes can be minimized and adjustments made as required. We stress however that even an extended timetable cannot justify misconceived or badly calibrated reforms.

We stand ready to further contribute to the indispensable dialogue required by this fundamental reform that will deeply affect the banking industry, the financial system and furthermore the economy.

Best regards



Baudouin PROT



BNP PARIBAS

1. Capital definition

Issue	BNPP Position	Argument
Minority interests	<ul style="list-style-type: none"> The exclusion of Minority Interests from the Predominant Tier 1 capital is a debatable and unwelcome harsh measure: <ul style="list-style-type: none"> They have undisputable loss capacity absorption for the subsidiaries where they are invested. They are also active ingredients to banking development through partnership, particularly in Europe and emerging economies. There are different ways to respond to these well grounded objections: <ul style="list-style-type: none"> Deducting the part of the subsidiary RWA (Risk Weighted Assets) covered by the minority interests from the consolidated RWA for the determination of the Predominant Tier 1 solvency ratio. Deducting only the minority interest portion that increases the consolidated solvency ratio (the minority interest part of the subsidiary overcapitalization in comparison with the consolidated benchmark) Deducting the minority interest only from the total capital 	<ul style="list-style-type: none"> Minority holdings cannot absorb losses incurred in other subsidiaries of the group but they obviously do for their share in the losses of the subsidiary where they are invested. The RWA adjustment for the Predominant Tier 1 ratio is the easiest way to deal with the issue. The subsidiary undercapitalization incentive is actually remote if the rule applies only to operative subsidiaries, the adequate capitalisation of which is monitored by the supervisory college On the other hand, the alternative method that directly evens out the deducted minority interest has also its shortcomings; its implementation and computation is more complex. The partnership development model is a useful and often prudent way for a bank to expand in less known areas, particularly abroad. In some cases, it is the only way to enter a market or to help restructuring a weakening bank; it may even be imposed by the supervisory bodies. Most of the time, these minority interests are construed as an expression of a long term support that, all in all, may even justify their classification as Tier 2 Capital

Issue	BNPP Position	Argument
DTAs	<ul style="list-style-type: none"> Restrict the deduction to the <u>tax losses carried forward</u> category of DTAs 	<ul style="list-style-type: none"> We perfectly understand that from the supervisors' point of view operational losses do not have immediately available loss absorption capacities. In comparison, tax credits resulting from time differences between accounting and fiscal rules are true assets that have a recoupable value verified by the external auditors. Besides, this kind of DTAs can vary greatly from one jurisdiction to another depending on their accounting and moreover tax provisions. Deducting them from capital would generate distortions across countries.
Unrealized gains and losses on debt instruments	<ul style="list-style-type: none"> It should be made clear that the envisaged rule is only relative to gains and losses recognized through the own funds adjustments and not those affecting the net income (current state of the IAS). Filtering out the gains would be then a prudent and stabilizing modification of the proposed regulation. 	<ul style="list-style-type: none"> Favours a prudent determination of the regulatory capital Boils down the volatility of own funds
Deduction of (i) own shares (\$100) and (ii) participations over the threshold in non consolidated financial institutions (\$101)	<ul style="list-style-type: none"> Disagree with the « non-netting » of short positions involving counterparty risk 	<ul style="list-style-type: none"> It does not make sense to mix considerations on counterparty risk (captured through RWAs and strengthened “wrong way” rules) with the calculation of the net position (i) on own shares and (ii) on other financial institution common equity for double gearing purposes. Doing so would make the resulting capital requirements totally disproportionate and unrelated to the actual risk. See also technical memo on Delta net positions

BCBS CP 164 & 165 – BNP Paribas Position - 16 April 2010

Issue	BNPP Position	Argument
Investment in consolidated insurance subsidiaries	<ul style="list-style-type: none"> • When the double gearing issue for this category of investment is already addressed by a specific regulation, for instance by the European Financial Conglomerate Directive, the banks' regulatory capital should be adjusted according to this regulation while taking into account the new capital definition proposed by the Basel Committee. • No redundancy or interference should be added. 	<ul style="list-style-type: none"> • French banks' insurance subsidiaries, as well as similar cases in other European countries, are the result of a specific business model and development pattern that adds to the diversification of the banking activities. The investment they represent should then be treated accordingly. <p>The double gearing concern is already dealt with through the conglomerate regulation that applies in Europe. Therefore, we strongly oppose to the proposed treatment of investments in insurance companies without appropriate adaptation.</p>
Pension fund assets	<ul style="list-style-type: none"> • The proposed measure appears adequate 	<ul style="list-style-type: none"> • Pension fund commitments cannot be considered as Predominant Tier 1 Capital component even though they may come due on medium or long term maturities.

2. Risk weighted assets

Issue	BNPP Position	Argument
<p>Remaining debated critical “correlation book” issue in the previous market risk package</p>	<ul style="list-style-type: none"> • Oppose CRM floor based on non risk sensitive grounds. • Suggest reliability check through benchmarking of standardized exposures or developing a risk sensitive floor. 	<ul style="list-style-type: none"> • The proposed floor calculation has no economical justification and is, by construction, always over the CRM required capital.
<p>CVA capital requirements</p>	<ul style="list-style-type: none"> • As CVAs can be assimilated to prospective provisions for counterparty risk, therefore it is questionable whether their variations should be capitalised at all. • CVAs and the current capital charge for counterparty risk address the same risk. There should be only one capital charge, not the addition of two charges; we should avoid any double counting between a charge for the variation of CVAs and the current counterparty risk capital charge. • Any capital charge for the variation of CVAs should at least reflect the risk effectively incurred by the bank, taking into account the way CVAs are priced and managed. If the CVAs are priced and managed as a credit position in the banking book, only the risk of default and migration risk should be capitalised through the existing capital charge for counterparty risk. CVAs are very similar to credit provisions and there should be no charge for their variations. • If CVA are priced and managed as any other trading positions, they should incur the market risk charge suite of charges (VaR + Stressed VaR + IRC) and the current capital charge for counterparty risk should be dropped. <p>The current proposal of the one year VaR on bond equivalent is a very bad compromise between the two situations above and badly distorts the risk.</p>	<ul style="list-style-type: none"> • At the time of default, the total amount of CVAs is available again to absorb default losses. • There is no capital for the variations of credit provisions or of market reserves. This creates a precedent. Should a bank be penalised to build up its reserves? The more a bank has CVAs, the less it will suffer at the time of default, losses due to CVAs and losses due to default do not add to one another. • If a counterparty does not default in the coming year, the bank will only face a loss due to the potential increase of CVA, • If a counterparty defaults, any loss made by the bank to increase its CVAs before the default will diminish the loss at the time of default by the same amount. • The capital charge should then be the maximum between a charge to account for a potential increase of CVAs and the current capital charge for counterparty risk (EL+UL) less the existing amount of CVAs • The proposed methodology to capture the CVA volatility charge is highly disputable. The 1-Year bond equivalent does not fit with the sensitivity to CDS spreads and precludes hedge recognition/ impact. The impact on required capital resulting from this approach amounts over tens of billions of Euros per significant banks, which shows clearly its inadequacy. Even a re-calibration would not make it a relevant approach. • See also technical memo on CVAs

Issue	BNPP Position	Argument
Prioritization of the RWA approaches	<ul style="list-style-type: none"> Recalibrating the Standardized Approaches in order to make sure they do not become more favourable than the Advanced Approaches. 	<ul style="list-style-type: none"> It is critical to keep an incentive to adopt the Advanced Approaches and, hence, the risk management best practices.
Increase capital requirements for large financial institution exposures	<ul style="list-style-type: none"> We acknowledge that there is some rationale in increasing the correlation parameter for financial firms. However, the proposed measure will negatively affect a wide range of activities with unwelcome consequences. We are therefore in favour of a bearable recalibration of the correlation factor, hence a lower one than envisaged. We advocate for the extension of the size threshold to all firms (as opposed to only regulated firms) and the use of net asset value as a common size metric. Mutual funds should be clearly excluded from the scope of the measure. 	<ul style="list-style-type: none"> The measure impacts all banks' credit risk exposures and is therefore detrimental to the inter-bank money market, hence to the implementation of central banks' exit strategies, as well as to the international trade and export financing. We consider that there is no evidence that small hedge funds are more correlated than small regulated banks. The measure of total assets is not a comparable metric across industry sub-segments (<i>i.e.</i> banks <i>versus</i> insurance) and may be largely distorted by differing accounting standards. We suggest using Net Asset Value as a better metric, using a lower threshold (<i>e.g.</i> \$3b) The recent crisis has not evidenced any specific risk issue with mutual funds, as they are not leveraged (most regulations such as UCIT will limit borrowing to 10% of total assets).

3. Leverage ratio

Issue	BNPP Position	Argument
Leverage Ratio concept	<ul style="list-style-type: none"> The Leverage Ratio may have had its rationale in the “old good days” but is nowadays totally powerless to assess the leverage level of the economy. Taming excessive leverage is legitimate but cannot be only achieved through a banking ratio. Leveraging can be found in many financial actors regulated or not and particularly through market instruments. 	<ul style="list-style-type: none"> Except for its apparent simplicity, the Leverage Ratio has no objective and clear justification. No demonstration has been convincingly made of its ability to keep the leverage of the economy within a reasonable range compatible with the financial stability. Proven failure or flawed definitions wherever it has been applied, in particular in the USA. Harmful to the exit strategies of central banks as, commingled with the hardened solvency and liquidity ratios it will create conflicting pressures to reduce balance sheets, especially inter-bank money markets and repos: high volumes, low risks, low returns. Harmful to the economy : it will also create a pressure to reduce lending
Pillar 2 with a view to migrating into Pillar 1	<ul style="list-style-type: none"> The proposed Leverage Ratio has unclear objectives. Conceiving it as a possible Pillar 1 hard rule is an historic error and is totally at odds with the successive risk sensitive BCBS solvency reforms. It must solely remain a Pillar 2 indicator. The “crude and neutral” approach inflates significantly the denominator of the ratio; the resulting level of the ratio, read without care by non professional, potentially carries misunderstandings, irrelevant worries, and damaging unintended effects. Because of the complexity of its analysis and its classification as a Pillar 2 component, the Leverage Ratio should not be disclosed in Pillar 3. 	<ul style="list-style-type: none"> The level of banks’ leverage ratio is impacted by many external factors like the accounting and consolidation standards –for instance the accounting of repos- and the prudential rules for the valuation of assets, derivatives and other off balance sheet commitments. It cannot be read, as well, without considering the banking business mix. The ratio or rather its evolution needs to be carefully interpreted by the supervisor in conjunction with other indicators before drawing conclusion, thus acting as an efficient tool. On the contrary, the explanation of the Leverage Ratio evolution may provide new angles of analyses and raise issues that could not be observed otherwise. Such an approach calls for the expertise and the necessary adjustments and judgment of the supervisory bodies
Definition of the Leverage Ratio	<ul style="list-style-type: none"> The “crude and neutral” proposed definition avoids accounting and consolidation standards inconsistencies and encompasses all the possible leveraging components. It is however particularly hazardous to elaborate on the definition of a notion that has neither clear objective nor expected outcome. 	<ul style="list-style-type: none"> The proposed definition circumvents some of the inconsistencies mentioned above, gives a neutral basis for further analyses and could be read in combination with other key risk indicators. It allows comparability over time. This crude definition can also be misleading at first glance and for non perfectly informed persons. We thereafter suggest some adjustments that will have to be contemplated in the course of the dialogue with the supervisors.

4. Other Capital Issues

Issue	BNPP Position	Argument
Pro-cyclicality of the minimum capital requirement	<ul style="list-style-type: none"> The whole concept that aims to correct the so called pro-cyclicality of the Basel 2 framework is flawed. We reject it as such but would favour measures allowing banks to build up reserves in good times for the bad times. Requiring all countries to be compliant with the Basel 2 recommendations, in particular as far as the “through the Cycle” concept and the Pillar 2 requirements Requiring the accounting standard setters to share the financial system stability objectives Discarding the “downturn” PD proposal Relying on the ICAAP and SRP (Pillar2) to set bank’s specific solvency ratios taking into account loss stress testing and capital planning 	<ul style="list-style-type: none"> The Basel 2 framework has introduced a great number of safeguards against excessive cyclicality (long term data horizons to estimate PD, downturn LGD, stress tests considering downward migration, etc..). The pro-cyclical nature of the B2 framework, correctly implemented is not demonstrated nor shown in actual data. The “downturn” PD would have cumulative effect with the “downturn” LGD and the use of the highest average PD estimate or the average of historic PD estimates to each of the bank’s exposure classes would be a strong disincentive to review obligors’ ratings. Moreover, the “downturn” PD does not meet the “use test” requirement. Bank’s resilience stress testing and, more generally, the Pillar 2 process, are much more efficient to set an adequate solvency ratio floor than this new and non experimented concept. No one knows, ex ante, the status of the economic cycle.
Capital buffers	<ul style="list-style-type: none"> This concept should not be anything else than the Pillar 2 requirements. 	<ul style="list-style-type: none"> The calibration of these “buffers” is based on unknown methodology and does not seem to have any theoretical grounds. The objective of the measure will not be achieved. Banks will not be allowed, neither by their supervisor nor the market, to use their buffer when the economic situation gets worse. The best way to tackle the issue is to improve the proposed accounting standards on forward looking provisioning so that they become in line with prudential point of view. There will be then no need for additional prudential rules.
Earnings distribution constraints	<ul style="list-style-type: none"> There is no need to formalize such provisions. These constraints are partially a sub-product of the Pillar 2 process. The ways and means to meet the solvency requirements determined by the supervisors is the bank’s responsibility 	<ul style="list-style-type: none"> The measure is contrary to most of the legal frameworks: distributions of earnings are determined by the shareholders’ representatives. The measure would mean the disclosure of the supervisor’s buffer requirements, implying many drawbacks and responsibility issues. This intrusion of the supervisory bodies in the banks’ management is excessive and fundamentally not consistent with the independence principle between the supervisors and the bodies under their control.
Excessive credit growth	<ul style="list-style-type: none"> This concern is already handled by the other bank’s constraints like the solvency ratio or the liquidity requirements. It should be discarded. 	<ul style="list-style-type: none"> The proposal to limit the excessive credit growth is too imprecise both in its content and its scope to be seriously taken into account.

5. Liquidity

Issue	BNPP Position	Argument
The need for a liquidity regulation	<ul style="list-style-type: none"> • The liquidity regulation is critical to the financial stability. Banks must undoubtedly be able to survive a one month stress and to restrain from excessive transformation. • However, the consultative paper proposes rules that have severe flaws and jeopardize severely the banking intermediation role. 	<ul style="list-style-type: none"> • Banks' failures are firstly caused by liquidity shortage as an early expression of solvency issues • Liquidity resilience is a complex issue that cannot be adequately handled through two "one-size-fits-all" ratios • Liquidity management, business diversification and corporate reputation play a critical role • See also our technical memo on Liquidity
Consistency of the proposed liquidity regulation set up	<ul style="list-style-type: none"> • The regulation must be applied by all countries and all institutions • Host and Home Regulators' roles should be clearly defined within the Euro zone Coordination through Colleges must be enhanced • The supervision should be focused on the consolidated banking group situation, even though currency and legal body constraints cannot be ignored. • Intra-Group funding should not be considered as pure inter-bank transactions 	<ul style="list-style-type: none"> • Liquidity concerns do not stop at banks; they are also essential for the whole financial industry: across countries (incl. US) and institutions, banks as well as non banks or ad hoc entities like Government sponsored ones. • Application to sub-perimeters / local entities would hinder proper trans-national banking group liquidity management, have severe consequences on resource allocation mechanisms and be in contradiction with the free movement of capital within the Euro zone. • Intra-group funding is critical for the resilience of the banking system and the balanced development of national economies. Without capacities to reallocate resources across agents, countries and time horizons, the economy dies.

Issue	BNPP Position	Argument
<p>Bank's specific set of liquidity limits and procedures</p>	<ul style="list-style-type: none"> • The “one-size-fits-all” assumptions of the proposed ratio framework is at odds with both: <ul style="list-style-type: none"> ○ Facts evidenced in the crisis; ○ Bank's specific factors and business mix. • A standard minimal LCR could make sense from a systemic point of view. • The NSFR should be a Pillar 2 regulation. 	<ul style="list-style-type: none"> • The assumptions are the same for a 100%retail bank, for a 100%investment bank and for a bank that would completely depend on market funding (ex: Northern Rock), which is clearly non appropriate: diversified banking institutions cannot have a single set of ratios, none being adapted to its various business activities • The assumptions deny facts evidenced during the crisis, examples of which are: equities have remained liquid, only a very small portion of lines of credit have been drawn down, repo exchanges and tri-party repos have enhanced liquidity, etc. • If the recognition of adequate liquidity and gap management policies were to be denied to banks, one-size-fits-all assumptions would need to be dramatically revised to accommodate for more granular breakdown and more realistic runoff/rollover assumptions. We propose then to create two different regulatory regimes: (i) a standard regime, based on standardized liquidity risk measurement framework and (ii) an advanced regime, based on advanced set of risk metrics, adapted to diversified multinational banks. The advanced regime would be the application of the full set of “Sound liquidity management principles” defined by the Basel Committee himself in September 2008. This approach includes the following strong points: <ul style="list-style-type: none"> ▪ It is based on risk simulation and stress testing, leading to the definition of the liquidity buffers which will allow the bank to withstand a liquidity crisis over a given period of time ▪ It ensures a full convergence between regulatory reporting, and management methodologies, which guarantees an all-time compliance with regulatory standards ▪ It makes Supervisors fully informed of all components of internal liquidity management, and enables them to assess the quality of information and management systems ▪ It requires a total commitment from General Management (Executive Committee, Board) who are directly responsible for the main decisions regarding liquidity policy (liquidity buffers, gapping limits, diversification, internal transfer pricing..) ▪ It outlines the Governance set up and rules implemented by the bank <p>It fits the specificities of the bank's business model, which cannot be obtained through a standardised set of risk metrics.</p>

BCBS CP 164 & 165 – BNP Paribas Position - 16 April 2010

Issue	BNPP Position	Argument
LCR High Quality Liquid Asset definition	<ul style="list-style-type: none"> The definition of high quality liquid assets is unduly too narrow. It should at least encompass all the assets that are currently listed as eligible for refinancing by central banks. 	<ul style="list-style-type: none"> The LCR scenario is not consistent with market behaviour. Either we assume a double stress (both idiosyncratic and systemic) and then it will be impossible to sell or repo government bonds in a dislocated market without triggering a systemic risk characterized by the well-known process “firesales-losses”, the only solution being to repo all eligible assets with Central Banks. Or we keep on avoiding any reference to the Central bank eligibility criteria and the stress can only idiosyncratic so that the sale or repo of highly liquid assets is possible, which implies normal market conditions. Liquid assets should also include assets whose liquidity has been reality-checked in the most acute liquidity crisis in decades (such as equities).
LCR assumptions	<ul style="list-style-type: none"> The runoff assumptions for the 1 month ratio needs to be more granular and derived from facts observed during the crisis that have shown to be less severe A symmetric treatment should be applied to liquidity lines given to and received from financial institutions Cash inflows should take into account the actual liquidity of capital market assets 	<ul style="list-style-type: none"> Only a small part of the liquidity back up lines would be drawn down, as evidenced during the crisis. Runoff deposits rates should be derived from facts experienced during the crisis, especially as regards financial institutions
NSFR assumptions	<ul style="list-style-type: none"> The NSFR needs to be bank specific, to take into account the bank's business mix and not be derived from a “one-size-fits-all” assumption set. In the event it is not, the 1 year long bank-specific stress test assumptions, which the Net Stable Funding Ratio (NSFR) derives from ignoring the changes in business models that would take place over such an extended crisis period. In case it is derived from stress test-testing, the NSFR should embed scale down assumptions on specific businesses of the bank. NSFR assumptions should result from the Pillar 2 dialogue with the supervisors, taking into account the diversity of the business models involved. 	<ul style="list-style-type: none"> The NSFR scenario is not consistent with the management of banking institutions. First, requiring a bank to do more than matching its credits with same duration of resources is not conceivable. Second, under its assumptions, the NSFR require banks to term fund loans that have not been made yet. And third, the ratio does not consider the capacity to react to a funding depletion in a timely manner, which characterizes well-managed banking institutions (especially in a one year time frame). In particular, it is totally unrealistic to consider that the renewal rates on credits and on resources are identical, since a bank will quickly consider stopping asset production in case of funding depletion Equities cannot be considered 50% illiquid on a one year time frame It is odd that 85% of retail credits are assumed to be renewed while ABS maturing in the year are not. Does it mean that banks should stop making retail credits and buy ABS, which was just one of the main reasons why the crisis did spill-over worldwide?

BCBS CP 164 & 165 – BNP Paribas Position - 16 April 2010

Issue	BNPP Position	Argument
NSFR objectives	<ul style="list-style-type: none"> • The objective of the ratio is unclear, which make its requirements questionable • It forces banks to downsize liquidity gapping, which is at odds with their very social role in the economy: short term loans would need to be partially medium term funded. 	<ul style="list-style-type: none"> • This requirement will cause banks to raise huge amount on medium term funds in competition with government bond and programs and corporate bond issuances. In a context of inelastic demand for medium term instruments, interest rates will raise, banks will reduce their lending activities and pass their funding cost increase on to their clients. • If banks were obliged to scale down their transformation role significantly, liquidity gapping would increase outside the banking industry, out of the supervisory framework and without access to banking safety nets (liquidity buffer, access to central banks..), which would dramatically increase systemic risks. • The NSFR will require a dramatic increase of banks' medium term funding; but who is going to take the gapping position? Private individuals? Investment funds? Hedge funds?
NSFR Financial Institution discrimination	<ul style="list-style-type: none"> • Financial institutions should not be discriminated from the other economic agents. • Their funding is as reliable and stable as most of the large corporate counterparts • Reciprocal funding relationship is far from being the general rule 	<ul style="list-style-type: none"> • This is the negation of the basic banking role of reallocating financial resources. • Contrary to credit risk exposure, working with other regulated banks would be more penalizing than working with non regulated industries! • This would increase systemic risk.
Systemic risk associated to the required disclosure	<ul style="list-style-type: none"> • The liquidity bank's position should not be disclosed. For this matter, transparency is both dangerous and illusory. 	<ul style="list-style-type: none"> • Risk disclosures make sense when they don't change the risk being disclosed: disclosing the bank market risk or the bank credit risk does not change the market risk or the credit risk. • This is completely different for liquidity risk since the disclosed liquidity risk can trigger or reinforce a liquidity crisis. • Each week, market behaviours show that they can trigger a crisis on no robust grounds. • This is a form of pro-cyclical risk which actually increases the risk that it intends to manage. • The disclosure will mostly be outdated
Operational issue	<ul style="list-style-type: none"> • The complexity comprehensiveness and time availability requirements of the data expected by the regulators 	<ul style="list-style-type: none"> • None of the CP expectation can be met by banks particularly given the time allowed to make the data available to supervisors.

BCBS CP 164 & 165 – BNP Paribas Position - 16 April 2010

Issues	Topics	Comments
Unintended consequences	<ul style="list-style-type: none"> As regards liquid asset definition: 	<ul style="list-style-type: none"> Significant reduction in liquidity of Government bonds, since banks will keep frozen huge portfolios Compliance with LCR will depend on rating agencies, since rating will be the main criteria for asset liquidity. In other words, the regulated system's liquidity will be under the pressure of a very few number of non regulated institutions The already jeopardized banking system will be almost destroyed by the discrimination of banking institutions In some countries, the Government bonds market will be too small and will not allow local banks to comply with the LCR (Norway, Australia..)
	<ul style="list-style-type: none"> As regards NSFR assumptions 	<ul style="list-style-type: none"> Strong competition between banks, corporates and Sovereign on debt markets ; no room available for all of them, and increase in cost of debt Liquidity issues will be significantly transferred from regulated to non regulated institutions ; coupled with the reduction of short term funding, this will reduce the role of Central Banks in the management of liquidity Complying with a standard ratio whatever the business model may lead to an harmonization of these models between banks, which may increase systemic risks Credit renewal assumptions may lead to increase investment in ABS, which was one main reasons why the crisis spilt over worldwide
	<ul style="list-style-type: none"> On the whole 	<ul style="list-style-type: none"> The amount of medium/term debt to be taken on the market being totally unrealistic, banks will have to reduce dramatically their credits, which opposes to Government's will, and will impact economic growth High competition on debt markets will trigger a general increase of financing costs for the whole economy In case of unlevelled playing field, these two consequences will impact economic growth in those countries applying the new regulation, such giving to the other countries (USA, Asia?) to possibility to perform much better in terms of economic growth.



BNP PARIBAS

1. Capital definition

Issue	BNPP Position	Argument
Grandfathering of instruments included in the Predominant Tier1 Capital	<ul style="list-style-type: none"> Instruments eligible to the Predominant Tier 1 Capital should be strictly compliant the new definition Grandfathering is not justifiable 	<ul style="list-style-type: none"> Deviating from this approach would be detrimental to the overarching objective of the BCBS to have a consistent own fund definition across the institutions and the countries. Grandfathering cannot be conceived for a notion that does not exist beforehand.
Criteria for classification as Tier-1 Additional Going Concern Capital	<ul style="list-style-type: none"> We fear that a limited number of Basle's eligibility criteria are too strict and will effectively deprive banks of a large and flexible source of diversified capital. We strongly support adjustments to criteria 7.a and 11. Criteria 7.a: Allow dividend pusher mechanism, which are critical to the Going Concern Capital investor base. Criteria 11: Deletion of the requirement for terms of instruments classified as liability to include either a conversion into common shares or a permanent write down. 	<ul style="list-style-type: none"> It is critical to maintain a hierarchy between the different types of investors in order to have an efficient and diversified capital investor base. The seniority of holders of instruments included in Tier-1 Additional Going Concern above the holders of most subordinated instruments included in Common Equity must be respected. In this respect, we strongly support the application of article 83 from the CEBS implementation guidelines for hybrid capital instruments, dated Dec, 10th 2009. As long as Criteria 10 is fulfilled, we see no regulatory benefit in requiring this Criteria 11 nor does it increase the capital quality of Tier-1 Additional Concern Capital. This would only create a competitive distortion with US and UK practice (preference shares which have a legal nature of equity, would not be subject to such conversion or write down). Permanent write down embedded in Criteria 11 is conceptually not acceptable as it effectively subordinates Going Concern Capital to Common Equity, while Common Equity must be the most subordinated form of capital according to Basle's eligibility criteria.
Participations over the threshold in non consolidated financial institutions (2)	<ul style="list-style-type: none"> Exempting of the deduction rule holdings: <ul style="list-style-type: none"> in market place organisations in ancillary banking services undertakings Risk-weighting them as other assets (100%) 	<ul style="list-style-type: none"> Operating structures required for a proper functioning of the market place or the institution itself should be risk-weighted as other assets, i.e. with a 100% RWA Organizational choices of the market place or the institution should not be influenced by capital requirement considerations, in particular as they are made to reduce both risks and operating costs

BCBS 164 & 165 – BNP Paribas Position (Additional points) – 16 April 2010

Issue	BNPP Position	Argument
Shortfall of the stock of provisions to the one year EL	<ul style="list-style-type: none"> • Agreement on the principle but point on hold until the “CVA” issue is clarified • Excesses of provisions, CVAs included, over the 1-Year EL should symmetrically be recognized fully as Tier 1 capital (subject to the previous caveat) 	<ul style="list-style-type: none"> • This issue must be considered jointly with the treatment of the prospective provisioning and the capital requirements relative to the CVAs. • These excesses are actually an allocation of retained earnings but their benchmark against the 1-Year EL cannot make them a predominant tier 1 component.
Cash flow hedge reserve	<ul style="list-style-type: none"> • Agreement on the proposed rule 	
Cumulative gains and losses due to changes in own credit risk on fair valued financial liabilities	<ul style="list-style-type: none"> • Support the proposed recommendation 	<ul style="list-style-type: none"> • This observation should remain valid in all circumstances, including for CVA computation
Goodwill	<ul style="list-style-type: none"> • Accept the proposed recommendation that remains very strict 	<ul style="list-style-type: none"> • The goodwill value, which does exist, has always been challenged from a prudential point of view because of its immateriality and lack of robustness.

2. Risk weighted assets

Issue	BNPP Position	Argument
Treatment of highly leveraged counterparties	<ul style="list-style-type: none"> The scope of the measure and the concept of “performance of assets based on periods of stressed volatilities” is unclear. The measure should be removed or, at least restricted to unregulated counterparties. 	<ul style="list-style-type: none"> Rating practices for hedge funds already include a large amount of conservatism. The proposal is inconsistent with the principle of “through the cycle” ratings that apply in the Basel framework.
Addressing reliance on external credit ratings and minimising cliff effects	<ul style="list-style-type: none"> Agreement with the proposal. 	<ul style="list-style-type: none"> We believe such proposal will limit further any procyclicality in capital requirements.
Effective EPE with stressed parameters to address general wrong way risk	<ul style="list-style-type: none"> Oppose the principle of two calculations (stressed and current) and plead for one single calibration on a period covering a full economic cycle <u>and</u> the stressed period used for the stressed VaR. Fall-back: calibrate on a period of <u>at least</u> 3 years including the stressed period used for the SVaR. Plead for a parallel increase in capital requirements on the standard approach equally. 	<ul style="list-style-type: none"> Such a proposal bears many negative operational consequences (use-test issues, impact on filters at origination set-up, etc). We advocate keeping in place a hierarchy in the approaches. Advanced Approaches are supposed to better grasp the true level of risk.
General and specific wrong way risk	<ul style="list-style-type: none"> We support the measures on the principle as they are widely consistent with sound risk management practices. However we recommend the use of “own risk based assessment” for correlation between the underlying and the counterparty for specific wrong way risk <p>We oppose the use of notional for CDS presenting wrong way risk and propose to use the jump-to-default measure.</p>	<ul style="list-style-type: none"> “Legal connection” criterion is too vague and sometimes mis-represents the correlation risk In addition, whenever there is a degree of de-correlation between the underlying and the counterparty, the exposure must be commensurate with the degree of correlation. CDS are more and more traded on an up-front basis implying that the maximum loss is much lower than notional.

BCBS 164 & 165 – BNP Paribas Position (Additional points) – 16 April 2010

Issue	BNPP Position	Argument
Collateralised counterparties and margin period of risk	<ul style="list-style-type: none"> • BNP Paribas stands neutral on the principle but is opposed to the proposed criteria triggering the increase in margin periods. • A clearer and widely accepted definition of the “illiquidity” trigger such as level 3 assets should be specified. • In favour of size materiality thresholds of illiquid collateral, illiquid OTC derivatives and collateral disputes. 	<ul style="list-style-type: none"> • The measure would promote potential cliff and/ or spill-over effects. • Incentives for avoidance tactics, which will decrease the possibilities. of netting and hence, ultimately increase the risks • Room for interpretation and hence arbitrage.
Central counterparties	<ul style="list-style-type: none"> • Supportive 	
Enhanced counterparty credit risk management requirements	<ul style="list-style-type: none"> • Neutral / supportive • In particular, supportive of alpha recalibration 	
Addressing reliance on external credit ratings and minimising cliff effects	<ul style="list-style-type: none"> • Supportive 	

3- Leverage ratio : interpretation and possible related adjustments

Issue	BNPP Position	Argument
Pillar 2 interpretation together with other indicators	<ul style="list-style-type: none"> • The appropriate interpretation should be made on a case-by-case basis by the supervisor, defining with the institution the range of possible adjustments necessary to understand rightly the meaning of the ratio changes in the context specific to the bank. • Total Tier 1 (on a consolidated basis at group level) appears to be an acceptable basis for the calculation of a leverage ratio as a going concern measure of capital. 	<ul style="list-style-type: none"> • Supervisors must assess the institution's capital strength within the Pillar 2 framework. The Leverage Ratio is an additional tool to identify changes that would show an excessive use of leverage in the conduct of bank's activity or the structuring of market instruments. • The analysis of the Leverage Ratio behaviour must also take into account the structure of the financial markets concerned, the level of intermediation, the existence of actors absorbing part of banks' off-balance sheets (such as US mortgage agencies), the business mix of the financial institution • Total Tier 1 is by definition the new "going concern" measure of capital.
Netting and margin requirements benefits	<ul style="list-style-type: none"> • The Basel 2 netting and mitigating rules would be useful adjustments in order to avoid inadequate assessment of the leveraging of some activities affected by inflated amounts. 	<ul style="list-style-type: none"> • Although we reckon that in respect of comparability across jurisdictions the no-netting and credit risk mitigation rejection approach has some merit, it makes the ratio very volatile and inflated.
Off balance sheet items and CCFs	<ul style="list-style-type: none"> • The credit conversion factor ascribed to certain off-balance sheet items (100%CCF) should be reviewed on a case by case basis and carefully mitigated by consideration of the effective leverage represented by off-balance sheets assets. The credit conversion factors as per Basel 2 existing rules could be the basis of this adjustment. • The supervisors' review should be undertaken based on a sound understanding of both the operational context of the relevant transaction and the mechanics of the transaction. 	<ul style="list-style-type: none"> • Certain commitments are not necessarily turned into leveraging, for example acceptances, standby letters of credit, trade letters of credit, unsettled securities, etc. • Trade finance would be severely hit, even in a Pillar 2 context, while their leveraging component is far from being clear and certainly not the cause of the crisis.

BCBS 164 & 165 – BNP Paribas Position (Additional points) – 16 April 2010

Issue	BNPP Position	Argument
Credit Derivatives	<ul style="list-style-type: none"> • The Leverage Ratio analysis should take into account the particular nature of these instruments and the inflating effect on the gross asset figures due to: <ul style="list-style-type: none"> ○ The use of the full notional for protection sold ○ The absence of any offsetting for bought protection, which creates double counting effects within the denominator of the leverage ratio; 	<ul style="list-style-type: none"> • CDS are the representation of the underlying asset credit risk. They are not as such a leveraging factor even though it may be sustained that they contribute to easing the leveraging, which actually occurs through the underlying instrument. • The leverage ratio is an inappropriate answer to the issue of sold CDS and exposures. The response to such exposures is the market transparency of CDS exposures by counterparties, using data provided to trade repositories and central counterparties in the CDS market.
Securitizations	<ul style="list-style-type: none"> • Each firm should have its supervisor reviewed its products and practices, as well as the actual legal and marketing documentation in order to determine the adequate treatment of the transaction in the Leverage ratio. 	<ul style="list-style-type: none"> • Discrepancies in the accounting treatment cannot be dealt with by imposing a blanket rule requiring the inclusion of all securitized portfolios for leverage ratio purposes. • Where operational requirements for risk transfer in compliance with the regulatory framework are met, de-recognition of transferred securitisation transaction should be allowed
Disclosure issues	<ul style="list-style-type: none"> • If market discipline plays a key role in sound financial systems, the nature of certain information disclosed in the course of a dialogue between supervisors and institutions should be subject to a strict confidentiality and be restricted from a full public disclosure. • This is particularly the case of this indicator that raises many issues and may mislead investors. 	<ul style="list-style-type: none"> • Any disclosure regime on the issue of leverage should be carefully designed so that the right balance is achieved between the informational needs by the market, the careful and detailed analysis requested by the crude leverage ratio as proposed, and information obtained under the confidential auspices of Pillar 2.

4. Liquidity

Issue	BNPP Position	Argument
Transition Process	<ul style="list-style-type: none"> • Considering the far reaching consequences of the suggested funding regulation well beyond the banking industry, the transition needs to be carefully set up. • The regulatory framework could be articulated around an ongoing close consultation process up to the final liquidity framework <ul style="list-style-type: none"> ▪ Transparent Analysis of the Quantitative Impact Study, with its consequences on the economy as a whole ▪ Hearings/ bilateral discussions between supervisors and banks for suggested changes and updated liquidity framework subject to a consultation process 	<ul style="list-style-type: none"> • A phase-in transition so that the impacts on the economy and the required banks' adaptations in systems in particular are spread over time, its duration to be fine tuned with the second round of impact study. This could be implemented with binding thresholds that would be increased progressively over time. • Additionally, in order not to avoid regulatory and unlevel playing field between banks subject to LCR and NSFR requirements and other banks, the liquidity regulation should apply to <i>all</i> banks (internationally active or not), in <i>all</i> jurisdictions, with the <i>same</i> transition process, in particular in terms of timing.
Currency Convertibility	<ul style="list-style-type: none"> • Convertibility shutdown for usually highly convertible currencies is far too extreme an assumption 	<ul style="list-style-type: none"> • For idiosyncratic crisis-based NSFR, there is no rationale for assuming any reduction in currency convertibility. • For LCR, reduction in currency convertibility should not be applied to usually highly convertible currencies.
Scope of application	<ul style="list-style-type: none"> • We recommend that funding risk requirements are applied at consolidated level 	<ul style="list-style-type: none"> • Should sub-consolidated levels be considered, they should <i>not be smaller than</i> pools of entities when the following criteria are met: <ul style="list-style-type: none"> • actual liquidity risk management is global to the pool of entities; • capacity to transfer liquidity; • legally binding commitments between the entities. • Subject to those criteria and to address liquidity issue in respect of any specific entity, or group of entities, within the pool of entities that meet those criteria there should be an automatic waiving process for each entity in the group. This will require clearly articulated governance and coordination between the supervisors.

BCBS 164 & 165 – BNP Paribas Position (Additional points) – 16 April 2010

Issue	BNPP Position	Argument
Internal transactions	<ul style="list-style-type: none"> Should LCR or NSFR be required at sub consolidated levels, which we don't recommend, the treatment of internal transactions would need to be clearly articulated. 	<ul style="list-style-type: none"> Additionally, intra-group transactions, within between entities in the same group of pooled entities or between entities that are in different groups of pooled entities (some of which may be constituted of a single entity) must be treated under assumptions that: <ul style="list-style-type: none"> are consistent with legally binding commitments; must be symmetrical from both sides of the internal deal; must be consistent with the rollover assumptions of the transactions that are ultimately funded / invested. If an activity is scaled down in the stress scenario, the scale down assumption should be applied to the same extent to intra-group with this subsidiary. may differ within the same Group (ie: not necessarily a single method in a specific Group)
Standardized assumption sets of NSFR and LCR	<ul style="list-style-type: none"> The standardized assumption sets for LCR and NSFR need being modified 	<ul style="list-style-type: none"> LCR and NSFR should be considered in combination: <ul style="list-style-type: none"> NSFR addresses the liquidity position at 1 year horizon. Considering the NSFR, which enables a sound term liquidity position, LCR is designed to make sure the bank is able to resist a severe stress test on a one month horizon NSFR derives from a 1 year long idiosyncratic liquidity stress test scenario <ul style="list-style-type: none"> Central Bank eligibility is not a criterion <i>per se</i> for NSFR-liquidity Unsecured funding sources are assumed to decrease but not to completely disappear (notably, not all inter-bank funding is assumed to vanish) NSFR should be consistent with the transformation function of the banking industry, notably through the lower than 100% threshold that will be chosen NSFR should embed the bank's expected reactions / changes in its business models in such an extended stress scenario, by breaking down asset generating businesses into "ongoing concern businesses" (that can be partially scaled down) and "non ongoing concern business" (that can be completely stopped in a crisis) NSFR should embed the bank's expected prepayment on loans Consistency should be ensured between assumed decrease in funding sources and assumed roll over assumptions (ex: the higher the runoff for inter-bank funding source, the lower the rollover assumptions for loans)

BCBS 164 & 165 – BNP Paribas Position (Additional points) – 16 April 2010

Issue	BNPP Position	Argument
<p>Standardized assumption sets of NSFR and LCR</p> <p>(Continued)</p>	<ul style="list-style-type: none"> • (Continued) The standardized assumption sets for LCR and NSFR need being modified 	<ul style="list-style-type: none"> • LCR derives from a 1 month market-wide and idiosyncratic liquidity stress test scenario: <ul style="list-style-type: none"> ◦ Central Banks are part of the crisis management process and Central Bank eligible assets are considered as liquid assets¹ ◦ The severity of stress assumptions can be revised down to be consistent with observed facts in the direct crisis in decades • Liquid assets are evidence-based-derived and take into account sell-ability, repo-ability and market infrastructure (eg: repo exchanges, tri-party repo). Underlying stress scenarios are different as well both LCR-liquid assets and NSFR-liquid assets are different. • Symmetry should apply to similar assets and liabilities (ex: drawdown assumptions) • Deposit stickiness and loans' rollover should derive from both relationship and customer / counterparty types. <ul style="list-style-type: none"> - As an example, a deposit from a financial institution to which the bank has an ongoing strong relationship should be considered stickier than a deposit from a financial institution without such an ongoing relationship • The "<i>Financial institution</i>" category must be broken down in more granular categories • To cope with volatile balances, average balances, over relevant periods, could be used • Statistical methods can be used to map transactions to the pre-determined categories • Foreign exchange convertibility is unchanged for NSFR. Highly liquid and convertible currencies in normal times remain liquid and convertible for LCR • Assumption sets should be consistent with legally binding commitments • The assumptions to apply to transactions, pools of transactions or balance sheet accounts that are not explicitly covered by the LCR- or NSFR-assumption sets could be agreed upon with the relevant supervisor (local supervisor for local issues, college of supervisors for global issues) • Other assumptions will be needed to cover the entire balance sheet. A combination of standardized assumption set for all, and local supervisor adaptation : <ul style="list-style-type: none"> ◦ Regularization accounts on both sides of the balance sheets do not necessarily relate to funding issues. They should not be allocated a 100% overlay factor in the required funding ratio, and a 0% overlay factor in the available funding ratio • Derivatives accounted for as assets (eg: bought options and swaps with positive values) should not be considered as requiring 1 year term funding for their value. Conversely, derivatives accounted for as liabilities (eg: written options and swaps with negative values) should not be considered an available funding source.

¹ NSFR requires that non liquid securities need term funding. The combination of both NSFR and LCR makes sure that the central bank eligibility is not used not to term fund those assets. As the matter of fact it is the NSFR term funding requirements which provide that central bank eligibility is a liquidity buffer (ie: that it delivers additional liquidity).

THE CREDIT VALUE ADJUSTMENT ISSUE

Executive Summary

A Credit Valuation Adjustment (CVA) is the credit price of counterparty risk. As such it is part of the fair market value required by accounting standards (IFRS). On default, the amount of CVAs is available to offset any loss related to the default of the counterparty.

As a result, CVAs can be assimilated to prospective provisions for counterparty credit risk. They are a way to provision very early, well before a risk of default becomes likely. The losses due to CVAs do not add up to the losses due to defaults, they are mutually exclusive; they are resulting from exactly the same risk but are appearing at a different time of the underlying instrument's life.

- Either a counterparty defaults in the coming year and any CVA already charged will be available to offset the loss at time of default,
- Or the counterparty does not default in the coming year and the bank may only have to face a loss due to the potential increase of the counterparty CVA attached to the counterparty.

Depending on the methodology applied in computing the CVAs, they can represent significantly larger amounts than the regulatory expected loss for counterparty risk and can be materially more volatile. Actually, regulators claim that a significant part of the losses due to counterparty risk during the crisis were in fact due to CVAs and not to the default of counterparties. Regulators suggest consequently that there should be a capital charge addressing this particular phenomenon that would add to the current capital charge for counterparty risk and propose a methodology to do so which is completely at odds with the risk effectively incurred by the institutions.

We believe this reasoning is flawed in many ways:

- As CVAs are prospective provisions like prospective provisions for credit risk, requiring a capital charge to cover their potential increase in the coming year is unheard of. Do we want to penalise banks that build up adequate and prudent reserves?
- As CVAs address counterparty risk which is already capitalised, the charge for the variation of CVAs should not add to the current counterparty risk capital charge.
- Should a capital charge be retained to cover the potential increase of CVAs in the coming year, it should at least reflect the true risk incurred by the institutions so as to have consistent impacts in terms of earnings and capital and allow for a consistent management of the two. We believe that the diversity in the existing CVA frameworks in terms of accounting treatment and managing intent pleads for some flexibility in the associated capital charge, and we suggest a better approach than the current bond equivalent proposal.

What are CVAs?

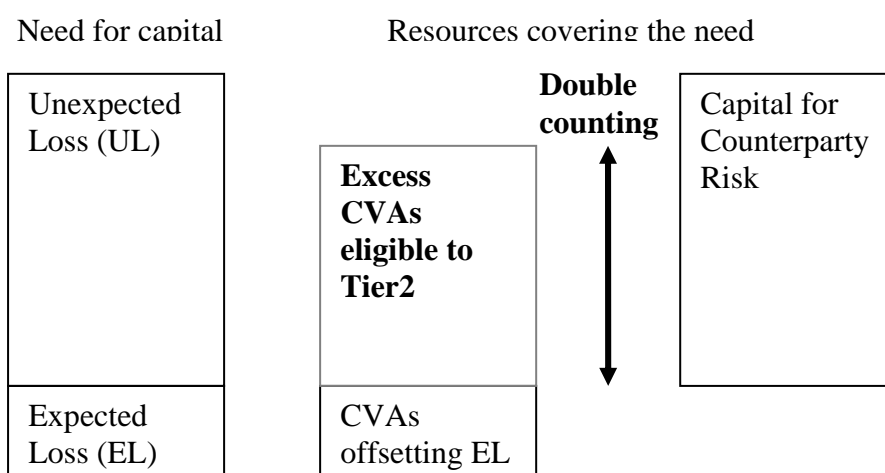
From an accounting point of view, a Credit Valuation Adjustment (CVA) is the credit price of counterparty risk. Banks should price their derivative products taking into account the credit quality of the counterparty. The idea is to discount from the counterparty portfolio, marked to market, the expected loss due to a potential default of the counterparty. CVAs are computed at counterparty level and not at deal level which explains why they are dealt with separately from the “counterparty risk free” derivatives valuation. CVAs are computed on a monthly basis with new deals or deals arriving at maturity or being unwound affecting the new stock of CVAs. For each new or expiring deal a marginal CVA is added or removed from the stock of CVA for the counterparty. In case of default, the total amount of CVA for the counterparty becomes available to offset the actual loss. CVA is acting as a prospective provision for counterparty risk.

From a risk point of view, CVA is a best practice that forces the banks to reserve for counterparty risk at maturity very early on an continuously updated basis. CVA is also an economic expected loss up to maturity rather than only for the first year. This explains why CVA amount can be substantially larger than the regulatory expected loss.

From a regulatory point of view, CVAs are currently used to show that the 1-Year expected loss for counterparty risk is covered. However, if CVAs materially exceed this regulatory expected loss, which is normally the case as the CVAs represent the risk until maturity, the excess CVA over the expected loss is only eligible for Tier 2 capital, whilst banks still need to cover the unexpected loss through the counterparty risk charge. This is what we call a double-counting below since the same potential loss is effectively covered twice, once by the excess CVA, and another time by the capital for counterparty risk.

Double counting – first part

This double-counting already exists in the current framework, which was designed before CVAs became a best practice or mandatory. It stems from the fact that the absolute amount of CVA acts as a provision fully dedicated for counterparty risk, but only a part can be recognised as a mitigant for the counterparty risk, the part in front of the regulatory expected loss.



The double-counting between this excess and the capital charge for counterparty risk can be very significant.

For BNP Paribas, at the end of 2008 amounts expressed on the EL base (100):

EL	=	100	
CVA	=	1129	
Excess	=	1028	UL = capital = 1102

As CVAs are fully dedicated to well identified risks, the excess of CVAs over the regulatory expected loss should be deducted from the regulatory capital charge for counterparty risk, rather than being made eligible to Tier 2 capital or be recognized as a TIER 1 component

Uncapitalised losses due to Credit Valuation Adjustments (CVAs) variations during the crisis

Regulators claim that a significant part of the losses due to counterparty risk during the crisis were in fact due to Credit Valuation Adjustments (CVAs) and not to the default of counterparts. Potential losses due to CVAs, i.e. variations of CVAs are currently not capitalised, as this practice is more recent than the counterparty risk capital framework.

This raises at least two questions:

- Should variations of CVAs equivalent to variations of provisions be capitalised?
- Even though variations of CVAs are not capitalised as such, CVAs address the same counterparty risk that is already capitalised. Why adding a charge for the variation of CVAs on top of the existing counterparty risk capital charge, when a bank cannot make a loss for building its stock of CVA on top of a loss at the time of default?

A capital charge for a variation of provisions?

As mentioned above, if we can assimilate CVAs to provisions for counterparty risk, similar to generic provisions taken for credit risk, charging the potential variation of those provisions would be a precedent.

There are other elements of earnings, the variations of which are not capitalised:

- Credit provisions: Would that mean that we should expect a capital charge on the variations of the credit future prospective provisioning when the credit risk Unexpected Loss is covered by a direct capital requirements.
- Market reserves: like CVAs are elements of fair value, and share similar characteristics: They can be volatile, impacting the P&L and represent significant amounts. Market reserves, by reducing the P&L, serve as their own capital charge (one can see the market reserve both as a need for capital and the provision dedicated to cover that need), but their variations are currently not capitalised even when they relate to instruments in the trading book.

One risk, one capital charge

As explained above, CVAs are reserved to protect the bank against a default of well-identified counterparts. They are meant to address the same counterparty risk that motivated the current capital charge for counterparty risk.

If we want a modified capital charge to take into account both the risk of making a loss whilst constituting the stock of CVA and the risk of making a loss at the time of default, it should cover the two mutually exclusive cases:

- Either a counterpart defaults in the coming year and any CVA already provisioned plus any increase of CVA during the year will be available to offset the loss at the time of default,
- Or the counterparty does not default in the coming year and the bank will only face a loss due to a potential increase of the counterpart CVA.

In no real scenario, would a bank make a loss due to an increase of its CVA PLUS a loss at the time of default. On the contrary, if a bank was to add to its stock of CVAs in the coming year, which would affect negatively its P&L, it would incur a smaller loss by the same amount at the time of default if it occurs later in the year.

If in no real scenario a bank could lose on both accounts (increase of the CVA adding to the loss at the time of default), regulators should not design a new capital charge for the variation of CVAs as an addition to the current capital charge for counterparty risk.

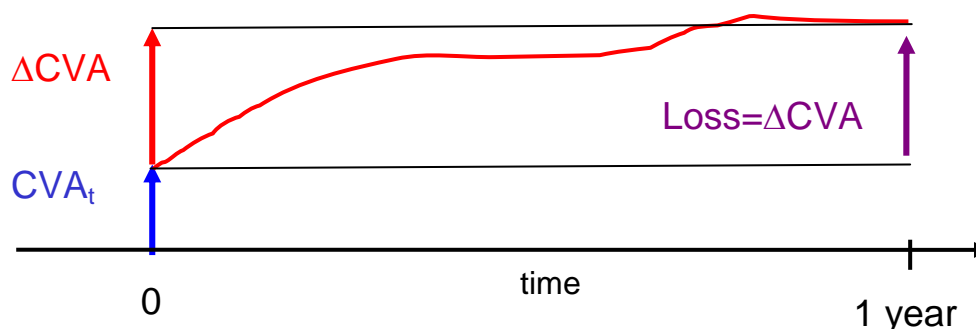
Double counting - second part

If on top of the CVA, we put aside a capital charge to protect the bank against the potential increase of these CVAs during the coming year, it means that we put aside today not only the CVA, but this new capital charge as well. Let's call this new capital charge VarCVA

Referring to paragraphs above, this means that we increase the double-counting we were speaking of previously. The more CVAs we have the less a loss due to default will affect the bank. The CVA plus this new capital charge are in total double counting with the current regulatory expected loss and unexpected loss for counterparty risk as they both address the exact same risk.

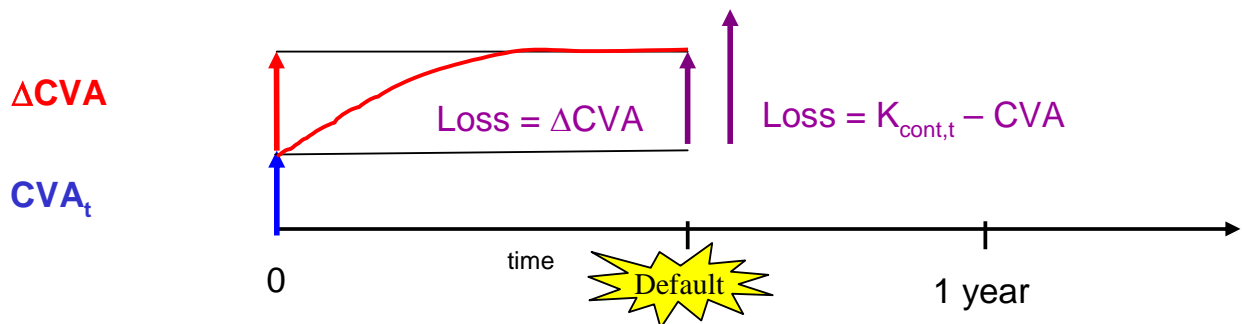
More precisely:

If there is no default, the new charge VarCVA is enough to cover the risk of loss which can only come from an increase of CVAs,



If there is a default, we would first face a loss by accumulating more CVAs in preparation of the default, but then the total CVA including this new CVA would reduce the loss at the time of default. Let's assume that the loss at the time of default is correctly forecast by the current counterparty risk framework $K_{\text{counterparty}} = EL + UL$, then we would face a loss due to the variation of CVA (ΔCVA) plus a gain or a loss at the time of default depending on the size of the loss compared with the total amount reserved i.e. $\max(EL+UL-CVA-\Delta CVA, 0)$.

All in all our loss would be $\max(\Delta CVA, EL+UL-CVA)$. As a result the capital charge in that scenario should be $\max(\text{VarCVA}, EL+UL-CVA)$.



In all cases, the capital charge should be the maximum of VarCVA and $EL+UL-CVA$.

The new capital charge for the increase of CVA should be compared to the full capital charge for counterparty risk ($EL+UL-CVA$), and the maximum should be retained.

Current practice around CVAs

Industry practices are still very heterogeneous both in the way bank compute their CVAs and in their managing intent around CVAs.

Whilst some institutions have no CVA framework, most institutions would compute CVAs to comply with IRFS or US GAAP definition of fair value. We would argue that the choice of a CVA framework is an accounting issue, linked to the definition of fair value adopted by each institution, whilst the managing intent around CVAs should remain the choice of the bank.

Several framework of CVAs co-exist (unilateral, bilateral or mixed approaches) but it is not the purpose of this document to elaborate on these different frameworks.

Banks can also compute CVAs very differently depending on their managing intent. For example, banks willing to hedge this element of their derivatives fair value would tend to compute CVAs using market credit spread so as to be able to hedge themselves in the market. Some banks have a dedicated trading desk to manage their CVAs which they consider to be a trading position like any other position of their trading book.

Other institutions, considering these CVAs as a credit risk that they are willing to carry would tend to compute CVAs based on historical probabilities, as if these CVAs represented a credit position in the banking book.

Some banks would mark to market and possibly hedge their CVAs for certain counterparts and carry the risk of their CVAs for other counterparts.

A capital charge depending on the CVA framework and the managing intent

If regulators want to capitalise CVAs as these can affect the bank's results, we strongly believe that this new capital charge should take into account the CVA framework in place so that the capital charge corresponds as much as possible to the real risk incurred by the bank.

We also believe that the capital charge should take into account the managing intent of the CVA position. The same way a bond, dynamically hedged in the trading book, would be marked to market and would attract a market risk charge (now VaR, Stressed VaR and IRC), whilst a bond in the banking book could be valued in accrued and would attract a credit risk charge, the same way CVAs could be valued differently depending on their managing intent and would represent a very different risk for the bank. As a consequence, we believe that the way CVAs are managed should be taken into account to decide how to capitalise them.

If a bank decides to mark part of their CVAs to market and hedge them dynamically, these should be considered as a trading book position and their capital charge should address their potential spread volatility when spreads move. With the addition of IRC, the full market risk treatment would then address the potential change of these CVAs due to all market risk factors, as well as the one year risk of credit migration and default. A counterparty risk capital charge for those counterparts would become unnecessary.

If a bank decides to carry part of their CVAs as a pure credit position which depend on historical probabilities, these should be considered as a banking book position and treated according to a credit approach. Particularly in that approach, where CVAs are very close to generic provisions for credit risk, it seems awkward capitalise variations of provisions, and their capital charge should be limited to the counterparty risk capital charge.

More on the trading book approach

We recommend that the regulatory capital treatment of portfolios of counterparty risks that are marked to market and managed within a trading book regime be consistent with other similar trading risks.

Specifically, we recommend that the regulatory capital on counterparty risks should be assessed by including the CVA (and all its single-name, credit index and other hedges) in the trading VaR, stressed VaR, and IRC frameworks. In this way, the CVA risks and hedges would be treated as integral parts of the full trading book and would be measured within the full trading book context.

The banking book EPE-based charge should be eliminated for those banks. It is inconsistent with the way that the CVA of those marked-to-market portfolios is managed and redundant with the IRC charge that already capitalizes the impact of default.

If it was maintained, for example instead of the IRC component, it would be absolutely fundamental to take into account the potential double counting explained previously, so as retain the maximum between the elements of a market-based VarCVA framework and the existing EL+UL-CVA.

More on the banking book approach

On the banking book approach, CVA calculations are mainly driven by counterparty credit quality assessed through ratings. This impact can be broken down into two components:

- The default risk is which already adequately capitalised through the current counterparty capital charge,
- The rating migration risk which will impact the CVA variability. Although this latest risk could be addressed using a separate charge similar (in terms of concept and method) to the IRC charge, but excluding the impact of defaults in the loss calculation (since it is already taken into account in the counterparty charge), the situation is so similar to the variation of credit provisions that it leads to the natural conclusion that such variations of provisions should not be capitalised at all.

Criticism of the bond equivalent approach

Compared to the two approaches presented above, the bond equivalent appears as a bad compromise between the two. It combines a “credit” exposure and capital charge with a “market VaR” approach, whilst distorting the risk through the use of the bond equivalent.

If the risk is dynamically managed as a trading book position, with CVAs computed using market credit spreads:

- The bond equivalent does not correctly represent the CVAs sensitivities to market risk factors. The use of the bond equivalent is not a benign approximation; it actually gives a wrong representation of the risk. The sensitivities of the bond equivalent to interest rate or credit risk are significantly different from the actual CVA sensitivities to interest rates or credit risk.
- The one year VaR is not consistent with any other trading book positions capital charge.
- The ineligibility of all hedges but single name CDS is also inconsistent with the real management of this position where other instruments can help manage interest rate or exchange rates risk. Also even though index CDS would not be fully efficient to hedge default risk, they do help hedge the sensitivity of CVAs to market credit spreads and should thus be eligible. Their efficiency would be measured by the VaR framework.

If the risk is carried as a banking book position, with CVAs computed using historical probabilities, a full market VaR measuring the sensitivity to interest rates, exchange rates and market credit spreads does not reflect the real risk.

*

* *

Whatever the regulation ends up imposing on the topic, it would be really a shame to impose significant investments in methodologies and systems that would consist in adding pervert layers of capital completely disconnected from the actual risk. Capital and risk should always be strongly linked to each other so that pressure on capital would actually mean better risk management.

BNP Paribas's Position on the Basel Committee's Proposals – Liquidity

1- Consistency in Regulatory Provisions

- The draft Basel regulations are being introduced in an inconsistent regulatory environment. We are asking that the following issues be settled before new regulations are implemented:
 - **The regulations must be global in scope;** but the US (see their adoption of Basel II, currently scheduled for 2014) and parts of Asia, will not be adopting the Basel regulation immediately. This non even level playing field will create an extremely difficult competitive position for European banks, because they are the only ones to immediately apply the new regulations. Moreover, it will not fulfil the stated objective of reducing liquidity risk since the major markets (US and Asia) will not be covered by the regulations.
 - **The role of the home and host regulators must be clearly defined within the Euro Zone.** Global control of liquidity would mean the home regulator takes precedence while local control of liquidity would mean that the host regulator takes precedence. In spite of this, the proposed system is based on global measures, and local application of these measures is left up to the host regulator (who is asked to be more rigorous), or made mandatory by the European Commission's CRD 4. This is tantamount to knowing little about any financing optimisation strategy, oversupplying bank subsidiaries with liquid asset portfolios, and forgetting that the liquidity of the Euro market is regulated by the same Central Bank. Finally, it is contrary to the principle of free capital movement within the Euro zone.
 - **At the global level, if a local approach is ultimately selected, it would be inappropriate to treat intra-Group loans/borrowings as simple interbank operations likely to disappear at the first sign of a liquidity crisis. In other words, it will be very difficult to manage simultaneously the implementation of a standard regulation and a re-localization of cash markets.**
 - **Lastly, the management of the liquidity of a geographically diversified group is based on the distinction between global currencies (mainly USD and Euro), managed at the global level, and local currencies, managed per country; the re-localization of global currency cash markets is totally opposed to this mode of management, and will call into question all the rationalization efforts already made.**

2- Consistency in Proposed Stress Scenarios

The stress scenarios on which the two proposed ratios are based are highly inconsistent.

- **As regards the LCR**, Basel 3 excludes eligible illiquid assets (self-funded securitizations, eligible credits, bank CDs), due to the fact that Central Banks do not need to intervene in the first month of a liquidity crisis. However, the scenario under which a bank can sell or repo its portfolio of Government securities during periods of systemic crisis is absurd. During such a crisis, there are virtually no more buyers; and the repo markets can in no way absorb the enormous increase in volumes due to the sudden refinancing of the liquid asset portfolios, often because the bank's credit risk limits are insufficient. The sale of securities would precipitate a market collapse and lead to the now well known spiral of mark downs and fire sales. Only recourse to the Central Banks would help avoid this self defeating mechanism. At times of institution-specific and systemic risk, access to refinancing from Central Banks is the only exit possible, and it is the concept of an eligible portfolio that should be taken into account.

The situation would be very different would the crisis be solely an institution-specific crisis. In such cases, the institution would place part of its liquid asset portfolios in a still active market.

In other words, the highly liquid asset portfolio (in the numerator of the LCR) must adapt to the selected scenario:

- **if Basel 3 continues to negate the idea of eligible assets, then the stress scenario underlying the LCR can only be institution specific, with well reduced impact on the denominator of the ratio.**
- **if Basel 3 maintains a dual stress scenario (institution- specific, and systemic), then the portfolio in the numerator of the ratio, can only be the total amount of eligible assets; otherwise, maintaining the ratio will force banks to create portfolios of “liquid” assets which liquidity would be only “theoretical” .**
- **As regards the NSFR, a bank cannot be asked to do more than ensuring a perfect matching of its assets and its liabilities.** However, by applying rates of renewal to assets regardless of the specific business, and by automatically linking the renewal of assets and liabilities, **Basel 3 will force the banks to fund in advance loans that have not been granted yet.** In so doing the system fails to adequately recognize the following:
 - the banks' ability to react to a liquidity crisis in a one-year time frame
 - the adaptation of the rate of asset renewal to the rate of resource depletion: the higher the latter, the lower the former
 - the diversity in bank business. In such a situation, it would be easy to stop the production of consumer credit business (a lag of three months would seem to be the maximum delay), to strongly curb growth in corporate credit, and to sell over 50% of the equity portfolio.

In other words, the assumptions on which the NSFR is based do not fit bank management. They force banks to over-finance themselves, to finance loans not yet granted and to reduce their liquidity gapping business, which questions their fundamental role within the economy. We think that such an outcome must be avoided since it would cause serious disruption to the economy as well as in bank management. The required level (100%) proposed for the NSFR is not called into question; what needs to be done is to correct the irrational characteristics of the assumptions on which this ratio is based.

3- Standard Approach and Advanced Liquidity Management Approach

The current approach being taken by regulators seems to be based on the following rationale:

- it is not possible to properly control the risks taken by banks
- for a bank, the liquidity risk is the first sign of insolvency risks (irrespective of their origin)
- imposing strong constraints on bank liquidity will thus provide time to manage the problem (one month in practice) in any type of stress scenario.

Based on this rationale, **the regulation apparently addresses the consequences of the problem but not its causes.** The analysis is quite clear when the origins of bankruptcies are examined:

- Northern Rock had a single-product marketing strategy and an extremely concentrated refinancing strategy. In the case of a sharp drop in the UK real estate market or a tightening of the securitization market, its liquidity position would become unmanageable. With the new ratios, the strategy remains possible, but Northern Rock would survive only a few additional weeks. Is this the best way to avoid this type of extreme situation?
- Holding too many securities which had become illiquid led to refinancing difficulties for some banks. Trying to avoid such a situation by requiring banks to refinance all “strongly-rated non-government” securities until maturity is probably not the right response, and is excessive.

This justifies proposing an advanced management approach; furthermore, the regulation mechanism must be based on the clear principle that **any liquidity policy must be closely linked to a bank’s business model. This is clearly established in principle 2 of the "Principles for sound liquidity risk management and supervision" published by the Basel Committee in September 2008: "A bank should clearly articulate a liquidity risk tolerance that is appropriate for its business strategy ..."**

The Basle Committee's proposals on liquidity supervision focus on standardized metrics which cannot apply to banking institutions well diversified in terms of activities, currencies, subsidiaries. In total consistency with the French SGCB's approach, the FBF suggests creating two different regulatory regimes: a Standard Approach, based on standardized liquidity risk metrics, and an Advanced Approach, based on an advanced set up of risk metrics.

An advanced liquidity risk management framework is based on few statistical assumptions; it is a complete set up of information, management and governance, based on compliance with a set of rules which enable Supervisors checking that liquidity risk is thoroughly assessed, and monitored cautiously.

This approach includes the following strong points:

- It is based on risk simulation, and starts from liquidity stress tests, leading to a definition of the liquidity buffers which will allow the bank to withstand a liquidity crisis over a given period of time
- It ensures a full convergence between regulatory reporting, and management methodologies, which guarantees an all-time compliance with regulatory standards
- It makes Supervisors fully informed of all components of internal liquidity management, and enables them to assess the quality of information and management systems
- It requires a total commitment from General Management (Executive Committee, Board) who are directly responsible for the main decisions regarding liquidity policy (liquidity buffers, gapping limits, diversification, internal transfer pricing...)
- It outlines the Governance set up and rules implemented by the bank
- It fits the specificities of the bank's business model, which cannot be obtained through a standardised set of risk metrics

In other words, an advanced liquidity management model complies exactly with the Basel Committee's « Principles for sound liquidity risk management and supervision ».

An advanced set up of liquidity management is always subject to prior audit and validation by supervisors. For a multinational bank, the home supervisor is responsible for this audit and validation process. Host supervisors participate to the final assessment through the Supervisory College set up for each relevant banking institution.

- Lastly, any system of liquidity management proposed must first be vetted by its supervisors. For a multinational group, that responsibility falls to the home regulator, knowing that the host supervisors are associated to the process as mentioned above.
- An advanced approach would need to be based on two principles:
 - **the same ratios** (LCR, NSFR) would have to apply to institutions using the advanced approach. The only difference would be the specific parameters being differentiated into “sub-categories,” justified by the business model and approved by the supervisors
 - **additional constraints** would apply to these institutions based on the management principles established by the Basel Committee in November 2008, notably as regards governance, liquidity risk monitoring tools, the internal transfer pricing policy, adaptation to the business model, risk diversification, and diversification of financing sources.

- The uniform stress assumptions underlying the LCR and NSFR ratio calculations must be reassessed.

4- Proposed Stress Test Assumptions

LCR:

- A softer treatment of Financial Investor deposits maturing within a month (assumed to be 100% lost) based on a differentiation by category, and considering the fact that investors who are also bank clients will have resilience similar to corporate clients
- A significant modification to the assumption on back up lines (assumed 100% drawn, which did not even happen during the post-Lehman period). Without such change, it is clear that the institutions not bound by this new regulation will have sole monopoly of this activity
- Symmetrical treatment of liquidity lines at financial institutions (lines granted drawn 100%, lines received, drawn 0%)
- Recognition of the liquidity of market assets (shares, non-government bonds, etc.) in cash inflows calculation

NSFR:

- A sharp drop in the assumptions on credit renewal, taking different business models into account.
- A re-assessment of the assumption of illiquidity (50%) of non-governmental shares and bonds
- A consistent treatment of direct loans (50 to 85% renewal rate) and of ABS (no renewal),

5- Unintended Consequences

- BNP Paribas believes that there will be a certain number of unintended consequences as a result of the Basel Committee's proposals:
 - With respect to the "highly liquid assets" definition:
 - Sharp drop in the liquidity of Government securities and gradual destruction of the secondary markets, since banks will have to keep their portfolios in order to comply with the LCR. As a consequence, the liquidity risk hedging provided by these securities will merely be theoretical
 - Dependence on ratings provided by rating agencies who will determine the level of compliance of the LCR standard by regulated banking institutions. This will give those agencies excessive power over the banking system

- Rapid destruction of an already severely undermined interbank market, due to the process penalizing the holding of bank assets
 - Blocked situation in certain countries characterized by the narrow volume of the government debt (Norway, Australia), whose banks would be forced to acquire government bonds denominated in other currencies, thereby increasing their exposure to foreign exchange risks
- With respect to the NSFR assumptions:
- The trend towards streamlining business models is likely to gradually eliminate diversification in bank activities, which will automatically increase systemic risk
 - An increase in medium-term financing will significantly reduce the influence of Central Bank's monetary policy. It may notably create a permanent short term cash surplus, and only the effect of changes in intervention rates on LIBOR-indexed bonds and loans would remain visible
 - Bank issuance programs will compete directly with sovereign's and corporate's; in other words, there will no longer be room for everyone on the bond market, and the average cost of financing will increase significantly
 - If bank liquidity gapping is downsized, liquidity gapping will move into a non-regulated set of institutions with no safety-line. Liquidity risks will thus be transferred from the regulated sector to the non-regulated one, thereby increasing the systemic liquidity risk
 - Banks will be "incentivized" to purchase ABSs, which will be detrimental to direct loans, thereby re-creating the conditions that originated the current crisis
- Overall:
- Being unable to meet the term financing needs resulting from the proposed LCR and NSFR, the banks will have to sharply reduce their credit activity, which is totally opposed to the objectives set by the Public Authorities, and will significantly undermine economic recovery
 - The increasing bank's funding costs will result into higher credit costs, which will generate an overall rise in the cost of credit for the economy
 - The absence of a level playing field will concentrate the two previous mechanisms on the countries implementing the new regulations (Europe particularly) and exempt the others, thereby accentuating disparities in economic growth rates and strongly penalizing the Euro zone

6- Public disclosure

- Though aiming to transparency, the public disclosure of liquidity ratios and other metrics gives rise to a "self-generated" risk. While the market has no immediate means of action when looking at capital ratios, it can immediately stop lending to a bank in the event of insufficient liquidity ratios, thereby immediately triggering a liquidity crisis, while its solvency and performance would not justify it..
- **We ask that the disclosure of liquidity ratios be reserved to Regulators, as is currently the case; the Regulators are the only ones able to fully analyze all components of a liquidity position.**



DEDUCTION OF INVESTMENTS IN THE CAPITAL OF CERTAIN BANKING, FINANCIAL AND INSURANCE ENTITIES WHICH ARE OUTSIDE THE REGULATORY SCOPE OF CONSOLIDATION

**(Deduction from gross long exposures of short positions, only where the short position
does not involve any counterparty risk)**

The Basel Committee seeks to eliminate own funds artificially created in the financial sector. The reform, which purpose is to remove the double counting of capital in the banking sector and limit the degree of double counting in the wider financial system, is welcome and it is necessary that its implementation is internationally adopted without further delay.

This topic is already addressed in our institution to the extent that net long positions resulting from investments in the capital of banks and financial institutions that are outside the consolidated scope are deducted from our own funds as specified in the proposal. Identical rules, without any threshold applicable, exist in respect of investments in own shares.

These rules, which have been applicable in France for long, should be harmonised, internationally approved and implemented.

The Basel Committee mentions that this deduction should apply to gross long position net of short positions if and only if the short position does not involve counterparty risk.

We believe there is no justification for this measure for numerous reasons:

- It does not make sense to mix considerations on wrong way risk (captured through increased capital requirements for counterparty risk) with the calculation of the net positions¹.
- The resulting capital requirements would otherwise be totally disproportionate and unrelated to the actual risk. The proposed measure would destroy several billions euros of own funds for any bank actively working with clients on OTC derivatives even if it has a nearly nil net position on the banking and financial sector in general and on its own shares in particular.
- In practice, any kind of client driven derivative activity on banking stocks would become unaffordable given the punitive capital requirements resulting from this regulation, as client trades tend to be tailor-made and “over-the-counter” by nature, hence triggering

¹ There is no ground which justifies to disregard such short positions when looking at the net delta exposure of the trading book :

- Some short exposures involving counterparty risk are not entered into with banks (e.g. reverse repo's with mutual funds, equity swaps with private banking clients), and hence are not subject to the wrong way risk this clause aims to capture.
- In the case where short exposures are provided by banking counterparties, a specific or general wrong way risk does arise, but such risks are already addressed in the Basel II accord and in this “Basel III” proposed amendment, and they do not need to be supplemented by such a specific measure.

counterparty risk. Only pure proprietary arbitrage on listed markets would remain affordable capitalwise.

- More globally, such a requirement would jeopardise both market making and equity trading activities as a whole, because exposure of the trading book to banks has to look through composition of indices, and as all major indices contain banking stocks, trading such indices would not be affordable.

*

* *

We urge the Authorities to review the sections 100 and 101 of this proposal which, under the current wording, will lead to extremely detrimental, and probably unintended, consequences on the financial system. We reckon that the Basel Committee attempt to better address the counterparty risk and especially the wrong way risk is fully legitimate, however, we believe that it is achieved in other parts of the regulation. Therefore we call the Basel Committee to delete sections 100 and 101 of the proposal.