CREDIT SUISSE

CREDIT SUISSE AG

Paradeplatz 8
P.O. Box 1
CH-8070 Zurich

Telephone 41 1 333 33 42
Telefax 41 1 466 63 61

Mr. Stefan Walter
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
Postfach
4002 Basel

Zurich, April 16, 2010

Credit Suisse Comments to Basel III Consultative Documents # 164 and # 165

Dear Mr. Walter,

We are pleased to submit our comments to the Basel III Consultative Documents "Strengthening the resilience of the banking sector" and "International framework for liquidity risk measurement, standards and monitoring" of December 17, 2010 (Basel III).

The thoughts and recommendations contained in the attached document represent the work product of a cross section of senior professionals in our risk, finance, treasury, capital management and front office areas.

We are available to discuss in more detail the thoughts contained herein and would be pleased to arrange for the appropriate resource on any given time.

We appreciate the opportunity to give input on Basel III and help foster the development of rules to promote a more resilient banking sector.

Yours sincerely,

CREDIT SUISSE AG

Dr. T. Guldimann
Member of the Executive Board
Chief Risk Officer

Dr. H. Stordel
Director
Risk Analysis & Reporting

Enclosure

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Basel 3 Consultation

Basel Committee on Banking Supervision
Consultative Documents:

164: Strengthening the resilience of the banking sector
165: International framework for liquidity risk measurement, standards and monitoring

(Issued for comment by 16 April 2010)

Official Comments of Credit Suisse AG

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i List of abbreviations

Abbreviation	Explanation
ABO	Accumulated benefit obligations
BCBS	Basel Committee on Banking Supervision
CAD	Capital Adequacy
CDS	Credit default swap
CRD	Capital Requirements Directive
CS	Credit Suisse AG
CSG	Credit Suisse Group AG
CVA	Credit valuation adjustment
DTA	Deferred tax asset
EAD	Exposure at default
EPE	Expected positive exposure
FASB	Financial Accounting Standard Board
FED	Federal Reserve System (US)
FINMA	Swiss Financial Market Supervisory Authority
FSA	Financial Services Authority (UK)
GAAP	Generally Accepted Accounting Principles
ICAAP	Internal capital adequacy assessment process
IFRS	International Financial Reporting Standards
IMM	Internal model method
IRB	Internal ratings-based approach
ISDA	International Swaps and Derivatives Association
LCR	Liquidity coverage ratio
LR	Leverage ratio
MTM	Mark-to-market
NOL DTA	Deferred tax asset on net operating losses
NSFR	Net stable funding ratio
OBS	Off balance sheet
PBO	Projected benefit obligation
QIS	Quantitative impact study
RWA	Risk-weighted assets
SIV	Structured investment vehicle
SME	Small and medium-sized enterprise
SPV	Special purpose vehicle
TD DTA	Deferred tax asset on so-called timing differences
US GAAP	Generally Accepted Accounting Principles (United States)
VaR	Value at risk

1 Introduction

Credit Suisse AG ("CS") welcomes this opportunity to give direct feedback to the Basel Committee on Banking Supervision ("BCBS") on the Consultative Proposals on "Strengthening the resilience of the banking sector" and an "International framework for liquidity risk measurement, standards and monitoring", published by the BCBS on 17th December 2009 (commonly referred to as "Basel 3").

CS has been an active contributor to prudential banking regulation for several years and participated fully in the design and analysis of the Basel II framework leading up to its implementation in Switzerland in 2008.

In formulating our response to the Basel 3 proposals, our primary motivation is to assist in securing a sound and well functioning, resilient, and stable financial system rather than to pursue our own particular business interests or objectives. In addition to this comment paper, we will be continuing our public commitment to the change agenda via positive engagement with the Swiss Bankers' Association working group and various other industry and regulatory working groups, as well as providing further commentary via conferences and the public media.

1.1 Approach taken

In keeping with our track record of positive engagement and comment on regulatory change, the views expressed in this document are intended to be as forthright, definite and constructive as possible. In doing so, we have chosen to focus our comments on those aspects of importance to us. As a consequence, we have not commented on other areas where our views are well reflected in the extensive comments of industry associations such as the Institute of International Finance or the Swiss Bankers Association. The remainder of the document is organized in three sections as follows:

Section 2 addresses our general areas of concern. These refer to issues that are overarching in nature, impacting the various detailed proposals in different ways. Our view is that without concerted focus on these key themes, any efforts to improve the detailed proposals will be wasted, because they will fail to realize the stated objective of strengthening the resilience of the banking industry.

Section 3 develops some key specific issues of concern in more detail. These issues are highlighted separately given their importance to the overall proposals. We have included recommendations on how to address the issues we have identified.

Section 4 provides a detailed assessment of critical paragraphs and concrete proposals with respect to "Strengthening the resilience of the banking sector" on potential solutions to address our concerns in a pragmatic fashion.

1.2 Summary of overall assessment

We believe that the Basel 3 proposals do a good job at highlighting the aspects of the regulatory capital and liquidity frameworks that need to be strengthened. We support the BCBS's aim of making fundamental reforms where necessary to take account of the lessons learned from the financial crisis, but we believe that many of the proposed measures have been calibrated far too severely. This is the case for many of the proposals on an individual basis, but it is even more relevant when the reform package is considered as a whole, since the impact of any double counting, non-recognition of risk mitigants or conservative calibration embedded in individual measures is multiplied if it is also present elsewhere.

The proposals include several elements which tighten the requirements for good quality tier 1 capital. Moving over time to a level playing field for equity requirements is an important reform which we fully support. We believe it to be premature – on the basis that common equity must form the majority of Tier 1 capital – to introduce the possibility that further restrictions will be applied. Various instruments, such as contingent capital, are currently being designed to offer cost effective ways to meet legitimate regulatory concerns about quality of capital. We are convinced that this may be an important part of creating additional protection for the system. We suggest not restricting instruments which meet such quality requirements at this time, i.e. even before the development of contingent capital and other approaches has been finalized.

The proposals with regard to the leverage ratio (LR) are, in our view, inherently flawed for a diversified institution. The underlying purpose of a leverage test – safety – can be handled much better via liquidity and risk tests that address real underlying issues. A recent study[1] has shown that leverage tests are poorer at predicting distress in a financial institution than tier 1 calculations, and that leverage tests add no incremental value when both tests are run together. Moreover including a LR in Pillar 1 may shift the binding constraint for many institutions to a leverage test. This is a non-economic capital requirement that, as illustrated in the recent crisis, creates significant incentives for regulatory arbitrage, could push many lower risk activities outside the banking system and, in some cases, incentivizes institutions to actually increase the riskiness of their assets as a way to preserve income when asset size is constrained. The supposed simplicity of the leverage tests masks the fact that it outsources the calculation of the denominator to ever changing accounting rules. Recent accounting trends have placed more contracts on the balance sheet "for visibility", which could subject bank capital to unexpected volatility, and hurt the ratio over time, even for an institution with a constant portfolio. Both the current inflation of the denominator - and the risk of further increases - could cause significant challenges in the political and public sphere where simple calculations are most often used. We believe that the LR is primarily useful for simple institutions with a more monoline type of business – traditional lending for example. For more complex institutions, the LR should be used primarily as a starting point for a more thoughtful analysis. Accordingly, we think it should be placed firmly in Pillar 2.

In their current form, the proposals would have a very material impact on the financial sector and, more importantly, the economy as a whole. The size of the changes to banks' business models that would be required to meet the capital, liquidity and leverage requirements should not be under-estimated. We believe that, without significant recalibration, the proposals would have very undesirable consequences for cross border financial flows and the ability of banks to provide access to funding and risk mitigation instruments to the real economy. The proposals would also introduce unwelcome limitations on banks' business models that risk moving certain financial activities to less regulated financial service providers.

We believe that it is essential to get the proposals right so there is no need for further major revisions in a couple of years. This requires a thorough evaluation of the proposals and their impact, so that an overly tight timetable does not result in an unsatisfactory result. The comprehensive QIS should provide useful information on the likely impact of the initial proposals, but we believe that there should be a second consultation to take account of the changes that will be required to the initial proposals and a second comprehensive QIS in 2011 to evaluate their impact. CS stands ready to play a constructive role in assisting the BCBS to deliver a revised regulatory framework that results in a materially safer financial system while not endangering the ongoing economic recovery.

[1] See McKinsey, Dec 2009, "Capital ratios and financial distress: Lessons from the crisis".

2 General areas of concern

2.1 The role of bank regulation

We strongly believe that effective banking regulation has to be rooted in the reality of how banks operate. This provides the basis on which the approaches, interests, practices, tools and focus of bank management and banking supervisors can be naturally aligned, thereby promoting better communication, common understanding and the effective recognition and mitigation of material issues that may impact the financial health of an institution.

This alignment can be achieved both by co-opting part of bank practice into the regulatory mechanisms (e.g. use of internal credit ratings in the IRB framework in Basel II), as well as promoting improved practices within banks (e.g. development and use of economic cycle stress testing under the ICAAP in Pillar 2). In addition, the presence of strong linkages between bank and regulatory practice increases the likelihood that good practices will be sustainable through time and provide the targeted benefit.

In the aftermath of the financial crisis, there has been much questioning of this linking of internal bank practice with regulation and supervision, with particular criticism of the role played by internal risk and pricing models in underestimating certain key risks leading up to the crisis. This analysis has prompted the conclusion that neither bank management nor regulators can competently assess and manage appropriately the risks faced by financial institutions. The logical outcome of this conclusion, the argument runs, is that bank regulation must be designed in a way that both operates independently of the practitioners involved at any given time, and guards against any future extreme circumstance *ex ante* in the belief that any action taken at the relevant time to address the issue will be too little and/or too late.

In this context, we have seen the emergence of proposals that materially blur the line between the responsibilities of management and those of bank regulators. Examples of this include:

- Regulatory designed stress tests that are severe in nature but that effectively become the default constraint under which a financial institution is managed in normal market conditions
- Regulatory capital charges that are designed to address P&L volatility but use methods that show little relationship to the volatility being addressed

This approach extends beyond technicalities of design or the setting of constraints. It rather aims to impose orthodoxy on what constitutes good management of a financial institution. The world, however, is too complex and too rapidly evolving to rely on such a rigid approach - departing from rules that are aligned with markets – without creating significant potential for regulatory arbitrage, moving business out of the system, and making supervision materially more difficult. In addition, the use of relatively crude risk assessment approaches that are not closely aligned with actual economic practice could give conflicting signals that could results in inappropriate actions being taken by management or regulators.

We are fully supportive of driving improvements in risk management and capital management practices across the industry. However, one of the striking features of the crisis is the lack of a common thread between the institutions that ran into severe difficulty and the regulatory framework they operated under. The examples are well-known, but bear repeating to make the point clear:

- **Leverage ratio:** leverage was certainly a problem for some institutions, but such problems occurred both in countries with a record of a leverage ratio constraint (the US in particular) and those without such a constraint (e.g. UK, Germany, Switzerland)
- **Market know-how / MTM framework:** the discipline of daily marking-to-market of a financial institution's portfolio is often cited as a driver of clarity with respect to its current capital and liquidity position; the large US investment banks that were at the forefront of these practices are, however,

precisely the ones whose business model and operating practices have most been called into question

All types of banks have been hit by the crisis, including regional banks, saving institutions, mortgage banks, state controlled banks, investment banks, universal banks, cross-border active banks and domestic-oriented banks. In our view the only true differentiator between the institutions that did not survive the crisis - or did so only with substantial state support - and those that withstood the stressed market conditions relatively well, is the judgment and decision-making of the senior management of the institutions. Certainly, robust and well-executed risk and capital planning practices were a major contributor to this effective management. However, several institutions that, prior to the crisis, were recognized widely as market-leading in their risk practices (e.g. in the adoption of an economic capital framework), nevertheless encountered material issues as the market crisis unfolded. Hence it is critical to distinguish between the promotion of improved risk and capital management practices (undoubtedly a good thing) and the belief that these *ex ante* steps will by themselves strengthen the resilience of the banking sector.

The conclusion we seek to draw from this distinction is that there needs to be a change in emphasis from promoting wholly quantitative constraints (whether on risk, capital, balance sheet or liquidity) to a regime in which the **evaluation of the effectiveness of bank management plays a more fundamental role**. This is naturally problematic to formulate, but the difficulty in articulating what "good" looks like should not divert focus from the need to attain this goal. Indeed we strongly believe that the overhead and effort implied by several other parts of the new framework can be reduced significantly by a greater emphasis on the overall management of an institution.

We therefore suggest that bank regulation continues to provide clear incentives – both in terms of Pillar 1 and Pillar 2 – to regulated institutions for moving towards adequate and comprehensive risk management practices. Accordingly **the calibration of the BCBS proposals should continue to recognize the relative capital incentive of moving from standardized approaches to more advanced approaches**. This will help to ensure that firms continue to invest in sophisticated measurement approaches to enable management and regulators to analyze risks in a comprehensive fashion.

2.2 Accounting view versus regulatory view

The issues and conflicts that are present between global accounting regimes (US GAAP and IFRS in particular) and the approach to regulatory regimes are not new. However, the crisis has brought some of these issues more sharply into focus. For example, we have seen some institutions use accounting techniques to meet regulatory constraints (e.g. moving trading assets to an accrual accounting treatment to reduce loss recognition and "preserve" reported capital).

The proposals in the Basel 3 package increase the level of interaction and interdependence between accounting and regulatory regimes to such an extent that choices made in one regime may strongly impact the treatment accorded by the other. These effects are potentially very material, and well-known inconsistencies in accounting regimes can have dramatic impacts on the regulatory outcome. Notable examples include the treatment of netting (for derivatives, repo and securities financing) and proposals for permissible forward-looking provisioning.

We acknowledge the engagement of the BCBS with the accounting bodies on these points of intersection. However, we remain concerned that the guiding principle of fair value in international accounting regimes is in direct conflict with the bias towards conservatism in the current and any future regulatory framework. We are also concerned at how two different netting standards – one based on accounting regimes and one based on regulatory regimes – will be applied within any future regulatory framework. Finally, we are concerned that the inevitable outcome of different national accounting regimes inputting into any future global regulatory standard will undermine the consistency and integrity of disclosed regulatory metrics. It is essential that these differences are ironed out prior to implementation otherwise there is a major risk of:

- accounting regimes driving regulatory outcomes
- national accounting regime specificities undermining the integrity of a global regulatory regime
- conflicting objectives and standards between accounting and regulatory regimes weakening the resilience of the banking industry

The quality of the convergence of accounting and regulatory regimes - where the former are used as inputs for regulatory metrics - will be a critical element in ensuring that the Basel 3 package does not incorporate elements that would actually serve to weaken the resilience of the global banking industry.

We suggest not sacrificing the time needed to secure the requisite quality of the alignment in the haste to reach a speedy solution. In case such a convergence cannot be established at the accounting regime level, the global regulatory regime should seek explicitly to build in jurisdiction-specific adjustments to the accounting-based inputs in order to ensure a consistent and comparable outcome of regulatory metrics.

2.3 Level Playing Field

The issue of a "Level Playing Field" is a frequently recurring theme in the ongoing discussions concerning bank regulation. To date our overriding impression is that it is regarded as an insurmountable challenge. Given one of the goals of the whole package is to "strengthen **global** capital and liquidity standards" it could be reasonably argued that a failure to meaningfully address the need for global consistency in practice will undermine the majority of the benefits that are sought to be achieved by implementing a new set of standards.

We certainly support the concept of common implementation of equivalent standards in all major markets, for all major market participants. However, we also realize that the BCBS itself is not in a position to secure this outcome, particularly as regards market participants that fall outside its direct scope (e.g. insurance or hedge funds). However, we should also acknowledge that too frequently the laudable goals of BCBS proposals have been undermined by domestic approaches that have resulted in partial implementation and, in some extreme cases, in no implementation at all (e.g. Basel II in the US).

With this in mind and given the scale, impact and complexity of the Basel 3 proposals, we believe that the BCBS should be prepared to disclose regularly, publicly and in reasonable detail the extent to which the new proposals are or are not being implemented at the domestic level. If this were done systematically, it would allow market participants, regulatory authorities and indeed national governments to obtain transparency on the status of compliance among different markets and market participants. It would also make it fairly straightforward to highlight those jurisdictions where the standards had been implemented in a less than comprehensive manner, as well as those locations whose domestic implementation exceeded the expectations set out in the global standard. This is particularly pertinent to banks based in jurisdictions (such as Switzerland), which have a track record of super-equivalence with extra layers of conservatism being added by national authorities.

We suggest considering the following elements to ensuring and assessing progress on global consistency at any time:

- **Timing:** this is straightforward to monitor but is essential to ensure that what is agreed by the BCBS is indeed enacted in all countries. The proposals – to support synchronized implementation – could include a clause disallowing standalone national implementation before the new rules are also implemented by other critical G20 jurisdictions.
- **Content:** the easiest way to ensure global consistency of application of the new standards is to require each national authority to self-assess their national implementation against the global standard set by BCBS and to highlight any major divergences. The proposals could also include a clause explicitly disallowing national discretions and sub- / super-equivalences.

- **Constraints:** national authorities should endeavor to develop an implementation where the regulatory constraints are systematically and consistently applied.
- **Incentives:** to ensure that what is agreed by the BCBS is indeed enacted in G20 countries, BCBS could annually disclose the status of implementation vs. the agreed international timetable and apply multipliers – increasing with the lag to timetable – e.g. to RWA for exposures against all the counterparties of a jurisdiction lagging behind the agreed international implementation schedule.

2.4 Predictability of outcomes

It should come as no surprise that banks will find it very difficult to implement the complex and wide-ranging set of proposals within the Basel 3 package with any reasonable certainty of outcome over the timescale currently proposed.

We appreciate the BCBS's acknowledgement of the need for appropriate phase-in and grandfathering measures. We also recognize that the current political environment demands a rapid driving forward of change, to some extent above and beyond the perceived benefits and outcomes being targeted.

However, the Basel 3 regulatory reforms are so wide ranging and fundamental – affecting capital, risk weighted assets, leverage ratios, capital ratios (through the cycle) and introducing a new liquidity framework – that they will create interactions that are difficult at present to fully predict with any confidence. There is, in our view, a material danger from the changes of:

- **unintended negative impacts** on financial markets and financial services available to the real economy
- **miscalibrations that result in disruption** to otherwise well-performing financial institutions.

We therefore strongly believe that it is in the best interests of all stakeholders to incorporate sufficient time into the implementation agenda to allow for a thorough evaluation of the outcomes that are likely to result from adoption of the new measures. This would also **credibly reduce regulatory uncertainty** – making sure the proposals are right and will not need another major overhaul in a few years – and raise market participants' confidence in the stability of the financial system.

We suggest planning a 2nd consultation round in 2010, after having calibrated the proposals, and a 2nd QIS exercise in 2011, preferably after an initial calibration, also to allow banks to better prepare the implementation.

3 Key specific issues of concern

3.1 Strengthening the resilience of the banking sector

3.1.1 Capital constituents

3.1.1.1 Grandfathering of hybrids

We fully support BCBS's focus establishing a common international quality standard for core capital. However, we believe that the phasing-out of "innovative" hybrids requires further clarification as to exactly what features are to be phased out, other than step-ups. In addition, it should be clarified that a bank's "economic interest" in exercising a call should be understood to refer not only to contractual funding cost but also take into account the quality and terms of potential refinancing instruments and applicable market conditions.

Appropriate grandfathering and phase-in provisions will be essential to managing the impact of the new requirements. Grandfathering should cover all relevant elements of the new rules, including the required proportion of Tier 1 and definition of its components, the "predominance" requirement, and deductions.

In designing the grandfathering and phase-in requirements, it is important that market perceptions and effects be taken into account. Grandfathering and phase-in periods will need to be defined with care, to avoid diluting their purpose, as the markets may be induced to factor in higher costs of capital well in advance of the grandfathering or phase-in date, thus unduly burdening firms' capital raising activities.

In addition, because of likely market effects, it will be advisable to "amortize" the grandfather period, rather than create a cliff effect by reference to a final deadline. In this connection, the pattern proposed by CEBS could provide a pragmatic avenue: it requires non-compliant hybrids to be phased out over 30 years, with additional going concern limited to 20% of total Tier 1 after 10 years, 10% after 20 years, and 0% after 30 years.

3.1.1.2 Deferred tax assets

We fully endorse the BCBS's efforts to establish a common international standard for deferred tax assets ("DTAs"). We believe that any such proposal should recognize:

- The inherent difference between DTA on net operating losses ("NOL DTA") and DTA on so-called "timing differences" ("TD DTA"). A NOL DTA arises where an entity has incurred commercial losses. This can be contrasted with a TD DTA, which arises solely because the timing of a tax deduction differs from the equivalent accounting expense recognition .[2]

[2] DTA on NOLs arises where a bank incurs losses and there is insufficient other income against which the losses can be offset. DTAs on timing differences (also referred to as temporary differences) are not associated with losses. Instead, a DTA on timing differences arises where there is a timing mismatch between the taxation of income/expense and the period in which the income/expense is recorded in the financial statements. For example, a bank may record expense for deferred compensation in the financial statements over the vesting period (say, years 1 to 3) while this expense may not be deductible for tax purposes until the compensation is delivered (say, year 4). In this case, a DTA would be recorded in years 1 to 3 in respect of the future tax deduction that would be available for the deferred compensation expense. However, the existence of this DTA does not imply that the bank has incurred losses - instead, this DTA represents a tax accounting concept designed to deal with differences in the timing of expense recognition between the financial statements and for tax purposes.
Where a bank has been operating for a number of years, it will typically have a core level of timing differences which will continue in existence from year to year. This arises, in the case of deferred compensation for example, due to the DTA being reduced through share deliveries, while at the same time being increased as a result of new awards being expensed in the financial statements.

Even a constantly profitable entity will typically have a core amount of TD DTA which will persist from year to year. The disallowance of such TD DTA would result in a permanent reduction in Tier 1 capital - this would seem an inappropriate outcome, given the nature of the DTA.
- The stringent US GAAP/ IFRS DTA recognition tests which must be met before any balance sheet DTA can be recorded. Particularly in the case of an entity which has incurred losses, there is a high evidentiary hurdle to be overcome before DTAs can be recognized, even where there is a long or indefinite future period available for utilization of those tax losses[3].
- The value frequently ascribable to DTAs even in a gone concern/disposal scenario, through the sale of a business with associated tax losses[4].
- The strong pro-cyclical effect introduced by any DTA regulatory deduction from common equity. It should be noted that this effect is not fully consistent with the efforts of the BCBS to reduce pro-cyclicality on the risk weighted asset front.

Taking these factors into account, we believe that, should BCBS apply DTA deduction treatment:

- The disallowance should be limited to DTA arising on NOLs only.
- The disallowance of NOL DTA should only be partial. For operational simplicity, we would suggest that allowable DTA should be limited to a percentage of Tier 1 capital (before disallowances) e.g. 10% of Tier 1 capital as currently applicable in the US.

Furthermore, in our view, recognizing the value frequently attributable to DTAs even in a gone concern scenario, a proportion of the disallowance should be allocated against Tier 2 capital.

Finally, because of likely market effects, transitional provisions should also be introduced, either deferring the application of the rule beyond 2012 or providing for a phased reduction in allowable NOL DTA as a percentage of capital.

3.1.1.3 Pension fund assets and liabilities

We view the deduction treatment for pension funds from core Tier 1 capital as overly conservative. It also results in increased pro-cyclicality of capital requirements. We believe this is not desirable from a financial markets stability perspective. We also believe that the current and expected future accounting standards for pension assets and liabilities are not a suitable starting point to derive capital adequacy rules.

- The proposed **treatment enhances pro-cyclicality**. Pension liabilities – reflecting the underfunded status of pensions – are typically highest at times of stressed financial markets, when declining stock markets lead to temporary pension deficits. Since pension deficits of going concern banks have historically been of a temporary nature, a deduction treatment from core Tier 1 capital appears unjustified and would further restrict banks' lending activities in downturns.

- The **reliance on accounting standards appears problematic** in the context of the proposed capital standards, both with regard to de-recognition of any balance sheet pension fund assets and an unfiltered recognition of pension fund liabilities.

Pension assets often stem from the off-balance sheet treatment of estimated future pension liabilities (actuarial losses[5]). We understand regulators' preference for an on-balance sheet treatment of such losses, as this would provide a snapshot of a bank's capital base. However, such a treatment would lead to significant volatility in banks' capital bases. We believe this to be undesirable both from capital planning and

3 For example 20 years in the US and indefinite tax loss carry-forward in the UK

4 This is permitted (subject to conditions) for example, under the US, UK and Swiss tax regimes

5 An actuarial loss is a deficit of a pension plan's actual costs over those estimated from actuarial assumptions.

pro-cyclicality perspectives. Should a deduction treatment nevertheless be chosen, we recommend performing it on Tier 2 capital. This ensures consistency between the temporary nature of losses of going concern banks and, on the other hand, the loss of pension assets in the event of no going concern at which point Tier 2 capital will be available.

Individual banks apply differing accounting standards and methodologies to record **pension liabilities** on the balance sheet. The proposals will thus create substantial differences between banks applying US GAAP and those applying the IFRS Corridor approach.

For regulatory capital purposes, it is essential to filter out these differences. In particular, we suggest making the method of recognizing liabilities consistent through the use of a single regulatory methodology. Such a methodology will not necessarily be aligned with accounting standards – particularly with regards to their forward-looking component – whose objectives may be at variance with the prudential mandate of high quality, non pro-cyclical capital. We also suggest applying adequate assumptions – consistent with the conditions when high quality capital is required – to derive the "regulatory" pension liabilities, factoring in:

- disruption of salary increases in times of financial stress
- discount rates based on historical averages to reduce volatility of rates used for calculation
- no inflation, to reflect the price behavior during periods of financial stress

Alternatively, BCBS could consider the statutory obligations of banks towards their pension funds as a basis for a regulatory treatment of pension deficits that could be dissociated from forward-looking accounting standards.

We also recommend – as pension entries impact regulatory capital in an order of magnitude of billions of USD – that the BCBS considers extensive grandfathering periods to allow sufficient time for banks to restore their regulatory capital bases in order to accommodate for the effects of the new pension rules.

3.1.2 Risk coverage: Capital charge for CVA

3.1.2.1 Overview

We understand the rationale behind the BCBS's desire to introduce amendments to the counterparty risk capital framework to improve the capture of losses linked to banks' CVA calculations. We support the BCBS's desire to ensure that the regulatory capital charge appropriately reflects the range of CVA-related losses experienced by banks during the recent financial turbulence.

However, we believe that the proposed approach is far too conservative. In particular, there is significant double-counting with existing capital charges, overly severe parameterization and non-recognition of hedging activities that do, in practice, act to reduce CVA volatility. That said, we believe that these considerations can be addressed within the draft framework outlined by the BCBS in a way that delivers a suitable increase in capital requirements while preserving the incentives for banks to undertake real risk mitigating activities.

3.1.2.2 Issues

The BCBS's understandable desire to avoid unnecessary or unsupported complexity in the regulatory calculations has resulted in various assumptions, some of which may be reasonable on an individual basis, but which, taken together, result in an overly conservative charge. For example, as shown in the example below, the proposed rules would result in an effective shock of 1,500 basis points being applied to a typical A-rated exposure.

$$\text{Effective shock} = \underbrace{50\text{bp}}_{\text{Typical 99\%, 10 day shock for CDX.NA}} * \overbrace{\text{SQRT}(25)}^{\text{10-day to 1-year annualisation factor}} * \underbrace{6}_{\text{VaR multiplier (3 for VaR + 3 for Stressed VaR)}} = 1{,}500\text{bp}$$

Shocks of this size are simply not justified, particularly as they are significantly larger than those in the standardized approach, which is supposed to cover all risks, not just those associated with credit spread movements over and above those already captured by EPE. Model-based approaches typically provide more scope to recognize economic hedges than the standardized approach, but this is not really the case in this instance, which means that the exposures to which the shocks will be applied will be significantly larger than they are in reality. The lack of hedge recognition plus extreme shock size means that the model-based approach is approximately twice as conservative as the standardized approach, in our estimation. The main areas of conservatism that we believe should be addressed are set out below:

- **Double counting with EPE:** In practice, the CVA charge has considerable overlap with the existing EPE charge, as changes in default and migration probabilities are significant drivers of credit spread movements. We appreciate that, given the timeline to which the BCBS is working, it may be difficult to rework the EPE charge to cover spread changes, but it is important to factor in this element of double counting when assessing the merits of the other measures presented below.

- **Double counting with VaR:** For firms that calculate their CVA using market credit spreads, there are no conceptual problems with calculating the market risk and CVA charges on an integrated basis given that the same inputs directly drive each measure. No additional modeling assumptions or methodologies are required to calculate a combined risk profile. Any diversification with other market risk exposures is fully justified based on historical correlations and spread behavior.

- **Interaction between the (credit risk) holding period and (market risk) multiplier:** The proposal incorporates elements of both the counterparty risk regime (e.g. one year holding period) and market risk framework (e.g. use of market risk VaR and the multiplier, which are intended to be used for a 10 day holding period). This means that it is more severe than either. Given the clear similarities with the market risk VaR calculation, we believe that the one-year holding period should be reduced to ten days. If any additional conservatism is required, we believe that this should be addressed through an adjustment to the multiplier, as having a common holding period facilitates the aggregation with market risk VaR noted above.

- **Exclusion of economic hedges:** The proposed rules allow only single name CDS to act as hedges, whereas in practice firms use a variety of credit and market risk instruments to mitigate their CVA risk. Within a VaR-based calculation that takes account of the basis risks between different instruments, there is no reason to exclude these hedges, as this will not provide suitable incentives for firms to manage their exposures actively. If there are concerns about basis risks not captured by some models, this could be addressed by a capital surcharge. It also worth noting that the use of CDS spreads to discount the bond-equivalent exposures implies that these instruments with bond and loan deliverables are the correct way to value the risk, which means that those same instruments should be allowable as hedges.

- **Exposure calculation:** The proposed framework uses a bond-equivalent measure of counterparty exposure, rather than the CVA sensitivities that firms use to calculate their actual CVA P&L. We believe that it would make more sense for there to be an option, subject to supervisory approval, for firms to use their actual CVA sensitivities instead, to align the regulatory capital and economic impacts more closely.

Regardless of whether this is introduced, we believe that the standard calculation should be based on Effective EPE excluding alpha as a basing the calculation on EAD (i.e. EPE x alpha) overstates the actual risk.

3.1.2.3 Suggested approach

We believe that it is possible to modify the framework outlined in the proposalsasel 3 to address the issues listed above by making a small number of changes. These are shown as the "Modified standard approach" below. In addition, we advocate permitting firms to adopt more sophisticated approaches if they meet additional eligibility conditions regarding the integrity of their modeling and control processes. These are characterized as either foundation or advanced methods, depending on the extent of the modeling involved.

The advantage of our proposal is that it achieves the twin aims of introducing a relatively simple calculation that can be applied to all firms, while also permitting more sophisticated approaches that align the regulatory charge more closely with the actual economic impact of CVA. Regulators can control entry to the foundation and advanced approaches by establishing suitable qualitative and quantitative conditions, similar to those already in place for EPE and VaR. Given the similarities with those regimes, we believe that these conditions could be developed over a relatively short timeframe in line with the BCBS's desire to finalize the capital regime in the near future.

1. Modified standardized approach	
Overview:	Modifications to BCBS initial proposal:
Standalone CVA capital calculation using regulatory exposure measure	• Use Effective EPE, rather than EAD, to derive the bond-equivalent exposure • Use 10 day, rather than one year, holding period • Allow any hedges held by the CVA management desk, rather than just single name CDS
Suitable for: Default approach for firms without interest rate specific risk VaR approval covering CDS.	

2a. Foundation approach: alternative A	
Overview:	Modifications to BCBS initial proposal:
Standalone CVA capital calculation using internal exposure measure	• Use the internal credit spread sensitivities that are used in the CVA P&L calculation to generate VaR • Use 10 day, rather than one year, holding period • Allow any hedges held by the CVA management desk, rather than just single name CDS
Suitable for: Firms that are able to satisfy their regulators that the internal exposure calculation fully captures the risk associated with counterparty credit spread moves.	

2b. Foundation approach: alternative B	
Overview:	Modifications to BCBS initial proposal:
Integrated market risk and CVA capital calculation using regulatory exposure measure	• Use Effective EPE, rather than EAD, to derive the bond-equivalent exposure • Use 10 day, rather than one year, holding period • Allow any hedges held by the CVA management desk, rather than just single name CDS • Bond-equivalent exposures integrated with market risk

	exposures to generate a combined VaR
Suitable for: Firms that have an appropriate market risk VaR model that covers interest rate specific risk but are unable to meet eligibility criteria to use their internal CVA exposure measure.	

3. Advanced approach	
Overview:	Modifications to BCBS initial proposal:
Integrated market risk and CVA capital calculation using internal exposure measure	• Use the internal credit spread sensitivities that are used in the CVA P&L calculation to generate VaR • Use 10 day, rather than one year, holding period • Allow any hedges held by the CVA management desk, rather than just single name CDS • CVA and market risk exposures modeled together to generate a combined VaR
Suitable for: Firms that have an appropriate market risk VaR model that covers interest rate specific risk are able to satisfy their regulators that the internal exposure calculation fully captures the risk associated with counterparty credit spread moves.	

3.1.3 Leverage ratio

3.1.3.1 Introduction

We understand the need to address inflated leverage in the financial system and believe these efforts should not be limited to the banking sector. Given that material market participants such as insurance companies and hedge funds are not subject to banking regulations, the proposed rules may lead to a risk shift to the shadow banking system weakening the stability of the financial system overall.

We appreciate and fully endorse the BCBS's efforts to harmonize rules across different accounting regimes in the context of the Leverage Ratio ("LR"). However, we disagree with the overly undifferentiated treatment of netting, derivatives and off balance sheet items.

The proposed LR rules introduce an entirely new standard that overrides basic principles of international accounting and regulatory netting which have been evolved over decades. In its current form it will artificially overstate the risk exposures of banks. We are concerned that the proposed standard will not be understood, and will therefore have the potential to confuse market participants. As an alternative to introducing a fully new methodology and in order to foster confidence in financial markets, the BCBS should consider increasing minimum ratios taking the existing set of LR rules as applied, for example, in the US or Switzerland.

We also note that, under the new liquidity rules, banks will have to hold more government securities. Unless these securities are excluded from the LR, there may be a conflict between the two risk measures, whereby the need to meet a minimum LR restricts a bank's ability to hold the securities it needs to meet the liquidity requirements.

Our key concerns regarding the current proposal are discussed in the following sections.

3.1.3.2 Pillar 1 vs. Pillar 2

We support the introduction of a LR as a complementary measure to address leverage under a Pillar 2 approach. However, the BCBS should be careful in its design so that the LR does not become the binding capital constraint, which would result from a mechanical application of the current proposal under Pillar 1. Such a situation would undermine the risk-based nature of the capital framework and potentially give rise to

a build-up of risk in banks' balance sheets, as this would offer an incentive for banks to use their capital capacity for high risk assets.

Under Pillar 2, in contrast, a properly designed LR can be a useful tool for supervisors in their assessment of the leverage in a bank's balance sheet. Such an assessment contains a high degree of in-depth and individual analysis and therefore is by definition a Pillar 2 tool. A Pillar 2 LR will also foster a comprehensive supervisory dialogue between individual banks and supervisors, allowing supervisors more opportunity for appropriate intervention should the need arise. Within such a dialogue, an adequate treatment of G7 government securities and low risk items such as domestic lending and residential mortgages could be agreed. This would allow tailoring the LR to the specific needs of the supervisor while avoiding unduly penalizing compliance with the new liquidity standards – which will require banks to hold increased volumes of government securities – and economically important low risk and low return activities. Therefore, we propose to keep the LR as a Pillar 2 tool and focus on a design suitable for its intended use as a supplementary tool to support regulators in detecting inflated leverage.

3.1.3.3 Treatment of netting

We support the BCBS's efforts to align netting rules between the different accounting standards for LR purposes. Prohibiting netting entirely, however, would result in perverse incentives for adequate risk management and the use of central counterparties that require users to daily margin based on net exposures. Taking no account of netting would also artificially increase total assets and decrease the LR, without adding any supervisory benefit, which would not be well understood by the market. In addition, un-netted derivative volumes typically increase in market downturn situations, thereby also reinforcing pro-cyclicality.

Three different major netting sets are currently used in the market: US GAAP, IFRS and Basel II. The proposed rules introduce a further entirely new netting concept, which creates an undue operational burden on banks without an apparent supervisory benefit. The Basel II regulatory netting rules are a known concept and already in use at banks globally, irrespective of the GAAP applied. The application of these netting rules would have the same benefit of international comparability without generating the inappropriate impacts described above.

We thus recommend applying Basel II regulatory netting rules for LR calculation purposes, only allowing banks to net exposures arising from transactions executed in netting-friendly jurisdictions. In this respect, legal enforceability of netting would be determined by either internal or external legal opinions. We also support regulators' efforts in continuing to work with ISDA to ensure that ISDA agreements not only protect creditors but also provide protection against overstated claims to defaulting parties.

3.1.3.4 Treatment of credit derivatives

We believe that ignoring hedges entirely in the LR calculation is an inappropriate simplification. It assumes hedges are worth nothing in a stress scenario or that all hedging counterparties would be in default while the reporting entity survives. Such an assumption is unrealistic and creates misleading incentives.

The addition of sold credit protection, without recognizing hedges,[6] creates an inconsistency with the trading book treatment of sold credit derivatives, potentially negatively impacting the entire credit hedging business due to the disproportionate capital requirements for protection providers. This will increase general lending costs and reduce the number of banks being able to sell credit protection.

[6] BCBS also recognizes the hedge effects of single name CDS under the bond equivalent approach for CVA losses.

A weakened credit derivative market is undesirable as banks would not be able to transfer credit risks to diversify their credit risk portfolios any longer. This would leave banks vulnerable to market downturns and will most likely reduce corporate lending volumes.

We thus recommend to add credit derivatives for the LR calculation, if at all, to total assets on a net basis, i.e. after application of the hedging impact of bought protection. To further ensure a consistent treatment between on and off balance sheet exposures, we recommend the LR should include hedged exposures on a net basis, i.e. assets hedged through the purchase of CDS protection should also be excluded from total assets. This would ensure a credit risk neutral calculation that results in net (real) exposures without systematic double-counting. Risks other than credit risk, such as operational risk, continue to be captured by the risk-based capital rules. We believe this recommendation reflects the spirit of a going concern LR.

3.1.3.5 Treatment of off-balance sheet items

We believe that ignoring conversion factors – i.e. treating off-balance sheet as on-balance sheet items – does not provide sufficient differentiation between the actual risk characteristics of these exposures. It is also inconsistent with GAAP and their treatment under Basel II. In addition, it will also have an adverse impact on several financial services – e.g. trade finance – provided to corporates and, in particular, SMEs.

We recommend capturing the leverage stemming from off-balance sheet exposures, if at all, by a separate off-balance LR calculation recognizing distinct likelihoods of commitments being drawn. If they are to be included in the balance sheet LR calculation, the conversion factors currently applied for regulatory reporting should be used, as they would be a more appropriate reflection of risks.

3.1.4 Capital conservation buffers

We agree with the principle that banks ought to hold capital above the regulatory minimum. However, we believe that publicly prescribed capital conservation buffers will not fulfill their goal of effectively being callable in downturns but instead be turned into new shadow Pillar 1 minima. Also undifferentiated "one-size-fits-all" derived remediation measures will fail to appropriately address the specificities of individual institutions.

We therefore recommend keeping buffer levels undisclosed and integrate their setting and derived remediation actions into the existent Pillar 2 framework. This will also allow these items to be tailored to the individual institution, their market, business mix and other specificities in order to allow a robust and effective oversight interaction with the bank.

3.2 International framework for liquidity risk measurement, standards and monitoring

3.2.1 Introduction

In general we are supportive of the concept, approach and direction laid down in the proposals, which are generally consistent with the qualitative paper “Principles for Sound Liquidity Risk Management” issued by the BCBS in September 2008. We fully support the need for the financial industry in general to raise standards in liquidity risk management and supervision and believe the proposals will, once implemented, be a material step towards achieving this goal.

We recognize that events since July 2007 – impacting both internationally active firms as well as local banks – and the short comings and inconsistencies in the existing regulatory liquidity framework globally, all give strong support to the conclusion that liquidity regulation needs to be harmonized, strengthened and an appropriate level of globally consistent reporting standards introduced.

The key areas of concern that we have with the proposals are as follows:

3.2.2 Internal model vs. prescribed standards and rules

Liquidity risk management is driven by many bank specific factors – strategy, business model, markets, distribution etc. – which cannot be simply pressed into a rule-based quantitative framework. Although a standardized approach may be appropriate for wholesale and institutional type funding, an individual business and local market specific approach is required for retail and corporate deposit markets. Therefore we continue to favor a bank specific internal model as indicated in the qualitative framework "Principles for Sound Liquidity Risk Management and Supervision".

We remain convinced that comprehensive bank-specific risk models that have been developed over many years (including "lessons learned" from the recent crisis) are superior to a "one-size-fits-all" approach. Moreover, the internal model approach clearly allocates the ownership of risk management to the bank and its management and to supervisors overseeing it. A strong focus on external quantitative guidelines can divert the focus to a mechanical regulatory-driven liquidity risk management approach which does not fit its purpose and may delay the inclusion of new aspects of risks, thereby reducing the quality of liquidity risk management.

3.2.3 Economic impacts

The proposals set various minimum standards on the composition of eligible liquidity buffers, the minimum outflows on retail, wholesale and contingent liabilities and inflow of corresponding assets. These standards have a bearing on one of the core functions – the maturity transformation of contractual short term deposits into longer term lending – of commercial banks to society and the economy.

The more conservative the assumptions used, the more significant will be the wider economic implications resulting from the banks’ reduced maturity and amount transformation capacity. Contractually short term 'wholesale-like' deposits cannot or only to a very limited extent be used as funding source. This reduces loan capacity for borrowers. In effect, an undue reduction of the banks' transformation capacities will have a direct adverse impact on world economies and may even reverse the current path to economic recovery. Moreover, overly conservative assumptions will lead to a disintermediation of banks into other markets and sectors which might not deal with liquidity risks appropriately.

We therefore recommend carefully assessing these direct and indirect costs and risks before calibrating and implementing a series of assumptions, particularly in light of the fact that they are planned to be introduced in concert with other regulations on capital, leverage ratios and increased risk weights on assets. The careful calibration across functions is the prerequisite for ensuring the proposals achieve their goal and do not lead to unintended results.

We also recommend giving banks sufficient time for adjustments to their funding and asset buffers and ensuring a reassessment once the rules are finalized in order to avoid pro-cyclicalityto make.

3.2.4 Quantitative impact study

Given the complexity and the current dynamic economic, legal and fiscal developments and in view of other regulatory measures scheduled to be introduced, any quantitative changes need a careful calibration.

Apparently minor adjustments of percentages on the liquidity stress assumptions can have a major impact on funding and demand for liquid assets.

We recommend recalibrating the assumptions following another series of quantitative impact studies later in the process. This will ensure robust results based on multiple feedback and continued improvement of data quality within the industry.

3.2.5 Consistent regulatory treatment (intra- vs. cross-border)

One of our main concerns is the globally consistent application of reporting standards. The use of a harmonized reporting framework will avoid complexities and facilitate comparisons between jurisdictions and bank groups. Competing standards will divert the focus from liquidity risk management to reconciliation.

Assumptions may vary depending on local markets in some jurisdictions but these should be based on a uniform base stress scenario. We recommend home regulators to base assumptions for the global group-wide application not on the 'lowest common denominator' but rather to ensure they reflect an average of the individual market assumptions.

Further, the diversification of funding sources and assets must be considered. This is not addressed in the proposals, but it was revealed to be a key factor during the crisis. We strongly recommend considering funding diversification and individual ratios, depending on the quality of funding and its diversification.

To achieve these goals we support an open interaction with and between the relevant regulators.

We fully support the recommendation in various sections of the proposals that supervisors should disclose their requirements to increase transparency and harmonization.

3.2.6 Stress Scenario and Assumptions

We endorse the severity and clear definition of the stress scenario. It should allow the setting of realistic minimum stress parameters which may vary by jurisdiction but be based on uniform definitions of underlying positions to ensure consistency.

The stress scenario laid out in paragraph 22 is in our view applicable to the Liquidity Coverage Ratio ("LCR") only. We note that the impact of a three-notch downgrade very much depends on the initial public rating of a bank. The impact of a downgrade is much less severe for an AA rated bank compared to an institution rated A- or below.

The same scenario cannot apply to the structural funding measure of the Net Stable Funding Ratio ("NSFR"). The NSFR is based on a cash capital type analysis which should reflect milder stress assumptions to demonstrate the robustness of long term structural funding, including diversification and the wider range of possible mitigation actions to defend a structural term funding position.

3.2.7 LCR and NSFR measures (interconnection, horizon, publication)

We consider the LCR as an improved and harmonized measure to ensure resilience against short term stress. We appreciate the 30-day horizon which avoids an overly strong focus on the very short term of 1-2 weeks only. In order to avoid "cliffs" after 30 days, we recommend that banks applying their internal models demonstrate a survival horizon that shows a smooth development rather than drastic declines in the ratio further out.

We understand the LCR is a tool to report the impact of a combined idiosyncratic and market-wide shock, based on the stress assumptions under paragraph 22. We also understand the NSFR establishes a standard to ensure stable funding on an ongoing viable basis over one year in an extended firm-specific stress scenario as per paragraph 83. We agree in principle with this approach. However, the percentage factors used, i.e. the required funding factors and the availability factors, appear largely driven from an LCR perspective and therefore imply much more severe stress assumptions for the NSFR context. We suggest better delineating the methodologies used for LCR and NSFR purposes. Otherwise the proposed additional monitoring tools would be of limited value added.

We view the LCR as an expanded tool under Pillar 1 while the NSFR, given its higher level of aggregation, should exclusively be considered under Pillar 2 for discussion with regulators. We suggest limiting the public disclosure under section IV, paragraph 4, to the main elements of the NSFR. We understand that further work will be required in this context. We also caution that such a disclosure may have negative implications, due to its potential negative affect on investors.

3.2.8 Definition of Liquid Assets

The definition of unencumbered assets that are freely available is further restricted in paragraph 26 to assets that are not held as a hedge for any other exposure. Where a hedge relationship can be substituted with other assets or derivatives, we recommend not further restricting the encumbrance of such liquid assets.

3.2.8.1 LCR

Based on the stress scenario, the definition of high quality liquid assets as per paragraphs 34 - 37 is too narrow to serve even its implicit purpose of a primary liquidity buffer comprising high quality liquid assets that can be monetized without delay. We note an over-emphasis on government debt. We recommend the definition also includes highly liquid regional development banks, agencies and agency MBS with explicit or strong implicit government guarantee enjoying broad and deep repo markets. The Basel II risk weight limit should be increased up to 20 % for such assets. Securities issued by banks should be accepted where the guarantee does not constitute temporary aid. In general, we have a clear preference to apply open market operations based on central bank eligible baskets as "primary buffers". This would help a global consistent approach for security classes and haircuts.

We acknowledge that a high cash generating capacity is important to cover a material cash drain in the near future. This is particularly valid for the first few days of continued liquidity drain.

We understand there is a concept of "secondary buffer" as per paragraphs 36 and 37 comprising corporate bonds and covered bonds. The potential use of such additional unencumbered assets should be increased to reflect their value for longer periods of stress. The predefined very narrow rules to calculate the haircut for corporate bonds and covered bonds are far too complex and unrealistic in practice. For example the 10-year

observation period based on bid-ask-yield spread testing and additional haircut stability testing is 1) not realistic, 2) cannot be applied to shorter term bonds and 3) will certainly lead to strongly diverging results between banks' own calculations. The haircuts setting should be simplified and set at around 120% of observed market haircuts or as applied by central banks. This will also ensure level playing field for same asset types in the same markets.

Moreover, we recommend the inclusion of major market index equities which proved a particular stable source of funding in the past crisis and were superior to many types of fixed-income debt. This would also help to provide further diversify liquid asset buffers and resilience of the system to shocks and concentrations.

We also note that the proposal contains an asymmetry between interbank borrowings and investments in financial assets, regardless of their liquidity or rating. We understand that the purpose may be to avoid any contagion in the financial industry that may trigger a systemic crisis. However, this extreme approach in itself undermines the restoration of a functioning interbank lending and borrowing market, which is important for the efficiency of financial markets.

3.2.8.2 NSFR

It should be considered that the NSFR is a measure with a one year horizon. In order to effectively manage the NSFR to a positive ratio, banks will need to raise considerable amounts of debt in the capital markets from non-financial investors (not subject to the Basel rules) with terms of minimum 3 years in practice. The aggregate impact of conservative assumptions will be material on all stakeholders in the capital markets and may lead to an unintended "crowding out" if not carefully calibrated.

Almost the same severe haircut deductions on liquid asset buffers are applied for the longer term availability in the NSFR as in the LCR. This is unrealistic and leads to a disproportionately high long term funding requirement for a large range of marketable assets. A required factor (haircut) of 50% for listed equities and corporate bonds rated between A- and A+ fails to acknowledge the long timeframe of one year available to monetize such assets and/or adjust the business strategy and balance sheet accordingly. This also applies to other asset categories such as corporate bonds and financial assets. Under a continued idiosyncratic stress, with a decline of profitability, a bank will certainly be able to reduce its funding needs to a larger extent than prescribed in the required funding factor table in Annex 3. Moreover, as with the LCR, the complex cumulative haircut assumptions defined in Annex 2 for fixed income papers, equities, gold, etc. should not be applied here.

Moreover, we note a strong asymmetry between "other liabilities" with a 0% availability factor and "all other assets" with a 100% required factor. The proposals and the QIS give very little guidance on balance sheet items with immaterial or no funding impact which should be matched. We strongly recommend to break out the "other assets and liabilities" into funding neutral or matched items (accruals, gross-ups, failed sales, replacement values, receivables/payables etc.). The implied mechanical application for "other assets and liabilities" in the reporting template to cover the full balance sheet would lead to a dramatic and unachievable increase of long term funding need.

Finally, off balance sheet exposures should be limited for the same reasons above, given the long term nature of this measure.

3.2.9 Cash outflows

3.2.9.1 Deposit run-off (retail and wholesale)

We appreciate the focus on client/counterparty type rather than product type as clients shift between products, depending on the interest cycle. This may lead to shifts from a contractual perspective while the behavioral nature remains largely unaffected. However, the description and granularity used in paragraphs 48 and 49 for the definition of SME deposit eligibility based on Basel II are not practical because the nature of the relationship may be different from one arising in the loan business, where such information may be available to the bank in its role of a lender.

There is also undue focus on the distinction between natural persons and legal entities. In many cases and depending on jurisdiction proprietorships, partnerships or entities are established to facilitate the management of assets for a single or group of private persons. The inherent assumption of highly sensitive "treasury-like" behavior for non-private persons dealing with amounts > EUR 1 million does not reflect reality and no amount limitation should be applied.

The run-off rates should range between 5% (full deposit guaranteed schemes) and 50% (wholesale non-financial clients or deposits managed by professional and sophisticated investors). Special focus should also be given to core relationships qualified by strong coverage rather than the connection to operational relationships. Similarly this applies to foreign currency deposits as per paragraph 44 where a different treatment can only be justified based on strong evidence that foreign currency deposits are more volatile. The definition of a foreign currency itself may already be difficult when a bank's local reporting currency differs from the primary currency in circulation. Tracking specific client groups, relationships, and customer segmentations as outlined in the proposal will be very cumbersome and difficult to implement due to the interdependence and various levels of granularity.

Although we acknowledge that interbank funding raised in wholesale markets should not be assumed to be rolled under stress, we note that relationship-based bank-to-bank business comprising transactional and custodial services is typically much "stickier" than term deposits raised via "auction-type" funding channels.

We do not share the view that deposit insurance should form a basis for lower outflow assumptions. Although deposit insurance proved effective in some jurisdictions depending on the perception of government support beyond the overall pre-funded insurance pools, it may lead to the wrong incentives and moral hazard. Liquidity risk should not be subsidized by premiums paid for the deposit insurance: on the contrary, overall prudent capital and liquidity management should substitute the need for deposit insurance.

3.2.9.2 Secured funding run-off (LCR)

The proposal requires that any secured funding gaps resulting from repo and securities lending and borrowing activities that use collateral outside the definition of liquid assets (paragraph 34-37) must be covered. Given the overly narrow definition of liquid assets as stated above (see 3.2.8.1), this would have an undue impact on repo activities involving stable and liquid collateral such as agencies and MBS. The result would be an unjustified loss of attractiveness of the repo market leading to decreased liquidity and efficiency of financial markets. We strongly suggest a more differentiated approach to reflect the proven stability and resilience of the secured markets as witnessed during the crisis.

3.2.9.3 Additional requirements and contingent liabilities

The derivatives are singled out in paragraphs 62-63. We recommend a wider definition of activities that may have an impact on banks' liquidity positions, applying stress tests on market shocks that reveal asymmetries in collateralization arrangements and reductions on potential overcollateralization received. We view the draw-down assumptions on committed credit and specifically on liquidity facilities as excessively high. Empirical

evidence and statistics gathered by Moody's over the past 70 years do not support such extreme draw-downs. We recommend draw-down assumptions for credit facilities at 7 % and for liquidity facilities at 10 %. These factors are still much higher than our long term experience would indicate is necessary.

3.2.10 Other monitoring tools

We support the harmonization and streamlining of further common metrics.

3.2.10.1 Contractual maturity mismatch

The current proposals add limited value as they do not differentiate between the relevant products. They would for example, mix contractual flows of retail deposits with wholesale deposit flows. As a result valuable base information would be lost, making any comparison meaningless. We also believe there is a strong loss of value the further the time horizon is extended and therefore recommend its application to a maximum of 1 year. Going further out on the curve, aggregation of maturity buckets should be allowed as the cash flows will still change considerably when approaching maturity. Including expected cash flows on derivatives further adds complexity far beyond the value of the information and should be relaxed.

We note that an individual specification of the reporting template by individual regulators as stated in paragraph 96 does not support the goal of global consistency and ability to aggregate across jurisdictions. Individual local requirements will also lead to high development, maintenance and reconciliation efforts distracting from risk management goals. We thus suggest agreeing to an internationally common reporting template.

3.2.10.2 Concentration of funding

This proposal is overly prescriptive and should instead require that banks have acceptable procedures in place to measure, monitor and manage funding concentrations. Significance thresholds by counterparty, product and currency should not be too descriptive and narrowly defined at 1% as this may lead to artificial activities to reduce concentration. We recommend a higher threshold of 10 % which is applied to a smaller basis such as unsecured funding. To reveal potential concentration risks within and across funding sources, markets, products etc., more emphasis should be placed on stress testing.

3.2.10.3 Available Unencumbered Assets

We support the definition in general and would further distinguish it from the primary pool of assets as determined for the LCR. With regard to central bank eligibility and haircuts, we note that there may be strong variations in haircuts for the same instrument in various jurisdictions and markets. We recommend that the central banks further harmonize their applications of haircuts and eligibility criteria of standing facilities to avoid the unintended creation of inappropriate incentives.

3.2.10.4 Market-related monitoring tools

We recommend that the application of monitoring tools is not only addressing regulators. As laid out in Principle 8 of the "Principles for Sound Liquidity Risk Management" such measures should be used by the banks as well and linked to contingency measures where appropriate.

4 Detailed Comments to Consultative Paper 'Strengthening the resilience of the banking sector'

Para	Comments	Recommendations
I	**Executive Summary**	
3.	*Introducing a global liquidity standard*	
50	We appreciate internationally harmonized standards which should aim at building the largest coverage of banks adhering to it. Better capitalized/rated banks are less prone to liquidity shocks and have more flexibility to adjust their funding.	• We suggest not providing for local regulatory discretion to change the overall methodology/approach and scenarios to ensure a level playing field, comparability and linear impacts of locally tighter assumptions if applied.
51	Well capitalized banks experienced difficulties in the early phase, primarily due to the lack of transparency of the complex assets some of them held in their liquidity buffer. Transparency and leverage of Non-Bank institutions (Money Market Funds, Security Lenders, and SIVs) lead to the perception that medium term funding 6-18m capacity was abundant.	• We suggest considering government and financial issuers' papers, transparency of the product (e.g. covered bonds) and also liquid, listed equities as eligible liquidity, rather than making efforts to limit liquidity buffers to cash.
52	Qualitative aspects, governance, systems and processes are important and full implementation is needed. Yet, the recent market crisis was driven by an instant and market wide lack of transparency and following freeze which is more a point of macro-prudential measures.	
53	The concept overall makes sense. NSFR is strongly focused on the 1yr snapshot and does not provide any relation to the LCR.	• We suggest relating the 2 ratios (LCR and NSFR) with each other. • We recommend building in flexibility into the minimum ratios, i.e. ranges, to allow differentiation by banks.
54	It is important that there be a common, aligned understanding around cross-border issues to ensure consistency and symmetry.	
55	NSFR matching/netting application on various balance sheet items needs further clarification and specification.	
56	The stock of liquid assets is defined too narrowly. Excluding all equities from LCR and all financial issuers (banks and insurance companies) debt for both ratios goes too far. This assumes too much of financial issuers' contagion risk.	• We recommend performing a thorough analysis of the QIS, evaluating alternative liquidity buffer holdings and assessing the impact of the proposals on the broader economy.

Para	Comments	Recommendations
	The stress tests must be calibrated based on a uniform and manageable scenario, i.e. not on a wind-down scenario. We believe the given scenario allows this interpretation and allows stress tests that permit conducting "business as usual" in a non-crisis environment. The goal of the regulators should neither be to reduce the liquidity of the markets in normal times nor to calibrate the measures to a continued crisis level.	
II	**Strengthening the global capital framework**	
1.	*Raising the quality, consistency and transparency of the capital base*	
73	The term "Core Tier 1" rather than "Common Equity" should be used given that Core Tier 1 is an internationally accepted expression	• We recommend using the term "Core Tier 1" rather than "Common Equity" throughout the document. • We recommend changing paragraph 72 to "[...] Tier 1 capital must be common shares, retained, additional paid in capital and minority interests. [..]"
82-83	We agree at a conceptual level, although the calibration of appropriate limits and minima is critical.	• We recommend a thorough evaluation ensuring an appropriate calibration of the limits.
84	We agree at a conceptual level.	• We recommend that grandfathering periods should be long enough to allow restructuring and replacement of existing instruments not meeting the Tier 1 criteria.
85-86	We agree at a conceptual level, although the calibration of appropriate limits and minima is critical	• We recommend a thorough evaluation ensuring an appropriate calibration of the limits.
89	There are several criteria that reference the term "liability". The wording of the proposal should make clear that the term "liability" is meant in a legal and not an accounting sense. Principal loss absorption (Criterion 11) can be achieved through either conversion to common shares or a write-down mechanism. There is general uncertainty about how the write-down would occur – by individual instrument or by category of pari passu instruments. The restriction that the bank cannot directly or indirectly fund the purchase of the instrument (Criterion 12) needs to be carefully worded to ensure that the following normal course of business activities are allowed: 1) underwriting and general	• We recommend clarifying in the document that "liability" is meant in a legal sense, and not an accounting, sense. • We recommend defining in paragraph 89, criterion 11 if the write-down mechanism is by individual instrument or by category of pari passu instruments. • We recommend amending paragraph 89, criterion 12 with the phrase "Underwriting, general market making, and general banking or funding relationship with a client are not subject of this rule." • We recommend clarifying that in case certain instruments are

Para	Comments	Recommendations
	market making, and 2) general banking or funding relationship with a client.	not considered eligible anymore under the proposed new rules, bank will have flexibility of early repayment without being restricted by the regulator.
90-92	Additional Going concern capital and Tier 2, as gone-concern capital, play a vital role in providing assurances that when a firm falls into difficulties, its resources will largely cover its obligations. This capital takes pressure off deposit-guarantee schemes and aids the recovery and resolution process. Amortization of the regulatory capital credit during the 5 years before maturity can be inconsistent with the statement that the instrument should include no incentive to redeem (Paragraph 90, criterion 4), as such amortization is an incentive. The restriction that the bank cannot directly or indirectly fund the purchase of the instrument needs to be carefully worded to ensure that the following normal course of business activities are allowed: 1) underwriting and general market making, and 2) general banking or funding relationship with a client.	• We recommend deleting paragraph 90, criterion 4, part b ("recognition in regulatory capital in the remaining 5 years before maturity will be amortized on a straight line basis"). • We recommend amending paragraph 90, criterion 8 with the phrase: "Underwriting, general market making, and general banking or funding relationship with a client are not subject of this rule."
93	While the Consultation Document notes the distinction between going-concern and gone-concern capital, it is striking that almost all deductions are made from common equity. A dogmatic approach on this point risks failure to recognize that several of the items proposed for deduction have value in "gone-concern" situations and are of sufficient quality to be included in Tier 1, and thus there should be adjustment appropriately to reflect that fact.	The treatment of deductions from common equity should be amended as recommended in the comments below.
94	A stock surplus represents paid-in capital and is therefore fully loss bearing, regardless of whether it relates to common shares or others. An unequal treatment is not justified and adds to complexity.	• We recommend deleting paragraph 94.
95	Minorities do provide equity to parts of the group, and minority interests are therefore loss absorbing from a consolidated perspective. If the interest is a qualifying minority, it should not be treated as second class Tier 1. The current proposals contain an asymmetry between the full deduction of minority interests as presented in the current text, on the one hand, and the full consolidation of RWA's in affected subsidiaries, on the other. In addition, although assets represented by minority interests may sometimes not be available	• We recommend re-formulating the box above paragraph 95 as follows: "Minority interest will only be eligible for inclusion in the Common Equity component of Tier 1 if it belongs to a qualifying minority." • We suggest inserting the follow text in the box above paragraph 95: "RWAs of fully deducted minority interests are excluded from the scope or regulatory capital calculations"

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	to the entire group, they are available to the relevant parts of the group, and thus benefit the group as such. The concern about certain SPV structures should not be allowed to dictate a harsh regime for all joint ventures and minority interests in operating companies; rather, if there is a need for a full-deduction regime, it should be applied only where well-defined concerns arise. A full deduction regime should however only be implemented in combination with the removal of the RWA that are associated with the minority interests. Regulators raised the concern that this could provide incentives to undercapitalize entities with minority interests. This can be prevented with rules that limit the RWA reduction by the capital ratio of the associated subsidiary. As such we do not share this concern.	
96	This proposal is welcome as a simplification due to its consistency with GAAP. The outcome is a better reflection of regulatory capital.	
97	While it may be appropriate to envision deduction of pure goodwill, full deduction is not appropriate for "intangible" items that have an objective, transferable value. Such intangible include: • Software: In some countries, software is an intangible (in others, it is a tangible asset), yet it has a real value if, for example, a subsidiary is transferred, and may have transferable value on its own. • Mortgage Servicing Rights have clear cash flows attached to them and are transferrable in certain circumstances. • Purchased Credit Card Receivables similarly have well-understood and predictable cash flows, and are transferable.	• We recommend re-formulating the box above paragraph 97 as follows: "Goodwill and other intangibles, that have no objective, transferable value, should be deducted from the Common Equity component of Tier 1. […]. Specifically Software, Mortgage Servicing Rights and Purchased Credit Card Receivables, having objective, transferable value, are not subject to deduction."

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98-99	Disallowance should be limited to DTA on NOL's only See Section 3.1.1.2 for more details on the rationale of our recommendations.	• We suggest the following amendment to the current wording in the box above paragraph 98: "**Deferred Tax Assets** Net deferred tax assets arising on tax losses are limited to 10% of Tier 1 (before any disallowance). This limitation applies only where the deferred tax asset relies on future profitability of the bank to be realized. "Net deferred tax assets arising on tax losses" represent deferred tax assets on operating loss carry forwards recognized for tax purposes, net of any valuation allowance and net of deferred tax liabilities. Other deferred tax assets are not subject to deduction from capital." Deferred Tax Assets – Transitional Provisions In the first year of implementation of the new provisions net deferred tax assets arising on tax losses are limited to a maximum of 25% of Tier 1 (the "allowable percentage"). In each subsequent year the allowable percentage is reduced by 5% until the allowable percentage is equal to 10%."
100	<u>Index securities</u> In general, the exposure to individual names underlying broad-based index positions is incidental to trading activities. As such, it is akin to general market exposure rather than specific risk-taking. The application of a look-through approach for holdings in index securities causes incommensurate operational costs with limited supervisory benefit. Index securities are listed on exchanges and as such liquid instruments that do not expose banks to equity risks in other banks. The proposals would also discourage activities in index securities. These are useful to the market for a number of purposes, and that tend to augment rather than detract from sound risk management. For the most part, firms active in	• We recommend re-formulating the first sentence of the box above paragraph 100 as follows: "All of a bank's investments in its own common shares should be deducted from the Common Equity component of Tier 1 (unless already derecognized under the relevant accounting standards) by these shares notional amount." • We recommend re-formulating in the box above paragraph 100, bullet point 1 as follows: " Gross long positions may be deducted net of short positions only if the short positions

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	trading or market-making of index securities will typically have balanced long and short positions, which facilitates market liquidity; here it appears that the long but not the short positions would be recognized, leading to an imbalance. If it is deemed necessary to maintain some version of the rule, then balanced positions should be distinguished from outright long positions. Moreover, it should be secured that double-counting with other capital requirements in the system is avoided. <u>Determination of long position</u> The rule as currently drafted requires the deduction to be based on the long positions, calculated as follows: • Long cash holdings net of short cash holdings; • Long notional holdings underlying derivatives. Short notional holdings underlying derivatives can be excluded if these contracts involve no counterparty risk. The treatment is overly conservative, and may give rise to a deduction across the banking system that exceeds the underlying amount of shares in play. The proposals would result in multiple layers of double counting of exposures, and thus in significant, redundant capital requirements within the banking sector. This, in turn, would make trading positions on banking stocks unaffordable given the overlaying capital requirements. The latter would harm markets at times when robust markets for bank securities are most needed to make it possible for banks to meet new capital requirements. Purchased call options are not subject to the common equity deduction given that banks have a right rather than a contractual obligation to purchase the share. As a consequence, the treatment of treasury shares held as a hedge for share awards will not change. For the purposes of the deduction for holdings in banking and finance entities, the determination of the net long position should be based on risk considerations.	involve no counterparty risk (as is specifically the case with central counterparties)." • We recommend to delete in the box above paragraph 100, bullet point 2 ("Banks should look through holdings of index securities to deduct exposures to own shares.").

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101	A number of banks hold common stock of other financial institutions to hedge stock-based compensation programs and other business strategies. The intent of such holdings is risk management, not reciprocal or sister-company arrangement. It is difficult to see why such holdings undertaking for hedging purposes should be subject to these requirements.	• We suggest to clarify in this paragraph, that it is not intended to restrict the possibility of a banking group to obtain third party funding by way of issuing common shares and potentially other going concern capital components and downstream the proceeds to its core banking subsidiary by way of a capital injection.
102-103	The proposal to deduct from Common Equity any shortfall of provisions by comparison with expected loss is consistent with the view that the expected loss shortfall calculation is in essence a means of topping up any accounting provision. However, in the interests of consistency, and in order to establish a level playing field between banks using different accounting standards, we believe that any excess of provisions over expected loss should be credited to Common Equity without restriction. This implies the removal of the arbitrary 0.6% cap. The expected loss calculation should be net of tax as currently applied in the UK. The net calculation is a better reflection of the negative impact expected losses have on capital.	• We recommend rephrasing the box above paragraph 102 as follows: "The deduction from capital in respect of a shortfall of the stock of provisions to expected losses under the IRB approach should be made 100% from the common equity component of Tier 1 capital. Analogous any excess of provisions over expected loss should be credited to the common equity component of Tier 1 capital without restriction by any cap. The expected loss calculation should be net of tax."
105	The extension of the own credit adjustment to all financial liabilities will newly include own credit adjustments on derivatives (negative replacement values) as well. This will create an inconsistency given that the impacts on positive replacement values are ignored.	• We recommend deleting the box above paragraph 105.
106-107	The requirement that banks should recognize pension fund liabilities without filter, and de-recognize any balance sheet pension fund asset, is not desirable from a financial markets stability perspective as it increases pro-cyclicality of capital requirements. In addition, accounting standards for pension assets and liabilities are not a suitable starting point to derive capital adequacy rules. **Pro-cyclicality** Pension liabilities reflecting the underfunded status of pensions are typically highest at times of stressed financial markets when declining stock markets lead	• We suggest BCBS designs a methodology that includes assumptions and statutory pension obligations for banks to consistently derive pension liabilities. • Given the significance of this change, extended phasing in periods should apply to the derecognition of ineligible pension assets.

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	to temporary pension deficits. Since pension deficits of going concern banks have historically been temporary, regulatory capital requirements should not restrict banks lending activities at recessionary times by requiring pension deficits to be deducted from bank's capital. **Use of accounting standards** *1. Pension liabilities* Differences in accounting standards are not addressed in the rule as drafted. The current proposal will create substantial differences between banks applying US GAAP and those applying the IFRS Corridor approach that is currently only penciled in to be withdrawn in 2013. All pension impacts on equity for regulatory capital purposes should be calculated so as to ensure a level playing field between banks applying different accounting standards. In particular, the method for recognizing liabilities should be made consistent through the use of a single regulatory methodology that should not necessarily be aligned with accounting standards that follow objectives that differ from the prudential mandate of high quality, non pro-cyclical capital. Under US GAAP, pension liabilities recorded on-balance sheet historically only had to cover pension deficits measured against accumulated benefit obligations (ABO) based on past service years. In 2006, the Financial Accounting Standard Board (FASB) decided that a forward looking approach would be more suitable. Consequently, since 2006, US GAAP requires the surplus/deficit based on the projected benefit obligation (PBO) of the defined benefit plans to be recorded on balance sheet. If a plan is overfunded, an asset is recognized on balance sheet. If a plan is underfunded a liability is recognized on balance sheet. Regulators did not adapt the above change (FED and FINMA grandfathering of US-GAAP FAS 87, FSA 5 year additional contribution rule) for various reasons,	

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	being among other things the differences in the account standards being applied within the financial industry and also due to the variability of assumptions necessary to derive PBO. The latter include assumptions on applicable discount rates, future salary increases, and inflation which should, from a regulatory perspective, not be applicable for the determination of pension liabilities and indirectly of regulatory capital. Instead, for the determination of high quality capital, more realistic assumptions should be applied that factor in o disruption of salary increases in times of financial stress, o discount rates to reflect historical averages instead of current spot rates so as to avoid the short-term volatility in this underlying assumption o no inflation as during periods of financial stress either no inflation or deflation is normally observed Such an approach would have the desired anti-cyclical effect and provide a more realistic view of pension liabilities that banks would face in a stress scenario. Coincidentally, this treatment would turn gross pension liabilities back to something closer to ABO which excludes future salary increases. This has historically been accepted by regulatory standard setters and it allows in our view for a more realistic accounting reflection of a bank's obligation towards a pension fund. Similarly to the FED and FINMA filters, it is noted that the FSA has not imposed IFRS pension accounting rules on UK banks but instead requires banks to record statutory contributions of the next five years as a pension liability. As such, and as an alternative, regulatory standard setters could consider the statutory obligations of bank's towards their pension funds as basis to come up with a regulatory treatment of pension deficits that could be dissociated from forward looking accounting standards.	

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	2. Pension assets Pension assets result from the off-balance sheet treatment of actuarial losses. We understand why regulators prefer actuarial losses to be treated on-balance sheet as this would show, at a snapshot, a current reflection of a bank's capital base. However, the on-balance sheet treatment would result in significant volatility in banks' capital bases which is not desirable from a credit risk management, associated lending volumes and a capital planning perspective. As stated above, pension deficits are for going concern banks usually temporary. As such we would like to highlight the trade-off in high capital quality between steadiness and continuity vs. the reflection of actuarial losses. If pension assets are to be deducted from capital, then this should be from Tier 2 capital. This ensures consistency between the temporary nature of losses of going concern banks and, on the other hand, the loss of pension assets in the event of no going concern at which point Tier 2 capital will be available. **Grandfathering** Since pension entries impact regulatory capital by billions of USD, regulatory standard setters should consider extensive grandfathering periods to allow for sufficient time for banks to restore their regulatory capital bases for negative effects new pension rules may have.	
108	We disagree with the proposal as risk weights would no longer be capped at 1250%. This is due to scaling factors of 1.06 and Pillar 2 surcharges/buffers that could be significant. For example, a securitization exposure currently subject to deduction from capital could theoretically obtain a risk-weighting of 1250% times 1.06 scaling factor times e.g. 1.5 capital buffer. This resulting capital requirement would be close to 2000%. This appears overly conservative and effectively results	• We recommend deleting paragraph 108.

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	in a hidden increase in capital charges. An alternative approach would be to exclude these items from capital buffers and scaling factors. This would require adjusting the mechanics of the capital calculation to allow for such a distinction.	
109	The level of detail of the data that banks are required to disclose is unclear (e.g. all regulatory adjustments). We note that such a disclosure requirement has the potential of further confusing the market participants, if national supervisors' instructions are not fully standardized as is currently the case in Pillar 2. We would assume that the details of bilateral agreements with the national supervisor are excluded from such a disclosure, particularly where regulators' instructions require fulfilling even higher standards than those required by the BCBS. National regulators should be encouraged to follow the BIS rules as closely as possible. Any deviations from the BIS rules should ideally be made either by scaling the RWA or by adjusting the target ratios to maintain the rules sets structurally equivalent and reduces the need for special disclosures of the local requirements. There should be no obligation to disclose bank specific Pillar 2 adjustments. This is also in the interest of the regulators as the need for public disclosure would make it more difficult to impose such requirements as the market could view them as signals and thus could trigger market reactions.	We recommend refining paragraph 109 considering the following issues: • Exempting information that would normally be held on a confidential basis from disclosure. • Clear definition of the level of detail to be disclosed in order to ensure comparability and level playing field. • Limitation of disclosure of capital limits and minima to those prescribed by the BIS as limits and minima prescribed by local regulators on a bank-specific basis are proprietary and market-sensitive. • Exempting the new Leverage Ratio standard to be used in Pillar 2 from disclosure. • Emphasizing that local rules should follow BIS rules as closely as possible in order to ensure comparability
2.	*Risk Coverage*	
118-122	The use of stressed market parameters in risk measures for regulatory capital is now firmly established in market risk. A similar approach in counterparty credit risk seems reasonable. The proposed implementation is relatively simple to implement, but will require the ability to calculate several sets of parameters on a regular basis.	
123-125	See sections 3.1.2.1 / 3.1.2.2	• See section 3.1.2.3

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139	Although we do not disagree with the observation that financial institutions may have a higher systemic risk than other industries, it is not clear what the rationale for the 1.25 factor is, or how it is calculated. We would be interested in the details of the underlying calculation.	• See section 3.1.2.3
153	We understand the arguments for increasing the margin period of risk. However, we believe that the proposed rules are inconsistent and also very difficult to apply in practice. The definition of 'illiquid' makes sense but is not an operational definition that can be used when designing the risk systems. For example, a requirement that one should be able to "within two or fewer days, obtain multiple price quotations that do not move the market" can only be implemented as a (near) manual process. Also the rules specify that for all counterparties with more than 5,000 trades, an extended margin period of risks has to be used. It is not clear why a large number of trades per se is a problem (say, instead of fewer, but large trades.)	• See section 3.1.2.3
3.	*Leverage Ratio*	
202-207	The proposed LR rules override basic principles of international accounting and regulatory netting which have been evolved over decades. These overrides will overstate risk exposures of banks which will cause uncertainty in the market rather than building confidence in the banking industry.	• Instead of imposing a Pillar 1 Leverage Ratio, we recommend the BCBS issuing a Leverage Ratio requirement that is part of the supervisory review process under Pillar 2. • Similar to rules implemented in Germany in 2009, banks should be obliged to report to their supervisors any significant changes in the relation between accounting equity and the total balance sheet. Supervisors will on that basis assess institute specific risks and impose additional Pillar 2 surcharges if necessary. • We recommend applying Basel II regulatory netting rules for LR calculation purposes, only allowing banks to net exposures arising from transactions executed in netting-friendly jurisdictions. • For the LR calculation, we recommend adding credit

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		derivatives, if at all, to total assets on a net basis, i.e. after application of the hedging impact of bought protection. To further ensure a consistent treatment between on and off balance sheet exposures, we recommend the LR to include hedged exposures on a net basis, i.e. also assets hedged through the purchase of CDS protection should be excluded from total assets.
208	Excluding e.g. hybrid instruments from the LR calculation would contravene the stringent conditions for these hybrids to qualify as Tier 1. The use of Tier 1 would be in line with the current perception of the Leverage Ratio in the market.	• We recommend using Tier 1 Capital (and not Common Equity) as capital measure.
210	The treatment of subsidiaries that are consolidated for GAAP but not for capital adequacy purposes is welcome. However, more detailed specifications are required for the treatment of investments in limited private equity partnerships.	• We recommend that assets of consolidated investments in limited private equity partnerships be deducted from total assets and that the investment continue to be risk weighted, thus not deducted from capital.
212-216	Common netting rules are necessary for the sake of comparability. Applying no netting at all means that an additional set of exposure measurement rules would be artificially created. This would result in undue operational burden and is in our view not necessary to achieve the overarching objective of comparability. This should instead simply be achieved by the use of existing regulatory netting rules which are typically based on legal enforceability. Paragraph 214 states that an approach disallowing netting recognizes that zero gross exposure is different from zero netted exposure, where the latter may still entail significant counterparty, operational or other risks. With the introduction of a risk perspective, we are of the opinion that the central counterparty concept should also be reflected in the LR calculation, given that derivatives traded through recognized exchanges or central counterparties are risk-weighted with 0%.	• We recommend applying Basel II regulatory netting rules for the leverage ratio calculation as banks should not be disincentivised from entering legally enforceable netting agreement. • We recommend excluding exposures with central counterparties from total assets. This will foster the incentives of market participants to use central counterparties.
218-219	High quality liquid assets are used as liquidity buffer in the proposed BCBS liquidity rules. As these serve as a liquidity cushion, inclusion in total assets would in our view be a double-counting: Banks have to hold liquid assets to meet	• We recommend that high quality liquid assets forming part of a bank's liquidity buffer are excluded from total assets as currently considered by the BCBS as an additional option.

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	liquidity rules and are penalized for doing so. Furthermore, if liquid assets (and other exposures with e.g. central counterparties) would be included in total assets, they would be de facto equally weighted like off-balance sheet items, which would be a wrong message to the public.	• We recommend that exposures with central counterparties are excluded from total assets.
220-221	Refer to comments on para 212 to 216	• Regulatory netting rules should be applied to Repos as set out in the Basel II framework so that exposures comprise of margin shortfalls.
222-225	We agree with the proposal to follow the accounting derecognition rules as otherwise a new set of rules would be applied to book values that derive from the application of accounting standards. The proposed alternative to use the total of all securitized portfolios would in our view overstate risks that banks are exposed to. The issues encountered with the "originate to distribute model" have been addressed by regulators by higher due diligence, retention and disclosure requirements. As such, we consider adding the total of all securitizations to a bank's risk exposures to be inappropriate as it would imply that investors enter no risk to underlying assets when purchasing securitization products.	• We recommend using accounting derecognition rules for securitization exposures. • We recommend not pursuing the alternative approach consisting in adding the total of all securitizations to a bank's risk exposures.
226-229	We support BCBS's efforts to align netting rules between the different accounting standards for LR purposes. Prohibiting netting entirely, however, would result in perverse incentives for adequate risk management and the use of central counterparties that require users to daily margin based on net exposures. Taking no account of netting would also artificially increase total assets and decrease the LR, without adding any supervisory benefit, which would hardly be understood by the market. In addition, un-netted derivative volumes typically increase in market downturn situations. Disallowing netting would therefore also reinforce pro-cyclicality. Three different major netting sets are currently already used in the market: US GAAP, IFRS and Basel II. The proposed rules introduce a further fully new netting concept, which creates an unduly operational burden on banks without an apparent supervisory benefit. The Basel II regulatory netting rules are a known	• We recommend applying Basel II regulatory netting rules for LR calculation purposes, only allowing banks to net exposures arising from transactions executed in netting-friendly jurisdictions. In this respect, legal enforceability of netting would be determined by either internal or external legal opinions. We also support regulators' efforts in continuing to work with ISDA to ensure that ISDA agreement not only protect creditors but also provide protection against overstated claims to defaulting parties. • We recommend not pursuing using the current exposure method to measure potential exposure without being allowed to apply netting.

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	concept and already in use at banks globally, irrespective of the GAAP applied. The application of these netting rules would have the same benefit of international comparability without generating inappropriate impacts described above. The defaults of Lehmann Brothers and the Icelandic banks demonstrated that ISDA agreements work as CS and other banks were able to offset exposures and to file net claims. To improve the benefits of ISDA agreements, regulatory supervisors should continue to work with ISDA to ensure that ISDA agreements not only protect creditors but also provide protection against overstated claims to defaulting parties (this was one of the concerns that was publicly discussed in the work out periods of the above-mentioned defaults). In addition, un-netted derivative volumes typically increase in market downturn situations. Disallowing netting would therefore have a negative pro-cyclicality impact.	• We recommend that the potential future credit exposure, represented by the add-on, should not be added to the derivative exposure since the add-on is already subject to the regular capital charge and the counterparty credit risk further reflected in the additional CVA charge.
230-231	The addition of sold credit protection without recognizing hedges creates an inconsistency with the trading book treatment of sold credit derivatives potentially negatively impacting the entire credit hedging business due to the disproportionate capital requirements for protection providers. This will increase general lending costs and reduce the number of banks being able to sell credit protection. This will increase general lending costs and reduce the number of banks being able to sell credit protection. A weakened credit derivative market is undesirable as banks would not be able to transfer credit risks to diversify their credit risk portfolios any longer. This would leave banks vulnerable to market downturns and will most likely reduce corporate lending volumes. In addition, under the bond equivalent approach for CVA losses, the BCBS recognizes the hedge effects of single-name CDS. The LR treatment however goes in the opposite direction. Given that material market participants such as insurance companies and hedge funds are not subject to banking regulations, the proposed rules may lead to a risk shift to the shadow banking system. We thus recommend credit derivatives be, if at all, only added to total assets on a	• We recommend that credit derivatives be, if at all, only added to total assets on a net basis, i.e. after application of the hedging impact of bought protection. • To further ensure a consistent treatment of on and off balance sheet exposures, we recommend that the LR include hedged exposures on a net basis (i.e. also assets hedged through the purchase of CDS protection should be excluded from total assets).

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	net basis, i.e. after application of the hedging impact of bought protection. To further ensure a consistent treatment between on and off balance sheet exposures, we recommend the LR to include hedged exposures on a net basis, i.e. also assets hedged through the purchase of CDS protection should be excluded from total assets. This would ensure a credit risk neutral calculation that results in net (real) exposures without systematic double-counting. Other risks than credit risk such as operational risk continue to be captured by the risk-based capital rules. We believe this recommendation reflects the spirit of a going concern ratio. Ignoring hedges entirely would otherwise assume that hedges are worth nothing in a stress scenario, or even worse, that all hedging counterparties would be in defaulting while the reporting entity survives. As such a scenario is unrealistic, hedges should be factored into the calculation.	
232-235	Non-application of conversion factors and unweighted aggregation of on- and off-balance sheet items does not properly reflect the real risk situation, is inconsistent with both GAAP and capital adequacy rules and generally downplays the importance of the balance sheet. A potentially better solution is to have separate leverage ratios for the on- and off-balance sheet. This could take the form of two parallel ratios calculated with different denominators, one with balance sheet and one with the off-balance sheet. Another alternative would be to calculate the balance sheet leverage ratio as the ratio between capital and the balance sheet assets and the off-balance sheet leverage ratio as the ratio between the off-balance sheet positions and the on-balance sheet assets. Furthermore, the proposed rules for failed transactions and unsettled securities require clarification. Finally, the consultative document does not take into account the intrinsically safe structure of trade finance instruments. Proposals to increase Credit Conversion Factors could have the effect of amplifying business cycle fluctuations, forcing banks to curtail lending in recessionary climates in order to comply with capital	• Conversion factors for off-balance sheet items should be applied to ensure consistency with capital rules and proper reflection of risks. • Separate parallel leverage ratios for on- and off-balance sheet items should be introduced. • Failed and unsettled securities trades should only be added to total assets to the extent they are not already reported on the balance sheet by means of trade date accounting • We recommend issuing specific rules for trade finance instruments taking into consideration their fixed, short-term and self-liquidating nature.

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	requirements. Trade related OBS instruments, including trade related contingencies, transaction related contingencies and unconditionally cancellable commitments could be reduced or cancelled under the proposed increase in the Credit Conversion Factors, leading to substantially reduced trade flows and inhibiting the recovery in international trade. Issuing specific rules for trade finance instruments will ultimately have a positive effect on the trade finance markets and will spur growth in the global economy.	
238	The LR and especially the denominator (total assets) is designed to be a simple measure (as outlined in paragraph 218). The proposals, however, add complexity to the accounting values based LR calculations currently being used. We are thus concerned that yet another new standard will not be understood by the market. The proposed LR rules – especially the artificial increase of the denominator – will automatically lead to significantly lower leverage ratios, which would be a wrong message to the public and the market. Instead, in order to foster confidence in financial markets, BCBS should rather increase minimum ratios taking the existing set of rules as e.g. applied in the US or Switzerland. Domestic lending business should be deductible from total assets by consent of local regulators. This would avoid local credit shortages as the LR would otherwise restrict banks with large credit volumes. Such an exception – relating to the economically vital domestic lending business - would prevent the leverage ratio from being the root cause for reduced or more expensive domestic lending.	• A leverage ratio should be based on one clear and well accepted standard not on a mix of several different standards. • Rather than establishing rules causing significantly lower ratios, the minimum ratios should be increased with the current parameters (Tier 1, Total assets) left unchanged. • Domestic lending business should be deductible from total assets by consent of local regulators.
4.	*Pro-cyclicality*	
243-249	The risk of a provision shortfall due to the incurred loss concept is already properly reflected in the Basel II "Expected Loss Provision Shortfall Concept" for IRB banks. We however agree with the removal of disincentives to sound provisioning practices. Regarding sound provisioning (paragraph 246) please refer also to our comments to paragraphs 102 – 103. *Expected loss vs. Incurred loss model* Supporting the introduction of the expected loss concept under IFRS will result in	• Regarding sound provisioning (paragraph 246) please refer to our recommendation to paragraphs 102 – 103.

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	a new difference between IFRS and US GAAP, which contravenes the effort to align the different accounting standards. The expected loss according to Basel II denotes the expected amount of a credit that will be lost within one year in case of default. Under the IFRS proposals, expected losses are recognized throughout the life of the loan. Therefore, a provision against credit losses would be built up over the life of the financial asset. The expected loss model under IFRS is likely to increase provisions under GAAP, which would have a negative impact on capital. This should be properly reflected in the regulatory expected loss provision shortfall calculation so that an excess of provisions over expected losses is added back to common equity rather than to Tier 2 capital. The 0.6% cap should consequently be abolished as it makes no sense to understate capital just because of an excess of provision.	
256 - 259	We believe it is bank's management responsibility to manage its capital within the constraints of the regulatory limits, and in accordance with any relevant guidance or agreed code. The ability of a bank's board to manage its business could be undermined by an unduly restrictive framework of capital distribution constraints, or by excessive regulator intervention in this area. Similarly, regulators may expose themselves to legal accountability and moral hazard if they hold themselves out as controlling the capital and distribution policies of their regulatory community.	• We recommend keeping any buffer level and related requirements in Pillar 2. Capital conservation measures, e.g. appropriate remediation actions, could be made an integral part of the Pillar 2 dialogue between the local regulator and the bank. • We recommend not publicly disclosing any buffer levels.