



KOREA FEDERATION OF BANKS

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Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

E-mail: baselcommittee@bis.org

Subject: KFB comments on *Fundamental review of the trading book*

Dear Sir or Madam,

The Korea Federation of Banks (KFB) is a bankers' association that represents and promotes the interests of the Korean banking industry as a whole. Our membership comprises banks and other financial institutions, both domestic and international, operating in Korea.

Thank you for providing the opportunity to industry stakeholders to comment on the "*Fundamental review of the trading book*". Having sufficient understanding of the background behind this consultation paper, the KFB and our member banks have reviewed the paper, in particular giving attention to the questions mentioned in the text. The following are our comments on these questions.

1. Alternatives to the current boundary between the trading book and the banking book

Both the trading evidence-based boundary and the valuation-based boundary have some weaknesses. Korean banks prefer the trading evidence-based boundary, however, because it requires more comprehensive internal control requirements that better ensure "trading intent", and would enhance banks' risk management abilities. The valuation-based boundary considers all available-for-sale securities assessed at fair value as the trading book. The result of this,

however, is that the volume of the risk assets used to calculate regulatory capital is larger than the actual trading volume.

2. Approaches for capturing market liquidity risk

To capture market liquidity risk, the BCBS proposed the following three options, which apply different liquidity horizons by instruments.

- A. Producing simulated or historical scenarios classified by the asset's liquidity horizon, and then applying different liquidity horizons according to the particular risk factor
- B. Applying liquidity horizons scaled by applying the square root of time rule to one-day shocks
- C. Computing one-day shocks with an aggregate risk measure and then applying liquidity horizons scaled to the weighted-average liquidity horizon of the portfolio using the square root of time rule

Some of our member banks support the third option because it encourages banks to employ more practical risk management procedures and allows for better comparability across banks. Other banks, however, are concerned about the credibility decline of the measure in the process of scaling up to a longer horizon.

3. Establish a stronger relationship between standardized and internal model-based approaches

To strengthen the relationship between standardized and internal model-based approaches, and to supplement banks' internal models, the BCBS suggests the following options.

- A. Calibrate standard parameters to the relevant internal model-based measures
- B. Mandate the calculation of standardized capital requirements for all instruments in the trading books, even if banks have approved internal models
- C. Apply a standardized floor (or surcharge) on regulatory capital requirements generated by banks' approved internal models

Some of our member banks favor the second method of mandatory standardized measurement as a supplement to internal models; however, they oppose applying a standardized floor or surcharge on regulatory capital because it would disrupt the fundamental nature of internal model-based approaches.

4. Introduce desk-level approaches to the internal model approval process

The BCBS has proposed that the approval, P&L attribution assessment, and back testing of internal models be conducted at the trading desk level.

Some member banks are in favor of this because this method has consistency with their internal P&L attribution assessment and back testing system. Other banks, on the other hand, are against this because any ambiguous division among desk levels damages the consistency among desks in cases where they are trading the same instruments at different desks.

5. Two approaches for identifying a stress period and calculating capital requirements under stressed ES

The direct method identifies a stress period by using a full set of risk factors and then finding the historical period that maximizes the risk measure. The indirect method, in contrast, uses a reduced set of risk factors to find a maximum stress loss in the historical period. It then scales that loss by multiplying by the ratio of the current ES measure using full risk factors to the current ES measures using the reduced factors.

Most of our member banks prefer the direct method, since this allows for establishing a stress period using ES measurements without data manipulating. Where there is insufficient historical data for any of the risk factors, however, the stress period for that risk factor could be measured by the indirect method as an alternative.

6. Conversion of trading desk into risk factor

A bank calculates its regulatory capital by either a risk-factor based or by a trading desk based method. For the sake of consistency between regulatory capital calculations and the current risk management scheme, most of our members support desk-based aggregation. They add, meanwhile, that one drawback of the desk-based approach is that regulatory capital is calculated when a desk enters into internal transactions with other desks, which generates no risks.

7. Integrated market and credit risk modeling

The BCBS has suggested an integrated modeling approach to be applicable to banks that calculate specific risk using approved internal models. There are no comments on this issue because Korean banks measure specific risk using standardized methods.

8. Operational constraints involved in moving from VaR to ES, including the delivering of backtesting

The BCBS has proposed measuring market risk using ES instead of VaR, thus measuring risk at the desk rather than bank level, and adding robust backtesting that factors in the volume of excess losses when assessing the validity of the model. Regarding this, the Korean banks are in favor of both backtesting and applying the multiplier method in detail.

9&10. Revised standardized approach

The BCBS has proposed the partial risk factor approach as an alternative of the current standardized method, and also has suggested the fuller risk factor approach additionally.

Considering the main purpose of using a standardized approach is measuring market risk with a simple and consistent base, Korean banks support the partial risk factor approach. Though the fuller risk factor approach can serve as a supplement to internal models, it reduces comparability across banks because the fuller risk factor approach requires banks' subjective judgments.

Thank you for providing industry stakeholders with the opportunity to comment on the BCBS's *"Fundamental review of the trading book"*. The KFB and its members shall continue to closely follow future developments regarding this work stream. If you have any questions whatsoever about the comments we made, please do not hesitate to get in touch with us.

Yours sincerely,

A handwritten signature in black ink, reading "Sang-Cheon Ma". The signature is fluid and cursive, with the first name "Sang-Cheon" and the last name "Ma" clearly distinguishable.

Sang-Cheon Ma
Executive Director
Korea Federation of Banks