18th October 2013

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

(By email: baselcommittee@bis.org)

Dear Sirs,

Response to BCBS Discussion Paper
The Regulatory Framework: Balancing Risk Sensitivity, Simplicity and Comparability

1 DBS Bank is pleased to have the opportunity to comment on this Discussion Paper. In light of the wide ranging regulatory reform agenda instituted in response to the financial crisis, it is timely to assess whether the capital framework remains, as described by the BCBS, "fit for purpose"; in this regard, achieving an appropriate balance among the complementary goals of risk sensitivity, simplicity and comparability has been highlighted as a main objective.

2 While we acknowledge that these elements are valid conceptual considerations that should underpin a regulatory capital framework, we share the BCBS's observation that challenging trade-offs are involved. As a quick summary, our view is that:

- These concepts need to be separately addressed as it would be very difficult to integrate them within reported capital numbers. Accordingly, we propose that Pillar 1 of the Basel capital framework be adapted to give effect to simplicity and comparability, while Pillar 2 would address risk-sensitivity based on internal models;
- The capital requirement applicable to each specific bank should be the amalgamated outcome of both Pillars 1 and 2;
- The effects of the interaction between Pillars 1 and 2, including further information such as the capital adjustments emanating from pertinent regulatory risk assessments or the exercise of national discretion, should be covered by appropriate disclosures – Pillar 3 could be tailored further for this purpose.

3 Our specific comments are set out below.

06-18-008 (08/2010) AW
Co. Reg. No. 196800306E

DBS Bank Ltd
12 Marina Boulevard, Level 45
DBS Asia Central @
Marina Bay Financial Centre Tower 3
Singapore 018982 www.dbs.com

4 Improving Simplicity and Comparability

Using additional metrics (Paragraphs 54 to 56)

4.1 The proposal to identify other useful and robust predictors of serious distress, other than regulatory capital, must address possible deficiencies in the chosen measures. For example, market-based metrics, such as those referencing market values of equity or which use equity volatility as inputs, would be susceptible to known limitations such as excessive volatility due to market noise, rumours, herd mentalities, unfounded views from short sellers etc.

4.2 More importantly, teasing out the "right" level of volatility that is symptomatic of early distress is not methodologically easy. As such, it is not immediately apparent if such measures would lend themselves well to standardised definitions and a disclosure template, nor are they necessarily comparable across banks as the markets often have unique perspectives of specific institutions. Metrics of this nature could be used as further inputs to inform an overall regulatory assessment (as part of the "multiple lenses" mentioned at paragraph 55), but should not by themselves trigger any specific regulatory action.

Ensuring the effectiveness of the leverage ratio (Paragraphs 57 to 59)

4.3 The risk-insensitive feature of the leverage ratio has been both lauded and maligned. As a regulatory tool, it works best in situations where ex-ante risk estimates significantly under-estimate ex-post losses and is best positioned as a "backstop". The agreed form of the Basel III leverage ratio should aid the comparability objective, although a proliferation of different jurisdiction – specific calibrations and requirements could be confusing to constituents.

4.4 It would not be advisable to extend the scope of its use as envisaged at paragraph 59. Beyond a suitably calibrated level, the risk insensitive nature of the leverage ratio will increasingly dent its value as a regulatory tool as banks could be forced to undertake counter-intuitive remedial measures in seeking to ensure compliance with a leverage regime akin to that of the capital conservation buffer; an extreme case, as an illustration, is to shed cash in a bid to reduce the balance sheet. For the leverage ratio to function as a "backstop" rather than a binding constraint, we do not advocate any increase beyond the 3% threshold.

Utilising added floors and benchmarks to mitigate complexity (Paragraphs 60 to 64)

4.5 The stated objective here is to constrain the variation in Pillar 1 risk-weighted assets arising from internal models excesses through the imposition of floors that would bring model-derived capital requirements more in line with the standardized calculations. As we had mentioned at the outset, forcibly integrating simplicity/comparability with risk sensitivity makes the Pillar 1 process unduly complicated and may reduce overall clarity.

06-18-008 (08/2010) AW
Co. Reg. No. 196800306E

4.6 The use of floors is always complicated, as paragraph 64 has succinctly articulated. While the regulatory intent is not to interpret these as hard benchmarks, many other constituents do. There is also literature highlighting that the Basel I floor has been misinterpreted in its application and inconsistently applied. Calibration issues, such as whether a similar sliding scale in the floor requirements over time, akin to that seen in Basel II, will continue to apply in this latest incarnation and, if so, what will the appropriate gradient (to be standardized globally, or also subject to national discretion?) be, are not easy decisions and could potentially threaten the simplicity quest.

4.7 Instead of floors, we believe that Pillar 1 capital computation should be based on standard, regulator-prescribed non-model based parameters and assumptions. These could be periodically reviewed to improve risk sensitivity or address known deficiencies, as seen in the proposal to replace the Current Exposure Method with the Non-Internal Models Method for the computation of counterparty risk, and ongoing work to review the market risk Standardised Approach as part of the overall trading book review. This would seem to be a more viable way of preserving the simplicity/comparability objectives, but without severely compromising risk sensitivity in the process.

5 Search for a compromise

Revisiting Pillars 1, 2 and 3

5.1 At Paragraph 74, the Committee indicated that "there may be value in re-assessing the relative balance given to each of the three Pillars of the Basel framework". We believe that the Pillars actually lend themselves well in streamlining the objectives and outcomes of this exercise. We suggest the following possible approach:

- Pillar 1 will measure capital requirements based solely on the non-internal models based approaches for credit, market and operational risks, as articulated earlier. There is no need for floors or other benchmarks therefore. The output can be disclosed, but will not constitute minimum capital requirements;
- Pillar 2 will continue to encompass the supervisory review process. This will take into account the strength of the internal risk modeling process, the integrity of internal risk estimates and parameters, review of in-use (we strongly support the proposed further refinement of the use-test to guard against gaming, as mentioned at Paragraph 66) and other supervisory considerations, such as model validation findings and elements of national discretion, that can inform further regulatory deliberation on the Pillar 1 output. Technically, the Pillar 2 process can increase or decrease the Pillar 1 capital requirement e.g. supervisors may assess that, for residential mortgages, risk weights generated by internal models are more reflective of historical loss experience compared with the 35% Basel II standardized risk weight. This could then warrant a Pillar 2-driven adjustment to the Pillar 1 output;

06-18-008 (08/2010) AW
Co. Reg. No. 196800306E

- Pillar 3 will also continue to address disclosures, but these should be widened to include a discussion of the pertinent Pillar 2 regulatory considerations mentioned earlier and how these have shaped the final capital requirements. This will go some way towards addressing the comparability limb, as constituents are able to form their own assessment of these adjustments that are made off the same Pillar 1 base.

5.2 With capital requirements being an outcome of the amalgamated Pillars 1 and 2, it is probably necessary to consider how the calibrated Basel III minimum requirements would be applied, along with other parameters such as the G-SIB add-on etc. This is unavoidable, even in the instance where floors are used to compel Pillar 1 to a Standardised Approach outcome. Considering that the Basel III minimum requirements are expressed as percentage ratios, it would appear that the amalgamated output should be in RWA terms for consistency and alignment (although the re-grossing of capital into RWA, if needed, would involve an implicit assumption of a capital ratio).

6 Long-term alternative approaches

6.1 Paragraph 75 provides some examples of possible measures of capital adequacy that could be explored in the long term, in response to the changing nature of the banking industry. While it is thus premature at this stage to undertake any in depth critique of the merits of these potential tools, I would like to highlight that these parameters are themselves, much like the Basel III leverage ratio, being shaped by changes in accounting standards. This obviously sets the stage for a renewed debate on the value of prudential filters, which the Committee should provide for.

6.2 The pre-commitment approaches introduce a further dimension of concern. Since the introduction of FRS 39, the sources of income volatility are much more varied. We have mark-to-market accounting on a much larger scale today. The incurred loss regime, which had governed loan loss accounting, is due to make way soon for a new approach. The recognition of the impact of own credit risk within the P&L created huge swings that are not only counter-intuitive, but also largely beyond the ability of firms to actively manage.

6.3 The other important consideration is that a lot of volatility is taken straight to reserves. This is going to persist even under IFRS 9. In fact, the "Other Comprehensive Income" category has become a parking ground of sorts, harbouring some of the volatility that had hitherto been manifested in the P&L. For equity investments, banks can also elect to take the volatility in either P&L or reserves. Then there is the issue posed by breakage – derivative positions taken to hedge underlying assets may be marked to P&L, while the offsetting movements in the hedged items are carried in reserves (to the extent that hedge accounting is not admissible). Volatility in the balance sheet, and how this interacts with the P&L, is something that the pre-commitment approaches cannot yet address.

7 **Conclusion**

7.1 We trust that the comments provided are useful in assisting with the Committee in its evaluation of the capital framework. The issues are difficult, but would have huge ramifications on the financial industry going forward. This initial consultation is an excellent start and forward momentum should be maintained.

7.2 Should you require any further clarification, please contact me at sokhui@dbs.com. Thank you.

Yours faithfully

CHNG SOK HUI
CHIEF FINANCIAL OFFICER

06-18-008 (08/2010) AW
Co. Reg. No. 196800306E