Basel Committee on Banking Supervision

Consultative document

Fundamental review of the trading book: A revised market risk framework

October 2013

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Fundamental review of the trading book: A revised market risk framework

This is the Basel Committee's ("the Committee") (1) second consultative paper on the fundamental review of trading book capital requirements. (2)

1 The Basel Committee on Banking Supervision provides a forum for regular cooperation on banking supervisory matters. It seeks to promote and to strengthen supervisory and risk management practices globally. The Committee comprises representatives from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. Observers on the Basel Committee are: the European Banking Authority, the European Central Bank, the European Commission, the Financial Stability Institute and the International Monetary Fund.

2 To view the first consultative paper, see Basel Committee on Banking Supervision, *Fundamental review of the trading book*, May 2012 (www.bis.org/publ/bcbs219.pdf). It is intended that this second consultative paper can be read as a standalone document, without the need for cross reference with the first consultative paper.

The Committee might take into consideration: *Decision making humans – who are putting all efforts up to the best of their knowledge, on the process to derive (e. g. inductively or deductively)* ***their decisions, are using as "logical" rule*** *– increasing or decreasing* ***informational content*** *(e. g. not equivalent to probability statements but complementary to* ***conventional*** *(e. g. main stream)* ***banking****).*
Example: A market participant *has to make an investment decision-* ***on two*** *future cash flows (fixed coupon bond, zero coupon bond) which are from the same counterparty, do have identical* ***yields, and*** *the same* ***remaining maturity.*** *Investors who do compare the fixed coupon bond with the zero coupon bond, will purchase the fixed coupon bond as only one future payment more – will decrease investors expected losses (risk),* ***but the probability*** *to receive this additional payment* ***will be smaller.***
"Thus if our aim is the advancement (e. g. to mitigate on future payments expected losses), ***then a high probability*** *(in the sense of aggregated probabilities)* ***cannot*** *possibly* ***be our aim as well: these two aims are incompatible."****(Karl, R. Popper, Conjectures and Refutations: The growth of scientific knowledge, 1968 by Harper & Row, New York, N. Y. 10022, chapter 10, paragraphs 2 and 3)*

Notes and comments:

The trading book/banking book boundary

"The Committee believes that **the definition of** the regulatory **boundary** between the trading book and banking book has been **a source of weakness** in the design of the current regime". (Fundamental review of the trading book: A revised market risk framework, issued for comment by 31 January 2014, October 2013; further on - Consul. trading Book 2nd review, bcbs265, Oct.2013, page 2)

The Committee might be with it believes to mitigate weaknesses of defined regulatory boundaries between the trading book and banking book, too optimistic or even be mislead, as "definitions never give any factual knowledge about "nature", or about "the nature of things" (e. g. regulatory boundaries, principles for complete and incomplete markets)." (Karl R. Popper, Conjectures and refutations: The growth of scientific knowledge, 1968 New York, N. Y. 10022, introduction, chapter VII, pages 20, 21)

And as the Committee in regard to definitions of regulatory boundaries might know – "the logical problem of induction arises from (a) Hume's discoverer **that it is impossible to justify a law by observation or experiment,** since it "transcends experience"; (b) the fact that science proposes and

uses laws "everywhere and all the time". To this we have to ad (c) *the principle of empiricism* which asserts that in science (definitions of regulatory boundaries), **only observation and experiment may decide upon the *acceptance or rejection* of** scientific statements, including **laws** and theories". (Karl R. Popper, Conjectures and refutations: The growth of scientific knowledge, 1968 New York, N. Y. 10022, conjectures, chapter IX, page 54)

Based on these logical problems of by induction "defined" boundaries:

- The Committee believes that a "key determinant of the boundary has been banks' self-determined intent to trade". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 2)

- The Committee infers from e. g. "Meta principle": "Trading intent has proven to be an inherently subjective criterion that is difficult to police and insufficiently restrictive from a prudential perspective in some jurisdictions". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 2)

- The Committee does conclude: "Having reflected on feedback from the first consultative paper, the Committee has developed a revised boundary that retains the link between the regulatory trading book and the set of instruments that banks deem to hold for trading purposes, but seeks to address weaknesses in the boundary by reducing the possibility of arbitrage and by providing more supervisory tools". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 2)

And the Committee continues to define: "For certain instrument types, there will be a presumption that they are included in the trading book. This will facilitate the development of a common understanding among supervisors regarding the types of instrument that would typically be included in the different books." (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 2, amending herewith proposals on the first consultative document to set out a list of instruments that need to be split into two or more elementary instruments (e. g. a swap or future, convertible bonds, securitized or structured assets (Basel, Fundamental review of the trading book, May 2012, Page 49)).

- The Committee is setting **a legal frame** by stating: "The Committee has also agreed on a range of **documentation** that banks would need to make available to supervisors, as part of new valuation **and evidence-based reporting** requirements for all trading book positions." (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 2)

- The Committee applies *the principle of empiricism* on the "risk of arbitrage", and does propose to define further principals for the boundary of trading/banking book positions: "To reduce the incentives for arbitrage, (hereby is) the Committee seeking **a less permeable boundary** with **stricter limits on switching between books** and measures to prevent "capital benefit" in instances where switching is permitted". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 2)

- The Committee did observe by applying *the principle of empiricism* material **differences in capital requirements against "similar types of risk" on trading/banking book positions**, therefore is: "The Committee aiming to reduce the materiality of differences in capital requirements against similar types of risk on either side of the boundary. For example, the Committee has decided that the calibration of capital charges against default risk in the

trading book will be closely aligned to the banking book treatment, especially for securitizations". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 2)

- The Committee is setting **a legal frame** by defining: "**Section 1** sets out the main changes to the boundary, and provides a proposed "**presumptive list**" **of instruments** presumed **to be included in the trading book** as well as a list of instruments that does **not** meet the revised definition of the trading book." (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 2)

In regard to the Committee's aim "to reduce the materiality of differences in capital requirements against similar types of risk on either side of the boundary" the Committee does propose **to test** the "presumptive list of instruments presumed to be included in the trading book" in accordance with the aim to reduce differences in capital requirements against similar types of risk out of similar types of instruments and positions **by QIS.**

- "The Committee is also investigating the development of Pillar 1 charges for interest rate and credit spread risk in the banking book". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 2)

And this investigation will also include **tests** for charges on interest rate and credit spread risk out of similar types of instrument **though QISs**.

Treatment of credit

- "The Committee has agreed (did define), as a general ("Meta") principle, to bring trading book requirements closer to those of the banking book, and the Committee has agreed (to define) a differential approach to **securitization** and **non-securitization** exposures." (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 2, being in line with Mr. Stefan Ingves, Chairman of the Basel Committee on Banking Supervision, comments: - " Making capital adequacy ratios more risk-sensitive should, in theory, also make them more comparable. Capital adequacy assessments are about measuring the adequacy of capital relative to the risks a bank is taking. Measuring capital, e. g. the numerator, is relatively easy. The denominator, e. g. risk, is a much more slippery concept, and a certain degree of sophistication and complexity is needed to measure it. But by enhancing the accuracy of risk measurement, we should be making capital adequacy ratios more comparable and reliable, both over time and between banks." Speech by Stefan Ingves, "Strengthening bank capital – Basel III and beyond", Abu Dhabi, United Arab Emirates, 18 November 2013.)

Enhancing the accuracy of risk measurement in regard to securitization exposures:

• Securitization exposures: "The Committee remains skeptical that existing internal models-based risk measurement methodologies used by banks can adequately capture the risks associated with securitized products. As a result, or therefore will capital charges for securitization positions in the trading book – including correlation trading activities be base on the revised standardized approach". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 3)

The Committee does herewith amend proposals on the first consultative document **securitization exposures** are exclusively included in the **revised standardized approach**, and taken out from **internal models-based risk measurement methodologies.**

Enhancing the accuracy of risk measurement in regard to non-securitization exposures:

• Non-securitization exposures: "Internal modeling will continue to be allowed for non-securitization positions. But the Committee has decided that joint modeling of the discrete (default risk) and continuous (spread risk) components of credit risk is likely to involve particular practical challenges. It could also make a more consistent capital treatment of credit risk across the balance sheet more difficult to achieve." (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 3)

Enhancing the accuracy of risk measurement in regard to non-securitization exposures by making capital adequacy ratios more comparable (and reliable)**, both over time and between banks:**

"The Committee has agreed (to infer from observations) that non-securitization credit positions in the trading book will be subject to a separate "Incremental Default Risk" (IDR) charge". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 3)

Credit Valuation Adjustments (CVA) charges: "Basel III introduced a new set of capital charges to capture the risk of changes to CVA, collectively known as the CVA risk capital charge. The first consultative document did discuss whether CVA should be captured in an integrated fashion with other forms of market risk within the market risk framework or continue to be calculated as a standalone capital charge". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 3)

The Committee did infer from observations, aiming to make capital adequacy ratios more comparable: "For the time being, the Committee has decided that it is not appropriate for CVA to be fully integrated into the market risk framework". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 3)

"The Committee believes that CVA must be treated separately given the complexity and model risk in an integrated model, and that allowing full integration may lead to significant variation in results. A limited number of changes to the CVA calculation are being introduced to maintain consistency with the revised market risk requirements set out in this paper". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 3)

Note: The hypothesis that the full/partial integration of CVA into the market risk framework may lead to significant variation in results on CVA charges on similar types of instrument, should be **tested by QISs** – e.g. to compare rejecting results of increased variation of CVA charges, with the Committee's aim to make capital adequacy ratios more comparable (and reliable), both over time and between banks.

Approach to risk measurement

- The Committee has confirmed its intention seeking to attain **two key reforms** outlined in May 2012 consultative paper.

Stressed calibration: "The Committee recognizes the importance of ensuring that **regulatory capital** will be **sufficient in** periods of significant market **stress**. As the crisis showed, it is precisely during stress periods that capital is most critical to absorb losses.

Furthermore, a reduction in the **cyclicality** of market risk capital charges remains a key objective of the Committee.

- Consistent with the direction taken in Basel 2.5, the Committee will address **both** (cyclicality and stress) **issues** by moving to **a capital framework that is calibrated to a period of significant financial market stress** in both the internal models-based and standardized approaches.
- The Committee is aware that similar care is needed in selecting **appropriate periods of stress**, recognizing that in general **not all** asset classes or **exposures** are **subject to market stress at the same time"**. (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 3)

Comment: Being aware that **not all** asset classes or exposures are subject to market stress **at the same time**, does not guide the way to solutions – e. g. defining or selecting appropriate periods of stress, as definitions "can never give any factual knowledge about the nature" (1) of the appropriateness of a period of stress, and "… it is impossible to justify a law (e. g. the defined period of stress") by observation or experiment". (2)

1) Karl R. Popper, Conjectures and refutations: The growth of scientific knowledge, 1968 New York, N. Y. 10022, introduction, chapter XII, pages 20, 21
2) Karl R. Popper, Conjectures and refutations: The growth of scientific knowledge, 1968 New York, N. Y. 10022, conjectures, chapter IX, pages 54, 55

Move from Value-at-Risk (VaR) to Expected Shortfall (ES)

- "The Committee proposed in May 2012 to replace VaR with ES. **ES measures** the riskiness of a position by considering both the **size and** the **likelihood of losses** above a certain confidence level.
  The Committee has agreed to use a **97.5% ES** for the **internal models-based approach and** has also used that approach to calibrate capital requirements under the **revised market risk standardized approach**". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 3)

Comment to Expected Shortfall (ES): **ES measures** the riskiness of a position by considering and aggregating both **the size** (informational content) **and the likelihood** (measured by probability statements) **of losses.**
Example: A market participant has to make an investment decision - on two (future) cash flows which are from the same counterparty, do have identical yields, and the same remaining maturity. Calibrating and comparing "yields" (e. g. internal rate of return, for a defined time period, between present value and future value, by tableaus or by calculators) of cash flows (e. g. "bullet loan, zero coupon bond", and "installment loan, fixed coupon bond") with the same but more than one year outstanding maturity, issued, and taken by the same "borrower", will enable decision maker to distinguish between these cash flows (e. g. zero coupon bond, fixed coupon bond, installment loan) by informational content.
And, based on investment decision maker's interest to mitigate expected losses, the investor will purchase the "fixed coupon bond" (e. g. as there is in case of identical yields, the same underlying borrower, the same maturity, same redemption payment (=100), at least one additional outstanding payment (<100) more which is capable to mitigate in money terms investor's expected losses).
Investors who do compare the fixed coupon bond with the zero coupon bond, will purchase the fixed coupon bond as only one future payment more – will decrease investors expected losses (risk), **but the probability** to receive this additional payment **will be smaller.** "Thus if our aim is the

advancement (or "to mitigate by additional payments expected losses"), then a high probability (in the sense of the calculus of probability) cannot possibly be our aim as well: these two aims are incompatible."(Karl, R. Popper, Conjectures and Refutations: The growth of scientific knowledge, 1968 by Harper & Row, New York, N. Y. 10022, chapter 10, paragraphs 2 and 3)

- "The Committee believes these changes (e. g. to replace VaR by ES) represent **a rationalization** (or also to call improvement, after experiment did show that VaR fails to capture "tail risk") **of the framework** with the internal models-based approach **moving to a** single, **stressed metric**". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 3)

But in regard to **the issue how to aggregate** under a 97.5% ES **the size** (informational content) **and the likelihood** (measured by probability statements) of losses at certain time buckets,

- "the Committee acknowledges that in the revised standardized approach, **the full market value of an instrument** may be placed into several different risk buckets (each is calibrated to a stress event holding other risk factors constant), **and the capital requirements** then added together. **This could potentially result in a capital charge** for a position **that exceeds its market value**.
- This is particularly the case for debt products that are placed into both the general interest rate risk (GIRR) and credit spread risk (CSR) frameworks, as well as default risk.
- Several solutions were considered to this issue, but these had potentially serious unintended consequences. Therefore, the Committee has decided to proceed with the approach and consider the implications through the QIS". (Consul. trading Book 2nd review, bcbs265, Oct.2013, pages 33 and 34)

Comment: There is and **there will be no confirming test** that aggregated or simply added capital requirements of a financial instrument which is placed (mapped) into several different risk buckets cannot exceed the market value of the underlying financial instrument. **But the approach** that the market value of an underlying financial instrument does reflect (calibrated) risk - measured by ES, **can be tested within QIS and** be **rejected by observations**.

QIS cannot justify within risk buckets calibrated and **accumulated** (added) **capital requirements** of an underlying financial instrument**.** But **QISs can reject** on risk measure approaches that **the market value** of an underlying financial instrument **does reflect** by VaR or ES **calibrated risks**. The observation the market value of an underlying financial instrument does **not** reflect by VaR or ES calibrated risks might bring the **Committee** to the question - how to integrate the **observation** that for certain financial instruments which need to be split into two or more elementary instruments (e. g. a swap or future, convertible bonds, securitized or structured assets (Basel, Fundamental review of the trading book, May 2012, Page 49)), calibrated and accumulated (added) capital requirements do exceed their market value - e. g. into the revised standardized approach.

The Committee, market participants and regulators might be aware that …"neither a deductive nor an inductive inference can lead, from consistent (ES calibrated capital requirements of an instrument) premises, to a conclusion (these capital requirements do exceed the market value of the same instrument) which contradicts them." (Karl, R. Popper, Conjectures and Refutations: The growth of scientific knowledge, 1968 by Harper & Row, New York, N. Y. 10022, chapter 1)

And as Mr. Stefan Ingves, Chairman of the Committee does admit in regard to risk …"by enhancing the accuracy of risk measurement, we should be making capital adequacy ratios more comparable and reliable, both overtime and between banks". (Stefan Ingves: Strengthening bank capital – Basel III and beyond, Abu Dhabi, United Arab Emirates, 18 November 2013, page 3).

A comprehensive incorporation of the risk of market illiquidity

"…There is neither a psychological nor a logical induction (e. g. by observation and quantitative figures or numbers). *Only the falsity of the theory can be inferred from empirical evidence, and this inference is a purely deductive one.* Hume showed that it is not possible to infer a theory from observation statements; but this does not affect the possibility of refuting a theory by observation statements (e. g. the accuracy of risk measurement)". (Karl R. Popper, Conjectures and refutations: The growth of scientific knowledge, 1968 New York, N. Y. 10022, conjectures, chapter IX)

In this sense might the **Committee promote** to test by QISs - e. g. the definition of liquidity horizons as tools for measuring risk (e. g. "Banks' risk factors will be assigned five liquidity horizon categories, ranging from 10 days to one year", Consul. trading Book 2nd review, bcbs265, Oct.2013, page 4).

Treatment of hedging and diversification

"Hedging and diversification **are intrinsic to** the active management (*but should be never inferred, in any sense, from the empirical evidence e. g. observed active management*) of **trading portfolios**.

Hedging, while generally risk-reducing, **also gives rise to basis risk** (and creates counterparty risk). And portfolio diversification benefits can disappear **in times of stress**. (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 4)

Relationship between internal models-based and standardized approaches

"As set out in May 2012, the Committee considers the current regulatory capital framework for the trading book to have become **too reliant on** banks' **internal models** that reflect **a private view of risk**. In addition, the potential for very **large differences** between **standardized** and **internal models**-based **capital requirements** for a given portfolio can leave supervisors without a credible option of removing model permission when model performance is poor". (Consul. trading Book 2nd review, bcbs265, Oct.2013, pages 4, 5)

Comment: To reconcile mechanics and definitions on both approaches - standardized approach and the internal models-based approach in regard to **risk** is helpful for applicants (supervisor, treasurer, portfolio manager), and **did disclose by tests** – e. g. "second report on the regulatory consistency of risk-weighted assets in the trading book issued by the Basel Committee, 17 December 2013,bcbs 267", **divergences** between models-based and standardized approaches **risk** measurement attempts which reflect "that differences in modeling choices are the most significant drivers of variation in market risk of risk-weighted assets (RWAs) across banks" (e. g. reflecting banks risk manager's private view of risk).

And as Mr. Stefan Ingves, Chairman of the Basel Committee and Governor of Sveriges Riksbank did outline, "Today's report complements and reinforces the Committee's earlier trading book report. It shows that, as portfolios get more complex, the variability can increase. These findings, along with the results of the Committee's banking book review, have been important inputs to our ongoing work to address RWA variations." (Press release Dec. 17, 2013 to bcbs 267 report) **And,** the "second report on the regulatory consistency of risk-weighted assets (RWAs for market risk) in the trading book issued by the Basel Committee, 17 December 2013,(bcbs 267)", **does remind us** (page 82) **by** – "Caveats: **Statistical tests cannot prove the hypothesis**. For example the classification of driver impact as "low" does not prove a low impact but rather indicates a low observed correlation. A low correlation could result from low variability of the driver characteristics (e.g. when only a few

observations are available). Also, spurious correlation might be detected – i.e. significant correlations might be identified, whereas in reality the result is driven by a hidden third variable".

"The Committee is taking a number of steps to **strengthen** the **relationship** between **models-based** and **standardized approaches**.

First, it is establishing a closer link between capital charges resulting from the two approaches.

Second, it will require mandatory calculation of the standardized approach by all banks.

Third, it will require mandatory public disclosure of standardized capital charges by all banks on a desk-by-desk basis.

Finally, the Committee is also considering the merits of introducing the standardized approach as **a floor or surcharge** to the models-based approach". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 5)

Comment to the **first Consultative Paper**: As regulators do capture up to the best of their knowledge risk drivers, this simply **cannot include - all drivers of risk**. The partial risk factor approach applied by banks and supervising authorities as **"snap – shot"**, will be **of limited (or no) prognostic power**, but reviewed daily by Banks' – e. g. traders, treasurer, accountants and risk manager, responsible according to Basel II (pillar 2, "Capital Adequacy Assessment Process" (ICAAP), will improve market risk management).

Revised models-based approach

"As stated in the first consultative paper, the Committee has identified (*on risk measurement the falsity of the models-based approach by inferring from empirical evidence)* a number of weaknesses **with risk measurement** under the models-based approach under the 1996 market risk amendment.

Specifically, (*by inferring from empirical evidence*) the **10-day VaR calculation did not** adequately **capture credit** risk or **market liquidity risks**; **incentivized** banks to take on **tail risk**; **inadequately captured basis risk** and **proved pro cyclicality** (*despite Hume who did show that it is not possible to infer a theory from observation statements*) **due to its reliance on** relatively recent **historical data**". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 5)

To **strengthen** – and **make more objective** – the **criteria for** allowing banks to calculate capital requirements using **internal models**, the Committee has agreed (*despite Hume who did show that it is not possible to infer a theory from observation statements*) to break the **model approval process into smaller**, more discrete **steps**, including **at the trading desk level**". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 5)

Revised standardized approach

"The revised standardized approach should achieve **three objectives**.

First, it must provide a method for calculating capital requirements for banks with business models that do not require a more sophisticated measurement of market risk.

Second, it should provide a credible fall-back in the event that a bank's internal market risk model is deemed inadequate, including its potential use as a surcharge or floor to an internal models-based capital charge.

Finally, the approach should facilitate transparent, consistent and comparable reporting of market risk across banks and jurisdictions. As discussed above, the Committee has agreed that the **revised standardized approach** will be the **only method** used **to capture** the risk of **securitizations**.

Hedging and diversification benefits will be better **captured through** the incorporation of regulatory-determined **correlation parameters**. **Correlations to be used in the aggregation formula** have been calibrated based on a long time period – because **stress** period correlations will **not always** (*inferred from empirical evidence and the inference was a purely deductive one*) **be prudent** for certain portfolios.

In order **to capture the lack of stability in correlation parameters** in some cases, two values have been specified for each pair of risk positions: a higher correlation to be used when the risk positions have the same sign (to capture diversification benefits) and a lower correlation to be used when their signs differ (to capture hedging benefits).

The Committee has sought to balance the different objectives for the **revised standardized approach.** The increase in risk sensitivity that is required in order for the standardized approach **to function as a fall-back to internal models** comes at a cost in terms of increased complexity.

The Committee therefore encourages **participation** from a broad spectrum of banks **in the QIS"**.
(Consul. trading Book 2nd review, bcbs265, Oct.2013, page 6)

Comment: Banks (advisors, consultants, risk manager) participating in QISs will try to combine "additional risk sensitivity concepts" with conjectures – "how a single calibration for risk weights does impact the revised standardized approach". Here by do advisor - define interrelations (or ratios) between e. g. the "standardized approach additional risk sensitivity" and the "impact on a single calibration for risk weights", and will keep in mind that defining ratios is not equal to explanations.

Example: Each advisor can implement the ratio - e. g. the standardized approach additional risk sensitivity is impacting a single calibration for risk weights, into another by the advisor given recommendation (or formula) like "history (including historical data) can be replicated". The advisor might justify his recommendation, by interpreting the following statement - "the history (including historical risk data) of ideas (e. g. to measure risk), like of all human ideas (e. g. to measure and aggregate risks), is a history of irresponsible dreams, of obstinacy, and of error" (1), as given (approved) by observations.
But advisor's attempt to apply his recommendation - to replicate (e. g. by historical data measured risk), brings each advisor via the question - how, into the process of "infinite regress" by looking for reasons (explanations… or sources of risk).
And other advisor trying to avoid infinite regress, might come up with the question - to replicate - e. g. by historical data measured risk, by models on earth?

(1) Karl R. Popper, Conjectures and refutations, the growth of scientific knowledge, New York, N. Y.: Harper & Row, Publishers, Inc., 1968, chapter 10.

"The Committee has discussed the appropriate treatment for generalized interest rate risk (**GIRR**), and in particular the question of whether to differentiate between exposures - based on the volatility of domestic interest rates in different jurisdictions.

Although the Committee believes some level of differentiation would increase risk sensitivity, it is also concerned about **arbitrary classifications** associated with **a bucketing scheme**.

And, "therefore, the Committee is consulting on a single calibration for **GIRR** but is seeking feedback on alternatives to introduce additional risk sensitivity into the revised standardized approach". (Consul. trading Book 2nd review, bcbs265, Oct.2013, page 6)

Comment: Mr. Ingves makes in his speech ("Strengthening bank capital – Basel III and beyond", Abu Dhabi, United Arab Emirates, 18 November 2013) perfectly clear the Committee is not looking for "the silver bullet" or a comprehensive ratio (e. g. which applied worldwide by banks will strengthen risk management reliability, consistency, quantity and quality), the Committee is focusing on by Basel III increased capital requirements and herewith on the nominator of the ratio - in the Committee's opinion widely "accepted by the global banking industry". And as Mr. Ingves did admit in regard to risk, the denominator, "i. e. risk, is a much slippery concept, and a certain degree of sophistication and complexity is needed to measure it", and therefore we have to continue - in my understanding in an optimistic mood, …"by enhancing the accuracy of risk measurement, we should (make) … capital adequacy ratios more comparable and reliable, both overtime and between banks".

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• Basel Committee on Banking Supervision to review and to invite for comments at BIS consultative document, Fundamental review of the trading book: A revised market risk framework, issued for comment by 31 January 2014, October 2013

• Mr. Stefan Ingves, Chairman of the Basel Committee on Banking Supervision, speech: "Strengthening bank capital – Basel III and beyond", Abu Dhabi, United Arab Emirates, 18 November 2013

• Basel Committee on Banking Supervision, Second report on the regulatory consistency of risk-weighted assets in the trading book issued by the Basel Committee, 17 December 2013, (bcbs 267)

• Karl, R. Popper, Conjectures and Refutations: The growth of scientific knowledge, 1968 by Harper & Row, New York, N. Y. 10022