

The Consultative Document being a follow-up of earlier studies, the essential question is of course that of envisaged improvements. Thus, the researcher examining the document will look for both quantitative and qualitative amendments that are supposed to facilitate the regulation of market risk as incurred by European banks.

It is understood that an in-depth analysis of the multitude of variables introduced and the alternative suggestions advanced will fill many more pages than those of the document on market risk presented by the Basel Committee on Banking Supervision, but in conformity with the wish of the Committee, the following ideas may be taken into consideration

The equation present throughout the text, and thus instrumental for regulatory measures envisaged on the European scale, figures first by way of bucket aggregation (p.32):

$$K_b = \sqrt{\sum_i RW_i^2 MV_i^2 + \sum_i \sum_{j \neq i} \rho_{ij} RW_i MV_i RW_j MV_j}$$

This is then the standard deviation, or the measure of the risk incurred and thus the capital charge required for bucket “b”.

However, the multiplication of Risk Weight and Market Value leads to an erroneous proportionality, in so far as the cost implied may be originated in different ways, i.e.

RW = 5%, for a MV = 1000 will render a cost of 50, and  
RW = 2,5%, for a MV = 2000 will also render a cost of 50 !

Then, there is the correlation between two notional positions that cannot be determined independently from each other, such as the size of individuals of a population. What we have here is an original dependence,  $\rho_{ij}$  representing the correlation of a portfolio. However, for this correlation to be used for purposes of risk evaluation, the correlation would have to be known, which may be the case when exchange rates are concerned, but not in most other cases. Thus, this appears to be a flaw in all equations where this correlation appears.

Moving on to more general considerations, we must deal with “fat tails” not as some sort of next to virtual curiosity, but as a reality. Extreme values must be recognized for what they are: symbols of the impossibility to be integrated into models, however sophisticated. Taleeb rightly calls efforts in this direction “charlatanism”, and his own doings these recent years, i.e. his activities by way of hedge funds, underline these shortcomings.

However, the use of derivatives is becoming more and more questionable, insofar as they are by now mostly used as speculative instruments and thus turned away from their original destination.

It is sterile to try and endeavour to escape any new financial crises via an evaluation of risk that present research still tries to let go only when there is *almost* nothing left of it. Indeed, there is no sense in being satisfied with achievements that may be overthrown at any time by something that *should never have happened*.

True, the text of the Consultative Document contains “non-modellable” components, but a forthcoming version should frankly abandon *risk analysis* and replace it by *risk management*.

This means that the mere notion of *probability* would have to be abandoned; as long as there remain “modellable” components in a proposition of risk evaluation, there will be no actual remedy.

We must thus look for ways and means – let us call them “instruments”, “safeguards”, “thresholds” or whatever else – that can under no circumstances be the object of *speculation*, which means that they must be found outside the realm of probability, given that the mere notion of *speculation* implies just that, once and again:  
PROBABILITY.

For this purpose, the table on p.16 “Liquidity horizons of broad risk factor categories” should be examined closely and safeguards provided, be it within a framework of percentages or by way of stand-by capital. This will of course be a rather colossal task, but less so than having to deal with *rare* but extreme losses.

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