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

Grant Thornton UK LLP
30 Finsbury Square
London EC2P 2YU

T +44 (0)20 7383 5100
F +44 (0)20 7184 4301
www.grant-thornton.co.uk

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Dear Sirs

"Fundamental review of the trading book: A revised market risk framework" (BCBS265)

Grant Thornton is pleased to provide feedback on Basel Committee on Banking Supervision's (BCBS) second consultative document on the "Fundamental Review of the Trading Book" (FRTB). We appreciate the effort to publish the second proposal and we fully support the consultation process.

We have reviewed the consultative document and we believe the overall recommendations will strengthen the capital standards for market risk. The recommendations proposed are a progression from the first consultative document and represent a significant evolution of the trading book regime.

However, we feel that there are a number of areas in which further analysis and consultation is required to ensure that the optimal solutions are adopted. In the following paragraphs we highlight some of these key areas, hoping that it will help focus common efforts and progress of the FRTB consultation process.

The trading book/banking book boundary

The decision to follow the evidence-based boundary condition was supplemented with a number of steps to reduce the risk of regulatory arbitrage. The trading book definition is proposed to include more explicit criteria and further guidance is given on which instruments are presumed to be included or excluded from the trading book. These measures will generally provide a more robust trading book definition framework. However, if some level of flexibility is not allowed there may be instances in which strict specification of covered instrument will create unintended consequences, particularly for desks that perform a combination of trading and banking activities. We therefore acknowledge the importance to allow both jurisdictional variance, to compensate for accounting framework differences, and the ability of individual banks to deviate from the proposed trading book definition specifications, subject to bilateral discussions with national supervisors.

Choice of market risk metric

We have long been an advocate of a more reliable/coherent risk metric to replace Value at Risk (VaR). We therefore welcome the introduction of Expected Shortfall (ES) and further support the joined efforts of the BCBS and the industry to establish a stable calibration framework. However, we would also like to highlight that the differences, both in motivation and theoretical representation, of risk between ES and VaR may hinder the application of the "Use Test" principle. Though firms will use ES for regulatory capital purposes, they will continue to use VaR in other internal risk and capital management applications. We would like to bring this issue to the attention of the BCBS and ask to

consider the unintended consequences that are likely to arise from potentially forcing the use of ES in firm's internal risk management practices in which the motive is not to capture "tail risk".

Factoring in market liquidity

The comprehensive incorporation of market liquidity risk in the capital requirement for trading book had been a particularly intense area of consideration and analysis. The incorporation of varying liquidity horizons in the market risk metric represent a trade-off between simplicity and rigor. The key characteristics of the proposal are to introduce five liquidity horizons, from 10 days to 1 year, at the risk factor level and integrate the varying liquidity horizons in ES through long horizon shock. We feel that the proposed market liquidity framework represents one of the largest advances in the trading book regime and therefore it is paramount that recommendations are both free of statistical bias and computational ambiguity. We would therefore welcome the results of a more detailed technical analysis to confirm intended purpose and practicality.

Model-independent assessment tool for desks

We acknowledge the replacement of the liquidity premia add-on with the proposed model-independent assessment tool for desks as a step towards the right direction. The view that each desk should explicitly assess market liquidity risk in order to validate the prudent use of internal models is consistent with the overall ethos of the new trading book regime, not to over rely on complex risk models. However, we would like to comment upon the particular tool/ratio proposed. Given our experience from the introduction of the leverage ratio in Basel 3, we would like to highlight the difficulties involved in devising a commonly acceptable definition for the three components, capital, exposure and threshold of the ratio proposed. The need to adopt the ratio at the desk level will introduce further complexities in terms of calibrating these parameters, particularly the regulatory threshold, and will perhaps introduce an uneven playing field between banks as different regulators may adopt varying implementation standards. We feel that, though the idea of applying the principle of leverage ratio to remove model bias and risk is valid, the application of such measure at the trading desk level may prove operationally difficult. Therefore, we may need to consider a simpler model-independent assessment tool that will be easy to implement at the trading desk level and consistent across banks globally.

Aggregation of modellable risks

We support, in principle, the BCBS approach to restrict diversification benefit through averaging firm-wide ES and the sum of partial ES charges. The relative weight assigned to the firm's internal model will determine reliance on internal models estimations on correlation parameters. The value of this parameter will be determined through the pending QIS. As the calibration of this parameter will have significant impact to both regulatory capital and methodology practices we encourage further collaboration with the industry on this topic.

Revised standardised approach

The use of risk sensitivities under the standardised capital charge framework is currently debated between stakeholders. We would like to encourage this dialogue so advantages and disadvantages of both propositions (risk factor vs. cash flow) are explored. It is important to conclude with a standardised framework that is both a creatable fall-back to the internal model approach and easy to implement. Regardless of this decision we would like to highlight some inefficiencies of the overall standardised framework approach. Particularly, we would like to draw the BCBS's attention to the issues of overlapping capital charges, as a position is assigned to multiple risk buckets, the diminishing impact of hedging and the decision not to receive any diversification benefit across risk types. We would welcome further analysis on the impact of these issues over the QIS.

Quantitative impact study

Overall we feel that the pending QIS will be critical in deciding many of the trading book regime details/parameters, it will also confirm the practicality of the options made between the first and the second consultative document. We would like, therefore, to highlight the importance of consulting with the industry over both the timelines involved and the interpretation of the QIS results, in order to ensure credibility and transparency in finalising the trading book regime details.

Transitional arrangement

We also look further to the BCBS's guidance on the transitional arrangement for the implementation of the new trading book regime. Given the on-going implementation of Basel 3 and future plans for consultation on Banking Book regime changes, we would look forward to any guidance on the Trading Book policy implementation road map.

We are keen to continue to participate in the on-going consultation process between the BCBS, the industry and other stakeholders. We would be happy to discuss the above comments further, if you would like to do so, please contact Thanos Karanasos at thanos.p.karanasos@uk.gt.com

Yours faithfully

Paul Garbutt

Partner, Head of Prudential Regulation