International Banking Federation

Pinners Hall
105-108 Old Broad Street
London EC2N 1EX

**tel:** + 44 (0)20 7216 8947
**fax:** + 44 (2)20 7216 8928
**web:** www.ibfed.org

Mr. Alan Adkins, Co-Chair, Trading Book Group
Ms. Norah Barger, Co-Chair, Trading Book Group
Mr. Ju Quan Tan, Member of Secretariat, Basel Committee on Banking Supervision

Sent by email to:
alan.adkins@bankofengland.co.uk;
norah.barger@frb.gov;
juquan.tan@bis.org

January 31, 2014

Dear Mr. Adkins, Ms. Barger, and Mr. Tan:

**Re: IBFed Response to the BCBS consultative document: Fundamental Review of the Trading Book: A Revised Market Risk Framework**

The International Banking Federation (IBFed) appreciates the opportunity to comment on the Basel Committee on Banking Supervision's (BCBS) second consultative document on the Fundamental Review of the Trading Book (FRTB). The IBFed is supportive of this fundamental review and committed to ensuring that this review is as comprehensive and thorough as possible. We would like to express our general support for the alternative proposals prepared by the International Swaps and Derivatives Association (ISDA), the Institute of International Finance (IIF), and the Global Financial Markets Association (GFMA), that were submitted to the BCBS's Trading Book Group (TBG) on January 19, 2014, and our general support for the joint ISDA/IIF/GFMA response submitted to the TBG today.

Our comments on some of the proposals contained in the BCBS's second FRTB consultative document are set out below for your consideration.

**Trading/Banking Book Boundary**

The IBFed is generally supportive of the proposed boundary approach in which trading intent is the primary determinant of trading book instruments. While we are in favor of the proposed approach, we believe that some improvements could be made. For example, we believe that, under certain circumstances, it should be possible to assign the same instrument to both books. In addition, we also believe that it should be clarified that hedging instruments applied to banking book positions should always be assigned to the banking book as well as at least some embedded derivatives.

The IBFed would also support a "notification" approach to address the switching of instruments from one book to another. This approach would require banks to notify their supervisor of any instrument being switched, which would be deemed to be approved by the supervisor if no objection was received by the bank after a pre-specified period of time.

**Determination of Trading Desks**

Under the proposed framework, validation at the trading desk level would be required for a desk to be eligible for the internal models-based approach. We believe that this framework should be flexible so as not to hamper a bank's ability to optimize their organizational restructuring. Therefore, we are of the view that trading desks should be defined and approved at the discretion of national supervisors through sufficient dialogue with banks, instead of defining trading desks in detail in the rules text.

**Model-Independent Risk Assessment Tool**

While the IBFed generally supports the proposed desk-level approach to be used in the revised internal models approach (IMA), it does not support the model-independent risk assessment tool introduced in the FRTB to assess the eligibility of a trading desk for the revised IMA. The IBFed does not understand how such a tool would achieve the objective of identifying desks with complex, potentially illiquid, instruments that carry higher model risk.

In the IBFed's view, this tool would be equivalent to introducing a non-risk sensitive floor to the IMA capital charge. This could imply that desks with a low-risk profile would not be validated for the IMA or that they would be obliged to mis-hedge their book to increase the internal model capital.

**PD for Sovereign Risk**

The IBFed believes that the PD floor for sovereign risk should be zero for the Incremental Default Risk (IDR) charge under the internal models-based approach. As the treatment of sovereign risk is also being discussed outside of the FRTB (e.g., banking book credit risk, the large exposure regime), we do not believe that this issue should be decided only within the context of the FRTB. We believe that the FRTB should allow for an approach equivalent to the current internal ratings-based (IRB) approach, at least until an agreement is reached on how to treat this issue in the credit risk framework.

The IBFed would also like to encourage the BCBS to eliminate any conflicting treatment of risk weightings for sovereigns that may exist, for example, with respect to the treatment of high quality liquid assets to meet Basel liquidity requirements, or through the posting of collateral to CCPs or other derivative counterparties. At a minimum, we believe that a PD of zero should be permitted for sovereign exposures meeting certain criteria.

**Complexity of Standardized Approach**

The IBFed believes that the standardized approach proposal in the BCBS's document is overly complex and should be simplified in order to meet its key objectives. We believe that the level of complexity of the current proposal would not be appropriate for those banks whose business models do not require complex calculations of market risk. We also believe that this complexity would detract from the objective of providing a consistent and comparable reporting framework for market risk across banks and jurisdictions. As an example, we believe the embedded adjustment intended to make the standardized approach charge more conservative adds complexity to, and reduces comparability of, the standardized approach.

Thus, the IBFed believes that the role of a benchmark would be enhanced by removing unreasonable conservatisms and through the BCBS's disclosure of the assumptions used for the SA calibration, which would enable banks to reasonably account for the difference between the IMA and SA (Benchmark SA). Furthermore, for small-sized banks that can only achieve a limited benefit from internal models as compared to the costs to build them,

greater attention should be paid to the practical burden to implement this more complex approach. Accordingly, the IBFed believes that the continuous use of the current standardized approach should also be permitted for the capital calculation so long as a more conservative calibration is made (Conservative SA).

In summary, the relationship among the above mentioned approaches would be:

- Conservative SA = Current SA x *a*, where a is appropriately chosen; and,
- Conservative SA > Benchmark SA

In addition, the IBFed believes that it is incorrect to assume that building the proposed cash flow approach would not rely on internal models. In fact, this approach would require the implementation of a very large, new set of internal models to construct the yield curves (including the calculation of appropriate OAS spreads) and calculate the PVs of each future cash flow. Further, as the TBG is aware, the proposed cash flow approach omits floating rate and contingent cash flows. We would therefore encourage the TBG to consider the alternative standardized approach proposals submitted by the IIF/ISDA/GFMA on January 3, 2014, as well as the proposal submitted by the Canadian Bankers Association on January 6, 2014.

**Potential Use of Standardized Approach as Floor or Surcharge**

The IBFed would strongly oppose the use of the standardized approach as a floor or surcharge to the models-based approach. While the proposed standardized approach would result in more risk sensitive RWAs relative to the existing approach, we believe the conservative adjustments built into the proposed approach would overestimate risk. Therefore, introducing the standardized approach as a floor or surcharge may significantly reduce banks' incentive to develop and refine internal models.

Instead, the IBFed believes that benchmarking internal models and holding banks accountable for any divergence between the benchmark and a bank's own internal models estimates would increase the quality of these internal models and result in more comparable RWAs.

**Comprehensive Risk Measure**

The IBFed sees no reason why the current comprehensive risk measure (CRM) approach should not be maintained for securitizations. In our view, it should still be possible to use internal models to calculate capital charges for certain correlation trading activities as the CRM model envisages.

**FRTB Timelines**

While we understand the BCBS's desire to complete the FRTB in a timely manner, we are extremely concerned with the aggressive deadlines that have been set. Given the significant number of issues that have already been identified with some of the FRTB proposals, we do not believe that a truly fundamental review can be conducted within the existing timelines set out by the BCBS (two QISs in 2014 and completion of the review by mid-2015).

Instead, the IBFed believes that this review should be carried out in an iterative manner until at least sometime in 2016, with multiple QISs that inform the TBG's proposals. We would also like to request that banks be provided with sufficient lead time for building and implementing systems and for developing the internal governance required by the changes. As the objective of the FRTB is not necessarily to increase capital levels – which was largely

accomplished by Basel 2.5 – we do not believe that the FRTB should be viewed as a response to the financial crisis and therefore completed with the utmost urgency.

As a result, we would also like to express our support for the letters sent by ISDA/IIF/GFMA to the Co-Chairs of the TBG and Mr. Stefan Ingves, Chair, BCBS, on January 6, 2014, and January 8, 2014, regarding these timelines.

We thank you for taking our comments into consideration and would be pleased to discuss these issues with you further at your convenience.

Yours sincerely,

**Mrs Sally Scutt**
Managing Director
International Banking Federation

**Mr Marion G. Wrobel**
Chairman
Prudential Supervision Working Group