1 PLUS i GmbH Postfach 130211 90114 Nürnberg

Basel Committee on Banking Supervision
Centralbahnplatz 2
4051 Basel
Switzerland

Nürnberg, 26.09.2017

- Consultative document „simplified alternative to the standardised approach to market risk capital requirements (R-SbM)“
- Published for consultation until 27th September

Dear Madams and Sirs,

1 PLUS i welcomes the opportunity to comment on the consultative document for the drafted simplified alternative to the standardised approach to market risk capital requirements (R-SbM).

Before illustrating our view and remarks on the proposal, let us briefly introduce our company to give you a better understanding of our background. Founded in 2003, 1 PLUS i provides advisory services in the key fields of risk management compliance with regulatory requirements to its mainly German customers across the whole banking sector. Many of our colleagues have already worked in financial institutions or for regulators before joining the company.

Postfach 130211
90114 Nürnberg
T 0911 - 56 79 94 99
F 0911 - 56 79 95 55
info@1plusi.de
www.1plusi.de

GESCHÄFTSFÜHRUNG
Hendryk Braun
Thorsten Gendrisch
Dr. Walter Gruber
Henning Heuter
Dr. Andreas Igl
Dr. Jochen Klement

SITZ DER GMBH
Neu-Anspach

REGISTERGERICHT
Bad Homburg HRB 13630

1 PLUS i strongly supports the Basel Committee's initiative to enable institutions with less significant trading and market risk positions to use a less burdensome approach for the pillar I capital charge.

You acknowledged that the R-SbM could pose implementation challenges and mentioned that the Committee is also considering the alternative of retaining a recalibrated version of the Basel II standardised approach. In our understanding, the R-SbM will indeed entail nonnegligible implementation costs and we therefore strongly support the idea of retaining this alternative. This is also being considered in the current proposal of the European Commission for an update of the Capital Requirements Regulation.

Irrespective of this general remark, we would like to share our thoughts on details of the proposed simplified approach hoping that this enriches the discussion for the final version.

We would be grateful to discuss with you any question you may have in further detail . Please do not hesitate to contact us.

Kind Regards

Gendrisch Hetmanczyk-Timm J. Kayser

Thorsten Gendrisch Matthias Hetmanczyk-Timm Jochen Kayser

Detailed remarks on the single chapters of the proposal

1. General remark on an introduction of a simplified approach - background

As stated in the consultation paper, the new proposal should allow institutions having less significant trading activities and market risk to calculate their capital requirements with less complex methods. In addition to the proposed R-SbM the option of a new calibration of the current Basel II standardised approach (B II SA) is mentioned. The current Basel II method is mainly based on nominals and market values, whereas for the R-SbM sensitivities have to be calculated, although for a largely reduced set of risk factors compared to the new standardized approach (SbM). Therefore, the R-SbM still implies a major change of the risk measurement architecture (because of the need for sensitivities in the regulatory reporting environment), leading to a significant implementation effort.

We therefore propose to keep the current Basel II concept as an alternative for less significant institutions with limited market risk exposure or at most adopt some changes to improve risk sensitivity that are expected to be implemented more easily (for example in the parts where correlation is implicitly integrated in the method like the "short-hand position" for FX-risk and net position for general equity market risk; additionally the current weights could be recalibrated).

In this context the role of the new simplified approach (R-SbM) within the review of the credit valuation adjustment (CVA) risk framework should be clarified. If the R-SbM can be classified as an FRTB-CVA-approach, this could result in more institutions using the more sophisticated method covering the risk more accurately compared to the very crude basis CVA framework.

2. Governance

As the eligibility criteria for using the R-SbM is a fundamental basis of the approach, the concept and the limits should be aligned with other national proposals (e.g. the EU draft) and implemented in an (almost) consistent way across the legislations. Concerning this point we have the following suggestions and remarks:

- Since FX and commodities positions of the banking book are taken into account for measuring market risk, these should also be included when determining the significance of market risk positions. For ease of calculation and consistency with the current rules, we would suggest basing the measure on the net position in each currency as they are calculated within the current Basel II framework.
- We consider that at least some basic offsetting of positions, such as resulting from back-to-back deals, should be allowed. The current Basel II framework could again be used for measuring net positions.
- From our perspective a limit on non-centrally cleared derivatives should not be used for the delineation between higher and less market risk related institutions. This relates to counterparty and not market risk, even if we acknowledge the link between the two risk categories.

The proposal does not allow the parallel use of the SbM and R-SbM. Having some institutions in mind, which are focusing on single risk types, we would support the idea to allow a simplification for the non-significant risk classes. Let's assume an institution has a rather extensive commodities related trading and sales business exceeding the proposed limits, but non-significant trading activity in other risk classes, then it might still be reasonable to allow the use of a simplified version for the other risks (e.g. interest rate or equities risk). Of course this would lead to the need to establish some additional thresholds, which should be risk orientated (like the proposed % of total RWA).

3. R-SbM: definition of sensitivities

The definition of the sensitivities is the same as in the regular SbM-approach. However in order to reach a relief for smaller market risk orientated financial institutions for some instruments (e.g. FX positions) the use of the market value or comparable figures like nominals should be allowed.

As the use of short positions in options is not permitted anyway (as stated in article 204, second point), the option delta equivalent for long positions should be sufficient for determining the position in the underlying.

These exposure measures, part of the existing Basel II framework, are already available in the calculation engines of smaller financial institutions. Thus their use can avoid significant implementation costs.

4. R-SbM: predescribed buckets, risk weights and correlations

We expect that the consequence on the pillar I requirement on an overall level is planned to be evaluated via a QIS before any fine-tuning of the risk weights and correlations. However we would like to challenge some parameters proposed already at this stage:

- The shift for the general interest rate risk class (GIRR) is proposed to be set at 500 BP independent of the bucket and currency. In the regular standard approach (SbM) the shifts are between 150 BP and 240 BP. Furthermore the parallel shift for the interest rate of the banking book IRRBB (covering "long term" positions) is up to 250 BP for major currencies. Against this background the proposal of 500 BP for trading book instruments seems to be extremely conservative.
- For evaluating FX risk a differentiation between "higher and less liquid" currencies has been made. We would propose to pursue this differentiation also in the general interest rate risk class (GIRR) as it is done in the regular approach (SbM). This reflects the liquidating period of interest rate positions in "advanced" versus other currencies more accurately.
- The proposed correlation between the long and short end of an identical curve is set at 20 %. In the regular, existing SbM-approach the values of the formula will lead to much higher figures, e.g. a correlation between a typical exposure of 2 and 10 years is roughly 90%. Given that a parallel shift in interest rates typically explains a very high proportion of interest rate curve movements, in our opinion the correlation between the long and short ends of the curve of 20 % needs be reconsidered.
- The buckets for the CSR of non-securitizations have been reduced to three for both investment and non-investment grade issues. In our understanding the proposed structure would mean, that corporate issuers must be assigned to the other sector resulting in 1500 BP or 3000 BP shifts. Compared to the typical shift of the regular approach of 300 BP this would be an excessive increase. We would therefore strongly advise to introduce an additional bucket for the industry sector with a risk weight more in line with the shift in the regular SbM-approach. Additionally we

propose to consider a special treatment of covered bonds, because in our experience the current proposal wouldn’t reflect the lower credit spread changes existing in reality.

- The new definition of the various commodities in article 250 is very helpful. However it might lead to different interpretation compared to the existing SbM-approach. In case of a change of the method this could lead to mistakes. The comparability of the results with different definitions is burdensome, too. We therefore propose the alignment of the classifications of the two approaches.
- We appreciate the inclusion of the reduction for the risk weight of the more liquid currency pairs for FX risk. However an increase of the weights of 50% compared to the existing SbM, with liquidation periods of 10/20 days to be used for internal models and “typical” daily market rate shifts of less than 1% (in high liquid currency pairs), the proposed scale is extremely conservative for these currencies.