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Re: **Revisions to the Basel II market risk framework, Jan 09**
Guidelines for computing capital for incremental risk in the trading book, Jan 09

The Bank and Insurance Division of the Austrian Federal Economic Chamber, representing the entire Austrian Banking Industry, welcomes the opportunity to comment on the above-mentioned issues as follows:

The revisions presented in January essentially correspond to the first drafts of July 2008. The amendments made generally constitute a further tightening of requirements. We would like to point out the following serious aspects:

- It is becoming **ever more problematic, given the financial crisis, to get a crisis that has already set in under control since further methods, higher-of rules and supplements as well as added stringency have been introduced.** We would suggest waiting for the supervisors to set the agenda first (more rules, less and simpler rules, self-control or surveillance, etc), before starting out to regulate the details.
- The **disclosure** requirements show that the requisite information in no way creates additional transparency, much rather it incurs additional work in the banks. The market does not call for details on the method used to determine the liquidity horizon nor does it require detailed theoretical descriptions of the IAA process, etc. to this extent.
- The **valuation requirements** have remained practically unchanged. As a crucial point in risk management, the **correlation between IFRS and the provisions according to and for Basel remains unresolved** and this calls for urgent consideration in the general discussion on the future of supervision.
- A striking change that we would like to mention is the **introduction of an additional capital requirement for stress tests** (Revision..., 718 LXXV, j, k). This change has not only tightened the provisions regarding capital requirements and made additional measurements necessary but it has also relaxed a number of basic principles in Basel II that used to be applicable:

- o The calculable VaR scenario is confounded with the stress test which can only be estimated in qualitative terms. What is more, this suggests that stress scenarios are mathematically determinable.
 - o VaR and stress VaR are added without any justification.
 - o Amidst the shock of the current crisis, a period of stress is equated to 2007/2008, not taking into account the next crisis.
 - o Resources in risk management are used up to generate a large volume of numbers.
 - o Complexity increases. What was criticised in the financial products is being further encouraged in the risk management methods.
- Increasing the capital requirement for shares in the standard method from 12% to 16% (Revision..., III, 16) and the 3-month minimum liquidity horizon (Guidelines..., II B 3, 20) constitute a further tightening of requirements. Although we appreciate the need of the individual measures, the tightening of provisions, the floors, the higher-ofs, etc. introduced in view of the present situation have taken on an enormous scope.

We understand why the changes were made to this consultation paper in light of the events that have transpired in recent months. What should be considered however, is that more, and particularly more detailed, requirements alone will not lead to the objective we have set ourselves. Regulatory requirements will always lag behind the ongoing events and too much detail will use up the capacities we have in risk management.

One possibility would be to integrate the proposed **additional verifications and analyses** into an upgraded **stress test**. Then we would actually be able to measure what supervisors are most interested in when examining the system as a whole; this would diminish the work load involved in ongoing, daily and even intra-day risk estimations, it would exempt the banks and supervisory authorities from implementing and accepting theoretical verifications and supervisors would be able to get an idea of the impact and, if a specific case so requires, intervene through the ICAAP. Additionally, supervision could also be strengthened through the proposed "standard decks of trading portfolios" or dirty backtesting.

The **illiquidity** issue of trading positions should be resolved not by focusing on additional risk calculations and valuation adjustments but mainly by ensuring that illiquid position are **no longer valued according to the rules of the trading book** after a certain time period.

Approving new procedures on condition that at least as much equity is provided as in the standard approach (**higher of**) is not expedient and should not be given too much weight in the rules on capital requirement as a wrongly conceived precautionary principle.

Below you will find further considerations which could help reduce the work load for banks - even based on the present concept - while ensuring that the objectives of the supervisors are still achieved.

PROPOSED REVISIONS TO THE BASEL II MARKET RISK FRAMEWORK

718 (LXXV) a)

The procedure by which banks justify individual components of their model and prove to the supervisors that they give rise to an appropriate representation of reality is very complex. Supervisors need to be satisfied with the functionality of the model as a whole anyway. In particular, reference should not only be to current developments (nonlinear behaviour, correlation risk). A certain risk inherent to the model will remain which cannot be dispelled by providing additional "proof". What would be important is to ensure better handling of this risk inherent to the model through stress tests, information from the management and pillar III (cf. above).

The requirement to include parameters that play a role in pricing in the risk model as well is legitimate. However, this should be restricted to taking adequate consideration of these additional parameters in the regular stress tests.

718 (LXXVi) c)

In this new regulation, too, banks are given the task of verifying at regular intervals that a modelling assumption is appropriate. As argued above, this verification at regular intervals unnecessarily uses up capacities. Upon approval, a review by the supervisors should be possible in the event of unusual stress test results and non-compliant backtesting results. In the general interest of everyone, we should not require any unfounded, systematic verification of appropriateness.

718 (LXXVi) d) Fußnote

Especially the developments in recent months have underscored the advantages of a weighted volatility approach. A "higher-of" clause is no solution, at any rate, since this also requires additional effort and offers no incentive for the application. Additional verifications and "higher-of" clauses make the application of the model more complicated and use up capacities which could be implemented more meaningfully elsewhere.

690 ff

The significance of valuation has undoubtedly increased enormously. Higher requirements in this context are therefore general justified. On the other hand, **however, we should keep IFRS valuation and valuation based on capital adequacy from diverging too far.** Before refining valuations for capital adequacy, the valuation parameters of IFRS and capital adequacy should be harmonised first. Particularly in view of the developments in recent months, supervisors should act on the assumption that - in a serious crisis (after all, the whole system is being managed in order to avoid the crisis or to keep it under control) - it will not be equity under Basel II that will play a role but primarily balance sheet equity under IFRS.

GUIDELINES FOR COMPUTING CAPITAL FOR INCREMENTAL RISK IN THE TRADING BOOK

We welcome the general course taken (building block approach, guidelines with fallback, which are acceptable). When introducing Basel II, regulators did not permit calculating risk based on the parameters 99.9% / 1 year using one's own models on the banking book side. An application in the banking book would require clearly liquid positions that could be liquidated at any time. In this case, however, the liquidity horizon and calculation horizon issue becomes less urgent. O uniform liquidity and calculation horizon would then be sufficient perhaps.

II A 11. / IX 1 b

In several passages, it becomes clear that the proposal are marked by the recent developments. We understand why all “credit risks” in the broadest sense should be taken into account when calculating the incremental risk (i.e. also positions in a broad share index), but not **commodity positions**. To maintain a global level playing field, significant commodity positions would have to be treated equally.

III B 3. / IX 4

The proposed **liquidity horizon** introduces a lot of subjectivity into the calculation results. This should also be covered by the above-referenced upgraded stress tests and not by the risk models for the ongoing calculation of capital requirement.

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A **weekly calculation** is acceptable; actually a monthly calculation would presumably suffice, provided the positions are the same.

Yours sincerely,

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