**Basel Committee on Banking Supervision**

## Aifirm Comments on *Consultative Document Simplified alternative to the standardised approach to market risk capital requirements - June 2017*

### Introductory Remarks

We welcome the opportunity to comment on the proposed simplified alternative to the standardized approach to market risk capital requirements (R-SbM).

In our view, the consultative document issued by the BCBS represents an important step to address a concrete concern related to the new standardized approach to market risk capital requirements (SbM), namely the fact that it might be too complex for smaller and less sophisticated banks. Having said that, the attempt to design a simplified version of the new standardized approach entails some significant challenges, which would require further analysis in order to assess:

- the potential consequences of the proposal on the aim to maintain a level playing field between large and small banks and between banks active in different jurisdictions
- the overall coherence of the R-SbM, in terms of proposed parameters, with the SbM
- the extent to which the simplified proposal actually entails lower implementation efforts.

In this view, we support the alternative option mentioned by the Committee of retaining a recalibrated version of the Basel II Standardised approach rather than adopting R-SbM.

### Specific comments

The structure of eligibility criteria for the R-SbM includes several conditions that should be effective in isolating only banks where trading is neither sophisticated nor carried-out on a large scale. However, quantitative parameters seem to be very low and might limit significantly the overall ability of the proposal to reach its goals.

In particular, we point out that, for the 5% threshold that refers to risk-weighted assets, it might happen that a bank ceases to fulfill the requirement as an effect of risk weighted assets for credit and operational risks dropping, without any change in the absolute level of risk-weighted assets for market risk. Since the threshold level seems to be very low, it seems likely that many banks will be rather close to its level, increasing the probability of this type of event. This concern could be addressed either by setting the corresponding level higher than 5% of risk-weighted assets, or using a different threshold, e.g. based on common equity tier 1 capital without considering the other RWAs.

In addition, for banks breaching the threshold we suggest:

- to consider a monitoring period for triggering the breach (e.g. 3 or 4 quarterly calculation of RWAs and Own Funds) and then being mandated to shift from R-SbM to SbM;

- to permit an implementation period (e.g. 12 or 18 months) during which the bank will work on implementation of SbM but still applying R-SbM, as otherwise banks should be ready anyway (i.e. despite of the possibility to apply R-SbM) with SbM in advance and therefore the benefit would be largely reduced.

As a further remark, we observe that the consultative document doesn't seem to specify if the eligibility criteria for the R-SbM should be applied at the consolidated level or subsidiary level. Our understanding is that they are meant to be applied at the consolidated level, however we encourage the BCBS to consider the alternative of an entity level approach, which might be more appropriate for groups that comprise several small banks carrying out trading activities on a small scale. If an entity level approach is allowed, RWAs calculated by subsidiaries under the R-SbM could be, in principle, aggregated through a "building block" approach with RWAs calculated by other legal entities in the same group using other methods.

The consistency of application of the R-SbM across jurisdictions is another point of concern, given that the use of R-SbM is subject to supervisory approval and oversight. Different approaches by national supervisors might entail different costs for small banks in different jurisdiction and have negative consequences on the creation of a level playing field.

Coming to the actual differences between the proposed R-SbM and the SbM, namely:

- removal of vega and curvature risk components
- correlation scenarios simplification
- basis risk calculation simplification
- lower granularity for risk factors, coupled with a different set of parameters

we notice that one of the main challenges and costs for banks implementing the SbM is the calculation of sensitivities, even first order ones. While the removal of vega and curvature risk components will certainly remove some of the complexity, the fact that the R-SbM is still sensitivity-based will require significant changes for small banks in terms of systems, processes and human resources. In this respect, we think that further cost-benefit analysis might be useful involving the BCBS and, possibly, a panel of small banks.

Lower risk factor granularity seems to come at the price of a significant change in risk weights and correlations assumptions. While a certain amount of additional conservatism can be justified, we see the risk that the coherence of the R-SbM with the SbM gets lost. We think that it might be worthwhile for the BCBS to carry out a quantitative assessment of the consistency between the R-SbM and the SbM for sample portfolios and publish the results, rather than leaving this type of simulation to the industry only. Since the R-SbM will not be an option for large banks, it is unlikely that they can devote resources to analyze in detail how it works compared to the SbM. Once vega and curvature risk are set aside, it might be argued that the additional cost for banks associated with retaining the SbM risk factor granularity might be very low. Therefore, we suggest to consider an alternative approach under which the R-SbM maintains the same risk factors as the SbM, but also the same quantitative parameters, or very similar ones.