I. Background and Purpose of the Revision

The Basel Committee on Banking Supervision has issued this consultative document to address issues identified in the course of monitoring the implementation and impact of the Minimum Capital Requirements for Market Risk standard, published in January 2016. This consultative document proposes several revisions to the Sensitivities-based Method put forward in the January 2016 standard, as well as introduces the simplified alternative to the revised standardized approach to market risk.

The Group of Governors and Heads of Supervision (GHOS) has acknowledged the ongoing challenges relative to the implementation of the standard and has endorsed an extension of the implementation date to 1 January 2022.

The following paragraphs represent the comments submitted by some members of the Association of Supervisors of Banks of the Americas (ASBA) to this consultative document.

II. Specific Comments

1. Revisions to the treatment of liquid FX pairs (Section 1.1)

ASBA members agree with the Committee's proposed changes to allow banks to combine two currency pairs in the current list of liquid pairs and treat the resulting new FX pair as liquid. Thus, the proposed modification would warrant lower associated capital requirements for transactions exposed to exchange rates with a high level of liquidity.

However, the consultative document does not recognize liquid FX pairs as those composed by currencies that can be used interchangeably to conduct transactions in a specific jurisdiction. In some ASBA jurisdictions, a foreign currency (mainly the USD) is widely used along with the reporting currency, resulting in liquid FX transaction given their high frequency and volume. In this regard, the Association requests the Committee to evaluate the possibility of considering as a liquid FX pair those which involve two currencies that are easily traded and widely used in a particular country or jurisdiction.

2. Revisions to correlations scenarios (Section 1.2)

The prescribed correlation coefficients in the January 2016 standard have been determined based on an impact study applied primarily to European financial institutions, in many cases, these do not necessarily adjust to the existing relationships between risk factors in other jurisdictions. Therefore, the application of the prescribed correlations could generate capital requirements inconsistent with the relationships between the risk factors observed in emerging markets. In this regard, ASBA members suggest that for cases in which the prescribed correlations in each scenario generate capital requirements that are not coherent with the expected changes in the market variables, the regulator in each jurisdiction be allowed to set the applicable correlations.

3. **Revisions to capital requirements for non-linear instruments (Section 1.3)**

   In the case of non-linear instruments, the January 2016 standard specified the use of the curvature risk capital requirements. This requirement is the result of calculating the maximum loss of two scenarios of shock – an upward and a downward shock. The Association considers it would be beneficial for the proposed modification to explicitly establish the minimum size of the upward and downward shocks to calculate the curvature risk charge.

4. **PLA test metric design (Section 2.1.2)**

   In assessing the similarity of the distributions of the HPL and the RTPL, the Committee is considering the use of the Kolmogorov-Smirnov (KS) test metric or the Chi-squared test metric. Associate Members consider the Chi-squared metric may present some problems related to power and type-1 error rates when the sample size is small. In other words, there is a need for an adequate sample size for the approximation to be valid. As for the Komolgorov-Smirnov test, the simulated type-1 error rate is smaller than that of Chi-squared.

   Nevertheless, Kolmogorov-Smirnov test is not without flaws. In particular, the fact that the distribution must be fully specified. In case of the location, scale and shape parameters are estimated from the data, the critical region of the KS test is no longer valid. Given this shortcoming, certain papers have advocated for the use of new tests, particularly the Anderson-Darling or Cramer-Von Mises. It would be interesting to know whether the Committee has evaluated using any of these alternatives or the possibility of banks using the statistical test of their choice, provided they can document and support their choice.

5. **Simplified alternative to the standardized approach (Section 4)**

   According to the 2018 consultative document, one of the criteria for a bank to apply the simplified alternative is that the bank does not use internal models in any of its negotiating desks. In that sense, if the entity is authorized to use internal models in any of its desks, the only alternative it would have under the current proposal of the BCBS (2018 document) would be the revised “full” standardized method of 2016, which the BCBS itself has recognized can be excessively complex. In this sense, considering that in some countries the trading portfolios of the largest entities are not as complex, it may be beneficial in prudential terms to have an alternative that does not involve calculating vega and curvature sensitivities, but that is more sensitive to risk than the recalibrated Basel II standardized method. In this case, the Sensitivities-based Method (R-SbM) could be applied. Therefore, ASBA members would suggest that the R-SbM be considered as an alternative for entities authorized to use internal models in any of their desks, but that according to the supervisor's evaluation do not require the full application of the 2016 standardized method.

III. Further Recommendations

ASBA members believe that the risk weights on the Credit Spread Risk (CSR) should also be opened to revision. In particular, a change is needed in the CSR risk weight for High Yield issuers, as it is expected to affect the funding of emerging market entities abroad considering the existing provisions on the use of ratings. In particular, the treatment of sovereign bonds is very punitive with risk weights for High Yield being six times those for Investment grade issuers. Although the proposed recalibrated weights were based on the latest QIS exercise, this distortion may have been hidden because the sample had very few emerging market banks. The Association would propose for the CSR impact in banks from Non-Senior Investment grade countries should be studied separately, and the resulting calibration should establish a flat ratio between the High Yield and the Investment grade buckets.