

**ABI's comments on the
BCBS Consultative Document**

**"Revisions to the minimum capital
requirements for market risk"**

June 2018

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General Remarks

The Italian Banking Association (ABI) welcomes the opportunity to comment on the BCBS Consultative Document “*Revisions to the minimum capital requirements for market risk*”.

ABI acknowledges and praises the effort of the Basel Committee aimed at addressing unresolved issues and fixing some flaws of the 2016 standards¹. The Consultative Document (henceforth, CD) touches on several significant elements of the package, broadly across the Standardised Approach (SA), the Internal Models Approach (IMA) and notably the P&L attribution (PLA) test and the Non-Modellable Risk Factors (NMRF) framework, the “structural FX” definition, the Trading Book (TB)/Banking Book (BB) boundary, the introduction of a simplified alternative to the standardised approach.

The CD addresses several points while leaving some grey areas, pertaining essentially to the desk eligibility test, the TB/BB boundary and a still not fully formed NMRF infrastructure.

ABI remarks are presented below.

1. Standardised Approach

The proposed changes to the SA framework are welcome as they address concerns and take into account proposals and recommendations from the industry. The resulting SA charge seems to become a credible fallback to the IMA charge, significantly reducing the insurgence of cliff effects.

1.1 Revisions to the treatment of liquid FX pairs

ABI considers the BCBS proposal a positive development.

1.2 Revisions to correlation scenarios

ABI considers the BCBS proposal a positive development.

¹ BCBS Standards *Minimum capital requirements for market risk*, January 2016 are henceforth referred to as “the 2016 standards”.

1.3 Revisions to capital requirements for non-linear instruments

The Committee has identified the following three aspects of the curvature risk measurement where minor changes could improve the 2016 standards.

The approach to apply shock scenarios

While the Committee is working on an alternative proposal to apply scenarios consistently across different buckets, ABI would highlight that the current formulation of the credit curvature could still lead to negative default probabilities when downward shifts are applied to the credit spread curves. Such scenarios cannot materialize in the market so should be prevented by allowing to floor negative hazard rates (or spreads) to zero.

Cliff effects caused by the approach used to calculate aggregate capital requirements

The proposed amendment is considered a positive development.

Potential double-counting of FX curvature risk

The current text (2016 standards) potentially introduces a double counting in FX curvature for those products written on a currency pair that does not include the reporting currency. The CD recognizes the specific double-counting issue, but it does not address the broader concern about the asymmetries in FX capital charges, including delta. It still remains dependent on the representation of the risk exposures. The proposed approach also leads to reduced comparability and increased RWA variability among banks with similar risk profiles. Twin portfolios could result in significantly different capital requirements solely depending on the bank's reporting currency.

While the BCBS proposal in Box 1 may reduce the effect of double counting, however a one size fits all approach for the definition of the scalar [X] would not be appropriate, since the double counting effect is not constant over the currency pairs. ABI would ask for a level playing field for FX curvature charges irrespective of the reporting currency and, therefore, propose that banks be allowed to calculate the FX curvature charge in an alternative way.

1.4 Revisions to risk weights

As to the risk classes considered in the proposal, the CD addresses industry concerns and is indeed a very positive development. Impact assessment are ongoing within the industry; preliminary indication of the overall SA proposed revision suggests it would be a much more credible fallback to IMA.

Nevertheless, ABI would highlight that the risk weights for credit spread risk (CSR non-securitisations), not addressed in the CD, are still very high. For the buckets 3 (Financials, Investment grade) and 11 (Financials, non-investment grade and non-rated), risk weights are respectively 5% and 12%. It means that for a zero-coupon bond with a maturity of 5 years issued by a bank rated BB, the capital charge is around 60%. In this case, the capital charge is close to the effective loss in case of default. To this capital charge, the Default Risk Charge component still has to be added. Therefore, in ABI's opinion, the Committee should also consider recalibrating the CSR non-securitisations risk weights.

1.5 Other clarifications

Treatment of multi-underlying options and index instruments

According to the CD, a look-through approach must be used for index instruments and multi-underlying options in the delta risk context. If the no look-through approach is adopted, the risk weight to be applied to the index/multi-underlying option for the computation of the curvature risk charge should be the highest prescribed delta risk weight for each of the delta risk factors in the curvature risk requirement.

The highest risk weight could pertain to components of the basket/index that are not representative of the overall composition. In this case, a risk weight selected from the most representative components (or an average risk weight) could better reflect the effective riskiness.

2. Internal models approach

2.1 P&L attribution test

Significant revisions were proposed to the PLA test, in line with industry recommendations. These include:

- Amendments to the input parameters allowing alignment of data between hypothetical (HPL) and risk-theoretical P&L (RTPL)
- Modifications in test frequency (from monthly to quarterly) and length of time series (observation of 12 months as opposed to 1 month)
- Revised test metrics: Spearman Correlation together with Kolmogorov-Smirnov (KS) or Chi-squared Test
- Introduction of a penalty function to reduce the volatility of capital requirements

2.1.1 PLA test input data

ABI welcomes the proposed amendments, which address industry concerns.

2.1.2 PLA test metric design

The measurement of “similarity” between hypothetical (HPL) and risk-theoretical P&L (RTPL) distributions is intended to assess whether the risk management model used for the trading desk sufficiently captures the P&Ls of the desk across the range of market conditions during the previous 12 months. Two alternative tests are proposed: the Kolmogorov-Smirnov (KS) test metric and the Chi-squared test metric.

Both tests are fairly standard and preliminary analyses suggest that KS and Chi-squared metrics behave similarly.

However, it is important to highlight that, despite the improvements, the metrics and in particular the Spearman Correlation test are still plagued by the “noise” issue. Namely, when a desk is well hedged, the test mainly measures the correlation between two noises resulting from possible hedges mismatches that, by its very definition, is close to zero.

An example of the hedging effect is showed below. A real portfolio is split into subcategories, Cross Currency Swap (CCS) and the rest (no CCS), which hedge each other as showed in the following plot.

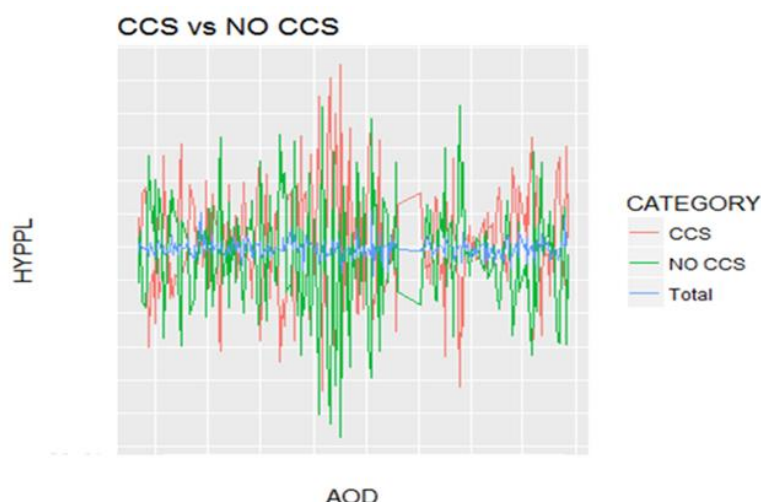


Figure 1 - Hypothetical P&L of the hedged portfolio together with its components

The table below shows the results of the test applied to the CCS portfolio, the no CCS portfolio and the entire portfolio given by the sum of the two.

Perimeter	Spearman Cor	KS	Traffic Light
CCS	0.94	0.04	Green
NO CCS	0.93	0.05	Green
Total	0.57	0.13	Red

Table 1 - Results of the eligibility test

Although the two subcategories pass the test, the resulting hedged portfolio does not. The following plots provide a graphical evidence of the decorrelation effects due to hedging.

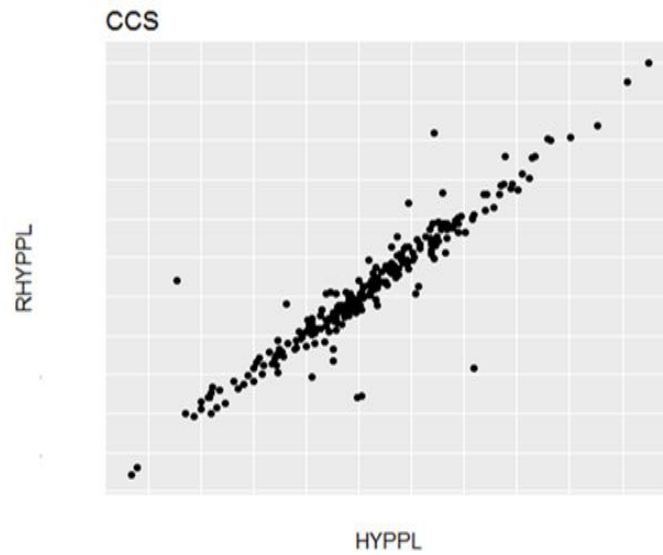


Figure 2 - RTPL vs HPL for the CCS portfolio

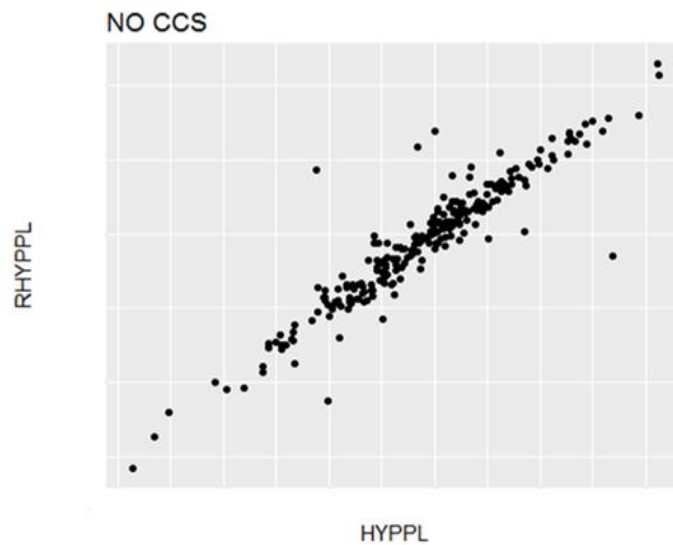


Figure 3- RTPL vs HPL for the no CCS portfolio

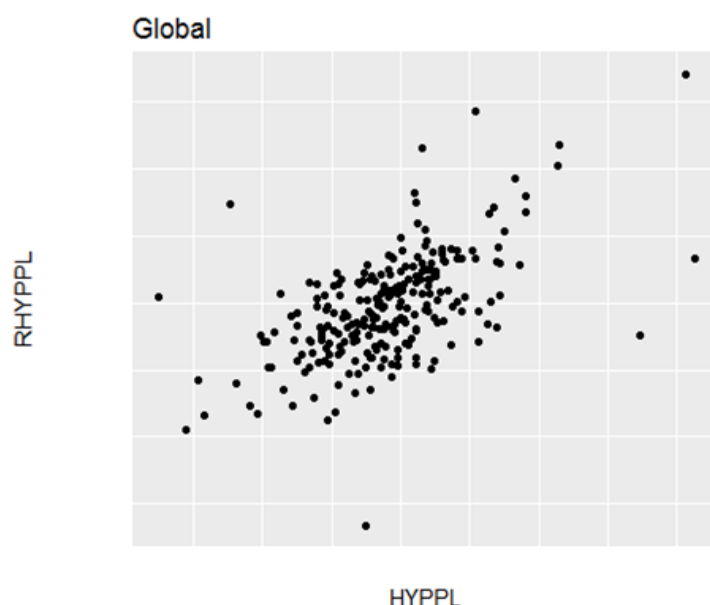


Figure 4 - RTPL vs HPL for the hedged portfolio

For this reason, it is important to discriminate between low volatility (hedged) and directional portfolios. Subject to supervisory approval, banks should retain the possibility to remove any PLA failure if a dedicated analysis shows that it is due to the hedged nature of the desk. An example of analysis could be:

1. splitting the desk into two (or more) partitions, for instance one could contain the positions and the other one the corresponding hedges (i.e. create two directional sub-desks)
2. performing PLA test on the two sub-desks, then
 - a. if both are GREEN, the failure is disregarded as due to noise, otherwise
 - b. the failure is registered.

Description of the PLA and backtesting frameworks at the trading desk level (Annex B §B.4 II)

NMRF in the context of backtesting

In the text of the CD, the RTPL used for PLA and backtesting (BT) should be based on the “desk risk management model”.

According to the Glossary:

“The desk risk management model includes all risk factors that are included in the bank’s ES model with supervisory parameters and any risk factors deemed not modellable by the supervisor in Step 3, and which are therefore not included in the

ES model for calculating the respective regulatory capital charge, but are included in NMRFs.”

Desk eligibility tests (PLA and BT) are conceived to produce an assessment of the desk risk management model. In order to retain an overall consistency of such assessment, VaR used for BT should be allowed to also incorporate NMRF.

Indeed, the 2016 standards clearly indicates, in the flowchart “The Internal Models Approach for Market Risk”, PLA and BT as Step 2(ii), whose failure leads to the application of the SA. Only with the following Step 3 modellability is introduced to distinguish between two different types of IMA Capitalization.

A clear statement on the matter is however not present, possibly leading to different interpretations in local jurisdictions².

ABI would advocate for such a clear point to be made in the Basel text not to lead to any local interpretation.

P&L Definitions

The CD requires P&L effects due to the passage of time to be included in the actual P&L and to be treated consistently in both HPL and RTPL. Time effects can include various elements such as: the sensitivity to time, or theta effect (i.e. using mathematical terminology, the first-order derivative of the price relative to the time), and carry or costs of funding.

Such requirement is welcome in that it positively clarifies the treatment of the passage of time in the definition of actual P&L, removing the need to carve out non-better-specified net interest income effects as required in some jurisdictions³.

Additionally, the CD sets the requirement that both actual P&L and HPL must be computed based on the same pricing models (e.g. same pricing functions, pricing configurations, model parametrisation, market data and systems) as the ones used to produce the reported daily P&L.

The condition that the *systems* producing actual P&L and HPL need to be the same appears not necessary to guarantee the similarity of the pricing models and should hence be excluded from the list of exemplifying conditions.

2.1.3 PLA test failure consequences

ABI welcomes the proposed amendments which address industry concerns and take into account industry observations. The boundaries among the Green, Amber and

² The draft Article 325bg of the revised EU Capital Requirements Regulation (CRR2) Commission proposal is an example.

³ In the EU such treatment is currently set out in Article 366 CRR.

Red areas would need to be subject to monitoring once the implementation on real portfolios is at a more advanced stage.

2.1.4 Trading desk requirements

No comments.

2.2 Non-modellable risk factors

Despite the proposed improvements, the NMRF framework still raises concerns. In fact, the proposed approach for identifying modellable risk factors is very demanding and de facto implies bank's recourse to external data providers⁴. This entails huge running costs for banks but, above all, banks remain liable for being compliant with the rules even though they cannot exercise any control over the data vendors, nor are the latter subject to supervisory control.

ABI suggests that for some categories of parameters, that are commonly considered as liquid, like interest rate curves of main currencies (e.g. USD, EUR, GBP), a "presumption of liquidity" be introduced. This list of risk factors for which modellability is presumed should be defined or subject to approval by the supervisors and could be periodically updated.

2.2.1 Process for satisfying modellability requirements and expectations for internal model calibration

The CD proposes two potential alternatives to determine how similar a risk factor of an executed transaction and a risk factor used to evaluate a financial instrument must be in order to count as an observation for the risk factor eligibility test (RFET).

Alternative 1

Alternative 1 requires that exactly one risk factor per bucket be defined, and the risk factors must correspond to the risk factors that are part of the RTPL of the bank for the purpose of the PLA test.

An explicit trade-off between RFET granularity and PLA granularity is established, since the use of more granular buckets may facilitate a trading desk's success in meeting the requirements of the PLA test, but additional granularity may challenge a bank's ability to source a sufficient number of "real" observed prices per bucket to satisfy the RFET.

⁴ This would not be the case if non-committed quotes, daily published by information providers, could contribute to the definition of "real price".

In order to assess this trade-off existence, a practical example has been performed, focusing on a sample desk of linear plain vanilla interest rate (IR) instruments and considering a subset of more impactful IR curves. The charts below show that in this context, as expected, taking into account the most granular bucket definition (i.e. single pillar level), results on PLA test are encouraging while this can lead to a skyrocketing NMRF capital charge.

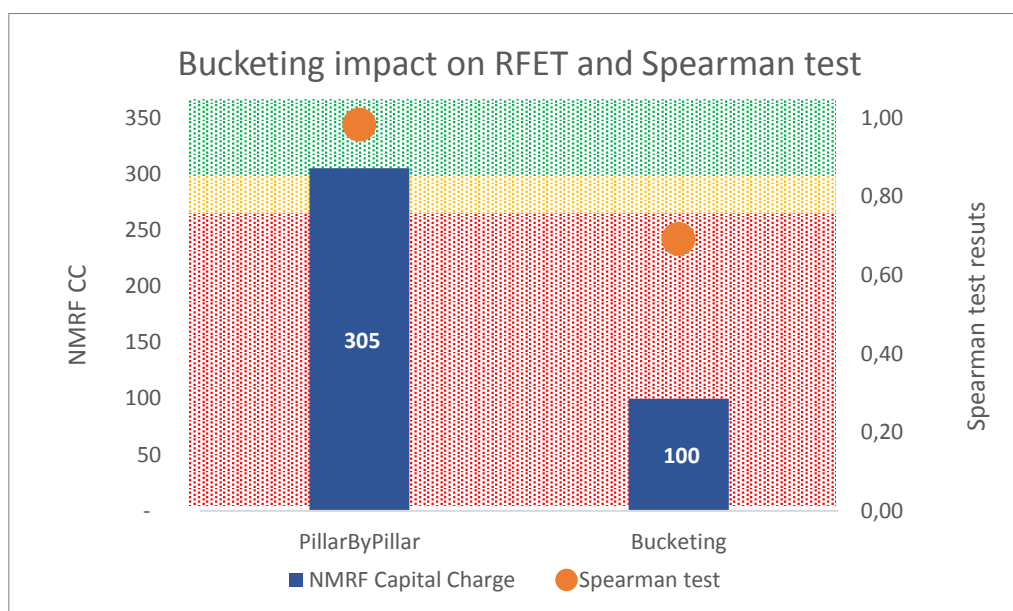


Figure 5 - Impact of the risk factor bucketing on the capital charge and the Spearman P&L attribution test

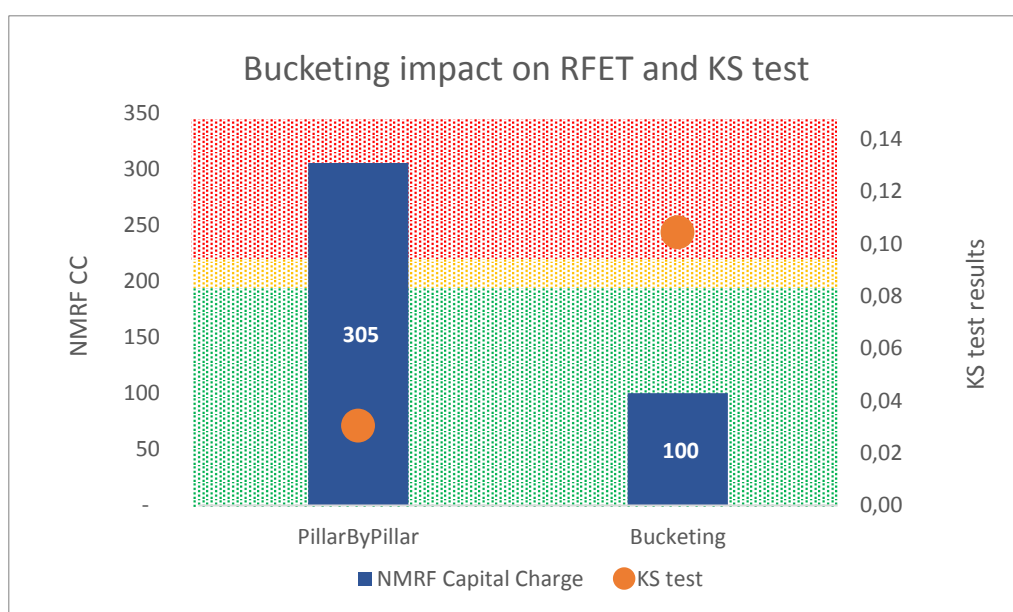


Figure 6 - Impact of the risk factor bucketing on the capital charge and the Kolmogorov-Smirnov P&L attribution test

Considering the maximum granularity approach into RFET, the number of risk factors deemed as non-modellable is 31% higher than in case a bucketing definition is applied, and this leads to an increase of the NMRF capital charge by 3 times. On the other hand, binding the shocks to be parallel within every bucket severely affects the P&L Attribution metrics (i.e. the Kolmogorov-Smirnov test, the Spearman Test and the Chi-squared Test), hampering the chances to gain internal model eligibility.

As expected, Alternative 1 poses a clear trade-off between the RFET and the PLA test and this makes Alternative 1 not preferable, unless the bucketing definitions for the aforementioned tests are unlinked.

Deeper analysis of Alternative 1 – Focus on domestic market and fallback solution

In order to avoid an overly burdensome NMRF capital requirement, ABI retains a fallback solution to be more suitable. For example, IR domestic curves should be by definition entirely modellable and this treatment should be extended to major currencies (i.e. USD, GBP). Both in IMA and in SBA these risk factors are granted a sort of *preferential treatment* since a higher degree of liquidity is recognized (i.e. due to barrier-free access to domestic capital market). Furthermore, the proposed approach fosters the level playing field, since medium-sized institutions not always trade each tenor of the curve and this could introduce distortions among players of different size. For these reasons, the proposed approach should also be applied in the modellability assessment framework.

To evaluate the impact of this assumption, the capital charge under FRTB has been calculated for a desk of linear plain vanilla IR instruments, considering as non-modellable only a subset of domestic IR curves⁵. The chart below outlines the effect in terms of capital charge.

⁵ A few assumptions were made:

- The IMCC component (capital charge for modellable risk factors) does not exclude NMRFs and is comprehensive of the 1.5 regulatory multiplier;
- The SBA does not include RRAO. The latter assumption is justified by the fact that we are considering a linear plain IR desk and the RRAO can be approximated to zero.
- The exercise has been run considering also the new revised risk weights
- The Default Risk Charge has not been computed given the marginality of debt instruments. Equity instruments are not included in the portfolio.

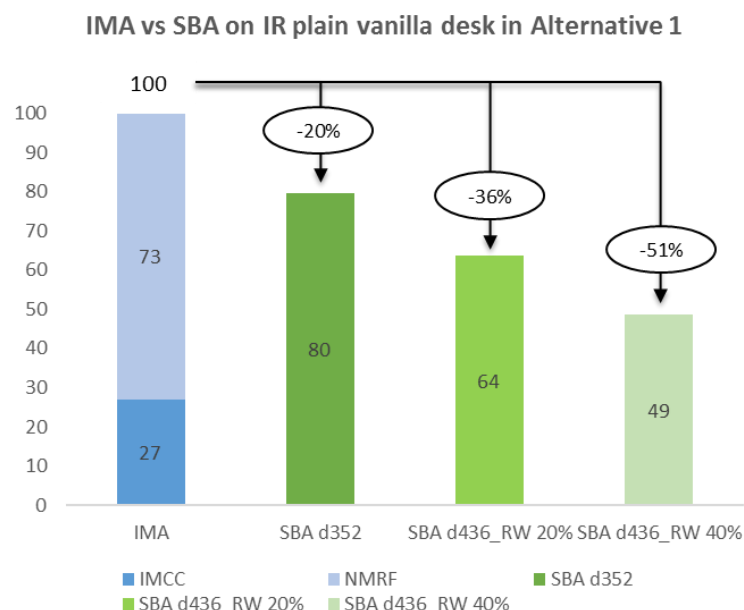


Figure 7 - Comparison of capital charges calculated under different approaches

The RFET constraints lead to a disproportionate IMA capital charge: if the domestic IR curves are considered modellable, the internal model capital charge is 3.7 times lower. This impact is even more evident if the IMA capital charge is compared with the standardised one. The latter is about 20% lower than the former and this implies that, under Alternative 1, institutions are incentivized to capitalize under SBA.

Alternative 2

Alternative 2 proposes a standard bucketization of the risk-factors that does not explicitly imply a trade-off with the PLA granularity.

Despite the fact that Alternative 2 is still posing an extremely demanding buckets granularity across the strike dimension, the diriment point when preferring one alternative to the other is the actual requirement to have the same granularity between PLA and RFET.

Impact of bucketing definition on NMRF Capital Charge on both Alternative 1 and Alternative 2

The impact on the capital charge have been investigated, focusing again on a sample market making portfolio of linear IR plain vanilla instruments, according to

a methodology outlined by the EBA⁶ and considering as non-modellable the *Forward Euribor 1M* interest rate curve. Applying the Alternative 1 (“*Single Term*” approach with bank’s specific buckets), the impact on the capital requirement represents the worst outcome ever possible, since the resulting add-on to the capital charge is by far larger than the IMA Expected Shortfall capital requirement (the total capital charge is 20 times the IMA Expected Shortfall charge computed on a standalone basis). On the other hand, applying the Alternative 2 “*SBA Bucketing*” the impact on the capital charge measure multiplier is lower. Results are summarized in the table below.

Time interval: Stress period 2011-2012		Stress/IMA Ratio ADD ON
No Proxy	Single Term Euribor 1M	x 16
	SBA Bucketing Euribor 1M	x 9
	Custom Bucketing Euribor 1M	x 8
Proxy	Single Term Base Euribor 1M-6M	x 4
	SBA Bucketing Base Euribor 1M-6M	x 1
	Custom Bucketing Base Euribor 1M-6M	x 0.8

Data in mln € - IMA Expected Shortfall Charge is 2 mln €

Table 2 - Comparison of the outcomes of different bucketing approaches

The example above shows that to avoid an excessively penalising capital charge, incentivizing banks to capitalize under SBA – the bucketing definition should not be the same in NMRF and PLA context. On the other hand, the Alternative 2 proposed by the Committee is too static, defining a *one size fits all* approach. The alternative based on standardised buckets is more suitable, even if the first best would be that the banks were allowed to use a dynamic bucketing definition based on their risk factors structure.

For example, different risk factors belonging to the same asset class (i.e. IR curves) could have different features (i.e. liquidity) so a one size fits all approach could not describe a risk factor properly. Hence, we propose that institutions, starting from a standardised bucketing approach, be granted flexibility to change the definition based on statistics test metrics.

Assuming Alternative 2 as a benchmark solution, a simple variant could be considered, which allows banks to define their own risk factors bucketing, under the assumption that no loss of data explained occurs with respect to the SBA bucketing. The bank internal bucketing structure must have a variance explained greater or equal to the one calculated from the “SBA bucketing” (no loss of data variance). A

⁶ See paragraph 253 of the EBA Discussion Paper “Implementation in the European Union of the revised market risk and counterparty credit risk frameworks” (EBA/DP/2017/04).

practical methodology such as the Principal Component Analysis (PCA) can be used in order to choose representative solutions in terms of internal bucketing approach, without loss of information with respect to the static “SBA bucketing” proposal. Alternatively, some statistical indicators, such as intra-bucket correlations, could be measured to define a bank-specific bucketing structure.

2.2.2 Impact of the NMRF framework on seasonal markets

As widely observed from market participants, seasonal effects have a significant impact on the number of risk factors passing the RFET, since there are clear seasonal changes in trading activities that influence the outcome of the 30-day gap rule. In particular, seasonality exists across all asset classes with periods of limited activity peculiar for some particular markets, such as commodity market, or simply due to summer and year-end holidays. This means that many risk factors, even if liquid based on the number of observations, still result non-modellable due to seasonality effect (that is, failure of the 30-day gap rule rather than 24-real observations rule).

In order to highlight the materiality of these aspects, the figure below shows real price observations (RPOs) on swap rates (main currency). The dataset covers the period March 2017 - March 2018 and it does not contain pooled data. The figure clearly shows that some seemingly liquid risk factors results non-modellable according to the RFET “one-month gap” rule, even though they would commonly be deemed liquid (the 6M, 1Y and 30Y tenors).

RPOs on Swap Rates (as of 29 March 2018)							
Bucket	6M	1Y	3Y	5Y	10Y	20Y	30Y
One-month gap (dd)	97*	73**	14	7	12	27	74***
Annual deal	125	137	743	1212	1609	1290	130

* Higher gap between 10 August and 15 November
 ** Higher gap between 29 August and 10 November
 *** Higher gap between 7 July and 19 September

Table 3 – Evidence of the seasonality impact on the RFET

As shown in the example above, there is a clear asymmetry between the two modellability criteria, since the 30-days gap rule is more restrictive than the 24-observations rule. For this reason, ABI deems that new proposals to address the seasonality issue, without weakening the modellability test, should be considered. ABI would propose two alternatives, consisting in defining as modellable a risk factor for which at least 3 or 4 observations in any 90 day period are available.

These assumptions are substantially similar to the 24-observation rule and, in addition, the largest gap will lead to increase the number of risk factors deemed modellable, since it relaxes the most constraining rule. This is clear from the example, in fact applying the “3 in 90” alternative gap rule both 1Y and 30Y buckets would become modellable.

2.2.3 Impact of NMRF idiosyncratic equity risk

Most of the risks to be capitalized under NMRF are going to be idiosyncratic risks. As such, the proposal to have equity along with credit aggregated under a zero correlation assumption is welcome.

Similarly, the residual aggregation rule for non-equity/credit risk factors appears extremely conservative assuming full correlation among NMRF. A milder correlation assumption should be allowed, potentially after some assessment period on the impacts of a 100% correlation on real portfolios.

The introduction of a correlation parameter that can be fine-tuned in the future would indeed offer a lever to set NMRF to a desirable level of capitalisation.

IMA DRC

Despite not being covered by the Consultative Document, there are two points on the Default Risk Charge (DRC) that are deemed particularly relevant.

Sovereign Floor

The proposed floor for the probability of default (PD) in the IMA DRC is set at 3 basis points across all issuer types. The floor is not risk-sensitive, which puts disproportionately high capital requirements on bonds issued by high credit quality issuers, e.g. AAA rated government and covered bonds, which could impact liquidity negatively.

The liquidity of these assets needs to be considered in the context of a 1-year PD horizon. In practice, given that these are typically high-quality liquid assets, a bank will have the ability to manage such portfolios if credit quality deteriorates.

A 1bp floor would hence appear more adequate.

Rolling Futures Hedges

The 2016 standards require the model to capture any material mismatch between a position and its hedge. With respect to default risk within the one-year capital horizon, the model must account for the risk in the timing of defaults to capture the relative risk from the maturity mismatch of long and short positions of less than one-year maturity.

While this could make sense for a static CDS/bond hedging strategy, it may lead to fake open risk for a dynamical rolling long bond/ short future hedging strategy. Indeed, the future is usually short term so that one ends up with a naked bond position for most of the time simulation.

Position\Default Time	3M	6M	9M	1Y
Future (Maturity = 4M)	-JTD*	0	0	0
Bond (Maturity = 10M)	JTD	JTD	JTD	0
Portfolio	0	JTD	JTD	0

*JTD = Jump-To-Default

Table 4 – Example of futures hedging

In reality, future is rolled upon expiry so the hedge is always in place. Even in the event of a market disruption leading to a melt-down of the futures market, at the futures expiry the bond would be delivered so it would be no longer in the portfolio.

We recommend that rolling hedging strategies be exempted from any maturity mismatch effect.

3. Scope of market risk capital requirements

3.1 Treatment of structural FX positions

No comments.

3.2 Boundary between the trading book and the banking book

The proposed revisions clarify under what conditions equity investments in funds (e.g. exchange-traded funds) can be included in the trading book. Under the proposals, banks may assign to the trading book funds: (i) for which daily price quotes are available; (ii) which track a non-leveraged benchmark; and (iii) which demonstrate a tracking difference, ignoring fees and commissions, for which the absolute value is less than 1%.

In ABI's understanding, according to the proposal a fund can be assigned to the TB if either

1. daily real price (NAV) and look-through are available, or
2. daily real price (NAV) is available but look-through is not. However, the fund tracks a non-leveraged benchmark with a tracking difference below 1%

In ABI's view, the risk associated to a fund is well reflected by its daily NAV fluctuations and can be appropriately captured in a Trading Book framework. Banks should therefore be allowed to assign funds to the TB provided that daily NAV is available, even though daily look-through is not⁷.

After that, a proper treatment under the Standardized Approach (SA) and the Internal Model Approach (IMA) should be specified. ABI proposal is the following:

- IMA
 - Expected Shortfall: using the times series of daily NAV and introducing dedicated liquidity horizons (or providing guidelines on how to map to the existing liquidity horizons)
 - Default Risk Charge: in order to properly compute a jump-to-default, the fund composition would be needed. However, being a one-year horizon measure, having an "approximate" composition should not affect the accuracy of the results. By "approximate" composition we mean a composition assessed on a monthly (as opposed to daily) basis or inferred from the fund mandate.
- SA
 - Sensitivity Based Approach: introducing a bucket dedicated to "Funds" (or multiple buckets according to the mandate/fund type) with a properly calibrated risk weight; otherwise, providing guidelines on how to map to the existing buckets. Only funds whose mandate is not known should be assigned to the "Other sector".
 - Default Risk Charge: as for IMA

As to the eligibility requirements, ABI would highlight that the proposed 1% threshold for the tracking difference seems a rather unfeasible condition. This would hamper the possibility of assigning to the TB funds genuinely hold for trading purposes and for which a proper capitalisation under the market risk framework would be possible (as described above). ABI would therefore suggest deleting such condition. In addition, the reference to the "non-leveraged" condition is unclear (leverage would in no way comprise the bank's ability to look to the benchmark for risk capture).

⁷ This point of view is also shared by the European Commission and reflected in the CRR2 proposal.

4. Simplified alternative to the standardised approach

ABI welcomes that the Basel Committee identified a recalibrated version of the current standardised approach - made by applying a multiplier to the capital requirements in each risk class - as a simplified alternative to the new standardised approach. The proposed recalibration should be carefully assessed to ensure its commensurateness, also compared to the new standardised approach. It is essential that an appropriate calibration of the simplified alternative, while taking into account the lesser degree of risk-sensitivity of the approach, does not unduly penalise smaller banks or banks with simple trading businesses, for which more advanced approaches are not suitable.

As to the eligibility criteria for the application of the simplified standardised approach, the Committee should take into account that, in some jurisdictions, capital requirements are applied at individual level. ABI believes that the Committee should therefore clarify that in those jurisdictions the eligibility assessment should be made - and the criteria should be met - at individual level. ABI agrees that globally systemically important banks (G-SIBs) should not be eligible to apply the recalibrated version of the Basel II standardised approach for the calculation of market risk own funds requirements; anyway, G-SIB subsidiaries with small trading books should be eligible, as they meet the other criteria (no use of internal model for determining the market risk capital requirements for part of their trading book and no correlation trading portfolios) on a standalone basis. It should also be clarified that RWAs calculated with the simplified approach at the entity level may be considered at the consolidated level (even though the parent company or other banks of the group are not eligible).

Annex D

The Consultation Paper has introduced, in the form of principles, some additional criteria a risk factor that is deemed modellable is supposed to meet.

While understanding the concerns these principles aim to address, the modellability framework appears already fairly prescriptive and extra requirements that might be down to national authorities to interpret might impair a level play field on such a delicate element of the reform.

In particular, ABI concerns are illustrated below.

Principle 1

While allowing the use of combinations of modellable risk factors, the principle establishes a link between ES configuration and PLA. How such prescription relates with Alternative 2 for modellability assessment needs to be clarified.

Principle 2

No Comments.

Principle 3

The principle seems overly prescriptive. The framework identifies PLA attribution and backtesting as the means to assess the quality of the Desk Risk Management model, which admits the use of proxies.

A model that passes those tests would have provided enough evidence of its adequacy in capturing volatility and correlations among the relevant risk factors.

There hence seems to be no need to impose additional qualitative requirements on top of the already prescribed quantitative ones. ABI proposes to remove Principle 3.

Principle 4

The principle seems overly prescriptive. NMRF definition already prescribes clear rules to establish a link between risk factors and real price observations. Additional comparison between front office vs back office vs risk prices would suffer for the incorporation of noise elements like time snapshots, bid/ask, CSA impacts and would pose a significant operational burden.

We propose to remove Principle 4.

Principle 5

No Comments.

Principle 6

Modellability is assessed on the current window under well identified criteria to establish a connection with real price observations. Coverage of the stressed period occurs via a reduced set of risk factors, which might incorporate proxies that are available across the whole history.

The principle seems to pose additional constraints on the characteristics of the reduced set of risk factors, that seem new in the context of the discussion of the criteria needed to be eligible for inclusion in the ES measure.

ABI would suggest to either better specify the additional set of requirements for a risk factor to be admissible for the reduced set or to remove Principle 6.

Principle 7

No Comments.