



October 2015

Mr. Bill Coen
Secretariat of the Basel Committee
on Banking Supervision
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Dear Mr Coen,

Review of the Credit Valuation Adjustment Risk

Barclays welcomes the opportunity to comment on the consultative document (CD) and we are fully supportive of the Committee's desire to ensure a robust and comprehensive framework to capture CVA risk, in particular, aligning more closely with industry practices and the inclusion of market risk hedges in the calculation of a capital charge.

We have been engaged with and fully support the Joint Trade Associations response to this document. In addition, we have a number of points of general feedback which are outlined in this covering letter, as well as a supplementary appendix covering responses to the specific questions posed in the CD.

Key points

Alignment with Accounting CVA

As stated in our response to the Basel Committee on the Revised Standardised Approach to Credit Risk and Capital Floors consultations, there should always be an incentive for internal modelling (subject to appropriate standards) under the capital framework. We consider Accounting CVA to be the most appropriate methodology to capitalise CVA risk as it represents the economic risk that goes through the P&L. Accounting and regulatory CVA should be as closely aligned as possible to avoid additional costs being passed on to the end users, primarily corporate and sovereigns, potentially dis-incentivising them from making appropriate risk management decisions. We therefore support the general principle of basing the CVA capital charge on a "qualifying accounting CVA" model.

CVA desks take on a very wide range of different risks, including all the risk factors affecting the underlying trades, as well as the credit risk of the counterparties. Given the broad scope of CVA desks, internal models are essential to ensure that the capital charge is aligned to the economic risk, something standardised approaches would be unable to achieve, whilst retaining a necessary degree of simplification in the calculation.

Inclusion of Securities Financing Transactions (SFTs)

Linked to the above, a broad inclusion of SFTs seems an un-necessary increase in the scope of CVA calculations. The existing Basel 3 requirements only require CVA to be calculated on SFTs where a supervisor determines that the bank's CVA loss exposures arising from SFT transactions is material. Typically this has not been the case and most firms do not apply accounting CVA to SFT transactions.

We anticipate that the Fundamental Review of the Trading Book (FRTB) style calculation will be imposed as part of the flooring mechanism proposed in BCBS d306. These proposed calculations will be onerous

to implement, notwithstanding potential inclusion of a high volume of SFT exposures for which no material exposure is expected. Alternatively, a punitive charge would apply to these exposures under the standardised approach which we would not support for the same reasons. On this basis, we propose that the previous carve out based on immateriality be reinstated in the proposed text.

Timing of the Quantitative Impact Study (QIS)

As also highlighted for other areas of regulatory change (such as the Fundamental Review of the Trading Book and the Revised Standardised Approach to Credit Risk), we believe thorough and well designed QIS exercises with sufficient time for completion play a crucial role in formulating good regulatory policy. We are keen to ensure the timescales for finalisation of the proposals allow adequate time for future QIS exercises for CVA and allows the Industry to provide usable data in the timescales agreed. We are committed to working with the Basel Working Group and Industry bodies to find a suitable solution to this.

Well-collateralised netting sets

There has been considerable progress in recent years on alignment of accounting CVA practices within the industry. Whilst we understand the committee has concerns around the remaining differences (such as MPoR of margined names), we do not consider that these variances will be on the most material exposures. In particular, the largest economic CVA exposures are now to non-financial corporate and sovereign counterparties, and are driven by long-dated uncollateralised trades (which also tend to be relatively vanilla, such as interest rate swaps), whereas most of the modelling complexity is driven by inter-dealer netting sets with strong bilateral CSAs. Therefore, we strongly support the industry's proposal of a materiality based assessment for exemptions, which would eliminate unnecessary computational burden. For example, the upcoming implementation of initial margin for uncleared derivatives will eventually render CVA risk for fully collateralised netting sets negligible and the proposals should reflect this.

Technical requirements for qualifying accounting CVA

We support the need for minimum standards around the concept of 'qualifying' CVA for banks to be allowed to use FRTB-CVA, however these requirements should be drafted in a way which allows the use of approximations and process optimisations where appropriate. The requirements for the generation of market risk factor paths should be made less prescriptive with CVA desks favouring stable models that better reflect the true cost of hedging, over typically long dated horizons, whilst removing unnecessary P&L noise – for instance use of longer run average implied volatility levels in the simulation. The Prudent Valuation framework already captures potential uncertainty around these model parameters.

We also view the need to model the co-dependence of counterparty credit quality with exposure or receive a higher m_{CVA} multiplier as overly conservative. There is no industry consensus around the calibration of such model, so requiring this would reduce the comparability of different firms' capital models. Wrong-way risk positions are limited by other governance processes and we would propose that firms identify the individual positions and capitalise the limited wrong-way risk via an explicit add-on rather than penalise the entire portfolio.

We hope that you find our comments and suggestions helpful. Please do not hesitate to contact Ross Edwards on Ross.Edwards@barclays.com or + 44 20 3134 2414 if you have questions or comments on any of the issues raised in this response.

Yours sincerely,



David Sawyer
Managing Director
Head of Portfolio, Counterparty Credit & Workout

Annex 1: Responses to specific questions outlined in the Consultative Document

Q1. To what extent do large netting sets; potentially illiquid transactions inside a netting set; and recent disputes affect the internal assessment of the margin period of risk (MPoR)?

Neither accounting CVA nor Counterparty Credit Risk Management use large netting sets, illiquid transactions or collateral disputes in consideration of the margin period of risk. These measures are only used in Regulatory capital calculations. As in the case of accounting CVA, when putting something through P&L and potentially hedging it, it is important that the measure is representative of the real economic risk.

Q2. Is Alternative 1 or Alternative 2 preferred with regard to the calculation of MPoR?

Alternative 1 is highly preferable over Alternative 2 with regard to the calculation of MPoR. The IMM extension of MPoR rules is disproportionate. The idea that one small illiquid transaction could potentially pollute a netting set with thousands of other trades extending the MPoR for all is very conservative, and for the same reasons as described earlier creates a mismatch with the true economic risk.

Q3. Should IMM approval be included as an additional eligibility requirement for the FRTB-CVA framework under Option A (ie accounting-based CVA method for generating scenarios of discounted exposure)?

We do not believe IMM approval should be a requirement for Accounting IMA-CVA as the infrastructure can be completely distinct from one another. The accounting CVA model would be subject to its own review and approval.

Q4. To what extent is there synergy between the calculation of accounting CVA and the EAD calculation for IMM with respect to processes, data and methodology?

Currently the accounting CVA sits in a completely distinct architecture to the IMM EAD engine. Certain input data will come from the same sources such as netting flags, CSA information, trade and position details etc, but the exposure calculations are separate. Accounting CVA only covers a subset of the full counterparty population, and there are differences in modelling capabilities and configuration. The methodologies share several similarities, but there are important distinctions in the calibration of the simulation dynamics, the treatment of collateral and the modelling of counterparty rating transition.

Q5. Is Option A (accounting-based CVA) or Option B (IMM-based CVA) preferred for exposure calculation?

Option A (accounting-based CVA) is our preferred choice for exposure calculation as it will be closer to the actual economic risk and is already producing a full set of risk sensitivities which are used in active risk management.

Q6. Is Option 1 or Option 2 preferred for simulation time horizons?

Option 1 is preferred for counterparty credit spread simulation time horizons as this brings it into line with the FRTB and distinguishes between different counterparty credit ratings.