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8 August 2019

The Secretariat
Basel Committee on Banking Supervision
Centralbahnplatz 2
4051 Basel
Switzerland

Doc Ref: GARYH/#264429_V1

Your ref: Consolidated Basel Framework

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Via direct upload link:

https://www.bis.org/bcbs/commentupload.htm?cdpath=/bcbs/publ/d462.htm

Dear Sirs, Madam

Response: **Consultative Document – "Consolidated Basel Framework"**

We thank you for providing our members the opportunity to comment on the above Framework that sets out a consolidated version of 14 global standards. We are supportive with the aims of the Framework and agree that it improves the accessibility of the Basel Committee's standards and promotion of consistent global interpretation and implementation. Our comments are as follows:

Q1	**Does the framework accurately, clearly and comprehensively set out the policy contained within the published Basel standards?**
Response	We are supportive of the new structure to update the original Basel framework with subsequent amendments. The addition of FAQ's help clarifies some of the interpretations. A single, complete point of reference is very helpful. ➢ However, on the BIS website there is a 'Basel III' link and a Basel III framework. Should these be combined? https://www.bis.org/bcbs/basel3.htm?m=3%7C14%7C572 https://www.bis.org/basel_framework/index.htm?m=3%7C14%7C697
Q2	**What are your views on the technical amendments in Section 1?**
1.1	Output floor before 2022
Response	• We support the approach to replace the old Basel I floor with an updated floor calculation based on the prevailing version of non-modelled risks for each risk class. • We are supportive of the proposal to allow supervisors the flexibility to develop appropriate floors that are consistent with the principles of Paragraph 49 of Basel II.

1.2	Clarification of the buffers framework	
Response	• We support the clarification provided around the capital conservation buffer. ➢ We would request clarity is provided as reference is made to the '*subsequent payment date'* and each '*distribution date'* – are these the same?	
1.3	**Standardised approach for credit risk**	
1.3.1	Reference to the 1988 Basel Accord	• Supported, as it removes redundant wording.
1.3.2	Commercial entities	• We welcome the clarity provided as it was not clear under the Basel III standardised approach whether the risk weight for commercial entities falling below the threshold should be 100% or align to the risk weights for equities. ➢ We are unable to trace the revised risk weights in CRE20.62 on the BIS website.
1.3.3	Treatment of multiple liens on regulatory real estate	• We support the amended property value calculation prescribed in CRE20.83 of the Consolidated Framework in determining the impact of multiple residential property liens on a Bank's exposure under the loan splitting approach in terms of the Standardised approach for credit risk.
1.3.4	Guidelines for implementing the mapping process	• We agree with the inclusion of the guidelines for supervisors in a separate document and exclusion from the consolidated framework, however: ➢ These guidelines should not be used as <u>minimum standards</u> in the Consolidated Basel Framework.
1.4	**Standardised approach: credit risk mitigation**	
1.4.1	Eligible financial collateral	• We welcome the clarification.
1.4.2	The simple approach to credit risk mitigation and SA-CCR	• We agree with the exclusion of these paragraphs from the consolidated framework to avoid any duplication of requirements.
1.4.3	Treatment under the comprehensive approach of securities financing transactions covered by master netting agreements	• We are supportive of the proposal for references to "repo-style transactions" to be changed to "SFTs", ensuring alignment with the Basel definition of "securities financing transactions" comprising both repo-style and margin lending transactions.
1.5	**Internal ratings-based approach for credit risk**	
1.5.1	Sovereign exposures	• We understand that the Consolidated Framework incorporates sovereign exposures within each risk component of the IRB risk weight, as opposed to

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<td>cross-referring Basel II in determining the treatment of sovereign exposures per Basel III.

➢ We would request that the Basel Committee complete the work started under the discussion paper d425: The Regulatory Treatment of Sovereign Exposures as this has a significant impact on the capital requirements for Emerging Markets banks on the holdings of local currency sovereign exposure.

➢ Our comments submitted under the “Revisions to the Minimum Capital Requirements for Market Risk” are summarised as follows:</td>
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<td colspan="2">➢ MAR22.7: Risk weight on sovereign bonds
- Claims on sovereigns may, at national discretion, be subject to zero risk weight.

<u>Concern</u>:
This is the only place in the text that permits a zero-risk weight. In all other cases (Standardized Approach (SA) and Internal Model Approach (IMA) for general risk and IMA for Default Risk Capital (DRC) this discretion is not provided.

The Internal Transfer requirements of RBC25.16, which disallows the transfer of bonds between the Trading and Banking book, as well as the punitive capital requirement of MAR 22.7, may result in primary dealers deciding to give up their license and exit market making in bonds. Whilst national discretion is provided for under the DRC standardized approach it is not under IMA.

➢ MAR21: Standardized Risk Weights for Sovereign debt and JSE[1] top 40 equities

It is clear that the remit of the Basel Committee is to limit global systemic risk in the largest economies. As a result, the Standardized Approach risk weights have been calibrated for G10, developed market banks investing outside of their local market.

This is evident in the risk weight calibration for High Yield debt. However, there is no relief for a local “Emerging Market” bank investing and facilitating trade in its domestic market, via its domestic currency. The risk weights assume a heightened level of risk for this activity rather than rebasing the risk weights against a local sovereign bond being risk free (or subject to limited credit risk).

The inclusion of national discretion for the treatment of sovereign risk in domestic currency for SA DRC, recognizes that Sovereign debt issued in its local domestic currency is generally considered safer than sovereign debt issued in foreign currency. This is subsequently reflected in the rating of the bonds which are typically rated higher for local currency issued debt.

However, there is a concern that this principle is not carried through to the Sensitivity-Based method in the SA, where there is no distinction made between foreign and domestic currency and both are equally subjected to all credit risk measures.</td>
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[1] Johannesburg Stock Exchange

	Concern: Sovereign debt which has a non-investment grade rating will attract a 2% credit spread risk weight as part of the standardised framework (this is also in addition to the capital charge for general interest rate risk (GIRR)), hence a sovereign bond issued in domestic and foreign currency will attract the same credit spread risk charge irrespective of issuance currency. This treatment is further extended to attracting capital for vega and curvature on sovereign bond options, irrespective of currency. No sovereign credit spread options market currently exists in domestic currency sovereign debt, making it difficult to measure vega risk especially. A negative consequence may be that a market is created for the trading of ZAR sovereign credit spread risk purely for the purpose of hedging regulatory capital. These risk weights cause a significant increase in Standardized Capital, with a likely knock on impact on liquidity. Emerging Markets need risk weights calibrated to our local sovereign being deemed risk free, in line with the view that sovereign risk in domestic currency is viewed as a proxy for the risk-free curve. Current risk weights do not account for the fact that local domiciled banks are required to operate and facilitate trade in their home markets and may result in a significant liquidity issue. It is especially important that this be factored into Government Bonds held as part of the Primary Dealer responsibilities. Furthermore, local liquid equity indices are subject to the same risk weighting for a local or offshore investor, even though it may not necessarily from a local investor's viewpoint, experience more volatility than an index traded in an advanced economy.	
1.5.2	Definition of bank exposures	• We are supportive of the differentiation between subordinated debt, and non-equity capital instruments, however: ➢ Will the treatment of the non-equity regulatory capital instruments (AT1) be dependent on the accounting classification (debt vs equity)?
1.5.3	EAD floor for retail exposures	• We support the inclusion of the EAD floor for retail exposures as previously included in the consultative document and the Basel III summary (Dec 2017) document.
1.5.4	Equity investments in funds	• We support the proposed amendment to the EIF rules per CRE60.7 in prescribing the aggregate add-on of 15% for unknown potential future exposure (PFE) in relation to EIF, as the amendment does not represent a change in principle, but rather ensures that the mandate-based approach (MBA) appropriately incorporates the revised framework for calculating counterparty credit risk under SA-CCR. ➢ We are unsure though if the new sentence aligns to CEM or SA-CCR?
1.6	**Credit valuation adjustment risk**	
1.6.1	SA-CVA margin period of risk	• We welcome the clarification that the MPoR for SA-CVA is set to 10 business days for derivatives and 5

		business days for SFTs in the case of daily margining.
1.6.2	Splitting of netting sets	• We support the alignment between CVA risk standards and counterparty credit risk as it is prudent to allow for legal netting to be split into synthetic netting, subject to the conditions proposed.
1.7	**Operational risk**	
1.7.1	Minimum observation period for loss data in 2022 standard	• Support the clarification of more than five years of good data to be included where available.
1.7.2	Inclusion of losses and business indicator items related to mergers and acquisitions in the 2022 standard	• We support this as it clears up a level of ambiguity. ➢ Will the losses / BI for merged entities follow accounting/regulatory consolidation, i.e. only if these entities are consolidated will the BI / losses be included in the group calculation?
1.8	**Leverage Ratio**	
Response	• The inclusion of the footnote clarifies the treatment.	
1.9	**Pillar 2**	
1.9.1	Stress Testing	• We support the update as the updated principles per the 2018 paper are most relevant and should be referenced.
1.9.2	1992 standards on cross-border establishments of international banking groups	• We support the inclusion of the two specific practices which were not superseded by subsequent versions of the Basel Core Principles.
1.10	**Pillar 3 disclosure requirements**	
1.10.1	Simple, transparent and comparable securitisation exposures	• We support the separate disclosure for STC and non STC securitisation structures.
1.10.2	Banks with insurance subsidiaries	• We support the inclusion of regulatory approach to insurance entities and any surplus capital from insurance entities recognised to be separately disclosed.
1.11	**Terminology**	
Response	• We support the replacement of references to SPVs with SPEs to promote consistency across the framework.	
	General	
Response	• We support the technical updates that aim to correct/clarify or remove ambiguity.	

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We would expect that the Consolidated Framework will be continuously updated to incorporate / align new standards through to 2022.
Following the regional implementation of the regulations relating to Equity Investments in Funds (EIF), we note the following:
Proposed EIF regulations provide for a look through approach to be applied to investments in Funds. We believe applying the approach to multiple cascading investments by funds to be too data intensive and costly to the bank.
➢ We propose applying a threshold to avoid multiple look through in funds; and to add the immaterial holding to the threshold deduction.
Proposed EIF regulations also require the calculation of a “Leverage” factor.
➢ We would propose applying a default factor of 1 due to the shareholding nature of money market funds.
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Yours sincerely

Gary Haylett
Prudential Division