

7 September 2012

Secretariat of the Basel Committee on
Banking Supervision
Bank for International Settlements
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Dear Sirs

Fundamental Review of the Trading Book

The Banking Association of South Africa Market Risk Working Group (BASA) welcomes the Basel Committee's consultation document "Fundamental review of the trading book" (BCBS219) and we acknowledge the importance of the issues raised therein.

In the response below we outline our key messages, provide subsequent details on significant areas of the Fundamental Review, and in the Appendix provide answers to the Trading Book Group of the Basel Committee on Banking Supervision's specific questions.

Key Messages

We fully support the work of the Trading Book Group in conducting a Fundamental Review of trading book capital requirements and the need to reform capital standards for market risk.

We completely agree that the Basel 2.5 revisions should be viewed as an interim solution that did not fully address the shortcomings of the overall design of the regime, as well as the perceived weaknesses in risk measurement under both the internal model-based and standardised approaches.

We believe the focus should be on the following-

- Strengthen the requirements for defining the scope of portfolios that will be eligible for internal model treatment;
- Strengthen the internal model standards to ensure that the output of such models reflects the full extent of trading book risk that is relevant from a regulatory capital perspective;
- Strengthen the criteria that banks must meet before regulatory capital can be calculated using internal models

We believe sound models remain the best way to measure and allocate risk.

Careful consideration needs to be given to the South African Banking system relative to the international environment and whether material increases in capital requirements locally, are necessary, or indeed prudent. Careful consideration should be given to the real economy impacts. We believe further thought is necessary around the quality of capital held by the local banking sector relative to international peers. Increases in capital should be weighed against availability of quality of assets. Consideration should be given to the impact increases in capital is having on pricing in the government sector, coupled with liquidity and funding e.g. Global bank sovereign holdings have created additional systemic stress and furthered concentrated risk in banks.

The trading book / banking book boundary

We support a trading-evidence based boundary.

We believe that this is an evolution of the existing trading intent based boundary (for us) and reflects the current direction of regulatory travel with enhanced focus on liquidity and pricing of these positions.

We are supportive of making the boundary less permeable but would draw the line at making it impermeable. It would be more appropriate to set a very high bar for transfers, requiring senior approval from all impacted infrastructure areas. Transfers with a material impact would need disclosure to the regulators. Our view is transfers continue to be needed for several reasons:

- A developing market (product or location) may not be liquid or a bank may not have adequate market access. As liquidity or access improves within a market, the case for trading book treatment would improve. It would be illogical to leave pre-existing trades (managed consistently with the new trading book trades) orphaned on a banking book.
- Market liquidity or access may dry up in a manner which is not temporary, particularly if the bank subsequently puts the books into “run-off” there would be a clear failure of a trading evidence based boundary.
- Correction of a simple error in set up/booking that was identified as part of the control function review process.

The alternative proposal for a valuation based boundary has many problems. At an absolute minimum the potential adjustment for allowing ALCO type swaps into the banking book (with hedging evidence), would need to be adopted. Further consideration should also be given to other banking book hedges such as hedges of FX and credit. Another concern is that a valuation based boundary will bring many firms into the trading book capital rules, which had not been previously subjected to these charges before, due to financial accounting issues. Given the increased level of complexity proposed under the standard rules charges, this would be potentially disproportionate.

Moving from value-at-risk to expected shortfall

We broadly support the proposed change from Value at Risk (“VaR”)/“Stressed” VaR to an Expected Shortfall (“ES”) measure. However, there are a number of practical concerns we think are worthwhile highlighting,

- Percentile measure
- Multiplier calibration

- Back testing difficulty

A comprehensive incorporation of the risk of market illiquidity

We agree that it is important to recognize higher risk of accumulated losses from illiquid instruments/risk factors and the risk that liquidity can significantly reduce during a stress period. However, one should recognize that there is also a valuation aspect to liquidity and it is important to take into account the portion of illiquid risk that is already captured via bid-offer valuation adjustment to avoid any double counting.

Beyond what is captured in valuation adjustments, some sort of liquidity horizon scaling can be a useful way to further enrich the set of tail scenarios to include the possibilities of higher cumulated losses when hedges are not available and positions cannot be unwound.

Among the 3 alternative ways of liquidity horizon scaling, we don't think it would be that useful to have an overall scaling given by some weighted average horizon. Scaling by the average does not really distinguish between the liquid and illiquid positions/factors.

Scaling of individual risk factor moves by corresponding liquidity horizons is a more effective way to capture the differences between liquid and illiquid risk factors. The biggest challenge is comparability across banks as assessments of liquidity will differ and ironically more so with the illiquid instruments/risk factors.

While pre-imposed liquidity horizons or liquidity horizon floors from regulators can mitigate the comparability problem, it is questionable how regulators estimate accurately and keep up-to-date the liquidity horizons of a large number of instruments/risk factors.

Perhaps to simplify the problem and to facilitate comparability across banks, it is better to introduce the concept of illiquidity only to the very complex products and leave alone all plain vanilla products. This is essentially treating liquidity horizon adjustment as a kind of penalty for exposures on very complex and illiquid products.

If forced around a consideration we believe it more appropriate to recognize endogenous liquidity and make provision via model approval conditions that support the liquidity.

Treatment of hedging and diversification

We favour disclosure of the diversification benefit as the sum of the stand-alone risk category, minus the fully diversified risk value. Based on this approach it is possible to set a floor on the level of diversification achieved and thus limit the diversification impact in the capital requirement. An internal model incorporating full diversification but appropriately calibrated to stress conditions offers a better for cross diversification addressing the TBG's concerns and linking capital more closely to a firm's internal risk management process. We are concerned that by severely limiting diversification we could be discouraging firms from pursuing a diversified business model.

Hedge effectiveness and testing would be incorporated by applying back-testing at a more granular desk level. Risk and model ineffectiveness would be adequately captured.

We favour the establishment of a common period of stress at a national discretion basis, which could provide an external benchmark and regional comparatives. This is more significant for emerging and frontier markets where periods of stress often vary to developed markets.

Revised standardised approach

We support the derivation of a more risk sensitive standardised approach to the calculation of regulatory capital. However, we are concerned that increased risk sensitivity and simplicity are mutually exclusive objectives.

At present the standardised approaches include a menu of options to reporting banks, from simplified approaches to more complex approaches. This is reasonable given the differing levels of sophistication of such institutions, with more sophisticated firms being able to report capital on a more efficient basis.

We are generally supportive of the partial risk factor approach however are concerned that the cross cutting general interest rate risk approach is significantly more complex than the existing set of rules. The existing modified duration approach is already sufficiently complicated as this information would not normally be available in finance systems. The cash flow vertices approach sounds risk sensitive, however it will be highly data intensive and it is unclear how many banks could implement this without highly significant upgrades to financial reporting systems. Furthermore, the use of cash flow data will reduce the “audit-ability” of the standard rules calculation as the existing link to the audited balance sheet will be broken.

Yours faithfully



Mark Brits
General Manager - Banking and Financial Services



Appendix: Answers to BCBS questions (1-10)

1. Which boundary option do you believe would best address the weaknesses identified with the current boundary, whilst meeting the Committee's objectives?

While we do not believe either option is entirely appropriate, we would support a trading evidence based boundary.

We believe that this is an evolution of the existing trading intent based boundary (for us) and reflects the current direction of regulatory travel with enhanced focus on liquidity and pricing of these positions. Furthermore the “trading evidence” approach is more in line with current industry practices and therefore would be less disruptive to implement

This will result in a narrower trading book, albeit for banks that already apply strict trading intent criteria the narrowing will be limited. Anecdotal evidence suggests that banks in other jurisdictions may have had much broader trading books e.g. loan warehouses for securitisation and structured equity financing transactions.

The trading evidence based boundary has certain requirements which are in addition to existing practice:

- Control functions to undertake on-going reviews of what is in the banking and trading books
- Provision of objective evidence as to active management and;
- Proof of market access

The “trading intent” approach would result in the banking book being tainted with actively traded positions classified as banking due to insufficient evidence being available at the initiation of the trade. This in particular would have an onerous impact on Emerging Market banks - though the intention may be to trade, the trading desk may be unable to provide sufficient “trading evidence” due to the developing nature of the market.

This issue would be compounded by the proposed restrictions on transferring positions between the trading and banking books. If trading evidence later becomes available as the market develops and the intent was always to trade, then a reclassification from banking to trading is entirely appropriate.

We are supportive of making the boundary less permeable but would draw the line at making it impermeable. Recommendation is to set a very high bar for transfers and senior level sign off. Transfers with a material impact would need disclosure to the regulators.

Transfers would continue to be needed for several reasons:

- A developing market (product or location) may not be liquid or the firm may not have adequate market access. As liquidity or access improves within a market, the case for trading book treatment would improve. It would be illogical to leave pre-existing trades (managed consistently with the new trading book trades) orphaned on a banking book.



- Market liquidity or access may dry up in a manner which is not temporary and if the firm subsequently puts the books into “run-off”, there would be a clear failure of a trading evidence based boundary.
- Simple error in set up/booking that was identified as part of the control function review process highlighted above.

Such transfers would be expected to be rare and would need to be carefully documented and evidenced. We do not believe that this would be an insurmountable issue. Furthermore, any concerns regarding potential arbitrage could be eliminated by the requirement to disclose transfers and the aggregate impact on reported risk weighted assets.

Supportive of trading evidence book approach with non-trading book evidenced deals included under the IRBB for assets that are MTM and non-MTM and equity risk for assets that are MTM. Until such time as the IRBB approach is formulated the AFS or banking book FV components should be excluded as they often hedge interest rate risk in the banking book and are managed on such a basis. This is aligned to the review of IRBB.

The alternative proposal for a valuation based boundary has many problems. At an absolute minimum the potential adjustment for allowing ALCO type swaps into the banking book (with hedging evidence), would need to be adopted. Further consideration should also be given to other banking book hedges such as hedges of FX and credit. Another concern is that a valuation based boundary will bring many firms into the trading book capital rules which had not been subjected to these charges before due to financial accounting issues. Given the increased level of complexity the standard rules charges suggested would be potentially disproportionate.

The valuation based approach although more quantitatively appealing relative to the trading evidenced-based approach (easier to classify) may be difficult to relate the requirement of “changes in fair value may pose risks to regulatory and accountancy solvency”.

The valuation based approach will result in clear dependency on the accounting definitions of valuation and income/balance sheet classifications and will drive the regulatory treatment and risk based capital requirements.

We believe that the only truly appropriate method of addressing the concerns raised by the Committee would be to remove any incentive for regulatory arbitrage by properly configuring the capital requirements in both the trading and banking books such that the identical risk is subject to the same correct capital treatment in either area.

2. What are commenters' views on the likely operational constraints with the Committee's proposed approach to capturing market liquidity risk and how might these be best overcome?

Existing Technology platforms and systems are geared for a static and uniform holding periods (one day or ten day). The proposal would result in significant reengineering of the existing systems and additional costs.

Assessment of liquidity for OTC products on an on-going basis would be extremely challenging for small firms which do not have visibility of the flows in the market when this information is not available in public domain such as liquidity in FX spot markets.

The other option of using scaled one day shocks does not lend itself to full revaluation as it does not provide for a suitable mechanism of scaling the cross-effects when the risk factors have different time horizons. (e.g. in the case of quantoed products where the vanilla underlying has a different holding period to the FX rate, by what measure would the P&L from the correlation between the two risk factors be scaled?)

Many products are sensitive to more than one risk factor. Having different horizon per risk factors will not generate realistic data sets for full revaluation pricing. It is not possible to have consistent horizons at risk factor level and at asset class level. In any case, having a non-unique horizon creates a major challenge in terms of aggregation and consistency. The analytical interpretation of these computations at aggregated level with mixing of different horizons will be extremely difficult, if not impossible. This defeats the “use case”, and makes back-testing impractical. Back-testing will also not provide meaningful answers from a statistical point of view

3. What are commenters' views on the proposed regime to strengthen the relationship between the standardised and internal models-based approaches?

We are understanding of the regulators move to having a more risk sensitive Standardised Approach as a backstop and alternative to the Internal Model Approach, thus allowing for switching “on and off” of IMA where deemed necessary.

We are supportive of the move to increase the risk sensitivity of the Standardised Approach and the calibration to Stressed period in line with the same movement in the IMA approach.

Calculating and generating minimum capital requirements and metadata under Standardised Approach as well as Internal Models Approach represents a material operational undertaking which will translate into higher operational base cost.

We are opposed to a regulatory floor based on a Standardised approach. A floor will negate any positive reinforcement mechanism or incentive for banks to model based on a more robust IMA approach.

We believe that there are significant downside impacts should the relationship between the standardised and the internal models approaches be strengthened too far.

- Banks will have far less incentive to invest in internal modelling going forward (especially if the floor is set at too high a percentage of the standardised approaches);
- There will be less benefit in hedging of risk ;
- The implementation of maintenance of the standardised approach for all portfolios would result in significant operational costs;
- Resources will be diverted to regulatory reporting instead of managing and controlling market risks.

To maintain both an internal model and a standardised calculation for all trading portfolios will incur significant project costs and of greater concern, a significant increase in “run-the-bank” costs. Market Risk managers will be required to produce standardised numbers on internal model approved portfolios which will not have any tangible benefit for risk management or capital requirements. This will distract resources away from looking at the actual risks the business is exposed to.

4. What are commenters' views on the Committee's proposed desk-level approach to achieve a more granular model approval process, including the implementation of this approach for banking book risk positions? Are there alternative classifications that might deliver the same objective?

We agree with the Basel logic in understanding and managing risk at a much more granular level. We note the role of regulator is largely that of a prudential supervisor and in our opinion largely focused on Macro level stability of banks. We would caution on placing undue on individual business units/desks compromising or micro level supervision. There exists the possibility that business units may be structured to suit regulatory requirements and not business operational efficient models thereby perversely creating elements of operational risk.

We are supportive of the desk level approach, but would be mindful of the following:

- The flexibility of firms to coordinate their org structures
- Binary outcomes should be avoided where small violations (which could be statistical noise) would lead to significant regulatory capital penalty

The approach to model approval should be based on the products (and the system infrastructure on which these products are risk managed) within an asset class as well as ensuring the risk factors associated with each product are captured correctly by the internal model. Using a trading desk level to model approval may not lead to a level playing field as firms can define their trading desks differently. Furthermore, consideration needs to be given to how internal trades between desks that are approved and those that are not are handled. Additional complications such as when a trading desk conducts activities qualify for both internal model approval as well as those that do not can arise. In the event that the trading desk level to model approval is implemented, there needs to be a linkage between a trading desk and the overall trading business – a quantitative materiality threshold is required.

With respect to the examination of the profit & loss attribution ("PLA"), more details of the calculation of "risk-theoretical" P&L is needed. There may be instances where for certain products that the "risk-theoretical" P&L is nonsensical depending on the calculation methodology. With respect to back-testing exceptions, both the magnitude and the frequency of exceptions need to be taken into consideration, with emphasis on the former.

Regarding FX and Commodity positions in the banking book, the rationale for the positions residing in the banking book must first be established. Thereafter the treatment, be it internal model method or standardised rules, can be determined. We think it is appropriate that the rationale should determine the treatment and not vice versa. However, as a general principle we do believe that the capital treatment of the same economic risk should not differ materially between banking book and trading book.

Systemic case will be greatly increased. Most desk are likely to face back testing problem in period of sustained stress. Withdrawing the model permission at the same time for all the desks in different banks will simply accelerate the crisis.

Finally, a grace period to allow firms to investigate and respond to "unacceptable" PLA and back-testing is required.



5. What are commenters' views on the merits of the "direct" and "indirect" approaches to deliver the Committee's objectives of calibrating the framework to a period of significant financial stress?

The process of identifying a stress period by using a full set of risk factors (i.e. the "direct" method) would result considerable strain on both people and IT infrastructure to implement and maintain.

The results from the "direct" method of calculation would not necessarily be significantly more robust than the "indirect" method (i.e. using a reduced set of risk factors representative of the portfolio) as there would be an ever increasing number of instruments that would need to be proxied given that they were not in existence for the full history of such a large time window (for example, on-the-run debt securities).

In addition, assuming that the "direct" method would only be run periodically (as opposed to "daily", the outcome of the calculation would be entirely dependent on the portfolio make-up as of the particular of running and may not be reflective of the on-going nature of the portfolio. This would be particularly true when business plans are changed as there is no room for discretion in picking up / dropping risk factors depending on their importance in the new business plan. The "indirect" method however would be more able to be run more frequently and therefore would be more sensitive to changing portfolio composition.

For these reasons, it is our opinion that the "indirect" method would be the most practical approach, permit qualitative adjustments for picking up the stress period in light of changing business plans and provide a better cost-benefit return.

6. What are commenters' views on the merits of the desk-based and risk-factor-based aggregation mechanisms to deliver the Committee's objectives of constraining diversification benefits?

The desk based approach naturally fits within the framework of organisations as it ties the capital usage with the P&L. Risk factor based approach would present institutions with management conflicts as no single desk is usually responsible for all the risk of an institution in a risk factor or asset class.

The desk based approach would also need lower investment in infrastructure to implement than Risk Factor based approach.

The Committee's proposed indicators in Section 4.2.2 to identify a desk assumes that desks trade either internal model ("IMM") qualified products or non IMM products. In reality, desks trade both types of products. Hence, the indicators have to be defined such as to avoid forcing institutions to create two desks in the place of one in order to fulfil these requirements.

In case of transactions which price using multiple risk factors, it would be difficult to implement constrained correlation across risk factors in a full revaluation mechanism as this would have to feed into the cross terms. This would involve substantial reengineering and could complicate the pricing of products.

With respect to the risk factor based aggregation method proposed, consideration needs to be given to a particular firm's trading strategy as a one size fits all approach to determining the correlations across all asset classes is not appropriate across all firms. Consideration needs to be given to the most representative risk factors in a

particular asset in order to determine the correlations. Furthermore, guidance on the frequency by which the correlations are reviewed and updated needs to be given

The “use-case” is very important as is the desk based view. Creating a perfect top down view of the bank’s risk by risk factor may be good from a regulatory perspective, but could lead to poor risk management.

- The people primarily in charge of the risk will not be connected to what is reported at the regulator’s level.
- The risk factor view may be very misleading, as cross-risk, correlation effect may not be well represented by a simplistic risk factor view.
- The centralisation of risk means a possible dilution of responsibility, with little accountability.
- Once the link between Risk and P&L is broken, no serious risk management can take place.
- Market risk at desk level should be managed in conjunction with the P&L analysis and with the other risk: Operational, Credit...etc.

Although the failure of assumed diversification was notable during the crisis and other crash scenarios, its importance as a means for banks to spread risk is highly relevant and important. We believe it should still be promoted through a reduced capital charge.

We favour a better disclosure around diversification benefits at a portfolio and desk level. We would favour an approach that quantifies the level of diversification and also allows for disclosure on a diversified and undiversified basis.

A prescribed correlation matrix would create incentive or open up model to arbitrage. A prescribed matrix would create pent up systemic concentrations around poorly conceived matrices and would be very difficult to create a fully diverse and all-encompassing approach.

The committees view should be to avoid poorly conceived correlation not viable and risk reducing diversification that is key tenet to risk management.

7. How can regulators ensure robust supervision of integrated market and credit risk modelling? In particular, how would an integrated modelling approach affect other elements of the proposed framework (eg the choice of the quantile parameter for ES, the P&L attribution and back testing processes, etc)?

The elimination of the patchwork of overlapping capital charges is an important objective, and therefore we believe that an integrated model is vital in order to realistically capitalise the market and credit risk modelling.

The challenges identified by the committee are:

- *Defaults & migrations are low probability events*: The ES model should be capable of differentiating between continuous and discrete risk factors – only the continuous risk factors should be subject to back-testing.
- *Survivorship bias makes calculating the correlation difficult*: There is a similar problem with the current IRC approach for models which rely on correlation matrices. The regulator should specify the correlation parameters to overcome this and ensure level playing fields.

- *Model complexity reduces the supervisabilty of the framework:* We do not believe having a separate model will lead to any tangible reduction in the overall complexity of supervision. The economic risk remains the same and the regulator must be in a position to adequately determine that this risk is correctly capitalised regardless of what model is chosen. Furthermore, the regulator has full visibility of all models used and should have sufficient expertise in order to fully evaluate the appropriateness of the model.

8. What are the likely operational constraints with moving from VaR to ES, including any challenges in delivering robust back-testing, and how might these be best overcome?

Moving from VaR to an Expected Shortfall model would require additional investment in system infrastructure and the development of new diagnostic tools for the calibration of models and input parameters (such as the proposed liquidity buckets).

Should too many distortions be introduced into the model (such as artificially constraining diversification), then two sets of back-testing would be required (one for internal purposes against a “purer” version of the model, and the second for regulatory purposes). This would result in duplication of work, and a break in the “use-case”.

The capital would become a function of two models – the model for generating P&L distributions and another for calibrating the distribution of the tail. The interaction of the two models is not fully understood in a practical context.

One other concern is that the modelled Expected Shortfall is unlikely to be widely understood outside of the Market Risk department, especially given the distortions introduced by including liquidity horizon adjustments and artificially reducing correlations – this would undermine the value of the model to senior management and reduce the usability of the results.

Key consideration would need to be given to appropriate model parameters

- Historical period
- Confidence interval
- Back-testing parameters
- Multiplier approach
- Averaging

9. Which of the two approaches better meets the Committee’s objectives for a revised standardised approach?

We support the derivation of a more risk sensitive standardised approach to calculation of regulatory capital. However, we are concerned that increased risk sensitivity and simplicity are mutually exclusive objectives.

At present the standardised approaches include a menu of options to reporting banks from simplified approaches to more complex approaches. This is reasonable given the differing levels of sophistication of such institutions, with more sophisticated firms being able to report capital on a more efficient basis.

We are of the opinion that there should still be a menu of choices available for firms, in particular, if the trading book boundary is based on valuation and hence more and less sophisticated firms are brought into the scope of reporting trading book capital.



- Where the reporting firm is not seeking to use a model based capital requirement (i.e. a small firm or a new/small trading location) it may be appropriate to use a simple, conservative and less data intensive approach.
- Where the firm wishes to use a model (e.g. Expected Shortfall) the increased risk sensitivity and credible fall-back provided by a more data intensive and complex methodology may be warranted.
- It will be important to ensure that incentives remain to adopt the more risk sensitive approaches. We recognise the Committee's objective to have credible fall-backs and avoid a cliff effect with changes to model permissions however, there still need to be incentives for firms to invest in the overheads associated with more sophisticated modelled approaches.

We are generally supportive of the partial risk factor approach however are concerned that the cross cutting general interest rate risk approach is significantly more complex than the existing set of rules. The existing modified duration approach is already sufficiently complicated as this information would not normally be available in Finance systems. The cash flow vertices approach sounds risk sensitive, however, it will be highly data intensive and it is unclear how many banks could implement this without highly significant upgrades to financial reporting systems. Furthermore, the use of cash flow data will reduce the "audit-ability" of the standard rules calculation as the existing link to the audited balance sheet will be broken.

The full risk factor approach is intuitively attractive in as much as it allows more risk types to be seen as cross-cutting and hence hedgeable. It appears highly complex and we would question the overhead associated with running both an ES model approach and the full risk factor "quasi model" approach. It would be more appropriate to ensure that the partial risk factor approach is calibrated in an appropriate manner to yield the desired outcome. A concern raised with the full risk factor approach is its dependent upon pricing models; this should be less of a concern for banks with approved ES models. The pricing models would be one of the basic inputs into such a regime.

We believe that the menu of options should include an appropriately calibrated partial risk factor approach and a variant of the existing standardised rules for firms with smaller and simpler trading books.

10. Do commenters propose any amendments to these approaches?

It is very hard to comment on the proposals in the abstract without any guidance on their calibration. Basel 2.5 market risk amendments sought to provide the 2-3x increase in trading book capital required by the Basel committee in response to the financial crisis. The approach taken for Basel 2.5 was tactical and had the disadvantage of charging for some risks multiple times and not necessarily picking up other factors such as market liquidity.

It is unclear whether the BCBS is seeking to change the overall level of capital associated with the trading book. If there is a desire to increase capitalisation beyond the levels committed to in Basel 3 it would be highly undesirable. Ever increasing levels of capitalisation have diminishing returns in terms of prudential safety and have real world consequences as banks are less able to provide credit to the real economy.

We have significant concerns regarding the potential use of a standardised approach as a floor to an ES basis of calculating capital. If the floor bites the firm would be reduced to calculating capital on the basis of the standardised approach and the

modelled approaches would fall away. Depending on the risk sensitivity of the standardised approach, this could result in a choice of hedging economic risk or regulatory capital. Rather than a floor it may be preferable to use a blended charge using both the model and standard rules. Where the model is under question (maybe due to back-testing exceptions) the blend could be progressively biased towards the standard rules charge. A benefit of this approach would be the progressive shift towards a standardised approach rather than a potential cliff effect.

We are supportive of an aim to maintain the increased levels of capitalisation for trading book activity albeit on a more coherent approach. We would like the BCBS to avoid hasty introduction of these new rules (as was undertaken with B2.5 and B3) and allow sufficient time to opine and test potential impacts.

- Allow B2.5, B3 and CCP changes to bed down, there should be a period of stability to enable the effectiveness of these new regimes to be assessed and to allow any residual implementation issues to be worked out;
- Adequately calibrate the new regime; and
- Allow for the significant investment in infrastructure (budgetary and planning exercises) which is likely as a result of these changes to be implemented in an appropriate manner.

The proposed overall approach is not practical, being mostly theoretical and “Top Down” oriented. Centralisation of the risk by asset class and allocation of different holding period is the wrong answer to a real problem. It is the wrong answer because it disconnects the risk management at the desk level, where Risk and P&L must be analysed together, in conjunction with credit risk and operational risk.

The proposed approach is overly theoretical and will make back-testing impractical, and risk measurement too far from reality to really be used on a day-to-day basis (therefore undermining the “use case”). We would rather suggest a framework based on a Stressed VaR, with a unique holding period of a month if 10 days is deemed too aggressive, complemented with some regulatory defined stress scenario, as a floor.

The liquidity in some markets (especially EM bond markets) cluster around events such as auctions, central bank operations, etc. as most participants are buy and hold investors. This is complicated by the fact that the events are reasonably ad hoc in nature and do not occur in line with a predetermined calendar – the liquidity parameters should explicitly take these events into account.

