中国银行业监督管理委员会
China Banking Regulatory Commission

Mr. Stefan Walter
Secretary General
Basel Committee on Banking Supervision

13 March 2009

Dear Mr. Walter,

We appreciate the recent efforts of the Basel Committee on improving the principles and practices of risk management in the banking industry. The three consultative papers are well prepared. Nevertheless, from the CBRC side, we still have a number of suggestions and please find them in the attached document.

Thank you for your consideration.

Yours sincerely

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Enclosures:1

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Feedback on recent Consultative Papers of the Basel Committee on Banking Supervision

This paper is a discussion paper on the three most recent drafts of new regulations as developed by the Basel Committee on Banking Supervision ("**Principles for Sound Stress Testing Practices and Supervision**", "**Revisions to the Basel II market risk framework**", "**Guidelines for computing capital for incremental risk in the trading book** "). In general, we welcome the new standards and amendment to existing standards; we think it will be helpful to fill the loopholes of the current regulatory framework in the context of present financial crisis. We put forward a few specific comments and questions for your reference.

1. Principles for Sound Stress Testing Practices and Supervision

(1)The outlined principles are based on the belief that the stress testing can provide forward-looking assessments of risk, overcome limitations of models and historical data, feed into capital and liquidity planning procedures and facilitate the development of risk mitigation and business contingency plans under a stressed condition. In our view, stress testing is one of the tools to achieve a better internal and external communication and help senior management understand the condition of the banks in the stressed time. However, to implement a continuous analysis of the likelihood and impact of catastrophic scenarios remains a practical problem in day-to-day operation.

(2) Some principles in the guidance should be formulated in a more specific way. For example, the guidance requires that stress test should also cover the

following specific risks: liquidity risk and domino effect, the behaviour of complex structured products under stressed liquidity conditions, basis risk in relation to hedging strategies, pipeline or securitization risk, contingent risks and reputational risk. These requirements are particularly difficult to implement, as stress-testing methodology is still evolving. Further, data shortage is another obstacle to our goal.

(4)The stress testing is not only the risk management tool for large banks but also small and medium-sized banks in accordance with their capabilities and their own needs. Many principles mentioned in this document have the same significance to some small and medium-sized banks as to large complex banks. Therefore, the introduction should be put as follows: "The following recommendations are formulated with a view towards application to large, complex banks. The extent of application should be commensurate with the size and complexity of a bank's business and the overall level of risk that it accepts. These recommendations should therefore be applied to banks on a proportionate basis. And other banks are encouraged to follow as appropriate.

2. Revisions to the Basel II market risk framework

This guidance contains some significant adjustments to the market risk framework, whereby the main change is to make the IRC calculation mandatory while introducing the conception of the stressed VaR.

VaR models should, in the future, capture nonlinearities beyond those inherent in options (e.g. for MBS, tranched exposures etc), as well as correlation risk and basis risk (e.g. between credit default swaps and bonds). If those risk elements are to be incorporated into the VaR model, rather than a simple add on factor, this requires a comprehensive review of VaR methodology, potentially upgrading the standard variance/co-variance matrix into a dynamic model of correlations, which poses significant technical challenges to analysis and research.

Under the amended framework, banks must update their data sets at leacomst once every month and reassess them whenever market prices are subject to material changes, whereby they must also have processes in place to update their data sets more frequently. This requirement may lead to additional significant investments for banks that run a large scale diversified trading activities.

We consider the treatment of illiquid positions as particularly important and emphasize the need for "guidelines for the use of unobservable inputs reflecting the bank's assumptions of what market participants would use in pricing the position", and we appreciate that the Committee make further clear instructions describing how this should be done.

Several specific questions to be clarified:

(1). The boundaries between general market risk, specific risk and incremental risk are not clearly defined. Specific calculating cases will be more than helpful.

(2). The background of incorporating stressed VaR in capital charge for market risk is not well founded, both from the perspective of theory and practice. It will be appreciated if follow-up issue papers would be available soon.

(3).The relationship between the stressed VaR and normal VaR is not clearly defined. Also, the relationships between the stressed VaR and results of stress test need to be further clarified.

3. Guidelines for computing capital for incremental risk in the trading book

The relationship between the stress test and reverse stress test, and how the two combined together, is not clearly defined. Under the framework of IRC, it is not clearly illustrated how the one-year capital plan horizon to be matched with liquidity plan horizon.