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18 February 2015

To: Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Re: BCBS Consultation on Fundamental review of the trading book: outstanding issues

Dear Sir/Madam,

We are writing to you as China Banking Association representing Chinese banks on the subject of Fundamental review of the trading book: outstanding issues. China Banking Association (CBA) is a nationwide non-profit self-discipline organization of China's banking sector. CBA serves for the common interest of its members through the functions of self-discipline, rights protection, coordination and service so as to safeguard lawful rights and maintain market order of the banking sector, and promote the healthy and sustainable development of the industry. By July 2014, CBA has 373 members and 4 observers.

We sincerely appreciate and support BCBS seeking to improve trading book capital requirements and to promote consistent implementation of the rules so that they produce

comparable levels of capital across jurisdictions. At the same time, we are concerned about the implementation challenges posed by certain elements of the new framework.

Below are our specific comments for your reference, which we hope can be helpful. And we sincerely appreciate the great endeavor you have made in the global regulatory reforms.

Yours faithfully,



Yang Zaiping

Executive Vice President

China Banking Association

Specific Comments

1. Comments on Internal risk transfers between the banking book and the trading book

(i). Regarding Box1, Paragraph 39(b) and (c), Page5: Treatment of internal risk transfers about [GIRR Option 1] and [GIRR Option 2]

The consultative document (henceforth as CD) is consulting on two options for the treatment of IRTs for GIRR. However, in our opinions, the CD does not clarify that if a bank is required to make a choice between GIRR Option 1 and GIRR Option 2, or a bank can adopt the two options simultaneously, according a bank's position management.

Meanwhile, the CD does not clarify that if those hedging items and hedged items in a banking book could be excluded in the capital requirement, regardless of GIRR Option 1 and GIRR Option 2 requirement, where hedging trades in a banking book are qualified with hedge accounting standards. Besides, as far as we understand, GIRR Option 2 allows a bank to hedge GIRR via a trading book portfolio, instead of hedging GIRR exactly meeting IRTs requirements one by one.

Thus, we suggest that the Basel Committee further clarify the two options and their relationships.

2. Comments on the revised standardised approach for market risk

(i) . Regarding Section 2.2, Page8: Treatment of basis risk

(a) basis risk correlation parameter

In order to clarify basis risk captured by Box 2, a basis risk correlation parameter which is set at [0.1%] would only be effective on the opposite instruments. However, Policy

direction of Section 2.2.1 does not explain principles of usage of basis risk correlation parameter.

(b) The correlation matrix starts from 0.25y to 30y, but sometimes banks would hedge forward risks by spot instruments. We suggest that the Basel Committee consider if it is necessary to add correlation parameter for spot vertex.

(c) According to analysis in Box 2, the correlation method should still be computationally manageable for most internationally active banks. We suggest that the Basel Committee take into account applying correlation matrix by the portfolio or bucket, rather than yield*instrument.

(ii). Regarding Paragraph 26, Annex 1, Page 27: When computing a first-order sensitivity for instruments subject to optionality, banks should assume that the implied volatility remains constant, consistent with a “sticky delta” approach.

In our opinions, it is not easy for banks to keep the implied volatility remains constant. We suggest that a bank be allowed to use the closed-form formula to calculate some options' PV01.

Besides, we think that volatility sticks to delta is common in FX option market, but the implied volatility is usually plotted against strike (i.e. sticks to strike) in equity markets. We wonder if a bank should always apply a “sticky delta” approach to FX and Equity Option. It would burden banks when doing market data transformation and introduce more model risks. We suggest that banks be allowed to choose either sticky-delta or sticky-strike, according to their market quotation conventions.

(iii). Regarding Paragraph 76, Annex 1, Page 38: The correlation parameters ρ_{kl} applying to sensitivity or risk exposure pairs within the same commodity.

The ways of dealing with precious metals trading are different in China and Western countries. Chinese financial institutions usually deal with precious metals trading in domestic & overseas market, such as Shanghai Gold Exchange and London Metals Exchange. Their common trading mode is to maintain a short position in one market and a long position in another market, with small net exposure. However, western financial institutions usually deal with precious metals trading in the same market.

This would cause capital requirements for commodity risks in western financial institutions to be much lower than those in Chinese financial institutions under the current SBA. The key reason is the “correlation”. Actually, the correlation of the precious metals price between domestic & overseas market is much closed to 100%. By applying the current correlation parameter in page 38, it would overvalue risk cost of commodity trading in Chinese financial institutions.

(iv). Regarding Paragraph 81, Annex 1, Page 39: “Maturity” of foreign exchange risk

In our opinions, it is unnecessary to allocate sensitivities separately to term buckets according to their “Maturity”. Because when we consider FX exposures in a banking book, most of which come from untradeable portfolio, it’s hard to get their information of “Maturity”, compared to trading portfolio. In addition, when we consider FX risks, we only take FX spot rate as a risk factor, rather than forward rate. As for forward FX cash flows, market risks from “Maturity” have already been calculated in GIRR.

(v). Regarding Paragraph 90, Annex 1, Page 40: sensitivities or risk exposures in the Credit Spread Risk(CSR) of non-securitisations.

With respect to the non-securitisations tools in Bucket 1 (IG, Sovereigns), most of their yields are risk-free in the market and their credit spread is set to be zero. We suggest that the Basel Committee take into account if it is appropriate that risk exposures in

bucket 1 are set to be zero while risk exposures in other buckets are calculated via bond credit spread.

3. Comments on incorporating the risk of market illiquidity in the internal models approach

Regarding Box 3 181.(c), Page 19: under the method of scaling to the liquidity horizon

We suggest that the CD clarify if it allows banks to apply risk factors which are based on the full collection to implementation of ES calibration in a stress period, and then apply the calibration results to all based-on-the-subsets risk factors, rather than using the calibration of each category independently .

In addition, we suggest that the CD clarify if it allows banks to implement direct calibration method, under the condition that the historical data is enough as an option, in order to minimize the workload and improve the accurateness of the calculation.

4. Comments on the balancing between simplicity, comparability, and risk sensitivity.

We appreciate the efforts dedicated by the Basel Committee to simplify the *Fundamental Review* framework since the CP2 was published in 2013. However, we are still concerned on the burden that banks with small trading businesses can have under the consultative framework, in particular, the revised standardised approach. Therefore we would be much grateful to see more progress to be made in the simplification of the SBA framework in the coming future.