

October 1, 2015

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

Dear Sir/Madam,

Consultative Document: Review of the Credit Valuation Adjustment (CVA) Risk Framework

1 DBS is pleased to have the opportunity to comment on the Basel Committee on Banking Supervision's (BCBS) consultative document on CVA. We note the rationale for revising the current framework. We would, however, like to bring forth some of the general concerns on the proposals.

Hierarchy of Approaches in General

2 With regard to the FRTB-CVA, the Consultative Document acknowledges that not all counterparties are actively traded in the credit derivative markets ("illiquid counterparties") and requires a bank to have a methodology for approximating the credit spreads of such illiquid counterparties in order to calculate the required sensitivities. At the same time, a use requirement (i.e., the active management of CVA risk by a dedicated function) is to be imposed. In addition, eligible hedges are to include not only direct hedges, but also proxies. While these proposals are intended to encourage the management of CVA risk, the proposals cannot will markets into existence. In particular, for banks operating in markets where the majority of counterparties are not actively traded in the credit derivative markets, the use of the FRTB-CVA would entail the widespread use of proxies and model risk as a consequence.

3 In such cases, the eligibility criteria for FRTB-CVA effectively force banks to choose between managing CVA risk estimated via proxies with proxy hedges and using the BA-CVA fall back. We note that the Consultative Document states that the BA-CVA is intended for banks that "are not willing or able to calculate regulatory CVA sensitivities to the satisfaction of their supervisory authorities". As noted above, the willingness and ability to calculate regulatory CVA sensitivities is distinct from the willingness to establish a dedicated function for managing CVA risk based on the pervasive use of proxies. In the case of less developed credit derivative markets, we feel that it is an important distinction. As such, we suggest that the Committee drop the third eligibility criterion for the use of FRTB-CVA, i.e., the use requirement, in respect of the SA-CVA.

4 As the Basel Committee proposals are intended to include jurisdictions that have only limited credit derivative markets or that have less sophisticated banks, the impact of the BA-CVA needs to be considered carefully in the light of the QIS results in order to avoid stifling risk intermediation by banks on derivatives.

Aspects of Proposed Approaches

5 We also note that the Consultative Document proposes to require the use of market-implied probabilities of default (PD). This requirement should be dropped. It would be preferable to allow the use of historical probabilities of default for regulatory CVA. This would avoid excessive accounting earnings volatility (with consequent impact on capital adequacy) in times of market stress when credit derivative prices incorporate significant risk aversion and risk-neutral assumptions to derive implied PD may not be valid.

6 We note with particular concern the abandonment of the external ratings-based risk weights in favour of the FRTB (SA-TB) buckets in the case of the SA-CVA and BA-CVA. We feel that the granularity of the FRTB (SA-TB) buckets in terms of credit rating, while possibly sufficient in the context of the trading book (i.e., credit spread risk is not necessarily a material risk in the trading book depending on a bank's business strategy), is certainly insufficient in the context of CVA risk. Therefore, we suggest that the investment grade buckets should be more granular to differentiate better and worse rated entities even within the investment grade universe in order to promote greater risk-sensitivity. In addition, the existing provision for the use of internal ratings in the absence of external ratings¹ should be explicitly retained in the revised CVA framework. We further recommend that a fall back risk weight be prescribed in the event that neither external and nor internal ratings are available.

7 The Consultative Document proposes that eligible hedges will exclude instruments that cannot be included in the FRTB (IMA-TB). We suggest that there should be an explicit list of such excluded instruments and that such a list be clearly stated as an objective list applicable to both IMA-CVA and SA-CVA, regardless of whether a bank uses the FRTB (IMA-TB) for any part of its trading book capital requirements.

Implementation

8 Lastly, we note that the implementation dates for FRTB and the revised CVA framework have yet to be announced. We suggest that they should be synchronised given that commonality between the two sets of rules and the operational impact they will have on banks, e.g., extensive system and process changes as well as investment cost. There should also be sufficient lead time to ensure that banks can prepare for implementation using strategic, rather than tactical, solutions.

9 We trust that our comments, along with the more detailed ones on specific items as attached in the Appendix, will be useful for the BCBS's further analytical work.

Yours faithfully,



CHNG SOK HUI
CHIEF FINANCIAL OFFICER
DBS BANK LTD

¹ See BCBS: *Basel III: A global regulatory framework for more resilient banks and banking systems* dated June 2011 paragraph 104

Appendix: DBS' Feedback on BIS Consultation Document – Review of the Credit Valuation Adjustment Risk Framework

S/N	Item	DBS' Feedback
1	Page 30, Para 100	In the proposed BA-CVA framework, the supervisory risk weights are to be assigned based on sectors whereas the current approach is by external credit rating. The impact would be significant as the current risk weights ranges from 0.7% to 10% as opposed to 4.1% to 20.4% in the proposal. As exposures to sovereigns and financials would form a significant part of a bank's portfolio, the Committee should consider in particular the need for more granularity to the risk weight sector assignments in order to enhance the risk-sensitivity of the BA-CVA. In the supervisory risk weight table, it was also noted that "Government-backed financials" were classified together with "Financials", attracting the highest supervisory risk weights, followed by "Sovereigns". Apart from providing more granularity to the risk weight sectors, the Committee should also consider the appropriateness of carving out "Government-backed financials" as a separate category or to be included in the "Sovereign" bucket to reflect how these such entities are rated. The Committee should also consider where multilateral development banks are to fit under the sector buckets. The Committee should clarify the appropriate classification for industries that span multiple sectors in the sectoral buckets. Are these industries meant to be classified under "Others" or "Indices spanning multiple buckets".