

2017.09.27

**FRENCH BANKING FEDERATION RESPONSE TO BASEL COMMITTEE ON
BANKING SUPERVISION d408 CONSULTATIVE DOCUMENT ON SIMPLIFIED
ALTERNATIVE TO THE STANDARDISED APPROACH TO MARKET RISK CAPITAL
REQUIREMENTS**

I- General comments

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

The FBF welcomes the opportunity to share its comments on the BCBS's consultative document on the simplified alternative to the standardised approach to market risk capital requirements.

The FBF reiterates its support for a stable and resilient global financial system, while facilitating economic growth. To this end, while we support the Committee's initiative to update and refine the "Minimum capital requirements for market risk" (BCBS 352) through the introduction of this new methodology, we believe that the proposed amendments do not take sufficiently into account the significant changes it brings.

Summary of key comments:

- (1) The simplified standardised approach (R-SbM) uses should be extended beyond banks with small trading books to subsidiaries of larger banks, including subsidiaries of G-SIB and D-SIB, as long as they meet the criteria on a standalone basis for the calculation of market risk own funds requirements. It should be clarified that RWAs calculated with the simplified approach at the entity level of a subsidiary may be considered at the consolidated level of a group.
- (2) The R-SbM method should be simple enough that it will not overburden banks or bank subsidiaries with limited trading activities. Further simplification of the R-SbM should be sought while a sufficient level of risk sensitivity retained.
- (3) The proposed simplified standardised approach (R-SbM) shall be benchmarked with the full standardised approach (SbM) in order to improve its design and calibration. It shall not be the case that the simplified standardised approach (R-SbM) lead to fewer own funds requirements than the standardised approach (SbM). Conversely, it shall not as well lead to overly inflated own funds requirements: there should still be some risk sensitiveness and commensurateness.

The BCBS proposal is for a simplified SbM (ie. R-SbM) or alternatively a re-calibrated Basel 2 method. **French banks favour R-SbM and make their support conditional on some improvements, in particular with respect to its complexity. We believe that there is still room for further simplification without affecting much its risk sensitiveness.**

Please find below our main comments and our detailed feedback to the BCBS consultative document.

Specific comments

1) General considerations

The complexity of the standardised approach (SbM) and the absence of a simplified methodology for small trading books in the Basel standard published in January 2016 were difficult to manage by smaller institutions. It may have led jurisdictions to introduce their own framework for small trading book portfolios resulting in hard to compare own funds requirements across jurisdictions and potential uneven level playing field between jurisdictions and between larger and smaller banks.

In this context, the French Banking Federation welcomes the consultative paper for a simplified alternative to the FRTB standardised approach capital charge (SbM) as it supports more harmonisation in prudential standards. Indeed, the introduction of the simplified alternative by the Basel Committee should permit to benefit from more transparency, consistency and comparability between market risk reporting and capital charges.

The standardised approach (SbM) introduced by the FRTB is a "Sensitivity Based Method" (SbM). The simplified variant proposed by the Basel Committee is a "Reduced Sensitivities-Based Method" (R-SbM) for smaller and simpler trading books. First, we believe that the calibration of the 3 approaches IMA (Internal Model Approach), SbM and R-SbM must preserve the correct incentives so that ceteris paribus the capital charge under R-SbM is above the capital charge under SbM which is above the capital charge under IMA. Second, if we support the introduction of a simplified standardised approach (R-SbM) for smaller portfolio we are urging the BCBS to ensure that the simplification is sufficient to be applicable by smaller banks or bank subsidiaries without undue complexity and IT developments while remaining sufficiently risk sensitive. Although we support the idea of the convergence between the standardised approach (SbM) and the simplified standardised approach (R-SbM). We think the R-SbM should be simplified further especially to alleviate the burden of computing sensitivities using the "bumping" approach for linear products.

The development of this new approach (replacing the current Basel II methodology) will oblige many credit institutions to make technical IT changes. The introduction of this new requirement should enter into force at least two years after the adoption of the new framework and concomitantly with the FRTB full standardised approach (SbM) and internal model approach (IMA).

2) Governance of the simplified alternative to the standardised approach

The constraints to set up a SbM or an R-SbM are not the same. We hope that the evaluation leading to use the one or the other of both approaches should only use a list of precise and objective criteria. The choice should not depend on the discretionary power of a National Competent Authority (NCA).

In the Basel consultative document, the simplified standardised approach (R-SbM) is for application to banks with small trading book fulfilling some criteria. We believe that this approach should also be made available to subsidiaries of a larger group which, in standalone, satisfy the criteria, both for their standalone reporting and for their contribution to the group consolidated reporting. Indeed, the same issue of complexity apply to small entities of a larger group which should therefore be allowed to make use of the simplified standardised approach (R-SbM). This flexibility should not lead to reduced group level own funds requirements for market risk if the simplified standardised approach (R-SbM) is properly calibrated.

We therefore recommend that articles 204 to 208 on governance shall be amended to reflect that they are applicable to legal entities. In particular:

- The use of “bank” in articles 204 to 208 should be replaced by “legal entity”.
- The first bullet point of article 204 should be deleted: legal entities within a G-SIB or D-SIB group should be entitled to the simplified standardised approach (R-SbM) for as long as it satisfies all the criteria.
- Finally, we do not understand the one before last bullet point of article 204: there is no connection between non-centrally cleared derivatives and trading book size or complexity. Hence, this bullet point should be removed.

Also, the consultative paper provides little guidance on the assessment process (article 204 only states that the assessment shall be quarterly). We believe that the framework should prevent instability in the way own funds requirements are calculated and allows for sufficient time to adapt to enhanced requirements. Therefore we suggest that:

- The criteria assessment is made no more frequently than quarterly,
- The invalidation of the simplified standardised approach (R-SbM) is only asserted if the criteria are breached several times (for instance two consecutive quarters)
- Sufficient time is given for the legal entity to develop the IT systems and infrastructures for the calculations under the full standardised (SbM) approach (for instance 6 months)

3) Structure of the simplified alternative to the standardised approach

From a methodological point of view, the “default risk charge” and the “residual risk add-on” (RRAO) remain the same than the one used for the standardised approach (SbM), whereas the SbM “risk charge” is revised.

The simplified standardised R-SbM main characteristic is the removal of (i) the “vega risk charge” though there may be options and (ii) the “curvature risk charge” though sold options may be part of the portfolio if covered. It is a welcomed simplification of the calculations for portfolios with limited optional positions. However, since some risks are no more capitalised and the simplified standardised approach (R-SbM) retains the residual risk add-on capital charge, we suggests that all options are liable for a RRAO capital charge.

There are many simplifications of the sensitivity based method (SbM) that makes it difficult to assess whether the R-SbM is too aggressive or too conservative.

- The absence of correlation scenarios (high, low and medium) applicable to the R-SbM creates lower capital charge in particular in the interest rates and commodities asset classes. This is beneficial to the R-SbM.

- Term structures aim to be extremely simplified (2 tenors for GIRR (ie. fewer than in SA-CCR¹), none for CSR) and the absence of basis (BOR, OIS, etc.) in GIRR and (bonds, CDS) in CSR allow more netting between trades. This is beneficial to the R-SbM.
- The calibration of risk weights, x2-x3 (x3-x4.5 for liquid currencies) for GIRR, x2-x4 for CSR, x1.5 for FX, are much more conservative in the R-SbM than in the SbM.
The calibration of the risk weights shall be reconsidered as they appear high in the context of small and usually fairly directional portfolios. One improvement would be to allow reduced risk weights for GIRR for selected more liquid currencies as is the case in the SbM [BCBS d352 Art-75 §(a)].
- Lower (GIRR) or similar correlations (CSR, FX). Note however that grouping the full-SbM buckets for CSR means that there are higher correlations recognised since the intra-bucket correlation is higher (35%). The effect of changed correlations on capital requirements are portfolio dependent.

The Basel Committee proposed simplifications and weightings should be justified and explained to alleviate any questioning on this new methodology.

It is also calling for a Quantitative Impact Study (QIS) covering every technical point of the simplified standardised approach (R-SbM) to compare its impact with the current standardised approach (SbM). This QIS will aim to make sure that this new methodology will not give a competitive advantage to the simplified standardised approach (R-SbM) users vs. the standardised approach (SbM) users while not unduly capitalising smaller banks. The QIS should consider the specificities of smaller portfolios which often are more directional than those of larger institutions.

4) Complexity of the simplified SbM

The requirements for the calculation of the GIRR and CSR sensitivities may be still too complex to implement and maintain for some small institutions or large bank' subsidiaries which are not much exposed to market risks as they are mostly conducting Treasury and Liquidity management activities. We think that further simplifications are required on the bucketing.

Most precisely, we suggest that it is allowed to neglect marginal sensitivities (e.g. GIRR for CDS) and to approximate the sensitivity exposure by the notional amount adjusted with maturity for vanilla bonds. For instance:

- Having T the production maturity in years, N the signed notional (positive =purchase, negative = sale) :
- Vanilla fixed bonds (no step up): $\Delta \text{GIRR} = - N * T / 10000$ on the bucket 1st bucket if $T \leq 5$ on the 2nd otherwise. $\Delta \text{CSR} = - N * T / 10000$
- Vanilla floating bonds (no step up): $\Delta \text{GIRR} = 0$, $\Delta \text{CSR} = - N * T / 10000$
- Vanilla CDS (purchase=buy protection): $\Delta \text{GIRR} = 0$, $\Delta \text{CSR} = + N * T / 10000$

Also, the SbM requires CIU (Collective Investment Undertaking) to be looked through. This is a very heavy exercise with little benefit considering the size of the portfolios eligible to the R-SbM. We therefore suggest that no look-through is warranted for CIU within the R-SbM and that CIU may be treated as a single financial instrument.

¹ SA-CCR is the standardised approach for counterparty credit risk exposure of derivatives. In SA-CCR, for the interest rates asset class, the term structure is split in three buckets: 0-1 year, 1-5 year and over 5-year.