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Dear Sirs,

Revisions to the Minimum Capital Requirements for Market Risk

We welcome the opportunity to respond to the Basel Committee on Banking Supervision's ('the Committee') consultative document ('the Consultation'): *Revisions to the Minimum Capital Requirements for Market Risk* ('FRTB'). Overall, as an internationally active banking group, we support the Committee's objective of a consistent implementation of a new market risk framework across jurisdictions. We have provided separately a more detailed confidential response and also contributed to, and support, the joint response from industry bodies via ISDA/GFMA/IIF.

We have been encouraged by the adjustments to reduce risk weights to more realistic levels for certain asset classes, the revisions to the definition of hypothetical Profit & Loss ('P&L') and risk-theoretical P&L, as well as the proposed changes to the P&L Attribution test. We also welcome the clarification on the use of committed quotes and the ability to pool data for real price observations for non-modellable risk factors ('NMRFs') determinations.

Despite the above, we are concerned that further steps are needed to maintain the risk sensitivity of the framework and avoid unintended consequences which are at odds with the G20's wider priorities and its goals for this stage of the financial reform process. Our observations in this respect are set out below, and where appropriate we have proposed some options to improve the outcomes.

Overall Capital Effect – disproportionate increase compared to risk

From our provisional estimates, even with the revised calibration, market risk risk-weighted assets ('RWAs') are expected to increase significantly. Although this increase is lower than for previous iterations of these rules, we still believe that it is disproportionate to the risk in some areas. We accept that regulators and supervisors may be inclined to take a conservative approach but any material gap between real risks and their regulatory assessment will be unsustainable in the long run. If the constraints on modelled approaches and/or the standardised approach generate RWAs which are fundamentally too high, banks will eventually either increase prices or reduce supply, thereby having an unwarranted adverse effect on the markets for underlying products.

As a large part of the disproportionate increase for the Internal Models Approach (IMA) arises from NMRFs. We believe the Committee should consider modifying several components: the aggregation methodology, the liquidity horizon and stressed period.

Generally speaking, simple sum aggregation is overly punitive and leads to an unrealistic capital charge for NMRFs. We propose that, subject to supervisory oversight, interconnected risks (e.g. those across the same curves and surfaces, whether modellable or non-modellable) should be granted benefit from some netting as this is more in line with risk management. The liquidity horizon and stressed period also need to be recalibrated in line with the expected shortfall, rather than individually for each risk factor. This will drive more consistency and comparability of the NMRF charge across the industry. To do this, we propose to set the liquidity horizon and stressed period equal to that outlined by the expected shortfall methodology.

These recalibrations should be seen as a package that needs to be implemented as a whole as they each drive the unrealistically high NMRF capital charge separately, which in turn feeds into the adverse market impacts detailed below.

High growth emerging market development impaired

We anticipate that the investment in high growth countries would be undermined as a result of the proposals, given the longer liquidity horizon for developing country currencies that are not in the list of approved currency pairs. The unintended consequence would be that derivative markets on these currencies are unlikely to develop further, as forward transactions would likely be treated as non-modellable. This would not help allay concerns from emerging market members of the FSB that the post-crisis financial reforms are leading to a reduction in global bank activity in their domestic markets[1].

This effect is likely to be somewhat lessened by our NMRF aggregation proposal (above), but our proposal should be supplemented by the alignment of risk weights and liquidity horizons to those of the listed currencies and the relaxation of real price observation requirements.

Given that foreign exchange is one of the most important risk factors, as reflected in the FSB's recent survey on infrastructure financing[2], the current proposal appears at odds with the G20's objective of securing greater private financing of infrastructure investment in emerging markets, including to support the UN Climate Change Conference and Sustainable Development Goals objectives.

Sovereign bond market pricing

In the modelled default risk charge, we also see a discrepancy between the floor applied to the probability of default and the real risk. In particular, it drives a significant increase in capital requirements for high quality sovereign bonds, which may affect bank participation in these markets when their wider risk-weighting is still being considered.

Given the Committee's on-going initiative on sovereign's capital treatment, we propose a removal of the probability of default floor as it mainly affects those types of assets. A review should then be scheduled within the wider initiative to ensure it is calibrated consistently across the regulations.

Disincentivisation of underwriting for new issues to be used for liquidity

The re-definition of the trading/banking book boundary means that underwriting banks looking to participate in government and other bond issuance for liquidity, rather than distribution purposes, are disincentivised from doing so, as such positions would automatically be treated as trading book.

As a result, we would propose that the determination of the trading book / banking book boundary be changed to link the requirement for trading book treatment to the intention to trade and distribute rather than to the mechanism by which assets are purchased (i.e. as primary underwriting or in the secondary market).

Our view is that the same product should be treated differently depending on the intent for which it is acquired, whether at issue or in the secondary market. It appears that significant assumptions are being made about the depth of the market for sovereign issues across the markets of all Basel member countries over the time horizon of FRTB. These assumptions should be made explicit for stakeholders to consider.

[1] FSB Implementation and Effects of the G20 Financial Regulatory Reforms (page 43): http://www.fsb.org/wp-content/uploads/P030717-2.pdf

[2] Press Release: FSB launches survey on infrastructure financing as part of its efforts to evaluate the impact of the G20 regulatory reforms: http://www.fsb.org/2018/03/fsb-launches-survey-on-infrastructure-financing-as-part-of-its-efforts-to-evaluate-the-impact-of-g20-regulatory-reforms/

Bond market liquidity

Liquidity in the bond markets would contract as an inability to meet the conditions for modellability would reduce banks' appetite for inventory. This is because the liquidity of a bond is at its highest in the period immediately after initial issuance, after which trades become less frequent, and thus many corporate and even some sovereign bonds may be treated as NMRFs.

Market liquidity has been raised, both by market participants[3] and public sector bodies[4] as a consistent concern with the post crisis regulatory framework that needs detailed analysis. The FSB reported to G20 Leaders on its views as recently as the Hamburg Summit in 2017[5]. This uncertainty over the depth of liquidity during periods of stress, rather than a change in pricing post-crisis, means that any reform that reduces incentives to support market liquidity deserves particular scrutiny, and a clear communication of its expected market impact.

Inconsistency of capital treatment at different consolidation levels

At different levels of consolidation, the trading book boundary can change, as can the desks and even the actual risk factors, depending on the approach taken by the relevant regulator. As an example, regulators at subsidiary, intermediate parent and ultimate parent levels could have different views as to whether the presumptive lists of instruments included in the trading book could be overridden based on the intent for which they are held. This could cause material differences in the capital requirements for a single product or risk at each level of consolidation and depending on the relevant national supervisor, thereby potentially fragmenting market pricing and reducing liquidity.

We propose that the Committee should look beyond the consolidated view in order to take account of issues arising on consolidation across borders; where necessary restricting national discretions and giving direction on consolidation treatments.

Unpredictable Capital Outcomes - lowered market liquidity and increased fragmentation

Any setting of P&L Attribution thresholds without a sufficient observation period risks a poorly calibrated framework which we believe could lead to particular products and markets having inappropriate relative levels of capital requirements. Therefore, we would suggest that a formal calibration is undertaken once an observation period of, say, two years has been completed. Such a period would allow time for a better observation of the relative performance of the modelled and standardised approaches in parallel and for any re-calibration considered appropriate.

[3] For example, the PWC study commissioned by the Global Financial Markets Association (GFMA) and Institute of International Finance (IIF), August 2015 *"Global financial market liquidity study"* https://www.pwc.se/sv/pdf-reports/global-financial-markets-liquidity-study.pdf

[4] For example: CGFS on Repo market functioning (https://www.bis.org/publ/cgfs59.htm), and CGFS on Fixed income market liquidity (https://www.bis.org/publ/cgfs55.htm)

[5] FSB Implementation and Effects of the G20 Financial Regulatory Reforms: http://www.fsb.org/wp-content/uploads/P030717-2.pdf

Structural FX hedging disincentivised

We are concerned that the proposed wording for structural foreign exchange ('SFX') is more restrictive than the current Basel standard, and is unlikely to provide the necessary flexibility required by banks to fully manage SFX positions in a timely and effective manner. To avoid this, we encourage the removal of granular supervisory pre-approval and other excessive requirements for SFX. We also urge the Committee to ensure that the definition of "structural" is both clear and encompassing. For example, it should be clear that scope includes both group and subsidiary ratios.

If the Committee would find it helpful, we would be pleased to discuss our comments further with you and your colleagues.

Yours faithfully,

Samir Assaf

Chief Executive, Global Banking and Markets