

Christopher McHugh

Managing Director and Head of Counterparty Exposure Management, Global Markets

Risk Management Group
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Dear Sirs,

Subject: Review of the Credit Valuation Adjustment (CVA) risk framework – consultative document

HSBC welcomes the opportunity to respond to the Basel Committee on Banking Supervision (BCBS) Consultative Document on the review of the Credit Valuation Adjustment (CVA) risk framework.

The industry has submitted papers via the ISDA/AFME joint response to the CVA review, to which HSBC has contributed and fully supports. While we fully support the comments made by the wider industry, there are nonetheless further issues to which HSBC would like to draw the attention of the Committee. Our high-level observations and views are presented in the body of this letter, while the subsequent annex includes more detailed feedback.

HSBC is one of the world's largest banking and financial services organisations with assets of US\$2,571 billion at 30 June 2015. Headquartered in London, HSBC serves customers worldwide from around 6,100 offices in 72 countries and territories in five geographical regions: Europe, Asia, Middle East and North Africa, North America and Latin America.

As an internationally active bank we are supportive of the Basel Committee's objectives to more closely align the market risk and CVA risk frameworks, as well as aligning CVA capital charges with economic risk. A key component of this alignment relates to fair value accounting treatment and introducing a greater degree of convergence in industry practice. With this in mind, we note that the choice of calculating regulatory CVA through an accounting-based CVA (Option A) or an IMM-based CVA (Option B) should not be mutually exclusive.

From HSBC's perspective, we would encourage the Basel Committee to permit firms with existing IMM approval to draw on the existing counterparty credit risk waiver, albeit enhancing and calibrating the underlying risk parameters to accommodate for accounting-based CVA requirements. As specified in the text, this should include elements such as integration of risk neutral drifts, market implied calibration, stochastic discount factors and exposure sensitivities amongst others. This could be achieved through an additional permission, granted based on the existing IMM waiver which would guarantee greater continuity in terms of supervisory oversight. This is likely to achieve a more satisfactory

HSBC Holdings plc

Level 4, 8 Canada Square, London E14 5HQ

Tel: 020 7991 5283 Fax: 020 7991 4880

Web: www.hsbc.com

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outcome given that any revisions to the CVA risk framework must be transposed and implemented into a number of different jurisdictions. A more detailed description of the design of this option is provided in Question 3 of the Annex.

We welcome the Committee's decision to widen the scope of eligible CVA market risk hedges to enable effective hedging of CVA market factor sensitivities. This will create a fair method to elect to hedge against CVA changes from market trends and ensure that it is possible to remove—or significantly decrease—this aspect of CVA volatility. We also believe that the final CVA framework should be designed in such a way that the choice to hedge CVA or remain unhedged is economically equivalent; in particular, the framework should not be designed in such a way that un-hedged positions are no longer economically viable. Hedging the credit risk component of CVA with credit derivatives can provide a useful dampener to P&L volatility. A bank should be at liberty to choose to leave positions unhedged in order to accrue back CVA in the counterparty portfolio to cover specific risk without being unduly penalised.

The consultative paper refers to the Committee's reservations as to whether CVA risk can be effectively captured under an internally modelled approach, indicating that this option may be removed from the final standard. We would urge the Basel Committee to recall the benefits of internal models which have become an integral part of firms' risk management. Not only do internal models guarantee greater risk sensitivity, they are also a key driver of regulatory capital, management information and strategic resource allocation. As it relates to CVA risk specifically, and in keeping with the Committee's stated policy objective, internal models are particularly important because they allow firms to more closely align regulatory capital to economic risk. Furthermore, because CVA risk is dependent on both the credit risk of the counterparty and the risk associated with the underlying portfolio, a modelled approach is needed to capture the full range of risk drivers, relevant risk factors and resulting sensitivities.

We would also like to draw attention to the fact that any removal of an internally modelled approach must be considered in the context of its impact on corporate and sovereign end-users. Sound and efficient risk management is of great importance not only to financial institutions, but also to the clients they serve who rely on hedging. While new margining and central clearing requirements are likely to significantly decrease the population of exposures that will attract CVA risk charges, one must remember that many corporates and sovereigns will be either unable or not required to meet new margining requirements. A standardised approach will not only fail to reflect the true level of underlying economic risk, but will raise the cost of prudent hedging, which will be passed on to end-users, potentially driving end-users to leave their risks unhedged, or to pursue less-expensive protection providers outside of the regulated banking sector. Clearly neither of these outcomes is desirable as they will both result in an overall increase of systemic risk. We would therefore encourage the Basel Committee to give due consideration to these end-users as it finalises the CVA framework at the global level.

Further, we believe that BCBS should consider an extension to the timelines for the finalization of the framework to allow for appropriate testing, impact analysis and re-calibration of the CVA framework. While we fully support the integration and alignment of the new CVA framework with the Fundamental Review of the Trading Book (FRTB) market risk framework, we recall that FRTB revisions have been ongoing for several years.

HSBC Holdings plc

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Web: www.hsbc.com

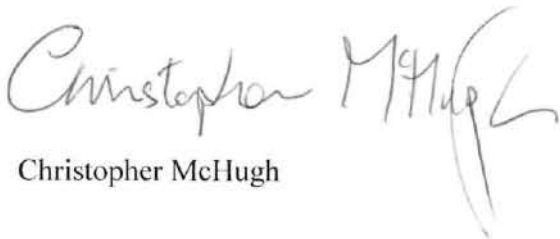
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Accelerating the CVA review to keep pace with changes to the market risk framework risks compromising the integrity of the final standard. Indeed, certain elements of the CVA review, such as the generation of market implied sensitivities based on more prescriptive methodology, are computationally intensive and will require time to complete.

It is regrettable that the Basel III CVA framework was developed in a fashion which did not more accurately align CVA risk to underlying economic risk, and which moreover failed to appropriately reflect the nature of the European financing model. This is particularly important given that Europe's economy relies heavily on bank-intermediated credit. It is therefore essential that sufficient time is allocated to the current CVA review to avoid repeating similar unfortunate outcomes.

We thank you for your consideration and for the continued industry collaboration the Basel Committee has provided. We would be happy to answer any questions on the points enclosed.

Yours sincerely,

A handwritten signature in dark ink, appearing to read 'Christopher McHugh', with a stylized flourish at the end.

Christopher McHugh

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