

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland



Japanese Bankers Association

JBA Comments on the BCBS Consultative Document: *Credit Valuation Adjustment risk: targeted final revisions*

Dear Basel Committee members:

The Japanese Bankers Association (the JBA)¹ appreciates the opportunity to provide comments on the Basel Committee on Banking Supervision's (the BCBS) Consultative Document "*Credit Valuation Adjustment risk: targeted final revisions*" (the Proposal).

In general, the JBA supports the Proposal as it brings material improvements over the CVA risk framework in the Basel III standards finalized in December 2017² by ensuring consistency between the CVA risk framework and the market risk framework finalized in January 2019. The JBA, however, believes that there remain several requirements that need further consideration to establish a better balanced framework in a manner consistent with other Basel III requirements.

The following sections provide the details of our comments.

1. Consistency with the market risk framework

While the proposal largely ensures consistency between the CVA risk framework and market risk framework, the following two points remain inconsistent. It is recommended to provide greater harmonization between the two frameworks.

(i) Base currency approach for FX delta risks (¶50.59)

- When the base currency approach was introduced in "*Calculation of RWA for market risk*,"³ the JBA understands the BCBS' intention was to align the currency used to calculate risk-weighted assets to the functional currency of the reporting bank, in order to reduce operational burdens, specifically aggregating FX data of currency pairs between a currency and the reporting currency even when the reporting currency is not the functional currency of the reporting bank.
- Given that the same operational challenge happens in the calculation of CVA risk-weighted assets, the JBA believes that it is reasonable to introduce the same approach to the CVA risk framework, taking a consistent approach between the market risk framework and CVA risk framework.

(ii) Currency bucket for FX vega risks (¶50.59)

- As is the case with the issue described above, consistency with the market risk framework should be considered for FX vega risks. In regard to the FX delta risks, MAR 21.14 of the market risk framework provides detailed

¹ The Japanese Bankers Association (JBA) is a premier financial organization whose members consist of banks, bank holding companies and bankers associations in Japan. As of January 1st, 2020, JBA has 117 Full Members (banks), 3 Bank Holding Company Members (bank holding companies), 74 Associate Members (banks & bank holding company), 58 Special Members (regionally-based bankers associations) and 1 Sub-Associate Member for a total of 253 members.

² "Consolidated Basel Framework": https://www.bis.org/basel_framework/index.htm

³ MAR 21.14 of "Consolidated Basel Framework"

provisions on the method to split the bucket in terms of reference currencies, which is explicit and clear. On the other hand, the provision for FX vega risks in MAR 21.14 is simple compared with the explanation for delta risks; it just states “the FX vega risk factors are the implied volatilities of options that reference exchange rates between currency pairs.” It can be understood that this provision does not necessarily require splitting the bucket in terms of reference currencies, in consideration of a concern that it may be difficult, in particular for non-USD reporting banks, to calculate precise FX volatilities for all pairs between the reporting currency and another currency because of significant operational burdens.

- For instance, the following undue burdens would arise if it were to be required to split the bucket in terms of currency pairs for vega risks.
 - (a) Consider the case where a bank whose reporting currency is JPY and functional currency is USD, has FX swap transactions of USD/JPY and USD/BRL but has no transaction of the JPY/BRL pair. In this case, if the bank is required to split the bucket, it has to calculate the vega risks of the JPY/BRL pair just because JPY is the reporting currency of the bank.
 - (b) It causes significant operational burdens for this non-USD reporting bank, because it is impossible for it to calculate the vega risks of the JPY/BRL pair from the vega risks of the other two pairs above due to the nonlinear characteristics of vega risks, even if the vega risks of both the USD/JPY and the USD/BRL pairs are known.
- In the Proposal, however, the provision regarding vega risks⁴ requires banks to split the bucket per currency pairs as it has not been amended from the finalized Basel III standards. In light of the facts above and the BCBS’ objective of promoting consistency between the market risk framework and the CVA risk framework, the BCBS should not require banks to split the bucket in terms of currency pairs regarding vega risks. The wording “must” in paragraph 50.59 of the Proposal should be replaced with “may” to allow discretion to jurisdictional regulators or reporting banks.

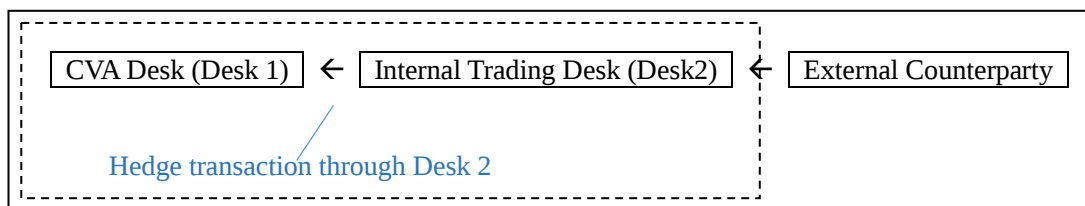
2. CDS swaptions as eligible hedge (¶ 50.18)

- One of the objectives of the revision to the CVA framework published in July 2015 is to “capture all CVA risks and better recognition of CVA hedges.” However, CDS swaptions were dropped from eligible hedge instruments in the revision, while it can be recognized as eligible hedge instruments under the current Basel framework (Basel 2.5)⁵.
- CDS swaptions are just options for selling/buying CDSs and these lead similar hedging functions as CDSs. Therefore, the JBA recommends again that the provision which allows banks to recognize CDS swaptions as eligible hedge should be included in the final Basel framework, considering the objective of the revision of the CVA framework and continuity from the current regulation.

3. Technical issues to be clarified

(i) CVA hedge through an internal trading desk (¶50.11)

- In the case where a CVA Desk (Desk 1) has a CVA hedge transaction through an internal trading desk (Desk 2), there is an ambiguity as to which party (i.e. Desk 2 or the External Counterparty) would be the appropriate target of CVA risk measurement of Desk 1.



⁴ “For FX delta and vega risks, buckets must be set per individual currencies...” in paragraph 50.59 of the Proposal.

⁵ According to the Consolidated Basel framework, MAR 50.13, FAQ2, “A CDS swaption can be considered as an equivalent hedging instrument, and therefore CDS swaptions are eligible hedge instruments, in both single-name and index CDS cases...”

(ii) Cross-bucket correlation of the equity delta and vega risks (¶50.71)

- Although bucket numbers 12 and 13 are added in Table 11 “*Buckets for equity risk*,” cross-bucket correlation γ_{bc} for bucket number 12 (Large cap, advanced economies) and 13(Other) is not described in the Proposal.

(End)