

Geneva, October 1, 2015

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

Submitted electronically via www.bis.org

MSCI response to the Consultative Document “Review of the Credit Valuation Adjustment Risk Framework”

Dear members of the Basel Committee,

We welcome the publication of the consultative document on the review of the Credit Valuation Adjustment Risk Framework and we appreciate the opportunity to provide you with our comments.

For more than 40 years, MSCI’s research-based indexes and analytics have helped the world’s leading investors build and manage better portfolios. Clients rely on our offerings for deeper insights into the drivers of performance and risk in their portfolios, broad asset class coverage and innovative research. Our line of products and services includes indexes, analytical models, data, real estate benchmarks and ESG research. Our risk management clients include many of the world’s largest banks, hedge funds, institutional asset managers and asset owners.

Accounting or IMM CVA?

Our answer to Question 5 of the Consultative Document is the following:

We believe that generating scenarios of discounted exposures should be based on accounting CVA (with some modifications) in the SA-CVA approach, while the regulation should stick to the IMM-based approach for IMA-CVA (if the Committee decides to provide for a treatment based on the internal model approach to the trading book in the final standard).

We agree with the pros and cons explored by the Committee in favour and against the introduction of accounting-based CVA to regulatory capital calculation. We believe, however, that the combined model risk of the IMA-CVA approach and the accounting-based exposure calculation (option A) is too large to be justified by the accounting-based CVA’s better recognition of CVA hedges.

We think that the model risk is less of a problem in the standardized approach, where we suggest the usage of Option A, with some modifications.

Option A uses risk neutral calibration whenever market data is available. Since implied volatilities often jump almost overnight reacting to market news, the generated exposures will also jump resulting in materially different CVA sensitivities after such jump. In the end, the CVA capital charge itself will become extremely volatile with day-to-day changes possibly exceeding 20-30% of the total CVA capital requirement. Figure 1 below shows the level of the CBOE Market Volatility Index for the past one year. The charge for any derivative whose exposure (and thus CVA) depends heavily on equity prices would have changed materially in August 2015. For example, an equity future's possible future exposure paths will widen significantly affecting CVA of options written on the equity future.

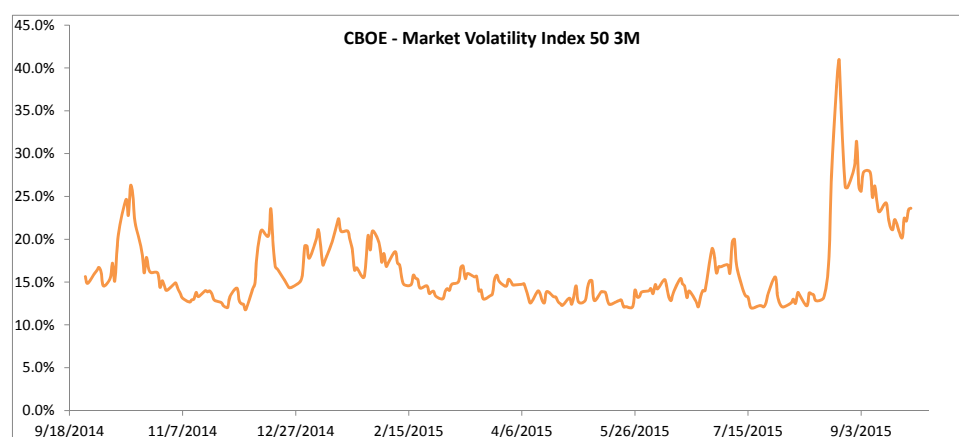


Figure 1 Level of the VIX index in the past year

To avoid the potential burden of highly unstable capital charges, we suggest including some smoothing to the CVA sensitivities used by the SA-CVA approach. For example, the Committee might consider using an exponentially weighted moving average (EWMA) with some regulatory decay factor (we would suggest a half life between two weeks and one month). The EWMA method would shield the capital requirement from huge day-to-day variations while could preserve the appropriate risk sensitivity of the model.

MSCI's RiskManager product provides both real world (IMM based) and risk neutral simulation, so we are in a very good position to answer Questions 3 and 4. In general, *we believe that there is a large amount of synergy between the calculation of accounting CVA and the EAD calculation for IMM with respect to processes, data and methodology.* Since the choice involves only scenario generation, all pricing models, netting and aggregation models and collateral

handling can be re-used in an accounting CVA model. The additional data required for risk neutral calibration (i.e. implied volatilities) are also likely available in existing databases, the linking of these volatilities to the risk factors might require some additional development. All in all, that transitioning to accounting CVA boils down to the implementation of risk neutral simulation models. Based on our experience, building a complete risk neutral simulation framework is a significant, but not disruptive challenge. In conclusion, *we think that an IMM approval should be included as an additional eligibility requirement for the FRTB-CVA framework under Option A, since the two models mostly rely on the same capabilities.*

Exposure risk capital under the Basic CVA approach

Our second comment is related to the proposed exposure risk capital charge under the Basic CVA approach. The Consultative Document clearly admits that “the Basic CVA framework does not recognise exposure hedges” so we see no reason why a separate exposure risk charge is needed in the basic framework. Specifically, the proposed charge will have no real connection with the actual risk of the changes in the exposure part of CVA. For example, the exact same instrument would bear materially different exposure risk charge based on the bucket of the counterparty (even if the probability of default of the two counterparties and thus the CVA itself is the same at the analysis date). We suggest removing the separate EE charge from the basic approach and the appropriately conservative calibration of the risk weights.

We applaud the efforts of the Committee in proposing the review of CVA risk framework in this Consultative Document, and for allowing the industry the opportunity to comment. We are available for further comment or clarification, if necessary.

Sincerely,

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