

20 September 2015

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

By email: baselcommittee@bis.org

Dear Sirs,

Review of the Credit Valuation Adjustment Risk Framework – Consultative Document

We welcome the initiative undertaken by the Basel Committee on banking Supervision (BCBS) to revise the Credit Valuation Adjustment (CVA) risk framework. We support the Committee's objective of increasing the risk sensitivity of the CVA risk framework by linking it to the CVA accounting framework; this allows a better recognition of the underlying economic risk and an improved alignment of the framework to industry risk management and hedging practices.

The responses to the questions raised in the consultative document are provided in the Appendix. In addition, we would like to provide some general comments that we consider relevant to the finalization of the framework.

The Consultative Document states that the Committee may decide not to provide for a treatment based on internal models in the final standard. We would urge the Committee to consider the role that internal models have played and continue to play in terms of enhancing risk management practices, and therefore the unintended consequences that such a decision may entail.

We would like to take this opportunity to remind the BCBS that the CVA risk posed by small and medium sized corporates remains in our view very contained, due to the relatively modest contribution to systemic risk posed by these counterparties. In the absence of the exemption created by CRD IV, the application of a CVA capital charge against these exposures would result in an increased cost of hedging for these corporates, with potential unintended consequences from a macro-economic and prudential point of view.

Finally, we would recommend the BCBS to adopt a longer timeline for implementation, in order allow for appropriate testing, calibration and implementation, particularly at times of significant regulatory changes the industry is exposed to.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Davide Crippa'.

Davide Crippa
Global Head Risk Measurement

Appendix

Q1. To what extent do large netting sets; potentially illiquid transactions inside a netting set; and recent disputes affect the internal assessment of the margin period of risk (MPoR)?

Internal assessment of risk does take into account the size of netting sets, the liquidity of transactions and any recent disputes. However, the impact that some of these factors may have on the effective risk has been mitigated over time through actions taken by the industry. For instance, the industry-wide trade compression activity has resulted in portfolios with a reduced number of trades and risk factors, in turn significantly reducing the likelihood of collateral disputes.

In our assessment and based on our historical experience, collateral disputes including those due to illiquid trades generally take much less time to settle than the supervisory floor of 9BD. This was the case even in the event of a large counterparty default such as Lehman Brothers, where the default management process was relatively orderly. This again leads us to believe that the supervisory floor of 9BD is adequate.

Q2. Is Alternative 1 or Alternative 2 preferred with regard to the calculation of MPoR?

Alternative 1 is preferred: for re-margining with a periodicity of N-days, the margin period of risk should be at least equal to the supervisory floor, F, plus N days, where F is proposed to be 9.

We nonetheless recommend that additional analysis be performed to ensure that F is sufficiently granular for different types of counterparties and collateral agreements. For example, a supervisory floor of 9 days for trades with a CCP appears overly conservative.

The supervisory floors provided in paragraph 41(i)-(iii) of the Basel framework appear to be overly prescriptive and unnecessary in light of the developments the industry has gone through in terms of risk management practice. Rather, institutions should assess the adequate MPoR based on the above factors, past experience and local circumstances.

Q3. Should IMM approval be included as an additional eligibility requirement for the FRTB-CVA framework under Option A (ie accounting-based CVA method for generating scenarios of discounted exposure)?

We consider IMM approval to be separate from the FRTB-CVA framework, and therefore would not recommend including it as additional eligibility requirement for the FRTB-CVA framework.

Accounting based CVA, which is typically computed on Front Office systems, and IMM measures, which are generally computed on Risk Management systems, serve different purposes and therefore imply a different level of complexity in their operationalisation. In particular, the former needs to precisely reflect the economic risk related to CVA in order to be able to recognise associated hedging strategies, and therefore it requires a risk-neutral measure implementation. IMM calculations, on the other hand, are generally performed under a real world measure in order to cope with the lack of market-implied data across the combined dimensions of risk factors and tenors, as well as to introduce correlation of risk factors.

Banks could be at different stages of evolution with respect to where models and infrastructure in both areas are. On this basis, conditioning one application on the other would prevent regulators from achieving their objectives of a unified FRTB framework, and therefore we would not recommend introducing this dependency.

Q4. To what extent is there synergy between the calculation of accounting CVA and the EAD calculation for IMM with respect to processes, data and methodology?

While the underlying trade, product and counterparty static data including legal and netting agreements are common between accounting based CVA and IMM models, as explained in the answer to Q3 the underlying market data and models could be different, with accounting based CVA models requiring a risk-neutral measure while IMM models are generally based on a real world measure.

Q5. Is Option A (accounting-based CVA) or Option B (IMM-based CVA) preferred for exposure calculation?

Option A – Accounting based CVA is the preferred exposure calculation method, since it helps alignment of capital charge with the economic risk related to CVA. Better alignment with economic risk would result in a better recognition of hedging strategies used to manage CVA risk.

Q6. Is Option 1 or Option 2 preferred for simulation time horizons?

Option 1 is preferred since it fully replicates the FRTB setup, with the exception of the 1-year liquidity horizon for the idiosyncratic component of credit spreads of non-observable illiquid counterparties.

Even though this may result in different capital requirements for counterparties with similar levels of credit spread and equivalent exposures, this option makes the treatment similar to what is envisaged in FRTB where two risk positions which are otherwise equivalent can have different capital implications based on liquidity horizons.

Option 2 is not recommended, since it proposes to use a unique liquidity horizon for credit spreads of liquid counterparties and for the systematic component of credit spreads of illiquid counterparties instead of those proposed under FRTB. This will lead to incongruity in risk calculation depending on whether an exposure comes from CVA or a traded risk. In addition, this will pose additional burdens to the maintenance of the data infrastructure.