

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

Zurich, 01 October 2015

Re: Review of the Credit Valuation Adjustment Risk Framework - Consultative Document

Dear Sir/Madam,

UBS would like to thank the Basel Committee on Banking Supervision ("BCBS") for the opportunity to comment on the consultative document ("CD") *"Review of the Credit Valuation Adjustment Risk Framework."*

UBS welcomes the BCBS's efforts aimed at enhancing risk and hedge capture, and alignment with industry practices for accounting CVA. In this regard, we provide below our specific feedback to the BCBS CD aimed at these laudable goals. Please note that our response should be considered complementary to the comment letter prepared by the joint industry associations (ISDA, GMFA and IIF), which we also contributed to and strongly support.

Alignment of accounting and regulatory CVA: As noted in the CD, the significant CVA losses banks suffered during the financial crisis provided the original motivation for a capital framework directed at variability in CVA. The prevailing capital standards at the time of the crisis focused on default risk and trading book risk, but did not capture CVA losses. This was a clear gap in the regulatory capital framework.

It is important to recognize that the CVA losses that eroded banks' CET1 during the crisis were direct outputs from the CVA accounting models implemented by each bank. This of course is also the situation today. Accordingly, banks' CVA risk management/hedging practices are driven by their accounting CVA models.

For these reasons, the IMA-CVA approach should align closely with accounting CVA and need not be highly prescriptive. While we recognize that BCBS members harbor concerns regarding variability of CVA accounting practices, large bank CVA models have converged towards the principles of exit price and risk-neutral parameters, and we expect that convergence to strengthen. Notwithstanding, we believe it is appropriate for the BCBS to expect banks' management and capitalization of CVA risk to meet best practices and that it is appropriate for BCBS to put forth its vision of such best practices without prescribing specific requirements for accounting models used for IMA-CVA. The national supervisor should, however, have the latitude to require supplementary capital underpinning of the CVA risk if it determines that a bank's accounting model does not fully meet minimum best

practices. This might be done through periodic comparisons of CVA requirements using the bank's accounting model vs. a model that meets the BCBS best practices. We prefer this to a prescriptive regulatory CVA model which would distort incentives between P&L management and capital management. Our proposed approach would also enhance the integrity of P&L backtesting and incentivize banks to adopt best practices.

Risk factor granularity/materiality required for IMA-CVA: We believe that the set of risk factors for which a bank produces sensitivities must capture the meaningful risks in the portfolio, but in order to be proportionate, it need not be fully comprehensive. In our view, the precise set of risk factors to be included should be agreed between the bank and its primary supervisory authority. We believe the language in paragraph 81 of Annex 1 is too restrictive. It should be possible for a bank to include a risk factor in its exposure model but not calculate sensitivities for purposes of the expected shortfall ("ES") calculation when the risk is not material.

In the spirit of focusing on the true drivers of potential risk, we propose that inclusion of exposure sensitivities for netting sets where the counterparty posts initial margin meeting the BCBS uncleared margin standards be considered optional, given the very small number of paths that would generate exposure exceeding the posted margin. This would include a blanket exemption for OTC transactions where the bank serves as clearing broker at a QCCP. These measures will maintain the focus of the bank's analytic resources on addressing its meaningful CVA risks and will lower operational risk associated with computing risk metrics on large trade sets with immaterial risk.

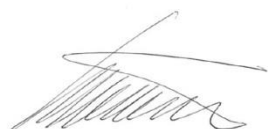
P&L attribution / backtesting: The misalignment between banks' accounting CVA and IMA-CVA holds the potential to result in a weak association between hypothetical P&L and actual P&L. It will likely be necessary to drop the P&L attribution requirement unless the proposed framework is modified to allow for closer alignment of accounting and regulatory CVA. Similarly, the backtesting of actual trading outcomes against regulatory CVA ES, while worthwhile computing, should not be included in the exceptions tally unless IMA-CVA is further aligned to accounting CVA.

Securities Financing Transactions ("SFTs"): SFTs and other forms of collateralized borrowing should remain outside of the CVA regulatory framework. These instruments are not captured in banks' accounting CVA. The repo rate directly embeds counterparty credit risk, as well as collateral risk, with the collateral haircut level sized to address the latter point. SFT exposures are not stochastic and the closeout risk for SFTs is already well captured by current regulation. Moreover, CVA is only meaningful for longer term exposures whereas the vast majority of SFTs mature in ninety (90) days or earlier. A CVA capital requirement for banks' SFT portfolios would therefore be immaterial and would consume significant resources that would be better directed towards material risks.

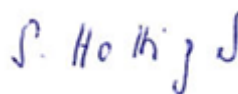
We would be happy to discuss the above comments and recommendations with you in further detail, and to respond to any questions you may have. Please do not hesitate to contact Gerald Elflein (gerald.elflein@ubs.com; +44 207 568 8474), Alan Baxter (alan.baxter@ubs.com; +44 207 567 7590) or Milton Brown (milton-j.brown@ubs.com; +1 203 719 6735).

Yours sincerely,

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