Basel Committee
on Banking Supervision

# Frequently asked questions on Joint QIS exercise

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## Contents

# Frequently asked questions on Joint QIS exercise

## 1. Introduction

This document provides answers to technical and interpretive questions raised by supervisors and participating institutions during the Committee's Joint QIS exercise. **The document intends to facilitate the completion of the Joint QIS reporting templates and is not to be construed as an official interpretation of other documents published by the Committee.**

In addition to the guidance for completing the monitoring template contained in this document, the Committee has published frequently asked questions as its official response to questions of interpretation relating to certain aspects of the Basel III standards. **Therefore, participating institutions should also take into account the frequently asked questions on capital and counterparty credit risk published by the Committee.**[1]

Reporting institutions should also consider the following consultative documents published by the Committee earlier this year:

- The non-internal model method for capitalising counterparty credit risk exposures, June 2013 (www.bis.org/publ/bcbs254.htm),
- Capital treatment of bank exposures to central counterparties, June 2013 (www.bis.org/publ/bcbs253.htm), and
- Margin requirements for non-centrally cleared derivatives – Second consultative document, February 2013 (www.bis.org/publ/bcbs242.htm).

## 2. General

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## 3. NIMM part

1. On the "All banks" worksheet, Panel B asks banks to identify the netting sets based on a non-IMM method (eg CEM) that banks currently employ. However, the five largest netting sets could have both CEM and IMM EAD *within the same* netting set. Do we need to select netting sets where the majority contribution is from a non-IMM method?

   **Answer:** Banks are asked to select regulatory netting sets. For these netting sets, there is typically only one exposure method (eg CEM or IMM) applied.

[1] Basel Committee on Banking Supervision, *Basel III definition of capital – Frequently asked questions*, December 2011; Basel Committee on Banking Supervision, *Basel III counterparty credit risk – Frequently asked questions*, December 2012.

2. How should a bank determine the direction of the delta adjustment for a basis swap (floating rate vs floating rate)?

**Answer:** Consistent with paragraph 49 of BCBS Consultative Document, The non-internal model method for capitalising counterparty credit risk exposures, the direction of the supervisory delta adjustment is determined by the sign of the change in market value of the instrument induced by an upward parallel shift of the entire yield curve.

3. Are there four hedging sets for commodities (as suggested by paragraph 76 of the Consultative Document) or five (as implied by the table in paragraph 96)?

**Answer:** There are four hedging sets defined for broad categories of commodity derivatives, including energy, metals, agricultural and other commodities. The energy category is divided into sub-classes such as crude oil, electricity, natural gas and coal. The presentation in the table in paragraph 96 is meant to highlight that electricity has a higher supervisory factor than all other commodity types.

4. In example 3 of Annex II of the NIMM Consultative Document, the sample trades are given as a WTI and Brent oil forward contract. As clarified in the example, the difference between WTI and Brent can be ignored, as they belong to the same commodity type "Crude Oil". Please clarify how granular the commodity types would need to be in order to aggregate into a single effective notional (particularly for refined energy products). It is clear that commodity types within "Metals" can be grouped together by type of metal, however it is less clear on how we would group gasoline and jet fuel, for example, within the "Energy" hedging set.

**Answer:** Fundamental difference of nature should be the main criterion to distinguish commodity types in a commodity derivative portfolio for the purpose of the NIMM calculation. The Consultative Document states that location and quality should be ignored in the determination of commodity types. If ambiguity remains between two commodity underlyings due to their similar nature, the ratio between their market value should demonstrate a long, stable dynamic for them to be included in the same commodity type.

5. Which of the following formulations for the PFE add-on should be used for a margined netting set in row 26 of the "IMM banks – IR" worksheet:

(a) The formulation for the add-on in paragraph 63 of the Consultative Document;

(b) The formulation in paragraph 81, which scales down the add-on by the appropriate margin period of risk; or

(c) The formulation implied by paragraph 85 that includes the effects of the multiplier for excess collateral and negative mark-to-market?

**Answer:** The formulation in paragraph 81 should be used for margined netting sets. This would also apply to rows 27-29 of the "IMM banks – IR" worksheet.

6. A bank has an approved A-IRB model for corporate exposures whereby the effect of collateral is taken into account in the LGD. In determining the EAD under NIMM, the replacement cost is defined as RC=max (V-C, 0). Should the bank not include the effect of collateral in the replacement cost formulation since it is included for purposes of LGD (ie to avoid double counting) or should the scaling formula be used to determine $EAD_{collateralised}$?

**Answer:** The scaling formula shown in Panel B (row 19) on page 6 of the Instructions for Joint QIS – NIMM part should be used.

7. In some Credit Support Annexes, the threshold values can be very high compared to actual exposure values. This can distort the calculation of EAD under NIMM and, in particular, the calculation of the replacement cost. How should banks calculate EAD in these circumstances?

**Answer:** Banks should use their best efforts to exclude netting sets where the threshold value is so large that exchange of margin is expected to be rare.

8. Are the supervisory factors included in the "Margin" column of Table 1 (paragraph 96 of the Consultative Document) directly applicable to margined netting sets?

**Answer:** The set of supervisory factors for unmargined netting sets, provided in the column "No margin" of Table 1, is the only set of supervisory factors that apply at the trade-level to form the asset class-level add-ons. For margined netting sets, the adjustment given in paragraph 81 of the Consultation Document applies to the asset class-level add-on. The supervisory factors provided in the "Margin" column of Table 1 should not be used in the calculation; they only reflect the application of this adjustment to the supervisory factors for unmargined netting sets with a 10-day MPOR.

## 4. CCP framework part

9. It is not clear what non-IA CCPs should report in row 11 of Panel A in the "CCP clearing member information" worksheet.

**Answer:** Non-IA CCPs are asked to designate their clearing members that are banks by entering "Bank" for the names of these clearing members. For all other clearing members of non-IA CCPs, the "Name" field should be left blank.

10. Please clarify which supervisory factors should be used in computing the add-ons for credit and equity that must be entered into the CCP framework spreadsheet. Should these supervisory factors be the factors assuming no margin, or should the add-ons be computed with supervisory factors adjusted for margin? If the supervisory factors assume margin is posted, should they be the factors listed in the NIMM Consultative Document (BCBS 254), item 96, table 1, which reflect a margin period of risk of 10 days, or should they be rescaled (by 1/sqrt(2)) to reflect a MPOR of 5 days?

**Answer:** The relevant supervisory factors are defined on page 7 (Table 6) of the Instructions for Joint QIS – CCP framework part. They reflect a 10-day MPOR. They should not be rescaled to reflect a 5-day MPOR.

11. What do you consider to be the mark-to-market value of derivative trades as requested in rows 593-594 of the "CCP clearing member information" worksheet?

Example: Consider a futures contract with a fair value of $88 at day 50. On day 51, the fair value is $90. This would require the holder of one side of the futures contract to pay $2 on day 51 to track the changes in the contract value. Suppose that this margin has not yet been paid.

In this example, would the mark-to-market value be $2 or $90 (or does the phrase "this should not include variation margin that has been called but not received" mean that the requested value is $90 - $2 = $88)?

**Answer:** The mark-to-market value (as that term is used in rows 593-594) would be $2, which represents the change in value since the last exchange of variation margin.

12. Panel B3 of the "CCP clearing member information" worksheet asks for the number of transactions in a netting set. Is this value meant to reflect the number of transactions or positions?

Example:

- If on reporting date Member A bought 1 contract X and sold 1 contract X, should the CCP report two transactions or nothing?
- If on reporting date Member A bought 2 contracts X and sold 1 contract X, should the CCP report two transactions or one position (long 1 contract X)?

Would the answer change if multiple transactions are "compressed" into a single transaction via novation?

**Answer:** The reporting in Panel B3 is meant to reflect the number of transactions in the netting set *as of the reporting date*. The number of transactions reported should be consistent with the trades aggregated in the following rows (eg the "Sum of add-ons" and the "Sum of squares of add-ons" for credit and equity derivatives). If the summation was performed on the basis of two opposite transactions, then the number of transactions should also be two. If the two opposing transactions were compressed (novated) and thereby not included in the corresponding summation, then the number of transactions should be zero.

## 5. Incentives assessment part

13. In all instances, banks are asked to report the CVA capital charge on sub-portfolios based on a sub-group of counterparties or clients. Given that the CVA charge is calculated at a portfolio level, how are banks supposed to calculate sub-portfolio CVA charges?

**Answer:** Banks are asked to use an appropriate allocation methodology of their choice to allocate RWA for the CVA capital charge to sub-portfolios. The methodology should ensure that the sum of the reported sub-portfolio values (including both non-centrally cleared exposures and exposures of clearing members to clients) equals the overall RWA for the CVA capital charge.

14. How should banks report the CVA capital charge on clearing eligible derivatives in the "CurrentP eligible" worksheet? Should they calculate a standalone CVA charge or the contribution of these trades to the overall CVA charge resulting from an appropriate allocation methodology?

**Answer:** Banks are asked to leave the cells related to the CVA capital charge empty in the "CurrentP eligible" worksheet.

15. The CVA capital charge can be reduced on account of certain eligible hedges (eg using single-name CDS or CDS indices). In States 1 and 2 of the incentives assessment, the CVA charge needs to be calculated on a portfolio that is different from the one that the bank has today. In State 1 more trades are margined. In State 2 more trades are centrally cleared. However, there are no instructions on whether and, if so, how the CVA hedges should be assumed to adjust to the future states.

**Answer:** Banks are asked to ignore the effect of CVA hedges when reporting RWA for the CVA capital charge in States 1 and 2. To ensure consistency across states, banks are also asked to ignore hedges when reporting CVA RWA in State 0. To more fully capture the extent of hedging activity in this area, banks are asked to report their hedged CVA value for State 0 in the "Remarks" column of the worksheet. The same treatment would also apply for the CCR default charge (ie banks should assume no hedging for State 0 but are asked to reflect the hedged value in the "Remarks" column).

16. Which CVA charge are EU banks supposed to report: the BCBS Basel III version or the EU CRD IV version with the carve outs?

    **Answer:** As noted in Section 2.5 of the Instructions for Joint QIS – Incentives assessment part, banks are asked to report CVA charges in accordance with Basel III capital rules even if they are not currently subject to those requirements. If a bank is unable to report information that is compliant with the full Basel III requirements (regardless of national implementation), it should note this in the "Remarks" column of the worksheet.

17. There are five business categories in the incentives assessment, including "Dealer banks", "Non-dealer banks", "Non-bank financials – pension funds and insurers", "Non-bank financials – hedge funds, asset managers, and others", and "Non-financial firms". Could you clarify how we could categorise them? For example, which category can we put swap houses and securities firms? Can we assume that a swap house is a "Dealer bank" if it is a consolidated subsidiary of a bank?

    **Answer:** Banks are asked to exercise judgement in assigning institutions to the five business categories.