

Basel Committee on Banking Supervision

SRP

Supervisory review process

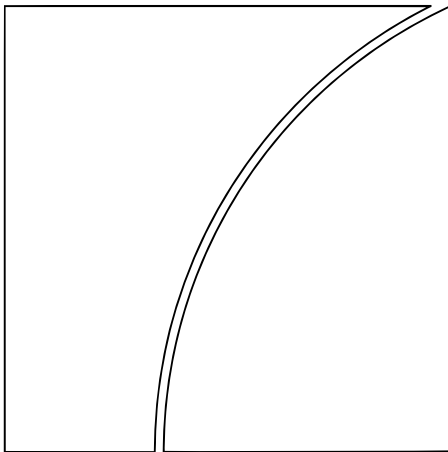
SRP33

Market risk

This chapter describes risks that supervisors should consider when evaluating banks' market risk practices under Pillar 2.

Version effective as of 15 December 2019

First version in the format of the consolidated framework.



BANK FOR INTERNATIONAL SETTLEMENTS

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Market risk in Pillar 2

33.1

Clear policies and procedures used to determine the exposures that may be included in, and those that should be excluded from, the trading book for purposes of calculating regulatory capital are critical to ensure the consistency and integrity of firms' trading book. Such policies must conform to [RBC25.4](#). Supervisors should be satisfied that the policies and procedures clearly delineate the boundaries of the firm's trading book, in compliance with the general principles set forth in [RBC25](#), and consistent with the bank's risk management capabilities and practices. Supervisors should also be satisfied that transfers of positions between banking and trading books can only occur in a very limited set of circumstances. A supervisor will require a firm to modify its policies and procedures when they prove insufficient for preventing the booking in the trading book of positions that are not compliant with the general principles set forth in [RBC25](#), or not consistent with the bank's risk management capabilities and practices.

33.2

Prudent valuation policies and procedures form the foundation on which any robust assessment of market risk capital adequacy should be built. For a well diversified portfolio consisting of highly liquid cash instruments, and without market concentration, the valuation of the portfolio, combined with the minimum quantitative standards set out in [MAR30.14](#) to [MAR30.17](#), as revised in this section, may deliver sufficient capital to enable a bank, in adverse market conditions, to close out or hedge its positions within 10 days in an orderly fashion. However, for less well diversified portfolios, for portfolios containing less liquid instruments, for portfolios with concentrations in relation to market turnover, and/or for portfolios which contain large numbers of positions that are marked-to-model this is less likely to be the case. In such circumstances, supervisors will consider whether a bank has sufficient capital. To the extent there is a shortfall the supervisor will react appropriately. This will usually require the bank to reduce its risks and/or hold an additional amount of capital.

33.3

A bank must ensure that it has sufficient capital to meet the minimum capital requirements set out in [MAR30](#) and to cover the results of its stress testing required by [MAR30.5](#), taking into account the principles set forth in [SRP20.19](#) and [SRP20.22](#). Supervisors will consider whether a bank has sufficient capital for these purposes, taking into account the nature and scale of the bank's trading activities and any other relevant factors such as valuation adjustments made by the bank. To the extent that there is a shortfall, or if supervisors are not satisfied with the premise upon which the bank's assessment of internal market risk capital adequacy is based, supervisors will take the appropriate measures. This will usually involve requiring the bank to reduce its risk exposures and/or to hold an additional amount of capital, so that its overall capital resources at least cover the Pillar 1 requirements plus the result of a stress test acceptable to the supervisor.

33.4

For banks wishing to model the specific risk arising from their trading activities, additional criteria have been set out, including conservatively assessing the risk arising from less liquid positions and/or positions with limited price transparency under realistic market scenarios. Where supervisors consider that limited liquidity or price transparency undermines the effectiveness of a bank's model to capture the specific risk, they will take appropriate measures, including requiring the exclusion of positions from the bank's specific risk model. Supervisors should review the adequacy of the bank's measure of the incremental risk capital

charge; where the bank's approach is inadequate, the use of the standardised specific risk charges will be required.