

Basel Committee on Banking Supervision

RBC

Risk-based capital requirements

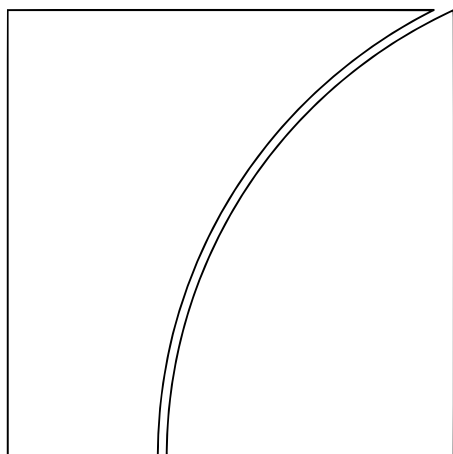
RBC25

Boundary between the banking book and the trading book

This chapter sets out guidance on instruments
to be included in the trading book.

Version effective as of 15 December 2019

First version in the format of the consolidated
framework.



BANK FOR INTERNATIONAL SETTLEMENTS

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25.1

A trading book consists of positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book. To be eligible for trading book capital treatment, financial instruments must either be free of any restrictive covenants on their tradability or able to be hedged completely. In addition, positions should be frequently and accurately valued, and the portfolio should be actively managed.

25.2

A financial instrument is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. Financial instruments include both primary financial instruments (or cash instruments) and derivative financial instruments. A financial asset is any asset that is cash, the right to receive cash or another financial asset; or the contractual right to exchange financial assets on potentially favourable terms, or an equity instrument. A financial liability is the contractual obligation to deliver cash or another financial asset or to exchange financial liabilities under conditions that are potentially unfavourable.

25.3

Positions held with trading intent are those held intentionally for short-term resale and/or with the intent of benefiting from actual or expected short-term price movements or to lock in arbitrage profits, and may include for example proprietary positions, positions arising from client servicing (eg matched principal broking) and market-making.

25.4

Banks must have clearly defined policies and procedures for determining which exposures to include in, and to exclude from, the trading book for purposes of calculating their regulatory capital, to ensure compliance with the criteria for trading book set forth in [RBC25](#) and taking into account the bank's risk management capabilities and practices. Compliance with these policies and procedures must be fully documented and subject to periodic internal audit.

25.5

These policies and procedures should, at a minimum, address the general considerations listed below. The list below is not intended to provide a series of tests that a product or group of related products must pass to be eligible for inclusion in the trading book. Rather, the list provides a minimum set of key points that must be addressed by the policies and procedures for overall management of a firm's trading book:

1. the activities the bank considers to be trading and as constituting part of the trading book for regulatory capital purposes;
2. the extent to which an exposure can be marked-to-market daily by reference to an active, liquid two-way market;
3. for exposures that are marked-to-model, the extent to which the bank can:
 1. identify the material risks of the exposure;
 2. hedge the material risks of the exposure and the extent to which hedging instruments would have an active, liquid two-way market;
 3. derive reliable estimates for the key assumptions and parameters used in the model.
4. The extent to which the bank can and is required to generate valuations for the exposure that can be validated externally in a consistent manner;

5. The extent to which legal restrictions or other operational requirements would impede the bank's ability to effect an immediate liquidation of the exposure;
6. The extent to which the bank is required to, and can, actively risk manage the exposure within its trading operations; and
7. The extent to which the bank may transfer risk or exposures between the banking and the trading books and criteria for such transfers.

25.6

The following will be the basic requirements for positions eligible to receive trading book capital treatment.

1. Clearly documented trading strategy for the position/instrument or portfolios, approved by senior management (which would include expected holding horizon).
2. Clearly defined policies and procedures for the active management of the position, which must include:
 1. positions are managed on a trading desk;
 2. position limits are set and monitored for appropriateness;
 3. dealers have the autonomy to enter into/manage the position within agreed limits and according to the agreed strategy;
 4. positions are marked to market at least daily and when marking to model the parameters must be assessed on a daily basis;
 5. positions are reported to senior management as an integral part of the institution's risk management process; and
 6. positions are actively monitored with reference to market information sources (assessment should be made of the market liquidity or the ability to hedge positions or the portfolio risk profiles). This would include assessing the quality and availability of market inputs to the valuation process, level of market turnover, sizes of positions traded in the market, etc
3. Clearly defined policy and procedures to monitor the positions against the bank's trading strategy including the monitoring of turnover and stale positions in the bank's trading book.

25.7

It is the Committee's view that, at the present time, open equity stakes in hedge funds, private equity investments, positions in a securitisation warehouse and real estate holdings do not meet the definition of the trading book, owing to significant constraints on the ability of banks to liquidate these positions and value them reliably on a daily basis.

25.8

When a bank hedges a banking book credit risk exposure using a credit derivative booked in its trading book (ie using an internal hedge), the banking book exposure is not deemed to be hedged for capital purposes unless the bank purchases from an eligible third party protection provider a credit derivative meeting the requirements of [CRE22.86](#) vis-à-vis the banking book exposure. Where such third party protection is purchased and is recognised as a hedge of a banking book exposure for regulatory capital purposes, neither the internal nor external credit derivative hedge would be included in the trading book for regulatory capital purposes.

25.9

Term trading-related repo-style transactions that a bank accounts for in its banking book may be included in the bank's trading book for regulatory capital purposes so long as all such repo-style transactions are included. For this purpose, trading-related repo-style transactions are defined as only those that meet the requirements of [RBC25.3](#) and [RBC25.6](#) and both legs are in the form of either cash or securities includable in the trading book. Regardless of where they are booked, all repo-style transactions are subject to a banking book counterparty credit risk charge.