

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland
baselcommittee@bis.org.

13th March, 2009

**Re: "Revisions to the Basel II market risk framework" (BCBS 148) and
"Guidelines for computing capital for incremental risk in the trading
book" (BCBS 149)**

Dear Sirs and Madams,

Nomura Holdings, Inc. is pleased to have an opportunity to make some constructive comments on the Basel Committee on Banking Supervision's proposed revisions to the market risk framework and the guidelines for computing capital for incremental risk in the trading book. Firstly, we would like to express our sincere appreciation towards all the efforts the Basel Committee have made in order to achieve more appropriate and robust regulatory framework under the recent predicament in the global financial market. And also we would like to show strong support for the proper and transparent process to convince the financial market participants and consumers of the necessity of such revised framework.

We agree that the current turmoil was partly caused by some financial institutions' underestimation of the risk involved in the trading book assets and the magnitude of the losses on those assets is enormous, leading European and US governments to use taxpayers' money to save some systemically important institutions in order to prevent a catastrophic event. Whilst we recognize that the historic use of the trading book - in some cases - provided a preferential capital treatment, the converse has also recently been true where use of the banking book has allowed mark-to-market relief. In many such cases where asset prices have declined dramatically, this has effectively provided huge capital relief to banking book assets.

Although we recognize that internal ratings processes can be more dynamic than external ratings, many highly rated assets are currently priced for significant expected loss. Where firms have taken MTM losses against well-rated assets, (where no banking book loss provision would have been necessary), the trading book treatment has been far more punitive in capital terms.

We would like to ask the Basel Committee to consider a new framework that captures all significant risks but also give firms a clear incentive to improve and enhance their risk management framework. In particular, we would like the Basel Committee to consider the following:

Stressed VaR - Double counting of risk

We understand the need for an increase in the market risk charge following the magnitude of the losses in the trading book experienced in many banks. However, the “additive” approach where the stressed VaR is simply added to the general VaR and specific risk will lead to double counting of the same risk in many cases. A better approach would be to allow the use of more integrated models for those institutions who can demonstrate the capabilities of modelling stressed VaR. If this is not acceptable to the Committee at this stage, then alternative approaches to reduce the impact of double counting should be considered. Some alternatives are:

- Using a weighted average of the stressed VaR and general plus specific VaR:
or
- Reducing the multiplication factor of 3 for the stressed VaR as well as the general VaR plus specific risk.

Capital increases during an economic downturn

Across the economic cycle we agree that there should be an increase in the overall level of market risk capital. However, we are concerned about the point in the economic cycle at which this increase is introduced. An increase in the market risk capital charge during the current economic downturn is most likely to aggravate the pro-cyclical nature of VaR models. This could further destabilise the financial system, prolonging liquidity crises and requiring more government bail-outs. Whilst we recognise that the financial system carried too much risk earlier in the cycle, we believe that immediate action to increase capital requirements would accelerate the spiral of asset deleverage. A more orderly approach would be to implement the new stressed VaR charge gradually as the world economy emerges from economic recession and this may not be by 31 Dec 2010. Since the current standard for VaR is procyclical by nature (via asset volatilities and correlations), we believe the timing of these changes needs to be sensitive to the point in the cycle.

Overall, we would encourage the Basel Committee to provide further explanation on how the capital increase arising from the stressed VaR charge is intended to work throughout the downturn and upturn of an economic cycle.

Use of an integrated modelling framework

The current proposals do not allow for integrated models which incorporates a better combination of market and credit modelling framework where stressed or tail VaR, default and credit migrations can be modelled more comprehensively and more in line with the models that are already used for internal capital allocation. The usual argument against the use of these internal models is that these models are not sufficiently developed. However, this is exactly the reason for the regulators to provide an incentive to the industry to develop more advanced risk management models that would more accurately and more comprehensively capture the risks within an institution. Those institutions who already have an integrated approach for internal management or for regulatory capital should be given the opportunity to satisfy the regulators that the use of such models would be sufficient to meet the new requirements.

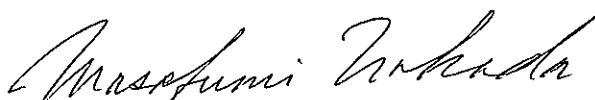
High stressed VaR and IR charges may encourage transfers from the trading book to the banking book

The high stressed VaR and IR charges could have an undesired consequence of reducing or even eliminating the difference between the trading book and banking capital charges. This discourages effective risk management by encouraging transfers from the trading to the banking book. Banking book capital charges may be high but it does not mean that these assets are “safe” as typically the daily controls (daily mark-to-market and risk calculations etc) in the trading book are better at ensuring that risk mitigation action is taken on a timely basis. We believe strongly that mark to market losses in trading books have been taken earlier than likely loan loss provisions in banking books. Not only has this been more reactive to changes in the financial environment, but it has also depleted the capital of those prepared to take their losses as they are priced by the market. Although, ratings based models have improved dramatically in recent years there can be no doubt that they have lagged market implied default probabilities reflected in MTM books. Transfers to the banking book where there is no mark-to-market would make these losses less apparent and so another “loss bubble” could be building up in the banking book with a devastating outcome for financial markets in time to come.

We encourage the Basel Committee to consider the consequences of this undesired and potentially explosive impact before introducing the high stressed VaR and IR charges.

Lastly, we would like to express our deep appreciation to the Basel Committee for designing a complicated and exquisite regulatory framework. Therefore, we hope our comments will be taken into consideration in the final draft of the Revisions to the Basel II Market Risk Framework.

Yours sincerely,



Masafumi Nakada
Executive Managing Director and
Chief Financial Officer