

## Comments

on the Basel Committee's consultative document  
on the revised Standardised Approach for Market  
Risk (Fundamental Review of the Trading Book)

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,000 banks.

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## **Comments on the Basel Committee's consultative document on the revised Standardised Approach for Market Risk (Fundamental Review of the Trading Book) dated 16 April 2014**

### **I. General comments**

We welcome the Basel Committee's making available for discussion the consultative document on the revised Standard Approach for Market Risk.

We are particularly pleased that the Basel Committee has acted on the suggestion from market participants and has not only further developed the Cash Flow Approach and now presented an "Adjusted Cash Flow Approach" ("ACFA") but has also developed a "Sensitivity Based Approach" ("SBA") based on sensitivities.

The German Banking Industry Committee ("GBIC") is amongst the market participants that favoured the development of a sensitivity-based approach in their opinions on the consultation paper "Fundamental review of the trading book: a revised market risk framework (BCBS 265)".

The Basel Committee has now presented its idea of the concrete design of an SBA. On the basis of this detailed idea the GBIC remains of the opinion that the SBA is preferable to the ACFA. However, in the further development of the SBA greater attention should be paid that the banks should be allowed to use their existing sensitivity data and that the regulations do not contradict the risk controlling procedures used in the banks. As already explained in our comments of January 2014, sensitivity calculation often depends on the system. So that existing sensitivities from the controlling systems can be used for reporting, the regulations must allow a certain leeway.

We would like to stress that the SBA developed by the TBG represents something totally new for the banks. Given the brief consultation period, virtually no bank or banking association will have been able to analyse the proposal in detail, let alone quantify its implications. Our comments are therefore necessarily of a general nature. We would nevertheless like to highlight a number of design flaws which we have noted.

As a main point we would like to emphasize, that the proposed risk weights, particularly in comparison with the current standard method (e.g. for equities and FX at present 8%), appear to be very high or even politically motivated. Admittedly, as already mentioned, in the short time available, we have not conducted any impact assessment, so that there is as yet no conclusive opinion on the suitability of the general level of the selected weight factors. Nevertheless, the uniform shift of 250 basis points in the credit spread risk (Bucket 1, paragraph 57, page 10) for German federal and federal state bonds and mortgage bonds (especially in comparison with other investment-grade sovereign bonds like Spain's) seems to be clearly too high.

### **II. Specific comments on the SBA**

These specific comments refer to the numbered points/paragraphs as well as the relevant pages in the regulatory text. In this context we would like to point out that the numbering in the SBA is inconsistent. E.g., after paragraph 116 on page 8 there follows paragraph 49. In

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addition to the paragraph we therefore always give the page also on which the paragraph appears.

Also the product descriptions starting on page 2 are in part inconsistent. E.g. the following products (sometimes with differing descriptions) appear more than once

- Swaps: paragraph 79, page 4 and paragraph 98 page 6
- Inflation: paragraph 100, page 6 and paragraph 81, page 4
- Swaptions: paragraph 76, page 4 and paragraph 97, page 6 (as interest rate option)

### **Details:**

**Paragraph 56, page 1:** In our view the use of zero coupon rates is more expedient than using market rates, since dealing with the latter leads to many problems/open questions in practice (e.g. short futures quotes, par rate effects, bond prices as market data for credit spread curves...). Apart from that, the Basel Committee's cash flow based proposal is based likewise on zero rates, cf. annex 1, paragraph 107, page 11).

**Paragraph 60, page 2:** In general, an institution will have available in its systems yield curves with more than the proposed 10 vertices. These additional sensitivities would have to be allocated to the proposed vertices which is is not defined. A sensible allocation would be for example the interpolation to the nearest vertices or a sensitivity allocation to the next vertex. Interpolation would be in line with intuitive understanding. However, the gap of not completely hedged risk positions could be problematic (in relation to the imperfect hedge).

**Paragraph 62, page 2:** The usual market data points (and thus the usual and available points for the sensitivity calculation) for CSR non-securitisation risk factors are 3Y, 5Y, 7Y, 10Y. The necessary data should, thus, be limited to these data points.

**Paragraph 64, page 2:** Our comments on paragraph 62 apply analogously to securitisations. For many of these proposed vertices there may not be sufficient market data available. We, thus, would recommend for a significant limitation of the relevant data points.

**Paragraph 75, page 3:** Here, it has to be clarified that in the case of GIRR and CSR a delta-equivalent position is not necessary, since this is already reflected via the sensitivities.

**Paragraphs 76 and 79, page 4:** In our opinion, with a sensitivity-based GIRR calculation the decomposition of the (interest rate) swaptions and swaps makes no sense.

**Paragraph 114, page 8:** "Identical" is very narrowly defined here. Particularly with regard to derivatives, the requirement of the "same contractual parameters" is defined too narrowly. A strict interpretation would thus regard even two identical swaps - except with regard to the start date - as non-identical. Our suggestion here would be to allow netting, provided the trade type (bond, interest rate swap, interest rate cap) is identical and with regard to derivatives, the underlying (e.g. same interest rate index) is identical. In particular, for plain vanilla interest rate derivatives such as swaps and caps/floors full netting would certainly be

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appropriate. We would, moreover, draw attention to the fact that a too rigorously selected netting criterion could significantly raise capital adequacy requirements. In addition, the SBA approach appears to allow less offsetting than the ACFA approach.

**Paragraph 49, page 8:** The use of a correlation of 0.9 for offsetting in the GIRR of two exactly reverse positions on two yield curves of a currency appears very conservative. The resulting risk amounts to 45% of the risk of the open position. Here, the reduction of the correlation value should be considered.

**Paragraph 54, page 9:** "Identical" is again very narrowly defined. Particularly with respect to derivatives the requirement of the "same contractual parameters" is defined too narrowly. A strict interpretation would thus regard even two identical CDS - except with regard to the start date - as non-identical. Here, our suggestion would be to allow netting, provided the trade type (bond, or CDS) and bond issuer and/or the CDS-underlying are identical. In this context, we would also prefer netting between bond and CDS.

**Paragraph 55, page 10:** In footnote 2 the factor should presumably be 0.0250 (instead of 0.0230), cf. paragraph 57.

**Paragraph 59, page 11:** Here too (cf. our comments on paragraph 54, page 9) the use of a correlation of 0.9 for offsetting in the GIRR of two exactly reverse positions on two credit spread curves appears very conservative. The resulting risk amounts to approximately 45% of the risk of the open position.

**Paragraph 60, page 11:** We consider the aggregation in the case of the same name in the case of the residual bucket as inappropriate. Even if issuers cannot be clearly allocated to another bucket, there exists a clearly higher netting relationship via the same credit underlying alone.

In addition, we regard 60% for the aggregation via the same name in the "non-residual bucket" in the "different signs" case as too small. This does not match content-wise to the 90% in the case of the same sign.

**Paragraph 61, page 12:** It seems unusual that the correlation between investment grade and high yield in the same sector is reflected in different ways (e.g. bucket 9 to bucket 3 in contrast to 10 to 4).

**Paragraph 64, page 12:** In footnote 3 the factor should presumably be 0.0300 (instead of 0.0180), cf. paragraph 66, page 13.

**Paragraph 66, page 13:** In footnote 4 it is unclear to which bucket the underlying "retail exposure" or "special purpose entity" is allocated in place of corporate CDOs.

**Paragraphs 77 and 78, page 16:** We suppose that the aim of distinguishing between "large" and "small" equity names via the market capitalization is to have a strict criterion for market liquidity of each equity name. However, we doubt that market capitalization alone would be

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suitable here. In practice, equity names which are part of a major equity index are more fungible than those which are not. The major equity indices generally have several criteria for assessing which equity names would be part of it and which not, one being the "free float" market capitalization (cf., e.g., the German DAX criteria). Thus in our view, a practical way for assessing market liquidity of an equity name would be whether it is part of a major equity index or not. Such a "major equity index" could be defined similarly as it is already implemented by the European Banking Authority (cf. EBA/ITS/2013/10).

**Paragraph 85, page 17:** This point appears to be no longer necessary.

**Paragraph 89, page 18:** Concerning the regulatory market risk categories, the underlying gold is currently classified as foreign currency, not commodity. We deem it appropriate to continue this classification.

**Paragraph 95, page 20:** A uniform correlation of 60% for all currency combinations does not appear to be risk sensitive, cf., for example, the behaviour of EUR/USD vs. EUR/CAD and EUR/USD vs. EUR/RUB. We thus, would favour a differentiated specification of the correlation of the most important currency pairs. The uniform correlation could be kept for all other currency pairs.

**Paragraph 116, page 24:** Here, there are lacking scenarios in which the volatility is unchanged while the underlying price or rate goes up/down (which are included in the current regulatory scenario-matrix method).

**Paragraph 119, page 25 in combination with paragraph 77 page 4, paragraph 124, page 26 and paragraph 127, page 26:** The treatment of the underlying shifts for basket products in the scenario matrix defined in paragraph 199 seems hardly manageable. As an example, consider an equity basket consisting of 20 equity names. The task here would be to find the combination of up/down/zero shifts of each underlying equity name which maximizes or minimizes, respectively, the payoff. This leads to testing  $3^{20} = 3.5$  billion combinations, the result usually being not unique. Moreover, it would then be unclear how to calculate the delta which is to be stripped out (cf. paragraph 124), in particular if the aforementioned combination is not unique. Furthermore, paragraph 77 (in combination with paragraph 75 page 3) seems to allow the decomposition of a basket option into delta equivalent notional positions of its constituents for the calculation of the delta position, which would then result in the application of different (delta) shifts as in the scenario matrix. Also, the requirement of separating each basket (from its constituents) in paragraph 127 bullet 4 would completely disincentive hedging a basket option by single name options but rather have the naked basket position. Thus in our view, it would be more consistent and practicable to treat basket options in the scenario matrix either completely as having one separate underlying (for determining the delta position, for the scenarios, and for stripping out the delta) or in analogy to the underlying constituents, i.e. distinguishing only by the buckets defined for the underlyings. This approach would be similar to what has recently been specified by the European Banking Authority (cf. EBA/RTS/2013/13).

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**Paragraph 120, page 25:** The differing treatment of vega-long and vega-short positions leads to a breaking up of back-to-back positions (micro hedges) and is therefore not appropriate.

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