Comments

Revisions to the minimum capital requirements for
market risk (BCBS d436)

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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 1,700 banks.

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On March 22, 2018, the Basel Committee on Banking Supervision issued the "Revisions to the minimum capital requirements for market risk" for consultation. We appreciate the opportunity to submit our comments.

1. General comments

The German Banking Industry Committee expressly welcomes the discussion of further revisions to the FRTB standard, especially as a response to the larger problem areas identified by the banking industry is also evident. This applies in particular to the recalibration of the standardised approach. However, this does not go far enough, as the recalibration does not apply to all asset classes. Especially for credit spread risks attributable to covered bonds, the risk weights appear to be far too high. A significantly lower risk weight would be appropriate here.

We particularly welcome those changes that ensure reasonable costs and proportionality, especially for smaller institutions without current trading book activities or only low trading activities and market risks. In this context, especially the option of continuing to use the current standardised approach to market risk as a simplified approach (see 4. "Simplified alternative to the standardised approach"), which mirrors the approach taken in the EU (draft CRR 2), is welcomed very much as it saves smaller banks from incurring disproportionately high implementation costs. However, the proposed multipliers – especially for equities – appear to us to be far too conservative.

2. Specific comments

Boundary between the trading book and the banking book

We welcome the intention to add clarifications relating to the boundary between the trading and banking books.

Nevertheless, we would like to note that, in our view, instrument-specific assignments to the trading book without taking clearer account of the trading intent still do not always appear to be adequate and are likely to result in a high level of uncertainty and effort associated with the necessary rebuttal of the trading book presumption on both the bank and supervisory sides (see Annex E – Article 12ff.). In particular in the case of investment strategies in which the listed products are used as long-term investments, the criteria and products on the presumptive list may continue to result in unjustified assignment to the trading book, which would have to be rebutted separately or would at least be subject to review by the supervisor. Our understanding here is that assignment to the banking book is still possible even if the criteria are met and there is no trading intent. A clarification that defined benefit pension funds should be explicitly allocated to the banking book would be desirable.

It is our understanding that the revisions made to the boundary between the trading book and the banking book relating to the assignment rule for equity investments in funds now allow a more differentiated and more narrowly defined boundary with regard to assignment to the trading book. If we have interpreted this correctly, we expressly welcome it. The question arises in this context, however, of whether the new formulations in Article 15a sharpen a sufficiently clear differentiation and focus on criteria that really support the trading intent. In particular, the wording is not sufficiently clear when it comes to the mixed use of "daily real prices" and "daily price quotes". In this case, the conscious differentiation that only "real prices", which we interpret as prices based on actual transactions on trading venues, can be used should presumably be defined more precisely for the issue of trading book assignment. In our view,

for example, it should in particular be clear that funds for which daily prices are available from the investment company, but for which there is no daily pricing based on trading, may be assigned to the banking book. It is also necessary to clarify the extent to which "daily real prices" relate to the requirements for each non-modellable risk factors defined in the internal models approach. We do not believe that non-IMA banks are in a position to meet the corresponding documentation obligations for the purposes of defining the boundary between the trading book and the banking book.

We also wish to request clarification with regard to the instruments that are required to be assigned to the trading book as instruments in the correlation trading portfolio in accordance with Article 13(a) (BCBS d352). Article 61 (BCBS d352) defines the conditions under which an instrument must be assigned to the correlation trading portfolio. Article 61(b) (BCBS d352) refers to securitisations whose reference entities are single-name products with a liquid two-way market. To examine whether a liquid market exists for the reference entity, it must be possible to look through to all reference entities in the securitised loan portfolio. However, this is mostly not the case for securitisations with highly granular loan portfolios as underlyings, e.g. loan exposures to small and medium-sized enterprises or consumers. For purposes of defining the boundary between the trading book and the banking book, it should therefore be clarified that securitisations with highly granular loan portfolios as underlyings and whose contractual documentation does not permit a look through to individual reference entities debtors are regarded as securitisations with reference entities for which no liquid two-way market exists, and that therefore cannot be assigned to the trading book.

Hedging of structural FX positions

From an economic point of view, we welcome the revisions as a sensible move.

However, it remains unclear how the supervisor's approval can be obtained sufficiently quickly in the event of a short-term need to adjust the excluded position (see Annex E – Article 4(e)) in order to avert negative economic effects or negative effects on RWAs. An obligation to notify the supervisor appears to be more expedient here.

Simplified Standardised Approach

By using a simplified approach based on the existing Basel II standardised approach (see Annex F – Article 3), the BCBS offers smaller institutions in particular a very welcome pragmatic alternative to the potentially disproportionately high implementation costs of a new standardised approach.

The approach also corresponds to the preferred approach communicated in advance by the German Banking Industry Committee.

With regard to the RWA multipliers for each risk class proposed in this context (see Annex F – Article 3), basing the capital requirements on the FRTB standardised approach with a "slightly more conservative" capitalisation is appropriate; the concrete and, including in special cases, as homogeneous a structure as possible remains to be seen.

Nevertheless, the increases in own funds requirements still appear to be excessively high compared with the current calibration based on the specified weighting ranges.

In our opinion, a further comparison of more extensive QIS figures, which we understand is also planned, should lead to mitigating effects. Qualifying the above, however, we wish to note that the QIS figures may not be fully representative due to the limited participation of smaller banks, which may possibly be subject to a different risk profile with regard to their trading activities.

For example, there is no representative inclusion in the QIS comparisons of a long-term investment strategy today in equities that may be eligible for assignment to the trading book in the future (listed equities) and could justify a lower volatility assumption. It can be observed, for instance, that positions assigned to the trading book today tend to be of a lower quality and a higher volatility than an equity selection focused on long-term investment strategies. Ultimately, in our view, there is an increased probability that the business and portfolio assignments underlying the calibration might not be representative for banks outside the QIS focus with regard to shifts from the banking book to the trading book. This should be taken into account so as to avoid excessively unjustified calibrations.

The range of 3 – 3.5 proposed for the equity multiplier does not appear to be appropriate to us, including in light of the difference in market liquidity. Equity exposures are likely to be significantly more liquid here, for example compared with the "commodity" class: In the models, for example, the liquidity horizons for equity positions range from 10 to 60 days, but for commodities from 20 to 120 days. As a result, we are therefore urging that the multiplier of 1.5 for equities proposed in Europe within the framework of CRR II should not be exceeded (lower interval limit for commodities).

A further positive factor is that no quantitative criteria (see Annex F – Article 1 compared with Article 204 of the earlier consultative document) as were previously defined in the form of relative or absolute indicators are given for the application of the simplified approach. Against the background of the parallel changes in trading book assignment, a final calibration of such ratios at the present time appears to be hardly tenable. In particular, we also support the underlying statement that the usability of the simplified approach is less a question of quantitative thresholds than of the complexity and riskiness of the transactions being conducted, which can best be assessed by the competent supervisory authorities. In turn, we welcome the fact that the "ban" on option transactions still contained in the draft has been dropped.

Standardised approach: reduced risk weights

We welcome the planned recalibration of the FRTB standardised approach (see Annex A – Articles 75, 107 and 120), which is more risk-sensitive than Basel II but led to disproportionately high own funds requirements in the previous calibration.

However, we do not consider the revisions to be sufficiently far-reaching. As an example, revisions of the risk weights for credit spreads are missing or are too high. For instance, we consider a risk weight of 1% for covered bonds to be appropriate because evaluations of historical data show that the high risk weights lead to a multiple of what the historically measured highest credit spread rises actually amount to. In the case of covered bonds, it can also be seen that the LGD of 25% provided for these exposures is considered too high to determine default risk. Based on the experience in the EU with the F-IRBA, we consider an LGD value of 11.25% (which is also used in the F-IRBA) as appropriate.

In this context, we would also like to point out an inconsistency between the simplified standardised approach that is now based on a recalibrated Basel II standardised approach and the FRTB standardised approach in the treatment of securities issued by public sector entities and securities issued by multilateral development banks. In order to determine specific risk capital charges for issuer risk, Article 711(i) of the

Basel II standardised approach explicitly stipulates that securities issued by public sector entities and securities issued by multilateral development banks are assigned to the same category, so the same specific risk capital charge therefore applies. We consider the equal treatment of these groups of issuers to be justified and appropriate. This applies in particular to public sector entities, which may be treated in the same way as their sovereigns under the standardised approach to credit risk. By contrast, the standardised approach to market risk does not clearly assign public sector bodies such as the German development banks. Paragraph 82 (BCBS d352) should therefore clarify that, for the purposes of determining delta CSR non-securitisations, the term "Sovereigns" includes public sector entities that may be treated in the same way as their sovereigns under the standardised approach to credit risk.

A revision of the risk weights for the SA-CVA (see 1.4 "Revision to risk weights") would be welcomed as a consistent step towards recalibration of the standardised approach.

Standardised approach: extension of liquid FX currency pairs

In our view, the "triangulation" now permitted – and long called-for by the industry – for determining liquid currency pairs (see Annex A – Article 120(a)) makes economic sense and helps ensure more homogeneous risk capitalisation worldwide. We therefore welcome this proposal.

Standardised approach: revision of the low correlation scenario

The GBIC welcomes the revision of the low correlation scenario (see Annex A – Article 54(c)) as an economically plausible and sensible proposal. Especially for intrinsically strongly correlated risk factors, such as successive support points of a yield curve, disproportionate stress scenarios and hence excessive capital requirements were generated by the low correlation scenario in the adopted standard.

Standardised approach: revision of curvature risk

We welcome the proposed assessment of the curvature scenarios at the level of buckets as economically sensible (see Annex A – Article 53(a) — (d)). Harmonisation of the aggregation rule is also to be welcomed (see Annex A – Article 53(e)).

With regard to the introduction of additional granularity in the form of sectors (see 1.3 "Revision to capital requirements for non-linear instruments"), it should be considered that on the one hand, this could further complicate the already technically complex standardised approach, and that on the other the use of the existing buckets for other purposes would also have to be examined in this context (e.g. for determining correlation).

Standardised approach: multi-underlying options

From a technical point of view, the proposed changes appear to be plausible and rational.

Internal models approach

n/a