31st January , 2014

Wayne Byres
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2, CH-4002 Basel, SWITZERLAND

**Re: Consolidated Response to the Second Consultative Document on the Fundamental Review of the Trading Book (FRTB)**

Dear Mr. Byres:

The undersigned Associations appreciate the opportunity to comment on the Basel Committee on Banking Supervision ("BCBS") Second Consultative Document *Fundamental Review of the Trading Book* dated October 2013 ("Fundamental Review" or "FRTB"), and value the constructive dialogue with the Trading Book Group (TBG). We reiterate our support to the general objective of strengthening the capital framework for the trading book and we view the FRTB as a great opportunity to do this. In this respect, we believe that this should be done with deliberate speed so that all issues raised are considered and addressed.

It is in this spirit that we requested in our attached January 8, 2014 letter (Attachment 1) that the current timeline of the FRTB be reexamined to allow for an iterative process of policy-making combined with QIS exercises and resulting calibration and recalibration, as well as to allow firms sufficient time to implement the necessary changes in systems and processes. Indeed, the fundamental changes being proposed, particularly to the standardized approach (SA) and the inclusion of liquidity horizon component to the internal models approach (IMA), represent a significant departure from current industry practices, and hence needs significant work for firms to comply.

In this letter, please allow us to summarize the main points from our previous submissions and interaction, the details of which are in the attached letters dated January 3, 2014 (Attachment 2) and January 19, 2014 (Attachment 3) and the December 2013 list of questions (Attachment 4) regarding securitization which we have tabled informally for discussion. From a technical perspective, the proposed SA and the liquidity horizon component of the IMA pose the most concern to us and our members, followed by the proposed treatment of credit and model-independent approval process. In the following sections, we highlight our main comments on each of them in turn, as well as our other concerns regarding the trading book/banking book boundary, disclosures, floors, treatment of securitizations and CVA.

We hope that you will consider our comments and proposed alternatives, and the feasibility of the QIS timetable as currently envisioned. We believe that given an appropriate level of consideration and time to develop our proposals could be proven effective in achieving the objectives of the FRTB. As such, and if significant revisions in the proposed methodologies were to be undertaken, the industry would greatly appreciate 1) to be informed as soon as possible since significant changes may affect the banks' ability to participate in the QIS, and 2) the opportunity to comment on such revised proposals.

**Standardized approach**

The industry has serious concerns about the discounted cash flow framework being proposed for the SA. The need to source cash flows from trading systems, the build of a large number of interest rate curves and a large number of implied-OAS models, as proposed in the FRTB second consultation, would make the implementation of the standardized framework difficult, time-consuming and costly as well as less controlled and prone to model and operational risks. We have proposed recasting the SA in terms of the existing risk factor sensitivities, which are currently calculated by banks' pricing models. The risk factor sensitivities are more readily available, are tightly controlled and their utilization would significantly reduce the cost and time of implementation. Their use will also preserve the key elements of offsetting, diversification and aggregation that were specified by the TBG. We elaborated on this issue in the attached January 3 letter.

**Capturing market liquidity**

We support TBG's objectives of factoring in market liquidity and appreciate TBG's effort to balance simplicity, risk sensitivity and comparability when designing the approach. We believe the TBG's objectives would be achieved more effectively if a number of remaining issues were addressed. These include the modeling challenges posed by the use of longer, varying horizons and overlapping returns, the imprecise mapping to risk factor category, the lack of clarity on the mechanism to update the horizons for more appropriate weightings, etc. We elaborated on these issues, as well as on our proposed alternatives, in the attached January 19 letter.

**Treatment of credit**

We appreciate that migration risk will now be captured in stressed expected shortfall (ES) and removed from incremental default risk (IDR). This removes a potential double count and simplifies the default risk measure. It allows firms to account for overlap in IDR of risk which is already captured in the ES price risk model. However, there are remaining issues to address particularly on the need to clarify the definition of scope and the meaning of an n-factor model; the proposed sovereign PD floor and the use of correlation based on equity prices for sovereigns, quasi-sovereigns and municipal bonds, and which is inconsistent with AIRB for all exposure classes; and the mandatory inclusion of equity positions in IDR.

We provided some proposed language on definition of scope in our January 19 letter. In terms of the proposed sovereign PD floor, we understand that the BCBS is undertaking a comprehensive review of the prudential treatment of sovereign risk. The trading book treatment should be included in this review and not addressed separately.

With regards to the proposal to move correlation trading portfolios (CTPs) to the revised standard method, we believe it is too early to conclude that a model-based framework is not feasible for CTPs and disagree with the conclusion that the use of the SA will "narrow variability".

**Model-independent approval process**

While we do not fundamentally object to having a model-independent assessment tool, we have concerns about the proposed approach, particularly the possible use of the Basel leverage ratio exposure measure. The proposed approach provides very little information on market risk and as such is an inappropriate tool to evaluate the robustness of a bank's internal model to measure market risk at a desk level. We propose a more risk sensitive alternative, which is outlined in the attached January 19 letter.

**Trading book/Banking book boundary**

We understand and support the goal of harmonizing the trading book designation across jurisdictions, but would like to note that in some areas a rigid approach in terms of a presumptive list of trading book products would result in a construct that is not aligned with risk management. We would encourage the BCBS to acknowledge that there will always be need for regulators to apply some form of judgment on the appropriateness of a presumptive list to specific circumstances of individual institutions.

**Disclosures and floors**

We have reservations about using the SA as a floor and the Pillar III disclosure of SA numbers on a desk level. Both of these would make the SA the binding stakeholder capital metric for banks and, thus we believe, would result in similar unintended consequences. In particular, the lack of risk sensitivity in the proposed SA could result in the misallocation of capital.

For the proposed disclosure of SA numbers on a desk level, in particular, we do not think it would be useful given the differences in banks' desk structures and trading strategies. To address this, we believe that it is essential to allow for aggregation of desks along firm specific business lines that can be different from one bank to another.

With regards to the proposal to make the SA as a floor to internal models, if the objective is to achieve more comparability in the resulting capital numbers, we believe this is better achieved through model portfolio exercises in combination with harmonization of supervisory approval practices.

**Securitization**

Attached is a list of questions regarding securitization which we tabled informally in December 2013 for discussion. We very much appreciated the opportunity to discuss these briefly with members of TBG earlier this week, and while we have been unable to respond in detail to the proposed treatment of securitization under the FRTB by today's date, we look forward to continuing our dialogue and providing technical comments on securitization issues going forward. We thank the TBG for their flexibility in this regard. In particular, we believe it is important that the process for the re-casting of the rules for the treatment of securitization in both the trading and the banking books be coordinated, and move together. Such coordination, would avoid (for example) creating unlevel playing fields between firms which may have differently sized trading or banking books. This should be the case both in terms of content, and timing of implementation. As the TBG is aware, the proposals for the banking book are currently undergoing a second round of consultation, in which the undersigned associations are engaged.

**CVA**

There is a lack of clarity as to what the actual impact to CVA will be from the transfer into ES from the current VaR methodology and application of liquidity horizons, which is unclear in the FRTB proposal. We would propose that any changes made to CVA must be done in conjunction with any changes made via the wider CVA review referenced on page 13 of the proposals (i.e., appropriate treatment of all CVA book hedges including credit risk hedges, and any new design features introduced).

We would like to express our appreciation to the BCBS for the opportunity to comment, and we remain at the BCBS's disposal to discuss and elaborate on any of the issues we have raised in our letters.

Yours faithfully,

George Handjinicolaou, Ph.D Simon Lewis Andres Portilla

**c.c**.: Norah Barger & Alan Adkins, Co-Chairs, Trading Book Group; Ju Quan Tan, Member of the Secretariat, BCBS

**Attachment 1 -** A copy of our January 8, 2014 letter

**Attachment 2** - A copy of our January 3, 2014

**Attachment 3** - A copy of our January 19, 2014

**Attachment 4 -** List of questions regarding securitization