1st October, 2015

Norah Barger and Philippe Durand, Co-Chairs of the BCBS Trading Book Group (TBG)
Giuseppe Siani, Chair of the BCBS Risk Management Group (RMG)
Basel Committee on Banking Supervision - Bank of International Settlements (BIS)
Centralbahnplatz 2, CH-4002 Basel, SWITZERLAND

Re: Industry Response to the BCBS Consultative Paper on the Review of the Credit Valuation Adjustment Risk Framework – BCBS 325, published in July 2015

Dear Mrs. Barger, Mr. Durand and Mr. Siani,

The undersigned Associations, on behalf of their members, welcome the decision by the Basel Committee on Banking Supervision ("BCBS") to revisit the current Credit Valuation Adjustment ("CVA") capital framework and to incorporate CVA into the revised market risk framework, i.e. within the Fundamental Review of the Trading Book ("FRTB"). It is our understanding that the BCBS is working under a mandate to balance risk sensitivity and simplicity in the capital framework whilst enhancing the robustness of the financial system. We believe that the proposed framework is a step in the right direction towards achieving these goals, subject to certain modifications. Accordingly, we provide a number of recommendations herein that, if considered together, will facilitate in the swift and smooth finalization of the CVA framework review.

Underpinning our comments is our belief that risk sensitivity is imperative; we believe that i) retaining the use of the Internal Model Approach ("IMA") is essential to better balance the economic impact for those end-users that are not able to post collateral, and ii) the regulatory framework should align as much as possible with the approaches that drive risk management decisions. In particular,

- The industry is of the firm belief that only the proposed internal models approach for CVA ("IMA-CVA") can provide the level of risk sensitivity required to reflect the true economics and pricing of CVA risk. Forcing banks to adopt the same standardized model, based on the same regulatory CVA, with the same simplifications could penalize prudent economic hedging in the normal course of business and promote herding behaviour during periods of market stress. Moreover, although changes in the market and regulatory landscape will continue reducing the level of counterparty risk in the collateralized market, CVA will remain material for corporates and sovereigns that are not able, or required, to post collateral. A standardized approach ("SA-CVA") will not only fail to reflect the true level of underlying economic risk, but will raise the cost of prudent hedging, which will be passed on to end-users, potentially driving end-users to leave their risks unhedged or to pursue less-expensive protection providers outside of the regulated banking sector, resulting in an overall increase of systemic risk. In terms of the complexity concern expressed in the Consultation Paper ("CP"), the industry finds that the calculations of the regulatory CVA sensitivities is the most demanding task and is shared between both FRTB-CVA methodologies (i.e. both IMA-CVA and SA-CVA). We expand on our reasoning in the body of our response, but would strongly urge the BCBS to maintain the IMA-CVA option within the revised CVA framework and even consider reducing the data requirements in order to achieve this;

- The regulatory CVA, as proposed, is not defined consistently with the CVA accounted-for in the firms' financial statements and, consequently, firms will have to decide on whether to manage their P&L volatility or their capital base volatility (where managing the latter could create actual P&L gains or losses). In principle, the industry believes that the regulatory CVA should be aligned with the CVA reflected in books and records and appreciates the steps that have been taken in the CP to better align the two. The industry has identified, however, cases where further alignment can be achieved, specifically: the covered population (e.g. securities financing trades), the treatment of netting on close out and allowing some degree of flexibility in the model measures (e.g. the use of different recovery rate assumptions between secured and unsecured exposures). Moreover, we feel strongly that the BCBS should further outline its commitment over the coming years (as implementation of the FRTB standard at the national level approaches) towards ensuring that the CVA framework remains appropriately and prudently aligned to accounting best practice. In the future, we would welcome opportunities to engage further to find ways of closing the residual gap in the measures;

- To incentivize prudent risk management and hedging practices, the BCBS should consider the appropriate treatment of hedges for funding valuation adjustments ("FVA"). We believe banks should not be penalized in the capital framework for undertaking risk-reducing hedging activity.

To promote simplicity, we believe that a framework that concentrates the firms' resources in capturing and managing material economic CVA risks is paramount. As currently proposed, the new CVA framework would lead to extensive computational and quantitative resources being used for portfolios with marginal impact on the overall economic CVA risk. The scope of the regulatory calculation should be limited to those netting sets that contribute material CVA risk. In particular, the following should be excluded due to the nature of their collateralization: i) collateralized portfolios under the BCBS-IOSCO uncleared margin requirements rules ("UMR"), ii) client cleared listed and OTC derivatives, iii) Securities Financing Trades ("SFTs") and other forms of collateralized borrowing. Further, we recommend that a materiality principle is applied to all netting sets.

Apart from the fundamental framework design concerns and above recommendations, which we develop further in the body of the response letter, the industry has reviewed the proposed approaches and would like to outline its preliminary feedback on a number of technical aspects:

1. The proposed Basic Approach for CVA ("BA-CVA") and SA-CVA need to be calibrated to provide the right incentives. The BA-CVA leads to excessive capital requirements compared with the underlying economic risks or the FRTB-CVA methodologies, as should be apparent from the results of the recent CVA Quantitative Impact Study ("QIS"). In particular, the proposed supervisory risk weights are very conservative and should be recalibrated to better reflect the risk implied in market-based measures. We strongly recommend that at least one more QIS is carried out prior to the finalization of the framework;

2. The backtesting multiplier for the CVA capital charge should be decoupled from the FRTB level and should range between 1 and 1.33 depending on the results of the CVA model backtesting performance;

3. The application of a default m_{CVA} multiplier at 1.5 in IMA-CVA is unjustified when it comes to offsetting model simplifications since banks will be required to pass stringent backtesting and P&L attribution tests. To pass these tests, banks will need to model more risk factor sensitivities than those specified in the SA-CVA approach. We do, however, recognize that the proposed multiplier could be intended to cover Non-Modellable Risk Factors ("NMRFs") and are broadly supportive of this pragmatic approach. Industry stands ready to assist the BCBS in calibrating the multiplier to the appropriate level;

4. The proposed BCBS CVA framework should be implemented and supervised at a "desk level" in line with the FRTB, allowing for multiple CVA desks and appropriate Internal Risk Transfer hedging arrangements between desks;

5. We recommend that the revisions in Basel 3 to avoid double-counting downgrade risk between CVA and the credit counterparty risk ("CCR") charges should be adopted in the BCBS proposed revisions to the CVA framework.

As always, the industry is committed to supporting the BCBS in the comprehensive assessment of the proposed changes through participation in well-designed QISs. Since the recent QIS exercise required estimates for only the largest 50 counterparties, not for the whole bank, which consequently led to problems on hedge allocation and recognition, we strongly recommend that at least one more QIS is carried out prior to the finalization of the CVA framework.

As banks continue to analyze the results of the CVA QIS, which was completed shortly before the CP response was submitted, the industry may provide additional technical comments on the proposals to assist BCBS with finalization of the framework.

We would welcome an ongoing dialogue with regulators to address the points raised in this response.

Yours sincerely,

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Cc:
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I. COMMON ISSUES ACROSS ALL APPROACHES

Maintain Internal Models as they are essential to CVA risk management

We recognize the BCBS's concern as to whether the IMA designed for the FRTB can effectively capture CVA risks. However, we believe this concern is alleviated by the strict new eligibility tests being imposed onto CVA. Essentially, if a bank cannot demonstrate that the internal models are able to predict the P&L each day, it will not be allowed to use them. Conversely, when a capital model is accurate enough to predict the P&L each day, it must be more accurate than one which cannot. If we were to apply the same test to the standardized approach, itself being a simplified model, it would be more likely to fail than an internal model. By this token we should view an internal model that has passed eligibility tests as superior to the new standardized approach.

Within the standardized approaches, the simplifications employed distort measured risks versus observed P&L, which can create incentives misaligned with the real economics. More importantly, forcing banks to adopt the same model, based on the same regulatory CVA, with an identically simplified view of risk, will incentivize the optimization of banks' portfolios to the new model features. This will promote herd behaviour in the financial markets by encouraging all banks to take the same actions during periods of market stress. It could also penalize prudent economic hedging in the normal course of business. Removing internal models would consequently likely increase systemic risk.

Systemic risk can also be increased through another avenue. Despite the fact that in the new market and regulatory reality counterparty risk will be significantly reduced, CVA risk will remain material for corporates and sovereigns that will not be able or required to post collateral. In those cases, the SA-CVA will be too coarse to reflect the true underlying economic risk and the over-conservatism from a capital perspective will lead to unnecessarily high costs for these segments, which will be passed on to end-users. Faced with this, end-users may decide to either remain unhedged or seek solutions outside the regulated banking sector. Both outcomes would lead to an increase in systemic risk given that CVA risk will either shift to the economy, which is not as capable for dealing with it, or the unregulated sector, where the lack of transparency can be detrimental in stressed environments.

With respect to the challenge of meeting the requirements of the FRTB-CVA framework, it is clear to the industry that further focused investment will be required to calculate either the SA-CVA or IMA-CVA, given that both depend critically on the sensitivities of the regulatory CVA, rather than the accounting CVA sensitivities that banks already calculate. The concern that firms may have to build simulations of exposure within market risk simulations of the CVA can be directly mitigated through various mathematical techniques, themselves widely adopted across the major international institutions that would need to implement an IMA approach. From an industry perspective, the complexity of the calculation is almost entirely embedded in that task. To be clear, developing the expected shortfall framework, the P&L attribution, the backtesting are all secondary in complexity to the fundamental computational challenge of calculating the sensitivities for either IMA-CVA or SA-CVA.

From a technical perspective, the various fall-back methods envisaged by the CP cannot be relied upon to identify non-diversifying, unhedged idiosyncratic risks, or indeed those with systemic bias. The SA-CVA approach uses a generic calibration and will not be in a position to capture specific risks relevant to a particular portfolio. To exclude an IMA option, therefore, would make the internal measurement of these risks less transparent and comparable to supervisors. Moreover, the IMA-CVA would allow the incorporation of new risk factors in a timely fashion, as opposed to regulatory-driven SA-CVA which would require a lengthy BCBS consultation process.

Align the regulatory CVA with accounting practices

We believe that aligning the definition of CVA used for determining the CVA capital charge ("regulatory CVA") with the CVA accounted-for in the financial statements ("accounting CVA") is important for structuring a robust, risk-sensitive and consistent capital framework since this is the only way to ensure that banks i) capitalize the real economic risk in their portfolios, ii) internal risk mitigation measures are appropriately reflected in the capital requirement and iii) alignment with the market risk framework (FRTB) is achieved, since the FRTB risk sensitivities only hinge on the actual accounting fair value of the trading book financial instruments. Deviations from this principle distort the essential link between the risk assumed and the risk reflected in the capital base, leaving banks with the dilemma of hedging either the variability in their P&L or their capital base.

While US and international accounting standards have converged on the concept of "exit price" for fair-value, (via IFRS 13 and ASC 820 (formerly FAS 157)), we acknowledge that accounting CVA practices across industry are not fully uniform but understand that the BCBS does not intend to drive changes in the accounting approaches for CVA through the revised prudential CVA framework. We are concerned, however, that the combination of the "use test" in paragraph 15 with the various technical requirements for a regulatory CVA model could have this unintended consequence. We respectfully suggest that the wording of paragraph 15 is clarified to avoid this[1].

Noting the changes introduced in the current proposal of the CVA framework, we would like to propose the following:

- **SFTs** are not within the scope of accounting CVA and, as discussed later in the response letter, should be excluded from the regulatory CVA scope. SFTs have an immaterial contribution to the total CVA risk since the exposure is not stochastic but effectively similar to that of a collateralized loan.

- **Legal netting enforceability**. For sovereign and supranational counterparties in particular, views on netting enforceability contain some degree of uncertainty. The all-or-nothing approach to netting eligibility in paragraph 67 of the existing framework is appropriate for capitalising for actual counterparty default (where the netting agreement either will or will not be enforced by the bankruptcy court). CVA risk covers changes in fair value when no default occurs, and therefore netting enforceability remains uncertain. As long as the accounting model takes this uncertainty into account, it will reflect the economic risk better than an all-or-nothing approach. We accordingly recommend more flexibility in the recognition of netting enforceability in the CVA context so that cases where netting is highly probable, but not definitive, can still benefit at least from partial recognition. In particular, we would request that banks which incorporate probability-based netting assessments in their accounting CVA can carry them across to regulatory CVA, providing that the probabilities are provided by a legal department separate from the CVA management function and subject to appropriate internal validation.

- **Model parameters**. We acknowledge there is a broad-based adoption of market-implied parameters in Accounting CVA (Option A), including default probabilities, recovery rates and diffusion parameters. We appreciate the BCBS move regarding the definition of market-implied LGD in paragraph 13 which introduces the possibility of recognizing different Recovery Rates for

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[1]A draft that would address the industry's concerns while still reflecting our understanding of the policy behind Option A is "15. The paths of discounted exposure are derived from exposure models used by a bank for calculating front office/accounting CVA. Market and transaction data used for regulatory CVA calculation must be the same as the ones used for accounting CVA calculation. Model processes, implementation, calibration, and source data may differ where necessary to ensure that the regulatory model meets the requirements set out elsewhere in this regulation, provided that such differences are appropriately documented and disclosed to the national supervisor."

senior exposures, which is closer to market practice. In that spirit, we recommend that the BCBS also clarifies that banks should be able to use different Recovery Rates for certain specific type of exposures, e.g. because they are secured (such as covered bonds or project finance vehicles) or because their nature does not permit the reliance on the credit market (see for instance the uncertainty around political intervention in the context of sovereign exposures), subject to being able to demonstrate that the use of such parameters are properly governed and validated within the firm.

The industry strongly suggests that the BCBS continues to track the development of harmonized accounting policy and practice over the FRTB-CVA implementation timeline. We strongly encourage the BCBS to commit in the final standard to periodically review and assess best practices and to keep the framework appropriately aligned to accounting and risk management market practices. This will ensure that supervisory standards can be kept globally coherent and contemporary to the needs of the unsecured derivative end-users. In the future, we would welcome opportunities to engage further to find ways of closing the residual gap in the measures.

Focus on the Material Risks

The IMA-CVA and SA-CVA calculations are both dependent on the use of sensitivities which, as currently proposed, will lead to extensive computational and quantitative resources being expended on portfolios with minimal impact on the economic CVA risk. The industry urges the BCBS to consider introducing materiality-based exclusions as well as prescribing simpler approaches for immaterial portfolios. These changes should be based on the following broad principles:

1. Allow the exclusion from the scope of the CVA capital framework those portfolios that due to their nature or other regulatory requirements contribute minimal CVA risk. The industry has already identified particular types of portfolios that would attract near zero regulatory CVA requirement and can, therefore, be excluded at the outset: i) collateralized portfolios under the BCBS-IOSCO UMR, ii) client cleared listed and OTC derivatives, iii) SFTs and other forms of collateralized borrowing. The exclusion of such trades is very similar to the existing exclusion of trades with central clearing counterparties already contained within the initial CVA discussion paper.

    For SFTs and other forms of collateralized borrowing, notwithstanding that accounting CVA does not apply to such trades, the regulatory CVA on such portfolios in many cases will be de-minimus due to the applicability of at least one of the following features: i) the short term nature of many SFT trades, ii) the significant over collateralization in most cases beyond the Basel-IOSCO UMR standards for derivatives and iii) the use of custodian/3rd party accounts to house collateral where banks gain funding by such trades;

2. Allow a less than daily updating of immaterial sensitivities, subject to a bank demonstrating the immateriality of such sensitivities. For example, the delta risk for large collateralized portfolios will be immaterial as the initial price moves only affect the 10 days of exposure, after which collateral is called in the CVA simulation;

3. Allow less than daily updating of sensitivities that are typically changing very slowly (particularly when at same time they are computationally very expensive, e.g. volatility sensitivity in the now static legacy broker-dealer portfolios), even if they are not immaterial;

4. Allow the use of a simplified approach for determining the regulatory CVA amount of immaterial portfolios, subject to an upper threshold of regulatory CVA that can be quantified in this way. For IMA-CVA the backtesting and P&L attribution requirements can be used to demonstrate the immateriality of such simplifications.

Given the UMR rules, on a forward-looking basis, the industry expects that the majority of CVA risk will be concentrated in uncollateralized portfolios with corporate and sovereign counterparties (i.e. those exempt from the UMR), which would roughly constitute only one tenth of the OTC trade count.

The industry would like to propose a simplified approach for capitalizing the CVA risk of immaterial portfolios through an add-on. This approach is more risk-sensitive since the CVA itself will more accurately measure the risk in the portfolio than the IMM/SA-CCR EADs used in the BA-CVA. The proposed industry add-on approach will also avoid the overall charge getting dominated by extended MPOR/standardized charge calculation issues inherent in the current Basel 3 CVA calculation charge on portfolios where the risk is minimal. The steps to calculate the simplified approach are:

- Calculate the regulatory CVA and capital (IMA or SA) without hedges on the rest of the portfolio, denote these $CVA_{regulatory}^{include}$, and $Capital_{CVA}^{include}$.

- Calculate the regulatory CVA on the excluded portfolio $CVA_{regulatory}^{exclude}$.

- The add-on, $Capital_{CVA}^{exclude}$ is then given by

$$Capital_{CVA}^{exclude} = Capital_{CVA}^{include} * M_{exclude} * \frac{CVA_{regulatory}^{exclude}}{CVA_{regulatory}^{include}}$$

where $M_{exclude}$ is a multiplier to make the calculation generally conservative.

Align definition of a CVA desk with the FRTB framework

We welcome the BCBS TBG/RMG clarification that the intention is not to require firms to accede to the FRTB heightened standards for IMA for the entire firm's CVA Book and that, to the extent firms have CVA trading desks that meet the relevant criteria, approval can be sought from supervisory authorities for the application of IMA-CVA on a desk-by-desk basis. This would allow banks to have more than one CVA desk which, for example, may currently be organised along asset classes. This approach constructively recognizes the value of further aligning with the supervisory principles embedded in the FRTB. It also provides a valuable transition mechanism for the industry to progressively and continuously improve their CVA risk management capabilities, while not requiring unnecessary organizational changes.

In light of this clarification, it then seems straightforward to acknowledge the benefit in Internal Risk Transfers between a CVA desk and other trading desks within a single entity, or across entities within a wider banking group. This would preserve the integrity of the net risk position through their respective applications of the FRTB approach at the desk or entity level, and would be reflected appropriately in consolidated reporting.

Avoid double-counting downgrade risk between CVA and CCR Charges

Per BCBS189, for IRB banks it was recognised that the downgrade risk component embedded in the Basel 2 CCR charge double-counted risk when the VaR methodology appropriately captured the impact of downgrades through credit spread modelling. Where firms could show this, the maturity adjustment was set to zero in the risk-weight formula, equivalent to setting an effective maturity equal to one year. The industry strongly recommends this now be adapted and carried over to the new CVA framework, such that should the expected shortfall calculations be proven to account for downgrade risk, then the provision in BCBS189 would be equally applicable.

Recognize the economic risk of valuation adjustments in the capital framework

There has been an industry migration towards incorporating the cost or benefit of unsecured funding into valuations, with many banks recognizing funding adjustments in their derivative valuations. We acknowledge that in the current revisions to the CVA framework, the BCBS would like to target the unilateral CVA asset and maintain a deduction from capital for Debit Valuation Adjustment ("DVA" or CVA liability) of OTC derivatives. However, we believe that in order to incentivize prudent risk management and hedging practices, the BCBS should consider the appropriate treatment of hedges for FVA.

Some banks currently hedge CVA / DVA / FVA on a portfolio basis. Since FVA hedges are currently not recognized as risk mitigating hedges in the capital framework, this means a bank that fully hedges its net economic portfolio risk would appear to be under-hedged. The revised framework also clarifies that CVA hedges must not be split between the Trading Book and the CVA book: the entire hedging instrument must belong to one of the books. Since a net hedge partially covers FVA and liability CVA, under the proposed rules it must be included in the Trading Book as a naked market risk position. The outcome is that legitimate hedges of P&L volatility perversely *increase* a bank's capital requirements.

We believe banks should not be penalized in the capital framework for undertaking risk-reducing hedging activity. Market participants would welcome an ongoing dialogue with regulators on how the risk of P&L volatility from valuation adjustments can be more accurately reflected in the capital framework but as an interim approach we make two recommendations:

- Since BCBS has decided that the exposure sensitivity of FVA should be ignored from the capital framework we recommend that direct hedges of FVA should also be excluded from the capital framework to avoid distortions;

- Where a bank hedges its CVA and DVA / FVA on a net basis, the bank should be allowed to segregate the hedge into components and allocate the CVA component of the hedge to offset the regulatory CVA in the capital framework. The DVA / FVA component of the hedge should be excluded from trading book capital requirements.

II. KEY TECHNICAL ISSUES PER APPROACH

Basic Approach (BA-CVA)

Risk Weight calibration is overly conservative compared to the current framework

As should be apparent from the results of the recent CVA QIS, the level of the proposed risk weights is too high/conservative, making the ratio of counterparty credit risk RWAs and CVA risk RWAs increase multi-fold from the current levels. For some banks, the ratio could be up to 1:7.

Without further transparency on the derivation of the calibration it is hard for the industry to pinpoint precisely the areas to focus on, but we understand that the BA-CVA risk weights were derived from the FRTB risk weights (which are already stressed), coupled with a scaling to a one-year horizon.

We have serious concerns over a one-year time horizon presumption to derive the risk weights, contributing to making the proposed risk weight calibration overly conservative. It is not realistic to presume that the level of extreme stress during the last financial crisis will last for one year, and this is also inconsistent with the liquidity horizons in the FRTB-CVA framework.

We note that in the CP published by the BCBS in December 2009[2], it is stated that during the recent market crisis, roughly two-thirds of CCR losses were due to CVA losses and about one-third were due to actual defaults. From this observation, the ratio of CCR RWAs and CVA risk RWAs should be around 1:2. The proposed risk weights, however, materially overestimate the underlying economic risk and are likely to bring the ratio much higher than 1:2. The industry believes that the significant increase of risk weights under the current proposal is not appropriate even with the change in the measure from a 99% VaR to a 97.5% expected shortfall.

As a suggested solution, risk weight calibration should be reconsidered, taking into account the factors discussed above. In particular, a too conservative time horizon of one year should be changed to the same liquidity horizon with the FRTB-CVA framework to avoid excessive capital charge against underlying economic risk.

Risk Weight should reflect creditworthiness of counterparties

The CVA capital charge should appropriately reflect creditworthiness of counterparties because that is the primary factor for CVA variability. However, the proposed supervisory risk weights for the BA-CVA, assigned based on sectors and credit indices (investment/non-investment grade), lack sufficient risk-sensitivity due to the lower granularity in comparison to the current SA-CVA. In addition, assigning counterparties to sector buckets can be difficult since counterparties with multiple business lines do not necessarily fall under a single sector.

The industry also acknowledges the regulators' desire to achieve consistency between the FRTB framework and the CVA risk charge, and to use the same risk buckets for both frameworks. However, the industry believes that the negative impacts stemming from reducing the risk granularity in BA-CVA will be too big to justify the above alignment.

Consequently, we would urge the BCBS to make the BA-CVA more risk sensitive and would propose that the risk weight granularity is increased to better reflect the creditworthiness of the counterparties and better represent the diversity of external/internal ratings and sectors.

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[2] BCBS, "Strengthening the resilience of the banking sector", Consultative Document, December 2009, http://www.bis.org/publ/bcbs164.pdf

Computation Formula is too punitive for long-term derivatives

Under the proposed BA-CVA proportional treatment of maturity is double-counted, leading to unrealistically conservative RWAs for long-term uncollateralized derivatives, such as project and infrastructure finance, where direct CVA hedging is difficult. This is due the compounding effect of transitioning from CEM to SA-CCR.

Under SA-CCR, a potential future exposure add-on for interest rate and credit derivatives is calculated using the supervisory formula, with maturity being factored into the calculation without a cap, whereas there is a 5-year maturity cap under CEM. Because of this, EAD for long-term derivatives, which grows roughly in proportion to the maturity, becomes much larger under SA-CCR than CEM. Under the proposed BA-CVA, the computation formula for RWAs again multiplies EAD by the maturity although maturity is already factored into EAD calculation under SA-CCR. For example, the CVA capital requirement for an unhedged 20-year interest rate derivative will become 6 times greater than the current CVA capital requirement after the replacement of CEM with SA-CCR, and 20 times if the proposed BA-CVA is introduced (assuming BBB-rated SPC assigned to the risk bucket energy and MTM =0).

A punitive capital charge will have significant negative impact on real economic activities. As a suggested solution, the formula should be revised to include a relief from excessive capital charges for long-term derivatives (e.g. 5-year maturity cap).

Capital charge for market risk (K_{EE}) should reflect sensitivity to market risk factors

Proposed K_{EE} is calculated as a multiplier of un-hedged K_{spread} which does not take into account sensitivity to market risk factors and allowance for recognizing market risk hedges. This less risk-sensitive additional capital charge increases the already punitive CVA capital charge for all banks regardless of having market risk hedges. The industry believes that the BA-CVA risk weights are already conservative and, therefore, K_{EE} is not necessary (or, at least, the multiplier β (=0.5) should be reduced to avoid excessive capital requirements compared with the underlying economic risks).

SA-CVA

The industry believes the SA-CVA warrants additional time for analysis and testing. Regarding its appropriate calibration, we would urge the BCBS to consider establishing a monitoring period until implementation so as to assess its behavior as market conditions change. In the meantime, the industry would appreciate and support additional QISs before finalization.

IMA-CVA

Provide guidance and clarifications on the P&L Attribution tests

We welcome the BCBS TBG/RMG clarification that the P&L attribution and backtesting model performance tests are to be performed against the P&L from the regulatory CVA model. This is an important clarification given that a number of differences could potentially exist between the P&L calculated under applicable accounting standards and the P&L calculated based on the BCBS CVA criteria, leading to false exceptions if the regulatory CVA model was to be tested against the actual accounting P&L.

We believe the current drafting could lead to inconsistent implementation across jurisdictions. Paragraph 76 of the CVA CP refers back to the text in the second CP of the FRTB which specifies that the P&L attribution standard is with respect to Actual P&L, although the definition of the test had

been updated in the FRTB QIS instructions to refer to Hypothetical P&L. Nonetheless, Hypothetical P&L is used to refer to daily P&L where the impact of new transactions and fees have been removed to ensure a "clean", like-for-like number is used. We, thus, believe that neither of the Actual nor Hypothetical P&L definitions, as currently drafted, is in line with our understanding of the regulators' intention.

We recommend that the text in the final CVA rule is clarified to avoid the risk of implementation differences in local regulatory and/or legislative frameworks. One approach would be to explicitly define the P&L attribution tests that must be used in the CVA framework. For example the two P&L attribution metrics that would be calculated are:

1. mean unexplained daily P&L (i.e. risk-theoretical P&L minus hypothetical regulatory CVA P&L) over the standard deviation of hypothetical regulatory CVA daily P&L; and

2. the ratio of variances of unexplained daily P&L and hypothetical regulatory CVA daily P&L.

Where, Hypothetical Regulatory CVA P&L is the P&L produced by revaluing the positions held at the end of the previous day with the pricing models and assumptions used in the regulatory capital model for CVA using the market data at the end of the current day. Fees and commissions should be excluded.

The P&L attribution model performance test is a new requirement which may require some refinement as it is adopted by banks and supervisors. We recommend that the BCBS provides guidance to supervisors and firms on how to assess P&L attribution results with the knowledge that NMRFs are covered by the m_{CVA} multiplier (see section below) but may create unexplained P&L, particularly during periods of market stress. P&L attribution will be most effective if it is used to assess model performance as part of a wider model risk management framework giving due consideration to what drives any unexplained P&L. If a binary pass or fail assessment is used by supervisors, then, during periods of market stress, unexplained P&L movements may cause the model to fail the test, resulting in pro-cyclical capital requirements if banks must move to the SA-CVA approach.

Define a specific Backtesting Multiplier for CVA

The IMA-CVA calculation defined in the CP includes a m_{TB} factor which is *"the multiplier described in paragraph 189 of the FRTB"* (CVA CP, para 89). As currently drafted it seems that the same backtesting multiplier for the trading book in FRTB will be applied to the CVA book. It is our view that there should be a specific backtesting multiplier for the CVA capital charge which is independent from the FRTB trading book backtesting multiplier. The industry would recommend a CVA backtesting multiplier that ranges between 1 and 1.33 (this is sufficient for internal models) and is based on the CVA model backtesting performance.

In combination the P&L attribution and backtesting assessments will be a stringent test of model performance that will ensure internal models may only be used in cases where banks are able to accurately model the risk.

Review the purpose and calibration of the M_{CVA} multiplier

The revised CVA capital framework specifies a model risk parameter for CVA, m_{CVA}, that multiplies the CVA capital figure and has a default value of 1.5. The m_{CVA} multiplier is used in both the SA-CVA and IMA-CVA calculations. In SA-CVA, we acknowledge that the CVA multiplier m_{CVA} has some conceptual justification, offsetting the modelling simplifications versus the FRTB standardized approach. However, we do not recognize that there is the same justification for the m_{CVA} multiplier in the IMA-CVA approach.

Banks must pass stringent backtesting and P&L attribution tests in order to apply the IMA-CVA approach. These tests ensure that the model must be both conservative and *accurate*. In order to pass both of these tests it is likely that banks will need to model more risk factor sensitivities than those specified in the SA-CVA approach. Therefore the assertion that a default 1.5 multiplier is applied because of modelling simplifications and reduced granularity is not an accurate representation of the modelling that firms will be required to undertake. Furthermore, any coverage issues that could arise from a simplified model or reduced granularity would be addressed by the CVA backtesting multiplier to the extent that these items underestimate capital.

Nevertheless, we acknowledge and welcome the approach of capturing NMRFs through a prudent multiplier and believe this to be a pragmatic solution.

Since the m_{CVA} multiplier is not required for the reasons stated in section 3.5 of the CVA CP, the industry stands ready to assist the BCBS in calibrating it to the appropriate level. If supervisory authorities retain discretion to increase the multiplier, we recommend that the BCBS provides specific guidance to supervisors on how to set the multiplier to ensure that a consistent approach is applied across jurisdictions.

III.   RESPONSE ON THE QUESTIONS RAISED IN THE CP

[Q1] To what extent do large netting sets; potentially illiquid transactions inside a netting set; and recent disputes affect the internal assessment of the margin period of risk (MPoR)?

The above mentioned factors do not affect the internal assessment of accounting CVA.

[Q2] Is Alternative 1 or Alternative 2 preferred with regard to the calculation of MPoR?

The industry would prefer Alternative 1 as is it closest to internal accounting practices.

[Q3] Should IMM approval be included as an additional eligibility requirement for the FRTB-CVA framework under Option A (i.e. accounting-based CVA method for generating scenarios of discounted exposure?

The industry's view is that IMM approval should not be included as an additional eligibility requirement for the FRTB-CVA framework under Option A. If Option A (Accounting CVA) is chosen for the exposure calculation, the accounting method should be approved and the IMM method is irrelevant. The systems and models for accounting-based CVA may be separate from IMM systems and thus IMM approval may have little relevance to the accounting-based CVA system. The list of criteria in paragraph 19 seems sufficient, and the accounting CVA system is already subject to controls due to accounting requirements.

[Q4] To what extent is there synergy between the calculation of accounting CVA and the EAD calculation for IMM with respect to processes, data and methodology?

Due to the fundamentally different model requirements for CVA and IMM calculations, the synergy between accounting CVA and EAD calculation for IMM varies and is firm-specific. Accounting CVA is subject to appropriate governance, internal scrutiny and controls (e.g. price verification and internal auditing) which are comparable to the systems and controls for IMM.

[Q5] Option A (accounting-based CVA) or Option B (IMM-based CVA) preferred for exposure calculation?

The vast majority of firms do not prefer Option B and would welcome revisions and clarifications to the proposed CVA framework as set out in the section on "Align the Regulatory CVA with accounting practices".

[Q6] Is Option 1 or Option 2 preferred for simulation time horizons?

Option 1 is preferred industry approach as it aligns with the FRTB liquidity time horizons.