January 31, 2014

Comments on the Basel Committee on Banking Supervision's Second Consultative Document: Fundamental review of the trading book: A revised market risk framework

Japanese Bankers Association

We, the Japanese Bankers Association (JBA), would like to express our gratitude for this opportunity to comment on the second consultative document (CD): *Fundamental review of the trading book: A revised market risk framework,* released on October 31, 2013 by the Basel Committee on Banking Supervision(the "BCBS").

We hope that our comments below will be of assistance and offer an additional point of reference as you work towards finalising the framework.

Summary

General Comments

1. The JBA supports the proposed "revised boundary" from the perspective of ensuring consistency with banks' business operations and risk management practices.
2. The standardised approach (SA) should be revised to improve its role as a benchmark.
3. The JBA disagrees with the Committee's proposal to introduce the SA as a floor/surcharge.
4. The level of capital charges should not be increased without a reasonable background.
5. The recognition of "trading desk" for the regulatory purposes should be flexible.
6. PDs for sovereigns in Incremental Default Risk (IDR) framework under the internal models-based approach (IMA) should not be subject to a floor.
7. The Committee should provide a sufficient transition period for implementation.

Specific Comments

The numbering below ("x.x") corresponds to respective sub-section numbers of CD (on pages 7 to 45).

1.1 **The trading book/banking book boundary**

1.1.1 The JBA supports the proposed "revised boundary" from the perspective of ensuring consistency with banks' business operations and risk management practices (as described in General Comment 1).

1.1.2 Hedging transactions against instruments in the banking book should be assigned to the banking book for the regulatory purposes.

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1.3.4 It should be clarified that categories of longer liquidity horizon are applicable in specific cases.

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1.6.1 The JBA disagrees with the Committee's proposal to introduce the SA as a floor/surcharge (as described in General Comment 3).

1.6.2 The mandatory SA calculation and its frequency should be reconsidered.

2.1 The overall approach to internal models-based measurement

There is no particular comment on this issue.

2.2 The identification of eligible trading desks

2.2.1 The recognition of "trading desk" for the regulatory purposes should be flexible (as described in General Comment 5).

2.2.2 It should be clarified that IMCC is calculated across desks.

2.2.3 The multiplication factor should be subject to a minimum of 1, instead of 3.

3.1 Objectives and rationale for a revised standardised approach

3.1.1 The Committee is requested to revise the SA in light of the objectives to be accomplished (as described in General Comment 2).

3.1.2 The calculation method based on risk sensitivity should be allowed.

3.1.3 Consistency with the banking book framework should be ensured.

3.2 General features of the revised standardised approach

There is no particular comment on this issue.

3.3 Calibration of the revised standardised approach

3.3.1 Calibration should be carried out carefully and with the minimum frequency.

3.4 Proposed treatments by asset class

3.4.1 FX positions denominated in the same currency should be permitted to be offset regardless of the timing of cash flows

3.4.2 If sovereigns to which buckets 1 and 7 for the credit spread risk are assigned are fair-valued using the yield curve of an issuer, capital adds-on should not be imposed.

3.4.3 It should be clarified that internal trades between SA desks will be fully offset.

3.4.4 The method to aggregate across risk categories in the SA should be clarified.

4.1 Others

4.1.1 Rationale for determining parameters should be disclosed.

4.1.2 Contents and format of the disclosure should be modified. (Templates, SA-related disclosure and information on IMA desks)

4.1.3 The provision on the order of calculating eligible capital as defined in the Definition of capital should be modified.

General Comments

1. **The JBA supports the proposed "revised boundary" from the perspective of ensuring consistency with banks' business operations and risk management practices.**
   We support the revised boundary which was reconsidered to enhance consistency with banks' business operations and risk management practices while tightening its implementation with a view to reducing arbitrage. However, some amendments are still needed, as discussed in detail later in Section 1.1 of Specific Comments; for example, it should be clarified that hedge transactions to mitigate banking book risks are always assigned to the banking book.

2. **The standardised approach (SA) should be revised to improve its role as a benchmark.**
   While the revised SA proposed under this review of the framework is designed to achieve several distinctive objectives, such as "increase comparability across firms" and "ensure a directly available fallback to internal models if the models are deemed to be inadequate"; we believe that its function as a benchmark, which the Committee newly seeks in CD, can be improved by the following.
   - Reduce excessively conservative adjustments like differentiation of correlations between long and short positions.
   - Provide banks with the detailed calculation of the level of risk weights under the SA, etc. and then encourage them to use such information.

   These improvements would result in a more non-biased level of standardised capital charges built on clear construction of the SA and assumptions in its calibration, thereby increasing the SA's transparency as a benchmark. Furthermore, banks using the internal model approach (IMA) would become able to explain differences between SA and IMA capital charges to market participants including investors, which should help to recover credibility in the IMA capital charges.
   Conversely, if the SA is designed to produce unreasonably conservative capital charges, or if the background of calibration is not provided, banks will not be able to provide explanations on the differences between SA and IMA capital charges. Therefore such standardised capital charges would not be suitable as a benchmark to be disclosed. In addition, disclosing unreasonably conservative capital charges may, in some circumstances, lead to misunderstandings by the users of such disclosed information. Therefore, if such a case is expected, we do not support the Committee's proposal to require mandatory calculation and disclosure of standardised capital charges by IMA banks.

3. **The JBA disagrees with the Committee's proposal to introduce the SA as a floor/surcharge.**
The SA should not be used as a floor or surcharge to the IMA-based risk measures. Although the revised SA is more risk sensitive relative to the current approach, it still lacks enough risk sensitivity because, among other things, it does not take into account any diversification benefit across risk categories. If, despite this, a SA-based floor or surcharge is used, it will significantly undermine incentives to sophisticate the measurement technique in the IMA. The IMA itself already encompasses parameters (ρ, m) which lack theoretical rationale and can be used as tools to produce more conservative results. In this regard, use of the SA as a floor or surcharge would be another layer of conservatism, and increase the complexity of the framework. It is understood that the Committee is considering the introduction of such a floor/surcharge to address lack of confidence in internal models. As described in General Comment 2 above, however, by requiring banks to be accountable for the differences between the SA and IMA capital charges, the objective of achieving comparability of risk-weighted assets and securing confidence could be fulfilled without using the standardised capital charge as a floor or surcharge.

4. **The level of capital charges should not be increased without a reasonable background.**
In order to prevent an arbitrary increase of the level of capital charges, it is suggested that the calibration of IMA parameters, ρ and m, should be clarified to obtain fair results. More specifically, our understanding is that the multiplication factor m, which is subject to a minimum of 3, was originally introduced to address the tail risk of the loss distribution, possibly insufficient length of market liquidity horizons and model risk, including the inherent limitation in prediction due to the use of historical data. As it is understandable that the revised framework would solve these issues other than model risk, the role of parameter m should be limited to an add-on factor to the capital charges as specified in paragraph 189 based on backtesting results with the minimum of m=1.

5. **The recognition of "trading desk" for the regulatory purposes should be flexible.**
While the model validation is required at the trading desk level under the IMA, its implementation should be flexible so as not to undermine the optimal reorganisation of the desk structure by banks.
Qualified "trading desks" would be granularly subdivided on the basis of the definitions specified in CD. Therefore, the JBA is concerned that a model approval may be withdrawn easily reflecting, for example, changes in performance due to the traders' transfer or the organisational changes.
The Committee is requested to avoid drafting a rule under which the regulatory

definition of trading desks prevents banks from making organisational changes in a timely and appropriate manner. In other words, trading desks should not be defined in detail in the international regulation but should be determined and approved at the national supervisor's discretion, through sufficient dialogues with banks.

6. **PDs for sovereigns in Incremental Default Risk (IDR) framework under the IMA should not be subject to a floor.**
   Given that the treatment of sovereign risk is discussed not only in this Fundamental Review of the Trading Book ("FRTB") framework, but also in other frameworks (e.g. the review of the banking book and large exposure limits) this issue should not be concluded in isolation. At least until the banking book framework reaches a conclusion, the new Trading Book (TB) framework should allow banks to apply to PDs for sovereigns the current treatment under the IRB approach for credit risk (i.e. no floor). Furthermore, paragraph 153 of CD states that under the SA, "For government paper that is denominated in domestic currency…a lower default risk weight may be applied". To maintain consistency with it, it is preferable that the Committee provides flexibility in the application of floors to IDR.
   Additionally, when discussing risk weights for sovereigns, the Committee should give due regard to those cases where the requirements under the FRTB framework may contradict the objectives of other regulatory frameworks where, for instance, banks are encouraged to use sovereign bonds as a high quality liquid asset under the liquidity requirements or as a collateral to CCPs. In this respect, too, at least those sovereigns meeting certain conditions should not be subject to a floor in the same way as before.

7. **The Committee should provide a sufficient transition period for implementation.**
   In implementing the finalised rule, a sufficient transition period will be needed. Because banks need to calculate cash flows and create a yield curve in accordance with the measurement logic of the revised SA, and to calculate Expected Shortfall (ES) under the IMA at the level of desks assumed and to make other preparations, significant time and cost will be required for information systems development and implementation. In addition, it is requested that the Committee will set an adequate preparation period for the QIS and calibration and a sufficient transition period for a full-fledged implementation of the finalised rule, given the facts that risk-weighted assets calculation and the Quantitative Impact Study (QIS) need to be conducted with the infrastructure, and that the QIS results need to be carefully analysed for the purpose of calibration,.

Specific Comments The numbering below ("X.X") corresponds to respective sub-section numbers of CD (on pages 7 to 45).

1.1 The trading book/banking book boundary

1.1.1 **The JBA supports the proposed "revised boundary" from the perspective of ensuring consistency with banks' business operations and risk management practices (as described in General Comment 1).**

1.1.2 **Hedging transactions against instruments in the banking book should be assigned to the banking book for the regulatory purposes.**

We presume that hedging of those transactions which belongs to the banking book under the regulations should be also assigned to the banking book for regulatory purposes, even if they meet the general presumptions of the trading book instruments. This would include those cases where hedging is executed with a third party through the desk within the same entity which carries out trading activities. However, in such cases, positions related to internal and external transactions held by the desk carrying out trading activities are considered to be a trading book position. In finalising the rule, the Committee is requested to give due consideration to such cases when determining the general presumptions of the trading book.

1.1.3 **The rationale for requiring documentation of the expected holding horizon and the instruments that need documentation should be clarified. (Paragraph 18(b))**

Given the trading book is based on the general assumption that instruments are traded in accordance with market conditions, it is unclear as to why the expected holding horizon is required to be documented for all trading book instruments. For example, if the primary objective is to monitor those instruments that may be held for a longer period before sale due to customer demand and other reasons, such as in an underwriting activity, the scope and attributes of such instruments that requires monitoring should be clarified. Alternatively, rather than requiring the above documentation, it is considered as more practical to require banks to check whether there is any transaction which may not be able to be sold/hedged within liquidity horizons in light of market conditions at a given time.

1.1.4 **The Committee should avoid establishing multilayered preventive measures/penalties to address arbitrary re-designations between books. (Paragraphs 25-28)**

It would be sufficient to require the following as a preventive measure/penalty for arbitrary re-designations between books.

(i) Supervisory approval

(ii) Capital surcharge

Other multilayered measures (such as the requirement to disclose re-designations, the description prescribing that re-designations are irrevocable and the requirement to pre-determine "extraordinary circumstances") should be removed because their necessity and whether they could additionally enhance the framework's effectiveness are considered to be doubtful.

1.1.5 **It should be clarified that the recognition in the P&L account required in CD is different from the one for financial accounting purposes. (Paragraph 14)**

CD stipulates on page 8 that "any valuation changes must be recongised in the bank's profit and loss account" and adds "for accounting purpose".[1] In paragraph 14 on page 49, however, it simply mentions: "recognise any valuation change in the profit and loss (P&L) account".[2] It is recommended that CD should be amended to clarify that it requires the recognition in the P&L account not for financial accounting purpose but for managerial accounting or risk management purpose.

1.2 Treatment of credit

1.2.1 **PDs for sovereigns in IDR framework under the IMA should not be subject to a floor (as described in General Comment 6).**

1.2.2 **Equities should not be subject to IDR.**

Given that equities, particularly in the case of large cap whose liquidity horizon is 10 business days, would be able to be liquidated immediately even if an indication of default on such equities is observed, we believe that they do not need to be subject to IDR to which a risk horizon of one year applies. While the IRC is based on the assumption of a constant level of risk over the one-year capital horizon,[3] the trading book framework is based on the assumption that positions can be exited by the end of the liquidity horizon (namely by the tenth business day in the case of large cap). Practically, unlike the banking book, banks are able to exit positions in the trading book at their own discretion without taking account of their business relationship with customers. In addition, the rollover assumption of long positions for the one-year period even after an indication of default has been observed is considered to be unrealistic. Taking these factors into account, it is not considered appropriate to maintain consistency with the banking account treatment rigidly in the context of risk horizons.

Where positions cannot be exited by the end of the capital horizon after an indication of default is observed, such cases should be treated as an issue of

[1] The fourth paragraph from the bottom of page 8 states that: "For example, all trading book instruments must be fair-valued daily and any valuation changes must be recognised in the bank's profit and loss account for accounting purposes".

[2] Paragraph 14 states that: "Banks must fair-value daily any covered instrument and recognise any valuation change in the profit and loss (P&L) account".

[3] Guidelines for computing capital for incremental risk in the trading book; Paragraph 15, Note 3 (BCBS, Jul 2009)

jumps in liquidity premia. (See Specific Comment 1.3.2.)

In view of the above, at a minimum, we believe that the following concept explicitly introduced under the Basel 2.5 framework should be retained: "With supervisory approval, a bank can choose consistently to include all listed equity and derivatives positions based on the listed equity of a desk in its incremental risk model".[4]

1.3 Factoring in market liquidity

1.3.1 The categories and length of horizons should be reviewed to enhance balance and reasonableness, respectively. (Paragraph 181 (k))

(i) Categorisation of horizons

As the risk factor categories and corresponding liquidity horizons are both detailed and complicated[5], there is room for re-categorisation or integrating some of the categories. For example, more categories are assigned to commodities (i.e two categories (option and others) are assigned to each type of commodity) relative to the number of categories for interest rate and FX, and thus broader categorisation can be used for commodities.

However, it would not be our intention if re-categorisation resulted in overly complicated categories. The JBA requests that there should be a globally-agreed, broad and minimum categorisation (e.g. "Plain interest rate risk – x business days", "Exotic interest rate risk – x business days" and "Other interest rate risk – x business days"). Preferably, the details should be determined by national supervisors based on actual portfolios of banks, or clear and objective application standards should be established by supervisors.

(ii) Length of horizons

With regard to the risk factor categories of interest rates, FX and credit spreads (sovereign) to which the liquidity horizon of 20 business days is assigned, banks would be able to exit or hedge positions within 10 business days if they are denominated in major currencies, and thus the proposed horizon for such risk factors (i.e. 20 business days) is considered to be too long. Under Basel III, a supervisory floor of 20 business days is imposed for the margin period of risk in the case of OTC derivatives that cannot be easily replaced.[6] Plain interest rate and FX positions must be easier to replace, and thus should be assigned with

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[4] Guidelines for computing capital for incremental risk in the trading book; Paragraph 9 (BCBS, Jul 2009)

[5] For instance, in the table in paragraph 181(k), interest rates are broadly assigned to two categories only (i.e. "Interest rate" and "Interest rate (other)") (so as FX), whereas options are assigned to a specific category "ATM volatility", which is considered as lacking balance. On the other hand, there is no category for options other than ATM.

[6] Basel III: A global regulatory framework for more resilient banks and banking systems; Paragraph 103 (Dec 2010 (revised in Jun 2011))

shorter horizons, than such derivatives.

Furthermore, while liquidity horizons of 60 days or more are assigned to volatility other than Equity price (large cap) volatility, it is reasonable to add a new risk factor category for derivatives having a short remaining period and assign a short liquidity horizon to that category. This is to appropriately reflect maturity because in many cases (such as short-term currency options) transactions are settled within liquidity horizons.

1.3.2 **A model-independent risk assessment tool (MIA) should not be introduced. (Paragraph 183 (d))**

It would be difficult to apply a model-independent risk assessment tool in practice to address the possibility of jumps in liquidity premia because they are unpredictable. Therefore, instead of assessing the risk of jumps in liquidity premia, we would like to propose an alternative framework where the Committee designates extension of horizons at the time when a jump is deemed to have occurred.

The basis of proposing the alternative framework above is that (i) combined with stricter limits on switching between books introduced in CD, it would reduce the incentives to continue to hold instruments with the possibility of liquidity dry-ups; and (ii) while a reasonable basis would be required to establish the thresholds, it is considered as unrealistic to establish a framework that is capable of explaining unpredictable events over future periods. Plus, from the perspective of the banks, we are concerned that the Committee's proposed MIA framework may lead to unreasonably conservative capital charges.

1.3.3 **The Committee is requested to explain the background of deciding to apply "Historical long-horizon shocks" rather than "Historical one-day shocks directly scaled up to each liquidity horizon". (Paragraph 181(c))**

While Option 1 (i.e. an approach to apply historical long-horizon shocks) proposed in the first consultative document is retained in this CD, the rationale for such a decision is not clear. As reiterated in Specific Comment 4.1.1, the Committee is requested to disclose the results of its analysis and other information that supports its decision.

Note 36 of CD sets out an example of a risk factor with a 10-day liquidity horizon and a risk factor with a 250-day liquidity horizon. According to this example, P&L for 10-day shocks and that for 250-day shocks are computed with the terms for (t-x, t-x+10) and (t-x, t-x+250) respectively, and then the results are aggregated. As pointed out in the last sentence of Note 36,[7] market conditions

[7] Extracted below is the last sentence in Note 36:
This implies that for the 10-day liquidity horizon the most recent data point used is 240 days before the data point used for the 250-day liquidity horizon.

observed almost one year before the measurement date are applied to risk factors with short horizons, giving rise to inconsistency with the position at the time of measurement. The impact of this inconsistency would be greater particularly for those banks which hold portfolios primarily consisting of risk factors with short horizons. Therefore, to derive risk factor shocks by (t-x, t-x+10) and then multiply them by the square root of 25, which is Option 2 proposed in the first consultative document, can be considered to be a reasonable approach to a certain extent. In view of the above, it is respectfully requested that the result of the Committee's consideration on this issue will be made available for reference so that we can understand the rationale for the Committee's decision.

1.3.4 It should be clarified that categories of longer liquidity horizon are applicable in specific cases. (Paragraph 181(k))

It is requested that the application of longer, or more conservative, liquidity horizon categories than those designated in paragraph 181(k) will be allowed in measuring risks. If there is a difference in the liquidity horizon between the hedged item and hedging instrument, hedge effectiveness may not be sufficiently reflected, thereby resulting in an unduly excessive risk measure. The Committee is requested to clarify that, in such cases, liquidity horizons can be matched by conservatively extending the liquidity horizon of those transactions with shorter liquidity horizons.

1.4 Choice of market risk metric and calibration to stress conditions

1.4.1 The method and frequency of updating the stressed period should be reconsidered. (Paragraph 181(f))

Although CD requires banks to update their 12-month stressed period "no less than monthly", the JBA believes it is reasonable to require banks to perform such updating "on a regular basis" as amended under the Basel 2.5 framework. Given that the stressed period of financial institutions would not change significantly in a short period of time, the proposed frequency is considered to be too excessive for some banks relative to the benefits of increasing the frequency of full update. For example, it is an alternative to update the stressed period as necessary by capturing changes in monthly market conditions or positions. More specifically, banks could monitor risk factors of $ES_{R,C}$, which capture more than 75% of changes in ES, on a monthly basis, and if a stress is observed, then banks could update the stressed period. This method would enable banks to efficiently identify the stressed period while saving the cost of practical burdens from fully updating the stressed period.

1.4.2 The market data criteria should be relaxed. (Paragraph 183(c))

Given that fair value is the best estimate of the price of transactions, as one way of interpreting "price at which the institution has conducted the transaction", it should be made clear that those data used as an element of fair value measurement can be included in the market data criteria for assessing whether a price is "real".

Furthermore, in such cases, some banks use the services which provide the consensus of member financial institutions on a monthly basis. Since such data can be obtained only on a monthly basis, it is not realistic to require "at least 24 observations per year". The Committee is respectfully requested to reconsider this observation criterion to amend it to "at least 12 observations per year".

1.5 Treatment of hedging and diversification

1.5.1 The conservative treatment under the SA should be amended.

As indicated in General Comment 2, the proposed SA needs to be amended because excessively conservative treatments have been incorporated. The basis of this view is that since CD requires desks using the IMA to also calculate standardised capital charges, we are concerned that capital charges based on the unreasonably conservative SA may trigger skepticism about the relative level of IMA capital charges. Specific areas needing amendment include the following.

(i) As indicated in the provision pertaining to general interest rate risk, correlations for positions with different signs are estimated lower than correlations for positions with the same sign.

(ii) Diversification benefits across broad risk categories are not taken into account at all.

We would like to reiterate that the existence of the conservative treatment would make it very difficult for those desks using the IMA to give a clear explanation on differences between SA and IMA capital charges even if they need to calculate regulatory capital based on the SA in parallel. In other words, as far as unreasonable conservatisms are built in for calculating the SA capital charge without any sufficient rationale, it would be difficult for banks to justify and explain to investors and supervisors the reasonableness of the IMA capital charge that, for example, takes into account netting/diversification benefits by incorporating correlations.

1.6 Relationship between the standardised and internal model-based approaches

1.6.1 The JBA disagrees with the Committee's proposal to introduce the SA as a floor/surcharge (as described in General Comment 3).

1.6.2 The mandatory SA calculation and its frequency should be reconsidered. (Paragraph 47)

(i) Mandatory SA calculation

Unless the SA is sufficiently risk sensitive, or, is useful as a benchmark, we disagree with the proposal to require IMA desks to calculate standardised capital charges. As argued in General Comment 2, costs for implementing the revised SA proposed by CD are expected to be too large to ignore, and moreover, banks will be subject to significant practical burdens to calculate the SA in parallel to the IMA in order to use it as a floor or surcharge, whereas there would be no additional benefit of using the SA for internal risk management purposes. Furthermore, as mentioned in Specific Comment 1.5.1, the conservative treatment, if implemented, will undermine banks' ability to explain the reasonableness of capital charges from the perspective of comparability. At the same time, disclosure of capital outcomes based on an unreasonably conservative SA may cause stakeholders' incorrect risk assessment or misunderstanding that the SA is a highly reliable and precise approach, which eventually could lead to systemic risk. Therefore, it is unlikely that the benefits of implementing this requirement will outweigh the associated costs.

(ii) Frequency of the SA calculation

CD requires banks to calculate the SA at least monthly. Given the costs required to implement or operate relevant systems, it would be reasonable to require such calculations on a quarterly basis, which is in line with the frequency of the calculation of capital requirements.

2.1 The overall approach to internal models-based measurement

There is no particular comment on this issue.

2.2 The identification of eligible trading desks

2.2.1 The recognition of "trading desk" for the regulatory purposes should be flexible (as described in General Comment 5).

2.2.2 It should be clarified that IMCC is calculated across desks. (Paragraph 189)

Paragraph 189 of CD describes that "The stress period used in the desk-level $ES_{R,S,i}$…" which conjures the image of ES to be calculated by desk for each risk factor 'i'. Thus, the new TB framework should clarify that IMCC(C_i) is not calculated across risk factors but rather across desks for each risk factor "i".

2.2.3 The multiplication factor should be subject to a minimum of 1, instead of 3 (as described in General Comment 4).

3.1 Objectives and rationale for a revised standardised approach

3.1.1 The Committee is requested to revise the SA in light of the objectives to be accomplished (as described in General Comment 2).

In addition to our comment noted in General Comment 2, particularly for small-sized banks may enjoy benefits by focusing not on risk sensitivity rather on achieving simplicity and lowering the cost of implementation. Consequently, the continuous use of the current SA that reflects a more conservative calibration (Conservative SA[8]) should be permitted.

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[8] E.g.: Conservative SA = Current SA*a, where $a \geqq 1$ ("a" means a degree of conservatism, which is a constant determined by supervisors)

3.1.2 The calculation method based on risk sensitivity should be allowed.

The revised SA computes the standardised capital requirement based on notional positions or cash flows. However, the approach to use risk sensitivity for the delta portion should also be allowed. Some financial institutions use grid point sensitivity to manage their positions for internal management purposes. Retaining the choice of risk sensitivity may have advantages in that this approach will allow these financial institutions to calculate a more precise regulatory capital requirement than applying the revised SA proposed in this CD and will ensure the linkage between regulatory and economic capital.

3.1.3 Consistency with the banking book framework should be ensured.

We understand that, given that the purpose of each regulation and significance of individual issues for each regulation may differ, it is not necessarily practicable to require constructing a completely consistent framework for all regulations. Nonetheless, it should be avoided as much as possible to apply different approaches across regulations which have been inherently designed to aim at a common concept. Specifically, the consistency should be taken into account on the following issue:

(Example) Consistency with LGD under the credit risk framework (Paragraph 147)

Under the framework proposed in this CD, a LGD of 100% and 75% is assigned to non-senior debt instruments and senior debt instruments, respectively; whereas under the current credit risk framework, a LGD of 90% and 75% is assigned to equities and subordinated bonds, respectively.

3.2 General features of the revised standardised approach

There is no particular comment on this issue.

3.3 Calibration of the revised standardised approach

3.3.1 Calibration should be carried out carefully and with the minimum frequency.

We agree with the view stated in the first paragraph of subsection 3.3 on page 34 of CD: "the Committee will review its validation of this calibration on an annual basis and make necessary adjustments in the case of material changes". If calibration of the SA, which is a benchmark, is carried out too frequently, the time-series analysis will become complicated in accordance with the change in assumptions, which presumably would make it more difficult to ensure comparability and confuse users of the disclosed information. Therefore, the level of calibration should be adjusted carefully and with a minimum frequency.

Furthermore, whenever the Committee decides to revise the calibration, the rationale for such adjustment and its rule on maintenance should be clarified (as in the case of the multiplication factor described in General Comment 4) so that it will not be used as tools to increase the level of capital charges.

3.4 Proposed treatments by asset class

3.4.1 FX positions denominated in the same currency should be permitted to be offset regardless of the timing of cash flows

Under the current framework, positions arising from funding and investments in the same currency may be offset as a net position. The standardised approach (SA) proposed in this CD, however, allocates cash flows to each term bucket. Consequently, a funding and investment transaction in the same currency may not completely be offset.

For example, a bank which uses JPY as its home currency purchases a USD100 foreign bond with a remaining maturity of over 3 years, and makes USD100 borrowing with a maturity of less than 1 year to invest in the bond. The FX exposure under the current framework is 0, while USD84 of the exposure remains under the revised SA. (For simplicity of the calculation, the discount interest rate is set at 0.) Given interest rate risk being separately captured, this treatment is considered to be imposing a capital charge on the maturity mismatch between short and long currency positions, which is the same as the liquidity risk associated with a funding denominated in a foreign currency. We believe, however, such risk has been already covered under the liquidity framework.

Based on the above analysis, if there exists any risk to be captured other than interest rate risk which is separately addressed, it is respectively requested to identify its feature and modify the SA framework for FX risk to reflect "necessary" capital charges associated with the risk.

It should also be noted that, even if there is a gap between the terms of investment and funding, banks can practically mitigate FX risk arising from funding for investment/lending in foreign currencies over the investment maturity as illustrated above by managing positions by currency in accordance with clear and stringent hedging and foreign currency funding policies and by properly rolling over funding instruments.

3.4.2 If sovereigns to which buckets 1 and 7 for the credit spread risk are assigned are fair-valued using the yield curve of an issuer, capital adds-on should not be imposed. (Paragraph 105)

Capital adds-on associated with credit spread risk should not be separately imposed, as the risk does not exist when sovereigns to which buckets 1 and 7 are assigned are valued using the yield curve of an issuer.

3.4.3 It should be clarified that internal trades between SA desks will be fully offset. (related paragraph 23 (e))

It should be clarified that internal trades between desks using the SA will be fully offset.

3.4.4 The method to aggregate across risk categories in the SA should be clarified. (Paragraph 56)

The method to aggregate across broad risk categories in the SA should be clarified.

4.1 Others

4.1.1 Rationale for determining parameters should be disclosed.

The Committee should, to the extent possible, disclose the rationale for determining, or the concept anchoring the rationale, for the following parameters proposed in this CD.

Specific information suggested to be disclosed is as outlined in the table below:

Type	Information for which it is suggested to disclose the rationale and backgrounds	Reason for suggesting the disclosure
SA	Risk weights, the range of vertex and the correlation ρ	If the SA is used as a benchmark for the IMA, the rationale for these parameters needs to be disclosed to explain variances.
IMA	The ρ to allocate IMCC	Disclosure of this information is requested because there is a concern that the "ρ" could be used for a conservative adjustment in future without any clear justification provided to banks.
IMA	How to obtain a shock	Since the backgrounds for how options 1 to 3 proposed under the first consultative document are discussed and the outcome of such discussions are unclear. (Related comment: 1.3.3)
Liquidity horizon	The instrument category and time horizon	To understand the backgrounds before using the liquidity horizons. As noted in Specific Comment 1.3.1, specifically, the liquidity horizon of 20 business days assigned to "interest rates, FX and credit spreads (sovereign)" is considered to be long from the market participants' view point.

It is also considered useful to disclose the result of the preliminary study on the liquidity horizons conducted involving market participants.

4.1.2 Contents and format of the disclosure should be modified. (Templates, SA-related disclosure and information on IMA desks)

The disclosure framework should provide a template that only contains more high-level information, such as total RWA by broad risk category, and more detailed analysis and explanation should be disclosed to the extent considered necessary for banks to have a dialogue with investors. If a template listing detailed disclosure items is provided, preparation of such template itself will be the goal for preparers on the bank-side. This may give rise to a concern that the granularity of information provided to investors may be at an unnecessarily high level, and disclosed items may lack flexibility. A desirable framework is the one which enables banks to disclose information banks considered to be significant from their risk management perspective, among other things, matters that need to be conveyed to investors. In this regard, we do not support providing a template with detailed disclosure items.

Additionally, as discussed in General Comment 2, unless the SA properly functions as a benchmark (for example, the capital requirement calculated by the SA may be unjustifiably conservative, it lacks risk sensitivity, or the rationale for the level of capital requirement is unclear), the disclosure of SA-based quantitative information should not be mandatory for IMA desks.

Qualitative information of the trading desk (the structure of and products traded) would relate to the business strategy and hence is of a highly sensitive nature. In conjunction with the reason that it is unclear how disclosure of such information can enhance the market discipline, the JBA believes this disclosure is not appropriate for the trading book.

4.1.3 The provision on the order of calculating eligible capital as defined in the Definition of capital (paragraph 46) should be modified.

Under the Basel II Accord, Tier 3 was established as a capital to cover market risk. Although Paragraph 46 eliminates and modifies the requirement associated with Tier 3, it still requires first to calculate the bank's minimum capital requirement for credit and operational risks (the Basel II Accord framework). In this regard, we believe that this order should be deleted.