



EUROPEAN COMMISSION
Directorate General Financial Stability, Financial Services and Capital Markets Union

Call for advice to the EBA for the purposes of revising the own fund requirements for market risk as part of the CRR review

Context

The European Commission is currently undertaking a review of the CRR and is as part of this review considering the impact of implementing the agreed Basel Committee on Banking Supervision (BCBS) framework detailed in the document "Minimum capital requirements for market risk"¹. Prior to adopting the framework, the European Commission would like to seek technical advice from EBA to assess the impact for EU banks from adopting the BCBS framework with a particular emphasis on a quantitative assessment. In addition, the Commission would like to ask the EBA for an assessment of whether possible adjustments to the BCBS framework might be appropriate, especially adjustments in calibration and in the specific treatment for small trading books.

In light of the on-going assessment of investment firms, the EBA work should focus on credit institutions; however, those investment firms which, in the view of the EBA, are likely to be subject to the CRR requirements going forward should also be included.

Considering the relatively short timeframe given to the EBA for producing the report, the Commission is not expecting the EBA to publicly consult on its findings. However, to the extent possible, the EBA is nonetheless encouraged to discuss the consequences of the proposals with the EU banking industry.

Annex 1 provides a preliminary overview of data that could be relevant for the EBA to consider as part of its assessment.

Scope of EBA work

The EBA is asked to consider the following five elements in its report:

1. FRTB and derogation for small trading book

First of all, the report should provide an overview of EU trading instruments² and current market risk capital requirements for credit institutions. In particular, the report should include an overview of the size and composition market risk activities as well as of the associated market risk capital requirements in the EU as of today, clustering the information by jurisdiction and/or by institutions' different business models³.

Secondly, the report should put particular emphasis on the application of the proportionality principle. In this regard, the EBA should consider first the adequacy of the current threshold(s) for the derogation of small trading book business stated in Article 94 CRR and

¹ BCBS, January 2016: (<http://www.bis.org/bcbs/publ/d352.htm>)

² Trading instruments are defined as those meeting the definition in article. 4.1 (86) and market risk capital requirements are defined as total capital requirements associated with these assets.

³ It is noted that previous EBA reports, such as the NSFR report provided a break-down according to business models. Hence the EBA report could, if relevant, use existing classifications of business models.

should consider possible alternative definitions and levels for the threshold (s) in order to further reduce the burden on firms with limited or low-risk trading activities, taking in to account the scope of application of trading book rules in third countries. The analysis of alternative trading book derogation threshold(s) should ideally contain a materiality assessment of banks trading book risks. EBA could also usefully discuss if the fallback of applying banking book requirements is sufficiently clear and practical, which can be used for assessing the derogation itself.

The analysis should provide a characterization of the type of institutions which usually apply this derogation and of the trading instruments typically held by these institutions. Also, it should provide an idea of the impact, in terms of capital charges, of applying the derogation versus capitalizing these positions according to standard market risk requirements.

Also concerning proportionality, the analysis should help assess the convenience of introducing an eventual simplified standardised and its scope of application, as well as its interaction with the derogation. The materiality assessment mentioned in the previous paragraph can also be used for the purpose of defining the scope of application of this simplified framework.

2. Impact of the new framework and characterization of banks using the standardised approach or the internal model approach and

This section should consider the capital impact of introducing the FRTB on EU institutions and provide an overall estimate for the capital impact of introducing the new framework as a whole as well as for the different risk categories. The overall capital impact should be measured relative to the existing framework in place in the EU.

The impact analysis should also include the impact of the framework on market making activities and, subsequently, on market liquidity.

In particular it is noted that one of the main concerns in the calibration of the new framework is the ratio of standardised to internal models capital requirements. Therefore, we ask EBA to provide an estimate of the current value of this ratio for different types of trading activities or business models and whether a calibration adjustment is needed when implementing the new framework.

Additionally, the report should give some relevant measures of materiality regarding the application by banks of the standardised approach and the internal models approach respectively, as well as an idea of which of the business models described in section 1 are usually more connected to one approach or the other.

3. Impact of the new standardized approach for EU banks.

For a representative sample of EU banks currently using the standardized approach for all on most of the categories defined in art. 363 CRR, we would ask EBA to estimate:

- a. **Operational impact:** assessment of the feasibility and potential costs for banks currently using the standardised approach to adapt to the new standardised approach, with special reference to the calculation of sensitivities and the implementation of aggregation methodologies.
- b. **Capital impact:** assessment of the effect in RWAs of the introduction of the new Standardised compared with the CRR treatment for EU banks using the standardised approach for market risk for all or most of its exposures.

4. STS securitisations.

Taking into account ongoing work by the BCBS, EBA is asked to provide an assessment of the need for adjustments and specific proposals to adapt general FRTB securitisations capital charges for STS securitisations.

5. Interpretational issues regarding the revised market risk framework.

Finally, the EBA, should it consider it relevant, could include a section on the rules of the revised market risk framework for which interpretation issues are known to exist.

Final considerations

The Commission would appreciate it if the EBA could also report on any other issues or inconsistencies that competent authorities in the EU may have already identified in the BCBS new framework. Suggestions on how to rectify the identified issues and inconsistencies or on how to clarify the terminology used would in particular be welcome.

It is recalled that the analysis provided should not prejudice the Commission's final decision. Moreover, in accordance with the established practices of the Commission Expert Group on Banking, Payments and Insurance, the Commission will continue, where appropriate, to consult the experts appointed by the Member States in the preparation of its report.

The European Commission is aware that time and resource constraints may restrict the range of analysis methodologies to be used by the EBA in certain aspects of the Call for Advice. Should this be the case, the EBA should highlight these limitations in its final report. In these cases, and in order to perform the analysis needed, the EBA could rely on alternative, simpler methodologies.

The deadlines for this call for advice are the following:

-By June 1st 2016 the analysis contained in item 1 and a preliminary analysis of point 2 as regards capital impact, which could be based on existing analyses by the BCBS in combination with the aforementioned analysis in item 1.

-By October 1st, the final report, including a more developed analysis of item 2 where appropriate.

The Commission would like to obtain the final report by October 1st 2016.

Annex 1: data requirements

Notwithstanding EBA's judgment on how to perform the analysis, the list below aims to provide some guidance on features which would either constitute a useful input for the EBA analysis or would complement this analysis in terms of quantitative information. The EBA should explore the feasibility on getting the relevant data for all or a sample of credit institutions, on a case by case basis.

1. EU trading assets and market risk capital requirements for credit institutions

- a. For EU banks subject to the CRR, at consolidated level and excluding non-EU banks' subsidiaries resident in the EU:
 - i. Trading and total assets in the EU banking sector, in terms of absolute book values in euros.
 - ii. Risk-weighted exposure amounts for the different components of market risk⁴ and total risk-weighted exposure amount.
 - iii. Distribution of total trading assets by levels of banks' holdings of trading assets⁵ in absolute book value in euros.
 - iv. Distribution of total trading assets by levels of banks' share of trading assets⁶ in their balance sheet.
 - v. Bucketing of banks for different levels of bank's holdings of trading assets⁷ in absolute book value in euros and calculation for each buckets of: average total assets (both magnitudes in terms of absolute book values in Euros), and average share of trading assets over total assets. Scatter-plot of the following magnitudes:
 1. y-axis average trading assets per bucket;
 2. x-axis average total assets per bucket.
 - vi. Breakdown per member state of i. ii. and iii..
- b. For non-EU banks' subsidiaries resident in the EU subject to the CRR:
 - i. Aggregate trading and total assets, in terms of Absolute book values in Euros.
 - ii. Risk-weighted exposure amounts for the different components of market risk⁸ and total risk-weighted exposure amount in Euros.
 - iii. Breakdown per member state of i. and ii.
- c. Based on a representative sample of EU banks subject to the CRR at consolidated level and non-EU banks' subsidiaries resident in the EU:

⁴ This includes general and specific risk of debt and equity instruments, foreign exchange risk and commodities risk. This may include charges for "non-trading assets" in the case of foreign exchange and commodities risk.

⁵ The purpose of this item is to gather information to assess a potential recalibration of the derogation for small trading books. Therefore, the initial bucket level should be for banks up to 15 million of trading assets and then move in 5 Million steps up to 100 million. Beyond that level, the granularity can be lower.

⁶ With the same purpose as in the last item, the initial level should be 5% and then move in 1% intervals until a level of 15%. Beyond that level, the granularity can be lower.

⁷ For these purposes, the same bucketing as in number iv. or a more granular one can be used.

⁸ This includes general and specific risk of debt and equity instruments, foreign exchange risk and commodities risk. This may include charges for "non-trading assets" in the case of foreign exchange and commodities risk.

- i. Main types of business models and composition of the sample (number of banks for each category, total assets and total trading assets).
- ii. For each type of business model:
 1. Trading assets and total assets in absolute book values in Euros;
 2. Absolute book values in Euros for the following trading asset categories:
 - a. Equity instruments;
 - b. Corporate debt securities;
 - i. Also as a proportion a total corporate debt securities held by the bank;
 - c. Sovereign debt securities;
 - i. Also as a proportion a total sovereign debt securities held by the bank;
 - d. Other traded securities;
 - e. Derivatives instruments;
 - i. Gross absolute book values and notional values of derivatives assets and liabilities separately broke down by the following derivatives asset classes: interest rate, foreign exchange, credit, equity, commodities and others.
- iii. Breakdown per business models of the above mentioned securities and derivatives currently not subject to market risk capital requirements⁹ and reason why.
- iv. Percentage of the derivatives and securities listed in 1.c) ii. which are included in the accounting category "available for sale".

2. EU Banks subject to derogation for small trading books

- a. Based on a representative sample of EU banks that have been granted the derogation for small trading books:
 - i. Composition of the sample and identification of the main business models.
 - ii. Trading and total assets, in terms of absolute book values in euros.
 - iii. Breakdown of trading assets into the following categories:
 - Equity instruments
 - Corporate debt securities
 - Sovereign debt securities
 - Other traded securities
 - Derivatives instruments.

⁹ By market risk capital requirements, we refer the features of market risk only applicable to exposures in the trading book, which is basically position risk (general and specific risk of debt and equity instruments).

- f. Gross absolute book values and notional amounts of derivatives assets and liabilities separately broke down by the following derivatives asset classes: interest rate, foreign exchange, credit, equity, commodities and others.
- iv. If relevant, breakdown per business models of items 2 a) ii. and iii.
- b. Assessment of potential differences in capital charges on their trading assets were these banks applying the standardised market risk capital framework, with a focus on the main categories of trading assets held by these banks (as of 3 b) iii).

3. Characterization of banks using the standardized approach and the internal models approach and capital impact of the new framework.

- a. Relative usage of the standardized approach relative to the internal models approach for the different risk categories defined in art 363.1¹⁰;
- b. Share of trading assets over total assets in the sample represented by banks using the standardized approach for all of most of the categories defined in art. 363.1 CRR. Characterization of the main business models, composition and size of trading assets¹¹ of these banks.
- c. Share of trading assets over total assets in the sample represented by banks using the internal models approach for all of most of the categories defined in art. 363 CRR. Characterization of the main business models, composition and size of trading portfolios of these banks.
- d. Estimation of the ratio between risk-weighted exposure amounts calculated according to the standardised approach and according the internal models approach for:
 - i. a representative trading portfolio;
 - ii. the different risk categories defined in art 363.1
- e. Based on the conclusions and data from the Basel QIS and on the risk-weighted exposure amounts estimated in this call for advice, estimation of the relevant ratios indicating the capital impact of the new framework on standardised capital charges and on internal models capital charges respectively, for the different risk categories defined in art 363.1. Also, estimation of the ratio between standardised and internal models charges arising from the new framework.

¹⁰ Share of trading assets whose capital charge is calculated under one or the other approach. For example, out of all trading assets subject to an fx capital charge, the share of those whose charge is calculated according to the standardised approach.

¹¹ Including the break-down of derivatives among interest rate, equity, foreign exchange, credit, commodity and other.