

EBA FINAL draft Regulatory Technical Standards

On the definition of materiality thresholds for specific risk in the trading book under Article 77 of Directive 2013/36/EU (Capital Requirements Directive - CRD IV)



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1. Executive summary

These draft regulatory technical standards (RTS), in accordance with Article 77(4) of Directive 2013/36/EU (Capital Requirements Directive - CRD IV), set out requirements concerning the implementation of internal approaches for calculating own funds requirements for the specific risk relating to debt instruments in the trading book (TB).

The draft RTS establish criteria for assessing when the specific risk of debt instruments in the trading book (considered both at a solo and a consolidated level) is sufficiently material to trigger an evaluation by the competent authority. After this evaluation, competent authorities should determine whether it is worth encouraging banks to develop internal assessment capacity and to increase the use of internal models for capital calculations.

The RTS define 'exposures to specific risk which are material in absolute terms' as those where the sum of all net long and net short positions is greater than EUR 1 000 000 000, and establish two additional thresholds for what is a 'large number', and what are 'material counterparties and positions in debt instruments of different issuers', namely that the portfolio should include more than 100 positions, each greater than EUR 2 500 000 in absolute terms.

The scope of the RTS as defined by CRD IV relates exclusively to specific risk of debt instruments in the Trading Book (TB), excluding equity instruments in the TB. Banking book credit risk positions are not included in the scope.

CRD IV provides that the thresholds established in these draft RTS are relevant solely for institutions that apply the standardised approach for specific risk (as the remaining institutions already apply internal approaches). Accordingly, the materiality assessment reflects how the specific risk of debt instruments is measured under the standardised approach for market risk.

2. Background and rationale

Article 77 of Directive 2013/36 (CRD IV) establishes the conditions under which competent authorities are to encourage the use of internal models for credit risk in the banking book (BB) as well as for specific risk of debt instruments in the trading book (TB):

1. *Competent authorities shall encourage institutions that are significant in terms of their size, internal organisation and the nature, scale and complexity of their activities to develop internal credit risk assessment capacity and to increase use of the internal ratings based approach for calculating own funds requirements for credit risk where their exposures are material in absolute terms and where they have at the same time a large number of material counterparties. This Article shall be without prejudice to the fulfilment of criteria laid down in Part Three, Title I, Chapter 3, Section 1 of Regulation (EU) No 575/2013.*

2. *Competent authorities shall, taking into account the nature, scale and complexity of institutions' activities, monitor that they do not solely or mechanistically rely on external credit ratings for assessing the creditworthiness of an entity or financial instrument.*

3. *Competent authorities shall, taking into account institutions' size, internal organisation and the nature, scale and complexity of their activities, encourage them to develop internal specific risk assessment capacity and to increase use of internal models for calculating own funds requirements for specific risk of debt instruments in the trading book, together with internal models to calculate own funds requirements for default and migration risk where their exposures to specific risk are material in absolute terms and where they have a large number of material positions in debt instruments of different issuers.*

Paragraph 4 of this article requires the EBA to develop draft RTS to further define the notion 'exposures to specific risk which are material in absolute terms' referred to in paragraph 3 and the 'thresholds for large numbers of material counterparties and positions in debt instruments of different issuers'. The EBA is required to submit these draft RTS to the Commission by 1 January 2014.

Since the EBA mandate refers to the first subparagraph of Article 77(3) CRD IV, it appears that the scope of application of these draft RTS is limited to trading book (TB) positions. In this regard, defining solely a threshold for large numbers of material counterparties has no added value and could lead to confusion, as it would relate only to banking book (BB) positions and would make sense only if a minimum size for the BB portfolio was also defined. Therefore, the present technical standards focus solely on the definition of 'large number of material positions in debt instruments of different issuers'.

Scope of application:

To fulfil the RTS mandate the EBA has 'further defined':

- what a material **exposure** is in absolute terms, and
- two additional thresholds for :
 - o large numbers, and
 - o material **positions in debt instruments of different issuers**

Bearing in mind that Article 77(3) refers solely to 'debt' instruments, the EBA has established that the scope of the RTS relates exclusively to specific risk of debt instruments in the TB. Accordingly, equity instruments in the TB are not included in the materiality assessment.

The RTS establish criteria to assess when a bank's specific risk of debt instruments in the TB is material enough to trigger an evaluation by the competent authority. After this evaluation, competent authorities should determine whether they should encourage banks to develop internal assessment capacity and increase the use of internal models for capital calculations.

The thresholds established in these RTS are relevant solely for institutions that apply the standardised approach for specific risk. Accordingly, the materiality assessment reflects how the specific risk for debt instruments is measured under the standardised rules for market risk.

Article 327 of Regulation 575/2013 (CRR) on netting for own funds requirements for position risk in the TB does not refer to 'exposures' but to 'net positions' in equity, debt and convertible issues in the TB. The standardised capital risk weightings for debt instruments established in Article 336 CRR are applicable to both net long and net short positions (irrespective of their signs, i.e. whether negative or positive) in each of those different instruments.

The EBA has determined that the concept of 'positions in debt instruments of different issuers' mentioned in the RTS mandate is equivalent to 'net position' (i.e. the position in each instrument after offsetting effective credit risk hedging in accordance with the allowances established in Articles 346 and 347 of the CRR).

Material exposure in absolute terms

Both from a risk and a capital perspective all debt instrument positions (irrespective of their sign, i.e. whether negative or positive) are subject to specific risk. Thus, the sum of the net long and net short positions is the most sensible approach if 'exposures to specific risk' are to be captured broadly. In this regard, the templates for supervisory reporting of own funds requirements already include information both on the net long and net short positions and on the own funds requirements by category of instrument.

From a theoretical perspective, it could be argued that the own funds requirement should be the best indicator of 'specific risk'. However, Article 77 does not discriminate on the basis of riskiness. In any case, the EBA believes that the use of risk-weighted assets to define material positions would not be appropriate in this case, since the economic incentives behind the use of internal models should be independent from risk weighting.

Regarding the determination of a threshold based on the size of the 'exposure', the EBA considers that the most appropriate approach is the use of an absolute threshold (i.e. a fixed amount in Euros). This is consistent with a literal reading of the mandate. The EBA has gathered information from National Supervisory Authorities (NSAs) in order to calibrate this absolute threshold (see impact assessment)¹.

¹ As an alternative approach, the EBA considered linking the 'absolute' threshold to a certain percentage of the institution's own funds (i.e. a similar approach to the one applied in the 'large exposure' framework). Despite being more risk-sensitive, the EBA discarded this option, since it considers that the determination of the minimum

As a result of the above, the EBA has determined that a bank's exposure to specific risk of debt instruments should be considered material in absolute terms when the sum of net long and net short positions is greater than EUR 1 000 000 000.

Large number of material positions

The second part of the mandate includes defining what is meant by 'a large number of material positions in debt instruments of different issuers'.

This means that two materiality thresholds have to be defined, one for all net positions subject to specific risk and a second to spot 'individual' material positions. The EBA has calibrated what is a 'large number' of material (net) positions on the basis of a limited quantitative analysis, gathering information from a sample of banks that apply the standard rules to specific risk of debt instruments (see impact assessment).

The EBA has determined that a bank's TB debt instruments' specific risk portfolio has a large number of material positions in debt instruments of different issuers if the portfolio comprises more than 100 positions which are greater than EUR 2 500 000, irrespective of whether they are net long or net short.

Joint consideration of both criteria

Under Article 77(3), NSAs should assess whether banks must be encouraged to use an internal model if 'their exposures to specific risk are material in absolute terms and where they have a large number of material positions in debt instruments of different issuers'.

From a risk management perspective, it makes sense to require a minimum number of significant counterparties (i.e. some 'critical mass') before an internal model is developed. However the EBA considers that this requirement should not be overstated. The more 'stringent' the articulation of the second criterion is in the RTS (i.e. the larger the number of positions and the bigger the position threshold to be considered 'material') the more lenient the overall criteria in the RTS might end up being.

In particular, there is a risk that institutions that have large concentrated holdings will not be captured by the above definition if, despite fulfilling the absolute materiality criterion, they do not meet the large number of material positions criterion.

The EBA considers that banks holding large concentrated positions in the trading book should be encouraged to develop internal specific risk assessment capacity and to increase the use of internal models for specific risk.

portfolio size required to justify the use of an internal model is independent from a firm's own funds. In addition, this approach would not be in line with a literal reading of the mandate.

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3. EBA FINAL draft regulatory technical standards (RTS) on the definition of materiality thresholds for specific risk in the trading book under Article 77 of Directive 2013/36/EU (Capital Requirements Directive - CRD IV)



EUROPEAN COMMISSION

Brussels, **XXX**
[...](2012) **XXX** draft

COMMISSION DELEGATED REGULATION (EU) No .../..

of XXX

[...]

supplementing Directive 2013/36 of the European Parliament and of the Council with regard to regulatory technical standards on the definition of materiality thresholds for specific risk in the trading book under Article 77

COMMISSION DELEGATED REGULATION (EU) No .../..

of XXX

[...]

supplementing Directive 2013/36 of the European Parliament and of the Council with regard to regulatory technical standards on the definition of materiality thresholds for specific risk in the trading book under Article 77

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2013/36 of the European Parliament and of the Council of 24 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC² and in particular third subparagraph of Article 77(4) thereof,

Whereas:

- (1) Given that Article 77 of Directive 2013/36 refers solely to ‘debt’ instruments, equity instruments in the trading book should not be included in the materiality assessment of specific risk described in this Regulation.
- (2) The materiality of specific risk should be measured by applying the standardised rules for the calculation of net positions of debt instruments. The assessment should consider both long and short net positions calculated according to Article 327 of Regulation (EU) 575/2013, after recognising hedges by credit derivatives established in Articles 346 and 347 of Regulation (EU) 575/2013.
- (3) Article 77 of Directive 2013/36/EU refers to specific risk relating to debt instruments under the first subparagraph of its paragraph 3; accordingly, these rules should only apply to trading book positions, given that, defining thresholds for large numbers of material counterparties, which relates to the banking book, would result in no added value, without simultaneously establishing an absolute threshold for all banking book exposures as well. Therefore rules on the definition of materiality thresholds under Article 77 of Directive 2013/36/EU should focus on the definition of a materiality threshold for large number of material positions in debt instruments of different issuers.
- (4) This Regulation is based on the draft regulatory technical standards submitted by the European Supervisory Authority (European Banking Authority) to the Commission.

² OJ L 176, 27.6.2013, p.338.

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- (5) The European Supervisory Authority (European Banking Authority) has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093x/2010.

HAS ADOPTED THIS REGULATION:

Article 1 –Definition of ‘exposures to specific risk which are material in absolute terms’ according to Article 77(4) of Directive 2013/36/EU

An institution’s exposure to specific risk of debt instruments shall be considered material in absolute terms where the sum of all net long and net short positions, as defined in Article 327 of Regulation (EU) 575/2013, is greater than 1.000.000.000 €.

Article 2 –Definition of ‘minimum number of material positions in debt instruments of different issuers’ according to Article 77(4) of Directive 2013/36/EU

An institution’s specific risk portfolio shall be considered to comprise a large number of material positions in debt instruments of different issuers where the portfolio includes more than 100 positions which are each greater than 2.500.000 €. Such positions may be net long or net short, as defined in Article 327 of Regulation (EU) 575/2013.

Article 3- Final Provision

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission
The President*

*[For the Commission
On behalf of the President*

[Position]

4. Accompanying documents

4.1 Cost-benefit analysis / impact assessment

4.1.1 Introduction

1. In accordance with Article 10(1) of the EBA regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any draft implementing technical standards/regulatory technical standards/guidelines developed by the EBA – when submitted to the EU Commission for adoption - are to be accompanied by an impact assessment (IA) annex which analyses ‘the potential related costs and benefits’. Such annex should provide the reader with an overview of the findings as regards the problem identification, the options identified to resolve the problem and their potential impacts.

4.1.2 Problem definition and objectives of the regulatory technical standards

Issues addressed by the European Commission on the use of internal models for computing capital requirements as opposed to the use of external credit ratings

2. Through both specific measures as part of the CRD IV/CRR package and the revision of the Credit Rating Agencies (CRA) Regulation (Regulation (EC) No 1060/2009, as last amended by Regulation (EU) No 462/2013), the European Commission has proposed new rules to encourage the use of institutions’ internal models over external credit ratings for, among other purposes, the calculation of institutions’ capital requirements.
3. Further development of and increased reliance on internal models is first of all expected to result in:
 - a) improved quality of institutions’ risk measurement methods and risk management practices;
 - b) capital requirements that more closely reflect the actual idiosyncratic risk profile of the institution subject to the requirements.
4. Both objectives (a) and (b) contribute to the general regulatory objective of enhanced financial stability.
5. In addition, following the implementation of the CRA Regulation, the European Commission identified a series of issues relating to the use of external credit ratings which were not properly addressed by the regulation then in place. Among the problem drivers identified by the European Commission³, one relates to the overreliance on external ratings giving rise to pro-cyclicality and ‘cliff’ effects in computed capital requirements and, more generally, in capital markets. Procyclicality and cliff effects contribute to financial markets’ instability and low investor confidence. In order to tackle the problem of overreliance on external ratings the CRA Regulation was amended in 2011 with the introduction of provisions intended to discourage the mechanistic reliance, by institutions, on external credit ratings for assessing the creditworthiness of entities and financial instruments. The amended regulation provides for institutions to develop their own

³ See the impact assessment accompanying the European Commission’s Proposal for a Regulation amending Regulation (EC) No 1060/2009 on credit rating agencies .

internal credit risk assessment practices and for competent authorities to encourage institutions to do so, taking into account the principle of proportionality⁴.

Issues addressed by the RTS and objectives

6. These draft RTS propose a set of thresholds intended to trigger an assessment, by the National Supervisory Authority (NSA), of whether the individual institution should adopt internal models for the assessment of specific risk of debt instruments in the trading book.
7. The proposed provisions address materiality of specific risk of debt instruments in the trading book in absolute terms, given that all considerations concerning the proportionality of the adoption of internal models, e.g. the size, nature, complexity and business model of the institution, are mainly associated with the assessment carried out by NSAs.
8. The thresholds proposed in the RTS should strike the right balance between the objective of ensuring that material specific risk in the trading book is addressed through the use of internal models and the need to avoid internal models becoming an inefficient requirement for minor trading book portfolios of debt instruments for which there might be insufficient data, infrastructure and/or expertise.
9. In this regard, it is worth remembering that the purpose of these RTS is to spot those standardised banks that competent authorities should assess on an ad-hoc basis. Accordingly, since the consequences of ignoring banks with significant portfolios are more relevant than the consequences of spotting banks that may not need an internal model, the criteria proposed should work as a 'screening test'⁵, designed to minimise 'type I errors'⁶ though it may produce a number of 'type II errors'⁷.

4.1.3 Baseline current regulatory framework and market practices

10. The use of internal models for assessing the specific risk of debt instruments held in the trading book currently depends on case-by-case decisions taken in each jurisdiction by institutions and competent authorities. No harmonised criterion for the identification of institutions that should adopt internal specific risk assessments is in place at EU level.

4.1.4 Considered approaches and expected impact of the proposals

11. In order to assess the impact on NSAs, arising from the need to produce detailed assessments for specific risk trading portfolios of the institutions, the EBA has asked NSAs to provide individual institution-level data on:

⁴ See Article 5a of Regulation (EU) No 462/2013 amending Regulation (EC) No 1060/2009 on credit rating agencies.

⁵ In medicine, screening is a test used in a population to identify an unrecognised disease in individuals without signs or symptoms. In statistical test theory, the notion of statistical error is an integral part of hypothesis testing. The test requires an unambiguous statement of a null hypothesis. In this case the null hypothesis would be 'the Institution should develop an internal model since the specific risk portfolio is material.'

⁶ A type I error, also known as an error of the first kind, occurs when the null hypothesis is true, but is rejected by the test (i.e. the bank should develop an internal model for specific risk but its portfolio is not significant according to the criteria).

⁷ A type II error, also known as an error of the second kind, occurs when the null hypothesis is false, but erroneously fails to be rejected by the test (i.e. the bank should not develop an internal model despite the fact that the criteria determines that the portfolio is material).

- a) the total value of the positions in traded debt instruments subject to specific risk, as reported in COREP (intersection between column 50 and row 250 of the MKR SA TDI COREP template);
- b) the 200 largest net individual positions (in absolute value, i.e. irrespective of whether they are long or short) which form part of the figure reported in the intersection cells between columns 30 (Net Long Positions) and 40 (Net Short Positions) and row 250 of the MKR SA TDI COREP template.

12. It should be noted that the results do not cover the entire population of EU banks, which are currently applying the standardised approach, as only 11 countries answered to the relevant questionnaire. The feedback received following the data request can be summarised as follows:

Table 1

| Respondent National Supervisory Authority (NSA) | Number of institutions |
|--|-------------------------------|
| Austria | 2 + 1 related group |
| Belgium | 4 |
| Czech Republic | 4 |
| France | 4 |
| Germany | 4 |
| Denmark | 5 |
| Ireland | 2 |
| Italy | 4 + 1 related group |
| Latvia | 5 |
| Portugal | 5 |
| Spain | 3 |
| Total | 44 |

13. Three institutions within the sample reported in *Table 1* were excluded from the analysis because their COREP figure on 'positions subject to specific market risk' (item (I) above) was inconsistently smaller than the sum of the 200 largest net individual positions.
14. The remaining sample comprises 41 institutions, covering 11 EU jurisdictions. The size of exposures to specific risk of debt instruments as reported in COREP, within the institutions in the sample, varies from approximately EUR 2 million to EUR 100 billion. In particular:
 - a) only one institution reports a specific risk exposure above EUR 100 billion;
 - b) 17 out of 36 institutions report an exposure of between EUR 25 billion and EUR 1 Billion;
 - c) The remaining institutions in the sample report an exposure lower than EUR 1 billion.
15. The draft RTS propose that:
 - a) A bank's exposure to specific risk is to be considered material in absolute terms where the sum of all net long and net short positions is equal to or greater than EUR 1 000 000 000.
 - b) A bank's specific risk portfolio is to be considered to comprise a large number material counterparties and positions in debt instruments of different issuers where the portfolio

includes more than 100 net long or net short individual positions which are equal to or greater than EUR 2 500 000.

16. As shown in *Table 2* below, the proposed quantitative thresholds would give the following coverage:
- a) 17 out of 41 institutions in the sample;
 - b) 94% of specific risk exposure in the sample.
17. The provisions of these draft RTS contribute to the NSAs' assessment of whether individual institutions should adopt internal models for computing own funds requirements. The benefits of these provisions, therefore, depend on the overall realisation of the regulatory objectives linked to the development of internal models (see previous sections of this annex), and cannot be quantified within the framework of this impact assessment.
18. The development and use of internal models by institutions that do not currently use internal models is expected to result in operational compliance costs for institutions, and supervisory costs for NSAs supervising the use of such models. However, these costs are not expected to be large enough to offset the benefits to financial stability and market confidence stemming from the proposed provisions.

Table 2 – Coverage of proposed thresholds

| | Proposed thresholds |
|---|-------------------------------------|
| | |
| Material position in absolute terms (EUR) | 1 000 000 000 |
| Material individual position (EUR) | 2 500 000 |
| Number of material individual positions | 100 |
| | |
| | Resulting coverage in sample |
| No of institutions | 17 / 41 |
| % of sample total specific risk of debt instruments | 94% |

4.2. Views of the Banking Stakeholder Group (BSG)

No feedback from the BSG has been received.

4.3. Feedback on the public consultation and on the opinion of the BSG

| Comments | Summary of responses received | EBA analysis | Amendments to the proposals |
|---|---|--|-----------------------------|
| General comments | | | |
| Interaction with the Fundamental Review Consultation. | One respondent suggests taking into account that there already are active consultations underway regarding a Fundamental Review of the Trading Book. For this reason, it would be very onerous and costly if a potential model implementation was initiated on the basis of the technical standard only to be abrogated again in the near future. | The EBA intends to monitor the potential implications that the Fundamental Review process in Basel might have for Market Risk standards. However, at this stage, there is no known interaction between this particular RTS and the BCBS consultation on the FR. | No change. |
| Need to leave discretion to implement an internal model. | <p>One respondent considers that the decision about whether an internal model shall be used not only for the purposes of internal governance but also for the purposes of determining supervisory capital adequacy requirements should remain part of business policy decisions. According to this respondent, this understanding is part of current supervisory practices; it shall and may not be abrogated by means of a technical standard.</p> <p>The respondent considers that any mechanistic rule whereby exceeding these thresholds would automatically lead to a need for banks to declare an internal model for the purposes of Pillar I would have to be considered as an undue interference with banks' entrepreneurial freedom. In order to avoid</p> | The RTS does not impose any obligation to implement an internal model; it simply establishes criteria for assessing when the specific risk of debt instruments in the trading book is sufficiently material to trigger an evaluation by the competent authority. After this evaluation, it will be the competent authority that should determine whether it is worth encouraging a bank to develop internal assessment capacity and to increase the use of internal models for capital calculations. | No change. |

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| | misunderstandings, the respondent suggests clarifying this in the EBA standard. | | |
| Overreliance on external ratings. | One respondent considers that the intention of reducing the overreliance on external ratings won't be achieved introducing internal models. This respondent argues that when calculating the incremental risk charge (IRC), it is neither a binding standard nor a common market practice to use internal ratings. | The standardised approach is entirely based on external ratings while in IRC this is only a possibility. In addition the mandate also includes the obligation to develop 'internal credit risk assessment capacity'. | No change. |
| General / Specific risk interaction. | One respondent considers that compliance with the requirements for a specific market risks model, being defined under Article 370 CRR, is only possible by modelling the general interest rate risk as well. Hence, the bank would be automatically forced into implementing a model for the entire interest rate risk (general and specific interest rate risk). They propose taking this circumstance into account during the forthcoming definition of thresholds. | The materiality of general risk and the need to implement an internal model for general risk prior to the implementation of the specific risk model is outside the scope of this RTS. This should nevertheless be part of the assessment by Competent Authorities. | No change. |
| Joint consideration of the criteria. | One respondent notes that, under Article 77 of the CRD IV, the conditions are linked by the word "and" meaning that the scenario shall only be subsumed under the regulatory scope if both conditions are met. Their understanding is that, in its Consultation Paper, the EBA ignores this and proposes an "or" link. | The RTS sets the two thresholds that have to be applied under Art. 77 CRD. According to this article, both of them have to be considered jointly (the EBA is not proposing an 'or' link between both thresholds). | No change. |

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| <p>Modelling partial use / liquid asset buffers.</p> | <p>One respondent is concerned that there may be a regulatory requirement for an IMM firm to calculate its capital requirements for a particular portfolio based on the standardised method. This may be due to, for example, the portfolio containing securitisations for which the firms must calculate the capital based on the standard approach. The industry recommends that such portfolios, and more widely firms that have approved IMMs, should be exempt from the specific risk in the trading book calculation.</p> <p>In addition the respondent believes that an absolute materiality threshold may be problematic for smaller wholesale banks, such as subsidiaries of overseas banks, which hold the majority of their liquid asset buffer securities in their trading books. Since the EBA does not propose to use a risk-weighted approach, a lot of those assets will be caught under the proposed thresholds.</p> | <p>The RTS does not impose any obligation to implement an internal model; it simply establishes criteria for assessing when the specific risk of debt instruments in the trading book is sufficiently material to trigger an evaluation by the competent authority. After this evaluation, it will be the competent authority that should determine whether it is worth encouraging a bank to develop internal assessment capacity and to increase the use of internal models for capital calculations. The partial use of a model, as well as the importance of liquid assets held in the TB are elements captured in the threshold, but CAs should consider these elements as part of their assessment, this is stated in Art. 77 where it is noted that CAs should take <i>'into account institutions' size, internal organisation and the nature, scale and complexity of their activities'</i>.</p> | <p>No change.</p> |
| <p>Periodicity in the calculation of the thresholds.</p> | <p>According to one respondent the EBA should take into consideration that thresholds can be breached due to temporary spikes in trading activity and provision should be made for accommodating for such temporary breaches of the threshold. Rather than one breach of the threshold triggering an evaluation, a number of breaches over a period of at least three months should be required before an evaluation by the competent authorities is triggered.</p> | <p>The frequency in the calculation of the thresholds is outside the legal mandate. Competent Authorities should decide how and when they want these calculations to be performed.</p> | <p>No change.</p> |

Responses to questions in Consultation Paper EBA/CP/2013/33

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| <p>Q1. Do you agree with the use of an absolute materiality threshold?</p> | <p>One respondent consider that the thresholds shall be understood rather as guidance and not as mandatory criteria. As an alternative regulatory choice, they would be in favour of a solution where the respective banks are entitled to return their supervisory model approval (opt-out clause).</p> <p>The same respondent does not understand the rationale for defining an absolute threshold that is based on the nominal value of positions. According to their view, the definition should seek to assess in how far “trade” is de facto taking place in the specific risks (long – vs. short positions). Only in the presence of, for instance, a significant trading activity of CDS against bond positions is there a need in the first case for a risk model to treat the specific interest rate risk. Furthermore, they are concerned with the threshold’s lack of risk sensitivity. For instance, an instrument featuring an identical nominal value and a residual maturity of 3 months will feature far less specific risks than an instrument with a residual term to maturity of 10 years.</p> <p>Another respondent believes that an absolute materiality threshold may be problematic for smaller wholesale banks, such as subsidiaries of overseas banks that hold the majority of their liquid asset buffer securities in their trading books. They do not oppose the thresholds conceptually, if this proportionality issue is taken into account in the calibration of the thresholds (raising the threshold levels or alternatively, excluding liquid asset buffers securities).</p> | <p>The thresholds are not designed to be risk-sensitive on purpose, however they are not based on ‘nominal’ value but on ‘net position’, in accordance with Art. 327 of the CRR.</p> <p>The purpose of these RTS is to spot those standardised banks that competent authorities should assess on an ad-hoc basis.</p> <p>CAs should consider these elements as part of their assessment, this is stated in Art. 77 where it is noted that CAs should take <i>‘into account institutions’ size, internal organisation and the nature, scale and complexity of their activities’</i></p> | <p>No change.</p> |
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| <p>Q2. Do you agree with the proposed values for (i) overall specific risk and (ii) significant number of (iii) material exposures? If you believe the values are inappropriate, please provide some rationale and alternative values.</p> | <p>One respondent considers that, if a “simple” threshold on a ‘nominal’ basis remains applicable, they would be strongly in favour of at least doubling the envisaged nominal value threshold.</p> <p>Another respondent suggests increasing the proposed thresholds considering the liquidity requirements in the LCR, and more specifically the requirement for a material portfolio of liquid assets in order to avoid capturing these portfolios in small banks with limited trading activity. They propose the following thresholds:</p> <ul style="list-style-type: none"> a. The sum of net longs and net short positions should be greater than EUR 10bn rather than EUR 1bn; and b. Each position greater than EUR 10m for 200 positions rather than EUR 2.5m for 100 positions. <p>Alternatively, they consider that the thresholds can be kept as proposed by the EBA provided liquid asset buffer securities held in the trading book are exempted from the measure.</p> | <p>The thresholds have been calibrated to capture all banks with significant credit risk TB portfolios, this implies ‘capturing’ a number of institutions which do not have significant activity.</p> <p>The thresholds have been calibrated this way, since the consequences of ignoring banks with significant portfolios are more relevant than the consequences of spotting banks that may not need an internal model. In other words, the criteria proposed should work as a ‘screening test’, designed to minimise ‘type I errors’ though it may produce a number of ‘type II errors’</p> | <p>No change.</p> |
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