



Public Hearing on draft RTS/ITS on Benchmarking under Article 78 CRD

16th of June 2014

Introduction 1/2 - Consultation process

- The consultation has been launched on **28th of May** with the publication of the Consultative paper
- This public hearing is part of the consultation process to allow discussion on the topic
- The end of the consultation is the **19th of August**
- Before this deadline the interested parties should submit their comments using the EBA website:

<http://www.eba.europa.eu/regulation-and-policy/other-topics/regulatory-and-implementing-technical-standards-on-benchmarking-portfolios>

The comments should be specific and focused.

You are invited to provide your answers to pre-defined questions.

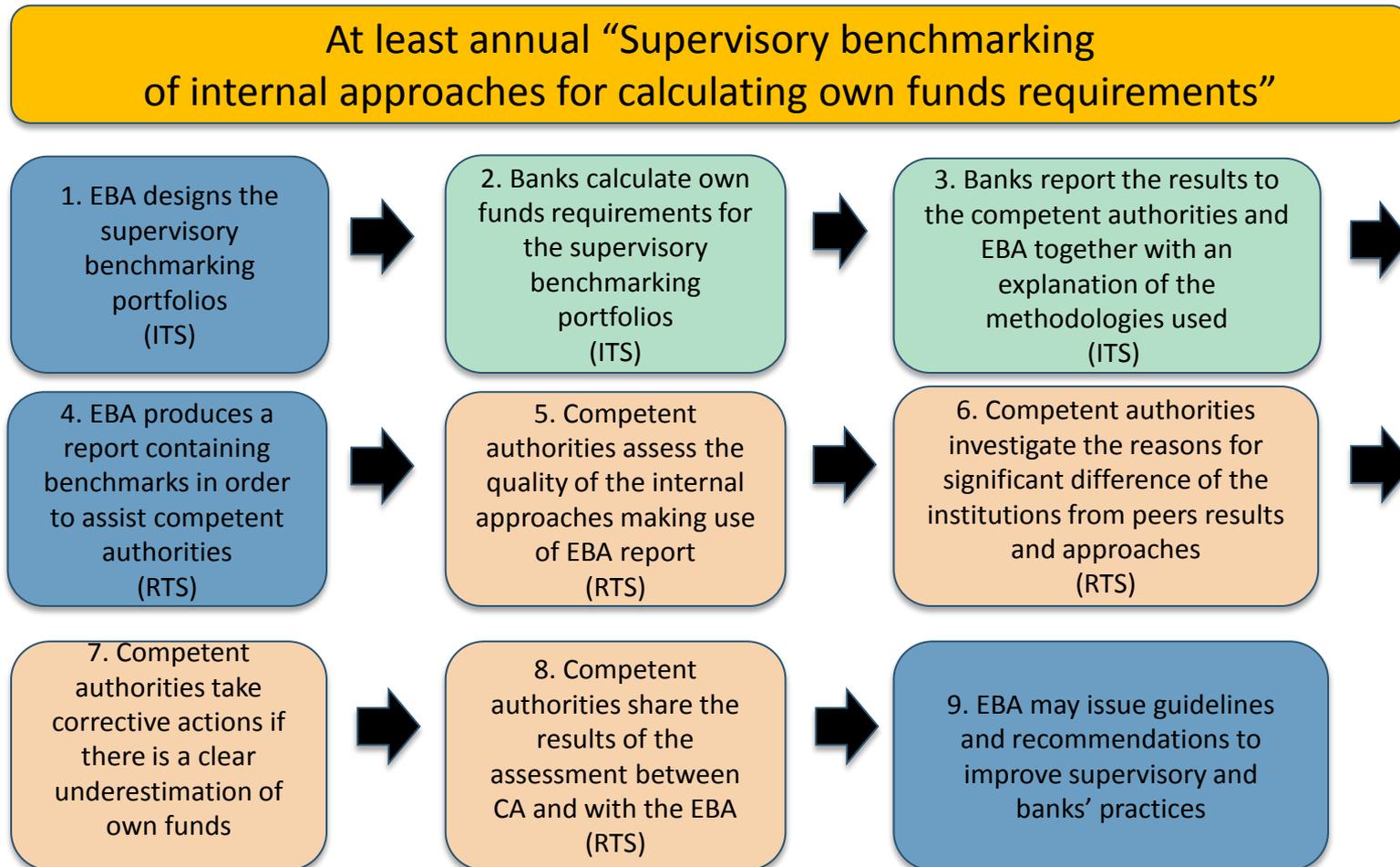
Introduction 2/2 - Consultative paper structure

- The consultative paper has 5 different sections:
 - A background section
 - The draft Regulatory Technical Standards (RTS)
 - The draft Implementing Technical Standards (ITS) and its annexes:
 - ▶ Annex I to VI are about Credit risk. For each template a instruction file is provided.
 - Annex I (template) and II (instructions) define the portfolio
 - Annex II (template) and III (instructions) are collecting the bank's data
 - Annex IV (template) and V (instructions) are collecting computation data.
 - ▶ Annex VIIa, VIIb and VIII about Market risk
 - Cost and Benefit analysis
 - Questions for the consultation

- We will focus our presentation on the RTS and the ITS as well as its annexes.

RTS presentation 1/3 - Workflow

Art. 78 CRD work-flow



RTS presentation 2/3 – benchmarks

- The RTS define also what types of benchmarks should be used for the assessment (article 3 of the RTS).
 - (a) extreme values
 - (b) output modelling values and standard deviation of the output modelling values falling in the first and fourth quartile of the peers' sample distribution
 - (c) own funds requirements that result from the application of the standardized approach
 - (d) own funds requirements that result from the use of outturns by the institutions

- Those are not exclusive/final ones. Other analyses should be conducted by the Competent authorities (article 7 to 12 of the RTS)

RTS presentation 3/3 – benchmarks related questions

Q1. Do you consider the use of common benchmarks for credit and market portfolios necessary to ensure a common approach?

Q2. Do you consider that the benchmarks outlined in the RTS are sufficiently proportionate and flexible? Do you have any alternative benchmark proposals? If yes, please provide details.

Q3. What limitations do you see in relation to the use of the proposed benchmarks, i.e., (i) first and the fourth quartiles; (ii) comparison between own funds under the internal models and the standardised approach; and (iii) comparison between estimates and outturns?

Q4. What in your view is the most appropriate benchmark and/or approach for the assessment of the level of potential underestimation of own funds requirements?

ITS presentation 1/9 – Credit risk specificities

- The ITS defines also that the exercise is annual but that a rotation approach will be used for the credit risk portfolio :
 - The even years : Low default portfolios (Large corporate, credit institutions and central government) with a Hypothetical portfolio and cluster approach, as well as hypothetical transaction exercise that targets large corporate portfolio.
 - The odd years: Retail portfolios for now restricted to SME corporate, SME retail and Residential mortgages using a cluster approach
- Further, the EBA is consulting about preferred phase-in in terms of portfolio coverage
 - Option 1: Some portfolios are defined and then additional portfolio are introduced in the next years (with new ITS).
 - Option 2: All portfolios are defined upfront but not applied the first years

ITS presentation 2/9 – Credit risk specificities related questions

Q8. Which of the two options for phasing-in do you consider preferable?

Q9. Do you see any potential ambiguities in the credit risk portfolios defined in Annex I? Please identify the relevant portfolio providing details and any suggestions that would eliminate these ambiguities.

Q10. Do you have any suggestions for additional credit risk portfolios? Please provide details.

Q13 Do you agree with the possibility of allowing firms to refrain from reporting portfolios if one of the conditions stated in Article 3 is met?

Q14 Do you have any suggestion about additional exemptions from reporting? If yes, please provide details.

ITS presentation 3/9 – ‘Market’ portfolios specificities

- ‘Market models’ encompass VaR, Stressed VaR, IRC, correlation trading models as well as models used for counterparty risk (IMM) and advanced CVA.
- The EBA intends to build on the experience gained in previous SIGTB / EBA exercises. Banks will be requested to submit ‘initial market valuations’ (IMV) ahead of modelling results to ensure the instruments have been correctly understood. Instruments are largely based on those used in previous exercises
- The individual portfolios are designed to assess individual risk factors (not so much own fund requirements)
- The aggregated portfolios should aim to allow an assessment of capital and diversification effects for (i) long-only and (ii) long-short portfolios (avoiding ‘accidental hedges’).
- Nevertheless, the aggregated portfolios are very different from real ones and any conclusions on the level of capital should be taken with caution.
- To allow efficient data compilation, all modelling options will be reported in the templates in the form of drop down menus (no separate questionnaires will be distributed). A blank cell will be provided in case the bank needs to clarify any of the answers.
- Regarding IMM and CVA the EBA intends to use exactly the same portfolios as the ones produced by the SIGTB

ITS presentation 4/9 – ‘Market’ portfolios specificities

EBA proposed portfolios

The approach intends to isolate individual risk factors, in order to be able assess them individually.

- example: CDS-Bond ‘basis’ risk portfolios incorporate an IRS to eliminate the IRR component

The approach implies using very similar portfolios, which may only differ in one individual risk factor, in order to allow an ‘incremental’ analysis of risk factors.

- example: Portfolios I to III below (equity risk for long index-only portfolio, long index + short positions in some of its components and long index + short equities not included in the index)

Indiv. Portfolio	Combination of Instruments	Base Currency	Main Market Risk Factors	Observations
I	1 – 50 instruments	EUR	General market risk for equities, delta 1 portfolio, no optionality.	
II	1 – 50 instruments 2 – 9 instruments 3 - 1 instrument	EUR	General market risk for equities, delta 1 portfolio, no optionality. Some components of the index (bank names) hedged.	Compared with P I, a consistent reduction in VaR should be observed
III	1 – 50 instruments 4 – 10 instruments 5 - 2 instruments	EUR	General market risk for equities, delta 1 portfolio, no optionality. Short positions in bank equities which are not components of the index (similar size than 2).	Compared with P I, a reduction in VaR might be observed, the result is likely to be higher than P II.

The EBA proposal also includes specific portfolios for DKK, SEK and GBP markets.

IMV is requested by instrument (and not by portfolio)

The portfolios only include plain vanilla instruments.

ITS presentation 5/9 – ‘Market’ portfolios specificities

EBA proposed portfolios

Advantages:

- It intends to allow an assessment of individual risk factors: (i) comparing the same portfolio across banks to assess risk factor variability and (ii) comparing similar portfolios (differing only in one individual risk factor) produced by the same bank to assess how that particular firm is modelling that RF
- Allows a more specific assessment of IMVs (i.e. at instrument level)
- Covers non-euro jurisdictions

Disadvantages:

- The portfolios have not been previously tested (likely to raise interpretative issues)
- It does not address complex instruments (at least for the initial exercise)

Annex VII.a: EBA proposal for Market Risk benchmark portfolios.

1. Common Instructions

- (a) Banks shall assume they enter all positions on xxxxxx 2014, and once positions have been entered, each portfolio ages for the duration of the exercise. Furthermore, assume the Bank does not take any action to manage the portfolio in any way during the entire exercise period. Unless explicitly stated otherwise in the specifications for a particular portfolio, strike prices for options positions should be determined relative to prices for the underlying as observed at market close xxxxxx 2014.
- (b) For the purpose of pre-exercise validation banks should provide to their local supervisor on xxxxxx 2014 the valuation of each portfolio. The exact timing of the valuation should be 4.30pm London
- (c) For the purpose of the benchmark portfolio exercise, banks should provide the valuation of each portfolio on xxxxx, together with the relevant required risk metrics as described in the accompanying results reporting template and explained below.
- (d) Banks should calculate the risks of the positions without taking into account the funding costs associated to the portfolios (i.e. no assumptions are admitted as per the funding means of the portfolio)

ITS presentation 6/9 – ‘Market’ portfolios specificities

TBG type of portfolio

Advantages:

- Already ‘tested’ several times
- (some) Banks and Competent Authorities should be familiarised with them
- They cover complex and non-complex instruments

Disadvantages:

- Only Banks and CAs which have already participated in Basel/EBA exercises would benefit from previous experience
- Does not allow an assessment of individual risk factors

Annex VII.b - TBG type market risk portfolios

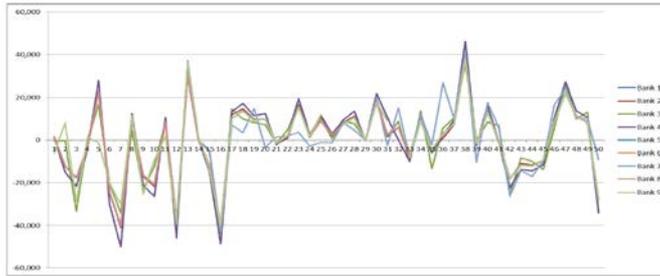
Portfolio number Risk factor	Portfolios	Currency	Comments
Equity Portfolios			
1 Equity	Equity index futures Long delta <ul style="list-style-type: none"> • Long 30 contracts ATM 3-month front running FTSE 100 index futures * Futures price is based on the index level at NYSE Liffe London market close on [N]. 1 contract corresponds to 10 equities underlying. 	GBP	
2 Equity	Bullish leveraged trade Long gamma and long vega <ul style="list-style-type: none"> • Long 100 contracts OTC Google (GOOG) OTM 3-month call options (1 contract = 100 shares underlying) * Strike price is out-of-the-money by 10% relative to the stock price at market close on [N]. 	USD	
3 Equity	Volatility trade #1 Short short-term vega & long long-term vega <ul style="list-style-type: none"> • Short straddle 3-month ATM* S&P 500 Index OTC options (30 contracts) • Long straddle 2-year ATM S&P 500 Index OTC options (30 contracts) 1 contract corresponds to 100 equities underlying effective date [N] * Strike price is based on the index level at NYSE at 4.30 pm New York on [N]. 	USD	

The EBA is asking for feedback on which one of the two set of portfolios is more appropriate (i) for 2014/15 and (ii) on a more permanent basis.

ITS presentation 7/9 – ‘Market’ portfolios specificities

Equity Portfolios: Number 1 – equity index futures

Portfolio # Risk Factor	Strategy	Base Currency	VolR	Stressed VolR	IRC
1 Equity	Equity Index Futures Long delta Long 30 contracts ATM 3-month front running FTSE 100 index futures * Futures price is based on the index level at NYSE Liffe London market close on Friday, May 10th, 2013 † contract corresponds to 10 equities underlying	GBP	*	*	



50-day P&L vector

PS	Bank 1	Bank 2	Bank 3	Bank 4	Bank 5	Bank 6	Bank 7	Bank 8	Bank 9
Bank 1	100	95	100	100	100	91	100	96	
Bank 2	100	100	95	100	100	100	90	100	96
Bank 3	95	95	100	91	95	95	88	95	94
Bank 4	100	100	94	100	100	100	90	100	96
Bank 5	100	100	95	100	100	100	90	100	96
Bank 6	100	100	95	100	100	100	91	100	96
Bank 7	91	95	88	90	95	88	91	89	
Bank 8	100	100	95	100	100	100	90	100	96
Bank 9	96	96	94	98	98	98	89	100	96
Mean	15.41								
Stdev	1.30								
Stdev / Mean	8.44%								

Correlations across one-year daily P&L observations

Main Risk Factors

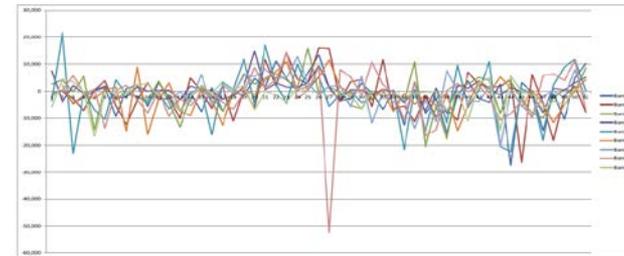
- Material risk factors are spot prices of FTSE components.
- No optionality

Comments

- Due to the type of underlying (observable market data) and lack of optionality, the P&L vector of banks using HS is very similar, with very high correlation (with banks 3 & 7 showing a bit less)

Equity Portfolios: Number 3 – Volatility trade number 1

Portfolio # Risk Factor	Strategy	Base Currency	VolR	Stressed VolR	IRC
Equity	Volatility Trade #1, Short short term vega & long long term vega _Short straddle 2-month ATM S&P 500 OTM options (30 contracts) _Long straddle 2-year ATM S&P 500 Index OTM options (30 contracts) † contract corresponds to 100 equities underlying - effective date May 10th 2013 * Strike price is based on the index level at NYSE market close on May 10th 2013	USD	*	*	



50-day P&L vector

PS	Bank 1	Bank 2	Bank 3	Bank 4	Bank 5	Bank 6	Bank 7	Bank 8	Bank 9
Bank 1	100	14	44	34	32	19	2	35	17
Bank 2	14	100	11	11	19	40	5	18	18
Bank 3	44	11	100	33	43	11	19	21	44
Bank 4	34	11	33	100	22	4	4	17	18
Bank 5	32	19	43	22	100	1	14	21	38
Bank 6	19	40	11	4	1	100	2	14	13
Bank 7	2	5	13	4	14	2	100	1	13
Bank 8	35	18	21	17	21	14	4	100	11
Bank 9	17	18	44	18	38	14	13	11	100
P&L Stdev	7.25	8.16	7.95	7.64	9.54	7.34	6.97	9.57	8.53
Mean	7.95								
Stdev	1.04								
Stdev / Mean	13.50%								

Correlations across one-year daily P&L observations

Main Risk Factors

- Material risk factors are spot prices of S&P and, specially, implied volatilities.

Comments

- Despite the fact that both options are ATM, the portfolio is not entirely delta neutral due to the different maturities of the long/short straddle; however, the effect of delta is limited, and the main risk factor stems from the implied volatility surface.

Banks using **Historical Simulation** will be requested to submit one-year P&L Data

This will be used:

- To **perform alternative VaR calculations** with the same assumptions (1 day VaR re-scaled to 10 days using the square root of time, considering a one year period with no data weighting).
- To **perform P&L correlation and volatility** analysis across banks.

The EBA considered requesting the same information for SVaR, however, due to the additional burden, this possibility was rejected (for the time being) since it would imply that banks would have to re-calculate SVaR using a common one-year period.

ITS presentation 8/9 – Market risk questions

Q5. Which set of market risk portfolios do you consider more appropriate for the initial exercise conducted under Article 78?

Q6. As explained in the background section, do you consider the approach proposed by the EBA appropriate for future annual exercises?

Q7. Do you have any alternative proposals? If yes, please provide details.

Q11. Do you see any potential ambiguities in the market risk portfolios defined in Annexes VII.a and VII.b? Please identify the relevant portfolio providing details and any suggestions that would eliminate these.

Q12. Do you have any suggestions for additional market risk portfolios? Please provide details.

ITS presentation 9/9 – Exemptions for reporting

Few exemptions for reporting will be allowed

- (a) such institutions do not have a model authorisation from their competent authority to model the relevant instruments, or risk factors, which are included in the portfolio;
- (b) there is no internal authorisation by the management of these institutions to operate in certain instruments or the underlying assets included in the relevant portfolios;
- (c) one or more of the instruments included in the portfolios incorporate underlying risks or modelling features which are not contemplated in the institution's risk metrics.

Question related

Q13 Do you agree with the possibility of allowing firms to refrain from reporting portfolios if one of the conditions stated in Article 3 is met?

Q14 Do you have any suggestion about additional exemptions from reporting? If yes, please provide details.



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