The European Banking Authority
20 Avenue André Prothin
92400 Courbevoie
France

Subject: Draft Implementing Technical Standards amending Commission Implementing Regulation (EU) 2016/2070 with regard to benchmarking of internal models[1]

The International Swaps and Derivatives Association ('ISDA') and the Association for Financial Markets in Europe ('AFME'), the 'Joint Associations' and their members ('the Industry') welcome the opportunity to comment on the European Banking Authority's ('EBA') Consultation on ITS amending Commission Implementing Regulation EU 2016-2070 on Benchmarking.

Market Risk

The Industry welcomes the EBA efforts to improve the effectiveness of the exercise with the introduction of Default Risk Charge and Residual Risk Add-on components of the Alternative Standardised Approach, and to promote the stability of the exercise by keeping the instruments unchanged from the 2023 exercise.

The Industry notes the proposed introduction of an SBM validation component that is very similar to the Unit Test element of ISDA's FRTB-SA benchmarking exercise[2]. In this regard the Industry would like to highlight the importance of consistency and harmonization in those areas where the industry has already developed standards, namely the FRTB-SA CRIF (Common Risk Interchange Format) and Unit Test framework. The creation of new standards by the EBA that are similar but not fully aligned could generate unnecessary effort and reduce the efficiency of the process and impact the standard that the industry has developed.

Therefore, the Industry strongly recommends that the SBM validation component should not be introduced as it is currently proposed. The industry further recommends that if this component is to be introduced, it should be fully aligned to the existing industry standards to maximize efficiencies and reduce implementation cost. We note that the industry Unit Test framework has been through a multi-year development and validation process with a large number of banks and is available to the EBA to use as part of the annual Benchmarking[3]. We are keen to support the EBA on how to best integrate the industry standard in the EBA Benchmarking process and address any questions in relation to the content and structure of the Unit Test.

[1] https://www.eba.europa.eu/regulation-and-policy/supervisory-benchmarking-exercises/its-package-2024-benchmarking-exercise
[2] https://www.isda.org/a/Q6DgE/ISDA-SA-Benchmarking-Factsheet.pdf
[3] ISDA welcomes the opportunity to engage with the EBA to help execute and address any questions.

The Industry would also like to draw attention to the diminishing returns observed from such a Unit Test aspect recurring on a year-on-year basis. When a firm has validated their model aggregation once there is limited benefit from annual revalidation unless there are changes to the regulatory requirements.

The Industry has also identified the specification of several instruments as problematic and requests these specifications to be amended.

We thank you in advance for your consideration and please do not hesitate to contact the undersigned associations with questions.

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Market Risk

MR Q1: Do you see any issues or lack of clarity in the definition of the data points of templates C120.04 and C120.05? Do you foresee any issues in terms of compatibility of template C120.04 and data standards used by the industry?

Response:
The Industry has identified the following issues with the data templates:

1. In respect column 0060 (Credit Quality Category) of the C120.04, the following additional allowable values are required to support the 'securitisations that are not in the ACTP' risk class as per the official mapping of SEC-ERBA credit quality steps[4].
    - 'Credit quality step 7', 'Credit quality step 8', etc. through to 'Credit quality step 17'
    - 'Credit quality step All Other'
2. In respect of C120.04, the allowable values for data points relating to 'securitisations that are in the ACTP' do not support the representation of non-tranched instruments that may be included in the ACTP (e.g., non-securitisation hedges and Nth-to-default instruments). This may not be required for the current set of instruments but may be required in the future.
3. FRTB-SA CRIF does not include Risk Weight as a data field as risk weighting is usually determined by the SA model itself based on the inputs, rather than being an input to the model. The risk weight applicable to a given row should be readily identifiable from the specification of the risk, excepting those cases for which there are methodological alternatives. In the case of 120.02, data fields to capture methodological alternatives have already been added to the template proposed by the EBA (e.g., (0090): Division of curvature risk components for foreign-exchange risk by scalar). It is proposed by the Industry that the addition of a data field to capture the methodological alternative "Division by sqrt(2) for liquid ccy/ccy pair", in addition to those already proposed, would eliminate any requirement for a distinct data field to capture the applicable risk weight.

Other minor points of divergence in the proposed DRC representation with respect to the existing data standards used by the Industry (i.e., the ISDA FRTB-SA CRIF) are as follows:

- FRTB-SA CRIF uses Recovery Rate notation rather than Loss Given Default
- FRTB-SA CRIF captures Tranche Thickness rather than distinct Attachment and Detachment Points for securitisations not in the ACTP

MR Q2: Do you agree with the proposed format for the collection of DRC data in templates C120.04 and C120.05?

Response:
As stated in the EBA RTS on Gross JTD amounts[5] (Article 2, paragraph 1): *"The alternative methodology to estimate the gross JTD amount of an exposure referred to in Article 325w(7) of Regulation (EU) No 575/2013 shall consist in calculating the difference between the market value of the instrument from which the exposure arises for the institution at the time of the calculation and the market value of the instrument from which the exposure arises calculated under the assumption that the obligor defaulted at that time."*

[4] https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2018_4274

[5] https://www.eba.europa.eu/regulation-and-policy/market-risk/regulatory-technical-standards-gross-jump-default-amounts

Firms using this alternative methodology may not distinctly produce notional and/or P&L + adjustment and so reporting of these values would be extremely burdensome. Therefore, the Industry recommends that the following columns should be made optional: 0140 (Notional), 0180 (Notional in reporting ccy), 0150 (P&L + Adjustment), and 0190 (P&L + Adjustment in reporting ccy).

MR Q3: Do you agree with the proposed amendments to template C120.06 (former C120.03) to include DRC and RRAO OFR by portfolio?

Response:
Yes, the proposed amendments are pragmatic.

MR Q4: In your view, what approaches would be suited to benchmark banks' implementation of the RRAO requirements more comprehensively?

Response:
The Industry has no recommendations in respect of approaches to benchmark RRAO more comprehensively at this time.

MR Q5: Do you agree with the proposed change to the reporting of vega sensitivities?

Response:
Yes, the proposed amendment is pragmatic.

MR Q6: Do you agree with the proposed clarification with regards to taking the reporting currency view for the consideration of FX risk? Do you agree with the proposed clarification with regards to converting reporting currency results to the EBA portfolio currency using the applicable ECB spot exchange rate?

Response:
The Industry does not agree with the proposal to take a reporting currency view with regards to FX risk. In the opinion of the Industry no significant benefits could be expected from the proposed change, while it could lead to a number of potential complications. These include an increase in the variability of results with a lack of visibility of the underlying causes (especially for results relating to Basel 2.5 measures), the unintended benchmarking of FX risk for portfolios that have not been designed for that purpose, and a requirement for additional clarifications in respect of instrument level instructions.

MR Q7: Do you agree with the proposed introduction of individual and aggregated portfolios for purposes of SBM validation?

Response:

The Industry does not recommend the introduction of an SBM validation component as currently proposed for the following reasons:

a) there is an existing industry gold standard (i.e., the ISDA Unit Test[6]) that has extensive use across the industry and

b) diminishing returns have been observed in respect of this validation element and hence the benefits of a year-on-year validation process are considered by the Industry to be negligible

Should the EBA introduce this element instead of relying on the existing industry gold standard (i.e., the ISDA Unit Test) as proposed by the Industry, the Industry recommends that the portfolios and representation should be fully aligned to the existing industry gold standard (i.e. the ISDA Unit Test).

MR Q8: Do you see any issues or lack of clarity with the instructions of Annex 5 defining the SBM validation portfolios?

Response:

The following issues are noted:

- The SBM validation portfolios do not align with the existing industry gold standard (i.e. the ISDA Unit Test).
- Unlike the ISDA Unit Test, the proposed portfolios do not test all possible combinations & permutations for GIRR Delta. Note the following example test condition deficiencies:
  - different inflation curves for the same currency
  - intra-bucket flooring
  - inter-bucket negative square root alternative specification
  - inter-bucket aggregation with ERM II currencies

MR Q9: Do you propose additional SBM validation portfolios to test other risk classes, components or specific features of the SBM calculation?

Response:

Additional portfolios should be fully aligned with those of the existing industry gold standard (i.e., the ISDA Unit Test), which covers all possible combinations and permutations of risk factors.

Other observations

Instrument definitions

The Industry welcomes the clarifications to various instrument definitions following industry feedback and the stability in terms of the number of instruments in the exercise.

However, the Industry has identified further issues with certain instrument specifications and is proposing amendments as described below.

[6] https://www.isda.org/a/Q6DgE/ISDA-SA-Benchmarking-Factsheet.pdf

The definition for the swaption (Instr. 202) can be interpreted as requiring the strike to equal the ATM spot rate or forward rate of the associated IRS. The industry therefore recommends clarifying as below:

- 202 – Two-year EUR swaption on 5-year IRS EUR – pay fixed rate and receive floating rate. The strike price is based on the **ATM spot rate of the** IRS defined within this instrument

The additional specification for the cross-currency swap (Instr. 220) has incorrect information for floating leg 2 and the following amends are recommended:

- 220 - Section 5: Additional specifications for instruments: *Float Leg 2:* Effective Date: Booking date **+ 6 months** Maturity date: Booking date +5**,5** years

The amendments to the specifications for the FX forwards (Instr. 301, 302) are acknowledged but the industry recommends more explicit clarification as below:

- 301 - 6-month USD/EUR forward contract. Cash settled. Long USD – Short EUR; Notional USD 10 000 000; EUR/USD ECB reference as spot rate ~~/ forward rate~~ as of end of the booking date **to determine forward rate.**
- 302 - 6-month EUR/GBP forward contract. Cash settled. Long EUR – Short GBP; Notional 10 000 000 GBP; EUR/GBP ECB reference as spot rate ~~/ forward rate~~ as of end of the booking date **to determine forward rate.**

The same clarifications are requested for the other FX Forwards in the portfolios (Instr. 310, 311) as below:

- 310 - 6-month EUR/DKK forward contract. Cash settled. Long EUR – Short DKK; Notional EUR 10 000 000; EUR/DKK ECB reference spot rate as of end of the booking date **to determine forward rate**.
- 311 - 6-month EUR/BRL Non deliverable forward contract. Long EUR – Short BRL; Notional EUR 10 000 000; EUR/BRL ECB reference spot rate as of end of the booking date **to determine forward rate**.

Clarification of the strike price of the gold option (Instr. 405) is recommended as below:

- 405 - Long Call option. 5 000 0zt of London Gold. Strike price: ATM **forward rate** as of end of the booking date

The duration of the CDS index option (Instr. 530) is longer than usually observed for such an instrument in the market and the following amendment is recommended:

- 530 - Short Put option. EUR 10 000 000. Underlying iTraxx Europe index on-the-run series (same instrument of 529). Expiry date: Booking date + ~~1 year~~**6 months**

Many instruments related to on-the-run CDS indices (Instr. 529, 602, 604, 606, 608, 610) are specified with a maturity of approx. 6 years (June Year T+5) while market convention is a maturity of approx. 5 years. The industry recommends amending these specifications as below:

- 529 – Long (Buy protection) EUR 10 000 000 CDS on iTraxx Europe index on-the-run series. Maturity: June Year T+**4**

- 602 - Long (i.e. Buy protection) EUR 5 000 000 CDS on iTraxx Europe index most recent on-the-run series. Maturity: June Year T+**4**
- 604 - Short (i.e. Sell protection) EUR 5 000 000 CDS on iTraxx Europe index most recent on-the-run series. Maturity: June Year T+**4**
- 606 - Long (i.e. Buy protection) EUR 5 000 000 CDS on iTraxx Europe index most recent on-the-run series. Maturity: June Year T+**4**
- 608 - Short (i.e. Sell protection) EUR 5 000 000 CDS on iTraxx Europe index most recent on-the-run series. Maturity: June Year T+**4**
- 610 - Long (i.e. Buy protection) EUR 5 000 000 CDS on iTraxx Europe index most recent on-the-run series. Maturity: June Year T+**4**