

European Banking Authority
Consultation Paper: EBA/CP/2019/07

4 October 2019

Re: EBA/CP/2019/07

Dear Secretaries:

ICE Data Services appreciates the opportunity to comment on the draft regulatory technical standards on the criteria for assessing the modellability of risk factors under the Internal Model Approach (IMA) under Article 325be(3) of Regulation (EU) No 575/2013, published on 27 June 2019. We believe that our experience as an independent provider of fixed income evaluated pricing services, OTC derivatives calculation services, related transparency data, reference data and analytics, serving more than 5,000 global organizations, gives us unique information and insights that may assist the EBA in refining the final rulebook as related to this aspect of the market risk standard. We have engaged with over 60 banking institutions globally to present ICE Data Services data and functionality that can assist with the RFET (Risk Factor Eligibility Test) and other components of the IMA (Internal Model Approach). ICE Data Services has actively participated in multiple FRTB industry panels and actively participants in an industry-wide FRTB working group, further providing ICE Data Services insights that we hope to be valuable for EBA to consider.

This response will address the following topics in connection with the Consultation Paper:

Definition and Acceptable Criteria for Committed Quotes and Verifiable Prices

- Q1: Do you agree that a committed quote, to be considered verifiable, should be required to have both a firm bid and offer price? If you think that solely a bid or offer price should be sufficient, please provide a convincing rationale.
- Q3: How would you define and check for a *“non-negligible volume of a transaction or quote, as compared to usual transaction sizes for the bank, reflective of normal market conditions”* for the purpose of assessing the validity of a price observation?
- Q4: How would you define and check for an *“unreasonably large bid-offer spread as compared to usual bid-offer spreads, reflective of normal market conditions”* for the purpose of assessing the validity of a price observation obtained from a committed quote? In your response, please provide a detailed reasoning.
- Use of the language “legally obliged” in the legal text concerning the definition of a committed quote.

The Usage of Independent Third-Party Data Vendors

- Q5: Do you see any problems with requiring that institutions are allowed to use data from external data providers as input to the modellability assessment only where the external data providers are regularly subject to an independent audit (independent of

whether the price is shared with the institution or not)? If so, describe them thoroughly (i.e. for which data providers and the reasons for it).

Background on ICE Data Services

ICE Data Services offers end-to-end market data services to support the trading, investment and risk management needs of customers across virtually all asset classes. Our range of data services for global financial and commodity markets includes intra-day and end-of-day pricing and reference data, exchange data, analytics, feeds, desktop and connectivity solutions and index provisioning services. ICE Data Services' data repository from global exchanges and broker-dealers allows clients to access market data pivotal to addressing FRTB regulation.

ICE Data Services provides reference data for millions of financial instruments, tracking key data points such as terms and conditions, corporate actions, entity linkages and identification information. For more than 5,000 commercial market participants, our reference data is an essential component of the full securities lifecycle across pre-trade, post-trade, settlement, reporting, risk mitigation and compliance.

Our pricing and analytics services consist of an extensive set of independent evaluated pricing services focused primarily on fixed income and international equity securities, valuation calculation services, reference data, market data, fixed income and equity portfolio analytics as well as risk management analytics. Our index services offer a range of products across fixed income, equities, commodities and currencies, designed to support all aspects of the benchmarking and performance measurement process.

Q1: Do you agree that a committed quote, to be considered verifiable, should be required to have both a firm bid and offer price? If you think that solely a bid or offer price should be sufficient, please provide a convincing rationale.

ICE Data Services believes that in certain markets (e.g. Fixed Income) one-way markets are typically as valid as two-sided markets and thus should be allowed to be considered a verifiable price for the purpose of demonstrating modellability.

We have aggregated real price observation data for the month of May 2019 within the corporate credit markets in order to support this recommendation. Firstly, as was highlighted in the proposal, there is significantly more volume of one-way quotations as compared to two-sided quotations - to a magnitude of 5x in this market. Please note that this is not true of all markets, where for example, quotations are generally only aggregated when two-sided in certain markets (e.g. CDS) where over 98% of our available data is two-sided in that market. One additional note is that one-way quotations were significantly more likely to be quoted throughout the day than two-sided markets and thus after filtering for one per day, and additional filters described below, we had more two-sided quotations than one-sided.

Our analysis started by looking at only one quotation per day. If both a two-sided market and one-way quotations were both available on a particular day, we considered that a two-sided market for the sake of this analysis. We then looked at how many of those quotations had ultimately resulted in a transaction on the same calendar day, 19% of total two-sided quotations consummated with a transaction on that day whereas only 3% of the one-way only quotations resulted in a transaction.

However, when the aggregated results are compared to any trade in the month, as opposed to same day, the results are starkly different. There were nearly 22,000 unique ISINs with two-sided quotes in

the month where 61.2% ultimately resulted in a transaction in the month. There were also over 19,000 unique ISINS with one-way quotes only (without two-sided markets available on the same day) where 26.2% ultimately resulted in a transaction in the month.

ICE Data Services agrees that two-sided quotations are statistically more likely than one-way quotations to lead to a timely transaction. However, there are still significant volumes of one-way only quotations that ultimately do lead to transaction activity. We believe EBA should not ignore all of these quotes for demonstrating modellability. We believe that the price validation approach discussed below concerning our response to Question 4 should offer comfort against the possibility of “manufactured” off-market one-way quotes solely for improving modellability metrics.

Fixed income instruments by nature trade very differently than either equity or derivative instruments. For example, certain corporate bonds trade differently than other instruments, such as an equity security or a 5-year point on a CDS curve, where the latter is more likely to have a tighter bid-offer spread. Institutional investors that trade the bond market typically have longer-term investment strategies, hence only a one-way market is required to transact, indicating the direction the investors intends to trade. Various Federal Reserve¹ and industry publications² resonate that corporate bond inventories at banks are low despite the increase level of bonds issued. One-sided corporate bond quotes are just as valid as two-side corporate bond quotes, as these tend to be long term investments and supported by the Volcker rule and certain Basel III mandates.

The Volcker rule and Basel III have influenced and discouraged dealers from holding a significant amount of bonds according to Euromoney³. On June 20, 2014, Bloomberg mentioned the low-interest-rate environment and the increased popularity of exchange-traded funds have led bonds to not actively trade and more are held longer, sometimes until maturity⁴. Furthermore, in Q2 2017 the Federal Reserve has also stated, “dealers’ inventories of corporate and foreign bonds increased a bit in Q1 2017, but remained near their lowest levels over the past decade”. Dealers are less likely to put out bids, given dealers hold less inventory because of regulation and bonds investors hold onto bonds longer. One-sided quotes are one-sided in response to the market interest and constraints on buying bonds.

Q3: How would you define and check for a “non-negligible volume of a transaction or quote, as compared to usual transaction sizes for the bank, reflective of normal market conditions” for the purpose of assessing the validity of a price observation?

Although different banks may have unique definitions of what a “non-negligible volume” is for a particular trade or asset type, ICE Data Services believes that allowing each institution the flexibility to set their own volume threshold would result in unintended consequences. For example, a smaller entity that has a lower negligible volume threshold could feasibly have certain modellable risk factors that a large institution would not be able to demonstrate as modellable if they only look at transactions and committed quotes of a larger size. For example, a retail driven market such as US municipal debt, or

¹ <https://www.federalreserve.gov/foia/files/bond-market-liquidity-report-2017Q2.pdf>

² <https://www.bloomberg.com/news/articles/2018-07-31/inventories-of-high-grade-debt-turn-negative-for-first-time-ever>

³ <https://www.euromoney.com/article/b12kjj6xt89xf5/regulation-us-dealer-bond-inventory-at-nine-year-lows>

⁴ <https://www.bloomberg.com/opinion/articles/2014-06-20/sec-wants-to-give-everyone-a-chance-to-be-a-bond-trader>

certain corporate issuers mainly have small average sizes that could be considered negligible for a large bank. Another unintended consequence is the increased complexity of examining FRTB compliance programmes with this additional degree of freedom, as each desk may have its own definition of negligible volumes, even for different assets within a desk.

As an alternative, ICE Data Services suggests creating an industry-standardised threshold as a function of existing MiFID II requirements. Among other potential options, we propose leveraging the MiFID II rules that define a retail size as any transaction below €100,000, which also could be used as the definition of a negligible size.

Q4: How would you define and check for an “unreasonably large bid-offer spread as compared to usual bid-offer spreads, reflective of normal market conditions” for the purpose of assessing the validity of a price observation obtained from a committed quote? In your response, please provide a detailed reasoning.

ICE Data Services has worked with the industry and other regulators to educate how the pricing service industry has become increasingly sophisticated and have benefitted from significant technological advancements. These enhancements have allowed ICE Data Services, as well as other pricing vendors, to generate intra-day, independent valuations that could be used to assess the validity of a price associated with a committed quote, even if one-sided only (i.e. no explicit quote-level bid-ask spread is available).

ICE Data Services believes that there are multiple tools available to the banks to verify appropriately the validity of prices associated with quotes and smaller transactions. The final text should explicitly permit the use of independent third party pricing. . This type of validation is more robust than the current proposal, and alleviates the rationale for requiring an eligible committed quote to have both a bid and offer side of the transaction, as we discussed above in Question 1.

ICE Data Services reviewed corporate bond quotes that matched to trades with at least one million notional from March 2019 to May 2019. Corporate bond trade prices, executed within an hour after the quote (with both a bid and ask), were compared to quotes and ICE Data Services' Continuous Evaluated Pricing (CEP). The histogram below buckets the trades into the basis point ranges of the difference between a CEP or quote and a trade price. The data shows that over the 90-day period, trade prices were closer to the CEP levels. Figure 2 is a histogram of how close the trade price was to the CEP versus the quote for May 2019. Trade prices for May 2019 in Figure 2 are more in-line with CEP than quote prices. Over each of the three-month period, consistently the first 5 bins account for between 66%-70% of the trades when compared to CEP and between 58%-60% of the trades when compared to quotes. The data supports that using an independent third party pricing tool, such as CEP, provides a smaller differential and therefore more accurate price validation.

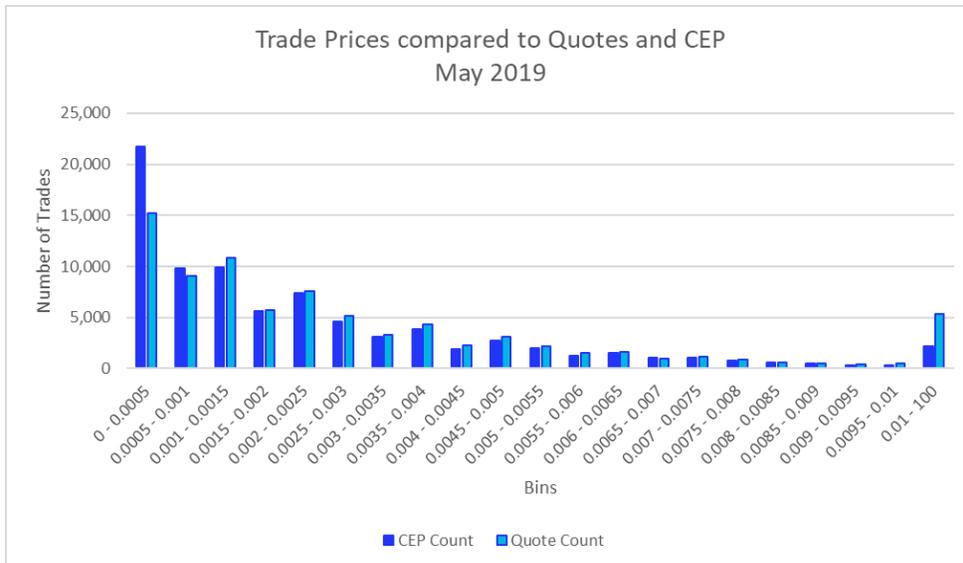


Figure 2: Histogram of Trade Prices differences from both CEP and Quote Prices, May 2019

The table below in Figure 3 further demonstrates that CEP, with typically tighter bid-ask spreads than those of two-sided quotations, would be an appropriate benchmark to validate the pricing quality of potential real price observations.

Size-Weighted Bid-Ask Spreads		
Month - Year	Quote	CEP
March - 2019	\$0.53	\$0.36
April - 2019	\$0.57	\$0.37
May - 2019	\$0.50	\$0.37

Figure 3: Average Bid-Ask Spreads of CEP vs. Quotations

ICE Data Services derivatives pricing data is available at any point in time throughout the trading day for all broad OTC asset classes. The ICE Data Services Derivatives pricing service allows for request and retrieval of a valuation at an execution timestamp for any OTC derivatives. Figure 4 below shows curve data by currency and tenor with associated quoted prices, liquidity data, dispersion value of quotes via min-max data points, total notional traded, and the average traded notional. The data in Figure 4 allows the client to compare bid-offer spreads to market data to verify if the spreads are in-line with normal market conditions.

Valuation Date	Currency	Curve	Tenor	ICE Bid	ICE Ask	ICE Mid	ICE Contributors	MIN	MAX	# trades during the day	Total Notional Traded	Avg Trade Notional
4/30/2019	USD	YieldCurve	1Y	2.4962	2.5022	2.4992	4	2.499	2.525	8	1,276,000,000	159,500,000
4/30/2019	USD	YieldCurve	2Y	2.379215	2.383215	2.38122	4	2.379	2.383	66	4,763,600,000	72,175,758
4/30/2019	USD	YieldCurve	3Y	2.313565	2.317565	2.31557	4	2.31493	2.317	48	2,244,600,000	46,762,500
4/30/2019	USD	YieldCurve	4Y	2.301515	2.304515	2.30302	4	2.298	2.305	26	763,950,000	29,382,692
4/30/2019	USD	YieldCurve	5Y	2.31888	2.32288	2.32088	4	2.319	2.321	217	3,201,180,000	14,751,982
4/30/2019	USD	YieldCurve	6Y	2.348205	2.351205	2.34971	4	2.348	2.352	19	701,000,000	36,894,737
4/30/2019	USD	YieldCurve	7Y	2.38265	2.38665	2.38465	4	2.383	2.387	49	1,874,700,000	38,259,184
4/30/2019	USD	YieldCurve	8Y	2.420105	2.423105	2.42161	4	2.419	2.422	20	532,000,000	26,600,000
4/30/2019	USD	YieldCurve	9Y	2.45599	2.45999	2.45799	4	2.455	2.45858	13	140,000,000	10,769,231
4/30/2019	USD	YieldCurve	10Y	2.49023	2.49323	2.49173	4	2.49	2.49306	239	2,586,320,000	10,821,423
4/30/2019	USD	YieldCurve	12Y	2.55177	2.55577	2.55377	4	2.551	2.55474	3	28,000,000	9,333,333
4/30/2019	USD	YieldCurve	15Y	2.615355	2.619355	2.61736	4	2.615	2.61891	3	36,000,000	12,000,000
4/30/2019	USD	YieldCurve	20Y	2.67128	2.67528	2.67328	4	2.671	2.67516	12	270,000,000	22,500,000
4/30/2019	USD	YieldCurve	25Y	2.69208	2.69608	2.69408	4	2.691	2.695	8	216,490,000	27,061,250
4/30/2019	USD	YieldCurve	30Y	2.69873	2.70273	2.70073	4	2.698	2.70226	152	1,413,220,000	9,297,500
4/30/2019	USD	YieldCurve	40Y	2.67862	2.68662	2.68262	3	2.682	2.684	1	46,000,000	46,000,000
4/30/2019	USD	YieldCurve	50Y	2.64453	2.65253	2.64853	3	2.645	2.657		0	0
4/30/2019	USD	YieldCurve	60Y	2.62447	2.62947	2.62697	0				0	0

Figure 4: ICE Data Services Derivatives pricing service data

“Legally Obligated” Language

ICE Data Services believes that the term “legally obligated” is very difficult to demonstrate and suggests the final legal text, under Article 2, section 1(c)⁵ not have it. We firmly believe that in conjunction with the robust price validation requirements that this language should be softened or removed. Many quotes, including even those submitted on certain electronic execution platforms, allow for a right-to-refusal, or refresh capabilities to the provider of the quote in the event the market moves from the time of the initial quote. This workflow and trading protocols do not invalidate the intent to transact by the quote provider. The workflow acknowledges that markets move and tradeable prices move over time, as should the associated quotes.

ICE Data Services acknowledges the goal of EBA that “*transactions shall not be conducted and quotes shall not be committed with the sole purpose of identifying a sufficient number of verifiable prices that allows to meet the criteria specified in Article 1.*” (Page 21 on the CP). On the quote side, we believe that robust price verification (as described above in our response to Question 4) combined with other restrictions inherently minimises the likelihood of these types of “manufactured” quotes without the term “legally obligated” included in the final text. Moreover, we believe it is exceptionally burdensome for banks and their vendors to demonstrate appropriately any sort of legal obligation associated with any individual quote with minimal to no benefit in the validity of the quote population used to demonstrate modellability.

Q5: Do you see any problems with requiring that institutions are allowed to use data from external data providers as input to the modellability assessment only where the external data providers are regularly subject to an independent audit (independent of whether the price is shared with the

⁵ The NPR reads “For the purposes of point (c), a quote shall be considered committed only where the provider of the quote is legally obligated to buy and sell the corresponding financial instrument at that price if requested.

institution or not)? If so, please describe them thoroughly (i.e. for which data providers and the reasons for it).

ICE Data Services does not see any issues with requiring external data providers to obtain an acceptable independent audit in order to be utilised by a reporting entity to assist with demonstrating modellability of their risk factors. We are currently preparing preliminary work and research to arrange for this independent third-party audit.

Conclusion

ICE Data Services appreciates the opportunity to present our views on the proposed draft regulatory technical standards on the criteria for assessing the modellability of risk factors. We are supportive of EBA's policy goal of promoting a more resilient banking system through more closely aligning regulatory capital with market risks. We stand ready to support our bank clients' compliance workflow needs with the unique content and services that ICE Data Services can provide. We welcome the opportunity to continue our dialogue with the reporting entities, industry trade groups and EBA as we continue progressing as an industry.

Summarizing our responses to particular items raised in the Consultation Paper:

- One-sided quotes are just as relevant as two-sided quotes given current regulations and market conditions.
- Institutions should be allowed to use multiple tools to price test quotations beyond bid-ask spread analysis. Third party pricing vendors provide banks with reliable tools to validate prices.
- Non-negligible volume should be standardised across the industry.
- Eligible quotations should not be required to demonstrate a "legally obligation".

Kind Regards,



Anthony Belcher
Vice President, Head of ICE Data Services, EMEA
ICE Data Services