



**Response to EBA Consultation on
Draft Regulatory Technical Standards on Back-testing requirements under
Article 325bf(9) and Profit and Loss attribution requirements under Article 325bg(4) of
Regulation (EU) No 575/2013 (Capital Requirements Regulation 2 - CRR2)**

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1. INTRODUCTION

In January 2019, Basel Committee on Banking Supervision (BCBS) finalised and published its standards on “Minimum capital requirement for market risk”¹. The text replaces the previous minimum capital requirements for market risk in the global regulatory framework, which are transposed in the EU via Regulation (EU) No 575/2013 (CRR).

After the publication of the final text of the CRR II² in the Official Journal of the European Union, EBA was delegated to develop Regulatory Technical Standards (RTS) to better detail certain aspects of the following topics:

- **Liquidity Horizons [Article 325bd]** – EBA should clarify how institutions shall map risk factors of trading book positions to risk factors categories and subcategories, providing ad hoc treatments for some specific risk factors. Moreover, the RTS shall specify the definition of a large capitalization for equities and, in addition, which currencies for interest rate risk and currency pairs for FX risk constitute are the most liquid.
- **NMRF³ [Article 325be]** – EBA is mandated to specify the frequency and the criteria used in order to assess Risk Factors modellability. In particular, the assessment of modellability shall ensure that the Risk Factors included in its Expected Shortfall model are sufficiently liquid;
- **Back-testing [Article 325bf]** – EBA shall specify the technical elements to be included in the actual and hypothetical changes to the value of the portfolio of an institution;
- **Profit and Loss Attribution [Article 325bg]** – EBA shall better clarify:
 - Criteria necessary to ensure that the theoretical changes in the value of a trading desk's portfolio is sufficiently close to its hypothetical changes and the consequences when this condition is not satisfied;
 - The frequency at which the P&L Attribution is to be performed;

¹ BCBS d457, Minimum capital requirements for market risk, January 2019 (rev. February 2019)

² Regulation (EU) 2019/876 amending Regulation (EU) No 575/2013, June 2019

³ As specified in article 325bk, EBA shall develop draft Regulatory Technical Standards in order to specify how institutions have to compute extreme scenarios of future shock applicable to NMRF. However, this draft should be submitted to the Commission by 28 September 2020 and it is not included in the *RTS June 2019 package*.

- Technical elements to be included in the theoretical and hypothetical changes in the value of a trading desk's portfolio
- The manner in which, under IMA, institutions aggregate the total own funds requirement for market risk for all trading book positions and non-trading book positions that are subject to foreign exchange risk or commodity risk;

Considering the relevance of these topics within the revisited framework to compute own funds requirements for market risk, Intesa Sanpaolo (hereinafter, the Bank) would like to participate to the Consultation phase proposed by EBA on the aforementioned topic.

This document has been prepared with the specific aim of providing feedbacks and observation on the proposals presented in the Consultation paper on draft Regulatory Technical Standard published by EBA on the 27th of June 2019.

2. FRTB – Back-testing and PLA attribution requirements

Q1. Which are the adjustments that institutions include in the fair value of a financial instrument that you consider not sensitive to market risk? Please provide a list of adjustments or a list of types of adjustments.

INTESA SANPAOLO Group considers not sensitive to market risk the following adjustments:

- Model Risk Adjustments (An adjustment reflecting uncertainty due to either of the following: estimation of a valuation parameter - choice of model e.g. local vs stochastic vol, 1- or 2- factor interest rate evolution)
- Concentration Adjustments (An adjustment reflecting deviation of model fair value from a realizable exit cost for an outsized position)
- XVA
- CVA
- DVA
- FVA
- MVA
- KVA
- Market operations (A PL component reflecting new deals, fixes, exercises and system changes)
- Intraday P&L (A PL component arising from positions bought after open and sold before close on the same day)

- Write down / Write offs (Valuation adjustment due to the default of the issuer of the exposure)
- Theta (A PL component attributable to the passage of time ceteris paribus)

Q2. Which are the adjustments that institutions include in the fair value of a financial instrument that you consider market risk sensitive? Please provide a list of adjustments or a list of types of adjustments.

INTESA SANPAOLO Group considers not sensitive to market risk the following adjustments:

- Independent Price Verification (An adjustment following independent verification of market prices or model inputs leading to a restatement of the fair value)
- Bid-Ask Adjustments (An adjustment reflecting uncertainty in fair value related to lower confidence in a parameter/price due to lower market activity).

Q3. Paragraph 4 specifies that no smoothing of adjustments is permitted over the readjustment period. Do you agree with the provision? Do you consider the provision clear?

INTESA SANPAOLO Group agrees with the provision and the evidence is that there are no cases of adjustments updated less than a daily frequency included in HPL. There are cases of these adjustments in APL, but they are computed in the evaluation business date (no smoothing is performed) and, anyway, this would not affect PLA Tests.

Q4. Paragraph 4 requires institutions to compute (for the purpose of the Back-testing) the value of an adjustment (that is included in the changes in the portfolio's value) performing a stand-alone calculation, i.e. considering only the positions in the trading desk. Do you agree with the provision? Do you consider the provision clear? [Article 1, paragraph 4]

INTESA SANPAOLO Group agrees to perform a stand-alone calculation for value adjustments. Although it implies an operational effort, a higher granularity helps the attribution of the adjustment to a single position.

Furthermore, INTESA SANPAOLO Group considers the provision not very clear, it would be appreciated a more detailed example of cross-desk adjustment.

Q5. Do you agree with the criteria in paragraph 5 allowing institutions to exclude an adjustment from the changes in the trading desk's portfolio value? Are there any other criteria you deem useful for this purpose?

According with the previous answer, the Bank does not apply cross-desk adjustments. Adjustments are usually on a single position.

Q6. How do institutions identify client margins and day-one profits/losses in the systems (e.g. as commissions, margins)? Please specify if currently they are taken into account in the end-of-day valuation process, in the actual P&L and in the hypothetical P&L.

The identification of Day-1 P&Ls is performed by Management Control Department for the computation of accounting P&L.

Client Margin, Commissions and Day-1 P&L are taken into account in the end-of-day valuation process, but they are not included in actual and hypothetical P&L.

Q7. Paragraph 4 requires institutions to compute (for the purpose of the Back-testing) the value of an adjustment (that is included in the changes in the portfolio's value) performing a stand-alone calculation, i.e. considering only the positions in trading desks that are calculating the own funds requirements using the internal model approach (i.e. desks meeting all conditions in article 325az(2)). Do you agree with the provision? Do you consider the provision clear?

The Bank agrees with the provision because excluding valuation adjustments for positions in the scope of standard approach would lead to not reliable PLA Tests and Back-testing. The coherence of perimeter must be maintained. Intesa Sanpaolo considers the provision sufficiently clear; however, a clear and detailed example would be very helpful.

Q8. Do you agree with the possibility outlined in paragraph 5 to include in the portfolio's changes the value of an adjustment stemming from the entire portfolio of positions subject to own funds requirements (i.e. both positions in standard-approach desks and positions in internal model approach desks)? Or do you think it would not be overly burdensome for institutions to compute adjustments on the positions in trading desks that are calculating the own funds requirements using the internal model approach only?

The Bank does not agree because PLA and Back-testing are not in scope of standard approach: indeed, removing standard positions' value adjustments could imply P&Ls misalignments and, therefore It could jeopardize the PLA tests and Back-testing outcome (both at desk and whole portfolio level). The coherence of perimeter IMA/PLA must be maintained.

Intesa Sanpaolo is able to isolate adjustments computed for standard model positions, for example adjustments for forex positions (FX risk is under standard approach). Therefore, we believe that it would not be overly burdensome to compute adjustments only for IMA positions.

Q9. Do you agree with the criteria outlined in this article for the alignment of input data? Please provide some examples where an institution could use the provision set out in paragraph 2.

The Bank agrees with the provision since PLA is meant to assess the coverage of risk management models, the misalignment in input data is a source of failure.

Furthermore, there are many cases of misalignment of input data used for the computation of Hypothetical & Risk-Theoretical P&Ls. In particular, the most evident example is that related to equity prices. In fact, for equity instruments booked in Murex 3 source system:

- Actual P&L and hypothetical P&Ls are computed using source system reference prices of 17.15;
- While risk-theoretical P&L is computed using closing prices (source: Bloomberg)

For this reason, it would be very important to align input data for PLA purpose in order to reduce misalignment of P&L not due to different pricing model.