



FEDERATION  
BANCAIRE  
FRANCAISE

*Banking supervision  
And Accounting issues Unit  
The Director*

Paris, October 8<sup>th</sup> 2013

## **EBA Consultation paper on Prudent valuation (EBA/CP/2013/28) - FBF comments**

Dear Madam,

The French Banking Federation (FBF) is the professional body representing over 450 commercial, cooperative and mutual banks operating in France. It includes both French and foreign-based organizations.

The French Banking Federation is pleased to take this opportunity to comment on the EBA Consultation Paper on prudent valuation.

### **GENERAL COMMENTS**

We understand that with this Consultation Paper (CP), EBA intends to provide technical details in relation to the Articles 34 and 105 of the CRR taking into account the comments formulated on the last year's Discussion Paper (DP). We acknowledge that compared to the DP, **this CP is generally improved in terms of clarity and presents some very positive developments** such as:

- The recognition of diversification factor of 50% as a standard measure
- A reduced confidence level to 90% from 95% proposed by DP which was deemed to be excessively prudent
- The exclusion of balance sheet substantiation from the categories of adjustments to be done for AVA computation.

However, as EBA proceeds to the final calibration based on the QIS requested in parallel, **we urge it should be cautious about the level of prudence to avoid unnecessarily penalizing regulatory capital requirement of EU banks**. Apart from this overall concern, we would like to raise some technical issues on this CP in the following paragraphs.

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**Ms Isabelle VAILLANT**  
**European Banking Authority**  
**Tower 42 (level 18)**  
**25 Old Broad Street**  
**London EC2N 1HQ**  
**United Kingdom**

### a. Scope of application

This CP stipulates that the scope of application should be all fair valued positions regardless of whether they are trading or banking book while Article 105 refers to all trading book and Article 34 to all fair valued assets. **We urge the EBA to clarify that the scope intended by the CRR for prudent valuation is in relation to financial instruments in the accounting terms, and that the term “assets” in article 34 is to be interpreted as “Assets and Liabilities”.**

We further draw the attention of the following issues that, in our view would deserve a specific treatment if not a zero AVA case:

- The instruments classified as **hedge accounting of the banking book** (notably interest rate risk hedges) are not intended for immediate realization or necessarily available for such realization.  
By definition, the fair value of such instruments offsets the hedged component of banking book items. It follows that if, under the RTS, these instruments are taken in isolation, the resulting AVA would be punitive and non-economic.  
Conversely, extending the scope to the hedged component of the banking book item would not correspond to a realistic exit strategy and may be non-compliant with the article 34 of the CRR notably for loan and receivable exposure.  
This example highlights the ambiguity of an AVA framework for instruments used as hedges of buy-and-hold instruments, and **we suggest that the RTS should clarify the CRR objectives in this respect. For stake of simplicity, the FBF would welcome a specific zero-AVA-case is introduced, at least of hedges of exposures that are not measured at fair value.**
- In application of IFRS13, EU banks are required to factor their **own credit risk** when measuring the fair value of derivatives and of own debt designated at fair value. Considering that the article 33 of the CRR states that the gains and losses arising from changes of own credit risk should be deducted from the own funds, **we believe that the RTS should also explicitly exclude these elements from the scope of prudent valuation framework. More generally, we believe the entire prudent valuation framework should exclude the own credit risk (as a risk factor).**
- Some equity instruments classified in the “available for sale” category for accounting purposes should be excluded from the scope of this RTS. However, the exemption from the scope should be limited to instruments fulfilling two conditions:
  1. They constitute equity holding of entities which are included in the prudential perimeter at Group level
  2. They are held for purposes other than generating investment returns (“strategic investment”).

When IFRS 9 enters into effect, these instruments would generally be classified in the “fair value through OCI” category (for equity instruments). This category prohibits recycling of gains and losses into profit or loss when an equity instrument is derecognised. Accordingly, this category will generally be dedicated to “strategic investment” and is not aimed at being sold.

This exemption would be particularly appropriate for the holding of cooperative banks in their central body which they are affiliated to.

**More generally we believe that EBA should explicitly exclude from the prudent valuation scope any amount filtered for the calculation of regulatory capital (as it is mentioned for the calculation of the simplified approach, page 14 “explanatory text”).**



## **b. The simplified approach**

In application of the principle of proportionality, this CP suggests two different approaches, a **simplified approach** for small institutions and a core approach for the others.

It seems important to accept that where the simplified approach is admitted at the subsidiaries level, the group does not need to recalculate all the positions of the given subsidiaries with the core approach applicable at the group level.

If this was the intention of EBA, it would not make sense for subsidiaries of a group exceeding the threshold to opt for the simplified approach as double calculation would impose a heavy operational burden.

We observe in this respect that in the market risk capital approach, the use of the standard method in one entity prevents the use of the internal model for the same entity. We believe that the same logic should be applied for prudent valuation.

**Accordingly, we ask EBA to amend the RTS such that:**

- **it allows the aggregation of the results from the simplified approach for small subsidiaries with the results of the core approach at the group level (excluding such subsidiary), and**
- **it provides guidelines for allocating AVAs estimated at group level through the core and simplified approach, to contributing subsidiaries.**

In addition, we believe that the concept of unrealized gains has no link with the valuation uncertainty and should simply be removed from the RTS. Indeed, a very exotic trade embedding unrealized losses encompasses much more valuation uncertainty than a plain vanilla liquid bond with unrealized gains. Further, the asymmetric treatment between unrealized gains and losses and the netting envisioned in the CP between these gains and losses for the purpose of determining a proxy of the size of the uncertainty makes little sense. This metric also depends directly from the date when the deal took place. This dependency makes unrealized P&L a rather poor proxy of a valuation risk which is (by definition) in relation to actual position and actual market conditions. Finally, from an operational stand point, this concept is not used by valuation and risk systems, which are the natural sources for tracking valuation uncertainties. Specifically, the initial cash proceeds are not systematically tracked by the valuation systems (for example for bonds); therefore, the implementation of this requirement will be very difficult and involve significant costs for a very limited benefit in terms of risk measurement.

**Therefore, we recommend the EBA to simply remove the component “25% of the net unrealised profit on financial instruments held at fair value” from the simplified approach formula.**

## **c. Risk representation based on Model Inputs**

For the purpose of calculating Market Price Uncertainty and Close Out Cost AVAs, the RTS requires that **valuation exposures** are projected (or mapped) on tradable instruments.

We understand that the objective of this requirement is to provide a clear link between market-based close out and uncertainty data, and the institutions' valuation exposures. However, we underscore that in many circumstances, this projection is far from simple from operational and computational perspectives especially for “exotic” instruments where sensitivities are generally computed and risk managed on the basis of the model inputs, after such model inputs are calibrated the relevant set of market traded instrument.



More importantly, we underscore that by imposing that AVAs are computed out of the sensitivities to the prices of the calibration set, the unintended consequence is such these would be based on risk representations that are not actually used for risk managing the book, measuring market risk capital or the accounting fair value.

**We believe that imposing prescriptively the risk representation of institutions is detrimental to the global consistency between the different accounting and regulatory setups but also to a proper understanding of the AVAs dynamics and by consequence the appropriation of the AVAs by risk takers and control actors.**

In another hand, and while underscoring that the **risk reduction test** (volatility ratio test) in articles 8 and 9 is relevant in principle, we find that the prescriptive nature of the wording may have the unintended consequence of imposing unnecessary calculation burden upon implementation. We therefore call for more flexibility and simplicity.

We believe that these above issues could be overcome easily without distorting the principles of proposed methodology. We propose below small adaptations or alternatives that we believe would bring immediate and concrete simplifications and practicability:

- **the FBF would favour that EBA offers a simplified method where the AVAs are determined on the basis of valuation exposures that are expressed in the inputs of the model.** In this alternative, the risk reduction test and the calibration of the uncertainty ranges would be done separately as part of the regular review of the model adequacy ruled by article 105. **If the risk reduction test is failed, a model risk AVA would then become mandatory as part of article 11 of the RTS,**
- the FBF would favour that it is explicitly accepted that the risk reduction test can be made on the basis of the sensitivities.

Finally, we observe that the current calibration of the risk reduction test may practically mean that no risk offsetting is allowed.

Indeed, a P&L volatility ratio below 0.1 implies a level of correlation of 99.5% between the P&L series based on the reduced set and the P&L series based on the unreduced set.

The FBF also observes that the use of ratio volatility is not customary, as correlation measures usually use variance ratios. Therefore, the FBF would welcome that the EBA's replaces the ratio of volatilities by a ratio of variances, which would imply a still-prudent level of correlation of 95%. Benefits would be to grant a non-nil imperfection in the risk offsetting and better intuition of the test objectives.

#### **d. Non derivative positions**

In continuation of the above, we underscore that the articles 8 and 9 impose that for the **non-derivative positions**, the valuation input should be the directly observable price of the instrument.

We fear this requirement imposes an unnecessary constraint on the risk representation through isolating securities positions. We further highlight that if it was the EBA's intention to compute AVAs on securities positions in isolation, this would mean that EBA is willing to determine prescriptively the exit strategy regardless the reality of the market, which could then lead to a non-economic and punitive charge.



As an illustration, under such approach a bank would be required to estimate the exit cost of a portfolio of bonds and Credit Default Swaps as if each was liquidated separately, while it is widely admitted that there might be opportunities to trade these as a "basis" package, and in such circumstances, lower exit cost would be incurred.

As we suspect that this is not the text intention, we believe that the RTS wording should be such institutions are forced to appropriately consider the uncertainty and exit cost of "basis" positions, where the risk offsetting is not perfect.

This principle would ensure the RTS remains economically sound, and also consistent with accounting requirement IFRS13 (paragraphs 48 to 55).

**We believe that the removal of the reference to the "non-derivative positions" would keep the level of requirement identical because a portfolio of securities and derivatives would still need to be "mapped" (article 9 paragraph 5-b and article 8 paragraph 4-b) to market-traded instruments, and therefore the market price uncertainty and exit costs AVA still remain market-based. Therefore we call for a simplification of this wording.**

#### **e. Article 20**

**The ongoing data quality assessment process described in the Article 20 is absolutely impracticable and we recommend it to be deleted from the final RTS.**

Not only the methodology proposed for the back-testing is not technically sound, the requirement to use systematically the actual prices entails a heavy system and process changes to enable to handle the storage of data.

Should EBA persists in preserving this requirement, we urge it to **drastically reduce the application scope by targeting only the most exotic instruments**, and to **entirely delete the prescriptive methodology**, leaving it up to the institutions to design the appropriate methodologies to make use of this trade data.

We believe that at very best, this test could bring value to institutions when assessing their valuation uncertainty, if restricted to an equivalent to Level 3 instruments in accounting terms.

#### **f. Diversification**

In theoretical terms, there is no reason to assume that uncertainties in estimating mid prices, close out costs and in measuring the fair value through a model would adversely materialize at the same time. Therefore, we see no scientific ground to restrain the benefit of diversification to the Market Price Uncertainty and Close Cost AVAs and do not understand the underlying rationale.

In particular, we believe that Model Risk should be in the list of AVAs where the 50% haircut applies (paragraph 3 of article 17). The reason is that Model Risk and Parameter uncertainty are two variations of very similar risks and using one category or another is less due to the economic substance of the uncertainty and more to the practical measure (shifting parameters vs comparing two distinct models).

**Should the EBA persist in restraining the diversification benefit to some AVAs while excluding others, we propose that the CP is adapted such as those AVAs that are substantiated through data range approaches (for example Model Risk AVA determined under paragraph 3 of article 11) are made eligible for diversification, while AVAs obtained through judgmental approach are not.**



This distinction is in line with the underlying statistical rationale of the diversification benefit i.e. the existence of a certain degree of correlation between sources of uncertainties that are described in a statistical manner.

Moreover, **we believe that such rule would provide the right incentive to institutions to develop objective and measureable assessments of the uncertainties**, and accordingly, this would reduce the diversity in the assessment of model risks.

In continuation of the above, and since **Concentrated Positions AVAs** are required to be based on a statistical approach (through the use of the volatilities of the input and its bid/offer), we would welcome that the EBA further explores the possibility to include this AVA in the scope of paragraph 3 of article 17.

We propose in this respect that two options are offered: a judgmental approach that where, if applied, the Concentrated Positions AVA would not benefit from diversification; and a statistical demonstration where, if applied, the resulting AVA is eligible to diversification.

#### **g. Unrealized profits and losses as proxy of fair value uncertainty**

**We wonder whether the reference to the net unrealised profits in article 4 (the simplified approach) and article 7 (fall-back method) provides a sound proxy of the uncertainty in the valuation of a portfolio of financial instruments. In fact, we believe it does not since:**

- there is no obvious reason to assume that the valuation of a portfolio showing net unrealized loss is actually nil or lower than a portfolio showing unrealized profit,
- an obvious drawback of this metric is that it is directly dependent to the time at which the trade was closed, while the valuation uncertainty relates to a one-point-in-time measurement, which solely depends on the then prevailing market conditions.

Furthermore, we underscore that the notion of unrealized gain (or loss) does not allow any differentiation between the valuation risks of different portfolios or instruments, which makes it an even poorer proxy.

Finally, we believe that none of the systems or processes in relation to valuation or risk does make use of the concept of unrealized gains and losses, which could result in additional operational costs to have this requirement implemented.

As the EBA is currently developing the technical advice to the Commission under article 80 of the CRR, we draw its attention to the fact that the unrealized gains and losses cannot act as a proxy for two purposes that are fundamentally different i.e. the fair value variation, and the fair value measurement uncertainty.

#### **h. Punitive default approach and cost effectiveness considerations**

The Article 7 of the CP provides a **default approach** where the core approach is not possible.

The thresholds proposed based on net unrealised profit or notional value or market value of financial instruments turn out too severe to make this "alternative" valid, notably for the less material positions. In fact, there might be cases where the cost of deploying the core methodology may be disproportionate with the objective of prudence at the institution level given that positions are immaterial (for example new businesses).

In such circumstances, it is understandable to aim at developing a "reasonably prohibitive" default rule. By contrast, a "punitive" rule would dissuade from undertaking business at the first place because of the unsustainable entry cost of either deploying the full core methodology or the punitive capital deduction. We therefore urge EBA to decrease the level of the threshold such as it reads as "reasonably prohibitive" but not "punitive".

In order to address the above, and for the sake of keeping this default rule simple for implementation, we propose to retain a simple rule such as imposing a 0.5% notional charge per year of residual maturity, capped to 5%.

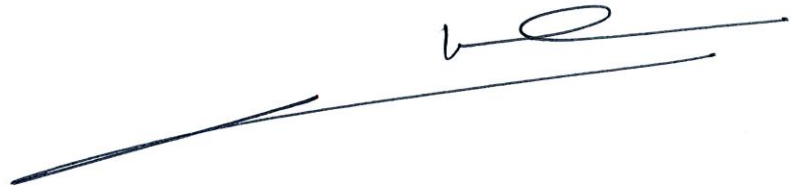
**i. Implementation**

We believe institutions should be granted a 6 months period to be able to implement the final version of this RTS.

You will find in the annex attached detailed comments and specific responses to the questions of the consultative document.

We thank you for your consideration and remain at your disposal for any questions or additional information you might have.

Yours sincerely,

A handwritten signature in dark ink, consisting of a stylized 'J' followed by a loop and a long horizontal stroke that tapers to the right.

Jean-Paul Caudal



## ANNEX RESPONSES TO SPECIFIC QUESTIONS

**Q1. Do you agree with the minimum list of alternative methods and sources of information defined above for expert based approaches? If not, what others could be included, or which points from the current list should be removed? State your reasons.**

We agree that the market data used or the source of information for expert based approach both need to include reliable and available data. We do not believe that all the data listed here needs to be sourced which seems unrealistic from operational point of view. We therefore call EBA to clarify that the purpose is not to multiply the sources for the sole purpose of constructing data ranges, but to undertake reasonable effort for collecting reliable data from the indicative list provided.

**Q2. Do you agree with the introduction of a threshold below which a simplified approach can be applied to calculate AVAs? If so, do you agree that the threshold should be defined as above? State your reasons.**

No comment

**Q3. Do you believe there are any practical issues with a parent institution being required to apply the 'core approach' to all fair value positions whilst a subsidiary is allowed to apply the simplified approach? State your reasons.**

Yes. Having parent institutions computing AVAs on a different methodology from the one used for subsidiaries requires a double computation and therefore a heavy operating burden. The CP should rather shed clarity that it is possible to net the exposures between different legal entities, and concentrate on how the resulting AVA can be split amongst the entities contributing to the exposure. We believe therefore that the two methods must be exclusive from one another. If a subsidiary is using the simplified approach then the perimeter of this subsidiary needs to be excluded from the application of the core method.

**Q4. Do you agree with the proposed simplified approach? Do you think the risk sensitiveness of the approach is appropriate? Are there alternative approaches that you believe would be more appropriate? State your reasons.**

While we understand the possible regulatory concern that the CET1 capital can be made of substantial unrealized gains, we believe that this concept virtually has no link with the valuation uncertainty and should be removed from the RTS.

A simple example may show that a very exotic trade with unrealized loss has considerably more valuation uncertainty than a plain vanilla liquid bond with unrealized gain. Accordingly, we also dislike the asymmetric treatment that is proposed between unrealized gains and losses and we further underscore that netting these gains and losses for the purpose of determining a proxy of the size of the uncertainty makes little sense.

Another remarkable drawback of this metric is its direct dependency to when the deal took place. This dependency makes unrealized P&L a rather poor proxy of a valuation risk which is (by definition) in relation to actual position and actual market conditions.

From an operational stand point, we underscore that this concept is not used by valuation and risk systems, which are the natural sources for tracking valuation uncertainties. Specifically, the initial cash proceeds are not systematically tracked by the valuation systems (for example for bonds); therefore, it is expected that the implementation of this requirement will involve significant costs.

Globally, the reference to unrealized profits is not a good proxy for valuation uncertainty, while its implementation burden will stand as pure compliance cost with no economic benefit to the assessment of the real sources of valuation uncertainty.



Therefore, we recommend the EBA to simply remove the component “25% of the net unrealised profit on financial instruments held at fair value” from the simplified approach formula.

Should the EBA nevertheless decide to keep the approach unchanged, the percentage related to unrealized gains and losses should be revised. Indeed, based on our calculations, it leads to record more than three times the average AVAs recorded by UK banks. We believe 5% instead of 25% would be more appropriate.

**Q5. Could a differentiated treatment for some asset/liability classes be considered, for example with regard to their liquidity? Please state the pros and cons of such a differentiation. How would you define the degree of liquidity of an asset/liability class (e.g. fair value hierarchy, eligibility for the LCR, other)?**

An approach based on (or similar to) the fair value hierarchy is definitely the right way since it would pave way for convergence between the accounting and regulatory requirements.

Liquidity ratio classification is also a possibility, but we believe that the LCR liquidity flag differs from the fair value classification because the fair value hierarchy focuses on the degree of observability (transparency and in-exchange liquidity) and its scope is wider than securities. Therefore the use of the LCR liquidity flag is at best complementary to another form of classification applicable to derivative exposures. .

Had the EBA chosen a differentiation of the positions by type and level of liquidity (in-exchange), we believe that the estimation of the valuation uncertainty should remain simple and based on either the present value or the notional (or a combination of these)

We obviously acknowledge limitation of these proxies as it is well known that the risk is not necessarily proportional to the present value, and that the notional is not sensitive to the market conditions changes. However, we think that the EBA choice must remain pragmatic and simple.

Had the present value be retained amongst these, the AVA formulation should allow for distinction between funded and unfunded valuation positions.

In substance, the simplified proxy could consist in a percentage of the present value or notional value of groups of assets and liabilities, which are specialized by valuation risk class (possibly a fair value hierarchy classification or a more granular alternative to such classification). In this formulation, we emphasise that balance sheet positions in each of the classes of instruments should be taken on netted basis, since the distinction between assets and liabilities is not meaningful from a valuation risk perspective.

**Q6. Do you agree with the approach defined above to calculate an AVA where the approaches in Article 8 and 9 are not possible for a valuation exposure? If not, what other approach could be prescribed? Explain your reasoning.**

Again, we dislike the use of net unrealized gains concept and further underscore that the proposed rule is such when the sign of the P&L changes, the appreciation of the valuation risk changes, while there can be virtually the same valuation risk whatever the P&L sign.

The reference to the notional value or present value makes the proxy more meaningful, and we call EBA to retain either of these as the basis of the measurement in line with the answer to question 5 above.

However, the proposed charge of 10% reads as overly punitive when compared with existing AVAs.



We understand the regulatory perspective and objective with such charge, but we underscore that there are situations where the rule might be an “over-kill” or inappropriately hamper innovations and new business undertaking.

In fact, it is customary that when positions are not material at the institution level, the institution could conclude that deploying the core approach does not pass the cost/benefit test and that it is more reasonable to retain reasonably prudent valuation adjustments (even prohibitive ones). Along the lifecycle of the business, when positions and business flow grow in size and risk, institutions may further invest in methodology refinements and adopt more sophisticated data collection processes and calculations, whose cost is in relation with the business profitability.

That reflects that there is proportionality between the size of the risk and the degree of sophistication in the IPV and valuation adjustment process. This proportionality is of utmost importance when seen from a granular level (i.e. desk level) because it directly affects the entry cost to the business. When no proportionality applies, desks are either subject to heavy investments costs on IPV and valuation adjustment process, or to a punitive capital deduction, which in turn affect their competitiveness.

In order to preserve the playing field of EU banks, we call EBA to retain this proportionality principle. The calibration of the default charge should in our view correspond to a “reasonably prohibitive charge”, but not turn to be a pure punitive one. We therefore propose to :

- at least half the charge that applies on the notional amount (to 5%),
- remove the formulation based on the 100% of the net unrealized gain (in line with our comment on this concept).

In any case, and since we expect this default charge to apply for immaterial positions for which there is no willingness to develop sophisticated measures, we urge EBA to have this default calculation be simple and to avoid reference to multiple ingredients in the calculation.

**Q7. Do you agree with the approaches defined above to calculate AVAs for market price uncertainty, close-out costs, and unearned credit spreads? If not, what other approach could be prescribed? State your reasons.**

We agree on the zero AVA exception for Market Price Uncertainty and Close Out Cost, and we welcome the relevant reference to art 338.

We also welcome the recognition of risk offsetting and find the risk reduction test (P&L volatility ratio) relevant in principle.

However, as stated in our general comment, we underscore that the formulation of the articles 8 and 9 of the RTS might have the unintended consequence of imposing prescriptively the risk representation beyond what is necessary to achieve the text purpose. This is twofold:

- the prescriptive statement that the valuation exposure for a non-derivative exposure is the price, might lead to isolating securities risk positions within a portfolio, which would possible depart from the institutions’ risk representation expression. We believe that this distinction is unnecessary and brings no benefit on the methodology applied. In fact, the removal of the reference to the “non-derivative positions” would keep the level of requirement identical since valuation positions from portfolio made of derivatives and non-derivative would still need to be mapped to traded instruments.
- The requirement that the AVA calculation is made out of risk representation based on traded instruments, might also be unnecessarily prescriptive. As stated in the general comments, we would welcome that the text allows that the AVAs are still based on the sensitivities used by the institutions in their day to day risk management pending that the applicable charges are calibrated to market data. The institutions electing this option would still be required to test the validity of their risk representation through a P&L volatility test. Had such test failed, a model risk AVA would then become mandatory to the institution.



As outlined by many responses to the DP, and although significant clarification have been provided by the CP, notably through the paragraph 2 of article 9, we believe that there is still a risk of overlap between the close out and market uncertainty measures.

In fact, in most institutions, the valuation adjustment process is operationally distinct from the independent price verification (market data verification), even if they share the same datasets. In practice, there are generally two distinct steps: one consisting is determining the appropriate mid-point amongst available data which is used to value all positions, and another consisting in determining the valuation adjustment on the net exposures.

We would welcome more clarity in the RTS that when the estimation of the valuation adjustment is using exit price data, there isn't any need to compute both Market Price Uncertainty and Close Out Cost AVA.

Put differently, we would welcome clarity that the RTS intention is not such if the IPV process is not based on the adverse bid/offer prices, the two AVAs are required.

Regarding the Unearned credit spreads AVA, we welcome the treatment of the CVA as any valuation position that is subject to uncertainty in the inputs and in the modelling. We would welcome more clarity in the RTS that according to paragraph 2 of article 10, when the Market Price Uncertainty component of the ACVA is aggregated with other Market Price AVAs, this would be eligible for diversification benefit under article 17. Similarly, the same clarification for the model risk component applies.

**Q8. Do you agree with the approaches defined in Articles 11 to 16 to calculate the various categories of AVAs? If not, what other approach could be prescribed for each AVA? State your reasons.**

We agree on the approach for **Model risk AVA**. However we reiterate that since there is a continuum between Market Price Uncertainty on the model inputs and the model risk itself, it is of utmost importance that the text does not lend itself to arbitration such the choice of how model risk is estimated leads to different classification in the AVA categories and hence to different treatment of diversification.

A simple way of addressing this issue to allow for diversification when the model risk is being assessed through a data range approach, as explained in the general comments.

We find the article 12 about the **Concentrated positions AVA** too prescriptive on how the concentration risk AVA is computed. This article further requires significant amount of additional data that might not be collected in a systematic manner during the IPV process, or be hard to obtain (notably the market size); it finally remarkable that this article does not contain any provision about a possible judgmental approach.

In order to reduce the level of prescription while providing incentive to institutions to opt for a sophisticated approach to Concentrated positions AVA, we believe that the RTS should be amended such two options are offered:

- A judgmental approach where institutions would document a thought process to determine the concentrated positions AVA, without undertaking systematic data collection exercise. In this case, the regulator is notified and the resulting AVA is not eligible for diversification,
- The RTS proposed approach (paragraph 2 of article 12) which is required to be substantiated with actual data from the IPV process. When institutions opt for this sophisticated approach, the resulting AVA would be eligible to the diversification benefit under article 17.

With regard to the **investing and funding AVA**, we agree on the current wording of the text.



**Q9. Are there cases where the above AVAs may have a zero value that could be defined in the RTS? If yes, please specify.**

For the sake of simplicity of the RTS, and since we believe that past experience on client early termination is not predictive of the future early terminations, we believe that the text should assume zero value AVA for early termination. The RTS might however impose a yearly assessment of the non-materiality of early termination based on both past experience and judgment.

We believe that own credit risk for securities designated at fair value and derivatives' debit valuation adjustment should be placed outside the scope of this RTS and assumed to have zero AVA.

We finally believe that the future administrative costs should be assumed to be negligible for plain vanilla instruments which would allow to put the focus on most sophisticated exposures that involve non-standard booking, trade processing, risk measurement or valuation processes. EBA might impose that institutions define a list of criteria to be met to determine the portion of their portfolios that would fall within a "non-standard" category.

**Q10. Do you agree with the approach defined above for the aggregation of valuation exposure level AVAs within the market price uncertainty and close-out cost AVA categories? If not, what other approach could be prescribed? State your reasons.**

We agree to the proposed approach. However we would welcome some clarification that the purpose of paragraph 3 (a) is to avoid that institutions arbitrate the diversification rule by subdividing artificially fungible AVAs.

**Q11. Do you agree that category level AVAs described in Articles 11 to 16 within the core approach should be aggregated as a simple sum? If not, what other approach could be prescribed? State your reasons.**

We reiterate our call to enlarge the scope of application of the diversification benefit to some of the model risk AVAs and some of the Concentrated positions AVAs as exposed above.

**Q12. Do you agree with the requirement for institutions using the core approach to implement the above ongoing monitoring tool as an indicator of the adequacy of data sources of valuation inputs used to calculate the AVAs described in Articles 8 to 10? If not, what other approach could be prescribed? State your reasons.**

We strongly disagree.

**The ongoing data quality assessment process described in the Article 20 is absolutely impracticable and we recommend it to be deleted from the final RTS.**

Not only the methodology proposed for the back-testing is not technically sound, the requirement to use systematically the actual prices entails a heavy system and process changes to enable to handle the storage of data.

Should EBA persists in preserving this requirement, we urge it to **drastically reduce the application scope by targeting only the most exotic instruments**, and to **entirely delete the prescriptive methodology**, leaving it up to the institutions to design the appropriate methodologies to make use of this trade data.



We believe that at very best, this test could bring value to institutions when assessing their valuation uncertainty, if restricted to an equivalent to Level 3 instruments in accounting terms.

**Q13. Do you agree with our analysis of the impact of the proposals in this CP? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?**

No comment