


POSITION PAPER



ESBG response to the EBA consultation its RTS on criteria for assessing risk factors modellability under IMA

ESBG (European Savings and Retail Banking Group)

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Dear Sir/Madam,

Thank you for the opportunity to comment on the EBA consultation on the new Internal Model Approach (IMA) under the Fundamental Review of the Trading Book (FRTB). We welcome the proposals made. At some points we feel that the proposals are far more normative than the Basel text. This could lead to unnecessarily rigid rules. The discretion of supervisors would be too limited. Against this background, we would like to share with you the following reflections that we hope will be considered by the EBA.

In general, EGB agrees to the argument brought forward by ISDA/IFF that a further narrowing definition of “legally obliged” would reduce liquidity and usage of quotes for main instruments. Furthermore, we think that the requirements for the RFET should be set in a way that they can be fulfilled not only for the most liquid risk factors. Especially for volatility surfaces a proof of the modellability based on the current proposal would be simple not possible or in the best case very time consuming and/or expensive dependent on the availability of the data providers. In the current proposal the requirements are set independent of the significance of the overall position in a certain risk factor. ESBG sees these strict requirements as an entry barrier for the implementation of an Internal Model, especially for smaller and medium size institutions.

Question 1: 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.

ESBG thinks that for certain markets/instruments one firm side could be sufficient e.g. available firm bids for corporate bonds would prove existing market liquidity – which is the overall purpose of RFET.

Question 2: Please provide an estimation of the impact of requiring solely a firm bid or offer price compared to requiring both. Please provide this impact e.g. in terms of number of non-modellable risk factors, stress scenario risk measure charge or number of eligible committed quotes for different risk factors/ risk factor categories.

Some of our members have not contracted specific vendor service we cannot provide an answer. No impact analysis was done so far in those cases.

Question 3: 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?

All 3 restrictions (Intragroup, Volume, Bid/Ask) are overly (and unnecessarily) complex in our view. It should be possible to use all quotes provided that banks show that the quotes reflect normal market conditions.

Question 4: 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.

All 3 restrictions (Intragroup, Volume, Bid/Ask) are overly (and unnecessarily) complex in our view. It should be possible to use all quotes provided that banks show that the quotes reflect normal market conditions.



Question 5: 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, please describe them thoroughly (i.e. for which data providers and the reasons for it).

Yes, potentially. The question must therefore also be discussed with the data providers. Since it can be assumed that a significant amount of information would be required of them, it must be ensured that the requirements can be fulfilled with reasonable efforts by them. Otherwise the information needed for the model would not be available or be very expensive.

Question 6: Do you have any proposals on additional specifications that could be included in the legal text in order to ensure that verifiable prices provided by third-party vendors meet the requirements of this Regulation?

We have no additional proposals.

Question 7: How relevant are the provisions outlined above for your institution? How many and which curves, surfaces or cubes are (planned to be) represented by a mathematical function with function parameters chosen as risk factors in your (future) internal model?

This topic is of high relevance. Some of our members use parametric functions for all important volatility surfaces (Interest rates, Equity and FX volatilities) as e.g. SABR model, SVI model. However, although pricing is based on the parametric representation, these parameters are not risk factors. The risk factors are still the volatility quotations themselves (which are shifted in each scenario and afterwards new SABR parameters are derived in the scenario calculation).

Question 8: Do you have a preference for any of the options outlined above? For which reasons? Please motivate your response

We do not have a strong preference for either. In fact, we share the opinion of ISDA/IIF that both options have significant practical limitations.

Question 9: Do you consider any of the options outlined above as impossible or impractical? For which reasons? Please motivate your response

If option 1 requires a historic recalibration it would not be possible from an operation point of view. Option 2 can be based on all input factors – including non-modellable – a parametric model is to deliver calibration parameters as well as output risk factors. On this output level the exclusion of risk factors from non modellable buckets would take place. In cases where pricing functions are setup on model parameters it would require to establish new pricing functions (e.g. SVI). In cases where the pricing functions is setup to use the output risk factors we see open questions with respect to use of a non modellable basis in contrast to a full exclusion of the bucket.

Question 10: Do you have alternative proposals to define the consequence on the modellability of the parameters where some buckets of a curve, surface or cube are modellable whilst others are non-modellable?

We support the ISDA/IIF proposal.

Q11: Do you intend to apply paragraph 4? If so, for which risk factors will it be relevant? Do you expect any implementation issues related to it? Please explain expected issues thoroughly.



Some of our members intend to rely on the services of data providers to be established and avoid building up own tracking routines of original maturities vs. actual maturities. Notwithstanding, these are in favor of any possibility which helps to improve the diminishing demand for bonds with remaining short term maturities 0-1,5years (which were often highly liquid when issued at e.g. 5Y original maturity).

Question 12: Do you agree with the outlined methodology for the assessment of modellability of risk factors? If not, please explain why

Since some of our members will not have sufficient own trades, they will need to rely on data service provider.

Question 13: Do you expect any problems for the modellability assessment arising from the upcoming benchmark rate transition that could be addressed via this regulation? If so, please provide a thorough description and potential solutions if any.

As soon as a liquid markets new reference rate is established, we do not expect additional problems. The important question is to ensure recognition of equivalence of the new benchmark: the industry is in favor of a legal act to ease the transition with clients.

Question 14: How do you intend to integrate the risk factor modellability assessment (i.e. RFET) into the processes of your institution? Do you expect those data to be used for the purpose of the RFET only or do you think those data would increase the data availability used e.g. for the calibration of your internal model (under para 31.26 of 2019 Basel rules)? What percentage of data used for the RFET do you think will be used also for the calibration of your internal model?

We believe that the RFET is primarily a stand-alone test. Daily marked-to-market prices are available shortly following the close of trading. Vendor service data will most likely not be available during this time but only later with a considerable time delay.



About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping savings and retail banks in 20 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 1,000 banks, which together employ 780,000 people driven to innovate at 56,000 outlets. ESBG members have total assets of €6.2 trillion, provide €500 billion in SME loans, and serve 150 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking.



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