INTESA SANPAOLO

Response to EBA Consultation on

Draft Regulatory Technical Standards on Liquidity horizons for the Internal Model Approach (IMA)under points (a)to (d)of Article325bd(7)of Regulation(EU) No575/2013(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 II[2] 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.

- **NMRF[3] [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*.

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- 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 – IMA Liquidity Horizons

Q1. Do you agree with the general methodology? If not, please explain why.

INTESA SANPAOLO Group agrees with the general methodology proposed and with the prudential approach upon which it is based. Since the publication of the EBA Discussion Paper in 2017[4], some concerns were expressed on the relaxation of mapping rules at the risk factor level (DP point 148). Therefore, the Bank favourably accepts the exclusion of the possibility to map all risk factors used for modelling an instrument to the category/subcategory of the "most material" risk factor, in such a way to deter capital benefits and a non-homogeneous impacts on the capital charge among institutions for the same exposures.

Together with it, INTESA SANPAOLO Group supports also the decision of assigning to the broad risk factor subcategory 'Other types' of the broad risk factor category 'Commodity' the risk factors which could be potentially mapped to more than one category/subcategory. This choice will again increase the capital comparability through harmonisation of practices among different institutions.

[4] EBA/DP/2017/04, Implementation in the European Union of the revised market risk and counterparty credit risk framework

Q2. Besides systemic risk factors (i.e. risk factors capturing the market/systemic component of the modelled risk), are there other risk factors/parameters that would reflect risks embedded in more than one categories or more than one subcategories?

The Bank believes that, besides systemic risk factors, there are other Risk Factors that could be assigned to more than one categories. Examples are gold and other precious metals (silver, palladium, platinum), indeed:

- Under the FRTB Simplified Standardised Approach gold is treated under the FX asset class because its volatility is more in line with foreign currency and, therefore, institutions manage it just like foreign currencies;
- Under the FRTB SA, gold is explicitly included in the commodity risk class;
- Under FRTB IMA, gold is not explicitly mentioned: however, in the categorisation of Liquidity Horizon precious metals are grouped with commodity risk factors.
- Under Basel 2.5, gold is treated under the FX asset class;

Therefore, the treatment of this typology of Risk Factor could be ambiguous. As of today, within the actual FRTB IMA framework, Intesa Sanpaolo treats gold as FX Risk Factor; however, although the actual treatment is in line with Basel 2.5, reconsidering the Gold as a commodity could ensure from one side a better alignment with FO price and market best practice and from the other side it would avoid operational burden (i.e. isolate the FX Gold from ETF, ETC).

Q3. Do you agree with the treatment reserved for homogenous indices?

In principle, INTESA SANPAOLO Group generally agrees on the treatment reserved for homogenous indices. However, the Bank retains some concerns on operational and computational burdens that this approach would imply connected with the identification of the Liquidity Horizon (LH) for each index constituent. However, since the information for each indices constituents are not always available, we would suggest to consider the proposed methodology not as mandatory, but as a possibility given to those institutions who are able to assign each constituent to a proper LH. In the case in which a drill-down at constituent level is not possible, the whole index would be mapped to the longest LH.

In addition to that, in order to streamline the process and reduce computational burden, the Bank would suggest assigning to the listed equity indices a LH of 10 by default, since we do not expect to obtain a different result by considering the weighted average of the LH of their constituents. Indeed, considering for example EUROSTOXX 50 and FTSE MIB, since all their components are assigned to a LH of 10 (Article 7, Definition of small and large capitalisation) then, consequently, also the entire index should be assigned to the same liquidity horizon.

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Moreover, the approach to define the LH of an index as weighted average LH of the constituents could lead to possible issues. Indeed, in some situations, a constituent of an *Investment Grade* Index may be downgraded and therefore the weighted average will become slightly greater than 20 days: hence, the LH of the entire index will have to be switched to the next highest LH, i.e. 40 days.

Q4. Do you have any example of other risk factors that should be subject to the treatment specified for indices?

No, the Bank does not have further example of Risk Factors which should have the same treatment prescribed for indices or baskets.

Q5. Are there any other risk factors for which an ad-hoc treatment should be specified?

No, Intesa Sanpaolo believes that the provided list of Risk Factors that should be subject to an *ad-hoc* treatment is exhaustive.

Q6. What is your preferred option? Please explain why [Article 7, Definition of small and large capitalisation]

Intesa Sanpaolo strongly supports Option B, which defines small and large capitalisations for equity considering not only the absolute threshold agreed in the international standards, but also the specificities of EU equity markets. Indeed, the proposed approach takes into account the heterogeneity of financial markets across the EU in terms of size and allows for a more proportionate treatment for smaller economies. For example, is reasonable that an equity quoted within a European Index, even if has a capitalization below the prescribed threshold, could be deemed sufficiently liquid and therefore assigned to smaller Liquidity Horizon.