

14th August 2013

EBA

Via e-mail: EBA-CP-2013-19@eba.europa.eu

Dear Madam/Sir,

Response to EBA Consultation Paper on Draft Regulatory Technical Standards on additional liquidity outflows corresponding to collateral needs resulting from the impact of an adverse market scenario on the institution's derivatives transactions, financing transactions and other contracts for liquidity reporting under Article 411(3) of the Draft Capital Requirements Regulation (CRR)

Standard Chartered welcomes the opportunity to comment on the European Banking Authority (EBA's) Consultation paper on Draft Regulatory Technical Standards (RTS) on additional liquidity outflows (derivatives). We fully support the general principle of developing a Technical Standard to calculate the likely amount of collateral outflow that an organisation is likely to incur on its derivative positions during a stress.

Our key concern is that banks should be allowed to operate different methodologies across different businesses or locations / entities based on materiality and complexity of its respective derivatives business. The RTS mentions that there is a perceived risk that banks may choose to "cherry-pick" methodologies to suit their needs, which is clearly undesirable. However there are valid reasons for a bank to combine methodologies based on set criteria. For example, if an institution only has model approval for a sub-set of products it should be able to use the sophisticated methodology for derivatives for which there is model approval and the standard approach for the rest, with the agreement that as products and entities obtain model approval they move to the sophisticated approach.

The draft RTS rejects a Stress-VaR based approach, however we believe it should be considered as a valid methodology to use in order to calculate derivative collateral outflow. This method has the benefit of providing a result that is based on real-world market wide price movements and correlations in a stress (rather than un-calibrated price movements as per the standard approach). It should also be efficient to implement for most banks.

Likewise despite the reservations outlined in the RTS, the Historical Look-Back method has the advantage of being simple and easier to implement than many of the other proposals and should therefore be considered as a genuinely viable option.

Finally we believe the adopted methodology should take into account the terms and conditions of the counterparty margining set (posting thresholds, collateral eligibility, minimum transfer amounts). In particular if a counterparty which accepts non-liquid collateral has a posting requirement during a

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stress, then this collateral should be allowable under the outflow calculations and not require posting of HQLA.

More detailed comments on each of the methods described in the draft RTS and the VaR based approach are shown below:

1) Standard (Default) Method (Q5 – Q10)

Whilst we agree that some level of harmonisation of collateral outflow calculations may be of some benefit, the methodology described in the RTS does suffer from some shortcomings which have the potential to significantly overstate any derivative collateral outflow, in particular:

- a. The methodology shocks individual risk factor and calculates the maximum collateral outflow taking the worst case of each individual shock (“max of the worst”). This leads to scenarios that are not self-consistent, e.g. taking the “up” shock in one entity and simultaneously taking the “down” shock in another. Scenario based modelling should be based on specific scenarios applied consistently across product groups and legal entities. This illustrates one of the attractions of a VaR based approach.
- b. Details showing how the risk factors were calibrated were not given in the draft RTS. If these details could be provided we would welcome the opportunity to review the risk calibration and compare to data used in our internal systems and provide feedback on the results.
- c. It is not fully clear from the draft RTS, but it appears that individual margining details are not taken into account which has the potential to overstate the outflow especially if a significant proportion of the portfolio is subject to one-way CSA or no CSA at all.
- d. To the extent that non-HQLA collateral is received under stress then this collateral should be able to be used to satisfy collateral requirements where the margining set permits.

2) Simplified Method (Q11 – Q14)

The simplified method does not properly take into account portfolio diversification, it appears not to take into account margin sets (posting thresholds, collateral eligibility, minimum transfer amounts) and relies on pre-defined loosely calibrated shocks in order to calculate a collateral outflow which has the potential to be significantly overstated, especially if a proportion of the banks derivative portfolio is documented under one-way CSA or no CSA at all.

Consideration should be given to using the historical look-back approach with a stress add-on as an alternative simplified method.

3) Internal Model Based Method (Q15 – Q18)

We are concerned that the current wording of the RTS implies that a model based approach will only be available for banks with full product and geographic coverage. In practice most banks

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only have model approval for a sub-set of derivative products, which would preclude them from using the model based approach even if the substantial part of their portfolio is covered. We would welcome clarity on this issue.

4) VaR based Method (Q19)

We believe that a VaR based approach is a valid methodology to use in order to calculate derivative collateral outflow. A VaR based approach which uses historical stressed price movements has the benefit of providing a result that is based on real-world market wide price movements in a stress (rather than un-calibrated price movements as detailed in the standard approach). The result of the VaR based methodology can be summarised by margin set and details of individual margin sets (posting thresholds, collateral eligibility and minimum transfer amounts) can be incorporated into the results in order to calculate the collateral outflow under stress.

The draft RTS gives reasons as to why the EBA has not progressed a VaR based approach; our response to these reasons is given below:

- a. We do not necessarily agree that significant adjustments to existing stress VaR processes are necessary in order to calculate collateral outflow. Providing the stressed VaR result set is summarised by margining set it is relatively simple to apply margin set conditions (posting thresholds, collateral eligibility, minimum transfer amounts) in order to calculate potential derivative collateral outflow.
- b. 30 day outflow can be calculated by analysing the peak (at relevant confidence level) of the 30 day overlapping collateral outflow scenarios although it is acknowledged that this methodology ignores convexity.

5) Historical Look-Back Method (Q21 – Q23)

The main benefit of this method is its simplicity. The method should be available to be used in countries / locations where banks have an immaterial derivative portfolio. The simplicity of this method maybe preferable to the simplified mentioned in the draft RTS because this method does take into account, admittedly on a historical basis, the actual level of collateral calls that the portfolio has generated. A vulnerability of this method, as mentioned in the draft RTS, is that it is backward looking which could lead to pro-cyclicality. This vulnerability is acknowledged, however this issue could be addressed by the use of a stress add-on to gross up the historical collateral outflows.

A moving 30 day window over the last 2 years (largest 30 day outflow over last two years) would seem to make sense in terms of applying this methodology, alternatively a fixed window (say Lehman stress period) would also make sense.

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We hope you find these comments helpful and look forward to engaging with the EBA on this and other areas of CRDIV/ CRR implementation. Please do not hesitate to contact us if you wish to further discuss any of the above issues.

Yours faithfully



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