



## **Consultation on draft regulatory technical standards on additional outflows corresponding to collateral needs resulting from the impact of an adverse market scenario on the institution's derivatives transactions, financing transactions and other transactions**

Public Hearing

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# Mandate

- > Article 423(3) CRR – reporting on additional collateral outflows:

*The institution shall add an additional outflow corresponding to collateral needs that would result from the impact of an adverse market scenario on the institution's derivatives transactions, financing transactions and other contracts if material.*

*EBA shall develop draft regulatory technical standards to determine the conditions of application in relation to the notion of materiality and methods for the measurement of this additional outflow.*

*EBA shall submit those draft regulatory technical standards to the Commission by 31 March 2014.*

- > The mandate derives from Title II, Part Six CRR concerning liquidity reporting. Hence the scope will follow the scope and level of application of CRR on an individual and consolidated basis.

## Definition of additional outflows

- >The additional outflows under Article 423(3) have the following characteristics:
  - They correspond to collateral needs. This implies:
    - that flows representing the settlement of a transaction or contract, for example at the end of the maturity of a transaction or contract, are out of scope.
  - They result from the impact of an adverse market scenario. This implies:
    - that collateral needs from a material deterioration in the credit quality of the institution are out of scope (already captured under Article 423(2)).
  - They relate to derivatives transactions, financing transactions and other contracts if material. This implies:
    - that, for example, SFTs are included, but the effect of the adverse market scenario on the value of the collateral is not (already captured under Article 423(1)). It is about the effect of the market scenario on the value of the instrument and the resultant additional collateral requirement.

# Range of methods

Three methods proposed and detailed in RTS to determine additional collateral outflows:

1. Standard Method
2. Simplified Method
3. Internal Model Based Method

A fourth method - Historical Look Back Approach as proposed by BCBS in Jan 2013 may also be considered.

# 1. Standard method

- > Default method
- > Basic stress test leading to risk sensitive outcome with limited complexity.
- > Institutions to revalue their positions according to pre-defined set of shocks in market variables.
- > Re-usability of collateral inflows is a key concept and prudently addressed.
- > Iterative process of which first steps involve:
  - Revaluation of each transaction and contract against each of the scenarios and risk factors in Annex 1 to calculate the effect of upward and downward risk factor shocks. Select the scenario, per risk factor, that leads to the lowest aggregate value of all transactions and contracts.
- > Subsequent steps:
  - Again a revaluation of each contract and transaction assuming that the selected scenarios occur simultaneously on the reporting date. Inflows of transactions that do not offset outflows in margining sets or are not re-usable are excluded.

# 1. Standard method – contd.

- > For our purposes define a margining set where contracts and transactions in the set comply with the following:
  - They are marked-to-market daily and any aggregate change in value leads to immediate collateral flows that fully cover the value change.
  - Collateral flows take place on a net basis.
  - Collateral received within the set can be fully and immediately used to cover outflows on any other contracts and transactions within this set.
  
- > For our purposes inflows are considered usable when the following conditions are met:
  - The inflow is unilaterally and immediately available to cover outflows to any other counterparty.
  - The inflow is a liquid asset reported under Art 416 (1) (a) to (c)

## 2. Simplified method

- > Designed for institutions with less material portfolios of limited complexity and where requiring implementation of the other approaches could create considerable costs.
- > Only apply the method if the additional outflows estimated by this approach is less than 5% of liquid assets reported under Article 416 (1) CRR, otherwise revert to Standard Method in prescribed circumstances.
- > Multiplication of notional amounts with outflow factors specified in Annex II.
- > No revaluation of positions necessary. Only categorization of sensitivity per transaction.
- > Only the larger of the either upward or downward sensitive transactions need to be multiplied by the appropriate outflow factor to determine additional collateral outflows.

### 3. Internal Model Based Method

- > Internal-model based / Unexpected Negative Exposure (UNE) method:
  - An option for institutions with an Expected Positive Exposure (“EPE”) model approved by their competent authority for the calculation own funds requirements for counterparty credit risk.
  - The model has been validated for the transactions and contracts or risk factors covered by the RTS.
  - Unlike standard method, institutions generate scenarios, by means of simulation capabilities of EPE.
  - Unlike EPE, the intent of UNE is to model negative re-valuations. So adaptations would be key.
  - Institutions that fail to meet the conditions of application are to notify their competent authority and adopt the standard approach.



## 4. Historical look-back approach

- > Introduced by BCBS in January 2013
- > Not detailed in CP but under consideration
- > Suggested approach
  - Largest absolute net 30 day net collateral flow in preceding 24 months.
  - Absolute net collateral flow based on both realised outflows and inflows.
  - Only count inflows that can be fully used to cover outflows?
- > Backward looking and may lead to procyclicality

## Concluding remarks

- We have chosen a range of methods, which should enable the applicability of the RTS to different institutions
- Open to practical suggestions, to enhance the feasibility of implementing the methods.

Thank You

Questions Please?

# Contact information

Send comments to:

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