ABI Associazione Bancaria Italiana

ABI response to the EBA Consultation Paper on the

Draft Guidelines on Stressed Value at Risk (Stressed VaR) (CP 48)

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POSITION PAPER

General remarks

The Italian Banking Association (ABI) welcomes the opportunity to comment on the EBA Consultation Paper on the Draft Guidelines on Stressed Value At Risk (Stressed VaR).

ABI strongly supports initiatives contributing to an effective level playing field and, for this purpose, considers it of the utmost importance to enhance the convergence of supervisory practices among the competent authorities across the EU.

The following remarks on general issues and specific provisions within the draft Guidelines are intended to be helpful in this context.

As a general matter, the timing of publication of the Guidelines gives rise to some concerns since Directive 2010/76/EU has already entered into force.

In fact, at the time of publication of the draft Guidelines, institutions using an Internal Model Approach (IMA) for the purpose of calculating the capital requirement for market risk in the trading book (a) had already implemented their Stressed VaR methodology and procedures in order to comply with the forthcoming Directive, or (b) implementation by them was at an advanced stage and the approval procedure was already underway.

In both cases, the timing of publication of the Guidelines implies modifications and related costs that would not have been necessary had the Guidelines been published much earlier.

As such, we urge attainment of a higher level of coordination among the competent EU supervisory authorities. This would avoid similar mismatches in the timing of publication of regulations and allow the institutions concerned to implement them in a straightforward manner.

We hope that the publication of these Guidelines after the entry into force of the related regulations will represent an exception to EBA’s normal practice.

Specific comments and requests for changes in the text of the draft Guidelines are presented below.

Specific comments

A. Identification and validation of the stressed period

In terms of identifying the stressed period, a first concern arises with reference to paragraph 5.2 of the draft Guidelines, concerning the number of stressed periods to use for calibration.

The consultation paper affirms that "if different legal entities of a group report their capital requirements based on individual VaR measures, then each legal entity needs to separately identify a relevant stressed period…". This provision would entail significant computational and maintenance costs for institutions and is not consistent with risk management practices. If different legal entities within a group made reference to the same stressed period, the group's economic capital would be calculated on a consistent basis that facilitated managerial understanding.

The adoption of different periods of stressed risk factors for each legal entity would imply different capital weights for identical positions held in different portfolios within the group.

Therefore, in ABI's opinion paragraph 5.2 should be modified to state that "if different legal entities of a group report their capital requirements based on individual VaR measures, they can either identify a common stressed period or adopt the separate stressed periods relevant to each entity".

Clarification is also required about which competent authority should approve the approach to identifying the stressed period adopted by cross-border groups, given that the internal models of its different legal entities are authorised by different supervisory authorities. We think that, in this case, the EBA itself should be in charge of the supervision.

Moreover, on the topic of the documentation that institutions must produce to support the approach used to identify the stressed period, paragraph 7.2 requires institutions to consider significant stress periods prior to 2008 as part of their justification for the historical period chosen.

However, complete historical data may not be available for those periods, as acknowledged in the draft Guidelines, and some risk factors might not have been known at all. Hence, at a minimum, consideration of those periods would not be meaningful and, additionally, the application of quantitative analysis (also required for judgement-based approaches) might lead to misleading results.
For these reasons in ABI's opinion paragraph 7.2 should be deleted.

As a final remark, it is useful to address the issue of periods of distressed market conditions: in this case, the Stressed scenario is very likely to be the VaR Scenario; as a consequence, determination of the Stressed VaR would not add information for risk management purposes and, indeed, would merely seem to be a multiplying factor.

B. Review of the stressed period

Directive 2010/76/EU provides that institutions shall perform periodically (at least yearly) a review of the identified stressed period.

According to the consultation paper (para. 8.3), institutions shall communicate to the competent authority any changes to the choice of the stressed period, following the outcome of the review, "at least two weeks before the intended implementation date of the proposed changes".

It should be considered that some time is already required between the outcome of the review and actual implementation of the proposed changes, due to internal procedures involving the risk management function and the top management of the institution. Hence, the rationale for a further lapse of two weeks (which is quite a long period with respect to the timing of the markets) is not clear, given that no authorisation or other feedback is required from the supervisory authority prior to implementation.

Therefore we propose modifying paragraph 8.3 as follows: "Any changes to the choice of the historical period following the outcome of the review of the stressed period shall be communicated to the competent authority ~~at least two weeks~~ before the intended implementation date of the proposed changes."

Furthermore, under the draft Guidelines, institutions must have procedures in place for the ongoing monitoring of the relevance of the chosen stressed period. In this regard, it is not clear how to implement quantitatively the procedures described in paragraph 9.2. It would be very useful if some clarifying examples could be provided.

C. Stressed VaR methodology

With respect to the methodology, a first concern relates to the periodicity of the Stressed VaR calculation.

Point 10.3 (iii) c) of the draft Guidelines states that "An institution should be able to prove that, on the day of the week chosen for Stressed VaR calculation, its portfolio is representative of the portfolio held during the week and that the chosen portfolio does not lead to a systematical underestimation of the Stressed VaR numbers when computed weekly."

Since the trading book is by definition very changeable, such proof could only be provided by calculating Stressed VaR daily. However, Directive 2010/76/EU does not require the daily calculation of Stressed VaR.
Hence in ABI's opinion, point 10.3 (iii) c) should be removed.

The draft Guidelines also discipline the use of proxies and state that it "would only be acceptable provided they are well documented and their limitations are taken into account and addressed in the capital requirement through capital add-ons or other means" (para. 12.6).
In ABI's opinion this addition of a new vague, unspecified capital add-on, determined by the bank itself, is not appropriate. In fact, the supervisor is already able to impose capital add-ons, if deemed necessary to take account of any shortcomings in the internal models used.

Therefore ABI considers it necessary to delete paragraph 12.6.