

Comments

on the EBA Consultation Paper on
*Draft Implementing Technical Standards
amending Commission Implementing Regulation
(EU) 680/2014 on supervisory reporting of
institutions (EBA/CP/2016/02)*

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

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Comments on draft ITS amending the Reporting Regulation (EBA/CP/2016/02)

Dear Sir,
Dear Madam,

The German Banking Industry Committee (GBIC) welcomes the opportunity to comment as follows on the EBA's *Draft Implementing Technical Standards amending Commission Implementing Regulation (EU) 680/2014 on supervisory reporting of institutions*:

1. General comments

Broadly speaking, most aspects of the template are achievable in the long run. We support the submission of more detailed prudent valuation data, such as AVA category breakdowns.

However, we note that the suggested template includes a great deal of data that does not directly relate to prudent valuation, instead requesting fair-value-related items, revenues, risks, etc. That goes particularly for templates C 32.02, C 32.03 and C 32.04. Including multiple types of data on the same template at the same level of granularity with a common split (e.g. product/portfolio) is a significant challenge and was not something we expected to perform based on the content of the RTS. We criticise that the requirements of the ITS exceed those of the RTS and that a transgression of competence is thus involved. We also fail to understand the reasons given for this.

Furthermore, we would like to clarify the scope of this reporting requirement. The German banks understand fair value as an accounting concept. However, not every institution in Germany is required to apply this concept. The vast majority of banks in Germany prepare their financial statements in accordance with the German Commercial Code (*Handelsgesetzbuch*). This law requires institutions to value their financial assets that are not trading assets at the lower of cost or market (LOCOM). Those assets should explicitly be excluded from prudent valuation reporting because the fair value accounting concept does not apply to them (as stated in EBA's Final Draft RTS of January 2015, p. 52). Furthermore, we would regard the requirement to calculate AVAs for LOCOM assets as inappropriate, since the LOCOM methodology itself already represents a prudent valuation approach as market values that exceed cost are not recognised in the valuation process.

Implementing this reporting requirement will in some situations take significant time and considerable resources in the form of both people and expenditure. Regression testing will also be important to ensure that no other reporting dependencies are impacted by system developments.

We understand the likely implementation date for this additional reporting would be September 2017. If no changes are made to the template, development of systems to meet this date would be extremely difficult. The regular six-month period for changes to COREP would not be sufficient in this case. Due to further recent requirements of BCBS d356, we suggest an implementation date that should not be earlier than 31 December 2017. A firm implementation date and finalised requirement need to be communicated as early as possible.

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2. Detailed comments (replies to questions)

Question 1: Do you agree with this statement? If not please explain your reasoning. [Annex 2, page 1]

No.

We see little value in determining an upside uncertainty. Assuming this showed that the fair value was closer to either the upside or the downside confidence (high or low in the plausible range of values), it is difficult to see what use this information would be. Ultimately, the fair value is an accounting concept with the results audited based on accepted interpretation of the standard. The approach to determining fair value would not be changed in response to its position within the range of plausible values.

Any indication that one bank was higher or lower in the range could just as easily be a factor of range definition (market data availability to the institution) as opposed to any indication that their fair value approach may be aggressive or conservative. In the absence of balance sheet bid-ask adjustments, an upside AVA based upon sensitivities is not necessarily of the same magnitude and not even of the opposite sign as their downside counterparts. It is, on the contrary, to be expected that, for example, also an adjustment from a mid-price to a 10% quantile of a bid or ask price (instead of an adjustment to the 90% quantile) still results in a negative adjustment. (This underlines the necessity to express AVAs net of balance sheet adjustments as discussed in the following point).

Also, we suspect that institutions will be making normal distribution assumptions within their AVA methodology (e.g. for MPU). Broadly speaking, this would result in symmetrical upside/downside uncertainty by definition, further limiting the value of the figure and certainly calling into question the comparability of such data between institutions.

AVAs are calculated as a net CET1 deduction after application of balance sheet fair-value adjustments attributable to the same source of uncertainty. Thus, for consistency and to remedy the above issues about distortion of results, any upside potential should also be computed with respect to properly adjusted balance sheet fair values (e.g. an upside valuation must be computed with respect to a fair value to which balance-sheet adjustments for close-out and model adjustments have been applied beforehand).

For several AVAs there is, by definition, no upside potential, as they are, by nature, attributable to future costs that are normally not part of an accounting fair value. This applies particularly to the Operational Risk AVA, the Early Termination AVA and the Concentrated Positions AVA, as a balance sheet value can, by definition, not account for the position size (see IFRS 13.69).

Any additional context this does provide would be limited at best and would not justify the additional burden of implementing what is essentially an additional set of AVAs not mentioned in the original RTS on prudent valuation.

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Question 2: Would the 'upside uncertainty' measure defined above and used in column 120 be suitable as a definition of the upside uncertainty? If not please provide reasons and any alternative suggestions for how such an upside measure could be defined. [Annex 2, page 1]

The definition is suitable, but would benefit from further clarity to highlight that the upside uncertainty confidence interval is above the fair value. That is, it should be made clear this is tantamount to a 'negative AVA' rather than just being a smaller AVA that achieves a lower level of prudence compared to the normal AVA. Clarity could be enhanced by an annex with some graphs showing skewed price distributions and indicating hypothetical situations where fair value may be closer to either the 10% or 90% confidence, and what the hypothetical AVA and upside uncertainty would be in these situations. Also, the method for incorporating AVAs beyond MPU and COC is unclear. For example, is it acceptable to compute a possible upside based on model risks and operational risks? These points should be clarified before putting the ITS into effect.

Question 3: Is the above approach to splitting out fair valued assets and liabilities and fair-value adjustments on the one hand between the different types of AVAs and on the other hand between asset classes and product categories practical to implement? If not please describe the practical obstacles. Please suggest any alternative approaches (particularly if an alternative approach has been found useful for internal reporting purposes). [Annex 2, page 5]

Mapping/grouping fair-value adjustment types by AVA category is possible. The need to map fair-value adjustment types to AVA categories for the suggested reporting could lead to inconsistency of mappings between institutions. This may impact the comparability of data. Moreover, due to the structure of the trading portfolios, a significant number of miscategorised trades could be expected when assigning them based on the individual institution's portfolio. Calculating the AVA per asset class and product category will likely inflate the reported AVAs due to miscategorised hedge relations and the failure to consider netting effects. And, additionally, as internal trades are used to transfer risks between different books, desks and portfolios, this would severely distort a portfolio-based AVA aggregation with respect to the total position of the bank.

This could be avoided by assigning the mismatched trades from a portfolio individually to a different asset class, as proposed in the ITS. Nevertheless, in this case, the reported portfolio-based fair-value adjustments will be misaligned with the AVAs, as they are not redistributed with the trades.

Within internal reporting, German banks do not report fair value and prudent value side by side. They see them as different concepts requiring specialist individual reporting. Prudent value reporting focuses on the AVA/CET1 deduction rather than the actual prudent value itself. Reporting prudent value, fair value and AVAs together can lead to confusion between what is relevant to the accounting balance sheet/P&L and what is a regulatory capital deduction.

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Internal reporting of AVAs focuses on reporting by business/segment rather than by product. This is important in ensuring each business can adequately assess their economic value added. AVA product information is often part of the information disseminated internally, but is seldom the focus of reports.

Risks can be managed on an institution-wide basis. Identification of a portfolio principally responsible for main risk management is not individually possible. Other AVA risk categories are not assigned to individual portfolios, e.g. model risk, future administrative costs, early termination and operational risks. An attachment of these AVAs to a portfolio is inconsistent with the general risk management perspective.

For the MPU and COC AVA (after incorporating the netting benefit), a drilldown to the relevant cost centres and individual trades can be used for internal reporting. The drilldown can be achieved by redistributing the AVA per risk factor to the trades proportionate to the absolute sensitivities. The computed AVA per trade can easily be aggregated on any higher level. This approach is both easier to implement and more consistent than re-computing the AVAs for a set of newly defined portfolios while considering netting effects only on the portfolio level.

Another – in our view, more meaningful – alternative to the proposed approach would be the assignment of AVAs to asset classes based on the corresponding risk factors (valuation inputs), at least for sensitivity-based AVAs. This assignment is straightforward and would represent the actual exposure on a bank-wide level to the different asset classes. For instruments for which the AVA was calculated based on quoted market prices, the approach in the ITS consultation paper for assignment to the different asset classes could be used.

In conclusion, a more flexible approach to categorising the positions and reporting the AVA depending on the individual portfolio structure and reporting methodology would be preferable. Reporting of fair-value adjustments should only be required on an aggregate level.

Finally, the benefit of reporting both AVAs and fair-value adjustments on the chosen level of granularity specified in the ITS consultation paper should be questioned, especially given the objective of “*keeping [the] EU regulatory framework cost-effective and at an optimum level*” (section 5.3.3 of the consultation document). If the proposed reporting requirements were implemented, this would require a stricter alignment between portfolios and the methodologies for computation of AVAs/fair-value adjustments (many of the adjustments are currently not measured per portfolio but on a different level of granularity). In our understanding, this requirement is not obvious from the RTS on prudent valuation and the Delegated Regulation.

Question 4: Is the above portfolio-based approach to splitting out AVAs and other attributes between ‘Exotic’ and ‘Vanilla’ practical to implement? If not please describe the practical obstacles. Please suggest any alternative approaches (particularly if an alternative approach has been found useful for internal reporting purposes). [Annex 2, page 12]

Any portfolio-based approach will be subject to significant levels of interpretation/judgment, which, in our view, undermines the usefulness of gathering data in this format. In particular,

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the term 'principal activity' is difficult to define in a way that will ensure consistency of interpretation.

In practice, German banks would have to map valuation data to a portfolio/book as a first step. This would mean they need to allocate the results of group-level risk/parameter-based processes to individual portfolios before they can follow the above steps. As a second step, they would have to then assess which product dominates the activity of the portfolio/book to classify it as equities/rates/commodities, etc. Then, a third step would require them to assess whether a book is exotic or vanilla in nature based on the dominant content.

In practice, this would likely involve implementing a field in hierarchy static data to represent the COREP portfolio classification. This would be a large one-off exercise to create the static data, followed by a commitment to ongoing maintenance and review/control of the hierarchy data as the principal activity of a book/portfolio potentially changes over time.

A classification as 'Exotic' or 'Vanilla' is not something German banks currently maintain in their reporting system. Without a clear definition for all participants of what exactly constitutes a 'Vanilla' book, no meaningful cross-firm comparison will be possible and is impractical for many reasons:

- For example, there are portfolios with principal activities in Bermudan bullet and accreting swaptions which cannot be assigned to one product category as defined in Article 7 in the RTS on the assessment methodology for internal models. Since AVAs are not calculated on a product basis, inclusion of a subset of products from the portfolio in another product category is impracticable.
- The technical problems are intensified by the fact that the corresponding (vanilla) hedge products
 - are kept in different portfolios/trading desks
 - cannot be mapped to specific products in such portfolios, especially if the relevant risk factors are macro-hedged on a portfolio level.

We kindly request clarification of the definition of 'portfolio' in this context. In addition, hedge relations would not be represented on this level. Consideration should be given to allowing a splitting of the AVAs on the basis of profit centres/organisational units, as this level of granularity is used for internal reporting and is more representative of the risk of the institution.

Question 5: Do you think such mismatches between the portfolio-level AVAs and the institution-level AVAs would be significant? Please give examples. [Annex 2, page 12]

It is difficult to assess materiality here.

German banks' AVA methodology aggregates individual risks on the group level and then calculates AVAs for the group as a whole. This ensures that the group's AVA CET1 deduction is

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an accurate representation of the group's risk. Institutions do not perform separate calculations at lower levels of the hierarchy (e.g. different segments, business units, etc.), so cannot quantify the risk-netting benefits of taking their current approach. We do not see any value in performing calculations based on grossed-up risks that do not properly reflect the group's aggregate risk profile.

For internal reporting, institutions have a disaggregation algorithm to allocate the group-level AVA to businesses for steering purposes. The sum of this disaggregated AVA is, by design, equal to the group-level AVA.

A significant mismatch between the portfolio-level AVAs and the institution-level AVAs can be expected due to the unclear method for assigning trades to the given asset class and product type. The separation would not account for hedging effects between different asset classes and product types. It would also not account for internal risk transfer and macro-hedging of exposures resulting from structured portfolios with vanilla portfolios. This would lead to an artificially increased AVA that does not reflect economic reality.

As described in the answer to Q4, we consider it impractical and in some cases virtually impossible to calculate all AVAs on a portfolio level. The currently employed drilldown for the AVA to the profit-centre level results in a consistent result for the portfolio-level AVA and the institution-level AVA and already incorporates the netting effect.

Question 6: Where the difference is significant what additional practical difficulties would arise from calculating AVAs for each of the portfolio categories in rows 050-170? [Annex 2, page 13]

German banks would have to implement very significant changes to the systems they use to calculate AVAs. Additional data sets (different levels of aggregation) and calculations thereon would have to be created. Potentially significant IT spending would be required to support these calculations within the required 24-hour period before the next day's processes begin to run (i.e. institutions would have to buy more servers/cores to ensure that other processes sharing the same system are not endangered.)

Question 7: What are stakeholders' views on the ability to usefully summarise in a few key words the models and products concerned, as well as on the associated reporting burden or IT issues? [Annex 2, page 15]

It does indeed require considerable one-off effort to populate fields C 32.03 040 and 050. Yet, for the limited number of models subject to model risk prudent valuation AVA in German banks, this is deemed manageable.

However, currently institutions have no automated updating process, i.e. there is no way to update these fields in a regular fashion in an automated way. Moreover, limiting the maximum characters to, for example, 60 would not allow them to list all products.

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Without a standardised and well-defined taxonomy across all participants, the intended use for cross-firm analysis is seen as highly questionable.

Additionally, the ITS do not specify the granularity of the required model reporting. One challenge, for example, is the case where the same model is employed in a different context for different (internal) product types. Should these be summed up as one entry or should each product type be listed individually in the reporting template?

In addition, determining the model risk fair-value adjustments and additional value adjustments on a model, asset-class and product-type basis would require breaking these down to the individual trade level and re-aggregating the data. Currently, the data is not available on this level and making it available would be a significant conceptual and implementation burden. Also, in this case, hedging effects between different exposures/products that have opposite "sensitivities" to a valuation model but are reported individually in the template would no longer be visible, so that the sum of the asset class/product-type level model risk AVAs would be substantially larger than the bank-level model risk AVA.

Another challenge for the technical implementation of the top 50 model risk AVAs is accounting for individual model risks from subsidiaries. Especially if there are common models and product types present in different subsidiaries, an additional aggregation step is required in order to generate the top 50 list. The EBA should also clarify whether entries for model risk AVA are to be made in decreasing order before diversification or not.

In the model risk section of the reporting template, new parameters that were not required previously, such as "Observability", have been introduced. Incorporating these into the COREP template will require additional data collection and reporting mechanisms. Therefore, they should be excluded unless a clear benefit from this extension of the reporting requirements can be shown.

Only the main features of the model or products should be reported. This information is meant to highlight what is referred to behind the internal names reported in Columns 010 and 030, in particular for the purposes of cross-firm analysis. While this is expected to introduce substantial one-off costs on first-time implementation of the template, it is considered that the descriptions should be relatively stable over time and not impose any significant burden thereafter.

Question 8: Do you find the proposed instructions on prudent valuation clear? Are there specific parts where definitions or instructions should be clarified?

Broadly speaking, they are clear, but they are difficult to implement in practice and leave a lot of room for interpretation. This could undermine the ability of EBA to draw comparisons between institutions. In addition we would like to mention that the difficulty typically arises as processes involved for these different data sets are not always conducted by the same departments or within the same systems, and are often available only at different granularity levels or use inconsistent taxonomy ('product A' may be called 'product B' in a different

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system). This is a legacy of organic system development over time and is of course a general issue that many in the industry are struggling with.

The following points should thus be clarified:

- The calculation methodology for the upside uncertainty should be clarified, particularly regarding negative AVAs.
- If the accounting fair values are independently calculated and there is no IPV difference in general, can the row 'IPV difference' be left void?
- The definition of the order criteria for the top 50 model risk AVAs is unclear. Are such AVAs to be set out in decreasing order before or after diversification? Do valuation exposures with a model risk of zero after diversification need to be included?
- The RTS on prudent valuation (Article 11(1)) only requires the calculation of AVAs on a valuation-model basis ('individual model risk AVA'). We feel that this is an adequate approach in the case of model risks, and German banks generally use this approach. Template C32.03 requires instead the model risk for a specific product type. An AVA calculated on the basis of a valuation model cannot be split in a meaningful way if the model is used for a wide range of product types.
- The intention of template C32.03 regarding the process of merging products into one line should be clarified. In the case where one model is used to evaluate a large number of product types and only the model risk at the level of the valuation model is available, can all products be summarised in one row? If so, which product type should be reported?
- In template C32.03, column 060, do price indications from counterparty collateral valuations or consensus service data qualify as a price observation?
- The relationship between the fields in the columns for the "Fair Value Adjustments – Unearned Credit Spread" and "Fair Value Adjustments – Investing and Funding Costs" (table "C32.02", in Annex 1, columns 210 and 220) should be made clear. Currently, all of them are specified as the sum of unspecified fields in the Excel template.
- We kindly request clarification whether detailed reporting of prudent valuation adjustments in accordance with IFRS is sufficient or if reporting in accordance with other national GAAP is required at the same time where multiple financial statements are filed.
- 'Principal activity' should be better defined with regard to allocating AVAs to portfolios/product.

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Question 9: Do respondents have any comments on the structure and content of the proposed templates on prudent valuation?

Some technical comments on certain data requirements:

- **Duplication** (C32.01, Column 010/Row 10-210): of existing COREP & FINREP reporting has been noted for certain items (those in Annex 2 with F01.01/F01.02 references). This is not efficient and should be avoided, in our view.
- **Fair Value Exclusions** (C32.01, Column 020-070/Row 10-210): For institutions that are close to the €15bn threshold used to determine if the simplified approach is appropriate, some additional reporting of exclusions makes sense (C32.01, Column 020-070/Row 10-210). For those institutions that are very far above the threshold, this reporting represents an unnecessary burden. We propose that columns 020-060 should only be a requirement for those institutions using the simplified approach (i.e. those below the threshold where exclusion data is useful to judge whether the exclusions are material to their position relative to the threshold). Those using the core approach could ignore this item.
- **Valuation at lower of cost or market** (C32.01, Column 010-020 and 040-070/Row 120): Assets that are valued at the lower of cost or market (LOCOM) should be explicitly excluded from this reporting requirement (cf. EBA Final Draft of January 2015). The fair value accounting concept is not applicable to those assets. It would create an unnecessary reporting burden for the vast majority of small institutions if those assets were included in this reporting template.
- **Overhedges** (C32.02, Column 280/C32.03 Column 210): Reporting these in a common format with prudent valuation would require substantial effort and system investment.
- **Revenues** (C32.02, Column 150/Row 10-210): Revenues by product category are not routinely reported at present. This would be an additional burden, requiring additional resources.
- **Observability** (C32.03, Column 060): This data is currently not reported internally and would thus require additional efforts to collate and validate. We do not see the benefit of reporting this data for the top 50 model AVAs that exist, partially because of the lack of available market data. It seems counter-intuitive to report these side by side.
- **Fair-valued Assets/Liabilities by Model** (C32.03, Column 120/130): German banks' fair value balance sheet is not currently available by model. Significant resources would have to be expended to achieve this.


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- **Fair-Value Adjustments by Model** (C32.03, Column 180/190): German banks' fair-value adjustments are not currently available by model (except for model risk adjustments). Significant resources would have to be expended to achieve this.
- **IPV Difference by Model** (C32.03, Column 150/160): German banks' IPV differences are not currently available by model. Typically, these are aligned with risk/parameter types, rather than model types. Significant resources would have to be expended to achieve this.
- **Upside Uncertainty** (C32.02, Column 120): We do not see the benefit of producing this figure. It will not be used for financial reporting or capital deductions. It is seemingly only requested to provide context. No mention of this requirement was made within the RTS on prudential valuation. It has not been built into systems and processes that were created/enhanced to address the RTS requirements. We feel it is inappropriate at this late stage to introduce a new concept such as this.
- **Cross-asset class**: The differentiation between AVA categories that are considered by portfolio and AVA categories that are classified as "cross-asset class" should be challenged. For example, it is unclear why future administrative costs and model risks should be assigned on a portfolio level.
- The template for model risk AVAs requires a splitting of AVAs on the basis of model and product type. In conjunction with the requirement to aggregate AVAs on a portfolio basis, the only way to fulfil both requirements is to calculate model risk on the basis of individual products. We feel that these requirements pose an unduly heavy calculation burden.
- The handling of subsidiaries for group reporting is left unclear. Incorporating their reported AVAs in the given reporting scheme will require a significant effort.

Yours sincerely,

on behalf of the German Banking Industry Committee
Association of German Banks


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