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London, July 6th 2016

Consultation paper on amending RTS on Proxy Spread and Smaller Portfolios

Dear Sirs,

Markit is pleased to submit the following comments to the European Banking Authority ("***EBA***") in response to its Consultation Paper on *Amending RTS on Proxy Spread and Smaller Portfolios* (the "***Consultation Paper***").

Markit[1] is a leading global provider of financial information services. Our services facilitate firms' compliance with regulatory requirements, help financial markets function properly, level the playing field and ensure that competition is effective. Founded in 2003, we employ over 4,000 people in 11 countries and our shares are listed on Nasdaq (ticker: MRKT).

Services that are most relevant in the context of the Consultation Paper include:

- Markit's CDS pricing service:[2] the service provides indications of Credit Default Swap ("***CDS***") spreads at which single names are quoted, and also CDS Sector Spreads differentiating by rating, region and sector across tenors;
- Credit indices:[3] we own and administer traded CDS indices that, based on transactions concluded in the marketplace, provide market participants with credit spread indications across regions and asset classes, e.g. Markit iTraxx Europe (European High Grade) and Markit iTraxx Crossover (European non-investment grade), Markit CDX North American Investment Grade and Markit CDX North American High Yield;
- Bond spreads: our pricing services for corporate bonds[4] provide our customers with an indication of where the bond market views the credit risk of an entity; and
- Credit assessment service: provides credit spread indications for illiquid issuers based on fundamental analysis and observable spreads in the marketplace.

Introduction

We welcome the publication of the Consultation Paper and believe that the clarifications made by the EBA are relevant given today's market conditions in the credit markets. Specifically, the EBA recognised that liquidity in the CDS markets has diminished and that institutions might therefore need to consider the use of alternative methods to reliably measure credit risk of their trading counterparties as input into calculating capital

[1] See www.markit.com for more details.
[2] See http://www.markit.com/Product/Pricing-Data-CDS-Sectors
[3] See http://www.markit.com/product/indices
[4] See http://www.markit.com/Product/Pricing-Data-Bonds

requirements. We support the EBA's suggestion to allow institutions to use alternative approaches that are based on fundamental analysis. Below we suggest some improvements to the framework as laid out by the EBA which, we believe, will form the basis for a robust mechanism to compute proxy spreads.

Comments

Question 1: Do stakeholders agree with the amendment?

We agree with the principles as laid down by the EBA in it proposed amendments of the proxy spread framework to determine CVA risk. Particularly, we support its proposal to allow institutions to consider the use of alternative credit quality assessments. We believe this would be a helpful addition or substitute to existing methods of measuring credit risk of counterparties where such counterparties have no "peers at all with observed credit spread data".

However, we encourage the EBA to consider certain amendments to its proposal to make it more robust and ensure it results in the most accurate and representative measurement of credit risk. Specifically, we note that the EBA referred to the use of "credit spread data" in a number of instances, namely when describing its use in proxy spread methodology and when recommending fundamental analysis in the absence of credit spread data. We recommend that the EBA clarify, consistent with the previously issued final RTS on CVA risk for the determination of proxy spreads,[5] that institutions consider not just CDS spreads but also "spreads of other liquid traded credit risk instruments"[6] in the calculation. On this basis market participants would derive credit spread data from other market-based instruments such as bonds where those are sufficiently liquid and representative. To allow for the use of such measures, institutions should be able to quantify the liquidity of the instruments used and demonstrate they are sufficiently liquid.

We agree with the EBA that, where available, market-based[7] measures of credit risk should take precedence over alternative approaches based on fundamental analysis to get an accurate indication of credit risk. To provide institutions with sufficient clarity, the EBA might consider specifying a hierarchy of methods and data sources used to derive credit spreads as basis for CVA calculations. Specifically, institutions could apply the following hierarchy:

1) Single name CDS spread of the institution;
2) Bond spread of the institution – importantly, such spread will still reflect the idiosyncratic credit risk which and should hence be preferable to a proxy spread approach;
3) CDS sector proxy spreads – derived from traded CDS spreads using the attributes of rating, region and industry as specified in the RTS;[8] (if the sub-sector of the which CVA is being calibrated from is sufficiently liquid and the drivers of business creditworthiness are the same)[9].
4) Bond sector proxy spreads – derived from bond spreads using the three attributes rating, region and industry (if the sub-sector of the which CVA is being calibrated from is sufficiently liquid and the drivers of business creditworthiness are the same); and

[5] *See https://www.eba.europa.eu/documents/10180/535344/EBA-RTS-2013-17+(Final+draft+RTS+on+CVA).pdf*

[6] See Article 1.1 (e) of the RTS on CVA risk for the determination of proxy spread: *https://www.eba.europa.eu/documents/10180/535344/EBA-RTS-2013-17+(Final+draft+RTS+on+CVA).pdf*

[7] Such as credit spreads derived from CDS and bond spreads

[8] In this context, the EBA uses the notion of "rating attribution". We believe this should be discovered through additional fundamental credit assessments to enable the practitioner to model the basis caused by this additional attribution of risk factors to the liquid market.

[9] For example, spreads for the Oil Refiners sector could be proxied from spreads of the more liquid Oil Producers (same sector band as their credit risk should be negatively correlated, i.e., to the price of oil).

5) Alternative approach based on fundamental credit analysis, which should, however, still make use of market-based inputs to the extent possible.

Importantly, even where no relevant CDS or bond spreads are available for the specific name or sector, any fundamental credit analysis should be coupled with the use of relevant market-based measures for counterparties with comparable creditworthiness and characteristics to derive a representative credit spread that will then be used for the CVA calculation.

Question 4: Do stakeholders agree with the possibility provided by the amendment to adjust the value of the LGDMKT term of the regulatory formula?

We agree with amendment that allows for the possibility to adjust the value of the LGDMKT term of the regulatory formula.

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We hope that our above comments are helpful. We would be more than happy to elaborate or further discuss any of the points addressed above in more detail. If you have any questions, please do not hesitate to contact Harsh Agarwal (harsh.agarwal@markit.com) or the undersigned.

Yours sincerely,

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