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Submitted via EBA website

European Banking Authority
One Canada Square (Floor 46)
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Re: GARP Response to EBA Consultation Paper on ITS Amending Commission Implementing Regulation (EU) 2016/2070 on benchmarking of internal models (EBA/CP/2018/16)

The Global Association of Risk Professionals (GARP)[1] appreciates the opportunity to provide feedback on the EBA Consultation Paper proposing modifications to its annual market risk benchmarking exercise to assess the quality of internal approaches used by banks. Over six years ago, we launched the GARP Benchmarking Initiative (GBI) with a similar objective: to develop hypothetical portfolios against which banks could run their risk measures to provide a transparent basis for benchmarking bank approaches to risk measurement and understanding drivers of differences. Since then, GBI has grown to serve as an independent analytic entity that helps global financial institutions measure the impact of regulatory initiatives and assess systemic risk issues rapidly and accurately. To date, GBI has executed over 45 studies with its participating financial institutions[2], including studies associated with the EBA Market Risk Benchmarking Exercises over the past three years. GBI recognizes the significant effort spent by all participants (banks and regulators) to execute these studies and aims to support these efforts by improving their efficiency, effectiveness and the value extracted.

The EBA Consultation Paper makes several recommendations to improve the banks' understanding of the benchmarking portfolios and to improve EBA's understanding of how bank pricing and risk measures are derived. To provide meaningful and helpful feedback to the proposed modifications, GARP prepared short responses to the "Questions for Consultation" pertaining to the market risk exercise, as well as general recommendations for future EBA benchmarking exercises.

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[1] The Global Association of Risk Professionals, http://www.garp.org, is a not-for-profit global membership organization dedicated to preparing professionals and organizations to make better-informed risk decisions. The GARP community represents over 150,000 risk management practitioners and researchers from banks, investment management firms, government agencies, academic institutions and corporations from more than 195 countries. GARP's mission is to educate, train and set global standards in financial and energy risk management. *GARP does not engage in consulting or lobbying activities*.

[2] As of January 2019, seventy-four (74) banks and thirty-four (34) investment management firms are participating members of GBI. GBI is completely self-funded by GARP.

A. Responses to EBA Questions for Consultation

Question 9 for Consultation: Do you agree with the additional pricing information requested?

With the goal of avoiding misinterpretation of portfolio instruments, we note that for considerably less effort than collecting additional pricing information, the EBA could work with the industry to develop more detailed term sheets for the entire portfolio (or portions that have been consistently misinterpreted). This approach has the greatest potential for improving the interpretation of the instruments and ultimately the validity of the submitted risk measures and would be less disruptive to the primary focus of the exercise.

Having banks provide the sensitivities of the instruments to assigned risk factors would likely not improve insight into differences in interpretation and therefore would not be worth the considerable amount of effort needed from both the industry and the EBA to collect for several reasons:

1. The risk taxonomies banks use and approaches banks take to calculate sensitivities will vary widely and rather than providing a deeper look into each firm's approach to its risk modeling would likely blur the view and introduce the need for significant explanation and investigation. Comparing sensitivities across multiple banks would be challenging and likely inconclusive.
2. There is no standardized approach for reporting sensitivities. Reporting standard measures such as VaR consistently generates variation due to factors such as sign, horizon length and currency. Reporting sensitivities (1st and 2nd order partial derivatives of the pricing function) will almost certainly generate a far greater magnitude of variation that will be very challenging to decipher.
3. With the proposed sensitivities information, being able to identify statistically significant subgroups with common risk factors and calculation methods to compare sensitivities and provide meaningful conclusions about appropriate values seems very unlikely.

In many cases, firms' risk models use PV ladders or full revaluation rather than sensitivities and, in some cases, sensitivities are not currently calculated at all for internal purposes. Therefore, the effort involved in generating and reporting the sensitivities for the banks would be significant, especially given the short time window between the proposed IMV reference date (26 September 2019) and the IMV/sensitivities submission date (4 October 2019). Similarly, the effort involved in understanding and analyzing the submissions for the EBA would be considerable. And even with all this effort, given the challenges with aligning submissions noted, the benefit would likely be minimal.

Question 10 for Consultation: Do you agree with the simplification introduced in the time setting of the references date for the instruments?

Yes, this simplification improves the current specifications and will allow banks to input reference dates for instruments in a manner consistent with market conventions.

Question 11 for Consultation: Do you have any concerns on the clarity of the instructions?

We surveyed the 28 banks[3] currently participating in the 2019 GBI EBA Market Risk Benchmarking Exercise about the clarity of the proposed 2020 instrument specifications. Generally, the EBA has taken steps to address many of the questions raised by banks about the specifications for the 2019 exercise. A few additional general clarifications would be helpful:

- For portfolios containing instruments specified in different currencies (e.g., Portfolios 10 and 50), the EBA should clarify whether banks must calculate risk figures inclusive or exclusive of any FX risk beyond that intrinsically included in the instruments.
- For any position intended in a listed instrument, we suggest providing the contract reference and the exchange (e.g., Eurex FGBL June 19 for Euro-Bund Future) to reduce uncertainty.
- For Swaps, we suggest clarifying if banks should assume to have a collateral agreement with the counterparty.

We also believe it would be helpful to publish specific instrument parameters which cannot be specified until the booking date, such as spot prices, strike prices, coupon rates, reference rates, etc. This would allow banks to enter the positions in line with market conventions and would further reduce the IMV variability due to misinterpretation.

Question 12 for Consultation: Can you please provide detailed explanation of the instruments that are not clear and a way to clarify the description?

Specific instrument clarifications and suggestions are:

- Instruments 1, 3-17: For the IMV phase, 100 contracts are used for these instruments (according to (jj)), but the number of contracts varies from 100 to 1000 in the portfolio definitions. This creates additional operational burdens, since two different setups of the positions must be entered. We suggest making the number of contracts constant in IMV and risk phases.
- Instruments 9-16: The expiration date for options expiring in December is the end of December whereas the expiration date for options expiring in June is the third Friday of the month, in line with market standard. We suggest changing the expiration date for options expiring in December to "December Year T".
- Instrument 17: "Short Future NIKKEY 225 (Ticker NKY) (1 point equals 1000 JPY)". The index traded on the standard exchange uses a ratio of 500 JPY per point instead of 1000 JPY. We suggest using the standard exchange.
- Instrument 23. "Cap and floor 10-year UBS AG Notes". We suggest using an actual bond (rather than having banks build or approximate bonds that do not typically exist in this form) or replacing this instrument with a vanilla instrument that has similar risk characteristics such as an IR cap or floor.

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[3] The following banks are participating in the GBI EBA 2019 Market Risk Benchmarking Exercise: Bank of America, Barclays, BNP Paribas, Citibank, Commerzbank, Credit Agricole, Credit Suisse, Deutsche Bank, DZ Bank, Goldman Sachs, HSBC, ICBC Standard Bank, ING, Intesa Sanpaolo, JP Morgan, Lloyds, Morgan Stanley, Mitsubishi UFG, Natixis, Nomura, Nordea, NordLB, Rabobank, Raiffeisen Bank, SEB, Société Générale, Standard Chartered, Unicredit.

- Instrument 37: "'5-year IRS EURO – Receive floating rate and pay fixed rate. Fixed leg: pay annually. Floating rate: 6-month EURIBOR, receive quarterly". Market convention would be to receive payments every 6 months, not quarterly. We suggest changing the payments to be received every 6 months, following the market convention.
- Instruments 38, 39: "Short 6-month EUR/USD (or EUR/GBP respectively) forward contract" is misleading. Direction of forward contract should be defined by the currency exchange rate. We suggest removing the descriptions "long/short" for forward contracts.
- Instrument 40: "Long 1 MLN USD at the EUR/USD ECB reference spot rate" is misleading. We suggest changing the description to "Long 1 MLN USD Cash".
- Instrument 47. For this cross-currency swap, please indicate if risk measures should include FX hedge amounts or not. In addition, market convention would be to book the swap with a spread on the floating leg so that that value is zero at inception. Please indicate if a spread should be included.
- Instruments 58-62, 65: For the CDS credit entities, more than one name can be found. We suggest providing the RED code for each CDS credit entity specified.

B. General Recommendations for Future EBA Benchmarking Exercises

The EBA has taken several positive steps over the last few years to reduce misinterpretation of the market risk benchmark portfolios, including collecting feedback each year on the clarity of the portfolios, adding the IMV phase to study to identify problems early in the study process before the risk measurement phase and modifying the portfolios last year and adjusting the IMV phase to be at the instrument level. In addition, the current Consultation Paper offers several specification adjustments for the instruments and portfolios for the 2020 exercise.

To continue to advance the effectiveness of the EBA Benchmarking Exercise, we offer the following recommendations with respect to future studies:

- Given the challenges associated with providing clear and unambiguous portfolio/instrument definitions, we recommend that future portfolio/instrument modifications should be phased-in with at most one or two asset classes meaningfully modified per annual exercise.
- Following the booking date but prior to the IMV submission date, GBI could work with the EBA, the national competent authorities and the participating banks to organize and publish specific instrument parameters which cannot be specified until the booking date, such as spot prices, strike prices, coupon rates, reference rates, etc. which will allow banks to enter the IMV phase with greater confidence in the portfolio definitions and should further reduce the IMV variability due to misinterpretation.
- The EBA should consider working with the industry to develop detailed term sheets for the entire portfolio. Alternatively, given the changes made for the 2019 exercise, the EBA could determine which positions require more precise specification. Positions with significant variability in IMV and PV could be assessed carefully for either removal from the portfolio or modification including the development of appropriate term sheets.

C. Conclusion

We thank the EBA for the opportunity to provide input to potential modifications to its annual market risk benchmarking exercise. Hypothetical portfolio exercises are a valuable tool for assessing internal risk models but must be executed carefully to ensure a consistent understanding of the portfolios across all participants and hidden assumptions don't pollute the results. GBI supports the EBA's efforts to clarify portfolio specifications and encourages the EBA to focus efforts on removing ambiguity from the instrument definitions with detailed term sheets as needed, which would eliminate the need for additional pricing information beyond the IMVs.

Yours Truly,

/s/ Christopher J. Donohue, Ph.D.
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Global Association of Risk Professionals