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EBF response to EBA consultation paper (EBA/CP/2019/03) on Draft Regulatory Technical Standards on mapping of derivative transactions to risk categories, on supervisory delta formula for interest rate options and on determination of long or short positions in the Standardised Approach for Counterparty Credit Risk under Article 277(5) and Article 279a(3) of proposed amended Regulation (EU) No 575/2013 (Capital Requirements Regulation 2 - CRR2)

General comments

The European Banking Federation (EBF) appreciates the opportunity provided by the European Banking Authority (EBA) to express their views on the consultative document (EBA/CP/2019/03)[1] on the Regulatory Technical Standards (RTS) on the Standardised Approach for Counterparty Credit Risk (SA-CCR). In addition, to providing responses to the specific questions in the consultative document, the EBF would like to take the opportunity to raise some general issues that are of high concern to the EBF and its members.

To begin with, the frequency of the mapping of the trades to risk categories is not explicitly mentioned in the text. In the response to the EBA discussion paper titled "Implementation in the European Union of the revised market risk and counterparty credit risk frameworks", the EBF had already pointed out that conducting the quantitative analysis (in cases where necessary) repeatedly, for example monthly or quarterly, is likely to result in certain trades (e.g. cross currency swaps) switching the category or categories during their lifetime. The EBF would like to repeat that this would lead to instability in the calculation which would be unjustified and undesirable from a risk management point of view. Therefore, we ask for clarification that a "once and for all"-mapping of particular trades is sufficient in any case. Moreover, in order to avoid disproportionate burdens especially for smaller banks, institutions should be given the possibility to conduct the quantitative analysis for several trades of a product type once annually and then map all following trades of that same type

[1] Please see https://eba.europa.eu/news-press/calendar?p_p_id=8&_8_struts_action=%2Fcalendar%2Fview_event&_8_eventId=2711843

based on the previous outcome instead of re-running the analysis for every single new trade.

Also, the frequency of determining lambda is not explicitly addressed in the draft. Some institutions are going to use the SA-CCR for the bank management and perform the respective calculations on a day-to-day basis whereas other institutions will perform the calculation as per the reporting reference date. The EBF would like to ask for clarification that the frequency of updating lambda will consequently be bank individual according to the frequency of calculating the SA-CCR exposure amounts themselves.

Furthermore, the EBF is still of the opinion that the following part of article 1 (b) should be removed: "where the currency of the underlying of the transaction is the same as the settlement currency of the transaction" In the EBF's view the FX risk, which is referred to here, is not material. Although the FX risk may impact the product performance, ultimately, the magnitude and direction of that performance is driven by the primary risk factor (i.e. equity or commodities).

Lastly, in the present consultation response the EBF requests several discretions for banks, which would allow the banks to choose between different regulatory options. The EBF is aware that those proposals could raise concerns on the side of the regulator as well as the supervisor about potential cherry-picking on the side of the banking sector. The EBF would therefore support the idea that institutions, which exercised one option, should be obliged to apply the chosen option in the future.

Q 1: Which one of the two options do you think is more appropriate as thresholds in Article 3(b) steps (v) and (vii) (option 1a: Y%=50% and Z%=25%, or option 1b: Y%=60% and Z%=30%)? Please provide the rationale for the chosen option.

In order to identify the most material risk driver for transactions with more than one material risk driver, the EBF proposes that credit institutions should be free to choose between option 1a and option 1b, as detailed in steps (v) and (vii) of Article 3(b) of the Commission Delegated Regulation.

Q2. What are your views about the general quantitative approach methodology, which hinges on FRTB SA sensitivities? Please provide examples of cases where computing FRTB SA sensitivities might raise some issues.

Scope of the approach 1

In the Basel SA-CCR text, derivatives are mapped to the asset class of its primary risk driver[2]. Banks are required to use sensitivities and volatilities for the determination of the primary risk driver of complex trades that may have multiple risk drivers[3]. Only those complex trades designated by supervisors are to be mapped to more than one asset class.

In the consultation paper, it is said[4] that the method should be "simple for all cases where the primary and only material risk driver of the transaction is immediately discernible from the nature of the transaction".

We therefore would like the EBA to consider additional products to be covered by the approach-1 which would ensure that the vast majority of transactions are captured by the qualitative approach and not by the approach in Article 3(1)(a).

[2] Please see BCBS d279, Article 151
[3] Please see BCBS d279, Article 152
[4] Please see the draft RTS, Recital (1)

Transactions with a different currency between settlement and underlying:

Where the only reason to resolve to approach-2 is that the currency of the underlying of the transaction is not the same as the settlement currency of the transaction, the FX risk-category represents only a fraction of the underlying risk-category.

The EBF therefore recommends the removal of the following part of article 1(b): "where the currency of the underlying of the transaction is the same as the settlement currency of the transaction", since the FX risk concerned here is not material.

Cases where the use of approach-2 lead to the determination of two material risk categories are rare. It would not justify the extra burden to resort to it.

Cross currency swaps:

It can hardly be claimed that common transactions such as cross currency swaps are complex. If clearly they are sensitive to both Foreign Exchange and Interest Rates risk factors, it can be shown (see thereafter) that FX risk is by far the predominant risk driver. This is being recognised in the Basel text which is considering the cross-currency swaps as foreign exchange contracts[5]. Annex II of Regulation (EU) 575/2013 also classifies cross-currency interest swaps as Foreign-exchange contracts.

When applying the approach 2 to all the cross-currency swaps (i.e. at product level), FX risk delta FRTB-SBM capital charge represents about 80% on average of the total for a representative portfolio. This confirms that FX risk is the only material risk factor for this product.

Resettable cross-currency swaps are dominant among cross currencies that would be assigned to two risk categories according to the proposed Approach-2. Many of those resettable cross-currency swaps would have been mapped to a single risk category had the resettable feature been removed. The FX-reset feature is a risk mitigant, it lowers the FX risk embedded in the transaction while keeping the IR risk unchanged. We do not believe that the purpose of the regulation is to inflate exposure when risks are lowered. Hence, we do not see fit a systemic doubling of the exposure amount based on the sole relative importance of risk drivers. When well identified products can demonstrably been proven of lower risks than other products of identical primary risk driver, it should be mapped to that single primary risk driver.

Furthermore, cross currency swaps are a vanilla flow product, an important one for commercial end users, corporates for example, providing funding in various currencies. Doubling the exposure amount of those transactions will push banks to increase the cost for clients of such products and may, eventually, deter some to hedge their FX risk. This is even truer in Europe given that many of international transactions are denominated in US dollars.

Considering all those facts, we propose to include cross-currency swaps within the Article 1 of the RTS. Exposure for this vanilla product would be the same for every institution and it would ensure a level playing field.

When in approach 2, significant risk category determination

[5] Please see BCBS d279, Article 162, Footnote 14

First of all, the EBF would like to repeat that institutions should in general be free to use either internal sensitivities or FRTB sensitivities or SA-CCR add-ons for the assessment of the risk drivers' materiality.

As a general rule, FRTB sensitivities will only be available for trading book instruments, whereas counterparty credit risk (CCR) is broader, covering banking book instruments as well. According to the draft Delegated Act, the EBF understands that institutions that do not meet the conditions set out in Article 94(1) or Article 325a(1) of Regulation 2019/876 (CRR2), respectively, have two options with respect to the treatment of banking book instruments with more than one material risk driver:

- Either they produce FRTB sensitivities for derivatives in the banking book solely for the purpose of the SA-CCR.
- Or, alternatively, they apply the method set out in Article 3(1)(a) of the draft Delegated Act and consider all identified risk drivers to be material.

The first option might be unnecessarily burdensome. The quantitative approach methodology creates a clear dependency between the Market risk Framework and the Counterparty Credit risk (CCR) framework both in terms of methodology and IT systems. As such, depending of bank internal organization, using sensitivities for the identification of the most material risk driver may be burdensome and technically complicated. Therefore, some banks could end up using the fall-back methodology described in Article 3(1)(a) for a significant part of their portfolio, resulting in an overstatement of the exposure.

Therefore, at least with regard to derivative trades in the banking book, all institutions should be given the possibility to use internal sensitivities to conduct the quantitative assessment according to Article 3(1)(b) or to choose the method set out in Article 3(2) of the draft Delegated Act (materiality assessment using SA-CCR add-ons).

Q3. Do you have any views on the appropriateness, for smaller institutions, of the alternative SA CCR add-ons approach (Article 3(2)) in overcoming the issues (if any) raised by the general FRTB SA sensitivities approach?

First of all, the EBF supports the idea that an approach is available for banks that do not use sensitivities.

Second, the EBF asks EBA to confirm that the conditions set out in Article 94(1) of Regulation (EU) No 575/2013 or in Article 325a(1) of Regulation (EU) No 2019/876 and in Article 3(2) of the draft Delegated Regulation, can be applied to credit institutions that are independent or the subsidiary of a large banking group.

Q5. Which one of the three options (option 4a: 1 bp, option 4b: 0.1% or option 4c: 1%) do you think is more appropriate as a threshold? Please provide the rationale for the chosen option.

The EBF agrees with the EBA assessment that it would be preferable to set the threshold at a level where the distortions are reduced to a minimum, which is, as stated by the EBA, in line with the objectives of the BCBS. Therefore, the threshold should be set as low as possible (1bp).

However, the EBF would also like to emphasize that the impact of the different thresholds varies from bank to bank and depends on several factors, such as the directionality of the relevant portfolio. Therefore, the EBF's recommendation to the EBA would be that the EBA should reassess the impact of the various options based on additional examples and decide on this matter once the assessment has been concluded. The industry would be available for further exchanges on the topic.

Q7. Do you consider necessary an adjustment to the supervisory volatility parameter σ as defined in Article 5? In the case an adjustment is considered necessary, how should it be carried out?

In the response to the EBA discussion paper titled "Implementation in the European Union of the revised market risk and counterparty credit risk frameworks"[6], the EBF has noted that some problems could arise from introducing the λ shift into the formula. Therefore, the EBF would like to restate its preference for slightly adjusting the supervisory volatility parameter σ as follows:

> *When assuming that (R+λ) is log-normal (instead of R in the initial formula) we should introduce σ' defined as follows:*
> *We consider that (dR/R+λ) = σ' dW instead of (dR/R) = σ dW, we can then deduce that σ * R* dW = σ' * (R+λ) * dW, which means that σ in the formula should be replaced with* $\sigma' = \sigma * \frac{R}{R+\lambda}$

However, the EBF is aware that the calculation of the supervisory delta has already reached a situation where it is highly complex. Adjusting the volatility will therefore increase complexity. The new EBA proposal to set the supervisory volatility at 50%, which was not present in the earlier EBA discussion paper, is a welcome contribution to current discussion, because it would help to reduce complexity. Consequently, in order to minimize the operational burden on banks, the EBF proposes that banks should be free to apply the abovementioned proposal for adjusting the supervisory volatility or a fixed 50% supervisory volatility.

Q8. Do you think the specified method for determining whether a transaction is a long or short position in a material risk driver is adequate? If not, please provide an explanation.

The method proposed by EBA for determining whether a transaction is a long or short position in the primary risk driver or in the most material risk driver in a given risk category shall allow the qualitative approach set out in article 6(b) for transaction where the classification is done using article 1. As a consequence, the EBF suggests the removal of the following part of article 6(b) of the draft Delegated Regulation: "where institutions apply the approach set out in Article 3(1)(a)" or an amendment stating the following: "where institutions apply the approach set out in Article 1, Article 3(1)(a) or Article 3(2)." This is needed to reflect the different possibilities of conducting mapping that are proposed in the draft.

[6] Please see EBA-DP-2017-04 (https://eba.europa.eu/-/eba-publishes-discussion-paper-on-eu-implementation-of-the-revised-market-and-counterparty-credit-risk-frameworks)

About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.1 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

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