FÉDÉRATION BANCAIRE FRANÇAISE

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FBF RESPONSE TO EBA CONSULTATION PAPER ON DRAFT REGULATORY TECHNICAL STANDARD ON SA-CCR UNDER ARTICLES 277(5) AND 279a(3) OF PROPOSED AMENDED REGULATION (EU) No 575/2013 (EBA/CP/2019/03)

I- General comment

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, i.e. more than 340 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 340,000 people in France and around the world, and serve 48 million customers.

The FBF welcomes the opportunity to comment on the EBA's Consultation (EBA/CP/2019/03)[1] on Draft Regulatory Technical Standards (RTS) 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 (SA-CCR) under Article 277(5) and Article 279a(3) of proposed amended Regulation (EU) No 575/2013. Please find detailed feedback within our answers to the EBA's questions.

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

II- Answer to questions related to the consultation

Question 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.

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

If one option should be privileged, the FBF considers option 1b as the most appropriate to cover the vast majority of transactions.

Question 2: 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.

FBF answer:

Scope of the approach 1

In the Basel SA-CCR text[2], derivatives are mapped to the asset class of its primary risk driver[3]. 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[4]. Only those complex trades designated by supervisors are to be map to more than one asset class.

In the consultation paper, it is said [draft RTS EBA/CP/2019/03, Recital (1)] 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).

Transactions with a different currency between settlement and underlying:

Where the sole reason for applying approach 2 is because 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.

[2] Please see : https://www.bis.org/publ/bcbs279.htm
[3] Please see BCBS 279 Article 151
[4] Please see BCBS 279 Article 152

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

Cases where the use of approach 2 leads to the determination of two material risk categories are rare. It should 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 (IR) 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 cross-currency swaps as foreign exchange contracts[5]. Annex II of Regulation (EU) 575/2013 also classifies cross-currency swaps as Foreign-exchange contracts.

When applying the approach 2 to all cross-currency swaps (i.e. at product level), FX delta risk in the 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 among cross currency swaps 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 consider it appropriate to systematically double the exposure amount in this case. Where it can be demonstrated for well identified products that their risks are lower than those of other products with identical primary risk driver, they 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 force banks to increase the price for clients of such products and may, eventually, deter some to hedge their FX risk. This is even more relevant for European end users given that most international transactions are denominated in US dollars.

Considering all those facts, we propose to include cross-currency swaps within the Article 1 of the draft RTS EBA/CP/2019/03. Exposure for this vanilla product would be the same for every institution and it would ensure a level playing field.

Significant risk category determination in approach 2

First of all, the FBF 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 the trading book instruments, whereas counterparty credit risk (CCR) is broader, covering banking book instruments as well. According to the draft RTS, institutions that do not meet the conditions set out in Article 94(1) or Article 325a(1) of

[5] Please see BCBS 279 Article 162 Footnote 14

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 calculation;

- Or, alternatively, they apply the method set out in Article 3(1)(a) of the draft RTS 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 fallback 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 RTS (materiality assessment using SA-CCR add-ons).

Question 3: 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?

FBF answer: We ask EBA to confirm the conditions set out in Article 94(1) of Regulation (EU) No 575/2013 or in Article 325a(1) of Regulation (EU) 2019/876 and in Article 3(2) of the draft RTS apply whatever the credit institution is independent or the subsidiary of a large banking group.

Question 4: Do you think the approach outlined here should be applied at currency level (option 3a) or transaction level (option 3b)?

FBF answer: For more consistency at the international level and according to the Basel standard, institutions shall calculate the shift (λ) for any call and put options at the currency level (option 3a of Article 4(2) of the draft RTS). Nevertheless, we call for the introduction of a review clause if other jurisdictions favor another option.

Shift at currency level offers consistency across the portfolio, but may suffer from a threshold effect for options with a negative strike. As such, only one transaction may impact the exposure for the whole portfolio. Lambda calculation should be decomposed in a global shift at currency level that depends only on market conditions (i.e. does not depend on strikes K_j), and a shift at transaction level that incorporate a backstop in case that the shift is not sufficient.

$$\lambda_{transaction} = \max\left(\lambda_{currency}; threshold - K_{transaction}\right)$$

$$\lambda_{currency} = \max\left(threshold - \min_{j}\left(P_j\right); 0\right)$$

Question 5: 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.

FBF answer: No comment.

Question 6: Please provide examples of cases where the possibility to set the shift λ according to the prevalent market conditions (option 4) might:

- Provide some benefits
- Raise some concerns

FBF answer: No comment.

Question 7: 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?

FBF answer: No comment.

Question 8: 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.

FBF answer: 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. The FBF suggests the removal of the following part of Article 6(b): « *where institutions apply the approach set out in Article 3(1)(a)* ».

Additional points:

Clarification that interest rates for the purpose of discounting is not a material risk driver when identifying transactions with only one material risk driver: The "*Background and rationale*" section of the consultation paper clearly states in points 12 ("*disregarding interest rates for the purpose of discounting*") and 21 ("*discounting is disregarded as a potential risk driver*") that in order to assess whether a transaction has only one material risk driver, interest rates for the purpose of discounting should not count as a potential risk driver. However, Article 1 of the proposed regulation does not states this as clearly ("*risk factors on which the cash flows of the transaction depend*"). We believe it would be beneficial for all stakeholders to clarify this point by amending Article 1(1)(a).