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Consultation response

Joint response to European Banking Authority (EBA) consultation paper on the definition of materiality thresholds for specific risk in the trading book under Article 77 of Directive 2013/36/EU (EBA/CP/2013/33)

1 October 2013

AFME[1] and ISDA[2] welcome the opportunity to comment on the European Banking Authority (EBA) consultation paper on the definition of materiality thresholds for specific risk in the trading book under Article 77 of Directive 2013/36/EU (EBA/CP/2013/33).

We highlight below a number of overarching issues regarding the Paper and then respond to the EBA's questions regarding the thresholds.

Introduction

Overall industry views

The Industry welcomes the EBA draft RTS proposals, and is supportive of the overall aim to avoid firms risk-managing their debt portfolios based on capital requirements according to the standardized approach. However, the industry is concerned that the rules apply to firms that manage their market and credit risk exposures on internal models, which would counter the objectives of the CRR. Additionally, there may be a regulatory requirement for an IMM firm to calculate its capital requirements for a particular portfolio based on the standardised method. This may be due to, for example, the portfolio containing securitisations that the firms must calculate the capital for

[1] AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76. For more information please visit the AFME website, www.afme.eu.

[2] Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 60 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

based on the standard approach. The industry recommends that such portfolios, and more widely firms that have approved IMMs, should be exempt from the specific risk in the trading book calculation. We kindly ask the EBA to confirm that this is the intention.

Secondly, the industry believes that an absolute materiality threshold may be problematic for smaller wholesale banks, such as subsidiaries of overseas banks, that hold the majority of their liquid asset buffer securities in their trading books. This is as under the new EBA liquidity regime, firms are required to hold a large amount of high quality assets to cover their outflows/liabilities. Some of those assets are rated by multiple credit rating agencies as CQS1, but since the EBA does not propose to use a risk-weighted approach, a lot of those assets will be caught under the proposed thresholds.

The implementation of internal approach based on small materiality thresholds, bringing many smaller firms into scope, would create a significant additional cost burden for these smaller firms. The implementation of an internal model and its subsequent approval by the regulators is a time-consuming process for firms which are already in the process of implementing CRD IV from 1 Jan 2014. This will also further distract firms from implementing the COREP reporting.

Finally, we feel that the EBA should take into consideration that thresholds can be breached due to temporary spikes in trading activity and provision should be made for accommodating for such temporary breaches of the threshold. Rather than one breach of the threshold triggering an evaluation, a number of breaches over a period of at least three months should be required before an evaluation by the competent authorities is triggered. If repeated breaches over this three-month period take place, then the requirement should be to implement the internal approach over a three-year phasing-in period which we consider will be give firms sufficient time to assess relevant needs, requirements and determine approval.

Responses to consultation paper questions

Question 1: Do you agree with the use of an absolute materiality threshold?

Response: The industry believes that an absolute materiality threshold may be problematic for smaller wholesale banks, such as subsidiaries of overseas banks that hold the majority of their liquid asset buffer securities in their trading books. However, we do not oppose the thresholds conceptually, if this proportionality issue is taken into account in the calibration of the thresholds (as proposed in our answer to the second questions).

Question 2: Do you agree with the proposed values for (i) overall specific risk and (ii) significant number of (iii) material exposures? If you believe the values are inappropriate, please provide some rationale and alternative values.

Response: Considering the liquidity requirements in the LCR, and more specifically the requirement for a material portfolio of liquid assets, we would suggest increasing the proposed thresholds to avoid capturing these portfolios in small banks with limited trading activity. This is to avoid consequently creating unnecessary operational and financial burden that would be disproportionate to such banks. We propose the following thresholds:

a. Sum of net longs and net short positions should be greater than Euro 10bn rather than Euro 1bn; and
b. Each position greater than Euro 10mn for 200 positions rather than Euro 2.5mn for 100 positions.

Alternatively, the thresholds can be kept as proposed by the EBA but liquid asset buffer securities held in the trading book should be exempted from the measure.