# Response to the EBA consultation on draft RTS and draft ITS on benchmarking portfolios

ESBG welcomes the opportunity to react to the consultation launched by the EBA on draft Implementing Technical Standards (ITS) and Regulatory Technical Standards (RTS) which aim to specify the EU framework for the conduct of annual supervisory benchmarking of internal approaches for calculating own funds requirements for credit and market risk exposures (RWAs) (EBA/CP/2014/07).

**The responses to the questions submitted with the consultation paper are as follows:**

**Q2. Do you consider that the benchmarks outlined in the RTS are sufficiently proportionate and flexible? Do you have any alternative benchmark proposals? If yes, please provide details.**

ESBG considers that the benchmarks proposed are largely unsuitable for the purpose described; there is a set of criteria which good benchmarks must fulfill, among them (i) clarity of definition and uniqueness, and (ii) stability in time over several benchmarking cycles, at least.

RTS Art. 3 (2a) violates criterion (i) unless the absolute maximum and minimum of the sample are implied by the term "extremes". RTS Art. 3 (2b) violates criterion (ii) in that the same number of portfolios (resp. models, resp. banks) will be subject to increased scrutiny and specific supervisory assessment in every benchmarking cycle, no matter what changes were implemented by banks as a result of the preceding benchmarking cycles.

To solve these issues, **ESBG proposes two changes to the RTS Art. 3 (2a) and (2b):**

- RTS Art. 3 (2a): Replace the ill-defined term "extremes" by "outliers". This term is defined in statistics, and there are easy operational procedures in descriptive statistics to detect evidence for outliers (cf. below). Moreover, we are convinced that an outlier – a data point a significant distance away from the body of a sample distribution – is a valid target for an assessment by supervisors, indeed.
- RTS Art. 3 (2b): Replace the metric of the first and fourth quartiles by the metric of outliers as identified by Box plots. A Box plot will display stability in time when most of the changes induced by the benchmarking procedure are in the outlier portfolios but will adjust moderately when a large fraction of the portfolios evolve in time.

Specifically, in the standard implementation of Box plots,
 - a uniform distribution displays no outliers,
 - a normal distribution displays rare outliers on both sides

- a symmetric fat-tailed distribution displays frequent outliers on both sides, and
- a skewed distribution displays frequent outliers on one side only.

Most importantly, however, we believe that the metrics proposed in the RTS are inconsistent with Art. 78 (5) of the Directive 2013/36/EU.

**Q3. What limitations do you see in relation to the use of the proposed benchmarks, i.e., (i) first and the fourth quartiles; (ii) comparison between own funds under the internal models and the standardised approach; and (iii) comparison between estimates and outturns?**

(i)      The main limitation ESBG members see with the first and fourth quartiles is their stickiness on the sample distribution which is inconsistent with the idea of benchmarking. A solution is outlined in the answer to Q2.

(ii)     The calculation of a standardised approach is a labourious and costly procedure and should be avoided. With respect to benchmarking it is based on the unproven hypothesis that internal models and the standardised approach evolve in line from bank to bank and from NCA to NCA. Unless the variability of the standardised approach is understood in some depth, it will obscure benchmarking rather than support it.