

**ABI response to the EBA  
Consultation Paper on the  
  
Draft Guidelines  
on the Incremental Default and  
Migration Risk Charge (IRC)  
(CP 49)**

January 2012

## General remarks

The Italian Banking Association (ABI) welcomes the opportunity to comment on the EBA Consultation Paper on the Draft Guidelines on Stressed Value at Risk (Stressed VaR).

ABI strongly supports initiatives contributing to an effective level playing field and, for this purpose, considers it of the utmost importance to enhance the convergence of supervisory practices among the competent authorities across the EU.

The following remarks on general issues and specific provisions within the draft Guidelines are intended to be helpful in this context.

As a general matter, the timing of publication of the Guidelines gives rise to some concerns since Directive 2010/76/EU has already entered into force.

In fact, at the time of publication of the draft Guidelines, institutions using an Internal Model Approach (IMA) for the purpose of calculating the capital requirement for market risk in the trading book (a) had already implemented their Stressed VaR methodology and procedures in order to comply with the forthcoming Directive, or (b) implementation by them was at an advanced stage and the approval procedure was already underway.

In both cases, the timing of publication of the Guidelines implies modifications and costs that would not have been necessary had the Guidelines been published much earlier.

As such, we urge attainment of a higher level of coordination among the competent EU supervisory authorities. This would avoid similar mismatches in the timing of publication of regulations and allow the institutions concerned to implement them in a straightforward manner.

We hope that the publication of these Guidelines after the entry into force of the related regulations will represent an exception to EBA's normal practice.

Specific comments and requests for changes in the text of the draft Guidelines are presented below.

## Specific comments

### A. Scope of application

The scope of application of the IRC should be clarified with reference to the following aspects.

**Point 4.2.iv.** Where application of the look-through approach is not possible, the treatment of positions in the shares of collective undertakings (CIUs) is not clear. In ABI's opinion, it should be clarified that these positions are excluded from the scope of the IRC model.

In particular, we propose modifying point 4.2.iv. as follows: "positions resulting from the application of the look-through approach to the shares of collective undertakings (CIUs), when such positions, if they directly belonged to the trading book, would be included in the calculation of the IRC. Where application of the look-through approach is not possible, these positions shall be excluded from the scope of the IRC model".

**Point 5.2.b.** Clarification is needed concerning positions in asset-backed securities where cash flows from the underlying pool are allocated to securities holders on a pro-rata basis, but inclusion in the IRC model is not allowed. In ABI's opinion it should be specified that no charge is calculated for these positions.

**Paragraph 6.3** An issue arises in relation to the treatment of exposures to equity positions.

The draft Guidelines specify that "Notwithstanding the inclusion in the IRC of positions in listed equity or in derivative instruments based on listed equity, a specific risk capital charge for these positions – capturing event risk in the case of the use of an internal model – must still be calculated."

Clarification is needed about the provision of a specific risk capital add-on for such positions, given that its content is not clearly specified in the text. If this sentence refers to the specific risk charge already included in the internal model calculations, the reference to such capital charge should be made more explicit. It is worth mentioning that, following introduction of the IRC, all specific risk surcharges have been removed.

**Paragraph 7.1** An outstanding issue relates to the treatment of exposures to debt issued by other legal entities in the same group, where IRC is calculated on a stand-alone basis.

The proposed Guidelines specify that "Where IRC is calculated on a stand-alone basis (single entity basis), exposures to legal entities in the same group, where the group is not subject to supervision on a consolidated basis, or where the group is subject to supervision on a consolidated basis but the relevant entities are not included in the scope of consolidated supervision, should not be treated as own positions."

Clarification is needed to make it unequivocal that when different legal entities in a consolidated group calculate IRC on a stand-alone basis, they shall nevertheless treat their exposures to the other legal entities in that group as “own debt” (included within the scope of the IRC model, but taking into account only migration risk). The consolidated requirement can then be obtained as the sum of the standalone requirements.

In other words, it should be made clear that “supervision on a consolidated basis” does not refer to supervision of the IRC models but to inclusion in the scope of application of the consolidated capital requirements.

To this end, ABI proposes modifying paragraph 7.1 as follows: “Where IRC is calculated on a stand-alone basis (single entity basis), each legal entity shall treat as own positions the exposures to all other legal entities in the same group that are included in the scope of consolidation for the purpose of calculating consolidated capital requirements. ~~where the group is not subject to supervision on a consolidated basis, or where the group is subject to supervision on a consolidated basis but the relevant entities are not included in the scope of consolidated supervision, should not be treated as own positions.~~”

**Paragraph 7.3** Confirmation is required that the absence, among the examples of long positions in the institution’s own debt, of positions arising from selling protection on the institution’s own name is a mere oversight.

### C. Interdependence

On the topic of correlations between default and migration events, paragraph 13.2 requires institutions to “use a time horizon for correlations between default and migration events of different obligors that is consistent with the chosen liquidity horizon (or capital horizon where an institution assumes a “one-year constant position”) of their positions within IRC”.

The rationale for this provision is not clear, since it probably refers to the use of a transition matrix based on a period that is consistent with the capital/liquidity horizon.

Moreover, it is not clear how institutions that determine their liquidity horizon at a product level should implement the above provision.

Therefore in ABI’s opinion paragraph 13.2 should be deleted.

### F. General matters

First, confirmation is required that point 28.1.ii. and paragraph 28.4 are equivalent (thus one is redundant and can be deleted). Otherwise, clarification is needed as to the different meanings of the two provisions.

Additionally, with regard to the frequency of the IRC calculation, paragraph 29.2 of the draft Guidelines states that "The institution shall be able to prove that, on the day of the week chosen for IRC calculation, its portfolio is representative of the portfolio held during the week and that the chosen portfolio does not lead to a systematic underestimation of the IRC numbers when computed weekly."

Since the trading book is by definition very changeable, such proof could only be provided by calculating IRC daily. However, Directive 2010/76/EU does not require the daily calculation of IRC.

Hence ABI considers it necessary to delete paragraph 29.2.