CORPORATE MARKET RISK MANAGEMENT

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European Banking Authority

Department
MRMB Trading
Location
ALP B03.081
Reference
EBA CP 48, EBA CP 49

Subject
Response to EBA Consultative Papers 48 and 49

Date
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Dear Sir / Madam,

With this letter we would like to take the opportunity to respond to the European Banking Authority (EBA) Consultative Papers 48 on Stressed Value at Risk (Stressed VaR) and 49 on Incremental Default and Migration Risk Charge (IRC).

In general, we highly appreciate further guidance provided by the regulators to create transparency and a level playing field. Please see below our comment regarding specific items raised in the consultation documents. We also fully support the industry response to these consultation papers as written by ISDA and AFME.

Stressed VaR (CP 48)

Page 10, section A 5, point 2

For an international bank with many legal entities, the requirement to identify and calculate a separate Stressed VaR period for each legal entity puts a burden on system capacity, especially for institutions that calculate their Stressed VaR using full revaluation. Furthermore, we wonder how this requirement relates to the use test requirement. Will local entities be required to monitor Stressed VaR based on both the global and the local period?

IRC (CP 49)

Page 15, section C 13, point 2
Institutions are required to use a time horizon for correlations (…) that is consistent with the chosen liquidity horizon. Depending on the methodology used to estimate correlations, we think that the amount of information available is insufficient to adhere to this requirement.

Page 15, section C 14
The guidelines require the analysis of different copula assumptions and the justification of the choice of a particular copula. In this context, we question how the final assessment should be made choosing between the different copulas, given the extreme tail event of the IRC. We request more regulatory guidance with respect to this topic.

Page 16, section C 15, point 2
The requirement is stated that systemic risk factors should be continued over the capital horizon. We question how this relates to the constant level of risk assumption: if the systemic risk factor is negative at the end of the first horizon, the next liquidity horizon will likely be more negative (or less positive) at the end of the next horizon if not refreshed. This means the risk of more downgrades/defaults will be higher in the next period, which is inconsistent with the constant level of risk approach.

Furthermore, not refreshing the systemic risk factor leads to correlation between time periods which can cause issues with assumptions taken in the matrix scaling.

Page 17, section C 17, point 2
It is expected that institutions shall develop one (…) transition matrix that is specific to sovereign obligors. We question the consistency of this requirement due to two reasons

1) Ratings are set based on an expected PD level, irrespective of the region or sector. Looking back, however, migrations and defaults can be concentrated in certain sectors or regions. Given that ratings are set based on expected PD we think this would be better reflected via correlations and/or a multi-factor model than via the ratings and transition matrices.
2) The reliability of a separate sovereign matrix would suffer from a very limited number of observations, and various transitions will have a probability of zero.

Page 18, section C 17, point 4
The assumptions regarding the transition matrix shall be back-tested. We would like to receive some further clarification on this requirement. Given the limited amount of information available, especially on short time horizons, we think this requirement may not be feasible.

Page 21, section D 21
The valuation of positions has to be based on currently observable market data. It is not entirely clear what is meant with this. We assume this relates to for example interest rate & foreign exchange data. However in other sections it is clear that credit spreads (and PD/LGD) can be based on through the cycle data, which could be seen as inconsistent with this requirement.

Sincerely,

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