To:	EBA dist		From: Jonny O'Connell, Head of Valuations & IPV Assurance
Re:	EBA DP 2012/3 Response		Date: January 25, 2013

Q1. Do you believe that a proportionality threshold should be considered before requiring an institution to assess the prudent value of all fair value positions? If yes, how would you define the threshold?

We have no firm opinion on this matter. It ought to be incumbent on all institutions to be able to calculate the prudent valuation of their inventory unless it can be demonstrated that no AVA would result by definition.

Q2. Do you agree that the exit price used as the basis of prudent value does not necessarily need to be based on an instantaneous sale? If yes, provide argument to support your view.

Earliest sale within the prevailing market environment for that product or risk should be the basis for calculation. There are some product types which would require a period of negotiation prior to execution of agreement. If there is a normal period for this to occur, this should be the basis.

If time is a potential detrimental factor in exit, this ought to be incorporated into fair value in any case. Moving the market price is more likely to be a factor of size and concentration of position as a proportion of the liquidity rather than time to sale.

Q3. Should a specific time horizon for exit be set when assessing the prudent valuation? If so, how the time horizon should be set (e.g. the same time horizon for calculating Value-at-Risk (VaR), Credit Risk Capital Requirements, etc.), what should it be and how would it feed into the calculating of AVAs?

It is reasonable for a time horizon to be incorporated but as a guideline, exceptions should be allowed for certain types of product. The key is exit achievement not exit achievement in certain time horizons. Risks involved in time retention are covered by other measures e.g. VAR rather than price uncertainty. See above point in Q2

Q4. Do you support the concept of a specified level of confidence to determine AVAs? If not, why? Are there any AVAs where the use of a specified level of confidence is not appropriate?

Generally, we support a defined confidence level for AVA's calculated on Level 1 and Level 2 instruments. We have no firm opinion on the level used although 95% appears to be very prudent, a level of 90% would appear more appropriate in our view.

For AVA's using non-observable data or for Level 3 instruments whilst a defined confidence level as a is useful as a target, we do not expect it to be very useful if there is to be mathematical analysis is required to demonstrate compliance with a specific level.

Q5. If you support a specified level of confidence, do you support the use of a 95% level of confidence? What practical issues might arise or inconsistencies with other parts of the CRR when using this level of confidence?

See Q4

Q6. How prescriptive do you believe the RTS should be around the number of data points that are required to calculate a 95% level of confidence without any more judgemental approach being necessary?

See Q4: We believe judgement should not be circumscribed by pre-defined criteria where not appropriate.

Q7. If you support a specified level of confidence, do you support the explicit allowance of using the level chosen as guidance for a more judgemental approach where data is lacking?

Any incorporation of a pre-defined confidence level whether as guidance or as a requirement would not be helpful where more subjective considerations are applicable.

Q8. Should any additional possible sources of market prices be listed in the RTS?

The Discussion paper states 'including but not limited to when listing sources. This is sufficient to allow for other sources.

Q9. Should more description be included of how to use the various sources of market prices to obtain a range of plausible prices?

We believe that local supervisors should be able to assess and be competent enough judges of the appropriate usage of sources.

Q10. Should the RTS be more prescriptive on how to use the various alternative methods or sources of data to obtain a range of plausible prices where there is insufficient observable data to determine the range by direct statistical methods? If so how?

As with other cases of judgement, it would be folly, in our opinion to prescribe methodology for such a broad and diverse range of what are often unique positions. There is cause for principles and guidelines however these are already in place.

Q11. Are there any other indicators of large market price uncertainty which should be included?

The location and expertise available in the location of the calculation may be an additional factor. Whilst communication between locations is an improved element of modern day practice it is still considered to be a risk factor by regulators. This concept also extends to the availability of local expertise and dialogue within the Financial Centre at hand. It is almost inconceivable to believe that practitioners in a remote outpost or in a state with little Financial Market activity would be as aware of all current and relevant market related issues used in compiling valuations as practitioners with greater access to intra-firm discursive activity.

Q12. Do you believe the approaches set out above are appropriate for each of the adjustments listed in Article 100? If not, what approaches do you believe would be more relevant?

Overall, this is reasonable although Future admin costs be more feasibly calculated on a less granular level such as trade type / maturity rather than at position level. In addition, Model risks ought to be incorporated into Fair value (unless the product is liquid in which case its seems irrelevant).

The inclusion of 'voluntary' adjustments such as early termination is also problematic. As these are in ALL cases uniquely attributable to an unforeseen and unpredictable decision it does not seem appropriate as they are logically only operated with a view to securing profit at some point.

A bank would not give these if acting in a prudent fashion and if it did, it would expect some form of an unforeseen but nevertheless superior quantum of compensation.

Q13. Are there any other material causes of valuation uncertainty that the RTS should describe an approach for? Or are any of the adjustments listed above not material and should not be included?

We would not rule out anything on the grounds of materiality

Q14. Do you believe that the testing approach in Annex 2 represents a useful tool to test for prudence of valuation? If not, what weaknesses make it unsuitable?

Besides from the potential costs of disentangling IPV discovery from trade discovery (especially where risks are tested to parameter for IPV purposes but recorded at instrument level for transaction purposes), there are also some fundamental flaws in this approach. Not least of all being the effect that market volatility would have in destroying any usefulness of this approach. Markets move, and can move fast, this does not make for comparing valuations and transaction prices in an automated fashion very productive at all.

Q15. Do you believe that the RTS should be prescriptive with respect to validation techniques? If not, how do you believe that comparable levels of prudence should be ensured for the valuations across institutions? Are there other validation techniques that you believe should be detailed in the RTS?

We strongly believe that local supervisors are in a better position to recommend and monitor the sufficiency of firms' validation techniques and the requirements they may have. Back testing for Valuation uncertainty is not as feasible as in other statistical measures given the largest element in distance between valuation and trade execution is market movements which can not be easily attributed in each individual case.

As such we believe a regulator driven 'tarriff' approach may be more appropriate. That is, certain trade types should be expected to contribute to maximum levels of 'New or exit' P&L within P&L attribution systems and firms should ensure their overall prudential valuation and P&L attributions meet these expectations.

Q16. Do you support the concept that prudent value can never be greater than fair value including fair value adjustments at both the individual position and the legal entity level? If not, what would be the reason to justify your view?

We support this concept

Q17. Would you support the availability of a diversification benefit within the aggregation of position-level AVAs? Please explain the reasons and justification why, providing any evidence available to support your arguments

Diversification benefit is common sense. Its absence is literally nonsense. Without diversification or correlation benefits not only would valuation uncertainty be treated differently than most other risk measures but also firms with more refined and granular processes could be punished more than those with less refined control procedures.

It is inconceivable that when applying a potential uncertainty to correlated parameters that they would all move in opposite and adverse manners. This is illogical.

Q18. If simple aggregation better reflect your assumptions and practices or would you support the availability of diversification benefit, do you support creating a simplified standard approach, an example of which is shown in Annex 4? If you do, do you have alternative suggestions on how this standard approach should be specified? Are the suggested correlations in the example appropriate, if not what other values could be used?

We think that standard approaches may have some use as guidelines however we believe that they should not be limiting or prescriptive. The correlation guidance may be a reasonable starting point however it is superior to agree correlations that differ according to market and risk types and as such in-house approaches agreed between firms and competent authorities are preferred.

Q19. If you support the availability of diversification benefit, do you support allowing an in-house approach which should be subject to approval by the regulator, an example of which is shown in Annex 4?

See Q 18

Q20. Would you agree that offsets against AVAs for overlaps with other Pillar 1 capital requirements should not be permitted? If not, what offsets might be appropriate and under what conditions might they be allowed (e.g. individually assessed by the institution and agreed with the regulator rather than specified in the RTS)?

Valuation Uncertainty is a different aspect of risk than other forms of uncertainty. As such no overlaps should be considered with regards to Capital. However we re-iterate that there are very material offsets between risk volatility and measuring uncertainty between mtm and executed trades which is why the testing procedures referred to in Annexe 1 are inherently flawed)

Q21. Do you believe the above requirements are appropriate? If not, what other requirements could be necessary and what requirements stated above are considered not to be relevant?

We support most of the above requirements and feel that they ought to be standard as part of any valuation (prudential or otherwise). There are however some areas where it may not be practical to produce standardised Cross market thresholds e.g. linkage of attribution to IPV.

Q22. What would be the sources of costs and benefits of requiring (a) the implementation of a unique AVA methodology and (b) a consistent format for reporting AVA? Do you agree that the benefits of such requirements outweigh the costs associated with them?

This is dependent upon the costs as a proportion of the risk. There is a strong case that there may be considered levels of calculation uncertainty precision where greater degrees of AVA may be opted for using a more prudent, standardised method rather than invoking greater cost to arrive at a less prudent albeit more precise measure. Firms should have the option of applying a standard, prudent measure by certain risk types (satisfying the local supervisor that it is appropriate) rather than going to great costs and lengths to calculate a more precise but nevertheless still not definitive calculation.

Costs associated with testing and analysis should be a matter of judgement for firms and supervisors rather than be too precise especially given the inherent flaws of any standardised method.

Q23. If you agree with a reporting form being introduced, could you please provide a suggested template?

No firm opinions. The current FSA template is sufficient