Nederlandse Vereniging van Banken

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Via DP-2012-03@eba.europa.eu

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Regards: NVB reaction to EBA discussion paper on prudent valuation under Article 100 of the draft CRR, EBA/DP/2012/03

Dear Sir, Madam,

On behalf of the Dutch Banking Association[1] (NVB) I would like to thank you for giving us the opportunity to react to the discussion paper on prudent valuation. The importance of correct and prudent valuations was clearly underlined during the financial crisis. In this letter, we will provide our feedback to the discussion paper and address our main concerns.

Firstly, we like to point to the fact that article 100 is included in Chapter 3 “Trading Book” of the CRR. In our view, it would be inconsistent to put positions outside of the trading book in scope of the RTS, as it is to provide more details on the application of article 100. In case positions outside of the trading book would be included in the scope, we foresee that institutions will be confronted with additional accounting complexity, which we hope is not the objective of Article 100 of the draft CRR. For example, institutions that have considered or are considering the fair value option instead of fair value hedge accounting under IAS 39, could be negatively affected from a regulatory capital point of view.

Secondly, and a major concern, is that the proposal would result in the introduction of two different fair values. The first being the IFRS or GAAP fair value and the second one being a fair value for regulatory purposes. We believe there should only be one fair value. Introducing two fair values for the same position could lead to confusion, and complicate balance sheet- and risk management. We believe that the objective to assess an exit price under IFRS13 and article 100 of the CRR is the same. Furthermore, applying only one fair value avoids unnecessary complexity, operational burden and execution costs, both to the industry and regulators.

Furthermore, for trading positions accounted at fair value, the exit price as defined under IFRS13 would be most suitable, as it should incorporate all available information at the balance sheet date. Potential future losses that might occur due to changing market prices or parameters after the

[1] The Dutch Banking Association (NVB) is the representative voice of the Dutch banking community with over 90 member firms, large and small, domestic and international, carrying out business in the Dutch market and overseas. The NVB strives towards a strong, healthy and internationally competitive banking industry in the Netherlands, whilst working towards wider single market aims in Europe.

balance sheet date are to be capitalised for via the risk management capital requirements of the bank. This would be a combination of Value-at-Risk, stressed Value-at-Risk and the Incremental Risk Charge. A prudent valuation should cover the pricing uncertainties mentioned in article 100 such as model uncertainty and market price uncertainty. From that perspective, we support the EBA approach to give additional guidance for situations not foreseen in IFRS13. We would, however, like to have it embedded directly in the pricing methodology instead of having an additional valuation adjustment. This way, the same principle of prudent valuation is adhered to, but in a less complex and costly manner.

To achieve this, we suggest taking the fair value as defined by IFRS13 as the starting point. In case EBA considers the fair value definition and the application guidance of IFRS13 as insufficient or not explicit enough for regulatory purposes, we prefer that EBA would inform the sector where IFRS is not prudent and provide guidance that banks can use to draft a prudent valuation policy. Having EBA guidance would also promote the level playing field. When drafting the details of how article 100 should be applied, EBA could give guidance about the procedures and process. This guidance could state for which positions additional capital requirements would be needed, in accordance with the items mentioned in article 100, paragraph 11 of the CRR of May 2012. It could also state to which extent these requirements need to be discussed with and agreed by the competent authority.

We would also ask EBA to consider the regulatory updates that have already been applied to the trading book capital requirements (often referred to as Basel 2.5). These changes already take into account the impact of a potential decrease in the fair value after the balance sheet date. The effects of Basel 2.5 should be included. In any case, prudence in valuation (at balance sheet date) and future price changes (after balance sheet date) are and should remain mutually exclusive.

In closing, we propose to use one definition of a fair value, based on the exit price used in IFRS13. In cases where research uncovers improper coverage of risks in the combined finance and risk management domains, EBA should propose additional guidance for the trading book regulatory capital calculation to resolve the issues. The industry is standing ready to work with EBA to formulate detailed guidance for those cases, ensuring proper coverage of risks, and allowing for a comparable implementation across Member States.

Given the above, we did not answer the specific questions, as many of those loose their relevance if there were only one fair value. Please do not hesitate to contact me via holdtgrefe@nvb.nl in case you have questions or remarks based on our reaction, or if you would like to receive additional information.

Kind regards,

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