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FRENCH BANKING FEDERATION RESPONSE TO EBA CONSULTATION PAPER WITH REGARD TO SUPERVISORY BENCHMARKING FRAMEWORK FOR 2020

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

The FBF welcomes the opportunity to share its comments on the EBA's consultation paper with regard to benchmarking of internal models for credit risk and market risk.

The FBF reiterates its support for a stable and resilient global financial system, while facilitating economic growth. To this end, while supporting the EBA's initiative on benchmarking of internal models, we believe that the proposed consultation paper (EBA/CP/2018/16) raises some concerns and requires some clarification. In our view, it is essential that regulators and the industry engage in proactive discussions to ensure a high level of confidence in the output of such benchmarking exercises.

Summary of key comments:

- We welcome the will to simplify the exercise. Also, in doing so, we suggest that the EBA sticks to the conclusions made in the "EBA Report – Results from the 2018 low and high default portfolios exercise" as to stabilise reporting definitions which will ease the comparisons across time in a consistent way ("for future exercises, and with the benefit of a stable sample of institutions and clearer reporting definitions, more emphasis on comparisons across time will help to gain additional insight as to whether convergence in modelling practices is taking place as a result of the EBA review of internal models.").

Please find below our detailed feedback.

I- Credit risk

Question 1 for consultation: Is the risk type split a significant burden for your institution (for LDP/HDP)? Are there level 2 portfolios for your institution, for which the deletion of the split into counterparty credit risk (CC) and credit risk (CR) would lead to the loss of information that is relevant for the benchmarking of internal approaches applied to that exposure class?

- ✓ **Answer:**

We welcome the deletion of the split into counterparty credit risk (CC) and credit risk (CR). Such modification simplifies the templates and will be easy to implement.

Question 2 for consultation: Do you agree with the introduction of a new template C105.04 (concerns only columns c010 – c068) in order to replace the reporting of "empty" rating portfolios" or do you envisage any other alternatives?

- ✓ **Answer:**

We are strongly against the introduction of the template c105.04 for several reasons:

- First of all, the template C105.04 introduces a granularity in the analysis of PD-related metrics which is too detailed and not relevant. Risks stemming from such granularity encompass the low volumetry of clusters which makes the analysis of metrics not relevant;
- Information of the template C105.03 is considered sufficient to benchmark metrics related to internal parameters and at the adequate level of granularity (i.e. : model ID);
- The introduction of such template does not simplify the exercise as it will generate heavy work to report it.

We suggest to keep the current reporting: information on the rating scales used by banks is collected through rating grade split in portfolios C102 and C103.

Question 3 for consultation: Do you agree that the combined split of rating and country in template C103 can generally be replaced by a simpler rating split per model (i.e., rating distribution) in template 105, which will cover all models in the scope of the benchmarking exercise (HDP and LDP) without losing explanatory information on the variability of benchmarking parameters? Is there any data point collected in the new template 105.04 that involve significant IT costs or burden and should be dropped?

- ✓ **Answer:**

We will reiterate the comments in answer to question 2: the granularity of the template C105.04 is not deemed as relevant. Therefore, the introduction of further granularity will therefore introduce further bias in the interpretation of the template outcomes. We suggest dropping the template C105.04.

Question 4 for consultation: Do you agree that SLE portfolios should be reported in a separate exposure class? Do you agree that the proposed level-2 breakdown on (a) the proposed sectors of counterparties and (b) the proposed types of exposures (i.e. categories of specialized lending) might be relevant components to explain the variability of risk parameters? Which option do you prefer with respect to the rating split under the slotting approach?

- ✓ **Answer:**

We welcome the introduction of a specific exposure class for specialised lending. Our preferred option is option 1. Indeed, we consider that as weighting method in slotting approach to obtain RW is specific to each institution, the definition of RW bucket split will be a challenge to insure level playing field between institutions when benchmarking portfolios

Question 5 for consultation: Do you expect that the LDP sub-portfolio characterized by eligible covered bods will cover a material share of exposure? Do you expect that the separation of these exposures can contribute to explain RWA variability?

- ✓ **Answer:**

We do not consider this sub-portfolio as material to expect separation of these exposures in the reporting.

Question 6 for consultation: Do you think the alternative portfolio split would provide for a higher explanatory power as regards RWA variability induced by differences in CRM usage?

- ✓ **Answer**:

We welcome the alignment of the level-2 break down for LDP and HDP Portfolios to the extent possible.

Question 7 for consultation: Do you expect that the proposed NACE Code breakdown for HDP sub-portfolios will provide more explanation for RWA variability for a material share of exposure? Do you expect that the separation of these exposures can contribute to explain RWA variability in the according HDP portfolios or do you consider the current split using only NACE code F sufficient? Does the selection of a subset of NACE codes significantly reduce the burden of the data collection (compared to a comprehensive collection of all NACE codes)?

- ✓ **Answer**:

The introduction of such granularity of NACE code in the templates will raise the question of the analysis made with this information. So far, NACE code is not deemed as a strong driver of risk differentiation in risk parameters / RWAs. Moreover, there is a volumetry concern over the size of clusters once this NACE classification introduced. Also, each bank has its own business model, which makes it hard to compare banks' portfolio upon sectorial drivers. What would be the rationale to select the mentioned sectors? (Agriculture, forestry and fishing; Manufacturing; Electricity, gas, steam and air conditioning supply; Construction; Wholesale and retail trade; repair of motor vehicles and motorcycles; Transporting and storage ; Real estate activities ; All Other)

Question 8 for consultation: Do you expect that the proposed ILTV buckets for HDP sub-portfolios secured by immovable property will provide more explanation for RWA variability for a material share of exposure? Do you expect that the separation of these exposures can contribute to explain RWA variability in the according HDP portfolios?

- ✓ **Answer**:

The introduction of ILTV as the buckets seem closer to the Basel IV definition which is positive. However, as for the comparison of portfolios induced by such ILTV buckets, we have yet to see if they are relevant. One implementation concern relates to the distinction between commercial immovable property and residential immovable property.

II- Market risk

Question 9 for consultation: Do you agree with the Additional pricing information requested? Please, provided detailed explanation for your answer.

- ✓ **Answer**:

The proposal made by the EBA raises many operational constraints for credit institutions. We have no certainties on the added-value of this update for EBA and competent authorities to improve the accuracy of benchmarking on internal models for market risk. One could mention the high variability of sensitivities between institutions (VAR in currency or VAR converted in EUR, etc.), the different modelling choices made by each institution on the valuation framework or the heterogeneity of Risk factors definitions (one could define a 3M and 6M libor curve and another a 3M curve and a 3M/6M basis spread).
Regarding risk factors, one issue in analysis of results is the different methods for reporting in portfolio base currency. Most banks risk systems calculate VaR in their reference currency. In order to report VaR in a portfolio base currency different from the reference currency, banks need to convert the VaR numbers. Due to system constraints some banks apply straight conversion from the reference currency, which introduces a bias in the values, while some banks take into account the FX risk when converting.
To facilitate analysis by supervisors we suggest adding a methodology question allowing to differentiate between these two populations.

Question 10 for consultation: Do you agree with the simplification introduced in the time setting of the references date for the instruments?

✓ **Answer:**

We agree the change in the time setting of the references date to better capture future instruments.

Question 11 for consultation: Do you have any concerns on the clarity of the instructions?

✓ **Answer:**

As regard the 2019 update of benchmarking templates and instructions, some refinements and clarifications seems necessary:

- Phase 1/Phase 2 perimeter: The booking perimeter should be aligned between phase 1 and phase 2 to facilitate analysis by institutions and supervisors. In particular, we suggest using the same quantities for phase 1 and 2 reporting in order to reduce uncertainty.
- Product perimeter: Term sheet should be established to better define product perimeters. In addition, we propose using booking market standards (for expiries, etc.)
- Fixing: Not to suffer from fixing gaps, it should be clarified what are the rules to define the relevant market close for change and securities fixing.
- Listed instruments: For listed instruments the market exchange and reference of contract should be given.
- Swaps: For swaps, market convention is to book the swap with a spread on the floating leg so that that value is zero at inception. If this was intended, the instructions should be explicit.
- Collateral agreement: It should be clarified if banks should assume a collateral agreement with the counterparty.
- CDS: the coupon spread to be used for the trades is not specified. Coupon per market convention was assumed. Also restructuring clauses are not in line with market convention.

Question 12 for consultation: Can you please provided detailed explanation of the instruments that are not clear and a way to clarify the description?

✓ **Answer:**

Some detailed explanations should be added to the following instruments:

- Instruments 1, 3 to 7, and 17 (futures): Uncertainty on how to book instructions were not in line with listed contracts. If intention is to book as synthetic, then this should be indicated. If these were intended as listed positions, the exchange and contract should also be indicated.
- Instrument 18: The dates on the position seemed inconsistent with the annual observation period. The auto call level was assumed to be that of 19 September 2018.
- Instruments 38 and 49: As per standard FX conventions, long EUR/GBP means long EUR and short GBP, but instructions on these two instruments should be clarified.
- Instrument 40: The cash position should be better defined. Intention is not clear as a spot trade typically settles after 2 days. Treatment after settlement is unclear.
- Instrument 47: The Cross-currency swap instructions should indicate whether to include cash balance.
- Instruments 52-67, and 69: CDS trades should use restructuring clauses as per market convention: for EUR Corporates Modified Restructuring (MM14), for US Corporates No restructuring (XR14) and for Sovereigns Full restructuring (CR14). The main (liquid) currency should be used for each name.
- Stock option maturity should be the market standard one.