Banking & Payments Federation Ireland

BPFI Response to the European Union Public Consultation Document Implementing the Final Basel 3 Reforms in the EU

December 2019

www.bpfi.ie

15) In your view, which other aspects, if any, should be considered in the context of revising the standardised treatment of corporate exposures? Please elaborate.

We acknowledge the work carried out by the Basel Committee in respect to the treatment of unrated corporates and welcome the introduction of a specific risk weight (RW) for SME financing (e.g. 85% RW) within the corporate asset class. That being said, we believe the measure remains too narrow given a large amount of lending activity to SMEs would fall out of scope.

As a consequence, we would urge the European Commission, when drafting the forthcoming legislation, not to remove the SME Supporting Factor (existing and as amended by CRR2) e.g. applied to exposures towards eligible SMEs, even if assigned to other asset classes, and irrespective of the approach (standardised or IRB) under which they are capitalised (thus preserving the level playing field between banks applying the standardised and the IRB approach).

If it were to be removed, the resulting impact would be an increased level of RWAs for SME lending exposures, which in turn, would require credit institutions to hold higher capital requirements. This could have the effect of making lending to the SME sector in the EU less attractive, resulting in either higher lending costs (to compensate for higher capital requirements) or potentially a re-focusing of lending by banks into other sectors with higher risk-adjusted returns. Given that SME lending is an important part of the real economy, supporting employment in all sectors across the EU, any consequent reduction in attractiveness to SME lending could cause material knock-on consequences to employment, spending and economic growth. Hence BPFI strongly recommends that the existing RWA supports for SMEs remain in place, in order to avoid such potential negative economic and social impacts.

16) Views are sought on the costs and benefits of implementing the specific treatment of SL exposures provided by the Basel III standards (paragraphs 44-48). In particular, how does this treatment compare with the current treatment in terms of risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

BFPI acknowledges the objective of the Basel Committee to try and better align the SA-CR and IRB approach. However, we believe that the revised framework, if implemented, will have a significant impact in terms of financing designated SL projects due to the increase in RWAs under the SA-CR approach. Additionally, it is our opinion that this new framework fails to properly reflect the low risk profile of SL asset class as a whole. In particular, we believe that the criteria to meet in order to benefit from the 80% RW for Project Finance (PF) are very restrictive, which is likely to result in higher costs for many infrastructure projects.

At the same time, BPFI wanted to highlight its concern around a pure application of the Basel III standards for SL in relation to Project Finance, which may imply the removal of the existing EU Infrastructure Supporting Factor that was introduced via Regulation (EU)876/2019 (CRR2). The objective of this Infrastructure Supporting Factor is to encourage banks to provide financing to qualifying infrastructure projects e.g. roads, hospitals, schools and other socially beneficial pieces of infrastructure. Similar to the SME-Supporting Factor, we would be concerned that should this support be removed, it could have undesirable impacts on the availability of bank funding to these projects, or at a minimum it could make it less attractive than the existing regulatory environment.

We would further observe that if the existing CRR2 Supporting Factor is retained, certain off-taker qualifying criteria listed in article 501a 2b with regards to the eligibility of infrastructure projects should be reviewed.

In particular, this review should include qualifying criteria relating to off-takers that are a Local Authority ("LA") or Public Sector Enterprise ("PSE"). In such situations, to qualify for the Supporting Factor, we would recommend that the Risk Weight of the "LA" off-taker should be 0% in accordance with CRR articles 114 and 115 or is assigned an ECAI rating with a credit quality step of at least 3. At the same time, we would suggest the risk weight of the "PSE" off-taker should be 20% or below, in accordance with Article 116 CRR2 or assigned an ECAI rating with a credit quality step of at least 3.

In many, mostly smaller member states (e.g. Ireland), no LAs or PSEs meet these criteria, which limits the up-take of the supporting factor. For example, a risk weight of 20% is applied to all Irish Local Authorities per treatment in article 115 paragraph 5; and a risk weight of 50% is applied to all Irish Public Sector Entities (with exception of its debt management agency, the NTMA)that are treated as unrated PSEs per article 116 paragraph 1. However, these entities very often act as the off-takers in the infrastructure projects in Ireland. These infrastructure projects would otherwise qualify for the application of Infrastructure Supporting Factor because all other qualifying criteria listed in article 501a are met.

As a consequence of the existing legislation, the positive objective of this Supporting Factor is negated by an inability to qualify, reducing any potential benefits.

21)Views are sought on the costs and benefits of the revised standard treatment for equity exposures under Basel III (paragraph 49-50). In particular, would you consider any further differentiation among equity exposures (apart from “speculative unlisted equity exposures” and “national legislated programmes” – see 1.1.4.2. and 1.1.4.3.) warranted, and if so, how should this differentiation be made and what would be its prudential rationale? Please elaborate and provide relevant evidence.

We would consider a further differentiation among equity exposures warranted, because the BCBS framework subsumes too many exposures under the same risk category, while their risk profiles are different.

Under the current proposal unlisted equity investments would jump from 150% to 400% without justification based on evidence.

An additional category should be considered, in line with Article 155 of the CRR, of 190% risk weight for private equity and venture capital exposures in sufficiently diversified portfolios. It is BPFI’s opinion that the current proposals do not take into consideration the diversification within a private equity portfolio. For example, a fund may invest in 10 to 30 companies so diversification is built in and should attract a lower risk weight. In addition, one can also have a portfolio of direct equity investments similar to a bank’s portfolio and we believe this should be taken into consideration and given a lower risk weight.

Based on this, we believe that there should be a general definition that makes the distinction that any private equity, venture fund or portfolio of direct investments, which is sufficiently diversified, should attract the lower risk weighting.

26)In your view, should the discretion for “national legislated programmes” provided by the Basel III standards should be implemented in the Union? If you disagree, please explain and provide relevant evidence to substantiate your view.

BPFI welcomes the work by the Basel Committee around the treatment of equity holdings under national legislated programmes and supports the idea of assigning lower risk weights to such investments.

We would however like to outline that these types of programmes are only relevant to the Member States where they operate. Banks in Ireland have, in the past, been instructed under the restructuring process to invest in seed and growth capital funds, although these types of products currently do not fall under the scope of the definition.

In light of this, we would recommend that when transposing the Basel agreement, that the European Commission put forward types of funds/products that Member States should accept as part of national legislated programmes, highlighting in particular seed and growth capital funds.

34) Views are sought on the relative costs and benefits of the LS approach and the WL approach provided by the final Basel III standard. In particular, how do the two approaches compare in terms of risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

We support applying the loan splitting approach as currently applied in CRR. This, in our opinion, is more intuitive approach, while the tiering of LTVs in the manner of the LS approach fits more neatly into how mortgage pricing works. As a result, this approach makes it easier to price for cost of capital. At the same time, by applying the LS approach it has the following advantages:

- it avoids important differences in terms of RW when a loan moves into the next LTV band;
- it makes the framework more risk sensitive without unduly increasing the complexity of the methodology.

We don't see any great risk differentiation by the WL approach including the type of borrower, which will be primarily personal borrower for RE.

Another issue which we would like the European Commission to reflect upon when implementing the Basel agreement is the implicit use of the LTV ratio in the Basel LS approach. This approach does not take into consideration a loan-to-income model, which is applied by many EU banks and arguably a more useful instrument in determining default outcomes. We would therefore suggest that the European Commission look at refining the current Basel LS approach to take account of different approaches used by EU banks.

36)What would justify implementing both approaches in parallel from a risk perspective? If both approaches were to be implemented and made available on discretionary basis, how would comparability across institutions be ensured and how would regulatory arbitrage as well as undue complexity be prevented in this case?

Having a single approach consistently applied across all banks would appear to be preferable for ease of comparability. Based on our response to Q34, we would support the application of the LS approach.

37)Do you consider the assessment of the condition of "strong positive correlation" on a portfolio basis more appropriate than the assessment based on the individual RE exposure, and if yes, why? Please explain.

Banks' credit decisions are mainly based on the borrower according to the borrower's overall portfolio, which is aligned with the loan origination standards currently consulted by EBA, where they apply the standardised approach on a portfolio basis. As such, we are in favour of the assessment being based on a portfolio assessment as opposed to individual.

38)If the assessment based on a portfolio basis were introduced, what are your views on whether it should be the only approach available in the Union or it should be an alternative approach to be applied at supervisory discretion on a case-by-case basis? Please explain.

We believe that, where possible, there should be a consistent application of one basis across jurisdictions for comparability.

39)What are your views on the costs and benefits of implementing the preferential treatment for certain properties under construction as provided by the Basel III standards? Please provide relevant evidence supporting your view.

A self-build Private Dwelling House (PDH) is an important part of the Irish housing market. Therefore, BPFI supports the inclusion of the preferential treatment as laid out in the current standards from a wider policy objective standpoint.

41 Views are sought on the costs and benefits of the valuation criteria provided by the Basel III standards. In particular, how does this approach compare with the current approaches available under the CRR (MV and MLV) in terms of simplicity, comparability, risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

BPFI believes that the current Basel III standards around conservative valuation criteria is open to interpretation in that it puts a heavy burden on individual banks to make the assessments, e.g. how to disentangle expectations on price increases from current value (most standard economics would take the view that the current price of anything contains an element of expectation of future price growth) and what is a “sustainable value over the life of a loan”.

We support the recommendation to retain the current basis of valuation option as contain in CRR; that is, Market Value (MV) and Mortgage Lending Value (MLV). An independent valuation from a suitably qualified valuer using MV at origination will provide a rationalised and prudent valuation opinion which will be appraised in the normal credit approval process. The cyclical nature of property value and the fluctuation risk associated with a point in time opinion is understood but this risk should also be considered in the context of loan review and valuation update frequency requirements.

Basel requirement should be cognisant of all relevant regulatory guidance in CRR, the EBA and the ECB guidance publications and be easily understood and be capable of being read in this context.

42 Would you deem additional specifications necessary to clarify how the MV or the MLV currently used by institutions would need to be adjusted to meet the valuation criteria provided by the Basel III standards? Would you deem further clarifications necessary to ensure a consistent application of the valuation criteria across the Union? Please elaborate.

Yes. The Basel conservative valuation criteria suggest a form of mortgage lending value (MLV) but as with MLV more clarity is required if consistent use is required. MV is a more established method and is a more mainstream basis of origination which is easily understood and principally based on market transaction evidence expertly adjusted to value the subject property. A risk-based approach will inform the valuer judgement considering all factors including the market cycle and outlook. A further imposed prudential adjustment will be a very subjective exercise across valuers unless some more explicit guidance parameters are provided.

45)Views are sought on the costs and benefits of capping the property value at loan origination. In particular, how does the approach provided by the final Basel III standards compare with the current approach of the CRR in terms of possible cyclical effects on RWs, risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

BPFI believes that using origination value is operationally very burdensome, in particular for older mortgagesthis information may not be readily available on systems. Equally from a risk point of view, the value at origination approach is also a very blunt instrument. For example, when a house price correction comes then it will not treat houses differently according to when the mortgage was taken out. It also drives inconsistent outcomes for effectively the same risk e.g. if a borrower switches from one bank to another with the same size mortgage, the risk weight applied to it would be lower in the new bank as it would have a higher origination value.

BPFI agrees that a frequently updated valuation along with other credit review metrics provide the most accurate risk assessment moving through the life of the loan.

46)What other measures or safeguards could be provided to address possible cyclical effects of the re-valuation of real estate property? Please elaborate and provide relevant evidence.

Potentially a country specific haircut to current valuations under a similar framework to the calculation of the Countercyclical Buffer for capital could be explored by the European Commission.

47)In your view, which other aspects, if any, should be considered in the context of revising the requirement for re-valuation of RE collateral? Please elaborate and provide relevant evidence to substantiate your views.

We agree and restate our comments in this regard in response to Question 41 above.

48) What are your views on the costs and benefits of replacing the existing treatment of "speculative immovable property financing" with the treatment of ADC exposures as provided by the Basel III standards?

There is potential for an increase in RWA (and therefore costs) as a result of a different scope of the Basel definition of ADC compared with the "speculative immovable property financing" definition in the CRR.

However, the current CRR definition is vague and requires interpretation with resulting uncertainty for banks in the efficacy of implementation. Further clarity is therefore needed to distinguish speculative projects from non-speculative ones. We note that the need for this is recognised in footnote 52 of section 10.3 of the Basel III agreement, and call upon the European Commission to consider providing further clarity around this definition in its upcoming review of CRR.

Otherwise, if the current drafting of the Basel III text is adopted in the EU, capital requirements could increase by 50% for some categories of development exposures, with consequent increases in the cost of borrowings for SMEs and Corporates. This in turn, will feed through to the cost of housing and commercial property in the EU. It should be noted that the capital impact cannot be estimated until the conditions for assigning a 100% RW to certain ADC exposures is specified.

There are benefits to be derived from the introduction of specific criteria for the application of risk weights to ADC exposures in bringing a level playing field for banks in credit risk pricing, reducing variability in RWAs, and providing comparability for investors.

49) Would you deem further refinements or clarifications necessary concerning the scope or definition of ADC exposures, and if yes, what would those be and what would be their prudential rationale? Please elaborate and provide relevant evidence.

Note that there is an overlap between this question and question 50.

The scope of ADC exposures cannot be assessed by banks until the further guidance from regulators as referenced in footnote 52 of the Basel agreement is provided.

It is noted that the EBA in its "Policy Advice on the Basel III Reforms", recommendation CR-SA 33 calls for a mandate be granted to the EBA for specifying the conditions for assigning a 100% RW to certain ADC exposures. The proposed parameters to be included in that mandate are welcome.

- **Pre-sale or pre-let contracts amount to a significant portion of total contracts** – We expect the EBA will provide guidance of what a significant portion might be. F**or example, a suggestion could be 30% of projected number of units in the total development, or current phase of development (where development is on a phased basis) would be appropriate.** If the number of units is not the appropriate measure, an alternative measure could be the monetary value of units being developed relative to the peak credit exposure value of the total development, or current phase of the development.

- **Substantial equity at risk** – We expect the EBA will provide guidance on what substantial equity at risk for the obligor might comprise. It is important that this is based on the peak projected credit exposure for the obligor rather than the total development value of the project. The latter would be too conservative since the structuring of property development transactions incorporates revolving working capital facilities, reflecting the work-in-progress financing being drawn down and repaid as individual units are sold and additional units are subsequently developed. **An appropriate threshold would be [25%] for obligor equity (LTV ≤ 75%) to be measured against peak EAD;**
- **Substantial cash deposit from the purchaser(s)** – an appropriate level to be considered would be a [10%] deposit from the purchaser/lessee which is subject to forfeiture is sufficient for this purpose. This level of deposit is sufficient to provide assurance that the purchaser/lessee is committed to fulfilment of its obligations under the contract.

50) In relation to the condition for applying the preferential risk weight of 100% to certain ADC exposures, do you consider further specification necessary to ensure a harmonised application of this condition across the

Union, for example by defining or quantifying any of the terms mentioned above? Please elaborate and provide relevant evidence to substantiate your views.

Note that there is overlap between this question and question 49.

It is not clear why the condition for applying the preferential risk weight of 100% to certain ADC exposures does not encompass commercial property development as well as residential property development. We believe this risk weight should be available for commercial property developments which are pre-sold/pre-let (at the minimum threshold to be defined).

The conditions for accessing the "preferential" risk weight should not distinguish between commercial and residential property development as there is no prudential risk evidence to support this distinction. This approach has the potential to skew the property development market towards residential development when this choice should be driven by market forces unrelated to financing costs.

Furthermore, the conditions for accessing the "preferential" risk weight should incorporate the risk mitigation impact derived from access to alternative forms of collateral.

This approach is justified from a prudential perspective by recognising the gamut of lending structures which pertain across commercial banks to support development lending (both commercial and residential) including: the banks' risk is frequently supported by access to alternative forms of collateral such as other development land assets, investment property, personal guarantees from individuals with adequate supporting net worth, and/or cash deposits.

82) What are your views on the costs and benefits of using SA CCFs for the FIRB Approach? How would this change impact the robustness and level of RWAs for the affected portfolios?

BPFI recommends the retention of the existing 0% CCF for Unconditionally Cancellable Contracts. The introduction of a floor of 10% is likely to encourage banks to either remove such facilities (due to additional capital requirements) or result in an increased charge being applied accordingly. These changes could have the effect of increasing uncertainty and/or cost for customers including consumers and SMEs. In the event of removal /reduction of these uncommitted facilities, this could also result in delays for customers in accessing credit when required, due to the need to make new credit applications when new facilities are needed.

91)What are your views on the proposed enhancements of IRB risk parameter estimation practices?

In the EBA recommendation CR-IR 30 of "POLICY ADVICE ON THE BASEL III REFORMS: CREDIT RISK", the EBA recommend clarifying the definition of facility in CRR by explicitly linking it to the contract between the obligor and the institution. As noted by the EBA, this has implications for the estimation of LGD which must be conducted at facility level. **We are concerned that this additional clarity could result in institutions estimating LGD at an overly granular level which does not align with recovery process.** This could result in model bias as institutions use artificial approaches to assign recovery flows to facilities. Instead BPFI suggests that the CRR aligns with the expectations already outlined in the ECB Guide to Internal Models by Risk Type published in September 2018 (para 99) which provides flexibility for institutions to estimate LGD at a more aggregated level if this is aligned with the recovery process.

123) How would exercising the discretion affect the link between capital incentives and management of operational risks? Please elaborate.

Much of the recent operational and conduct risk losses are as result of the scale of activities undertaken and the less rigorous control environment in place in the years prior to 2008. The current regulatory and oversight regime is more robust and intrusive on banks to that which existed prior to 2008. In addition, banks are also allocating significantly greater proportion of the banking cost base to risk activities (including operational risk).

As a consequence, data tracking and early identification of control failures is significantly improved than during the pre-crisis period. Banks are also under-going significant culture change directly impacting conduct and operational risk management.

BPFI agrees with having a discretion to cap ILM at 1, which would incentivise the sound management of operational risk in order to reduce potential future loss events, while not over emphasising past events which have been remediated. We believe that consideration should also be given to the level of recoveries, as there may not be a net loss.

125) What are your views on how a loss data threshold that is increased for some institutions may affect the soundness and risk-sensitivity of the operational risk framework, the volatility of the ILM, its comparability between institutions, and the incentive to carefully manage small to medium-sized losses? Please specify your views.

BPFI believes that most of the financial loss event value is derived from higher value events e.g. €100k plus; hence in our view the threshold may not be that important but should be kept high. It also depends on the risk management approach within a bank and whether events less than the proposed threshold are already being recorded for risk management purposes. A high threshold will also help to reduce the administrative and financial burden for smaller Bucket 2 banks associated with managing a larger dataset.

126) If the discretion was retained, which conditions and criteria should be introduced in order to ensure a level playing field in its application by supervisors? Please elaborate.

BPFI suggests that a common rationale for excluding one off events should be introduced for all institutions, which would support the level-playing field principle. We would therefore welcome it supervisors developed a number of principles to guide banks when considering events for exclusion rather than establishing prescriptive and absolute criteria. Also, if it can be demonstrated that a high recovery rate exists e.g. low net losses then that could be used as a criterion for excluding certain events.

127) Which threshold (EUR 20,000 or EUR 100,000) would better reflect the current threshold used for your loss data collection? Please elaborate and provide relevant evidence.

The closest threshold is €20,000 although as a % of total loss value, most of the value is generated by €100,000 plus events.

128) What are your views on how this discretion might affect the overall level of own funds for operational risk of bucket 1 institutions and the comparability within bucket 1? Please elaborate your views.

BPFI suggests that depending on the size of the institution, the lower level threshold may be more representative of the typical event value. Hence, raising the threshold for some institutions could have a relatively bigger impact. This could be established easily from recent QIS returns.

129) If the discretion was retained, which conditions and criteria should be introduced in order to ensure a level playing field in its application by supervisors? Please elaborate.

BPFI suggests that an analysis of the potential thresholds versus total value of events, possibly through QIS return analysis, could form part of any discretion proposal (e.g. where events < €100,000 historically aggregate to less than 10-15% of the total value). Likewise, recovery rate could play a part. All of this could be analysed from QIS returns for example.

131) What are your views on the discretion for supervisory authorities to request the institutions to use less than 5 years of loss data (when the ILM >1)? In which circumstances would such a request be justified? Please elaborate and provide relevant evidence.

BPFI believes that starting with a shorter span of historic events could mitigate the impact of events at the start of the time horizon of ten years, while giving more impact to recent events under a five year or less approach. Conducting the exercise at both 5 and 10 years to compare the ILM, might be feasible, in order to avoid having an impact on institutions where large historic losses happened more than five years ago, provided remediation programmes have been completed.

132) What would you consider to be the appropriate thresholds for allowing a request for exclusion of loss events from loss data history, for current and divested activities? Please explain and provide relevant evidence to substantiate your views.

In cases where the event happened over 5 years ago (including where the losses are still being quantified or provisioned as) in theory they relate to past process and behaviour e.g. conduct related events, and not the current risk profile. In addition, where any supervisory driven actions have been completed it is generally the case that the likelihood of reoccurrence is small.

133) What would be in your view an appropriate minimum retention period for the losses that will be excluded from the loss dataset? What would be an appropriate starting point of this period? Please explain and provide relevant evidence to substantiate your views.

BPFI suggests that the losses should best represent the likely future loss profile and values that will continue for an organisation, given its current risk management level and risk appetite (for losses). 3-5 years retention of events that occur in that period rather than adjustments to older events etc.

136) Are there any concerns in terms of proportionality that you would consider important to raise? Which threshold would you consider appropriate for the applicability of the governance and organisational requirements? Please elaborate.

BPFI suggests that the threshold of €100,000 plus would make governance more manageable.

137) What are your views on requiring the inclusion of the above-mentioned elements (internal loss data, scenarios, external loss data and key risk indicators) in the ICAAP for operational risk? Please explain your reasoning in case of disagreement (separately for each element).

BPFI believes that this could mean an additional burden for non-AMA institutions. Hence introduction should be done on a phased basis and after first being embedded under an Op Risk management framework within an institution, and not included until robust process exists. We believe most institutions would have elements of this as part of a risk management framework, whether they were used formally in ICAAP or for internal modelling or not.

143) In your view, which other aspects, if any, should be considered in the context of revising the operational risk framework? Please elaborate and rank your answers from the most important to the least important aspect.

We would like to emphasise that the Basel framework insufficiently takes into account the mitigation of operational risk when the underlying issues of the operational risk losses have been remediated and the latter are therefore no longer representative of the current operational risk profile. Hence we recommend introducing a refinement in the new standardised approach for operational risk, which acknowledges the risk mitigating effect of insurance (provided that apposite eligibility criteria are met), aimed at enhancing the risk sensitiveness of the framework and encouraging banks to provide prudent practices in the management of operational risk.

As foreseen for other sections of the framework, we would suggest a phase-in period related to the implementation and the mandatory moving to the SMA. For example, in order to make the SMA impact more

gradual (which is especially relevant for EU AMA financial institutions), a 5-year linear phase-in could be introduced.

We further suggest that apart from mitigation through insurance etc., the level of recoveries or net loss is important to arrive at a true picture of the financial impact on an institution and the potential capital required.

145) Which elements of the revised SA-OR, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

We believe that it is reasonable to tie the reporting into the latest financial/interim statement production i.e. once or twice a year with a lag of say 6 months for preparation, which would ease the burden. Also, in relation to exercising governance over the collection and validation of low value loss events, we believe the higher the threshold the less administrative burden is caused.

146) What considerations should be taken into account regarding the implementation of the revised trading book boundary? Please specify and provide relevant evidence to substantiate your views

Our members would urge the European Commission to take into consideration the following remarks in respect to implementing the revised trading book boundary:

- Confirmation of when the new boundary will be enacted and what the final boundary will look like (i.e. will the version included in January 2019 Basel document be modified?)
- Clarification on the treatment of positions traded for client servicing – per CRR Article 4 client servicing is taken to be trading intent, this is not stated in then January 2019 Basel document.
- Rectification of whether booking errors are in scope for the new treatment of transfers
- Clarification around rules of transfers from trading book to banking book
- Paragraph 25.6 of the Basel agreement states that 'instruments that would give rise to a net short credit or equity position in the banking book' should be included in the trading book. At what level should the netting be taken at, i.e. individual instrument level, structure level, portfolio level, etc?

147) What considerations should be taken into account in implementing any other revised elements of the FRTB framework, finalised by the BCBS in 2019? Please specify and provide relevant evidence to substantiate your views

Our members would urge the European Commission to take into consideration the following remarks in respect to implementing the revised FRTB framework:

- For curvature risk (Art. 325g, CRR), the value of instrument as estimated by the pricing model of the institution based on an upward shift of the value of risk factor k $V(xkRW(Curvature)$+) has to be calculated. We would question if this should be calculated using a full revaluation (i.e. like a scenario-based stress test) or can approximations via Greeks be used?
- When using the look through approach (per Art. 325i), if constituents of a multi-underlying instrument or other multi-underlying instruments / CIU's must the rules of Art. 325i/j be applied to these instruments (i.e. must you keep decomposing until you have fully 'looked through')?
- Per Article 325j 1(b) 'the institution may consider the position in the CIU as a single equity position'. If the CIU is a multi-asset basket composed of equity, credit, commodities, etc – can you use the unrated equity approach even though it contains more asset type then equities.

149) What are your views on the costs and benefits of implementing the conditions provided by the Basel III standards for allocating investment in CIUs to the trading book? Please provide relevant evidence to substantiate your views.

- Look through approach (1(a) CRR)
    - Diversification benefits

  - Lower risk weightings than ‘Single Equity’ approach
  - Operationally intensive for large or actively managed portfolios to source constituent exposures and calculate own funds on each position

- ‘Single Equity’ Approach (1(b(i)) CRR)
  - Operationally straightforward
  - No diversification benefits
  - Harsh risk weighting
  - Optimal approach for matched-trades
- ‘Mandate Limits’ Approach (1(b(ii)) CRR)
  - Initial operationally intensive to set up hypothetical portfolio, but straightforward afterwards.
  - No diversification
- Lower risk weighting than ‘Single Equity’ approach
- Per Art. 325j if an institution can obtain sufficient evidence about the underlying exposures of a CIU then it shall calculate the own funds requirement by looking through to the underlying position. We believe that an institution should always have the option to use a ‘single equity’ approach.

153) Would you consider that the revised approaches for calculating the own fund requirements for CIUs in the SA-MR would significantly affect investments in those instruments? If yes, would there be any solutions to address this issue prudentially? Please explain and provide relevant evidence.

On the basis that the market risk own funds requirement does not need to be calculated for perfectly matched trades we would not see any impact, as all derivatives with exposures to CIU’s are perfectly matched. The operational complexity of calculating sensitivities on the positions with exposures to CIU’s could have a significant impact if the own funds requirement did have to be calculated on the perfectly matched positions.

155) Views are sought regarding the date of application of the new own funds requirements for market risk. Taking into account the time needed for the legislative process to implement the new own fund requirements for market risk in the EU and the time-consuming model approval process, which date would you consider appropriate for the application of the FRTB framework as a binding own fund requirements in the Union?

We would consider an appropriate timeline for the new own funds requirements for SA-MR to be for reporting, which should begin 1 year after the Delegated Act has been enacted and for the own funds requirement to become live 12 months after.

We would be concerned however around the lack of information with respect to when, and in what format, the trading book / banking book boundary legislation will be enacted.

We would like clarification on whether the reporting requirement will be on the previous or proposed BCBS trading book / banking book boundary.

156) In your view, which other aspects, if any, should be considered in the context of revising the market risk framework? Please specify and rank your answers from the most important to the least important aspect.

We would welcome due consideration to be given to enacting the trading book / banking book boundary legislation.

More specifically, we would appreciate confirmation that Article 104b CRR is purely for IMA banks, which in our view, would alleviate any confusion about who is required to implement the stated article. As way of background, the opening line of Article 104b CRR, Requirements for the Trading desk, refers to 430b (3), CRR, which itself only refers to the IMA. For many smaller banks who do not chose to implement the IMA, implementing 104b CRR would be costly.

157) Which elements/revisions of the SA-MR and, respectively, IMA, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the expected one-off costs to substantiate your views.

While it is difficult to assess with exact certainty, our members have indicated that in relation to SA-MR, the following should be taken into consideration from most to least challenging:

Most:
Generating sensitivities for complex derivatives
Definition of trading desk
Calculations of shifted valuations for curvature calculation
Revised boundary between trading and banking book
Treatment of internal risk transfers
Default risk capital requirement
Residual Risk add-on

Least:

159) Views are sought on the cost and benefits of implementing the revised CVA framework in the EU. In particular, how do the approaches provided by the final Basel III standards compare with the current approach of the CRR in terms of impacts on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

The revised CVA framework cannot be viewed in isolation from other Basel proposals or decisions. The new Standardised Approach for Counterparty Credit Risk (SA-CCR) directly affects the resulting CVA charge. By removing the exemption on EU NFCs would significantly increase the capital allocation and therefore the cost to the banks of providing essential client services (i.e. interest rate / FX hedging) to NFCs, which could potentially feed through into the pricing of these services. This could lead to increased business costs for SMEs and Corporates in the EU, or could potentially discourage customers from using these products, thereby taking unnecessary market risks.

Higher risk weightings will impact the calculation, especially those for financial counterparties. Previously the risk weights were granularly based on rating, but now they are more sectoral based and are only sub-divided by investment grade / non-investment grade.

Materiality threshold (i.e. EUR 100bn) for calculating CVA is welcome.

160)Would in your view any type of transactions be particularly affected by the implementation of the revised CVA framework in the Union? Please provide relevant evidence to substantiate your views.

See response to question 159.

161) One of the main objectives of the final Basel III standards was to enhance the risk-sensitivity of the CVA framework. Are there in your view elements of the approaches of the revised CVA framework that do not achieve these objectives? If yes, which ones and what are the potential solutions to address them prudentially? Please provide relevant evidence to substantiate your views.

The risk weights in the BA-CVA framework are not granular enough and do not take into account the relative ratings of investment or non-investment grade counterparties.

BA-CVA only allows you hedge the credit spread component of CVA risk, institutions cannot hedge the exposure component.

162) The final Basel III standards extend the scope of CVA risks subject to the framework. In this context, what are your views on the capacity of institutions in the EU to manage and hedge all CVA risks? Are CVA hedges under the SA-CVA and BA-CVA appropriately recognised? If not, what are the potential solutions to better recognise them prudentially? Please provide relevant evidence to substantiate your views.

BA-CVA should allow some aspect of exposures hedging. Supervisory correlations for indirect hedging are blunt.

164)How do institutions currently manage the CVA risks arising from the counterparties exempted from the current CVA framework under CRR? Please provide relevant evidence to substantiate your views.

Institutions currently manage the CVA risks arising from the counterparties exempted from the current CVA framework under CRR, with the accounting CVA framework. In addition, institutions do not take account of CRR exemptions when assigning internal capital against CVA risk.

165)What would you consider to be the potential impacts on RWAs and in terms of operational burden stemming from removing the existing exemptions under the CRR would have? Please provide relevant evidence to substantiate your views.

The impact on RWAs will be significant. The current CRR (article 382 of Regulation (EU) 575/2013) provides certain exemptions concerning the scope of the CVA risk capital charges that have been introduced in Europe to fix the shortcomings of the calibration of the CVA framework. Especially in the case of non-financial counterparties (NFCs), the exemption is essential to avoid adverse effects on employment and growth. Due to their nature, an efficient management of collateral is more than challenging for corporates and standardised instruments often fail to match their specific needs.

Therefore, OTC derivatives are usually the only option for corporates to hedge risks that inevitably arise from their businesses. Given challenges in collateral management, the bilateral arrangements are mostly not subject to a collateral agreement. Hence, the exposure value might be substantial, resulting in a substantial CVA charge. Also, most of the non-financial counterparties will be non-rated, resulting in a high weight and hence a high capital charge. In addition, bilateral OTC derivative arrangements with NFCs are already subject to own funds requirements in the area of Counterparty Credit Risk (CCR). An additional capital charge for CVA risk would force banks to pass the additional costs on to their counterparties. This, in turn, would most likely result in corporates either not hedging their risks or even refraining from certain business activities completely. Both consequences would be highly undesirable. A similar argument can be made for local authorities who are classified as “Retail” under MIFID i.e. not considered experienced or sophisticated users of derivatives

For an institution within a banking group that transacts a significant amount of its derivative contracts with the parent institution or other intragroup counterparties, the removal of the current exemption will have a significant impact on total capital requirements. Article 382 (4) (b) of the CRR currently exempts intragroup transactions as provided for in Article 3 of Regulation (EU) No. 648/2012 (EMIR). Specifically, article 3 of EMIR exempts intragroup transactions from the clearing obligation provided the “derivative contract is entered into with another counterparty which is part of the same group provided that both counterparties are included in the same consolidation on a full basis and they are subject to an appropriate centralised risk evaluation, measurement and control procedures”. The conditions for this exemption are consistent with those provided in Article 113 (6) of the CRR which allows for an exemption from the requirement to calculate risk weighted assets for certain intragroup exposures. For institutions that have been granted an exemption under Article 113 (6) of the CRR, maintaining the current exemption from CVA under Article 382 (4) (b) should be permitted for derivative exposures with the exempted intragroup counterparties.

See also response to question 159.

167) Views are sought on the costs and benefits of the simplified approach provided by the Basel III standards to calculate the own funds requirements for CVA risks. In particular, what would be the impact in terms of RWAs and operational burden? Please provide relevant evidence to substantiate your views.

For smaller banks this is a welcome alternative to calculating CVA using either the BA or SA approaches.

174) In your view, which other aspects, if any, should be considered in the context of revising the CVA framework? Please specify and rank your answers from the most important to the least important aspect.

A revision of the correlations applied to indirect hedging, especially for the EU where the NFC CDS market is not developed.

188) Once EUCLID is fully implemented, would you support that the EBA, on the basis of the collected supervisory data from all institutions established in the Union, centrally discloses the information of all those institutions that are subject to disclosure requirements under CRR/D, thereby relieving institutions from mandatory disclosures?

We fully support alignment of the templates submitted to supervisors but do not consider that a central disclosure approach significantly relieves the reporting burden for the reasons outlined in Q190.

190) If you do not support centralising disclosures at the EBA, please explain why.

- **Timing**: the requirement for P3 disclosure is that it is co-terminous with the financial report. A piecemeal or latest date disclosure approach wouldn't appear to serve the stakeholder base well.
- **Non-Disclosure option**: currently banks may decide not to disclose certain information on the grounds of materiality, confidentiality or proprietary information. It is not clear as to how this option can be retained under automatic central disclosure.
- **Narrative**: institutions can currently provide context and narrative to their disclosures and may where circumstances require re-cut previous year's figures (e.g. implementation of a new definition of default). In light of this, we would welcome confirmation around how this approach would ensure relevance of disclosures?
- **Additional Information:** banks may provide additional information to enhance the minimum P3 disclosure. This may duplicate disclosure where the enhancement and minimum disclosure are located separately.
- **Delineation of Responsibility:** unless the CRR is aligned with any related technical standard(s) on this approach to provide a clear distinction between what information would be disclosed by the bank and the EBA, there is a possibility that requirements are missed.
- **Reporting Burden:** the final step of publication is the least burdensome aspect of the disclosures. The greatest burden currently is the collation of information which is not in a format already required for the supervisory reporting requirements. If that burden were to be addressed, then the actual publication is less of an issue.

191) In your view, which further measures, if any, could be taken to incorporate ESG risks into prudential regulation without pre-empting ongoing work as set out above? Please elaborate and provide relevant evidence to substantiate your view.

We welcome actions agreed on sustainable finance, particularly the mandates given to EBA. BPFI recognises that climate-related financial risk will become integral to risk management strategies within credit institutions and we note the challenges involved, including lack of available data, need for planning for climate risk that takes a longer-term perspective than other risk planning, and the importance of scenario-based analysis.

We note the EBA Workplan on Sustainable Finance recently published and its rationale for focusing first on strategy and risk management metrics, then stress testing on climate change, before considering the evidence of the prudential treatment of green exposures and issuing guidance. Given the urgency of action required to support sustainable financial flows, it would be useful to introduce a sustainable supporting factor at the earliest stage possible. This would help align banks' investment decisions with the EU's ambitious sustainable finance agenda and help develop successful financial products and service at scale when they are most needed.

Measures to incorporate ESG risks into prudential regulation should take into consideration activities of Network for Greening the Financial System in this regard.

192) What would be the benefits and drawbacks of including the requirement for competent authorities to perform a fit and proper assessment of at least some key function holders in the CRD?

In Ireland, the competent authority does perform a fit and proper assessment of many key function holders, as they hold PCF designations, specifically, the heads of internal control functions (PCF 12, 13, 14) and heads of EEA Branches (PCF 16).

193) In your view, would it be useful to identify key function holders in a descriptive manner, and/or to specify certain roles as belonging, by default, to the set of key function holders? Please consider the practical implications of each option and the need for clarity and consistent application across institutions and competent authorities. Please elaborate and provide evidence.

If anything were to be proposed it would be helpful if it was aligned to local regulatory requirements e.g. Individual Accountability Framework

194) Were the CRD to specify a number of roles that would be considered, by their very nature, to be occupied by key function holders, which specific roles should, in your view, be included in this list?

In line with what is called out in CRD we would see heads of risk, audit and compliance as appropriate categories.

195) Views are also sought as to whether the scope of key function holders subject to fit and proper assessment should be limited to those holding these positions at group level or whether it should also include key function holders at the level of each institution? Please elaborate and provide evidence.

Some subsidiaries may have key function holders of their own. This seems appropriate where the subsidiary is a material part of a bank.

196) Should the key function holders be subject to fit and proper assessments by competent authorities, on what criteria could this assessment be performed?

The assessment process should align with local regulatory requirements.

197) Please explain what you consider to be the advantages and disadvantages of competent authorities conducting ex ante and ex post approval, respectively, of suitability of members of the management body.

Ireland already conducts ex ante approvals for members of the management body as they are PCFs.

198) If, in your jurisdiction, institutions are required to request approval for the appointment of members of the management body only after they take up their position, please explain what, if anything, would make it difficult for you to adapt to an ex ante system.

In Ireland this is not the case.

199) One issue that has been raised in the past in relation to ex ante assessment is avoiding vacant positions on the board. Please explain, based on your experience, to what extent this can be overcome (if it is an issue in the first place) giving examples and making reference where appropriate to succession planning and procedures in place for identifying skills/experience that could be particularly difficult to replace

It would require quick processing of pre-approval roles by the competent authority.

200) Which specific positions within the board and/or senior management of institutions do you believe should be considered as part of an ex ante assessment, given the responsibilities they hold and the risks they may pose? Please provide evidence and/or examples to support your views.

All board positions are currently PCFs in Ireland. Most senior management positions are also already PCFs in Ireland and therefore pre-approved.

201) Considering a scenario in which at least some fit and proper assessments were to be conducted by competent authorities ex ante, what would be, for you, the costs and benefits of a deadline for the assessment of proposed board members being set in the CRD ? What would you consider a reasonable period of time for the assessment?

There is a significant investment in the induction and onboarding of non-executive directors. Hence, we do not believe that assessments should be conducted ex ante.

203) If competent authorities had a fixed time period for giving their approval to proposed new board appointments , would you nonetheless consider it preferable for a decision to be issued in cases where the competent authority decides to approve a candidate? Could you instead envisage a system of "tacit approval" (i.e. whereby, if no decision has been issued by the deadline, the institution can consider the candidate approved)?

If banks were to take action on tacit approval and full approval does not follow, it could give rise to unwelcome contractual and employment law complications, though quicker responses would be welcome.

206) What specific risks do you see in allowing some degree of proportionality in the application of any new provisions, such as those discussed in Sections 9.2.1.1. and 9.2.1.2., on the timing of the approval of board members by competent authorities and of key function holders?

If proportionality led to quicker and faster decisions by the competent authority, it would be beneficial.

207) What would be the benefits and drawbacks of designing an accountability regime whereby the management body of each institution would be required to draw up a statement of responsibilities of each of its members clearly identifying the activities for which they are responsible, beyond the sole responsibilities linked to their membership of specialised committees (e.g. risk committee, remuneration committee)?

Our members believe the following benefits and drawbacks should be reflected upon by the European Commission before it makes any legislative proposals:

Benefits:

1. An accountability regime can ensure the embedding of a culture of ownership and responsibility, as well as a clear commitment to cultural change in the industry;
2. Improved documentation of rationale for key decisions, ownership of such decisions and actions required;
3. Better ability to demonstrate alignment of appropriate incentivisation with desired performance and behaviours;
4. Clear ownership and accountability can lead to improved end to end processes, decision making and providing reliable high-quality customer experiences.

Drawbacks:

1. Administrative burden can be significant (based on the experience of from other jurisdictions where similar rules are in place) given the dynamic and changing nature of organisations and roles in organisations. In the absence

of clear guidance and criteria, there is scope for inconsistency in application of conduct standards and reporting of breaches.

2. An accountability regime can potentially lead to challenges in recruiting of skilled personnel at board and/or senior management functions when competing with industries without such regimes.
3. A regime is proposed for Ireland and is in the process of being implemented. It is important that any Basel III regime would be sufficiently flexible to ensure that institutions are not subject to multiple regimes in one country and to recognise the differing legal regimes and rights of individuals within those regimes.

208) How might the collective functioning of the board be affected by the introduction of a system where each individual has a defined set of responsibilities? Please consider the possible effects on both individual conduct and the board as a whole (e.g. the impact on the collective responsibility of the board, or on the quality of its discussions).

An accountability regime may lead to increased challenges at board level, as noted in minutes clearly evidencing the challenge and consideration of issues.

At the same time, there is a potential for conflict between collective and individual responsibilities where individuals have responsibility for their own areas but may be required to make a decision that benefits the group as a whole rather than their own specific area. A regime should recognise that once there is evidence of a clear and rational decision-making process, decisions made in this context can be reasonably and correctly made.

209) What would be the benefits and drawbacks of designing a similar accountability regime for key function holders (e.g. information on key function holders, their responsibilities, details of the firm's governance and structure)?

We see benefit in certain key function holders being subject to an accountability regime given the control driven nature of their roles.

210) Would the assessment of individuals proposed for positions on the board or as key function holders be more accurate and/or reliable if the responsibilities the individual would be taking on were clearly defined, including in relation to any new provisions,

Greater clarity should assist in recruiting appropriately qualified personnel for roles; however, any regime should also allow for flexibility in roles to enable organisations change and evolve as is necessary for all organisations.

211) Do you consider that corporate culture could and should be taken into consideration as part of the fit and proper assessment? If yes, please explain how this could be most effectively achieved.

We believe that corporate culture should always be considered. Diversity of thought and openness to challenge and debate should be encouraged. The interview and recruitment process for members of the management body can assess potential candidates for cultural fit.

212) What do you consider would be the benefits of, and/or difficulties encountered in, including the ability to create and promote the organisation's desired culture as part of the "fit and proper" assessment of members of the management body?

The desired culture of tone from the top would be beneficial however it is difficult to envisage how this would be structured with the fit and proper assessment, other than institutions including this as part of their interview and recruitment process.