EBA/CP/2018/16

18 December 2018

Consultation Paper

Draft Implementing Technical Standards amending Commission Implementing Regulation (EU) 2016/2070 with regard to benchmarking of internal models

Contents

1. Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 31 January 2019. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) N° 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

Article 78 of Directive 2013/36/EU (CRD IV) requires competent authorities to conduct an annual assessment of the quality of internal approaches used for the calculation of own funds requirements. To assist competent authorities in this assessment, the EBA calculates and distributes benchmark values against which individual institutions' risk parameters can be compared. These benchmark values are based on data submitted by institutions as laid out in EU Regulation 2016/2070 which specifies the benchmarking portfolios, templates and definitions to be used as part of the annual benchmarking exercises.

For the 2020 benchmarking exercise, changes to the market and credit risk portfolios as well as changes to the reporting templates and instructions are necessary to keep the portfolios up to date and the reported data relevant for the abovementioned assessment.

The EBA supervisory benchmarking currently serves three major objectives, the first one being the abovementioned supervisory assessment of the quality of internal approaches. It also provides as well a powerful tool to explain and monitor RWA variability over time. In this role it triggered among others the development of EBAs Guidelines on PD and LGD estimation and the treatment of defaulted assets, published on the 17 November 2017. Lastly the Benchmarking results as well provide the banks with valuable information on their risk assessment compared to other banks assessment on comparable portfolios.

Credit risk

The benchmarking exercises carried out in 2018 highlighted some potential for improving the definition of the benchmarking portfolios and the reporting instructions. Clear and unambiguous definitions and instructions are necessary to foster a unique and coherent interpretation and implementation of the reporting requirements across institutions and, in turn, lead to better data quality and more accurate benchmark values. Therefore the revision of the benchmarking portfolios, which generally provide for homogeneous pools of exposures allowing to analyse RWA and risk parameter variability due to different practises, was based on three main principles, namely that the number of portfolios to be reported should be diminished to reduce the complexity of the exercise, to simplify the design of the portfolios by a closer alignment to the COREP's structure, and with a view on stable portfolios definitions for the future.

Therefore the main changes in the definitions of the credit risk portfolios are

- a reduction in the number of portfolios to be submitted,
- a simplification and alignment in structure, and
- a number of technical refinements.

The number of portfolios is reduced mainly by limiting the portfolios which were collected for all risk types. Moreover homogeneous portfolios in terms of rating, country, CRM and sectors covered are now collected in an independent manner, instead of achieving homogeneity of these characteristics simultaneously.

A simplification of the structure is achieved on one hand by identifying specialised lending as a separate exposure class in the definition of the LDP Portfolios (i.e. the 102 template) and on the other hand by the proposal to mirror the full exposure class breakdown in COREP in the HDP Benchmarking portfolios (i.e. the 103 template). Moreover it is proposed to align the portfolio breakdown of HDP and LDP portfolios at least as regards the breakdown by CRM to the extent possible.

Lastly some technical refinements are made in the existing breakdowns of HDP and LDP portfolios which should support the creation of more homogeneous portfolios. It has to be explored however in this consultation paper whether the costs for creating more homogeneous portfolios and more consistency between COREP and Benchmarking data requirements as well as more consistency between HDP and LDP data requirements are justified.

Market risk

The 2020 set of market portfolios are based on the EBA set of market risk benchmarking portfolios used for the 2019 exercise, which took on board suggestions and feedback from institutions during past interviews held as part of past Market Risk benchmarking exercises.

In addition, for the 2020 ITS, institutions are required to submit the pricing information for the benchmark instruments together with the initial market valuation (IMV). Furthermore, institutions are asked to submit the price factors assigned to the instruments as well as the sensitivities of the instruments with regards to the assigned price factors. Institutions are asked to submit those data in a non-aggregated way.

The new proposal set out in this 2020 ITS aims to improve the understanding of the ways the institutions reach the values they submit for the BM.

Next steps

Given the type of changes introduced by these draft ITS to the benchmarking portfolios as well as the reporting instructions and templates, the relevant Annexes are replaced in whole with those set out in these draft ITS in order to create a consolidated version of the updated draft ITS package.

These revised benchmarking portfolios and reporting requirements are expected to be applicable for the submission of initial market valuation data in Q3 2019 and of other market and credit risk data in 1H 2020 (i.e. with reference date 31 December 2019 for Credit risk).

3. Background and rationale

1. Article 78 of Directive 2013/36/EU (CRD IV) requires competent authorities to conduct an annual assessment of the quality of internal approaches used for the calculation of own funds requirements. The same article requires the EBA to produce a report to assist competent authorities in this assessment. The EBA's report is based on data submitted by institutions in accordance with EU Regulation 2016/2070, which specifies the benchmarking portfolios, templates, definitions and IT solutions that should be used as part of the annual benchmarking exercises by institutions using internal approaches for market and credit risk.

2. As part of these annual benchmarking exercises, the EBA collects feedback from institutions as regards the clarity of the benchmarking portfolios and reporting instructions as well as from competent authorities as regards the relevance of the portfolios and accuracy of benchmark values. Feedback from institutions is mainly gathered via interviews with selected institutions and direct contact between institutions and competent authorities, while feedback from competent authorities is shared with the EBA.

3. Some of the feedback received suggested changes to Regulation 2016/2070 which are deemed necessary to provide clearer instructions of reporting requirements, better data validation and more relevant portfolios for which benchmark values can be calculated, as well as an extension of the benchmarking scope, e.g. to new sub exposure classes. The changes are described separately for market risk and credit risk in the following sections.

3.1 Credit risk changes (Low Default Portfolios – LDP and High Default Portfolios - HDP)

4. The credit risk benchmarking is based on the specification of so-called benchmarking portfolios where risk based differences are stepwise reduced along various dimensions. In a first step institutions need to distinguish between LDP (low default portfolios) and HDP (high default portfolios).

5. For LDP, institutions should identify, for each regulatory approaches applicable (A-IRB, FIRB, slotting approach) all IRB exposures toward those counterparties listed in Template 101 of Annex I. Furthermore, institutions should report the following portfolios in Template 102 of Annex I (this split of the LDP portfolio is referred to as the level-1 portfolio split for LDP):

    a. Large Corporates (specified as the subset of the COREP sub exposure class Corporates - Others containing only counterparties with a total annual turnover of 200 million Euro or more, and which do not fall under the specification of specialised Lending in accordance with 147 (8) CRR), **the scope of this portfolio is therefore more restricted than the current benchmarking exercises ;**

b. Specialised Lending (SLE, specified as the COREP sub exposure class Corporates – Specialised lending is defined in accordance with Article 147 (8) CRR), **this portfolio is not collected as a separate asset class in the current benchmarking exercise**[1]

c. Institutions(identical to the COREP exposure class of that name); **the scope of this portfolio is unchanged from the current benchmarking exercise;**

d. Sovereigns (specified as the COREP exposure class Central Governments and Central Banks), **the scope of this portfolio is unchanged from the current benchmarking exercise**;

6. . In a second step each of the portfolios created are split into the share of defaulted and non-defaulted exposures. The resulting non-defaulted portfolios are further split along various dimensions: On/Off balance sheet exposure, rating assignment, country, CRM, sectors ((FINREP) counterparty sectors and type of exposure). The latter splits are referred to as level-2 portfolio split for LDP.

7. In addition, two additional sub portfolios are collected inside the Large corporates:

   a. Large Corporates Sample: which comprises all entities listed in template 101 of Annex I. **The scope of this portfolio is unchanged from the current benchmarking exercise** (and the changes of the portfolio splits of the "Larges Corporates" are generally applicable to this sub sample[2])

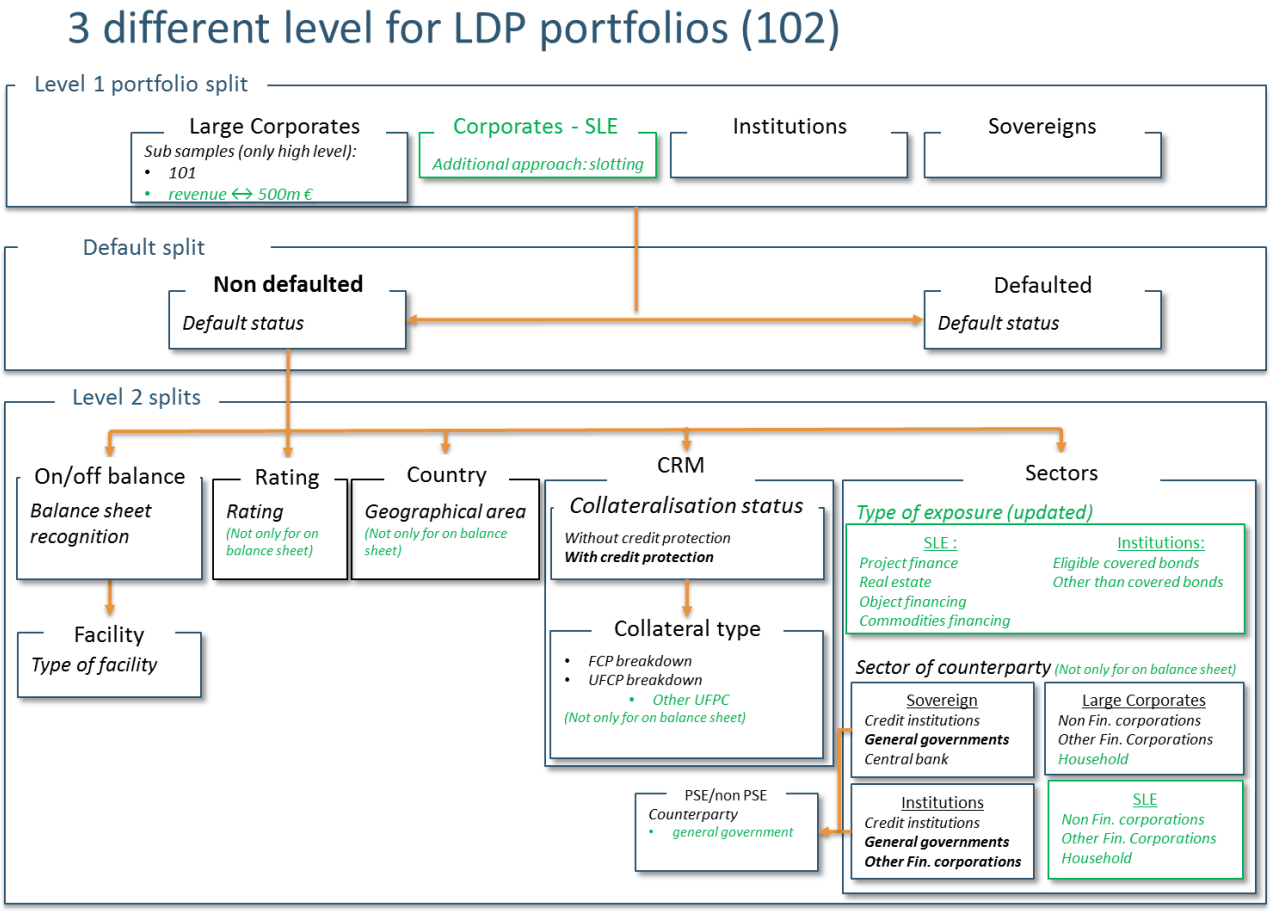
   b. Large Corporates with revenues between 200 and 500 million euros, as well as Large Corporates with revenues above 500 million euros. **These portfolios are not collected separately in the current benchmarking exercise.** It is proposed to collect data only at the highest levels[3]. This split is motivated by the fact that Large Corporates in EBAs Benchmarking are characterised by counterparties with an annual turnover of at least 200 million Euro, but that Large Corporates have been defined as counterparties with an annual turnover of at least 500 million Euro in the context of the final Basel III standard.

8. The following graphs illustrate the portfolio breakdown for the LDP portfolios, where a green colour indicates portfolios which are proposed to be taken on board in the 2020 Benchmarking exercise as explained in more detail below. The changes in the level 2 portfolios are discussed in detail in Sections 3.1. (1-3).

[1] The level 1 portfolio split differs from the specifications of previous benchmarking exercises in that Specialised Lending exposures are treated as a separate class in alignment with their treatment in COREP. The data collected is therefore the same, but in a different structure.

[2] There was no portfolio with default status set as "not applicable". It is now proposed to collect the 6 missing portfolios (3 portfolios for each credit risk type times 2 portfolios for each regulatory approach) in the ITS. The final structure of the Large Corporates Sample mirrors the Large corporates, with the main differences being that the geographical split, Sector of counterparty and On balance sheet splits are not implemented for Large corporate Sample

[3] 18 portfolios are collected for each of the sub portfolios: 3 portfolios for each credit risk type times 2 portfolios for each regulatory approach (AIRB –FIRB) times 3 portfolios for each default status (defaulted, non-defaulted, not-applicable)



9. For the HDP level-1 portfolio split it is proposed to align to the structure of COREP. The rationale for taking SME Retail exposure, QRRE and other Retail exposure on board is to enable the benchmarking exercise to assess almost the full scope of IRB[4]. The proposed level 1 structure is therefore the following:

    a. *CORP:* Corporates - Others (specified as the subset of the COREP sub exposure class Corporates-Other containing only counterparties with a total annual turnover of more than €50 mln and less than €200 mln.). **The scope of this portfolio remains unchanged from the previous benchmarking exercise and corresponds to the portfolio "Corporates - No SME" of previous benchmarking exercises**;

    b. *SMEC: Corporates – SME* (specified as COREP sub exposure class Corporates – SME, which contains only counterparties with an annual turnover of less than €50 mln[5]). **The scope of this portfolio remains unchanged from the previous benchmarking exercise**;

[4] Some exposure classes will still be missing, e.g. equity

[5] This definition is independent of the use of regulatory facilitations for SME (e.g. use of correlation factor)

c. *MORT: Retail - non-SME - Secured by immovable property* (specified as the COREP sub exposure class Retail - Secured by immovable property non-SME[6])**The scope of this portfolio is unchanged from the previous benchmarking exercise**;

d. *SMRE: Retail - SME - Secured by immovable property* (specified as the COREP sub exposure class Retail - Secured by immovable property SME[7]). **This portfolio was not collected separately at the level 1 in previous benchmarking exercise (but was part of the previous "Retail – SME" portfolio)**;

e. *SMOT, Retail - SME - Other, SME-R* (specified as the COREP sub exposure class Retail - Other SME[8]). **This portfolio was not collected separately at the level 1 in previous benchmarking exercises (but was part of the previous "Retail – SME" portfolio)**;

f. *REOT, Retail- non-SME Other* (specified as the COREP sub exposure class Retail - Other non SME[9]). **This portfolio was not collected in previous benchmarking exercise**;

g. *QRRE: Retail - Qualifying revolving* (specified as the COREP sub exposure class Retail - - Qualifying revolving[10]). **This portfolio was not collected in previous benchmarking exercise**;

10. This split of the HDP portfolio is referred to as the level-1 portfolio split for HDP Portfolios. The level 1 portfolio split differs significantly from the specifications of previous benchmarking exercises in order to achieve alignment with the specifications of COREP. In a second step, the level-1 portfolios are split into defaulted and non-defaulted exposure in the same manner as for the LDP split. The resulting non-defaulted portfolios are further split along various dimensions: On/Off balance sheet exposure, rating assignment, country, CRM, LTV and sectors (NACE code). The latter split is referred to as level-2 portfolio split for HDP portfolios. The following graphs illustrate the portfolio breakdown for the HDP portfolios, where a green colour indicates portfolios which are proposed to be taken on board in the 2020 Benchmarking exercise as explained in more detail below.

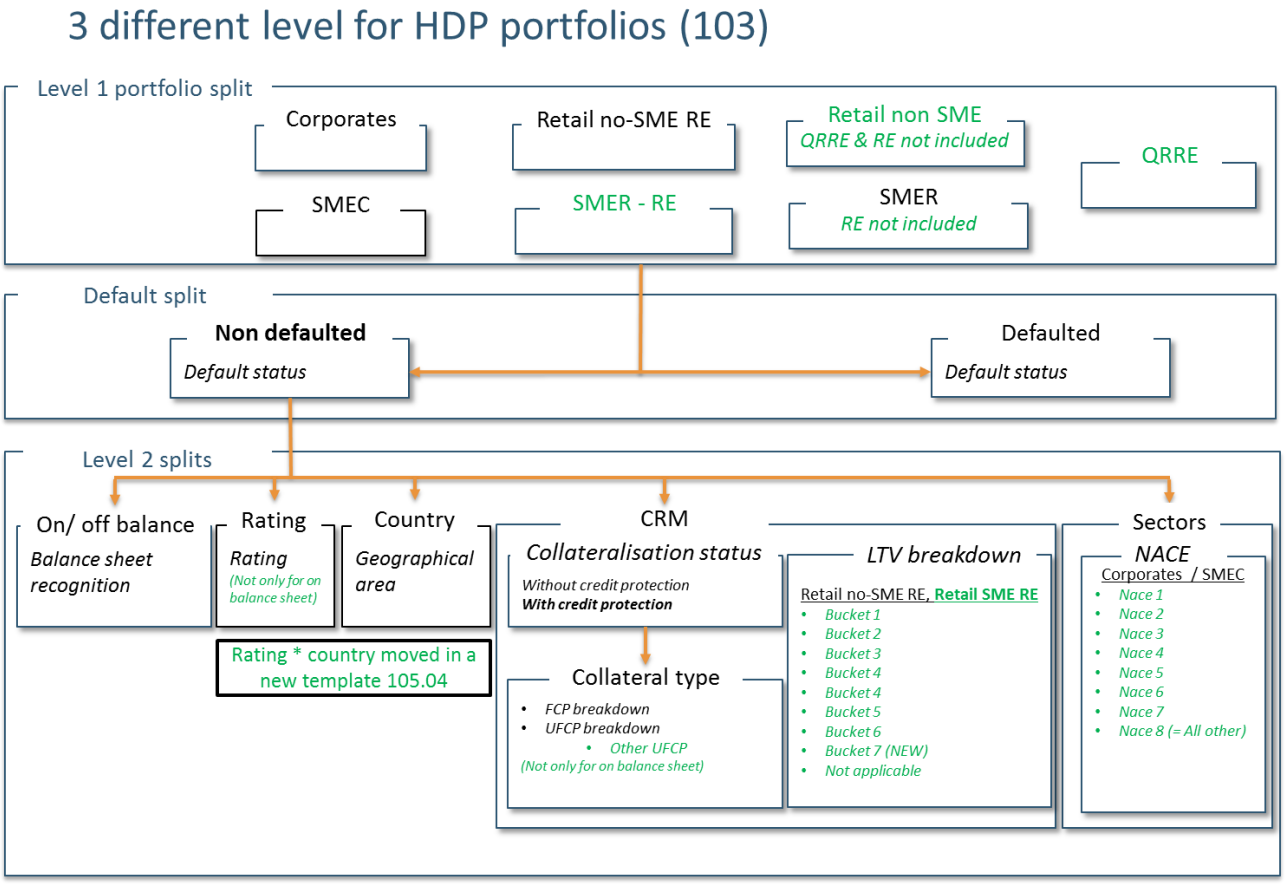
[6] Hence, where the risk weight is calculated in accordance with Article 154 (3) and where the counterparty is an exposure to one or more natural persons in accordance with Article 147(5)(a)(ii).

[7] Hence, where the risk weight is calculated in accordance with Article 154 (3) and which is to counterparties which are SMEs in accordance with Article 147(5)(a)(ii)

[8] Hence, where the risk weight is calculated in accordance with Article 154 (1) and which is to counterparties which are SMEs in accordance with Article 147(5)(a)(ii)

[9] Hence, where the risk weight is calculated in accordance with Article 154 (1) and where the counterparty is an exposure to one or more natural persons in accordance with Article 147(5)(a)(ii).

[10] Hence, where the risk weight is calculated in accordance with Article 154(4)



3.1.1 Reduction of the number of portfolios collected

a. Risk type split

11. For LDP Portfolios: For the previous benchmarking exercises and the upcoming benchmarking exercise 2019 ("current benchmarking"), all LDP Portfolios (specified in Sheet 102 of the Excel Annex I of the draft ITS on benchmarking of internal approaches for the 2019 exercise) have to be reported three times. One portfolio captures the Counterparty credit risk (CC), one captures to the Credit risk and free deliveries (CR) and one captures both types of risks are included (CT). For the 2020 Benchmarking exercise it is proposed that the risk type split for LDP Portfolios is significantly reduced with a separation into CR and CC only envisaged for the level-1 portfolios and default status splits. For all other levels, only CT will be used.

12. For HDP Portfolios: For the 2020 Benchmarking exercise it is proposed that no differentiation by risk type is made, only CT will be used at all levels.

> ***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?

b. Reporting of "empty" portfolios in the rating breakdown

13. Information on the rating scales used by banks is currently collected through the rating grade split portfolios in C102 and C103. For this purpose also "empty" rating grade portfolios (i.e. portfolios without exposure) need to be reported (see ITS on benchmarking Annex IV, PART I (4)[11]). In order to avoid reporting "empty" rating portfolios in future, the information on the rating scale for each model could be selected in a new template C105.04.

Explanatory Box – Rating scale information in C105

In order to reduce the amount of data reported by banks, i.e. to avoid the reporting of "empty rating portfolios" (where only rating grade and PD is reported currently), it is suggested to select the according model information in a new template C105.04 (see ITS Annex IV, C105.04 only columns c010 – c068).

The information to be selected should also be assessed, and the final template 105.04 could be adjusted depending on the feedback received from this consultation.

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?

c. Combined level 2 breakdown

14.. In the current benchmarking it is required that institutions provide a rating split also per country (combined split rating * country; "level 3" split) in template 103. For the 2020 Benchmarking exercise it is discussed to reduce the total number of portfolios in C103 by dropping the rating *country split and selecting according information on model grade level in the new template C105.04 instead. The rationale for this proposal is that the rating * country split has created an excessive amount of portfolios in the past, with some of them not containing a sufficient number of obligors to allow a meaningfully statistical analysis, and, which are not aligned with the institutions' perspective on internal ratings, which is based on rating systems rather than on countries. .

Explanatory Box – Rating Distribution by Country in 105

It has also been considered to completely drop the data collection on the country*rating split in an attempt to simplify the benchmarking structure. However, the analysis of the rating per countries split may still be relevant, in particular when the calibration is performed is a separate manner for different countries. This is because the variability of risk parameters may be

[11] *"For portfolios that are defined with a specific rating grade in Annex I, information on the probability of default ('PD') shall be reported for the entire rating scale used by the institution, even where no internal-ratings based ('IRB') exposure exists for the respective portfolio at the reporting reference date for each rating grade"*

explained by significantly different rating distributions of the different models used by an institution.

Therefore, the current proposal is a compromise solution where the rating distribution by PD model or calibration segment should rather be reported via the benchmarking data collected in the new template 105.04 (including all information/columns selected in C103) as specified in Annex III. In contrast to the previous approach, this split will also cover exposure in LDP. However, the remaining burden on the data collection should be assessed, and the final template 105.04 could be reduced depending on the feedback received from this consultation.

In this context, a further split by country only seems relevant where the considered rating system provides for different PD calibration segments in different jurisdictions.

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?

d. On-/Off balance sheet exposure split

15. In order to reduce the number of portfolios it is proposed for both LDP and HDP portfolios to collect the level-2 portfolios characterised by the rating split, the collateralisation/CRM split and the counterparty/sector split for all exposures regardless of their balance sheet recognition. Thus no separate portfolios characterised by on- and off balance sheet exposure will be reported at this level. This change is not expected to involve significant costs for reporting institutions.

3.1.2 Simplification of the structure of the benchmarking portfolios

a. The specialised lending as a separate exposure class

16. In the 2019 benchmarking exercise, Specialised Lending exposures will be reported as subportfolios of the Large Corporates benchmarking portfolios. For the 2020 Benchmarking exercise it is proposed that specialized lending exposures are treated as a separate e level-1 portfolio split. This is well justified for the purpose of consistency with the HDP level-1 portfolios breakdown into Retail Sub-exposure classes. Another reason to have a separate exposure class for SL stems from the different level risk compared to other corporates. Moreover, other than non-specialized lending exposure in the Corporates exposure class, specialized lending exposures allow for 3 different approaches for the purpose of calculating RWA under the IRB Approach, namely FIRB, AIRB and Slotting approach of Article 153(5) CRR. Last, it should be noted that all SLE are to be reported under LDP independent of the size.

b. Type of exposures (further split for SLE exposures and specific data collection for covered bonds)

17. The level-2 break down proposed for the newly introduced exposure class specialized lending is proposed to be aligned to the categories set out in the RTS on Assigning Risk Weights to Specialised Lending Exposures under Article 153(9) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)[12] : project financing, real estate financing, object financing and commodity financing. Moreover and for the purpose of consistency with the level-2 portfolio split for Large Corporates it is proposed that SLE portfolios are first split by the FINREP sector of the counterparty (Non-Financial corporates, other financial corporates, household, PSE and non PSE), as well as, in an independent manner, by the SLE-Category as set out above. The proposed level-2 split will provide SLE portfolios that are as homogeneous as possible and is more consistent in structure to the according breakdown for Large Corporates.

Explanatory Box – rating for specialised lending exposures under the slotting approach

One of the consequence of introducing the specialised lending exposures as an exposure class similar to the large corporates is the introduction of the rating breakdown for each regulatory approach, and in particular for the slotting approach. 3 options have been explored on this particular data collection:

- Option 1: no rating split for the specialised lending under the slotting approach 9current approach in the CP)
- Option 2: optional[13] rating split defined as a "RW bucket split", where the split would be based on the 8 RW buckets (4 risk categories times 2 maturity categories) defined in the CRR 153 (5). This option is closer to the philosophy of the slotting approach, but departs from the structure of the models used to estimate the data points collected.

The EBA is also reflecting on the need to collect further data, for instance the collection of PD estimates for banks relying on underlying PD models in their slotting approach in a template structure that mirrors the rating split of other exposure classes.

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?

[12] https://www.eba.europa.eu/documents/10180/1489608/EBA-2016-RTS-02+%28Final+RTS+on+specialised+lending+exposures%29.pdf

[13] The current provision in annex 4 C 102 would remain unchanged: "For portfolios with the regulatory approach defined as "Specialised lending slotting criteria", the following information may be omitted: PD (c060), LGD (c130), Maturity (c140)."

18. It is also proposed that in the type of exposure breakdown a new sub portfolio is added, namely covered bonds which are eligible for the treatment set out in Article 129(4) or (5).). In accordance with Article 161 (d), these covered bonds may be assigned an LGD value of 11,25 % where the FIRB approach is applied. This additional data collection would be conducted only for the institutions portfolio.

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?

c. Consistency between the HDP and LDP portfolios

19. In order to simplify the portfolio specification it is proposed to align the level-2 break down for LDP and HDP Portfolios to the extent possible and meaningful. Therefore the revised RTS implements the level-2 portfolio split by CRM as well for HDP Portfolios.

20. Moreover it is proposed to align the definitions to those used in COREP (i.e. unfunded credit protection should be renamed as other unfunded credit protection and instructions should be clarified such that exposures subject to double default treatment are included as well).

Explanatory Box – Data collection on CRM

It should be noted that the portfolios split by CRM, unlike all other splits, does not provide for a subdivision into sub-portfolios which are non-overlapping as one exposure can be secured by more than one CRM instrument. For example retail mortgages may be secured as well by further collateral other than real estate. EBA explored the impact of guarantees on the benchmarking risk parameters in its 2018 Benchmarking exercise.

As a result of this the current CRM breakdown cannot be used for the Top-down analysis, which illustrates in a transparent way the contribution of major drivers of RWA variability, such as the share of defaulted exposure or the portfolio mix. However already EBAs report on consistency and pro-cyclicality published in 2013 pointed out that different collateralization might be a major driver of RWA variability. Therefore in particular for the purpose of explaining RWA variability a clean sub-division of a considered benchmarking portfolio into homogeneous portfolios in terms of collateralization might be very helpful.

A major caveat of the current data collection is however that the data on collateralization is collected with respect to the type of CRM employed. Alternatively it could be considered to create homogeneous portfolios in terms of the share of exposure that is covered, regardless of the underlying CRM instrument.

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?

3.1.3 Technical refinements of the split by

a. NACE code (new NACE codes introduced)

21. In the previous benchmarking exercises and in 2019, the HDP level-2 portfolios for Corporates, Corporates- SME and Retail-SME include a split for sectors by which exposures related to construction firms (NACE code F) can be identified separately. For the 2020 Benchmarking exercise it is proposed to specify more portfolios in the sector breakdown, with the objective of creating more homogeneous benchmarking portfolios and thus reducing the share of unexplained variability. In detail it is proposed that the following sub-portfolios shall be reported:

- A - Agriculture, forestry and fishing
- C - Manufacturing
- D - Electricity, gas, steam and air conditioning supply
- F – Construction
- G - Wholesale and retail trade; repair of motor vehicles and motorcycles
- H - Transporting and storage
- L - Real estate activities
- All Other

22. By including more a granular NACE classification, it is the intention of the EBA to introduce further granularity in the risk differentiation. However, EBA is also mindful of the burden that the introduction of this classification may cause and is therefore seeking input on this aspect.

23. Last, it is also proposed not to collect the NACE breakdown for retail exposures.

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)?

b. Buckets for the ILTV.

24. For the 2020 benchmarking exercise, an update of the ILTV breakdown for the exposures secured by immovable property is envisaged as follows[14]:

- Bucket 1: ≤ 55% if the property is a residential immovable property, <=60% if the property is a commercial immovable property;
- Bucket 2: 55% < ILTV ≤ 70% if the property is a residential immovable property, , 60% < LTV ≤ 70% if the property is a commercial immovable property;
- Bucket 3: 70% < ILTV ≤ 80%;
- Bucket 4: 80% < ILTV ≤ 90%;
- Bucket 5: 90% < ILTV ≤ 100% ;
- Bucket 6: 100% < ILTV ≤ 110%;
- Bucket 7: ILTV> 110%

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?**

3.2 Market risk changes

25. The market risk benchmarking exercise is a market risk-weighted assets ('MRWA') variability assessment performed across institutions that have been granted permission to calculate their own funds requirements using internal models for one or more of the following risk categories:

- general risk of equity instruments;
- specific risk of equity instruments;
- general risk of debt instruments;
- specific risk of debt instruments;
- foreign exchange risk;
- commodities risk; and
- correlation trading.

26. Pursuant to Article 362 of Regulation (EU) No 575/2013 (CRR), the general risk component of debt instruments should refer to changes in the level of interest rates. Similarly, the general risk component of equity instruments should refer to broad equity-market movements.

[14] For QRRE no ILTV split is intended.

27. Institutions granted approval for only general risk of equity or debt instruments (in accordance with Article 363 of the CRR) may use a broader definition of general risk (for example by including elements of credit spread risk (e.g. sector-related credit spread) in the interest rate general risk). Separate permission is required for each risk category. Many institutions do not have permission for internal models for all risk categories. The number of contributions for each hypothetical portfolio in this exercise thus varies across the sample.

28. Institutions granted permission to use the internal model for calculating market risk own funds requirements (OFR) for only one or a selection of the aforementioned risk categories, in accordance with Article 363(1) of the CRR ('partial use'), exclude certain risks or positions from the scope of the internal model approval. In this case, the OFR for the risk categories outside the scope of the internal model is calculated according to the standardised approach.

29. Besides this, as set out in Article 369(1)(c) of the CRR, institutions should conduct validation exercises on hypothetical portfolios in order to test that the model is able to account for particular structural features. These portfolios should not be limited to the portfolios defined in the benchmarking exercise; however, the EBA market risk benchmarking exercise (EBA BM) is a useful starting point for institutions to meet this legislative requirement.

30. The market risk measures, requested from institutions' internal models/modelling units within the EBA BM, are value at risk (VaR), stressed value at risk (sVaR), incremental risk charge (IRC) and all price risk (APR) figures for specific financial instruments and aggregated portfolios. Moreover, a preliminary assessment of initial market valuation (IMV) for each instrument detects the pricing ability of the participating institutions.

3.2.1 Additional pricing information request

31. The new proposal set out in this ITS aims to improve the understanding of the ways the institutions reach the values they submit for the BM. With the updated ITS, institutions are required to submit the pricing information for the benchmark instruments together with the initial market valuation (IMV).

32. Furthermore, institutions are asked to submit the risk factors assigned to the instruments as well as the sensitivities of the instruments with regards to the assigned risk factors. Institutions are asked to submit those data in a non-aggregated way.

33. The additional information collected will help to verify the correct interpretation of the instruments by the institution. These can be done by the comparison and evaluation of the assigned risk factors (e.g. identification of missing risk parameters) and the magnitude of the related sensitivities (e.g. sign of the sensitivity as an indication if long or short instrument). Ensuring the correct interpretation of the instruments leads to better data quality and thus the possibility to deduct more robust conclusions from the collected data.

34. One objective of the benchmarking exercise is to identify drivers of variability in models' outcomes. Currently, credit institutions are asked to submit risk measures (VaR, sVaR, IRC, APR) which allow EBA and the CAs to measure the variability in models' outcomes for the hypothetical portfolios. The

data further allows identifying institutions with significantly deviating results. Additional collected information on modelling choices (e.g. approach, data weighting) allow connecting the results with high-level model properties.

35. The CRD 78(4) mandates further investigations if the submissions of a credit institution significantly diverge from the benchmark. In this case, the supervisory bodies use the information they collected in the process of supervision and inquire with the respective credit institution. This process requires iterative communication between supervisory authorities and credit institutions and allows, in general, to identify errors in the submissions. However, as this in-depth investigation is only conducted in case of significant deviations, there is no full overview of the assumptions and choices of the full sample. It is thus not possible to easily correlate deviations of or alignment with the benchmark with certain model choices. Hence, the described process does not allow to identify and measure drivers of justified variability in models outcomes, the second objective of the benchmarking exercise.

36. The enrichment of the collected data with the Present Value, introduced in the 2019 exercise, allows for a better separation of deviations arising in the pricing engine from separation arising in the risk model (VaR, sVaR, IRC and APR). The inclusion of risk factor and sensitivity information in the data collection for the IMV will allow identifying differences in pricing systems and differences in the integration of the instrument into the institutions' risk engine. This will help to pinpoint sources of deviations in the risk model output and hence allow to identify and quantify the drivers of model variability in the hypothetical portfolio exercise. While the collection and quality assurance of additional data might require additional efforts from the credit institutions and the competent authorities, it will allow a more targeted communication during the in-depth investigation of deviations.

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

3.2.2 Time convention and instruction simplification

37. In the past exercises, the time for expiry of the instruments for Market Risk portfolios has been a source of inaccuracies and confusion. These draft ITS a more general way to express the expiry of the reference dates of the instruments has been adopted, so that it should it would require a minor effort for EBA in the update the future benchmarking exercises, and therefore it should reduce the need to introduce additional information annually .

Explanatory Box – Examples on the time setting for MR instruments

In the common instructions, Annex 5 section 1, the letter "b" (i), "Booking date shall be: 19 September 2019"; and also, in accordance to the letter "ff" and "gg" of the instruction, the

following instrument shall be interpreted as follow from the credit institutions participating to the exercise:

Instrument	ITS text	Interpretation
1	Long EURO STOXX 50 index (Ticker: SX5E) Future (1 point equals 10 € movement). Expiry date: June Year T	Long EURO STOXX 50 index (Ticker: SX5E) Future (1 point equals 10 € movement). Expiry date: **23 June 2020**
10	Short Call Option. Underlying BAYER (Ticker: BAYN GR), ATM (1 contract = 100 shares). Expiry date: End of December Year T	Short Call Option. Underlying BAYER (Ticker: BAYN GR), ATM (1 contract = 100 shares). Expiry date: **31 December 2020**
41	Long Call option. EUR 10 MLN. Equivalent amount based on EUR/USD ECB reference spot rate as of end of the booking date. Strike price: 110% of EUR/USD ECB reference rate as of end of the booking date. Expiry date: Booking date + 1 year	Long Call option. EUR 10 MLN. Equivalent amount based on EUR/USD ECB reference spot rate as of end of the booking date. Strike price: 110% of EUR/USD ECB reference rate as of end of the booking date. Expiry date: **19 September 2020**

38. Furthermore in the section 2 of the Annex 5, a specific set of definitions should enhance the clarity of the information.

39. Finally, additional instruction on the conventions to be used in the booking of the instrument should reduce the ambiguity differences in the results submitted by the institutions to the Competent Authority.

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

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

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

4. Draft implementing technical standards amending Commission Implementing Regulation (EU) 2016/2070 on benchmarking of internal models

COMMISSION IMPLEMENTING REGULATION (EU) No …/...
of [date]
Implementing Regulation (EU) 2016/2070 as regards benchmarking portfolios, reporting templates and reporting instructions

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC[15], and in particular the third subparagraph of Article 78(8) thereof,

Whereas:

(1) Commission Implementing Regulation (EU) 2016/2070[16] specifies the information that institutions have to report to the European Banking Authority ('EBA') and to competent authorities in order to enable the assessments of internal approaches for calculating own funds requirements ('benchmarking exercise') in accordance with Article 78 of Directive 2013/36/EU.

(2) Considering that, pursuant to Article 78(1) of Directive 2013/36/EU, the benchmarking exercise is of at least annual duration and that the focus of the competent authorities' assessments and of the EBA's reports may change over time, exposures or positions that are included in the benchmarking portfolios, and therefore also reporting requirements, need to be regularly adapted accordingly. Therefore, it is appropriate to amend Annexes I to VII to Implementing Regulation (EU) 2016/2070.

[15] OJ L176, 27.06.2013, p. 338.

[16] Commission Implementing Regulation (EU) 2016/2070 of 14 September 2016 laying down implementing technical standards for templates, definitions and IT-solutions to be used by institutions when reporting to the European Banking Authority and to competent authorities in accordance with Article 78(2) of Directive 2013/36/EU of the European Parliament and of the Council (OJ L 328, 2.12.2016, p.1).

(3) This Regulation is based on the draft implementing technical standards submitted by the EBA to the Commission.

(4) EBA has conducted open public consultations on the draft implementing technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010[17].

(5) Implementing Regulation (EU) 2016/2070 should be amended accordingly,

HAS ADOPTED THIS REGULATION:

Article 1

Implementing Regulation (EU) 2016/2070 is amended as follows:

(1) Annex I is replaced by the text set out in Annex I to this Regulation.

(2) Annex II is replaced by the text set out in Annex II to this Regulation.

(3) Annex III is replaced by the text set out in Annex III to this Regulation.

(4) Annex IV is replaced by the text set out in Annex IV to this Regulation.

(5) Annex V is replaced by the text set out in Annex V to this Regulation.

(6) Annex VI is replaced by the text set out in Annex VI to this Regulation.

(7) Annex VII is replaced by the text set out in Annex VII to this Regulation.

Article 2

This Regulation shall enter into force on the twentieth day following that of its publication in the
Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President

[17] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ L 331, 15.12.2010, p. 12.

[For the Commission
On behalf of the President

[Position]

ANNEX

[where necessary]

Annex I (Credit Risk Benchmarking)

Annex II (Credit Risk Benchmarking)

Annex III (Credit Risk Benchmarking)

Annex IV (Credit Risk Benchmarking)

Annex V (Market Risk Benchmarking)

Annex VI (Market Risk Benchmarking)

Annex VII (Market Risk Benchmarking)

5. Accompanying documents

5.1 Draft cost-benefit analysis / impact assessment

A. Problem identification

Article 78 of Directive 2013/36/EU (CRD IV) requires competent authorities to conduct an annual assessment of the quality of internal model approaches, used for the calculation of own funds requirements, and requires the EBA to produce a report to assist them in this assessment. The report of the EBA relies on data submitted by institutions in accordance with EU Regulation 2016/2070, which specifies the benchmarking portfolios, templates, definitions and IT solutions to be used by the institutions as part of the annual benchmarking exercise, when using internal model approaches for market and credit risk.

So far, especially the EBA market risk benchmarking exercise has been relying on the framework of the Basel Committee on Banking Supervision (BCBS) to construct the theoretical portfolios. However, this framework has assisted the EU institutions only to a certain extent, as they mainly address the needs of international (and the most active on trading activities) institutions. Also, these portfolios consist of a mixture of instruments (plain vanilla and exotic derivatives), used by international institutions, something which implies that medium-sized and small institutions may have difficulties in modelling and valuing their portfolios which mainly consist of plain vanilla instruments.

A potential miscalculation arising from the lack of complete guidance could lead to non-consistent application amongst institutions' internal models and potentially to under- or over-valuation of the reported values. The current section assesses the impact of filling in the existing regulatory gap and thus the impact of the ITS.

For the credit risk of the exercise, the number of portfolios as well as some misalignment between the LDP and HDP templates and the COREP templates increase the burden of data collection and makes it more difficult to ensure sufficient data quality. Furthermore, some thresholds have been updated in the latest framework published at international level

B. Policy objectives

As mentioned above, the current framework for the conduct of benchmarking exercises does not address the needs of all EU institutions as to the guidance for modelling and valuation of typical portfolios of medium-sized and small institutions. This provides a leeway for free interpretations that could lead to non-consistent application, which contradicts the promotion

of the principle of harmonising the supervisory and reporting rules of the EU Regulation. To this end, the strategic objective of the implementation of the current ITS is the harmonisation of the current rules amongst EU institutions. The operational objective to achieve the strategic objective is to create a supervisory and reporting environment to ensure that institutions apply consistent modelling and valuation techniques. The following sections examine the options that could create such an operational environment, as well as the net impact that the implementation of such solutions implies.

For the credit risk part of the exercise, the main objective of the templates is to ensure the construction of sufficiently homogenous portfolios that can be compared among institutions. This sole objective would imply to build a portfolio structure as granular as possible; however, in order to ensure sufficient data quality, the magnitude of the data collection should be proportionate, and the structure of the portfolio breakdown should be as clear as possible in order to ensure a common understanding of the data to be reported.

C. Baseline scenario

For the market risk part of the exercise, for most EU institutions, the current status of reporting the results of modelling and valuations implies increased operational costs and possibly miscalculations which lead to over- or under- valuation of the reported values for the purposes of the benchmarking exercises. Since the extent and magnitude of over- or under-valuations cannot be identified, the impact assessment focuses on the assessment of the net impact on the institutions' operations.

For the credit risk part of the exercise, the baseline scenario is a no change of the portfolio's structure, and as a general principle no change in the ITS at all.

D. Options considered

When developing the current ITS, the EBA Staff considered the following options:

Option 1: "do-nothing"

This option implies that credit institutions continue reporting data for the benchmarking exercise;

- using the current guidance and hypothetical portfolios as defined for the exercises up to date.
- Using the current portfolio structure for the credit risk exercise.

For the market risk part of the exercise, the continuation of the current practice assumes that credit institutions and the EBA have an increased operational cost assigned to providing clarifications and ensuring the consistent submission of data. On the one hand, credit institutions would spend much more time in seeking clarifications on the methodology, while, on the other hand, the EBA would have to work bilaterally with each of the competent authorities to clarify the preferred means of modelling and valuation of the reported values.

For the credit risk part of the exercise, the continuation of the current practice would make it difficult to enhance the data quality. The number of portfolios is too high to enable a detailed data quality check process, and the structure of the portfolios structure is materiality different among different asset classes,

The 'do nothing' option would theoretically restrict EBA from dedicating resources to developing and drafting additional guidance to the participating banks. Likewise, the EBA will not bear any one-off arising from the development of additional guidance on the benchmark exercises. Similarly, the national competent authorities (NCAs) and the participating credit institutions would not be expected to bear any one-off costs either.

However, to refrain from drafting the present ITS would involve non-negligible on-going operational cost attributed to the allocation of credit institutions', NCAs' and EBA's human capital to the exchange of questions and answer interchangeably. This also implies the high risk of inconsistent application relating to benchmarking exercises and/or incorrect implementation of modelling, which diverges from the EBA's intended implementation.

Option 2: revision of the guidance related to the benchmarking exercises

The main arguments that support the revision of the guidance on the benchmarking exercises are

(i) to enhance the harmonisation of the benchmarking exercises across all EU credit institutions,

(ii) to reduce the operational cost assigned to the excessive communication amongst credit institutions, NCAs and the EBA.

(iii) to reduce the operational cost assigned to the data quality check of the exercise

For the market risk of the exercise, the current ITS could achieve the first objective by expanding the portfolios suggested by the Basel Committee on Banking Supervision (BCBS), covering the entire spectrum of EU credit institutions. The expansion of the portfolios would be along the lines of credit institutions' needs on the basis of the feedback received by them. Likewise, the vast majority of the EU credit institutions would receive complete guidance on the application of internal models and valuation methods, enhancing the harmonisation across the EU. At the same time, credit institutions would benefit from a streamlined framework that would reduce the cost of on-going cost of the benchmarking exercises across the EU. The second objective could be achieved within this ITS by enhancing the data collection and introducing the sensitivities, this should allow for a better understanding for the root causes of variability in the initial submissions of the IMV and for a more targeted communication with the credit institutions during the analysis phase.

For the credit risk part of the exercise, this option of revision of the benchmarking portfolios would be based on three main principles, namely that the number of portfolios to be reported should be diminished to reduce the complexity of the exercise, to simplify the design of the portfolios by a

closer alignment to the COREP's structure, and with a view on stable portfolios definitions for the future. The stability of the portfolio structures would then be a key to reduce the burden of the data collection on credit institutions. Nevertheless, it should be pointed out that the reduction of the number of portfolios also imply a reduction of the possible analysis that can be performed. It should however be noted that the proposed structure still enable most of the analysis already performed to be continued, and in particular the ones used in the EBA annual benchmarking report.

E. Cost-Benefit Analysis

The principle of proportionality applies to all aspects of the impact assessment, including methodology, depth of analysis, level of detail and necessity of quantitative analysis. Being consistent with this principle, the EBA Staff follows the principle of proportionality when conducting of the cost-benefit analyses. Given that the implementation of the current ITS would not have a detrimental impact, the following analysis focuses on the qualitative characteristics. In doing so, it provides rough estimations on the net monetary impact that relates to the conduct of benchmarking exercises.

The net impact on capital requirements, implied by the implementation of the current guidelines, cannot be precisely assessed because, substantially, it would depend on further actions agreed by institutions with NCAs in response of the benchmarking exercise results; however, it is expected to be on average close to zero due to the hypothetical market portfolio exercise framework. It may be slightly positive for the credit risk part of the exercise, in case the exercise reveals some deficiencies in the models that need to be corrected by the institutions.

Market risk:

Option 1

Costs: a slight increase of the additional operational cost attributed to the bilateral oral or written communication of best practices. This on-going cost is expected to increase over time as a consequence of the increase in the complexity or requirements of the benchmarking exercises. Magnitude of the costs: negligible

Benefits: one-off benefits (reduction of the existing operational costs) of not dedicating human resources to the drafting the present ITS. Magnitude of the benefits: negligible

Net impact (benefits minus costs): close to zero

Option 2

Costs: the one-off cost of dedicating EBA staff to the drafting of the ITS. There is also a source of negligible cost that relates to the need the EBA to explain the new framework to the national competent authorities and, through them, the participating credit institutions. Magnitude of the costs: close to zero

Benefits: the benefits of this option arise from the harmonisation and transparency of the benchmarking exercises and the consistent modelling and valuation of the reported data. In addition it would allow for a better and targeted communication with the credit institution as it offers more insights in the submitted data.

Credit risk:

Costs: the portfolio structure would be still complex, implying significant on-going costs for the data quality check for both institutions and CA, and a very high one off cost for institutions that would start the benchmarking exercise for the first time or do not have yet a fully automatized process. A significant running cost is also incurred for the training of all stakeholders participating in the exercise. On the long run, this exercise may also no longer be consistent with the key thresholds used in the regulatory framework (ILTV threhsolds and Large corporates portfolios defined using the €500mln. Threshold on revenue)

Benefits: no change would mean no additional IT cost for institutions already participating in the benchmarking exercise: negligible

Net impact (benefits minus costs): close to zero

Option 2

Costs: the one-off cost of dedicating EBA staff to the drafting of the ITS and the update of the IT structure of the institutions which have already a fully automatic process. The cost on the additional data collection (Covered bonds for the LDP, new portfolios for HDP to mirror the COREP structure, new template 105.04) are assumed to be low as closely related to already existing regulatory and reporting concepts. The exact cost of this options is difficult to assess, and therefore this consultation paper asks feedback on this matter.

Benefits: the benefits of this option arise from the streamlining of the portfolio structure. The technical amendments (Covered bonds, NACE code, ILTV, Large corporates sub portfolio) would also allow a better segmentation to explain RWA variability, as well as an alignment with the structure of the portfolios implied by the latest framework published at international level

Net impact (benefits minus costs): positive

F. Preferred option

Although these benefits are not directly observable and are spread in time, they are considered not being negligible and cannot be ignored. Magnitude of the benefits: low

Net impact (benefits minus costs): positive (low)

The cost-benefit analysis above designates that option 2 is the preferred option as it produces a positive, albeit low, impact. Thus, the cost-benefit analysis above justifies the production of the present ITS and its subsequent publication for consultation. Moreover, it is consistent with the feedback and requests of the participating credit institutions which sought clarifications on the methodology of conducting benchmarking exercises, as well as a simplification of the data collection for credit risk.

5.2 Overview of questions for consultation

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?

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?

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?

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?

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?

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?

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)?

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?

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

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

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

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