

The European Banking Authority
20 Avenue André Prothin
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Public consultation: Draft Regulatory Technical Standards on emerging markets and advanced economies (EBA/CP/2021/14)

The Association for Financial Markets in Europe (AFME) and International Swaps and Derivatives Association (ISDA), collectively ‘the industry’, welcome the opportunity to comment on the EBA’s consultation on the “draft RTS on emerging markets and advanced economies”.

Executive Summary

The industry would support an approach that takes into account economic evolution as well as development of markets instead of relying on the static BCBS list. The industry believes that there are no simple econometric methodologies that can be applied in order to achieve a precise definition of an advanced market. Broad factors such as economic integration, rule of law and advanced financial system, combined with more detailed factors such as transparency of disclosures, quality of insolvency laws and availability of hedging products are all important factors that banks consider when offering their clients investment products in a specific market.

We believe that the economic integration in Europe, both within the EU and the EEA, including advanced common investor protections and disclosure requirements, cross border access and access to a wide range of financial services providers have effectively resulted in a system that can be defined as an advanced economy. In addition, the BCBS list of countries outside the EU/EEA has omitted a few advanced markets, such as South Korea, Israel and Taiwan. The industry believes that the EBA should add these countries from the IMF list¹ to the EU framework and continue reviewing the list periodically. This is to ensure that economic advancements are reflected appropriately in the risk weights and economic development is not hampered by higher capital/investment costs.

Finally, because the classification is only used to assign equity risk weights to equity exposures under the standardised approach, the approach should focus on whether the equity capital markets of a country can be classified as advanced versus emerging. There are a number of complementary metrics we describe in our response to question two that may be used to capture volatility and liquidity of markets to determine if a specific market fulfills the definition of an advanced market.

¹ <https://www.imf.org/en/Publications/WEO/Issues/2021/03/23/world-economic-outlook-april-2021>

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Q1. Do you agree with the list provided in Article 1 or do you think that the EBA should propose an alternative list? In particular, do you think that there is a case for additional – or potentially all - EU/EEA countries to be added to the list? Please elaborate providing technical evidence and focusing on similarities and differences in risk across markets.

Response:

The industry would support an approach that takes into account economic evolution as well as development of markets instead of relying on the static BCBS list. Notably, the BCBS list excludes major equities markets such as South Korea, Israel and Taiwan and European countries such as Czech Republic and Iceland, which are all included in the IMF’s list of advanced economies. The IMF methodology takes into account factors such as income per capita, export diversification and integration to the global financial system, which are all helpful indicators to identify market specific risks.

With regards to the EU/EEA markets, we believe that the economic integration, advanced common investor protections and disclosure requirements, cross border access and access to a wide range of financial services providers have effectively resulted in a system that can be defined as an advanced economy.

Q2. What are the metrics, sources, and other criteria that should be used for potentially defining alternative criteria on which a list of advanced economies could be based? Please elaborate considering the context in which this definition this will be applied, i.e. assigning a lower/higher risk weight for equity risk.

Response:

The industry believes that there are no simple econometric methodologies that can be applied in order to achieve a precise definition of an advanced market. Broad factors such as economic integration, rule of law and advanced financial system, combined with more detailed factors such as transparency of disclosures, quality of insolvency laws and availability of hedging products are all important factors that banks consider when offering their clients with investment products in a specific market.

In more detail, because the classification is only used to assign equity risk weights to equity exposures under the standardised approach, the approach should focus on whether the equity capital markets of a country can be classified as advanced versus emerging. There are a number of complementary metrics that may be used to determine volatility and liquidity:

- Outright volatility of the equity market
- Daily turnover of the equity market as a percentage of market capitalisation
- Correlation of the market with G10 countries during time of stress
- Availability of listed hedging and risk management products
- Number of regulated local market makers

- The ratio of foreign to local participants

The following additional factors may be useful to consider on the basis that they provide an indication of the markets ability to function effectively during times of stress:

- Sophistication of the exchange:
 - Percentage of the market accessible through electronic trading;
 - The settlement mechanism; and
 - The ability of the exchange to perform daily margining.
- Number of exchanges (i.e. are there competing exchanges to the main exchange)
- Degree of oversight of the exchanges by the national regulator
- Level of the country's compliance with Basel regulations

We do not support the use of metrics such as GDP and debt to GDP or inflation as these metrics are more relevant for other asset classes such as interest rate, credit and foreign exchange risk. Similarly, entities holding equities in another country would be required to capitalise for FX risk. As a result, the assessment of the risk weights applicable to equity risk should exclude this impact.

Q3. Do you think that there are markets of other countries that are characterised by a higher liquidity and lower volatility if compared to those included in Article 1, which as such should not trigger a higher risk-weight if compared to those of the countries listed in Article 1? Please elaborate providing evidence.

Response:

As mentioned in our response to question one, the BCBS list of countries outside the EU/EEA has omitted a few advanced markets, such as South Korea and Taiwan. The industry believes that the EBA should add these countries from the IMF list to the EU framework and continue reviewing the list periodically. This is to ensure that economic advancements are reflected appropriately in the risk weights and economic development is not hampered by higher capital/investment costs.