Jon Newton and Lisa Robinson-Hammond
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA
CP5_21@bankofengland.co.uk

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Subject: Public consultation- Implementation of Basel standards[1]

The International Swaps and Derivatives Association (ISDA) and the Association for Financial Markets in Europe (AFME), the 'Joint Associations', and their members, 'the Industry', welcome the opportunity to comment on the PRA's consultation on the "Implementation of Basel standards".

As per the Financial Services Bill[2], which denotes the approach the PRA must take when making CRR rules, we have also taken account of the following in our response:

(a) relevant standards recommended by the Basel Committee on Banking Supervision (BCBS) from time to time;
(b) the likely effect of the rules on the relative standing of the United Kingdom as a place for internationally active credit institutions to be based or carry on activities; and
(c) the likely effect of the rules on the ability of CRR firms to continue to provide finance to business and consumers in the United Kingdom on a sustainable basis in the medium and long term.

Overall the Industry remains concerned by certain elements in the Basel III reforms and the significant impact the package will have on capital requirements for specific product and risk categories. The Industry is furthermore concerned that combined with certain elements of Basel III implementation as set out in the HMT's Implementation of the Investment Firms Prudential Regime and Basel standards consultation[3], the UK's attractiveness for global derivatives activity could be negatively impacted.

The Industry reiterates that consistency in the capital rules implementation is important both across UK institutions and globally across regions, in particular with regards to implementation timelines, and therefore welcomes standards that are aligned globally, but allow for targeted UK adaptations and improvements where necessary.

As part of this consultation response, we have responded to:

- Chapter 7 in the case of CIU exposures for credit risk, where we seek a solution to allow for the continued investment in CIUs, which supports investment in the real economy, due to the lack of existing equivalence decisions.

[1] https://www.bankofengland.co.uk/prudential-regulation/publication/2021/february/implementation-of-basel-standards
[2] https://publications.parliament.uk/pa/bills/lbill/58-01/162/5801162.pdf - 144C Matters to consider when making CRR rules
[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/958183/Prudential_Consultation.pdf

- Chapter 8 on the implementation of the Standardised Approach for Counterparty Credit Risk (SA-CCR) which will materially increase capital requirements for firms with market making activities in the UK and the Industry has highlighted key areas identified as priorities for remediation in the SA-CCR framework.

- Chapter 9 where we seek clarity, in the form of guidance, on the treatment of operating lease expenses for the purposes of calculating operational risk.

- Chapter 10 relating to the large exposures framework where we identify key areas that require immediate clarification to aid implementation as well as areas for re-calibration to ensure firms' capacity to support the real economy in not unduly constrained.

- Chapters 11 and 12 relating to liquidity requirements where some of our main points cover the historical look back approach under the LCR; the treatment of equities; and, what appears a very high impact omission in relation to the treatment of client clearing transactions under the NSFR.

- Chapters 13 and 14 where we seek clarifications and guidance regarding reporting and disclosure templates.

We thank you in advance for your consideration. Please do not hesitate to contact the undersigned Joint Associations with questions or if you would like to discuss our recommendations further. The Joint Associations remain committed to assisting the PRA in achieving the objectives of this important consultation.

Gregg Jones
Director, Risk and Capital
International Swaps and Derivatives Association, Inc. (ISDA)
25 Copthall Avenue (3rd floor), London EC2R 7BP
Tel: +44 (0)20 3088 9746
gjones@isda.org

Sahir Akbar
Managing Director, Prudential Regulation
Association for Financial Markets in Europe (AFME)
25 Canada Square, London E14 5LQ
Tel: +44 (0)20 3828 2732
sahir.akbar@afme.eu

Chapter 7: CIUs

The Industry would like to highlight some points concerning CIUs (Collective Investment Undertakings) and the issue of third-country equivalence relevant to the standardised approach for credit risk and large exposures.

In our response to HMT's public consultation titled 'Implementation of the Investment Firms Prudential Regime and Basel 3 standards', we welcomed HMT taking a pragmatic approach to implementation of the new hierarchy of approaches, however we urge the removal of the standalone equivalence requirement. Re-alignment with the Basel standards and removal of the equivalence requirement for these CIU exposures would support global competition. The third country restrictions do not solely impact investments but also collateral positions. They reduce the range of liquidity management products available to an institution in an emerging market, they make the establishment of CIUs by UK institutions in an emerging market prohibitively expensive, they restrict the range of investments available, they limit the amount of credit risk mitigation possible, and as noted below they have the potential to penalise firms for complying with the expectation of local regulators or governments that they participate in local solidarity or green investment schemes.

In the first instance, if equivalence is retained then it is imperative that key jurisdictions are assessed for equivalence ready by 1 January 2022 in time for implementation of the new framework. There is a risk of unintended cliff edge effects as firms manage investments to avoid attracting a 1250% risk weight in the period where equivalence assessments are not ready. Currently, HMT's CRR 132(3) equivalence table solely references the EEA as an equivalent jurisdiction. This is very restrictive.

Where necessary, and/or as an interim step, the PRA could require firms to make 'case-by-case' equivalence assessments using an independent third party assessment. The firm would incur the cost of doing the assessment, and this is an approach that has been previously used with the UK regulators for other exposures.

The Industry also believes that specific treatment should be introduced in relation to investments that are made to satisfy Government requirements (for example investments under the Community Reinvestment Act in the US) or investments which support Government endorsed investment programmes (for example the Business Growth Funds in the UK, Canada and Australia). These may not qualify as legislative programmes within the definition of the Basel standards but are nevertheless investments intended to support Government objectives.

Additionally, on another point of clarification, the Industry also notes that in Rule 7 in Section 5 of the new large exposures CRR part of the rulebook provides conditions where the structure of a transaction shall not constitute an additional exposure (i.e. look-through is not required). One of these conditions covers measures designed to prevent the redirection of cash flows away from the transaction to persons who are not entitled to receive them and sets out that UK UCITS's and similar structures in an equivalent third country are automatically assumed to meet this condition. The Industry assumes that the equivalence provisions for CIUs in Article 132 are relevant here however we would request that HMT explicitly state this in their list, and/or that the PRA makes the minor amendments to their wording (page 131, PRA Rulebook (CRR) Instrument 2021) to clarify which equivalence decisions are relevant here.

In relation to the ability to use LTA and MBA, one of the conditions is that there is sufficiently frequent and granular information by the CIU or its management company. The term 'sufficiently frequent' however is not defined and we ask that the requirement under Article 132(c)(iii) is clarified in this regard.

It would also be helpful to understand whether the PRA concurs with the recent EBA view (EBA/RTS/2021/04 page 59) that in principle CIUs are not subject to prudential consolidation. In respect of significant holdings in CIUs the interaction between the look-through rules and the consolidation rules is not clear, and if CIUs are subject to consolidation then potentially small changes in the size of a shareholding can produce a cliff effect in RWAs.

As a final point, the Joint Associations note that many of the same issues (particularly issues around regulatory equivalence) that arise in the calculation of credit risk for banking book CIUs also arise in the calculation of market risk (including the traded default risk charge) for trading book CIUs which will also form part of the UK delegated act currently under consultation by HMT. In order to avoid perverse incentives for firms to assign CIUs to one book or the other, the ability to qualify for a more favourable capital treatment (such as look-through) should be as consistent as possible.

Additional technical amendment

The PRA notes on Page 54 of Appendix 9[4] to the consultation i.e. the draft PRA rulebook, state that "Articles 134 to 154 remain in the CRR". The Industry believes this is an error and should be corrected to state "Articles 133 to 151 remain in the CRR".

[4] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2021/february/cp521app9.pdf

Chapter 8. Counterparty Credit Risk

The SA-CCR framework is a major development that will have multiple implications for the UK's capital framework as it replaces the Mark-to-Market Method (MtMM) and the Standardized Method (SM) for the calculation of Counterparty Credit Risk (CCR) exposures.

The introduction of SA-CCR not only affects the calculation of capital requirements for CCR, it will also be used in many other areas across the prudential framework, such as for calculating capital requirements for CVA risk, the exposure measure in the Large Exposures framework[5] (replacing the Internal Model Method (IMM)), for the Leverage Ratio, and for the forthcoming capital Output Floor requirement expected to be introduced from 2023 in line with the the Finalised Basel package[6]. Thus it will affect all firms, regardless of their current model approvals and users of derivatives. The impact to firms and the distortion versus risk calculated under previous methods are likely to be significant. Therefore, in the Industry's view, the significance of this change on a standalone basis warrants further review by the PRA before it is rolled out to other parts of the framework.

The proposals made in this response letter are based on two key principles. Firstly, the Industry expects that the UK regulations be aligned to the Basel standards, unless there is a compelling reason for divergence. Indeed the Industry strongly believes that SA-CCR should be reviewed by the BCBS to bring about consistent clarifications and improvements across all jurisdictions. Secondly, it is critical that the UK continues to remain competitive in the international financial markets and therefore implementation of SA-CCR needs to take into account international developments.

The Industry is supportive of the move to a more risk-based measure and believes that an appropriately revised version of SA-CCR would be a major improvement over the current framework. However, there are elements of the proposal that could have a significantly negative impact on liquidity in the derivatives market and could hinder the development of capital markets in the UK. The Industry believes that disproportionate impacts arising from the current design and calibration of SA-CCR ought to be addressed to avoid reducing the competitiveness of UK corporates and to avoid damaging implications for the standing of the UK as a major centre for international capital markets activity. Regarding this point the Industry notes that Section 144C of the forthcoming Financial Services Bill[7] states that : *"When making CRR rules, the PRA must, among other things, have regard to … (b) the likely effect of the rules on the relative standing of the United Kingdom as a place for internationally active credit institutions and investment firms to be based or to carry on activities …".*

The Industry would furthermore like to highlight to the PRA that, while SA-CCR is more risk-sensitive, its current design and calibration will lead to disproportionate increases in capital requirements for firms. In terms of impact, an Industry Quantitative Impact Study (QIS)[8] shows that the introduction of SA-CCR would lead to a 50% increase in CCR RWAs. This analysis only considers the impact on counterparty credit risk capital requirements in isolation and does not consider the impact of SA-CCR's interactions with other areas of the prudential framework such as the capital Output Floor. We would highly recommend that the

[5] https://www.bis.org/basel_framework/standard/LEX.htm
[6] Basel III: Finalising post-crisis reforms, Basel Committee on Banking Supervision (BCBS), December 2017, (available at: https://www.bis.org/bcbs/publ/d424.htm)
[7] https://publications.parliament.uk/pa/bills/lbill/58-01/162/5801162.pdf
[8] https://www.isda.org/2018/12/07/isda-response-to-industry-quantitative-impact-study-on-sa-ccr/

PRA conduct further impact assessments to determine and better understand the impacts of SA-CCR to the UK capital market.

The Industry is particularly concerned about the potential cost implications for commercial end-users ("CEUs"[9]), who benefit from using derivatives for hedging purposes. Any requirements that make the use of derivatives more expensive in the UK may affect the ability of CEUs to hedge their funding, currency, commercial and day-to-day risks, which would in turn weaken their balance sheets and make them less attractive from an investment perspective and less competitive globally. In addition, the Industry notes that some jurisdictions have opted to deviate from the Basel SA-CCR standard in certain respects, for example choosing more pro-business-oriented treatment of derivative usage by CEUs. Hence the PRA's implementation of SA-CCR would have important implications for the competitiveness of the UK in continuing to attract derivatives markets activity.

Outlined below are some of the areas which would benefit from being reconsidered. These topics are divided into separate sections: (i) Industry priority items which the Industry believes are crucial for the PRA to resolve; (ii) topics which should be addressed by the PRA raising them at BCBS level (which would naturally involve a longer-term resolution timescale); (iii) clarifications on proposed text; and (iv) capital requirements for exposures to central counterparties.

The Industry reiterates its strong support for the principle that unresolved issues stemming from the Basel SA-CCR standard should be reviewed by the BCBS.

I. Industry Priority Items

The priority topics for immediate action by the PRA fall into four of broad themes of the proposed rules which deserve reconsideration:

A. Alpha Factor
B. Netting
C. Calculation of Risk Position
D. Other Items

Further details on these priority topics are provided below.

A. Alpha Factor

One of the BCBS's stated goals for SA-CCR was to develop a risk-sensitive methodology that differentiates between margined and unmargined trades and provides more meaningful recognition of netting benefits than the previous non-modelled approaches.

[9] In this response CEU is intended to mean any market participant which is exempted from the uncleared margining requirements

The Alpha Factor, which is rooted in historical credit risk analysis performed for IMM calibration, was introduced in the methodology so that SA-CCR would not produce a lower exposure amount than a modelled approach.

However, the Alpha Factor, in combination with conservative assumptions and calibrations in the SA-CCR methodology (such as limited diversification benefit across hedging sets and the add-ons calibrated to a stress period) produces an exposure amount that is materially greater than exposure calculated under IMM.

To mitigate the significant uplift in requirements to firms that enter derivatives transactions with CEUs and to prevent negative implications to CEUs, the Industry recommends the removal of the Alpha Factor. This is the Industry's preferred measure both to provide relief to CEUs, for implementation purposes and to support the competitiveness of the UK more broadly in attracting derivatives activity.

While SA-CCR's focus on margining, directionality and clearing generally improves risk-sensitivity in counterparty credit risk calculations, SA-CCR does not include exposure adjustments to reflect CEUs' investment grade status or their use of credit risk mitigants that do not qualify as eligible forms of credit risk mitigations ("CRM") under the capital rules (e.g. letters of credit, liens, and similar pledges) but that still reduce a firm's counterparty credit risk.

Similarly, SA-CCR does not recognise the portfolio credit risk diversification benefits associated with exposures to CEUs or the fact that directionality in CEUs' derivatives portfolios may balance and offset directionality in the CEUs' underlying commercial positions, thereby potentially reducing CEUs' default risk on directional derivatives portfolio.

Finally, it is worth noting that CEUs' transactions are generally unmargined, hence the application of the Alpha Factor is even more punitive to CEUs than to other types of counterparty.

Given the above, the Industry expects SA-CCR to have significant negative implications to CEUs. The Industry's view is that the removal of the Alpha Factor uplift for CEUs is necessary to ensure that CEUs have ongoing access to derivatives markets to hedge and mitigate their commercial risk. On the one hand, the proposed 40% uplift of the Alpha Factor is by design a rough estimate added on to ensure conservatism in derivatives counterparty credit risk calculations, that is rooted in historical credit risk analysis performed for IMM calibration. On the other hand, the resulting uplift would impose important economic penalties on firms, it would constrain UK firms' capacity to support demand for derivative products at an acceptable cost, and would leave UK corporates with fewer affordable alternatives to hedge their structural commercial risk. The increased difficulty to hedge could in turn affect these corporates' financial strengths and competitiveness, when in the aftermath of the Covid crisis they may be most vulnerable.

Removal of the Alpha Factor is the preferred way to provide necessary relief to CEUs, and also to better align SA-CCR with the policy objectives of exemptions for CEUs in the mandatory clearing and UMR (Uncleared Margin Regulations) framework[10]. The Industry notes that exemptions of CEUs from regulatory non-cleared margin and clearing requirements also seek to ensure that CEUs have ongoing access to

[10] Basel Committee on Banking Supervision, Margin Requirements for Non-Centrally Cleared Derivatives (Sept. 2013), *available at https://www.bis.org/bcbs/publ/d499.pdf.*

derivatives markets to hedge and mitigate their commercial risk as a key policy objective. The large impact of the Alpha Factor to transactions with CEUs is not consistent with this objective.

Other jurisdictions such as the US have recognised this inconsistency and removed the Alpha Factor for transactions with CEUs. The Industry has similarly requested EU authorities to reconsider the impact of the Alpha Factor to CEUs in the EU's implementation of SA-CCR as part of a CRR3 Fast-Track process that could be finalized ahead of the overall CRR 3 legislative package. Hence also removing the Alpha Factor from the calculation of exposure for transactions with CEUs in the UK would avoid reducing the competitiveness of UK firms and corporates, and prevent negative implications for the standing of the UK in international capital markets activity.

Removing the Alpha Factor from the calculation of exposure for transactions with CEUs will better align with the counterparty credit risk presented by such exposures due to the presence of credit risk mitigants and the potential for such transactions to present right-way risk. In particular, derivative exposures to CEUs may be less likely to present the types of risks that the Alpha Factor was designed to address, and therefore removing the Alpha Factor for such exposures will improve the calibration of SA–CCR. In addition, removing the Alpha Factor for CEUs would also reduce the impact of an overestimation of expected exposures for unmargined transactions given the one year modelling horizon[11]. Under SA-CCR, the exposure for unmargined transactions would be modelled based on a one year modelling horizon.

Recommendation(s)

The Alpha Factor should be removed from the exposure amount formula for derivative contracts with commercial end-user counterparties.

B. Netting

B.1. Align with BCBS proposals on treatment of multiple margin agreements within a netting set

The original publication of the SA-CCR rule took place in 2014 at Basel level, and was introduced in the EU as part of the second iteration of the Capital Requirements Regulation ("CRR2")[12] as adopted in 2019 and onshored by the UK regulators. As proposed in the PRA draft rulebook SA-CCR articles do not reflect certain changes made by the BCBS[13] for the treatment of multiple margin agreements and multiple netting sets, and therefore could lead to an outdated calibration. Through this consultation process there is an opportunity for the UK SA-CCR rules to include the latest interpretations and clarifications provided by the BCBS in its consolidated Basel 3 framework (which now includes answers to FAQs) in light of promoting a level-playing field.

[11] For example, for an unmargined two year gas contract settled over time on a monthly basis, the overestimation could be 2 times by not reflecting reduction in exposure over the modeling horizon. In principle, this affect could also arise in unmargined interest rate / credit derivatives given that duration would decay over time as well.
[12] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0876
[13] In particular section CRE 52.74 of the consolidated Basel III framework on the treatment of multiple margin agreements and multiple netting sets

The original SA-CCR calculation methodology required firms to divide a netting set which is defined on the basis of a master netting agreement into separate netting sets, where multiple margin agreements exist. However, in December 2019 the BCBS provided further clarifications with regard to the treatment of netting sets with multiple margin agreements through the FAQ to rule CRE52.74[14] in which it is specified that grouping of derivative transactions in one netting set when calculating the Replacement Cost (RC) and Potential Future Exposure (PFE) is allowed subject to certain conditions.

Given that this BCBS clarification is available to all jurisdictions that are currently adopting SA-CCR (via the consolidated Basel 3 Framework), it would be beneficial for UK SA-CCR rules to be aligned with the Basel standards, which strikes a better balance in the recognition of legal agreements and of the benefit of having multiple margin agreements.

Recommendation(s)
The UK SA-CCR rules should align with the clarification provided by the BCBS FAQ on the treatment of multiple margin agreements in a single netting set.

B.2. Align with Basel standards on the treatment of liquidation period for un-margined netting sets

Article 276(3)(a) requires firms to apply a 1-year liquidation period to all unmargined netting sets for the calculation of collateral haircuts, irrespective of the maturity of the transactions in the netting set. This diverges with Basel FAQ CRE52.10[15], which takes into consideration maturity by requiring the liquidation period to be the maturity of the longest transaction in the netting set, capped at 250 days. The proposed treatment unduly penalizes netting sets with short maturities and unreasonably undermines the risk mitigation effect received from eligible collateral. It also adversely impacts the regulatory capital benefit arising from market developments in Settle-To-Market (STM), under which the variation margin is treated as cash settlement rather than collateralization and leads to a shorter, i.e., 1 day, trade maturity.

Under the current PRA proposal, the value of cash and securities collateral received for these transactions is reduced by a factor of 5 times more (√250/10) than required under global standards. Therefore, the Industry recommends that the UK implementation should align with Basel standards.

It is suggested to allow firms to apply a lower liquidation period that equals:
- Maturity ("M" as defined in Article 279c for Maturity Factor) floored at 10 business day, when the longest maturity of the trades in the netting set is less than 1 year;
- 1 year, when the longest maturity of the trades in the netting set is more than 1 year.

This proposal is aligned with the determination of the Maturity Factor for unmargined netting sets.

[14] https://www.bis.org/basel_framework/chapter/CRE/52.htm
[15] https://www.bis.org/basel_framework/chapter/CRE/52.htm

Recommendation(s)
Consider amending Article 276(3)(a) to read: '*the remaining maturity of the longest transaction in the netting set, capped at 250 business days and floored at 10 business days, for the netting sets referred to in Article 275(1)*' and adding the following: 'W*here a transaction is structured to settle outstanding exposure following specified payment dates and where the terms are reset so that the market value of the transaction is zero on those specified dates, the remaining maturity of the transaction shall be equal to the time until the next reset date*'.

B.3. Increase flexibility in certain parts of the methodology, such as allowing index decomposition

On the allocation of complex positions to more than one asset class (PRA CP paragraph 8.1), the fact that the PRA is moving away from the prescriptive EU approach and increasing flexibility for firms is a positive step. It is a good illustration of where the PRA can achieve the desired policy outcome by enabling firms to better reflect the risk associated with transactions and by obtaining sufficient assurance via implementation reviews. This approach should be encouraged in other parts of the methodology where it is also appropriate.

Firms should be allowed to use a look-through approach to decompose indices within credit, equity and commodity asset classes to more accurately reflect the exposure of highly correlated long and short positions. The hedging set amount for equity and credit derivative contracts requires a firm to differentiate between index and single name underliers for the purposes of different supervisory factors, option volatilities and correlation parameters. With respect to commodity indices, a firm would have to select a single supervisory factor to the index and treat it as a single commodity sub-class as opposed to a diversified index. As a result, firms are unable to decompose an index into its underlying components as they do for other capital requirements (e.g. in the FRTB under the Basel standards)[16].

The option to use a look-through approach to decompose credit, equity or commodity derivatives referencing an index into single-name derivatives each referencing one component of the index recognises the hedging benefit provided by the component of an index and provides enhanced risk sensitivity to SA-CCR framework.

The decomposition of indices for the purpose of calculating capital requirements is a well embedded practice for firms that is already required or permitted in other parts of the prudential framework. Therefore the Industry would support the PRA to provide for an option to decompose equity, credit and commodity indices within SA-CCR, should firms be able to carry out such decompositions. This approach will more appropriately represent the risk and will better align with the FRTB. It will also match the approach chosen by US regulators.

[16] MAR21.31 (Treatment of index instruments and multi-underlying options) https://www.bis.org/basel_framework/chapter/MAR/21.htm?inforce=20230101&published=20200327#paragraph_MAR_21_20230101_21_31

Recommendation(s)

Allow firms to use a look-through approach to decompose multi-underlying credit, equity and commodity derivatives into their single-name derivative constituents to improve recognition of hedging / offsetting benefits and hence better reflect the risk associated with transactions.

C. Calculation of the Risk Position

The calculation of the risk position, as described in Article 279, involves:

1. Supervisory Delta (Article 279a)
2. Adjusted Notional Amount (Article 279b)

The Industry makes the following suggestions:

C.1. Supervisory Delta

Apply lambda (λ) adjustment at trade level

The Black-Scholes based Supervisory Delta formula assumes a lognormal distribution of a trade's underlying prices. This means that underlying prices cannot fall below zero. Given that some interest rates have become negative firms are allowed to calibrate a shift parameter that accommodates negative interest rates.

Article 279a (1) states that institutions should use the same lambda (λ) parameter across all interest rate options in the same currency and that lambda (λ) should be set as the lowest possible value across all interest rate options in the same currency within the portfolio of an institution.

This approach has two disadvantages. Firstly, it may lead to a misstatement of the sensitivities to rates. Changes in the value of the lambda (λ) parameter should be matched by a change of the volatility of the same currency. However, the SA-CCR supervisory rates volatility is constant for every currency and maturity. Also, shifts vary significantly across maturities of the underlying swap, with larger shifts applied to shorter maturities.

Secondly, the calibration of the lambda (λ) parameter based on an institution's portfolio will result in different estimates of the Supervisory Delta across institutions for the same trade.

The Industry recommends setting the lambda (λ) parameter at trade level (as opposed to across all interest rate options per currency), as the absolute value of the minimum between the price (P) and strike price (K), floored to a minimum threshold. This approach guarantees that the treatment for a given trade is consistent and comparable across institutions regardless of the composition of their portfolios.

The Basel rules from 2018 state that the lambda (λ) parameter should be calculated and applied per-currency. The US implementation of SA-CCR followed this definition.

However, the EBA consultation of December 2019[17] resulted in the EU deciding that the lambda (λ) parameter should be calculated and applied per-trade. The Industry suggests that in the UK the lambda (λ) adjustment, if used, should be calculated and applied per trade.

Provide methodology to deal with negative underlyings across all asset classes
The shift parameter in the Supervisory Delta formula was introduced to accommodate negative interest rates. However, this fix is limited to interest rate options. The underlying assumption is that in other risk classes (e.g. equities and commodities), prices should always be positive. That is, however, not always the case. For example, on April 20th, 2020, the WTI futures contract turned negative. While this was a very unusual circumstance, it is common to trade commodity spread options (e.g. Brent vs WTI or WTI Houston vs WTI Midland) where the underlying spread can be negative. Another common example include options on the difference in performance across two equity indices which, by design, can be negative. At the moment, firms have to use a default mechanism to handle such situations. The Industry suggests the following alternatives to address this issue:

- The preferred method is for the Industry to expand the shift parameter application to all asset classes. In this case, the shift parameter could be kept at 0.1% or a higher value given that the underlying are price-based as opposed to yield-based.
- A more simplistic and less preferred method would be to set the Supervisory Delta for all call options to 0, long put options to -1, and short put options to 1. The underlying assumption is that the strikes are positive and therefore anything close to 0 or less is out of the money for a call option or deeply in the money for a put option.

Recommendation(s)
The lambda (λ) parameter should be calculated and applied per-trade not per-currency. Use of the lambda (λ) parameter to accommodate negative prices should be allowed for all asset classes not just interest rates.

C.2. Adjusted Notional Amount

As a general principle, it is important to align the notional definition of a derivative contract with the firm's actual closeout risk. While standard notional definitions may produce reasonably accurate exposure estimates for the majority of derivatives, this would not always be the case. For some derivatives, it is impossible to accurately calculate exposure using standard notional definitions.

17 https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Consultations/2019/CP%20on%20EBA%20launches%20consultation%20on%20technical%20standards/Final%20guidelines/EBA-RTS-2019-02%20%28Final%20draft%20RTS%20on%20SA-CCR%29.pdf

Recommendation(s)

Firms should be allowed to use internal definitions in cases where the rules are not prescriptive subject to internal governance practices and consultation with, and oversight from, their onsite supervisory teams.

D. Other Items

D.1. Margin in Transit

Under the current capital rules, firms are only allowed to reduce their credit risk exposures for derivatives by the amount of any eligible variation margin (VM) received by the firm. This frequently results in increased exposures to counterparties because of timing differences between a margin call and the receipt of variation margin, which is generally on a T+1 basis. Under the capital rules, VM received on T+1 cannot be used to offset derivatives exposures calculated on day T+0 even though firms fully expect the collateral to be received on T+1. This timing issue can result in significant increases in capital charges for firms in periods of stress and high volatility when trade values can move sharply. Most recently, this has been observed last year as a result of increased market volatility in response to the COVID-19 pandemic. In March 2020 the PRA allowed firms to recognize collateral called but not yet settled.[18]

This timing issue can result in procyclicality whereby capital increases cause client facilitation to become more expensive precisely when liquidity is required. Under both the IMM and the SA-CCR, the calculated exposure at default (EAD) represents an expected exposure measure. In this regard, it should be noted that over time the non-zero current exposures resulting from timing differences should be on average zero. Therefore, removing these timing differences by allowing firms to reflect collateral that has been called but not yet settled should be allowed as it is consistent with an expected exposure measure as long as there is no underlying margin dispute.

In order to prevent increased capital charges for the firms due to these timing differences and to align more closely with an expected exposure measure, the Industry proposes that firms should be allowed to reflect the VM that is received and posted on a T+1 basis under both SA-CCR and IMM. This change will reduce unwarranted volatility in exposures and RWA, because of collateral shortfalls as a result of ordinary settlement cycle.

Recommendation(s)

Margin in transit rules allowed under IMM should be extended for their use under SA-CCR to ensure consistent treatment of collateral under both approaches. That is, firms should be allowed to reflect the VM that is received and posted on a T+1 basis under both SA-CCR and IMM.

[18] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/publication/2020/exposure-value-for-internal-models-method-counterparty-risk.pdf

II. Topics for further consideration with the BCBS

The Industry recognises that these points may run counter to the general principle of alignment with the Basel standards, but they are nonetheless necessary as they support the broader argument that SA-CCR should be reconsidered holistically at BCBS level.

Reconsider Alpha Factor for RC and PFE components

Further to the issues justifying the removal of the Alpha Factor to transactions with CEUs specifically, the Industry encourages the PRA to reconsider the application of the Alpha Factor in the SA-CCR exposure calculation more broadly. The fair value of derivatives is captured on a firm's balance sheet and by its nature is not subject to additional model uncertainty with respect to the replacement cost. As SA-CCR is a non-modelled approach it does not require an adjustment to account for model risk in the context of the PFE component. It is important to consider the recalibration of the Alpha Factor based on recent data and its application to the RC and PFE component instead of simply importing the Alpha Factor from the IMM.

Allow firms to use internally-calculated deltas

The SA-CCR addresses one of the main shortcomings of CEM by allowing firms to delta adjust the notional for non-linear derivatives. While the Industry welcomes the application of deltas, we are concerned by the requirement to use the Black-Scholes formula to calculate the deltas for certain types of options. Firms should be allowed to follow existing internal practices applicable to path-dependent options and other complex non-linear derivatives for which the Black-Scholes formula does not work. Use of such internal practices would be subject to a firm's internal model governance framework and supervisory oversight.

Supervisory Factors

The PRA should revisit the supervisory factors set by the BCBS for all asset classes, as they seem to be calibrated to higher volatilities than can be justified by historical data. The Industry urges the regulators to consider observed volatilities during periods of varying market stress and recalibrate the supervisory factors accordingly.

Improve recognition of initial margin in calculation of total exposure

The benefit that initial margin provides to reduce derivatives exposure is not sufficiently recognised in the SA-CCR calculation of exposures. The methodology is very conservative and it leads to a disproportionate amount of initial margin needed to be posted to reduce the exposure. The lack of adequate recognition of IM results in overstated exposures and therefore unduly conservative capital requirements. Given the significant increase of IM in the financial system over the last years it is economically important that it appropriately recognises the reduction in counterparty credit risk.

Recognise diversification benefit across hedging sets within an asset class

SA-CCR does not reflect any diversification benefit across hedging sets within an asset class i.e. the positive exposure value of one hedging set cannot be offset with a negative exposure value of another hedging set. This is overly conservative and risk insensitive, and significantly overstates the exposure value compared to internal modelled approaches, where some degree of diversification is assumed.

Net cash flows to single amount per currency

In terms of FX transactions, SA-CCR calculates RWAs linked to distinct currency pairs (e.g. EUR/USD), which means that multiple exposure values could be calculated across multiple pairs separately. Nonetheless, if considered together, the exposure value would have been zero. This issue would be resolved if firms were allowed to net exposures by currency instead of currency pair. SA-CCR should allow for netting by currency (excluding settlement currency) instead of currency pair but only if this is combined with a correlation parameter to aggregate currency exposures or if only the maximum of the net long and net short exposures by currency are included in the add-on calculation.

III. Clarifications of proposed text

Clarification 1: Missing definition of MPOR

In the PRA draft CRR Instrument 2021, Article 279c(1)(b) appears to have been truncated compared to the EU version of that article. The effect of this truncation is that there is no definition of the margin period of risk (MPOR).

In the PRA draft instrument19 Article 279c(1)(b) reads:
"for transactions included in the netting sets referred to in Article 275(2) and (3), the maturity factor is defined as:
MF = (3/2)sqrt(MPOR / OneBusinessYear)"

In the EU regulations20 Article 279c(1)(b) reads:
"for transactions included in the netting sets referred to in Article 275(2) and (3), the maturity factor is defined as:
MF = (3/2)sqrt(MPOR / OneBusinessYear)
where:
MF = the maturity factor;
MPOR = the margin period of risk of the netting set determined in accordance with Article 285(2) to (5); and
OneBusinessYear = one year expressed in business days using the relevant business day convention.

[19] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2021/february/cp521app9.pdf?la=en
[20] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0876

When determining the margin period of risk for transactions between a client and a clearing member, an institution acting either as the client or as the clearing member shall replace the minimum period set out in point (b) of Article 285(2) with five business days."

The Industry recommends that Article 279c(1)(b) be expanded to include the definition of MPOR and its determination per Article 285(2)-(5) after the margined Maturity Factor formula.

IV. Capital requirements for exposures to central counterparties

The industry appreciates the UK efforts to enhance the regulatory framework for exposures to Central Counterparties (CCPs) and the alignment to the Basel standards.

However, the Industry would like to highlight that the proposal in the PRA rulebook does not address a key issue, the determination of a qualifying CCP (QCCP), post the UK's withdrawal from the EU.

Currently, Article 4 (88) as retained in the Capital Requirements (Amendment) (EU Exit) Regulations 2018[21] defines a QCCP in accordance with Regulation (EU) No 648/2012, i.e. the EU EMIR. This definition is not amended under the PRA proposal. Noticeably, the European Commission granted a limited period, until 30 June 2022, during which the UK CCPs can still be recognised under the EMIR and therefore treated as QCCPs for the purpose of regulatory capital framework. EMSA has committed a comprehensive review of the systemic importance of UK CCPs for official recognitions. It is therefore unclear if UK CCPs will continue to be QCCPs after 30 June 2022.

Meanwhile, the EMIR has been onshored into UK legislation via a number of statutory instruments (SIs) and Binding Technical Standards (BTS). Given the UK is no longer part of the EU, it is reasonable to remove any dependency on the EU regulations under the prudential regime in the UK.

The Industry recommends that the PRA clarifies the determination of a QCCP by referencing the respective UK legislation rather than EU legislation.

Recommendation(s)
The definition of a QCCP should be clarified by referencing the UK EMIR.

[21] The Capital Requirements (Amendment) (EU Exit) Regulations 2018

9. Operational Risk

The PRA's proposal states it relates to changing the calculation of the Basic Indicator Approach, i.e. CRR Article 315. However, the actual change refers to the treatment and inclusion of operating lease income and expenses in the calculation of the relevant indicator (CRR Article 316), which is also used in the Standardised Approach calculation, i.e. CRR Article 317. Therefore, the Industry would appreciate a clarification from the PRA regarding the actual scope of the proposed change since we believe it covers both the Standardised and Basic Indicator Approaches rather than just the Basic Indicator Approach as the PRA suggests.

The Industry is not convinced that the PRA needs to revoke the CRR text altogether concerning the Relevant Indicator (RI) calculation. If the intention is to make sure firms do not miss but add income and expenses related to financial and operating leases to their interest income and expenses lines in the RI, the PRA can achieve the same effect by providing guidance that clarifies the scope of interest income and expenses. Such RI treatment will be consistent with Basel III and will allow for continuity in CRR before CRR3/Basel III is implemented in the UK more fully.

In addition, many firms subject to BIA/TSA have found that income and expenses from financial and operating leases are not material P&L items and that such items are normally already included in their RI lines for interest income and expenses.

Firms' experience with the identification and calculation of RI and TSA has been straightforward - consistently understood and applied to date. Should the PRA wish to provide more extensive clarifications on the application of RI in BIA/TSA, again guidance could achieve the same effect – rather than require the revoking of the RI part of the CRR.

Chapter 10: Large Exposures

Section I: Immediate Priority Items

Substitution Approach

Clarification regarding scope of application

CRR2 introduces new amendments relating to substitution, particularly relating to Articles 401(4), 403(1) and 399(1) - relevant articles have been included in Chapter 10 Annex of this response for ease of reference. The impact of the changes, specifically amending the requirement in Article 403(1) from 'may' to 'shall', means that substitution of an exposure guaranteed by a third party, or secured by collateral issued by a third party will be mandatory rather than optional. Whilst this is clear, the interaction between Article 401(4) and Article 403(1) is unclear and therefore there is material uncertainty regarding the scope and manner in which mandatory substitution is to be applied, especially for funded credit risk mitigation.

The view of the Industry is that the revised drafting has changed the substitution requirements from optional to mandatory, but the CRR text is not sufficiently clear in terms of the scope of the substitution requirement. We understand (and believe) that the substitution approach should continue to only apply for funded credit protection for exposures calculated under the Financial Collateral Simple Method ("FCSM") (i) in line with the existing EBA Q&A interpretation of the scope of application of Article 403(1)(b)[22]; (ii) in line with the use of "substitution based approaches" under the Credit Risk RWA framework; and (iii) in line with the guidance for completion of COREP reporting templates C28 and C29, where there is a clear distinction between CRM techniques which have a 'substitution effect' and 'funded credit protection other than substitution effect'.

As such, the Industry asks that the PRA provides clarity to the scope of substitution requirements in the UK implementation. It should be noted that if the PRA adopts a wider interpretation than the industry has outlined and is of the view that substitution applies beyond funded credit protection for exposures calculated under FSCM, this would give rise to additional operational complexities and methodological questions.

If substitution is mandated for counterparty credit risk exposures nevertheless, there will be an economic cost, such as a reduction in firms' capacity to support SFT trades, potentially reducing the liquidity of these instruments in the market.

Any interpretation that applies the requirements beyond FSCM therefore, gives rise to significant methodological questions and has economic consequences - guidance from the PRA will be required to specify how the methodology should be applied under each approach. Additionally, the Industry does not believe the current COREP templates support reporting of exposure to collateral issuer and therefore the templates will need to be updated accordingly.

[22] https://eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2014_793

Sovereign Exposures

The Industry requests that the PRA updates the UK framework to follow the design of the Basel standards (LEX10.7) with respect to the treatment of sovereign exposures. Basel alignment should be preferred over the EU approach in order to i) improve clarity in the Industry and ensure consistent application across firms; and ii) prevent a disproportionate and punitive impact in the Industry's use of government bonds as collateral via the application of mandatory risk substitution – the impact is particularly detrimental on emerging market counterparties, where the domestic sovereign issued collateral is the primary form of high-quality collateral available.

In PRA rules as proposed, the combination of replicating the EU's approach without further guidance and the lack of flexibility in applying mandatory risk substitution is problematic.

Under the Large Exposure framework currently, per CRR Article 400, sovereign exposures may be exempted where they receive a 0% risk weight. Furthermore, under Article 114(4) and (7), where these exposures are "denominated and funded in the domestic currency", they may receive a 0% risk weight if the jurisdiction is deemed equivalent and a 0% risk weight is applied under domestic laws. The wording in Article 114 is ambiguous however, and has not been clarified to date including in the EBA Q&A process[23]. This ambiguity is being replicated in PRA proposed rules without the necessary guidance on what is meant by "funded" in relation to exposures "denominated and funded in the domestic currency"; specifically, that the term can be interpreted irrespective of the firm's liability structure.

In addition, consistent with the design of the Basel standards, sovereign exposures should not fall within the scope of mandatory substitution requirements. For instance, the default risk associated with an indirect concentration to sovereigns that attract a 0% risk weight is negligible and should not result in constraining exposures. The simplistic framework was not designed to and therefore should not constrain the use of government bond collateral, which is an essential and well established risk management tool. This would be overly burdensome and would risk impacting the Industry's capacity to support the real economy.

Based on these considerations, the Industry urges the PRA to consider an exemption of sovereign exposures from the framework in line with Basel standards.

Netting long and short positions

The ability to offset long and short positions is set out in the CRR. The spirit of the rules suggest that these rules are also applicable to indirect exposures, but this is not explicitly clear from the rules. As such, the Industry suggests clarifications as follows:

Indirect exposure

Offsetting between long and short positions in financial instruments as outlined in Article 390(3) is also applicable to indirect exposure arising from derivatives contracts listed in Annex II of the CRR and credit

[23] https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2018_3832

derivative contracts, where the contract was not directly entered into with that client, but the underlying debt or equity instrument was issued by that client, as per Article 390(5).

Indirect exposure from derivatives vs exposure from physical positions in financial instruments

Indirect exposure arising from derivatives as per Article 390(5) can be offset with other exposures in the trading book, following the principles as per Article 390(3). For instance, firms can offset a long equity position by a client with a short position arising from a derivative contract where the contract was not directly entered into with that client but the underlying debt instrument was issued by the same client.

The Industry believes these clarifications can be achieved by making the following amendment to Article 390(5):

> **For the purposes of Article 390(3)** ~~**i**~~Institutions shall ~~**add to the exposures to a client the**~~ **include** exposures arising from contracts referred to in Annex II and credit derivatives not directly entered into with that client but underlying a debt or equity instrument issued by that client.

Mandatory Use of SA-CCR in the Large Exposures framework

As noted in our response to Chapter 8 of this consultation, SA-CCR should be used on standalone basis before using in other areas of the prudential framework.

The introduction of SA-CCR not only affects the calculation of capital requirements for CCR, it will also be used in many other areas across the prudential framework, such as for calculating capital requirements for CVA risk, the exposure measure in the Large Exposures framework[24] (replacing the IMM), for the Leverage Ratio, and for the forthcoming capital Output Floor requirement expected to be introduced from 2023 in line with the the Finalised Basel package[25]. Thus it will affect all firms, regardless of their current model approvals and users of derivatives. The impact to firms and the distortion versus risk calculated under previous methods are likely to be significant. Therefore, in the Industry's view, the significance of this change on a standalone basis warrants further review by the PRA before it is rolled out to other parts of the framework.

With specific reference to the Large Exposures framework, it should also be noted that in the US implementation of SA-CCR, US Agencies have retained the use of IMM in the Single Counterparty Credit Limit (SCCL) rule because the available standardised approaches were not deemed to be adequate replacements.

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[24] https://www.bis.org/basel_framework/standard/LEX.htm

[25] Basel III: Finalising post-crisis reforms, Basel Committee on Banking Supervision (BCBS), December 2017, (available at: https://www.bis.org/bcbs/publ/d424.htm)

Section II: Additional Items

Exemptions

Intragroup Exemptions

The Industry understands that the PRA intends to review the treatment of intragroup exposures and there may be a related consultation. In advance of that review, we highlight the issue of intragroup exemptions which we hope can be addressed before the implementation of the related Basel III requirements in the UK.

Within the CRR, competent authorities may fully or partially exempt intragroup exposures per Article 400(2)(c). The PRA currently applies a partial exemption to intragroup exposures. These exposures will increase under CRR2, particularly derivative exposures for which SA-CCR will become the mandatory approach in the large exposures framework and IMM can no longer be used. Without any change to the risk profile of these exposures, the exposure value will increase significantly. Applying the full exemption that is allowable under the CRR would provide additional flexibility to managing these exposures in the UK, whilst remaining consistent with the ability to fully exempt intragroup exposures in the EU.

Covered Bond Exemption

The Industry believes that the PRA should also apply the exemption to covered bond exposures per CRR Article 400(2)(a) to the fullest extent possible.

Credit Conversion Factors

The UK should adopt the Basel standards approach to off-balance sheet items, where it is stated that these "items will be converted into credit exposure equivalents through the use of credit conversion factors (CCFs) by applying the CCFs set out for the standardised approach for credit risk for risk-based capital requirements, with a floor of 10%."

As per the Basel standard, such an approach would ensure consistency with the approach used for risk-based capital requirements, whilst maintaining a level of prudence through the 10% floor.

Reciprocation of French measure (limit to French highly indebted corporates)

In the PRA's policy statement PS24/19[26], the PRA reciprocated the measure imposed by the Haut Conseil de stabilité financière (HCSF) in France in July 2018, which tightened the large exposure limit in CRR Article

[26] Large exposures: Reciprocation of French measure | Bank of England

395(1) to 5% of eligible capital, in respect of the exposures of UK G-SIIs and O-SIIs to French non-financial corporations meeting the definition of 'highly indebted'.

This measure was applied by 6 other jurisdictions in the EU (Belgium, Denmark, Ireland, Lithuania, Norway and Sweden). This measure requires the monitoring of two different large exposures limits, requiring a methodology that is operationally complex to manage. In the context of the UK's departure from the EU, the Industry believes the reciprocity is no longer required and ask that it be discontinued. As this was neither an EU or BCBS requirement we do not believe this would give rise to any international equivalence considerations.

Shadow Banking

The EBA's guidelines on 'limits on exposures to shadow banking entities…' (EBA/GL/2015/20) defines shadow banking entities as entities that carry out credit intermediation activities, and specifically carves out from this definition entities that are subject to an appropriate and sufficiently robust prudential framework. The definition of an institution for large exposures purposes in Article 391 is restricted to those established in the UK or an equivalent third country. HMT's latest set of equivalence decisions restricts this to the EEA only, resulting in institutions outside of this geographic area to be out of scope of the definition of an institution.

i. Does the PRA intend for firms to treat these "non-institutions" as shadow banks? This is assuming that a "robust prudential framework" would be granted equivalent status.
ii. If not, we ask that HMT expand their equivalence decisions for Article 391 to be consistent with those for Article 107(4).
iii. CRR contained a mandate for the EBA to develop RTS to specify the criteria for the identification of shadow banking entities. This has been removed from the PRA's drafting of the rulebook. We ask that the PRA provide technical standards and guidance on this.
iv. The Bank of England's Statement of Policy on the interpretation of EU guidelines and recommendations after the UK's withdrawal from the EU states that the BoE and the PRA expect firms to continue to comply with the guidelines. These guidelines require that firms set both an aggregate limit and individual limit on exposures to shadow banking entities with various control and governance mechanisms in place. This could become burdensome if the scope of institutions is narrow, and other global institutions become eligible for assessment as a shadow bank.

In addition to the governance and limit requirements outlined in the guidelines, in Article 394(2), the Industry notes that reporting information in relation to our 10 largest exposures to institutions is no longer required, but there continues to be a requirement to report information of the 10 largest exposures to shadow banking entities. Without expanding the list of HMT equivalence decisions for Article 391, the largest shadow banking exposures will likely consist of exposures to large institutions treated as an institution for credit risk purposes, but not for large exposures. We do not believe this is the intention of the shadow banking governance framework and there is a risk that other, smaller but riskier shadow banking entities may be omitted from the PRA's internal assessments of this sector.

Collective Investment Undertakings

The Industry notes that in Rule 7 in Section 5 of the new large exposures CRR part of the rulebook provides conditions where the structure of a transaction shall not constitute an additional exposure (i.e. look-through is not required). One of these conditions covers measures designed to prevent the redirection of cash flows away from the transaction to persons who are not entitled to receive them and sets out that UK UCITS's and similar structures in an equivalent third country are automatically assumed to meet this condition. The Industry assumes that the equivalence provisions for CIUs in Article 132 are relevant here however we would request that HMT explicitly state this in their list, and/or that the PRA makes the minor amendments to their wording (page 131, PRA Rulebook (CRR) Instrument 2021) to clarify which equivalence decisions are relevant here.

Section III: Additional Technical Amendments

Reference to Securities Financing Transactions (SFTs)

The last subparagraph of Article 390(4) provides a derogation for SFTs from the first subparagraph. However, the first paragraph does not make reference to SFTs and should therefore be updated to ensure the derogation makes sense. See suggested amendment below:

> 4. Institutions shall calculate the exposure values of **securities financing transactions,** the derivative contracts listed in Annex II and of credit derivative contracts directly entered into with a client in accordance with one of the methods set out in Sections 3, 4 and 5 of Chapter 6 of Title II of Part Three, as applicable. Exposures resulting from the transactions referred to in Articles 378, 379 and 380 shall be calculated in the manner laid down in those Articles.
>
> When calculating the exposure value for the contracts referred to in the first subparagraph, where those contracts are allocated to the trading book, institutions shall also comply with the principles set out in Article 299.
>
> By way of derogation from the first subparagraph, institutions with permission to use the methods referred to in Section 4 of Chapter 4 of Title II of Part Three and Section 6 of Chapter 6 of Title II of Part Three may use those methods for calculating the exposure value for securities financing transactions.

Excess trading book exposure limit

The CRR permits trading book exposures to exceed 25%, but the excess exposure attracts additional own funds requirements commensurate to the size of the excess exposure. Whilst it is clear that the trading book exposures includes counterparty credit risk, this could be made explicit by amending Article 397 to reference "Title II of Part Three" rather than Article 299.

Reference to Eligible Capital

According to the new definition of *large exposure* in the draft rulebook, exposures are now limited to a percentage of Tier 1 capital. However, Article 6 of part 5 (previously Regulation (EU) NO 1187/2014) under the Large Exposures section references eligible capital rather than Tier 1 capital for the purpose of determining the contribution of underlying exposures to total exposures. Therefore, clarification is required if this is intended.

Chapter 10 Annex: CRR2 Amendments to Large Exposures Regulations

Article 399(1) is replaced by the following:

'1. An institution shall use a credit risk mitigation technique in the calculation of an exposure where it has used that technique to calculate capital requirements for credit risk in accordance with Title II of Part Three, provided that the credit risk mitigation technique meets the conditions set out in this Article.

For the purposes of Articles 400 to 403, the term 'guarantee' shall include credit derivatives recognised under Chapter 4 of Title II of Part Three other than credit linked notes.'

The following paragraph 4 is added to Article 401:

'4. Where an institution reduces an exposure to a client using an eligible credit risk mitigation technique in accordance with Article 399(1), the institution, in the manner set out in Article 403, shall treat the part of the exposure by which the exposure to the client has been reduced as having been incurred for the protection provider rather than for the client.'

Article 403(1) has been amended as follows:

Where an exposure to a client is guaranteed by a third party, or secured by collateral issued by a third party, an institution ***shall*** ~~**may**~~:

> (a) treat the portion of the exposure which is guaranteed as ***exposure*** ~~**having been incurred**~~ ~~to~~ the guarantor rather than to the client provided that the unsecured exposure to the guarantor would be assigned **a** ~~**an equal or lower**~~ risk **weight that is equal or lower** than **the** ~~**a**~~ risk weight of the unsecured exposure to the client under **Chapter 2 of Title II of** Part ~~**Three, Title II, Chapter 2**~~;
>
> (b) treat the portion of the exposure collateralised by the market value of recognised collateral as **exposure** ~~**having been incurred**~~ to the third party rather than to the client, **provided that** ~~**if**~~ the exposure is secured by collateral and provided that the collateralised portion of the exposure would be assigned a ~~**an equal or lower**~~ risk weight **that is equal or lower** than a risk weight of the unsecured exposure to the client under **Chapter 2 of Title II** ~~**of Part Three, Title II, Chapter 2**~~.

The approach referred to in point (b) of the first subparagraph shall not be used by an institution where there is a mismatch between the maturity of the exposure and the maturity of the protection.

For the purpose of this Part, an institution may use both the Financial Collateral Comprehensive Method and the treatment set out in point (b) of the first subparagraph **of this paragraph** only where it is permitted to use both the Financial Collateral Comprehensive Method and the Financial Collateral Simple Method for the purposes of Article 92.

Chapters 11 & 12: Liquidity – LCR and NSFR

The Industry is pleased to set out in a combined chapter its responses to Chapters 11 and 12 of the consultation paper on liquidity matters. Our assessment and comments are set out in detail below. We would note in summary that some of our main points cover the historical look back approach under the LCR; the treatment of equities; and, what appears a very high impact omission in relation to the treatment of client clearing transactions under the NSFR. We set out also our continued thinking in relation to the heavy impact of the NSFR on shorter term business models and customer servicing activities. Where proposed changes seek to rectify problems and areas of weakness in the Basel standards we would request that the PRA works proactively on changing these areas and that changes are effected at an international level to ensure consistency. The Industry would be very pleased to work with the PRA and to collaborate closely on the areas of suggested policy development.

LCR

Use of liquid asset buffers

The Industry recognises the PRA's statement of the principle that firms may make use of liquid asset buffers during times of stress and the adjustments intended to the associated EU notification and planning requirements. We would note, however, that many market participants and stakeholders remain concerned as to the perceived supervisory stigma associated with the use of liquidity buffers, and further communication and engagement with the Industry on this topic would be welcome.

In particular, one option for development could involve the specific mention in PRA rules that UK regulators are able to flex buffer requirements downwards during a stress, accompanied by a description of how and by whom such decisions could be made.

Historical Look Back Approach ("HLBA")

The Historical Look Back Approach introduces significant procyclicality to the LCR measure as it is calculated as the largest absolute net 30-day collateral flow realised during the last 24 months.

A possible way to mitigate the inherent procyclicality in this measure might be for policymakers to reconsider the calculation methodology, including at BCBS level to maintain international consistency. The Industry would welcome a PRA review of the calculation and would propose a change in the requirement to maintain a 100% outflow for the full two year period if subsequent peaks are materially below an acute stress period. We note that the HLBA does not specify adjustments to reflect changes in the composition and characteristics of institutions' derivatives portfolios that may have occurred over the last 24 months and that it does not allow changes for events that are not related to an adverse market scenario, e.g. idiosyncratic derivative counterparty events. One possible solution to the problems associated with the current standard could involve the consideration of a more flexible forward-looking approach.

We would encourage the PRA to commence work on this area in follow-up to this consultation to ensure an effective approach which can be applied in the UK and internationally, including through any necessary changes at BCBS level.

Inclusion of equities as liquid assets

Equities need to meet price stability criteria before they can be considered for inclusion as Level 2B liquid assets, and the Industry welcomes the PRA's acknowledgement of the procyclicality this can entail and its willingness to consider alternative arrangements. We recognise also that there exists a regulatory intent not to permanently exclude equities from Level 2B HQLA following a significant fall in price. The standards appear open, however, as to the time period over which firms need to look back which leads to a lack of clarity and the potential for uneven implementation. We would be pleased to engage with policymakers as further work is undertaken in this area, including in relation to considerations around the use of stress periods based on the 2008/9 global financial crisis or other events. At this stage we would note also the work the European Banking Authority intends to undertake in this area which was referenced in its March report on the monitoring of the LCR implementation in the EU.

Operational considerations may also be given further thought, such as the explicit statement of the ability of firms to apply a more static lookback period thereby eliminating the need for daily/monthly updates; more explicit recognition of the application of haircut widening tests as well as price decline methodologies; and, allowing improved processes around the exclusion of equities from liquid asset buffers so that this does not occur at the height of a stress period. There may also be operational efficiencies in permitting price tests to be applied at the level of equity indices which would be more straight forward than tracking individual ISINs and the PRA may wish to specify which indices are eligible for inclusion rather than each firm needing to replicate the task.

The Industry would recommend all Main Index and Recognised Exchange equities to receive the preferential 50% RSF. Additionally, we would propose a centralised list be used, e.g. the ESMA list used for the eligibility of collateral[27] under the capital framework. Or alternatively, can the PRA clarify that where a major index has not been identified by the local competent authority then the ESMA (or some other central list) should be used as an appropriate substitute. Both proposals ensure a consistent and harmonized approach across UK firms. (See the 'Further comments' section below for further details).

Finally, more significant developments could involve an assessment of alternative criteria for the inclusion of equities in liquid asset buffers including a re-consideration of the link with the CRR specific price stability requirements. Again, the Industry recommends that changes are made at BCBS level to ensure international consistency.

Reporting arrangements

LCR/ALMM – While it is not explicit in the consultation paper, the Industry understands that the PRA is proposing to stay on taxonomy 2.9 for these reporting templates in H2 2021 when EU entities will have moved to taxonomy 3.0. The PRA then proposes to adopt taxonomy 3.0 on 1 Jan 2022 including the new

[27] CRR Article 197 Eligibility of collateral under all approaches and methods

EBA NSFR template as well as the edits to LCR/ALMM templates. This is likely to be disruptive to implementation and systems work. While we understand that the UK and EU templates are likely to diverge over time, accelerating this technical work and adjustments is likely to prove challenging.

NSFR

Although the NSFR rightly seeks to reduce reliance on short term funding and encourages diversifying the overall funding mix to include longer term funding sources, the existing standard appears more geared to a credit institution than an investment firm. It does not reflect the true funding risk of certain investment firm business activities and could incentivise imprudent asset and liability management.

The current ratio calibration does not take into account the true short term or funding neutral nature of certain investment firm activities, applying punitive treatment and increasing requirements for investment firms above that of the liquidity coverage ratio which, over the COVID-19 stress period of early 2020 proved more than sufficient. The NSFR as currently calibrated would require investment firms to raise long term funding for activities that are short term in nature or do not require funding. The Industry does not believe this was the intention on the NSFR implementation and are concerned that it could result in adverse impacts to markets and to firms' business models.

Client clearing transactions

The PRA states that they cannot see any situations that would qualify as interdependent and have deleted the EBA text that created a presumption that client clearing activities can be treated as interdependent. The rationale for this is not clear and could lead to large amounts of additional stable funding being required. In particular, the Industry notes that the default RSF factor for initial margin pledged is 85%, and that this is applied to a notional value that can result in a very large funding requirement and can be procyclical. Where firms do not provide to their clients guarantees of the performance of the CCP, this activity does not incur any long-term funding risk.

This treatment of activity could result in potential revisions to client facilitation and operating models across market participants. It would also make the UK less competitive than the European based entities, incentivising business activity to migrate from the UK to European based entities.

It would be useful if the PRA would state clearly that client clearing activities are always exempted from stable funding requirements. The industry sees no benefit in the PRA soliciting waiver applications from the numerous client clearing firms operating in London when many other regulators recognise the interdependent nature of this activity.

Securities financing transactions

The PRA proposes to introduce additional netting conditions whereby transactions using Level 1 HQLA cannot be netted against transactions using non-Level 1 HQLA. This is super-equivalent to the Basel standard and there is no indication of the consideration that has been taken of the likely impact of this change on the users of financial services or on system wide financial stability.

The PRA has intended to copy across the CRR text which will include Articles 428p(2) and 428p(3) which are not clear and have caused some confusion among regulators and firms. The NSFR has predominantly been seen as a balance sheet based metric, however Article 428p has left open the interpretation of 'beneficial ownership', which could lead to significant divergences in treatment for securities financing transactions among firms. This absence of a regulatory definition of 'beneficial ownership' could lead to substantive differences in treatments for securities financing transactions. European policymakers have, however, confirmed that the NSFR is in principle a balance sheet metric based on accounting standards and that there is no 'policy intent' behind Article 428p(2) or 428(3) and that they are not intended for any specific types of transactions. This is consistent with the Industry's view, but it would be useful if the PRA could clarify that they are of the same understanding.

In addition, where the PRA proposes to apply asymmetric ASF and RSF treatment to the different legs of short-term securities financing, clarity is requested on whether the PRA intends to revisit this treatment at a later point in time, similar to the expectation that the EBA will re-assess this area over a transitional period.

Treatment of equities

The NSFR is a longer-term structural measure of liquidity risk rather than a stressed metric and therefore the application of price stability criteria for equities (i.e. 40% fall in price over a 30 day stress period) is not conceptually correct. The Industry suggests therefore that this is removed and that, as mentioned earlier in this section of our response on liquidity risk, that all stocks listed on main major indexes and recognised exchange equities receive a 50% RSF factor which is still conservative relative to the liquidity and funding value of these securities and that this is agreed at the Basel level to facilitate international consistency.

Securities hedging

Market participants may require equities performance in order to generate returns while minimising costs to meet financial obligations. Credit institutions and investment firms facilitate this by entering into swaps with market participants and hedging the risk by purchasing underlying equities. Swaps provide an efficient way for market participants to receive equities performance without holding the underlying securities. Swaps represent the dominant form of equity financing in the EU, given the heterogeneity of EU markets. There is a broad spectrum of market participants that engage in this activity, including pension funds, insurance funds, mutual funds, hedge funds and corporate institutions. Credit institutions and investment firms play an important role in providing end-users with this exposure but generally hedge the risk of the transaction by purchasing the underlying. For example:

1. An Asset Manager enters into a 3 month swap with a firm to receive performance on reference equities. Initial margin provided which is used by the firm to mitigate credit risk and partially fund the reference equities. Equity performance passed to the investor.
2. Firm purchases reference equities and holds these for the duration of the contract
3. Firm funds the purchase of equities through repo market for 3 months

The calibration of the securities RSF within the NSFR (e.g. 50-85% RSF) fails to take into account the short-term nature of hedging instruments and the legal and operational provisions in place which ensure the close out price is fully absorbed by the client.

A consequence of this treatment for firms is that it causes an asset and liability tenor mismatch, by requiring the firm to fund a short-term asset with a long term liability. This is adding cost to the transaction for the customer, thereby disincentivising the underlying commercial activity. Across the market as a whole, the expected consequences of the NSFR on this type of activity is a move either away from hedging or where possible towards hedging through derivatives (reducing physical positions), and a potential migration of business to other sectors.

The Industry therefore recommends the application of a 0% RSF factor to securities that are hedging a client facing derivative on which initial margin has been provided and less penal RSF factors for securities that are hedging other derivatives. Again, this is a topic which should be re-visited and agreed at a global level through the BCBS.

Domestic Liquidity Sub-Group ("DolSub")

The Industry has reviewed the conditions to create a DolSub, including the PRA's proposal to integrate NSFR and funding risk management into these conditions.

As a general matter, Article 8 requires that the parent institution be a regulated entity. This is contrary to the requirement under Article 7 for capital that allows non-regulated parent entities to manage capital on behalf of the group. The requirement that the parent entity be regulated is not prescribed by the Basel standards, where instead the treatment allows for an efficient Liquidity management function at the group level. Furthermore, previous PRA regulation under BIPRU 12.8, Cross-border and intra-group management of liquidity, allowed for liquidity support from a parent entity outside of the UK. These rules did not need to extend beyond the UK, but allowed consolidated UK entities to manage liquidity at the group level on behalf of UK and Non-UK subsidiaries. Therefore, the Industry proposes that for the purposes of liquidity requirements (e.g. LCR, NSFR, etc.), Article 8 allows unregulated parent holding entities to form part of a DolSub, subject to the PRA's approval on a case-by-case basis.

The Industry would urge the PRA not to exclude groups operating in the UK under a holding company structure from being eligible to manage their liquidity and the stability of their funding efficiently and prudently as a group. In particular in the context of the new CDR5 requirement to authorise financial holding companies (FHC), there is additional rational for liquidity and funding requirements to be able to be waived at individual level, and for the authorised FHC to be part of a DolSub. Without this, certain group structures would be subject to a higher burden and higher funding costs.

Article 428p(9) – CRR Drafting error

The Industry recommends that the PRA takes the opportunity to amend the CRR drafting error under Article 428p(9) as follows:
Institutions shall include financial instruments, foreign currencies and commodities for which a purchase order has been executed in the calculation of the amount of required stable funding.

Further comments

Application on a consolidated basis

The Industry notes that the LCR Delegated Act, (EU) 2015/61, under Article 3 stipulates that holding companies should apply upon consolidation any more stringent inflow and outflow factors that are applied to subsidiaries in third countries. This is super-equivalent to the Basel standard and can often result in over-conservative treatments which are not consistent with underlying levels of liquidity risk. We would suggest therefore that this requirement is not copied across from the EU text.

Similarly, taking the 'worst of' local rules and consolidated rules on an item by item basis under CRR Article 428a for the NSFR is overly prudent and was not included in the Basel standard. This treatment fails to recognise that, for many jurisdictions, some parts of the NSFR may be more conservative, and others less so. By only taking into account parts of the standard which are more conservative it will lead to overly prudent results, which overestimate the funding risk in overseas subsidiaries, both when compared to the Basel standard, the PRA's rules and the local regulatory implementation.

The provision should therefore not be taken forward, or if thought necessary to "overrule" the local regulatory calibration, this assessment should be conducted at the overall requirement of the subsidiary, i.e. less severe factors should be permitted to offset more severe factors.

Outflow rates for retail deposits covered by a guarantee scheme

The Industry notes that the provision in the LCR Delegated Act, that flows directly from the Basel standard, which permits the use of a 3% outflow rate for insured deposits, in certain limited circumstances, has been deleted. No analysis to support this deletion has been provided.

In contrast, the Basel standards, the EU rules, rules in a number of third country jurisdictions, and the BCBS RCAP of these jurisdictions have all endorsed this approach.

The Industry also notes this is an example of the unfair treatment in CRR Article 2, where more lenient treatments are ignored, and more severe treatments incorporated. As in Article 2, there is no justification for making this a permission. It should simply be applied in the consolidated ratio.

Therefore an outflow rate of 3% should be applied, where this treatment is authorised by third countries.

NSFR funding profile

The requirement for institutions to ensure that the distribution of their funding profile by currency denomination is generally consistent with the distribution of their assets by currency has been copied across from the LCR. The LCR is, however, a cashflow metric where it is intended to address over-reliance on transacting FX swaps during the 30-day stress period.

However, the NSFR is in contrast a balance sheet metric, and currency mismatches in funding are typically hedged using off balance sheet derivatives, e.g, through the use of FX swaps, which are not treated in the same manner as on balance sheet assets and liabilities.

It is therefore, perfectly possible for an institution to be fully hedged on a currency basis, and yet the distribution of their funding profile by currency denomination to not be generally consistent with the distribution of their assets. Equally the NSFR scenario is entirely consistent with FX swap markets remaining open.

Application of more penal RSF factors

CRR Article 428(c)3 stipulates that where an item can be allocated to more than one required stable funding category, it shall be allocated to the required stable funding category that produces the greatest contractual required stable funding for that item. The PRA has deleted the corresponding provision from the LCR (see Article 4(6) of the LCR Delegated Act) but it is not clear why the PRA has not made the corresponding change in the NSFR. Generally, in prudential regulation, there is not a requirement for firms to take the most penal regulatory treatment of an activity when an alternative exists.

NSFR exemption of derivative contracts with central banks

The PRA notes in the consultation paper that a BCBS discretion permits the exemption of derivative contracts with central banks, and states: "the PRA would consider granting rule modifications to exempt such transactions from the NSFR should that be necessary".

However, it has deleted the relevant provision in the final rules and not included it as a permitted waiver (as it has, for example, with the intragroup treatment in Article 428h amongst others).

It is not clear why the PRA has taken this approach, and if anything regarding the PRA's willingness to grant such waivers should be read into it. For consistency, the provision should be reinstated with the appropriate language regarding available waivers.

Interdependent assets and liabilities

As mentioned earlier in the context of client clearing transactions, the PRA has removed a number of CRR2 provisions that correctly identify interdependent assets and liabilities, and has not provided a justification for doing so. This approach will overestimate the funding needs of these activities, and the stable funding requirements of subsidiaries of UK headquartered firms in Europe.

The Industry notes in addition, that the PRA has amended, without comment, the maturity condition in relation to interdependent assets and liabilities under CRR2. Given the NSFR measures the stability of funding over a one-year time horizon, it is not necessary for the maturities to be precisely matched for there to be no funding risk on such a time horizon.

Multilateral development banks

It is unnecessary to limit the application of a 50% ASF factor to multilateral development banks ('MDBs') under CRR Article 428(l)(b))(iv) to those in CRR Article 117(2). This excludes a number of MDBs who can provide stable deposits, and does not recognise that many MDBs have been incorporated since the original CRR and are not included.

The PRA have the opportunity to carefully consider the definition of MDBs, noting the list currently used has remained broadly unchanged since 2013.

RSF factors in event of non-standard temporary central bank operations

The PRA notes the provision to apply reduced RSF factors in the event of non-standard temporary central bank operations is in the Basel standards (it is also in CRR2) but states that rather than following the BCBS and European approach of explicitly including it in the standard, were it to be thought necessary they would agree this approach with the Bank of England and offer, we presume, a modification by consent, at the time.

However, this significantly narrows the scope of the CRR2 provision which was not limited to the operations of the domestic central bank. As such if the central banks of third countries were to use this provision, UK headquartered firms would be unable to take advantage of it.

The PRA should reinstate this provision as it is applicable to third parties, and permit firms to use it if it has been incorporated in the national rules of the stable funding requirement of a third country.

Treatment of initial margin

The NSFR treats initial margin asymmetrically, and inconsistently with variation margin. In reality, initial margin received that can be rehypothecated is a funding source equivalent to variation margin, and should be treated symmetrically with initial margin placed. The PRA should proactively work on this topic and seek to ensure changes at BCBS level which can be applied in the UK and internationally.

Recognition of rehypothecatable collateral received on derivative assets

The PRA correctly departs from the Basel standards and permits the recognition of rehypothecatable collateral received, i.e. variation margin, as a funding source.

However, the proposed treatment does not reflect the funding value of non-Level 1 collateral received. This treatment does not reflect the fact that such collateral does have funding value, and is incoherent with the rest of the NSFR where such funding value is recognised with beneficial RSF factors. The PRA has not provided any justification for this apparent oversight which should also be amended at a global level for consistency.

Level 2B Equities requirements regarding indexes

The Industry notes that there is a divergence between the liquidity and capital guidance i.e. former refers to 'major', latter is 'main' and is linked to an ESMA listing as follows:

> (1) LCR DA guidance 12(1)(c)(i) Level 2B assets
>
> "they form part of a major stock index in a Member State or in a third country, as identified as such for the purposes of this point by the competent authority of a Member State or the relevant public authority in a third country. In the absence of any decision from the competent authority or public authority in relation to major stock indexes, credit institutions shall regard as such a stock index composed of leading companies in the relevant jurisdiction"
>
> (2) CRR Article 197 Eligibility of collateral under all approaches and methods
>
> ESMA shall develop draft implementing technical standards to specify the following:
> (a) the main indices referred to in point (f) of paragraph 1 of this Article, in point (a) of Article 198(1), in Article 224(1) and (4), and in point (e) of Article 299(2);
> …
> 1(f) equities or convertible bonds that are included in a main index;
> …
> Article 198 Additional eligibility of collateral under the Financial Collateral Comprehensive Method
> …
> Article 224 Supervisory volatility adjustment under the Financial Collateral Comprehensive Method
> …
> Article 299 Items in the trading book

The Industry notes that there is no defined list of major stock indexes for firms to use specified in the Delegated Act. The CRR does contain a specified list of main stock indexes for the purposes of capital requirements, this is maintained and updated periodically by ESMA but is not explicitly referenced in CRR liquidity articles.

The Industry recommends that the PRA defines major list as the ESMA (or some other central) list which will then provide the Industry a defined and expanded index listing, or; as an alternative, clarify that where a major index has not been identified by the local competent authority then the ESMA (or some other central list) should be used as an appropriate alternative. We believe that both proposals ensure a consistent and harmonized approach across UK firms.

13. Reporting

ANNEX II: INSTRUCTIONS FOR REPORTING ON OWN FUNDS AND OWN FUNDS REQUIREMENTS

3.3.3. C 08.01 - Credit and counterparty credit risks and free deliveries: IRB approach to Capital Requirements (CR IRB 1)

As per the mapping tool included in the EBA final draft ITS on public disclosures, the values reported for financial collateral, other eligible collateral, immovable property collateral, and receivables in the disclosure template "EU CR7-A – IRB approach – Disclosure of the extent of the use of CRM techniques" (columns b, c, d, and e respectively) would map to the corresponding collateral values reported in the COREP template "C 08.01 - Credit and counterparty credit risks and free deliveries: IRB approach to Capital Requirements" (CR IRB 1)" (Columns 180 to 210).

However, the mapping between these two templates is not clear in PRA CP5/21 as no mapping tool has been included in the consultation. UK Pillar 3 disclosure instructions for the CR7-A template requires that the collateral value reported in columns b to e to be limited to the value of the exposure at the level of an individual exposure, however UK COREP instructions for the C8.01 template do not specify such limits for collateral values reported in columns 180 to 210.

In light of the above, the Industry would like to know whether it is correct to assume that columns 'b' to 'e' of the Pillar 3 Disclosure template CR7-A would not be linked to columns 180 to 210 of the COREP C8.01 template under the PRA rules and collateral value reported in columns 180 to 210 of the C8.01 template would not be limited to the value of the exposure at the level of an individual exposure.

ANNEX II: INSTRUCTIONS FOR REPORTING ON OWN FUNDS AND OWN FUNDS REQUIREMENTS

3.3.6. C 08.07 - Credit risk and free deliveries: IRB approach to Capital Requirements (Scope of use of IRB and SA approaches (CR IRB 7))

As per the reporting instructions, institutions are required to report all Standardised and IRB positions with the exception of securitisation positions and deducted positions in the C 08.07 template. However, certain Standardised exposure classes such as exposures in default, exposures associated with particularly high risk, exposures in the form of units or shares in collective investment undertakings ("CIUs") and other items are not included in the exposure class breakdown of the C 08.07 template. The Industry needs further clarification on whether these exposures are required to be reported in the template and if these positions are in scope, under which exposure classes should these be reported.

In terms of the scope of the report, we would note that it applies to credit exposures only, and not CCR exposures, in line with the approach taken in the EU.

ANNEX VII: INSTRUCTIONS FOR REPORTING ON LOSSES STEMMING FROM LENDING COLLATERALISED BY IMMOVABLE PROPERTY

Paragraph 10(b) of Annex VII states that Institutions shall report a) one total template; b) one template for each national market in the Union the institution is exposed to, and; c) one template aggregating the data for all national markets outside the Union the institution is exposed to.

Post Brexit, as the UK is no longer a part of the European Union, should the reference to "the Union" in Paragraph 10(b) of Annex VII be replaced with a reference to "the UK". Accordingly, could the PRA confirm that the Institutions would need to report a) one total template; b) one template for the UK, and; c) one template aggregating the data for all national markets outside the UK the institution is exposed to.

ANNEX XXVI - SUPPLEMENTARY REPORTING FOR THE PURPOSE OF IDENTIFYING AND ASSIGNING G-SII BUFFER RATES

The PRA rulebook included with CP5/21 (Appendix 9) specifies a quarterly reporting frequency for this return (G 01.00- G-SII INDICATORS AND EBU ITEMS) with remittance dates of 1 July, 1 October, 2 January and 1 April. Current annual G-SII return is due for publication/submission at end of April (30 April). Would there be a need for submitting the G 01.00 template for the quarter corresponding to the year-end as this is only approximately 4 weeks in advance of the full return.

The consulting paper states that the supplementary information is being captured for the purposes of identifying G-SIIs and assigning G-SII buffer rates. However, it is not clear how a more frequent, but summarised return would add to the annual assessment.

The summary return proposed will not reduce the data collection or preparation timeframes. To generate the required values for the return, it would still be necessary to collect all of the underlying details (included in the published/score section) of the full annual G-SII return. With the proposed quarterly frequency, it would be operationally burdensome and the cost benefit is unclear.

ANNEX XXVIII - SPECIFIC REPORTING REQUIREMENTS FOR MARKET RISK

The Industry supports the use of the reporting templates in Annex XXVIII for the purpose of reporting the FRTB Standardised approach to the PRA as they are consistent with those developed by the European Banking Authority.

Further points

CP5/21 has not included a version of the EBA mapping tool although it has replicated the reporting and disclosure templates. It would be useful if the PRA could clarify whether it intends to publish its own mapping tool.

Annex V & VI – Template LI3 - Outline of the differences in the scopes of consolidation (entity by entity)

It is suggested that some degree of materiality should be set to the scope of this table.

Annex XXI & XXII – Template CR7-A IRB approach – Disclosure of the extent of the use of CRM techniques

Disclosure of the extent of the use of CRM techniques includes information on RWEAs before and after substitution effects, in columns 'm' and 'n'. However, the guidance for column 'm', which is described as "RWEA without substitution effects" states:

"The risk-weighted exposure amounts calculated in accordance with points (a) and (f) of Article 92(3) CRR, including any reduction of RWEA due to the existence of funded or unfunded credit protection, including where the PD and LGD or the risk weight is substituted due to the existence of unfunded credit protection. Nevertheless, in all cases, including where substitution approach is used, exposures are disclosed in the original exposure classes applicable to the obligor."

Therefore, the guidance, which appears to include substitution effects, appears to be contrary to the title of the column which appears to exclude substitution effects. Clarification is required, with column m title or guidance updated as necessary, to confirm exactly what should be disclosed in column m of CR7-A.

Annex XXII – Template CR6 IRB approach – Credit risk exposures by exposure class and PD range

The template requires a breakdown of exposures by PD range. The instructions have excluded certain exposure classes where this would not be appropriate, for example equity and securitisation, as the exposures cannot be split by PD. However, non-credit obligation assets (NCOAs) have not been excluded which would appear to be an oversight. The equivalent reporting template C08.03 does specifically exclude NCOAs in the instructions, part 3.3.1. It is requested that the disclosure template instructions are amended to exclude NCOAs.

Annex XXXVIII – Instructions for the disclosure of interest rate risk in the banking book

The Industry is concerned at the proprietary and commercially sensitive nature of some of the requirements, in particular (i) and (j) below from the UK template. For this reason the Industry's view is that these metrics should be removed from the disclosure requirement.

(i) Average repricing maturity assigned to non-maturity deposits (NMDs)
(j) Longest repricing maturity assigned to NMDs

As a potential alternative approach, in case removing the requirement is not possible, we would suggest aligning the approach for NMDs to the qualitative information requirements as a starting point. Firms would have the flexibility to provide adequate narrative around this information, and they will be able to consider, if appropriate, the disclosure of a duration range or indicative duration to give a sufficient indication of the NMD duration. This alternative would be proportionate, to achieve objectives without requiring sensitive specific metrics to be disclosed.

The Industry would also welcome further clarity on the first reporting dates and frequency of reporting expected for the quantitative and qualitative parts of the requirements.

Finally, the template compares current vs. prior period, however this would require disclosure for periods prior to the binding requirement. The Industry recommends that the first report is not comparative.

Shadow Banking

The EBA's guidelines on 'limits on exposures to shadow banking entities…' (EBA/GL/2015/20) defines shadow banking entities as entities that carry out credit intermediation activities, and specifically carves out from this definition entities that are subject to an appropriate and sufficiently robust prudential framework. The definition of an institution for large exposures purposes in CRR Article 391 is restricted to those established in the UK or an equivalent third country. HMT's latest set of equivalence decisions restricts this to the EEA only, resulting in institutions outside of this geographic area to be out of scope of the definition of an institution.

It is not clear at this stage whether the PRA intends for firms to treat these "non-institutions" as shadow banks. This is assuming that a "robust prudential framework" would be granted equivalent status. If this is not the case, the Industry would ask that HMT's equivalence decisions for CRR Article 391 are expanded to be consistent with those for Article 107(4).

The Industry notes also that the CRR contained a mandate for the EBA to develop RTS to specify the criteria for the identification of shadow banking entities. This has been removed from the PRA's drafting of the rulebook and we would ask that the PRA provides technical standards and guidance on this.

The Bank of England's Statement of Policy on the interpretation of EU guidelines and recommendations after the UK's withdrawal from the EU states that the Bank of England and the PRA expect firms to continue to comply with the guidelines. These guidelines require that firms set both an aggregate limit and individual limit on exposures to shadow banking entities with various control and governance mechanisms in place. This could become burdensome if the scope of institutions is narrow, and other global institutions become eligible for assessment as a shadow bank.

In addition to the governance and limit requirements outlined in the guidelines, in CRR Article 394(2), the Industry notes that firms are no longer required to report information in relation to their 10 largest exposures to institutions, but continue to have a requirement to report information to their 10 largest exposures to shadow banking entities. If HMT's equivalence decisions for CRR Article 391 drive what is considered a shadow bank, the Top 10 is likely to be satisfied by the reporting of large institutions in countries within a regulated framework which is treated as an institution for credit risk purposes, but not for large exposures. This appears contrary to the intention of the shadow banking governance framework and there is a risk that other, smaller but more risky, shadow banking entities may be omitted from the PRA's internal assessments of this sector.

Additional Points

As a wider and overarching point, the Industry suggests an alignment with the Basel standards in relation to the scope of consolidation which would avoid disclosure on a solo basis which is sometimes not meaningful and potentially misleading.

We believe that the continuation of signposting in a small number of situations significantly improves the usefulness of the Pillar 3 disclosures. For example:

- Owing to possible differences in schedules of Pillar 3 disclosure and G-SIBs reporting and disclosure, we would suggest a link to the sections on institutions' websites where stakeholders can find the most up to date G-SII indicators. The Industry believes that this would be in the interests of all stakeholders and would avoid the potential for delays and time-lags to information.
- Certain items, such as remuneration, require related disclosures to be made in the AR&A and the Pillar 3. The Industry believes that it would be in the interests of all stakeholders when all the relevant information is published in the same location and a signpost provided.