FRTB SA – Regulatory Update

Final draft RTS on gross JTD amounts (EBA-RTS-2021-09)

Final Report on draft RTS on RRAO (EBA/RTS/2021/10)

October 2021

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1. Regulatory roadmap

Main milestones

The following timeline provides context on the RTS subject to this summary note within the main FRTB milestones (since their inception as BCBS standards in 2016 to their final application as transposed EU regulation in 2023):

BCBS FRTB
BCBS
January 2016

January 2019
BCBS
BCBS FRTB (review)

EU CRR2 - FRTB transposition into EU regulation
EU
May 2019

January 2020
EBA
RTS on the treatment of non-trading book positions subject to foreign-exchange risk or commodity risk**– CP**

Waiver GL for Structural FX positions Final draft[1]
EBA
July 2020

December 2020
EBA
RTS on the treatment of non-trading book positions subject to foreign-exchange risk or commodity risk **– Final draft**

EBA
March 2021
- **Draft RTS** on gross JTD amounts
- **Draft RTS** on residual risk add-on
- **Commission Delegated Regulation** with regard to the alternative SA

New
EBA
October 2021
- **Final draft RTS** on gross JTD amounts
- **Final Report** on draft RTS on RRAO

EU/EBA
January 2023
Entry into force CRR2/RTS[1]

The implementation of this RTS is expected to follow the same timeline for the revised market risk framework for which the BCBS on March 27th, 2020, due to the COVID-19 outbreak deferred to **January 1st, 2023[2]**

[1]Enty into force: January 1st 2022
[2]The entry into force of the RTS follows the same timeline forseen for the alternative standard and IMA methods for market risk in art.3(6) of CRR2.

2. Final draft RTS on gross JTD amounts

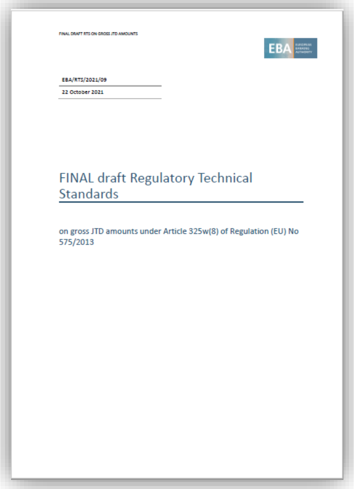
Executive Summary

To determine the DRC under the alternative standardised approach for market risk under the CRR, the gross jump-to-default (JTD) amount of exposures are to be calculated. In this regard, **the final draft RTS represents a contribution for the harmonised implementation in the EU of rules for the calculation of capital requirements for default risk of trading book positions under the alternative standardised approach for market risk**, being gross JTD amounts a key element needed for those calculations.

Scope of Review

The draft RTS **are intended to address the three mandates** set out in Article 325w(8) of the CRR, and specify respectively:

- (a) How the components $P\&L_{long}$, $P\&L_{short}$, $Adjustment_{long}$ and $Adjustment_{short}$ are to be determined for the purposes of calculating gross JTD amounts of exposures to debt and equity instruments with the formulae in Article 325w(1), (2) and (5) of the CRR.
- (b) Which alternative methodologies institutions are to use for estimating gross JTD amounts of exposures referred to in Article 325w(7) of the CRR.
- (c) How to determine the notional amount of instruments other than the ones referred to in Article 325w(4) of the CRR.


FINAL DRAFT RTS ON GROSS JTD AMOUNTS

EBA/RTS/2021/09

22 October 2021

FINAL draft Regulatory Technical Standards

on gross JTD amounts under Article 325w(8) of Regulation (EU) No 575/2013

2. Final draft RTS on gross JTD amounts

Point (a) of Article 325w(8) of the CRR

The mandate in point (a) of Article 325w(8) of the CRR requires the EBA to **specify how to determine the components $P\&L_{long}$, $P\&L_{short}$, $Adjustment_{long}$ and $Adjustment_{short}$ of the CRR formula** for calculating gross JTD amounts of exposures to debt and equity instruments.

- **The CRR formulae introduce the additional terms $Adjustment_{long}$ and $Adjustment_{short}$**, which are **not present** in the FRTB formulae for the calculation of gross JTD amounts as specified in MAR22.11.
- This also implies that the P&L term under the CRR and FRTB formulae will be associated to **different concepts**, and thus will generally result in **different values**. Regardless of the different formulae for gross JTD amounts under the CRR and the FRTB, **their output for equivalent exposures should be equal.**

$$P\&L_{long} = V_A - V_{notional}$$
$$P\&L_{short} = V_A - V_{notional}$$
$$Adjustment_{long} = -V_F$$
$$Adjustment_{short} = -V_F$$

$$JtD_{long} = \max\{V_A - V_D, 0\}$$
$$JtD_{short} = \min\{V_A - V_D, 0\}$$

- V_A is the **market value of the instrument** from which the exposure arises for the institution at the time of the calculation.
- V_F is the market value of the instrument from which the exposure arises for the institution **calculated under the assumption** that, at the time of the calculation, the **equity instrument** experienced a **full loss in value**, or the **debt instrument defaulted** and experienced a **zero recovery rate**.
- Under these premises, **the gross JTD amount is the difference between the market value of the instrument**, and the market value of the instrument **calculated under the assumption** that, the **equity** instrument experienced a **full loss in value**, or the **debt** instrument **defaulted** and experienced a prefixed (regulatory) **recovery rate** calculated with respect to the face value of the debt instrument.

2. Final draft RTS on gross JTD amounts

Point (b) of Article 325w(8) of the CRR

The mandate in point (b) of Article 325w(8) of the CRR requires the EBA to **specify which alternative methodologies institutions are to use for the purposes of estimating gross JTD amounts** of those exposures mentioned in Article 325w(7) of the CRR

ALTERNATIVE METHODOLOGIES

- The alternative methodologies should consist in **estimating the gross JTD amount** of an exposure **as the difference between the market value of the instrument**, and the market value of the instrument calculated under the **assumption that the obligor defaulted at that time.**

EXPOSURES THAT HAVE ALREADY DEFAULTED

- **If the obligor was already defaulted at the time of the calculation**, and the market value of the instrument from which the exposure arises for the institution at that time already reflects the gain or loss resulting from the default of the obligor, **an institution should set a value of zero to the gross JTD amount of the exposure, as the instrument would no longer be considered to constitute an exposure.**

2. Final draft RTS on gross JTD amounts

Point (c) of Article 325w(8) of the CRR

The mandate in point (c) of Article 325w(8) of the CRR requires the EBA to **specify the notional amount of instruments other than the ones referred to in points (a) and (b) of Article 325w(4) of the CRR.**

- To ensure that gross JTD amounts calculated under the CRR are aligned with those calculated under the international standards, the term Vnotional under the CRR formula should be specified as follows:

$$V_{notional} = \frac{V_D - V_F}{1 - LGD}$$

$$Notional_{long} = \frac{V_D - V_F}{1 - LGD}$$

$$Notional_{short} = -\frac{V_D - V_F}{1 - LGD}$$

- In accordance with the formulae specified, **the notional amount of an instrument is the same** (and has the same sign) **irrespective** of whether the institution **has a long or short exposure** arising from that instrument.
- **$V_{notional}$** of an exposure arising from an instrument **should be the notional amount of the instrument for a long exposure**, or the notional amount taken with a **negative sign** for a short exposure.
- The notional amount of instruments that constitute **exposures to non-senior debt instruments and exposures to equity instruments shall be zero**, which will imply that the term Vnotional of exposures to non-senior debt instruments and equity instruments will be zero.

2. Final draft RTS on gross JTD amounts

Treatment of exposures with multiple underlying, indices and CIUs 1/2

The EBA cites specifications for the exposures of gross JTD amounts arising from instruments referencing to multiple underlying, CIUs and indices.

- According to the Article 325ab(2) of the CRR II, it specifies that **“for traded non-securitisation credit and equity derivatives, JTD amounts by individual constituents shall be determined by applying a look through approach.”** Despite Article 325ab(2) has been included in Subsection 3 of Section 5 referring to own funds requirements for the default risk for securitisations included in the ACTP, the **EBA considers that this requirement is applicable for the purposes of Subsection 1 of Section 5, i.e. for the DRC for non-securitisations positions.**

New

- It is relevant to make a distinction among the treatments for:
  - I) **multi-underlying** instruments;
  - II) instruments that reference **CIUs**; and
  - III) instruments that reference equity and credit **indices**.

New.

I) Multi-underlying instruments

According to the EBA, referring to multi-underlying instruments, the look-through approach should apply for these instruments for the purposes of the DRC and calculating gross JTD amounts in accordance with Article 325ab (2) of the CRR II. This article transposes the equivalent MAR22.5 requirement of the Basel standard, where it clarifies the JTD equivalent **when decomposing multiple underlying positions of a single security or product**. This is defined as **the difference between the value of the security or product assuming that each single name referenced by the security or product defaulted, separately from the others**, and the value of the security or product assuming that none of the names referenced by the security or product defaulted.

2. Final draft RTS on gross JTD amounts

Treatment of exposures with multiple underlying, indices and CIUs 2/2

Moreover, the EBA cites the possibility of treating CIUs and indices positions without the look-through approach, considering the CIUs positions as single equities and the indices position as single debt or single equity instruments.

New

II) Instruments that reference CIUs

The EBA mentions the Article 325j (1)(a) of the CRR Commission Delegated Regulation (EU) 2021/424 of 17 December 2019 where it specifies that an institution shall calculate the own funds requirements for market risk of a position in a CIU where the institutions are not able to look-through, the institution may either: "**Consider the position in the CIU as a single equity position. In this case a unique gross JTD amount would be calculated for the position**." or "**Upon permission from its competent authority, an institution may calculate the own funds requirements for market risk of the CIU in accordance with the limits set in the CIU's mandate and relevant law** ."

New

III) Instruments that reference equity and credit indices

The EBA introduces an alternative to the look-through approach in the DRC for equity and credit indices, that is the **possibility of treating positions in an index as a position in a single debt or single equity instruments.** The EBA notes there is a lack of explicit provisions both in Basel and in the CRR related to the possibility of treating indices as single instruments. Consequently, there is a limit to the determination of gross JTD amounts for DRC for indices.

More information are expected to be published during this year in the CRR III.

KPMG

3. Final Report on draft RTS on RRAO

Executive Summary

The **EBA** has published the **Final Report on draft RTS** on the specification of **what an exotic underlying is and which instruments are instruments bearing residual risks**, for the purpose of Article 325u(2) of the CRR2.

The EBA refers the specifications given by the **CRR text** as the **clear guidance to identify the instruments subject to RRAO** and considers that it is not necessary further instructions.

Risk Weights	EBA specifications
RW = 1%	EBA confirms that any type of underlying not covered by the SBM or the DRC is an exotic underlying. It is explicitly confirmed that the underlyings ‘longevity risk', 'weather', 'natural disasters' and 'future realized volatility' are exotic underlyings, in line with the indication provided by the Basel text (MAR 23.3).
RW = 0.1%	EBA confirms the definition given by BCBS and establishes: - A non-exhaustive list of instruments bearing residual risks; as well as - A list of risks that do not constitute by themselves residual risks It also clarifies how index options, multi-underlying options and CIUs should be treated.

EBA

EBA/RTS/2021/10

22 October 2021

Final Report

Draft Regulatory Technical Standards

on the specification of what an exotic underlying is and which instruments are instruments bearing residual risks for the purposes of Article 325u(2) under Article 325u(5) of Regulation (EU) No 575/2013 (Capital Requirements Regulation)

Gonzalo Ruiz-Garma Gorostiza
Head partner FS Consulting
gruiz@kpmg.es

kpmg.com/socialmedia