

## Deloitte Banking Alert

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### The EBA published latest draft RTS on FRTB framework

The European Banking Authority (EBA) published on the 3<sup>rd</sup>, respectively on the 17<sup>th</sup> of December the final draft of the Regulatory Technical Standards (RTS) on how institutions are to calculate the own funds requirements for foreign-exchange and commodity risk stemming from banking book positions under the FRTB standardised and internal model approach; and on the capitalisation of non-modellable risk factors (NMRFs) for institutions using the FRTB internal model approach.

The both Regulations shall enter into force on the twentieth day following that of each publication in the Official Journal of the European Union and shall be binding in its entirety and directly applicable in all Member States.

### Key aspects

To begin with, the first three topics covered by the former RTS and the last one related to the latter RTS, are the followings:

- specify **the value** that institutions are to use when computing the own funds requirements for market risk for the **banking book positions**;
- **prudential treatment** for the calculation of the own funds requirements for market risk of **non-monetary items held at historical cost**;
- specify an **ad-hoc treatment** with respect to the **calculation of the actual and hypothetical changes** associated to banking book positions for the purpose of the **backtesting and the profit and loss attribution requirements**; and
- lay down a **specific methodology** that institutions are to use for determining the own funds requirements **related to non – modellable risk factors**.

### Accounting or fair value for banking book positions

**Article 105** requires institutions to revalue trading book positions at fair value on at least a daily basis.

However, it **does not set any specific** requirements with respect to the **valuation of banking book positions**, which are most often not fair valued. As a result, the final draft of the RTS sets out the followings:

- Institutions should use the **accounting value of banking book positions** as a basis for calculating the relevant risk measures;

- Institutions that are **fair valuing all banking book positions** on at least a **quarterly basis** may use the **fair value instead of the accounting value**;

Moreover, the draft RTS requires institutions to **update the FX component of a non-trading book positions on at least a monthly basis**. It should be noted that, regardless of whether the institution uses the fair value or the accounting value, **it must be able to identify the FX component in the value**.

## Prudential treatment of non-monetary items held at historical cost

An institution may have in its balance sheet non-monetary items that are held at historical cost that may be **impaired due to sharp movements in the exchange rate**; the carrying amount of an asset is the lower of:

- Carrying amount before considering possible impairment losses (using the FX rate on the date of the transaction);
- Recoverable amount (using the FX rate on the reporting date).

Considering that a institution **may suffer losses due to FX risk embedded in those items**, the EBA believes that it is important the **FX risk is captured under the Pillar 1** in the same way by all institutions in the Union.

## Specify an ad-hoc treatment with respect to the calculation of the HPL and APL

When it comes to positions that are **subject to FX risk or to commodity risk**, institutions are required to calculate the HPL and APL related to banking book positions for the purpose of the backtesting and profit and loss attribution requirement, **reflecting changed in the FX or commodity component**. However, institutions **may decide** to reflect in the HPL and APL changes the changes **related to all components determining the value of a non-trading book**, the institutions must **update all risk factors** determining the value of the financial instrument.

An institution that is fair valuing its banking book positions on a **quarterly basis will observe bumps** in the value of its portfolio at the fair-valuing date that **are not triggered by FX risk factors**. The RTS provides some guidance related to this problem of having bumps, which may lead to overshooting in the backtesting, although this is not due to changes in the FX risk component of the price.

## Specific methodology for determining the own funds requirements related to non – modellable risk factors

The institutions must calculate a **separate stress scenario** risk measure for **each non-modellable risk factor or bucket**, and then has to be **calibrated** to be at least as prudent as the **expected shortfall (ES)**. These draft RTS set out **the methodologies** that institutions are required to use for the purpose of determining the extreme scenario of future shock that, **when applied to the non-modellable risk factor**, provides the stress scenario risk measure.

RTS require institutions to **identify a stress period for each broad risk factor category** and to **collect data on non-modellable risk factors** for the stress period. Once the stress period is identified, institutions can use the **following methods**:

- **The direct method** – involves directly calculating the expected shortfall measure;
- **The stepwise method** – approximate the expected shortfall of the losses by **first** calculating a shock calibrated to an expected shortfall and **then** calculating the loss corresponding to the movement in the risk factor identified by that calibrated shock.

Furthermore, the draft RTS clarify the issue of the insufficient **number of observations** for a non-modellable risk factor and specifies a regulatory extreme scenario of future shock that should be applied where the institution is **unable to determine a scenario based** or where the competent **authority is unsatisfied** with the extreme scenario of future shock generated by the institution.

**For further questions regarding the aspects mentioned in this alert, please don't hesitate to contact us**



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#### **Links of the above draft RTS:**

<https://eba.europa.eu/eba-publishes-final-draft-technical-standards-treatment-non-trading-book-positions-subject-foreign>

EBA publishes final draft technical standards on capital requirements of non-modellable risks under the FRTB | European Banking Authority (europa.eu)