

European Banking Authority  
Tower 42  
25 Old Broad Street  
London EC2N 1HQ  
United Kingdom

Via email: [EBA/DP/2013/03@eba.europa.eu](mailto:EBA/DP/2013/03@eba.europa.eu)

Dear Sir / Madam,

27 September 2013

Dear Sir or Madam,

**Discussion Paper – Technical Advice to the Commission on possible treatment of unrealised gains measured at fair value under Article 80 of the Capital Requirements Regulation (CRR)**

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the EBA's Discussion Paper on Technical Advice on the possible treatment of unrealised gains measured at fair value under Article 80 of the CRD 4 Regulation (CRR) (EBA/DP/2013/03). AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

Our review of the discussion paper has, as you will see, focused on our key high level concerns with the discussion paper. As a result, we have not answered each of the specific questions that are posed in the discussion paper.

In general, in order to achieve a level playing field between European and non-European banks, AFME takes the view, wherever feasible, that the approach to developing and subsequently adopting any major piece of regulation in Europe is that it should be aligned with any international approach which is also being developed and adopted. Given that Basel have already stated that they are considering the issue of unrealised gains then we are of the view that Europe should not proceed unilaterally but instead focus on being aligned to the international approach on this issue. We note that this concern about inconsistency and therefore potential level playing field issues is to some extent reflected in the EBA's discussion paper in paragraphs 42 and 44. We therefore support the cautious views expressed in both these paragraphs and would support the view that such a cautious approach should be taken before any decision to apply or not to apply a filter is taken.

We believe that the EBA should take a holistic approach when considering the issue of determining a prudential filter for unrealised gains. However, it is not clear in the discussion paper that the EBA is doing so. Instead, it looks as if the issue is being addressed solely from an accounting point of view. As a result the paper does not seem to fully recognise or take into account the interaction of accounting choices and the risk

management of institutions. The decision by management to use a certain accounting category should be viewed in the context of how banks manage their risks, for instance by using the available for sale category, the fair value option or the use of hedge accounting.

Related to this, in relation to Question number 2 and in particular the first argument in the summary in favour of the introduction of a prudential filter, it is argued that unrealised gains may disappear. It is also worth noting, however, that one of the key functions banks perform is fulfilling the risk transformation role in the economy and in doing so they will hedge their risks within their pre-determined risk appetite. Apart from deliberately open asset and liability management and trading positions therefore, banks will hedge their risks using a range of instruments including securities, commodities, spot foreign exchange contracts and derivative financial instruments. As a result, for hedged positions, any unrealised losses are covered by unrealised gains in cases where such positions are subject to fair value accounting. Therefore, not taking into account unrealised gains but including unrealised losses will interfere with and potentially distort the application of an effective risk management and hedging strategy. It is also worth noting that the balance sheet and as a consequence information used for prudential reporting purposes represents the financial position of an institution at one moment in time. When applying internal models therefore, expected credit risks are taken into account and stress VaR for trading books will include the concept of potential value changes in the trading books.

Also in relation to the arguments outlined in Question number 2, it is worth noting that the RTS on Prudent Valuation will be applicable in the future for both the trading and banking book positions. When this has been implemented for banks, the risk that unrealised profits are not realisable will then be alleviated as the objective of prudent value RTS is to record assets and liabilities at their realisable value.

In paragraph 18 of the discussion paper concern is expressed about the quality of Own Funds as a result of the unreliability of fair value measurement of assets and liabilities. We are of the view that this concern is addressed in the EBA's recent consultative paper on Prudent Valuation under Article 105(14) of the CRR.

We are also of the view that the focus on 'unrealised' items is somewhat misplaced. In fact, it would appear as if many of the concerns expressed in the discussion paper are more about market risk. Although this sentiment in our view is expressed throughout the paper, one example would be paragraph 16 which states that "unrealised gains may disappear within a short period of time, in particular in a crisis situation, when at risk positions give rise to losses". As you are aware, market risk is separately measured and appropriately capitalised accordingly. As an example, if the market moves and as a result the bank loses on a position, it is irrelevant whether there had previously been unrealised gains associated with that position or the position was previously at the money. The market move results in a change in the firm's equity in both cases.

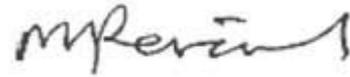
Finally, in the last section of the discussion paper, comments are requested in relation to the interaction between prudent valuation and the possible treatment of unrealised gains. Our main observation here is that the objective of the RTS on Prudent Valuation is to require banks to value positions for that price, that is 'haircutting' the IFRS fair value will mean in effect that the unrealised accounting profit for prudent reporting will become a realisable profit. Applying an additional prudential filter for unrealised gains and losses will therefore create a double count.

We look forward to working with the EBA in achieving its work programme and the full implementation of CRD 4 Regulation.

Yours faithfully,



Brian Harte  
Director, Compliance  
AFME



Michael Percival  
Director, Prudential Regulation,  
AFME