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Dear Sirs

Draft Regulatory Technical Standards: Non-delta risks

Barclays welcomes the opportunity to comment on the European Banking Authority consultation on “non-delta risk of options in the standardised market risk approach under Articles 318(3), 341(6) and 347(4) of the draft Capital Requirements Regulation”.

In this letter we outline our key messages on the proposals, while the specific questions posed in the consultation paper are answered in Appendix 1. Appendix 2 covers particular technical questions relating to the proposed approaches which we have also raised via the EBA CRDIV FAQ exercise.

Key messages

- Adopting a combination of approaches: The paper emphasises that sophisticated firms with large option portfolios should be using an internal modelled approach. The paper does not acknowledge the possibility of providing for a combination of approaches, where VaR approval may only cover some entities, business lines or products, and one (or more) of the less advanced approaches applying to the remaining population as would be the case for Barclays and a number of our peers.
- Exchange traded options: We acknowledge the precedence given in the level 1 text to deltas sourced from an exchange, however, we believe 1) these are not available in all circumstances and 2) own estimates of deltas are typically a more appropriate measure of risk. Option prices are more widely available, and can be used to derive a delta value. However, this value would generally embed the financing costs to hedge that option position and would reflect the cost of funds applicable to a particular institution. Naturally, this would vary from institution to institution based on the internal model and underlying assumptions, hence would not give rise to directly comparable deltas across the industry. Therefore, we request that the EBA review this section of the requirements in conjunction with industry working groups to derive a suitable, alternative, solution. Moreover, using a third party's models for products (which will for almost all exchanges be relatively standard) does not seem to be warranted provided that the deltas are derived from the exchange option prices.
- The integration of the scenario approach within an institution's risk management process: We are supportive of the premise that risk management and capital calculations should be aligned. In the scenario approach, however, they are separated from practical risk management through the delta neutralisation approach. We believe that requiring institutions to include the scenario approach into their risk management framework would be appropriately demonstrated using non-delta neutralised scenarios with scenario shifts of similar scope to those used directly for capital calculations.

Separately, we note there is an incorrect cross reference with regard to "implied volatility" as set out in Article 8.4; the reference should be to Article 4.2 not Article 2.4. Similarly, Annex 2 should refer to step 3 of Article 8, not step c.

I hope you find our comments helpful. Please do not hesitate to contact Katie Brannigan (katie.brannigan@barclays.com or +44 (0)20 3134 1619) if you have any questions or comments on any of the issues raised in this response.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'P. Estlin', with a long horizontal flourish extending to the right.

Peter Estlin

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Appendix 1: Response from Barclays to questions raised in the consultative document

Q1. Do you agree with the choice to use the Basel Framework to determine the capital requirements for the non-delta risks of options and warrants? Are there other approaches that can effectively be used for the purposes of these RTS? Which ones? Explain your reasoning.

Yes, we agree with the treatment as outlined, as it is broadly consistent with the Basel framework. A simplistic approach can be expected to make a number of assumptions with regard to risk types. In particular, the delta plus method adopts a “bottom up” approach regarding particular risk types- with a focus on gamma and vega. In our experience, losses during the crisis were also a result of skew, dividends and other higher order risks alongside gamma and vega. Therefore we continue to believe that the VaR model applies a more appropriate capital treatment and accordingly incentivizes more appropriate risk management and hedging.

We consider the scenario approach as a step towards a full VaR approval, as it incentivises better risk management than delta plus approach.

Ultimately, we believe that the VaR framework is the most appropriate mechanism for calculating and capturing risks arising in the Trading Book. For the avoidance of doubt, this would not only address delta, gamma and vega but also other risk drivers such as rho in addition to cross correlation between the greeks. We see the treatment of gamma and vega in Articles 329 is independent of the specific and general risk capital requirements. As such, the ability to capitalise non-delta risks through VaR is not conditional on the firm having specific risk VaR approval for the product category.

Q2. Do you prefer the first option (exclusion of a combination of methods within a single institution) or the second option (exact definition of the scope of the scenario approach)? Explain your reasoning. If you prefer the second option, what additional conditions and controls should be established?

We appreciate the emphasis that more advanced firms should be expected to use the internal model approach. However, as noted in our covering letter, some institutions may not have full coverage across all business lines or products and therefore a combination of approaches should also be envisaged within the final requirements (both across the group and within the same legal entity). This may be driven by the approach taken by the Competent Authority- for example, the PRA has historically given model approval on an entity by entity or business line basis (or a combination of both). In contrast, the Fed has taken a more “all or nothing” approach. We therefore believe that the second approach would be more suitable. Whilst we acknowledge that additional safeguards are necessary to avoid cherry picking, we would not suggest that a prescriptive list of requirements should be set out within the RTS. Where a firm is using a mix of approaches, we would expect any such discussion to form part of the review meetings on model application and broader meetings on market risk management with the relevant Competent Authority.

Q3. Do you believe that it is useful to implement the simplified approach established in the Basel text?

This approach would not be applicable to Barclays, but we feel it is useful to provide a simplified approach for firms with very limited options activity.

Q4. Do you agree with this prudential treatment, not contemplated in the Basel Framework, for non-standard options?

We believe that the risk on discontinuous options would be most appropriately calculated using a scenario based method, which would capture the risk for product types such a barrier options on a full revaluation basis. However, we acknowledge a proportional approach is appropriate and the proposed approach from the EBA may be best suited in these circumstances.

Q5. Do you agree that the RTS should require that the conditions of Articles 318(1), 341(1) and 347(3) of the CRR are met for the calculation of gamma and vega?

Whilst not explicitly covered in this Consultation, we believe that the deltas for Exchange traded options are not available in all circumstances. Option prices are more widely available, and can be used to derive a delta value. However, this value would be a reflection of the financing costs to hedge that option position and therefore would reflect the cost of funds applicable to a particular institution. This would vary from institution to institution based on the internal model and underlying assumptions, hence would not give rise to a comparable number across the industry. Moreover, using a third party's models for products (which will for almost all exchanges be fairly standard) does not seem to be warranted provided that the deltas are derived from exchange option prices. We have discussed this informally with several major exchanges who have said they do not publish greeks. In some cases, a company affiliated to the Exchange produces greeks for information but this is not a value the exchange itself takes responsibility for in the same way as a publicly-quoted price. If not available from the exchange itself, we believe it would be more appropriate to use our own values of the greeks, reflecting a firm's funding costs, rather than those of a third party.

Q6. Do you think that the unified treatment of interest rate risk is sound? Could there be difficulties in implementing it in practice?

We do not expect to have a significant population of interest rate options on standard rules therefore this treatment would not be applicable to us. However, we do not have any issues with the proposal and do not envisage any practical issues would arise.

Q7. How many hybrid options does your portfolio account for in terms of number of options and notional amounts (i.e. options which can be assigned to more than one underlying type as defined above)? Should the RTS specify the treatment of these hybrid options?

For Barclays, the hybrid risk is a lower order risk exposure than issuer, spot, or option volatility risk therefore we do not believe a treatment should be specified for hybrid options.

Q8. Do you agree with the rationale behind the exclusion of this provision contemplated in the Basel accord in the RTS? If not, please provide arguments in favour of its implementation.

We do not expect to have a significant population of interest rate options on standard rules therefore this treatment would not be applicable to us. We acknowledge that the proposed approach is intended to be a simplification, however, it does not necessarily follow that it will be easy to implement.

Appendix 2: Technical questions relating to the proposed approaches

Issue	Proposal
<i>For the scenario approach, should this be delta neutralised?</i>	Our proposal is a non delta neutralized measure. With a non Delta-Neutralised measure, one of the advantages is that straight differences would be taken through the Profit and Loss account. This would be a less subjective approach, as profit and loss moves are determined according to accounting policy, where the delta is not. This would also be a lot more comparable amongst institutions.
<i>What vega would be used- Parallel or time weighted?</i>	Our proposal is that this should be the 3 month time weighted vega (square root of 0.25 divided by the time to maturity in years) as this is a standard Industry measure and easy to source for listed options.
<i>What volatility would be used at a country level for General Market Risk?</i>	We propose the 3 month at the money implied volatility for the primary country of risk.
<i>Does the gamma and vega get charged independently and separately from the delta in the Taylor series approach, or is it netted then take the charge?</i>	Our proposal would be to net these charges, as this would encourage appropriate hedging behaviour.

