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Consultation Paper

Draft Regulatory Technical Standards

On the procedures for excluding transactions with non-financial counterparties (NFC) established in a third country from the own funds requirement for Credit Valuation Adjustment (CVA) risk under Article 382(5) of Regulation (EU) No 575/2013 (Capital Requirements Regulation - CRR)

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1. Responding to this Consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 05/11/2015. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

Regulation (EU) No 575/2013 (Capital Requirements Regulation - CRR) Article 382(4)(a) excludes from the own funds requirements for CVA risk an institution's transactions with non-financial counterparties (NFCs), regardless of whether these NFCs are established in the EU or in a third country, where those transactions do not exceed the clearing threshold as specified in Regulation (EU) No 648/2012 (European Markets Infrastructure Regulation- EMIR) Article 10(3) and (4) (in that case, the NFC is referred to as 'NFC-'). As a result, an institution's transactions with a NFC are excluded when the NFC is NFC- according to EMIR or would qualify as NFC- if it were established in the EU.

The cross-references to EMIR Article 10(3) and (4) require in the specific case of NFC established in a third country that the clearing threshold as specified in EMIR is applied by NFCs established in a third country in order for transactions with those NFCs to be excluded from the CVA risk charge.

The EBA is mandated to develop, in cooperation with ESMA, RTS to specify the procedures for excluding from CVA risk transactions with NFCs established in a third country.

These proposed draft RTS further clarify that the institution itself is responsible for taking the necessary steps to identify all non-financial counterparties that qualify for the exemption under CRR Article 382(4)(a) and calculate their own funds requirements for CVA risk accordingly¹.

In particular, these proposed draft RTS specify that:

- The institution should ensure that those of its counterparties established in a third country that are subject to the exemption under CRR Article 382(4)(a) would qualify as a NFC if they were established in the EU;
- The institution should ensure that those counterparties calculate the clearing threshold in accordance with EMIR Article 10(3) and (4) and do not exceed that threshold.

Article 382(4) last subparagraph of the CRR clarifies that, in case of the clearing threshold being exceeded at some particular point in time, outstanding contracts at that time remain exempt until the date of their maturity. This therefore makes it sufficient for an institution to meet the requirements of these RTS at trade inception only. However, as it could in some instances be disproportionate to require NFC established in a third country to compute the EMIR clearing threshold at the inception of each trade, the EBA is consulting on two options, the second of which introduces a minimum quarterly frequency of calculation of the EMIR clearing threshold.

¹ This is consistent with EBA Q&A 2013_472 which can be found in <http://www.eba.europa.eu/single-rule-book-qa>

3. Background and rationale

In December 2010, the Basel Committee on Banking Supervision (BCBS) published its 'Global regulatory framework for more resilient banks and banking systems', commonly known as Basel III, which aimed at addressing the lessons drawn from the financial crisis. In reaction to credit valuation adjustment (CVA) losses that appeared during the crisis, the Basel III standards introduced a capital charge against CVA risk².

Regulation (EU) No 575/2013 (the Capital Requirements Regulation - CRR) implements in EU legislation the requirements to compute own funds requirements for CVA risk. The scope of application of the CVA risk charge, however, has been limited in the EU due to the inclusion of specific exemptions, aiming at addressing concerns over unintended effects of the Basel CVA framework. Specifically, the CRR excludes from the CVA risk charge transactions with certain financial, non-financial and sovereign counterparties.

According to CRR Article 382(4)(a), transactions with non-financial counterparties ('NFCs'), where those transactions do not exceed the clearing threshold as specified in Article 10(3) and (4) of Regulation (EU) No 648/2012 (European Markets Infrastructure Regulation - EMIR), are currently excluded from the own funds requirements for CVA risk, regardless of whether these NFCs are established in the EU or in a third country. In particular, the CRR requires the clearing threshold as specified in EMIR to be applied by NFCs established in a third country in order for them to be excluded from the CVA risk charge.

The EBA is mandated to develop, in cooperation with ESMA, RTS to specify the procedures for excluding from CVA risk transactions with NFCs established in a third country. It should be noted that the EBA already partially addressed this issue in EBA Q&A 2013_472³, where the following preliminary answer was given, without prejudice of the approach developed in the present RTS:

'The institution itself is responsible for taking the necessary steps to identify all non-financial counterparties that qualify for the exemption under Article 382(4)(a) of the CRR and calculate their own funds requirements for CVA risk with respect to those eligible non-financial counterparties accordingly (regardless of whether they are located within the EU or in a third country)'. As a result, 'institutions should define appropriate arrangements with non-financial counterparties to ensure they remain informed of their status as regards the clearing threshold on an ongoing basis'.

² Revised version reflecting the CVA modification - June 2011

³ <http://www.eba.europa.eu/single-rule-book-qa>

EMIR clearing threshold and CRR CVA exemptions

Under EMIR, NFCs aggregate their positions in OTC derivatives and compare them to the clearing threshold using a number of rules, which derive from EMIR and ESMA RTS⁴. In particular, NFCs have to:

- include the positions of all the NFCs of the group (irrespective of the country of establishment)
- bucket the positions per asset class to compare the result to the respective five thresholds.

In addition, NFCs may exclude from the calculation of the threshold trades conducted for hedging purposes as defined in the RTS⁵.

If any of the thresholds is exceeded, the NFC becomes a so called 'NFC+' and is subject to specific requirements, in particular the clearing obligation. The specific requirements are then applicable to all the EU NFCs of the group and to all their future contracts. In particular, the clearing obligation would apply both to future contracts concluded for hedging and non-hedging purposes. Likewise, the clearing obligation would apply to all derivatives from all asset classes even if only one threshold for one asset class is exceeded.

In contrast, Article 382(4)(a) of the CRR excludes from the CVA risk charge transactions with NFCs, where those transactions do not exceed the clearing threshold as specified in EMIR Article 10(3) and (4). The drafting of Article 382(4)(a), and in particular the last sentence 'where those transactions do not exceed the clearing threshold', could be read as meaning that the positions that are relevant for the purpose of the threshold are:

- an institution's transactions with each NFC the institution has non-exempted transactions with, i.e. not taking into account other positions of that NFC with its other counterparties nor positions taken by other NFCs of the group; or
- an institution's transactions with all NFCs the institution has non-exempted transactions with, regardless of whether these NFC are NFC+ or NFC-, established in the EU or in a third country.

Both readings would lead to a misalignment between EMIR and CRR, whereas the intention of the EU legislator was to exempt from CVA risk institutions' transactions with NFC- regardless of the CVA risk for the institution of these transactions.

Under the first reading, transactions could be excluded from CVA risk even though the NFC is a NFC+ for EMIR purposes, provided that the total notional of transactions between the institution and the NFC+ is below the clearing threshold. However, it is unlikely that an institution's transactions with a NFC could exceed one of the clearing thresholds, since the clearing thresholds

⁴ COMMISSION DELEGATED REGULATION (EU) No 149/2013 of 19 December 2012

⁵ COMMISSION DELEGATED REGULATION (EU) No 149/2013 of 19 December 2012

were designed to consider all the derivative transactions, across all counterparties and asset classes, of all the NFCs of a group. This would result in transactions with non-financial counterparties being exempt from CVA risk charge.

Under the second reading, comparing the aggregated amount of all the transactions of an institution with all EU and non-EU NFCs to the EMIR threshold would result in removing the exemption depending on the importance of the derivative business of an institution. This postulates that this EU exemption (and the EMIR threshold) was designed as an acceptable level of exempted CVA risk for an institution, whereas in practice the intention was to exempt NFC-counterparties regardless of the institution's CVA risk. More generally, this reading would drastically reduce the relevance of the present RTS, as the aim of these RTS is precisely to specify how NFC established in a third country should apply the EMIR threshold despite not being subject to EMIR regulation.

Finally, the Corrigendum to the CRR has made the following addition in Article 382(4) last subparagraph: 'In regard to point (a) [EU-NFCs and non-EU NFCs], where an institution ceases to be exempt through [the NFC] crossing the exemption threshold or due to a change in the exemption threshold, outstanding contracts shall remain exempt until the date of their maturity'.

In summary, the EBA considers that the intention behind the cross-references to EMIR was the alignment with EMIR as far as the definition of referred to counterparties is concerned and that clearing thresholds would be too high if applied only to transactions between an institution and a NFC. Furthermore, whereas the reference to EMIR Article 10(4) would have been enough to make the link with the values of the threshold, the CRR Article is also referring to EMIR Article 10(3), which clearly states that the non-financial counterparty has to perform the computation: 'In calculating the positions referred to in paragraph 1, the non-financial counterparty shall include all the OTC derivative contracts entered into by the non-financial counterparty or by other non-financial entities within the group to which the non-financial counterparty belongs, which are not objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of the non-financial counterparty or of that group.'

As a result, in the context of Article 382(4)(a), transactions of an institution with a NFC are excluded when the NFC is NFC- according to EMIR or would qualify as NFC- if it were established in the EU.

NFCs established in a third country in CVA Report and Review

The EBA assessed separately the issue of NFCs established in a third country in the CVA Report⁶. As shown by Figures 19 and 20 of the CVA Report, the non-EU NFCs exemption represents the greatest impact in terms of CET1 ratio for one bank in the panel. In addition, its impact is non-negligible for other banks of the panel. On average, it is the most material exemption after EU NFCs and Sovereigns. As shown by Figure 21 of the CVA Report, banks still have operational

⁶ <http://www.eba.europa.eu/-/the-eba-advises-the-european-commission-on-credit-valuation-adjustment-cva-risk>

difficulties to identify the non-EU NFCs that are exempted from the CVA risk charge according to CRR Article 382(4a): this is the case for 9 respondents out of 24. It makes this type of exemption, together with the exemption of EU NFCs, the most difficult to apply. Half of the respondents seem to remove these counterparties automatically, whereas the other half remove them manually or both automatically and manually.

In the CVA Review⁷, the EBA concludes that, provided that the definition of the NFCs exemption from the CVA risk charge remains based on EMIR clearing threshold, there are no strong reasons from a technical point of view why this approach should fundamentally differ for NFCs established in a third country. As a result, the EBA recommends applying the same approach as for NFCs established in the EU, until EU exemptions are more globally reconsidered.

However, acknowledging that there are specifics to be taken into account when excluding NFCs established in a third country, the EBA, in cooperation with ESMA, is specifying in these RTS the procedures for excluding transactions with NFCs established in a third country.

⁷ See Section 6 of the CVA Report

4. Draft regulatory TS on the procedures for excluding transactions with non-financial counterparties (NFC) established in a third country from the own funds requirement for Credit Valuation Adjustment (CVA) risk under Article 382(5) of Regulation (EU) No 575/2013 (Capital Requirements Regulation - CRR)

In between the text of the draft RTS that follows, further explanations on specific aspects of the proposed text are occasionally provided, which either offer examples or provide the rationale behind a provision, or set out specific questions for the consultation process. Where this is the case, this explanatory text appears in a framed text box.



EUROPEAN COMMISSION

Brussels, **XXX**
[...] (2012) **XXX** draft

COMMISSION DELEGATED REGULATION (EU) No .../..

of **XXX**

[...]

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for procedures for excluding transactions with non-financial counterparties (NFC) established in a third country from the own funds requirement for Credit Valuation Adjustment (CVA) risk under Article 382(5)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012⁸, and in particular the fourth subparagraph of Article 382(5) thereof,

Whereas:

- (1) Article 382(4)(a) of Regulation (EU) No 575/2013 excludes from the own funds requirements for Credit Valuation Adjustment ('CVA') risk transactions with non-financial counterparties as defined in point (9) of Article 2 of Regulation (EU) No 648/2012, or with non-financial counterparties established in a third country, where those transactions do not exceed the clearing threshold specified in Article 10(3) and (4) of Regulation (EU) No 648/2012. However, as non-financial counterparties established in a third country are not covered by that Regulation, it is necessary to define procedures for excluding transactions with them from the own funds requirements for CVA risk.
- (2) With regards to determining whether the threshold is exceeded, Article 382(4) of Regulation (EU) No 575/2013 explicitly refers to Article 10(3) of Regulation (EU) No 648/2012, which provides that non-financial counterparties need to compute their total positions in over-the counter ('OTC') derivative contracts and compare the result of that computation with the threshold. As a result, the transactions between an institution and a non-financial counterparty, including where that counterparty is established in a third country are excluded from the own funds requirements for CVA risk, provided that the notional of all OTC derivative transactions of that non-financial counterparty, including all OTC derivatives entered into by other non-financial entities within the group to which the non-financial counterparty belongs, computed according to the methodology set out in Regulation (EU) No 648/2012 and Commission Delegated Regulation (EU) No 149/2013, do not exceed the clearing threshold specified in Article 10(3) and (4) of Regulation (EU) No 648/2012.
- (3) The last subparagraph of Article 382(4) of Regulation (EU) No 575/2013 clarifies that, where an institution ceases to be exempt through one of its non-financial counterparties crossing the exemption threshold at a particular point in time, outstanding contracts with that counterparty at that time remain exempt until the date of their maturity. In contrast, it results from the general rule of Article 382(4)(a) of Regulation (EU) No 575/2013 that, where an institution starts to be exempt through one of its non-financial counterparties crossing the exemption threshold, then all contracts with that counterparty, regardless of their inception date, would need to be excluded from the CVA risk charge.

⁸

OJ L 176, 27.6.2013, p.338.

Explanatory text for consultation purposes

When the clearing threshold is being exceeded by a NFC-, contracts of an institution with that NFC, which are outstanding at that time, remain exempt until the date of their maturity. This provision raises the issue of the treatment for CVA purposes of contracts with a NFC, where the NFC has moved from NFC- to NFC+ and vice-versa.

According to Article 382(4)(a), transactions with a NFC- are excluded from the own funds requirements for CVA risk regardless of the inception date of the transaction, and in particular regardless of the previous status (NFC- or NFC+) of the NFC.

According to Article 382(4) last subparagraph, when a NFC- becomes a NFC+, outstanding contracts remain exempt until maturity regardless of the inception date of these contracts.

Furthermore, when a NFC- becomes NFC+, new contracts that are subject to the clearing obligation and meet the requirements of Article 382(3) would carry on being exempt as per Article 382(3). However, new contracts not subject to the clearing obligation would normally attract a CVA risk charge.

To sum up, only OTC derivative contracts with a NFC qualifying durably as NFC+, contracts that are not subject to the clearing obligation, would attract a CVA risk charge. This implies, however, that institutions also monitor the cases where a NFC+ becomes NFC-, as they would have to remove from the CVA risk charge all their transactions with that counterparty.

Question 1: What are stakeholders' views on the proposed interpretation?

Option A: As a result, it is sufficient that the requirements of this Regulation are met at contract inception for a contract to be exempt until the date of its maturity.

Option B: As a result, it is sufficient that the requirements of this Regulation are met at contract inception for a contract to be exempt until the date of its maturity. However, this would require that non-financial counterparties established in a third country compute their positions in OTC derivative contracts for the purposes of the clearing threshold provided for in Regulation (EU) No 648/2012 for each contract at its inception. While indirect, such a requirement on non-financial counterparties established in a third country would be disproportionate, in particular in cases where an institution frequently enters into trades with a given non-financial counterparty, as it would require, for the sole purpose of the CVA exemption, that the non-financial counterparty re-computes its positions in OTC derivative

contracts for the purposes of the clearing threshold too frequently. Therefore, it would be appropriate to provide for a frequency of calculation.]

- (4) As Article 382(4) of Regulation (EU) No 575/2013 sets out the conditions for exempting transactions from the CVA risk charge: those are the qualification of a counterparty as a non-financial counterparty, and the compliance with the clearing threshold. Therefore, where, following the assessment set out in this Regulation, an institution discovers that one of its counterparties established in a third country either does not qualify as a non-financial counterparty, or does not calculate its positions in OTC derivative contracts for the purposes of the clearing threshold as specified in this Regulation, the institution is required to compute own funds requirements for CVA risk according to Title VI of Regulation (EU) No 575/2013 for all over-the-counter (OTC) derivative instruments with that counterparty that fall within the scope of Article 382(1) of that Regulation.
- (5) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (6) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010⁹,

HAS ADOPTED THIS REGULATION:

Article 1

Qualification as a non-financial counterparty

For the purposes of Article 382(4)(a) of Regulation (EU) No 575/2013, institutions shall document, based on the publicly available information and any other information submitted by counterparties, that those of their counterparties of over-the-counter ('OTC') derivative instruments included within the scope of Article 382(1) of that Regulation that are established in a third country would qualify as a non-financial counterparty ('NFC') as defined in point (9) of Article 2 of Regulation (EU) No 648/2012 if they had been established in the Union.

⁹ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

Article 2

Calculation of positions in OTC derivative contracts for the purposes of the EMIR clearing threshold

For the purposes of Article 382(4)(a) of Regulation (EU) No 575/2013, institutions shall ensure and document that non-financial counterparties which are established in a third country identified according to Article 1 calculate their positions in OTC derivative contracts in accordance with Article 10(3) and (4) of Regulation (EU) No 648/2012, and Commission Delegated Regulation (EU) No 149/2013, and do not exceed the clearing threshold referred to therein.

Explanatory text for consultation purposes

The EBA views that the reference to ‘the clearing threshold as specified in Article 10(3) and (4)’ of EMIR in Article 382(4)(a) of the CRR implies that the computation of the threshold for NFCs established in a third country should follow the same rules as for NFCs established in the EU (in particular, EMIR provisions, relevant delegated legislation, as well as ESMA Q&As). This means, in particular, that the computation of the threshold should be performed at group level.

Question 2: What are stakeholders’ views on the burden this might create for NFCs established in a third country? What could be a credible alternative treatment?

[Article 3- TO BE ADDED ONLY IF OPTION B IS CHOSEN UNDER RECITAL 3 ABOVE]

Frequency of due diligence requirements for confirming compliance with regulatory requirements

For the purposes of confirming compliance with the requirements of Articles 1 and 2, institutions shall carry out the relevant due diligence on a quarterly basis.]

Explanatory text for consultation purposes

1/ Trades entered into before the entry into force of these RTS

For trades entered into before the entry into force of these RTS, institutions will have to perform the due diligence requirements contained in these RTS for all NFC established in

a third country which they have outstanding contracts with at the date of entry into force of these RTS. This one-off reassessment will allow for the exclusion from the CVA risk charge until maturity of all transactions with non-EU NFC that meet the requirements of these RTS at the date of entry into force of these RTS.

2/ Trades entered into after the entry into force of these RTS

When the clearing threshold is being exceeded by a NFC-, contracts of an institution with this NFC, which are outstanding at that time, remain exempt until the date of their maturity. As a result, ensuring at trade inception that the NFC established in a third country qualifies as NFC and NFC- is generally deemed sufficient to meet the requirements for this trade to be exempt until the date of its maturity (**Option A**). This does not exempt institutions from checking, for trades entered into with an NFC+ at inception, that the NFC+ has not become NFC-, as this would require the institution to remove from the CVA risk charge all its transactions with that counterparty.

In some instances, however, especially in cases where an institution frequently enters into trades with a given NFC, it may be more appropriate to request the institution to perform the due diligence requirements of these RTS at a given frequency rather than at the inception of each trade. In this case, institutions could be required to ensure *‘on a quarterly basis’* that a NFC established in a third country qualifies as a NFC- under EMIR (**Option B**). This would reduce for the NFC the burden associated with the computation of the clearing threshold at the inception of each new trade. Where, following due diligence, an institution gets aware that a NFC- has become NFC+ in a given quarter, then all new transactions entered into during this quarter by an institution would be considered as transactions entered into with a NFC+ and thus subject to the CVA risk charge. In contrast, where, following due diligence, an institution gets aware that a NFC+ has become NFC- in a given quarter, then all transactions with that counterparty, regardless of their inception date, would be exempt from the CVA risk charge as per the general rule of Article 382(4)(a).

Note that the inclusion of a specific frequency would in theory require institutions to perform due diligence requirements even in the absence during the quarter of a new trade. However, in that case, the due diligence would be immediate for outstanding transactions with NFC- and limited to checking whether a NFC+ has not become NFC- during the quarter, even in the absence of a new trade, which is also a requirement under Option A (with no specific frequency in that case).

Under both Options A and B, institutions have to ensure that the counterparty established in a third country would still qualify as NFC under EMIR.

Question 3: What are stakeholders’ views on the relevance of the inclusion of a specific frequency? What is stakeholders’ preferred option?

Article 4

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission

The President

[For the Commission

On behalf of the President

[Position]

5. Accompanying documents

5.1 Draft Cost- Benefit Analysis / Impact Assessment

Article 10(1) of the EBA Regulation provides that when any regulatory technical standards (RTS) developed by the EBA are submitted to the Commission for adoption, they should be accompanied by an analysis of ‘the potential related costs and benefits’. This analysis should provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.

A. Problem identification

During the crisis, CVA losses occurred from the global deterioration of the credit quality of participants in the derivative markets. It appeared that institutions’ own funds requirements did not adequately reflect all risks stemming from derivative transactions. The credit valuation adjustment (CVA) risk charge is intended to remedy this problem. While the revised Basel framework envisages a comprehensive consideration of those derivative-related counterparty risks, the European implementation (CRD IV / CRR) facilitates the exclusion of transactions with non-financial counterparties (NFCs) from the calculation of the CVA risk charge.

Whereas EMIR Regulation allows for the identification of NFCs established in the EU, the procedure for the identification of NFCs established in third countries is not specified, as non-financial counterparties established in a third country are not covered by EMIR Regulation. This results in a lack of clarity for the purposes of applying the CVA exemption, which could – and effectively does¹⁰ – lead to different practices and outcomes across Member States. Potentially, it also creates divergence in the treatment between transactions with EU and non-EU NFCs. Obviously, this difference in the treatment of NFCs can hardly be justified from a risk management or prudential supervision perspective.

B. Policy objectives¹¹

At high-level, these RTS are expected to contribute to the general objectives of stability of the banking system and a high, effective and consistent level of banking regulation across the EU.

More specifically, these RTS should ensure consistency in the calculation of capital requirements for EU institutions.

¹⁰ EBA: Report on Credit Valuation Adjustment and Review on the Application of CVA charges to non-financial counterparties established in a third country (2015)

¹¹ EC: Impact Assessment accompanying the Regulation on prudential requirements for credit institutions and investment firms (2011)

At the operational level, these RTS aim at specifying the procedures for excluding transactions with NFCs established in a third country from the calculation of the CVA risk charge.

C. Baseline scenario

Under the baseline, the problems stated above, in particular the lack of clarity on the procedure for identification of NFCs established in third countries and, as a consequence, different practices and outcomes across Member States would persist.

D. Options considered

As the development of these RTS follows from the CRR mandate referred to above, considered options only concern technical specifications of the concrete procedure for excluding transactions with NFCs established in a third country from the own funds requirement for the CVA risk charge.

More precisely, these RTS could either specify that

- (i) due diligence requirements performed by institutions for exempting NFCs established in third countries are to be carried out at trade inception (Option A) or
- (ii) due diligence requirements performed by institutions for exempting NFCs established in third countries are to be carried out at a minimum (e.g. quarterly) frequency, irrespective of any inception of a new trade (Option B)

E. Cost-Benefit Analysis

When the clearing threshold is being exceeded by a NFC-, contracts of an institution with this NFC, which are outstanding at that time, remain exempt until the date of their maturity. As a result, ensuring at trade inception that the NFC established in a third country qualifies as NFC and as NFC- is generally deemed sufficient to meet the requirements for this trade to be exempt until the date of its maturity (Option A). The cost for institutions to perform their due diligence requirements for exempting NFCs established in third countries at trade inception, could be significant for institutions that frequently enter into new trades with NFCs established in third countries. At the same time, this requirement would ensure that, before entering into any new transaction, the situation of the NFC would have been re-assessed in order to avoid any non-compliance issue. The objectives of consistency in the calculation of own funds requirements and supervisory convergence across the EU would be efficiently achieved.

However, it may be more appropriate, in cases where an institution frequently enters into trades with a given NFC, to request the institution to perform the due diligence requirements of these RTS at a minimum frequency rather than at the inception of each trade. In this case, institutions could be required to ensure 'on a quarterly basis' that a NFC established in a third country qualifies as NFC- under EMIR (Option B). Where a NFC- becomes NFC+ in a given quarter, then all

new transactions entered into during this quarter by an institution should be considered as transactions entered into with a NFC+ and thus subject to the CVA risk charge. It should be stressed, however, that the introduction of a minimum frequency would require institutions to perform due diligence requirements at this minimum frequency even in the absence of a new trade. The cost for institutions to perform their due diligence requirements could be smaller for some institutions with benefits in terms of consistency in the calculation of capital requirements and convergence of supervisory practices almost equally achieved as in Option A.

In both cases however, these due diligence costs are largely balanced by the capital relief for institutions that is expected from the CVA exemption.

F. Preferred option

EBA's report on CVA shows that exclusion of third country NFC from the CVA risk charge calculation is the most material exemption for credit institutions after regulatory exemptions for EU NFC and sovereign counterparties. Given the materiality of those exemptions for credit institutions' own funds requirements, these RTS' objectives of ensuring risk-based own funds levels, as well as the higher relevance of the assessment at trade inception of whether a NFC established in a third country qualifies as NFC and NFC- under EMIR, the requirement of identifying third country NFC at trade inception appears proportionate. Thus, Option A is the proposed preference.

5.2 Overview of questions for Consultation

Question 1: What are stakeholders' views on the interpretation proposed?

Question 2: What are stakeholders' views on the burden this might create for NFCs established in a third country? What could be a credible alternative treatment?

Question 3: What are stakeholders' views on the relevance of the inclusion of a minimum frequency? What is stakeholders' preferred option?