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**BANKING STAKEHOLDER GROUP**

CONSULTATION ON EBA/CP/2015/21 ON  
GUIDELINES ON THE TREATMENT OF CVA RISK UNDER THE  
SUPERVISORY REVIEW AND EVALUATION PROCESS (SREP)

# General Comments and Replies to Questions

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BY THE EBA BANKING STAKEHOLDER GROUP

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## Foreword

The EBA Banking Stakeholder Group (“BSG”) welcomes the opportunity to comment on the Consultation Paper EBA/CP/2015/21 on Guidelines on the treatment of CVA risk under the supervisory review and evaluation process (SREP).

This response has been prepared on the basis of comments circulated and shared among the BSG members and the BSG’s Technical Working Group on Capital and Risk Analysis.

As in the past, the BSG supports an initiative that aims at harmonizing supervisory rules and practices across Europe, in order to ensure fair conditions of competition between institutions and more efficiency for cross-border groups. The BSG also expects these initiatives to facilitate data sharing between European supervisors and avoid reporting duplications for banks. However, the BSG identifies a number of issues which, unless properly addressed, could lead to unintended results.

This response outlines some general comments by the BSG, as well as our detailed answers to some questions indicated in the CP.

## General comments

The overall objective of the proposed guidelines is to promote coherent and uniform supervisory review practices with respect to Credit Value Adjustment (CVA) risk under Pillar 2. Although we might in principle support this purpose, we doubt that the proposed solution can contribute to reaching any real harmonisation and, moreover, we fear that these guidelines may damage the EU’s real economy

For banks above the materiality thresholds, it will partially or completely eliminate the exemptions on the calculation of CVA risk capital charges for derivatives entered into with non-financial end-users, namely corporates, sovereigns and pension funds. This exemption was intentionally decided by the European legislator in the Regulation 575/2013 on Capital Requirements (CRR) when Basel 3 rules have been implemented in Europe. Corporates and sovereign entities use derivatives to protect them against potential adverse movements in currencies, interest rates or other financial variables. This makes them stronger for the economy which is a systemic advantage including to banks. Unlike banks, these end-users cannot collateralize their derivatives transactions and/or clear through CCPs because of the limited scope of their derivative business, operational costs or lack of access to liquidity generally. These guidelines will lead to an increase in the cost of capital for non-centrally cleared derivatives banks entered into with non-financial counterparties, when these counterparties use risk management tools to hedge or mitigate their commercial or financial risks. This rise in the cost of capital will be passed to corporate and sovereigns. Corporates in particular will have to choose among; (i) bearing the costs, (ii) passing them to their clients or (iii) leave risks unhedged, which would make them more vulnerable to market price shocks. The burden of this charge will ultimately be borne by consumers and will badly impact the EU economy.

Furthermore, these guidelines are very prescriptive and detailed. The proposed quantitative approach gives it a quasi-Pillar 1 status, circumventing Pillar 1 rules. Indeed the appropriate coverage of CVA risk ~~called supervisory benchmark~~ ~~on nearly~~ the determin

automatic. A strict application of these guidelines could render SREP systematic and inappropriate processes. A “one-size-fits-all” process is likely to jeopardize the relevance of supervisory reviews as it will fail to capture special situations and necessary differentiations. We firmly believe that supervisors must maintain the ability to assess specific cases and take customised corrective actions if necessary.

Finally, the SREP process proposed in these guidelines is based on a supervisory benchmark whose calculation replicates the CRR Pillar 1 methodologies (basically, the guidelines propose that Pillar 2 charge would be a portion of the exempted charge under the CRR). This may give seemingly comparable outputs but it will actually fail to meet the SREP objectives of true comparability, relevance and proportionality as these outputs will not be close enough to the economic risks. This process does not consider the deficiencies of the Basel 3 methodology for the calculation of CVA risk capital charge. The SREP process should be based on a closer analysis on the CVA risk. This means a better calibration of the volatility of the accounting CVA : the CVA risk (net of DVA risk) is the measure that impacts the P&L of the banks and the true CVA risk banks have to deal with. It will therefore misrepresent the actual risks, leading to flawed conclusions and will finally be detrimental to sound risk management.

The Basel Committee and the EBA recognise shortcomings of the Basel 3 framework and the EBA is actively contributing to the Basel taskforce reviewing the CVA risk methodology. We therefore question the timing of this EBA initiative as Basel 3 rules are currently under review and should change quite dramatically in the near future. The EBA and the EU banking supervisors should refrain from correcting these exemptions in Pillar 2 before addressing the shortcomings of the Basel 3 methodology. It would be preferable to wait until the new methodology is implemented than temporarily imposing an undue Pillar 2 charge deemed unsatisfactory by the Basel Committee itself, assuming the internal model approach is retained We welcome the efforts to promote internal model approaches and Internal Capital Assessment, which are the most efficient solutions to reinforce the existing SREP framework).

Finally, the guidelines also propose the Pillar 2 charge to cover the CVA risk in intra-group transactions. We consider that this goes beyond Basel 3 requirements, and contradicts the Basel Committee response on FAQ 2a.1; “*As per the group consolidated reporting, no regulatory capital charge (including a CVA charge) applies to intercompany transactions*”.

## Replies to Questions

*Question 1: Do you agree with determining relevance of CVA risk by means of assessing the size of an institution's derivative business using the exposure value for non-QCCP cleared derivatives transactions?*

The threshold 2 is a better indicator to determine relevance of CVA risk than threshold 1. We would recommend it.

*Question 2: What are your views on how Threshold 1 should be calibrated?*

If however the EBA decides to maintain Threshold 1, it would be more appropriate to consider that the CVA risk is relevant when the two Threshold 1 **and** Threshold 2 are exceeded.

*Question 3: Do you agree with determining relevance of CVA risk by means of assessing the share of own funds requirements for CVA risk to the total risk exposure amount?*

The share of own funds requirements for CVA risk in total risk exposure is a better indicator to determine the relevance of CVA risk compared to the volume based indicator.

*Question 4: Do you agree with the approach provided for the determination of materiality of CVA risk?*

The share of own funds requirements for CVA risk in total risk exposure is a better indicator to determine the relevance of CVA risk compared to the volume based indicator.

However, the relevance of CVA risk should rely on the accounting CVA risks and not on the regulatory CVA formula.

*Question 5: What are your views on how 'x%' (Thresholds 2 and 3) should be calibrated?*

This is not a matter of value of x%. The "x" parameter is flawed because it is based on the regulatory CVA while the economic risk derives from accounting CVA variability.

Also, a unique x% value is inappropriate because it is a "one-size-fits-all" value. The specificities of the institutions should be part of the SREP process. Supervisors can assess **specific cases and take holistic views which may be different from those included in the guidelines** if deemed necessary.

***Question 6: Do you agree with the scope of derivative transactions to be included into the calculation of hypothetical own funds requirements for CVA risk?***

A precise assessment of the impact of any removal of the exemption on the derivative market is an important prerequisite, as shortage of supply of derivative may create market disruptions and impact badly the EU economy.

***Question 7: Do you agree that intra-group derivatives transactions should be explicitly included into the scope of calculation? If not, what do you think could be a credible alternative treatment of the CVA risk of intragroup transactions?***

No, we do not agree with this principle. The intra-group transactions should be exempt from the CVA charge at group level as soon as institutions are supervised on a consolidated basis. Hence, there is neither volatility to institutions' own funds nor CVA loss to institutions themselves.

***Question 8: Do you agree with the approach provided for the determination of supervisory benchmark for material CVA risk?***

The proposed supervisory benchmark is too arbitrary. The quantitative measure of what should be the appropriate coverage of CVA risk as part of SREP seems inadequate.

***Question 9: What are your views on how 'y%' (Threshold 4) should be calibrated?***

As for question 5, setting a unique y% value is inappropriate as it is a "one-size-fits-all" value. Moreover, the proposed approach seems inappropriate and no calibration appears to overcome the shortcoming of the proposed approach.

***Question 10: Do you agree with the approach provided monitoring of CVA risk by competent authorities and EBA and data to be provided to competent authorities for this monitoring?***

No, we do not agree. The Pillar 2 process allows institutions to use appropriate models for measuring CVA risk, in particular within ICAAP. This is a fundamentally sound principle.

***Question 11: What is your view regarding the potential burden of computing hypothetical own funds requirement for CVA risk at the same frequency as the regulatory CVA VaR and Stressed VaR figures?***

The global ICAAP framework is core and should set the frequency.

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Submitted on behalf of the EBA Banking Stakeholder Group

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