Subject: Commission intention not to endorse the draft Regulatory Technical Standards submitted on additional collateral outflows for derivative contracts according to Article 423(3) of Regulation (EU) No 575/2013

Dear Mr Enria,

The draft Regulatory Technical Standards (RTS) on additional collateral outflows for derivative contracts according to Article 423(3) of Regulation (EU) No 575/2013 (Capital Requirements Regulation- CRR) was submitted by EBA on 27th March 2014. The assessment of this RTS has been delayed pending the adoption of the Commission Delegated Act on the Liquidity Coverage Ratio. The Commission welcomes the transparent manner in which EBA has submitted this draft RTS and also acknowledges the efforts of EBA to submit a satisfactory standard in a complex area at a time when there was still insufficient clarity regarding the international Basel standard. However, I regret I must inform you of the European Commission's intention not to endorse the draft RTS as submitted.

The basic HLBA (Historical Look Back Approach) method as proposed by EBA establishes a floor methodology where the estimated outflow for extra collateral on derivative transactions is based on the largest gross difference in collateral posted for derivative contracts over any 30 day period in the last 2 years. In contrast, the Basel HLBA approach uses the largest net difference in collateral posted. The EBA method is more conservative because it does not allow banks to offset collateral received from other banks. In the documentation to the draft RTS, EBA noted that it was unable to estimate precisely the additional impact of its method but it did note that "for institutions with..."
significant derivative portfolios the calibration of the methods could have a material impact”.

EBA consulted industry on the basis of a wider range of methods, of which only 2 were retained in the final RTS, including the HLBA approach. Many respondents to the EBA consultation indicated their preference for close alignment with the Basel approach and emphasised the importance of a level-playing field. The Commission notes that the recommended EBA methodology based on the largest gross difference in collateral was not subject to the normal EBA impact assessment process because it was introduced as a compromise solution at a late stage to replace other approaches that did not command consensus. Although EBA has proposed to carry out a comprehensive review within two years, the Commission is nevertheless concerned by the lack of the normal EBA impact assessment process, particularly in the specific circumstances of this RTS.

Furthermore, leaving aside the procedural aspect, the Commission is also concerned by the substantive issues identified below.

First, the liquidity outflows under the EBA HLBA as compared to the Basel HLBA approach are much higher, perhaps 3-4 times higher for major players in derivative markets. Second, the Commission understands that 80% or more of collateral received by banks is cash, the rest is principally very high quality sovereign debt and banks have a valid self-interest to only accept high quality collateral. Therefore, there would seem to be good arguments to allow netting as permitted under the Basel HLBA approach. (The Commission recognises that the Basel Committee only clarified in April 2014, after the deadline for the submission of the RTS by EBA, that the additional collateral outflows should be calculated at a portfolio level (i.e. on a net basis). Third, from a broader market perspective, the EBA HLBA method could have a significant impact on the level-playing field in international derivative markets.³

In the light of the above analysis, I must inform you that in accordance with the sixth sub-paragraph of Article 10(1) of Regulation 1093/2010, the Commission intends not to endorse this RTS which the Commission is therefore sending back to EBA. The explanations for non-endorsement are as described above.

Nevertheless, I am pleased to inform you that, given EBA has already carried out a proper impact assessment and stakeholder consultation for the Basel HLBA approach, the Commission would be open to examining an amended RTS based on this approach, should EBA consider it appropriate to submit such an accordingly amended RTS. The Commission attaches particular importance to policy-making in the prudential field being evidence-based and subject to proper consultation. However, should EBA not amend the RTS in line with the above comments, I must inform you that the Commission would intend to reject it in accordance with the seventh sub-paragraph of Article 10(1) of Regulation 1093/2010.

Yours sincerely,

Signed

Olivier GUERSENT

³ It is understood that the Basel HLBA approach is being implemented by the US, Switzerland, Canada and Australia.