German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

EBA Consultation Paper
Guidelines on the treatment of CVA risk under the supervisory review and evaluation process (SREP)

Register of Interest Representatives
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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

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Comments EBA Consultation Paper Guidelines on the treatment of CVA risk under the supervisory review and evaluation process (SREP)

Thank you for the opportunity to comment on the draft guidelines.

It is our firm belief that the proposals amount to a tightening of requirements in a manner which is at odds with European law. We consider both the **basis** and the **timing** of the guidelines to be flawed and are concerned that, if implemented, they would have **damaging consequences**.

Basis

EU lawmakers consciously included exemptions for certain transactions in the CRR. These exemptions should not be rendered null and void by guidelines under Pillar 2 – all the more so given that Pillar 2 has come to be interpreted as a "Pillar 1 plus" approach, with supervisors indicating that additional capital requirements will in principle always be imposed.

The EBA cites its own CVA report of 25 February 2015 as a basis for the proposed guidelines. But the legal mandate for preparing this report, namely Article 456(2) of the CRR, makes it quite clear that the exemptions addressed by the EBA in its guidelines should not be part of the subject matter. The purpose of the report was supposed to be to indicate whether there might be a need for the European Commission to adjust the CRR requirements for CVA risk. The exemptions under Article 382(4) of the CRR were explicitly excluded from any possible changes. Since these exemptions alone are given specific protection from potential change, it is plainly the will of EU lawmakers that they should on no account be nullified.

Cost-benefit and materiality considerations are two further grounds for calling the guidelines into question. The SREP guidelines classify CVA risk as a sub-category of market risk and specify, as a general principle, that sub-categories should be individually monitored and assessed only in the event that they represent a material risk. In our estimation, CVA risk cannot be considered material for the vast majority of banks. We consequently see no need for dedicated guidelines on this specific issue. On top of that, the proposed standardised approach to assessing the risk flies in the face of the whole concept of Pillar 2.

Timing

As the draft guidelines themselves point out, the Basel Committee on Banking Supervision is currently working on a fundamental review of capital requirements for CVA risk. It is difficult to understand why, instead of first awaiting these foreseeable changes to the CVA framework, the EBA wants to introduce guidelines which cannot possibly represent more than an interim solution.

We assume, moreover, that CVA risk positions will increase substantially (up to fivefold) once the new basic approach proposed by the Basel Committee is applied. If these proposals were taken into account in the EBA's consultation paper, the results of the impact assessment on page 31 f. would be very different. Numerous banks that now use the CRR's standardised method for calculating CVA risk (which is virtually all banks; the number of banks in the Eurozone using the advanced method is in single figures as far as we know) would then exceed threshold 2 although their CVA risk is actually low.

We therefore strongly recommend waiting until the Basel Committee adopts its revised framework before there is any further discussion about introducing guidelines and about their compatibility with the will of EU lawmakers.

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Damaging consequences

While drafting EMIR, lawmakers identified a number of damaging consequences and, not least in the interests of protecting the real economy, included a number of exemptions from the regulation's clearing obligations. As a logical consequence, analogous exemptions from the CVA charge had to be granted under the CRR since the desired effect would otherwise not have been achieved. The EBA must, therefore, be clear on the fact that any restrictions on these exemptions would lead to the exact same adverse consequences which lawmakers originally wanted to avoid.

At the hearing on 27 January 2016, the EBA said no information was available about the implications for derivatives prices. This point notwithstanding, there are basically only two conceivable outcomes (or a combination of the two). Either the banks themselves would have to absorb the extra costs, which would reduce their profitability still further, or these costs would be passed on to customers – including non-financial counterparties (NFCs). At best, this would put a strain on the NFCs' finances and hold back growth, while in the worst case scenario, NFCs would become more hesitant about hedging their risks.

A further adverse consequence for NFCs is that the EBA's welcome plans to apply the principle of proportionality would bring them virtually no benefit at all. The more NFCs use the same bank as a counterparty, the greater the likelihood that this institution will exceed the thresholds (however they end up being set). In consequence, these NFCs, which presumably had a good reason for selecting a particular counterparty, would derive no advantage from the application of proportionality regardless of their size.

CDS markets would also experience negative effects. Under the CRR, only single-name or index CDSs are eligible hedges for CVA risk. These markets have recently become increasingly illiquid, partly as a result of regulatory requirements such as the Regulation on short selling and certain aspects of credit default swaps. The proposed guidelines therefore risk disrupting these markets as well, with rising funding costs for NFCs and governments as a result. Once again, it would make better sense to first await the sensible adjustments to hedging arrangements which the revised Basel framework is expected to introduce.

Nor are guidelines, as a Pillar 2 approach, a suitable or effective instrument for improving the assessment of Basel III implementation in the EU under the Basel Committee's Regulatory Consistency Assessment Programme (RCAP). Only by going through the full European legislative process of amending the CRR would it be possible to modify the rules in a manner which respected the will of EU lawmakers and might change the analysis of the RCAP.

For all these reasons, we are strongly opposed to the proposed guidelines and will refrain from replying to the questions in the consultation paper. We would be happy to discuss our fundamental concerns with the EBA at any time.