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Consultation Paper

On Draft Regulatory Technical Standards (RTS) on credit valuation adjustment risk for the determination of a proxy spread and the specification of a limited number of smaller portfolios under Article 383 of Regulation (EU) 575/2013 (Capital Requirements Regulation - CRR)

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Contents

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 25 September 2013. 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) N° 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 575/2013 sets out own funds requirements relating to Credit Valuation Adjustment Risk. Article 383(7) of Regulation 575/2013 mandates the EBA to prepare draft regulatory technical standards (RTS) in this area.

In 2012 the EBA conducted a consultation on draft RTS[1] on credit valuation adjustment risk based on the legislative proposal of the European Commission for Regulation 575/2013. Because Regulation 575/2013 introduces some relevant changes in relation to the original RTS mandate and in consideration of the first consultation of 2012, the RTS has been redrafted and the EBA is now conducting a second public consultation.

The new text Article 383(7) of Regulation 575/2013 has changed the mandate as follows: '*EBA shall develop draft regulatory technical standards to specify in greater detail… how a proxy spread should be determined by the institutions approved internal VaR model for the specific interest rate risk for the purposes of identifying* s_i *and* LGD_{MKT}'.

Furthermore, a new paragraph Article 383(6) of Regulation 575/2013 has been added. This paragraph confirms that institutions should apply the standardised method for the calculation of the CVA charge for exposures to those counterparties which do not produce an appropriate proxy spread with reference to industry, rating and region under the advanced method.

Consequently, the RTS do not deal directly with the VaR spread methodology, but specify the criteria that this methodology has to satisfy in order to allow for a proxy spread to be used in the calculation of the advanced CVA charge.

The main changes in the revised RTS as compared to the Consultation Paper published in July 2012 are as follows:

Proxy spread

- A higher level of granularity for the industry criterion has been introduced.
- In general, the estimation of a proxy spread by considering the credit spread of a single issuer will be considered appropriate, if the issuer is homogenous with reference to rating, industry and region.
- The use of the spread of the parent company as a proxy spread for a subsidiary is deemed appropriate if at least two of the three criteria of industry, rating and region are, for the subsidiary and the parent undertaking, equivalent on the basis of the minimum categories defined in the RTS.
- The use of the sovereign spread as a proxy spread for a regional government or local authority is deemed appropriate if the regional government or local authority and the sovereign have the same rating.

[1] The documentation can be found at; http://www.eba.europa.eu/Publications/Consultation-Papers/All-consultations/2012/EBA-CP-2012-09.aspx

- The approach for defining an appropriate proxy spread with reference to rating, industry and region has been modified in order to allow for multivariate estimates in the approved VaR proxy spread methodology.

Limited number of smaller portfolios

Following the guidance from the previous consultation and based on current practice with industry, the RTS has been re-drafted as follows:

- The size of a portfolio is defined following the exposure at default based on the mark to market method.

- The number criterion has been modified and is now based on transactions rather than portfolios (regulatory netting sets) as this is considered more appropriate.

- A new criterion has been added that defines the size of smaller portfolios based on the size of each individual non-IMM portfolio subject to the CVA risk charge versus total size of all portfolios subject to the CVA risk charge.

3. Background and rationale

Background to these draft RTS

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[2] which aimed at addressing the lessons drawn from the financial crisis.

Regulation 575/2013 translates the BCBS proposals into EU law. In terms of own funds requirements, both reforms raise the quality and quantity of the regulatory capital base. The draft RTS proposed by the EBA in this consultation derive directly from Regulation 575/2013, which will apply from 1 January 2014.

The draft RTS elaborates on certain specific elements of the calculation of own funds requirements for credit valuation adjustment ('CVA') risk. According to Article 381 of Regulation 575/2013, CVA means an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty. The adjustment reflects the current market value of the credit risk of the counterparty to the institutions, but does not reflect the current market value of the credit risk of the institution to the counterparty. In other words, it is the risk of loss caused by changes in the credit spread of a counterparty due to changes in its credit quality. The CVA charge integrates the capital treatment for counterparty credit risk on OTC (bilateral) derivative instruments.

It should be noted, that the scope of application has been limited substantially in the final CRR relative to the original CRR proposal, which the first consultation paper was based. Specifically, the final CRR excludes for the CVA calculation certain non-financial and central government counterparties. The changes in this CP are however not a consequence of the change in scope, but will limit its applicability significantly.

The requirements contained in the draft RTS are mainly addressed directly to institutions, although some of them are addressed to competent authorities. All the proposed requirements are likely to be of relevance and interest to both institutions and competent authorities.

Scope of the RTS on the determination of a proxy spread and the specification of a limited number of smaller portfolios

Article 383(7) of Regulation 575/2013 requires the EBA to draft RTS 'to specify in greater detail':

(a) how a proxy spread should be determined by the institution's approved internal VaR model for the specific interest rate risk for the purposes of identifying s_i and LGD_{MKT} for the purposes of the calculation required by Article 383(1); and

2 International Convergence of Capital Measurement and Capital Standards. Basel Committee on Banking Supervision, December 2010 and further revisions.

(b) the number and size of portfolios that fulfil the criterion of a limited number of smaller portfolios referred to in Article 383(4).

Article 383(1) of Regulation 575/2013 states that in calculating the Advanced CVA capital charge:

- institutions shall calculate a CVA VaR by using their internal VaR model (which has to be approved by the relevant Competent Authority under EU provisions for the specific risk of debt instruments;
- the calculation shall use a formula with several inputs including:
  - ✓ the expected exposure calculated by the internal expected positive exposure ('EPE') model;
  - ✓ CDS spreads over a set of tenors and related to single counterparties;
  - ✓ market implied Loss Given Defaults (LGD_{MKT}), based on the spread of a market instrument of single counterparties;
- in case a credit default swap for a counterparty is not available, institutions 'shall use a proxy spread that is appropriate having regard to the rating, industry and region of the counterparty';
- in case a market instrument for a counterparty is not available, LGD_{MKT} '*shall be based on the proxy spread that is appropriate having regard to the rating, industry and region of the counterparty'*.

Article 383(6) of Regulation 575/2013 states that for exposures to a counterparty for which the institution's approved internal VaR model for the specific interest rate risk does not produce a proxy spread that is appropriate with respect to the criteria of the rating, industry and region of the counterparty, the institution shall use Article 384 to calculate the own funds requirement for CVA risk.

Article 383(4) of Regulation 575/2013 states that institutions which are permitted:

- to use a VaR model for the measurement of specific market risk of debt instruments; and
- to use an internal EPE model for the calculation of the exposure values to counterparty credit risk on the majority of their business, but use other methods (Mark-to-Market Method, Standardised Method or Original Exposures Method) for smaller portfolios

may also be permitted by competent authorities to use the advanced method for the calculation of the CVA capital charge for the portfolios that are not covered by the internal EPE model. This permission may only be granted if 'a limited number of smaller portfolios' are excluded from the scope of the EPE model.

The scope of EBA's mandate for the draft RTS in this context cover:

- the specification of how a proxy spread should be determined in order to be considered appropriate with respect to the criteria of rating, industry and region of a specific counterparty;
- the specification of how the market implied loss given default of the counterparty, namely LGD_{MKT}, corresponding to the applicable proxy spread should be identified for the purposes of calculating the advanced CVA capital charge; and
- the specification of both the number and size of portfolios that fulfil the criterion of 'a limited number of smaller portfolios' (including the need for that criterion to be fulfilled on an ongoing basis).

The nature of RTS under EU law

Draft RTS are produced in accordance with Article 10 of the EBA Regulation[3]. According to Article 10(4) of the EBA Regulation, they shall be adopted by means of regulations or decisions. The EBA expects that the majority of its RTS, including those contained in the present consultation, will eventually be adopted as Commission Regulations.

According to EU law, regulations are binding in their entirety and directly applicable in all Member States. This means that, on the date of their entry into force, they become part of the national law of the Member States automatically without need for further transposition into national law.

Presenting these rules in the form of a draft Commission Regulation should ensure a level-playing field by preventing divergent national requirements and thereby facilitating the cross-border provision of EU financial services.

The EBA has developed these RTS proposals on the basis of Regulation 575/2013[4] published in the *Official Journal of the European Union* on the 28th of June 2013. The EBA will review the draft RTS before submission to the Commission by 1 January 2014 to ensure that they take account changes arising out of the consultation process.

[3] 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.
[4] Regulation 575/2013 can be found at http://eur-lex.europa.eu/JOHtml.do?uri=OJ:L:2013:176:SOM:EN:HTML

4. Draft Regulatory Technical Standards for credit valuation adjustment risk on the determination of a proxy spread and the specification of a limited number of smaller portfolios under Article 383 of Regulation (EU) 575/2013 (Capital Requirements Regulation- CRR)

EUROPEAN COMMISSION

Brussels, XXX
[…](2012) XXX draft

COMMISSION DELEGATED REGULATION (EU) No …/..

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supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for credit valuation adjustment risk on the determination of a proxy spread and the specification of a limited number of smaller portfolios

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 648/2012[5] , and in particular Article 383(7) thereof,

Whereas:

(1) The application of the advanced method to the determination of own funds requirements for CVA risk is liable to involve counterparties for which no CDS spread is available.

(2) The internal Value-at-Risk methodology specifies how, in the calculation of the own funds requirement for market risk, a proxy spread should be determined where no credit spread is available for a certain counterparty. However a proxy spread determined by this methodology should only be applied to the determination of the advanced CVA own funds requirement if it satisfies the criteria set out in this Regulation.

(3) An appropriate proxy spread should be estimated by the use of reliable market data and by applying the attributes of rating, industry and region of the single issuers. These attributes should be defined by considering minimum categories.

(4) It should be possible to extend the categories and to add additional attributes (such as ‘currency’, ‘seniority’ or ‘size of enterprise’) where these provide an appropriate differentiation and sufficient data is available.

[5] OJ L 176, 27.6.2013, p. 1.

(5) The estimation of a proxy spread on the basis of the credit spread of a single issuer should be allowed provided that the requirments set out in this Regulation are met.

(6) The use of the credit spread of a parent company as a proxy spread for a subsidiary is appropriate if the two companies are sufficiently homogenous having regard to to the criteria of rating, industry and region.

(7) The use of the sovereign spread as a proxy spread for a regional goverment or local authorithy may be appropriate where the regional goverment or local authorithy and the sovereign have the same rating.

(8) A proxy spread should be determined by using data that has been observed on a liquid market. Interpolation and extrapolation of data relating to different tenors should be conceptually sound.

(9) The determination of LGD_{MKT} reflected in liquid traded credit spreads should be consistent with the pricing of single name credit default swaps. LGD_{MKT} values for counterparties based on proxy credit spreads should reflect market consensus LGD estimates.

(10) For the purposes of permission to use the advanced CVA method for the non-IMM netting sets, it is appropriate to specify a limited number of smaller portfolios in terms of a percentage of the total number of transactions and the total size of portfolios, subject to the calculation of CVA risk in order to take account of the different dimensions of institutions.

(11) A withdrawal of permission should occur only when quantitative limits are breached for two consecutive quarters in order to mitigate possible discontinuities also known as ‘cliff effects’.

(12) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.

(13) 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 1093/2010,

HAS ADOPTED THIS REGULATION:

CHAPTER I

GENERAL PROVISIONS

Article 1- Subject matter

This Regulation specifies:

(a) how a proxy spread should be determined by an institution's approved internal VaR model for the specific interest rate risk for the purposes of identifying s_i and LGD_{MKT} as referred to in Article 383(1) of Regulation (EU) No 575/2013; and

(b) the number and size of portfolios that fulfil the criterion of a limited number of smaller portfolios referred to in Article 383(4) of Regulation (EU) No 575/2013,

in the context of calculating the own funds requirements for CVA risk in accordance with the advanced method pursuant to Article 383(7) thereof.

Article 2 – Definitions

For the purpose of this Regulation the following definitions shall apply:

(1) *'portfolio'* means a netting set used for regulatory purposes in the determination of the exposure value for the counterparty credit risk and for which the own funds requirements for CVA risk have to be calculated;

(2) *'non-IMM portfolio'* means a portfolio to which the exposure at default, used to calculate the own funds requirements for counterparty credit risk, is calculated using a method other than the IMM;

(3) *'size of portfolio'* means the exposure at default of a portfolio, calculated using the mark-to-market method outlined in Article 274 of Regulation (EU) No 575/2013 by taking account of the effects of netting, in accordance with Article 297 of that Regulation, but not the effects of collateral.

(4) ‘*proxy spread’* is the credit spread for a counterparty determined by the institution’s approved internal model for the specific risk of debt instruments in cases where no CDS spread is directly observable.

CHAPTER II

THE PROXY SPREAD

Article 3 –Determining an appropriate proxy spread

1. The proxy spread for a given counterparty shall be deemed appropriate having regard to the rating, industry and region of the counterparty where all of the following conditions are satisfied:

(a) the proxy spread has been determined by reflecting all of the attributes of rating, industry and region of the counterparty;

(b) the attribute of rating has been defined by the use of a predetermined hierarchy of sources of internal and external ratings. Ratings shall be mapped to credit quality steps, as referred to in Article 384(2) of Regulation (EU) No 575/2013. In cases where multiple external ratings are available the mapping shall follow the approach for multiple credit assessments set out in Article 138 of that Regulation;

(c) the attribute of industry has been defined by considering at least the following categories:

- public sector;
- banks;
- insurance;
- other financial services;
- industrials
- others.

(d) the attribute of region has been defined by considering at least the following categories:

- Europe;
- North America;
- Asia;
- Rest of World.

(e) the proxy spread reflects in a representative way available credit default swap spreads and spreads of other liquid traded credit risk instruments, corresponding to the relevant combination of applicable categories and satisfying the quality criteria set out in paragraph 5;

Text for consultation purposes:

Due to the change in the final text of Regulation 575/2013, the RTS does not deal with the VaR spread methodology, but specifies the criteria that this methodology has to satisfy in order to allow for a proxy spread to be used in the calculation of the advanced CVA charge, as such the EBA believes that the sectoral breakdown concerning financial counterparties should be more granular than first consulted in 2012.

Q1. Please provide information and data concerning the availability of CDS data with respect to the minimum categories for 'rating', 'industry' and 'region' defined in points (b), (c) and (d).

2. A proxy spread satisfying the conditions in paragraph 1, but in relation to which additional attributes have been added to those of rating, industry and region shall be deemed appropriate if such attributes reflect the characteristics of positions in the institution's CVA portfolio and take account of the availability of data satisfying the quality criteria set out in paragraph 5.

3. Notwithstanding paragraph 1, the estimation of the proxy spread for a subsidiary by the credit spread of the parent undertaking shall be deemed appropriate if at least two of the three attributes of industry, rating and region are, for the subsidiary and the parent undertaking, equivalent on the basis of the minimum categories defined in paragraph 1.

4. Notwithstanding paragraph 1, the estimation of the proxy spread for a regional government or local authority by the credit spread of the relevant sovereign issuer shall be deemed appropriate if the regional government or local authority and the relevant sovereign issuer are equivalent with respect to the attribute of rating.

5. All inputs used in the determination of a proxy spread shall be based on reliable data observed on a liquid two-way market as defined in Article 338 of Regulation (EU) No 575/2013. Sufficient data shall be available to generate proxy spreads for all relevant tenors and for an appropriate historical period with reference to Article 383(5) of that Regulation.

Text for consultation purposes:

Paragraph 1 Point (e) allows for single named proxies as long as they are appropriate with reference to rating, industry and region. Paragraphs 3 and 4 define the appropriateness of single named proxies in particular cases (‘parent vs. subsidiary’, ‘sovereign vs. local authority’).

Q2. Please provide information concerning the usefulness, appropriateness and coherence with market practices of the approach to the use of single-named proxies described in Article 3.

Q3. Paragraph 3 allows for the proxying of the spread of the subsidiary by the spread of the parent company. Where no rating is available for the subsidiary or the parent undertaking or both, should the entities be considered equal in terms of the ratings attribute? Do you think that this treatment is appropriate? Please state the reason(s) in favour and/or against it.

Q4. Paragraph 4 allows for the proxing of the spread for a regional government or local authority by the spread of the relevant sovereign. Where no rating is available for the regional government or local authority, should the entities be considered equal in terms of the ratings attribute? Do you think that this treatment is appropriate? Please state the reason(s) in favour and/or against it.

Q5. Please indicate other particular cases in which single named proxies might be appropriate.

Article 4 – Identification of LGD_{MKT}

1. The identification of LGD_{MKT} for the purposes of calculating the own funds requirements for CVA risk according to the advanced method using a proxy spread shall be:

    a. the market convention of LGD_{MKT} corresponding to single named credit default swaps;

    b. the determination of the particular proxy spread in accordance with this Chapter.

CHAPTER III

THE NUMBER AND SIZE OF QUALIFYING PORTFOLIOS

Article 5 – Quantitative limits

1. To fulfil the criterion of a limited number of smaller portfolios referred to in Article 383(4) of Regulation (EU) No 575/2013, the following conditions shall be satisfied:

a. the number of all non-IMM transactions subject to the CVA risk charge shall not exceed [15] % of the total number of transactions subject to the CVA risk charge;

b. the size of each individual non-IMM portfolio subject to the CVA risk charge shall not exceed [1] % of the total size of all portfolios subject to the CVA risk charge; and

c. the total size of all non-IMM portfolios subject to the CVA risk shall not exceed [10] % of the total size of all portfolios subject to the CVA risk charge.

Text for consultation purposes:

Q6. Do the proposed thresholds of [15] % for the number of non-IMM portfolios, of [1] % for each individual non-IMM portfolio, and [10] % for the total size non-IMM portfolios, together with the definitions, provide an incentive for institutions to limit their portfolio exposures not covered by the IMM? Will the defined thresholds of [15] %, [1] % and [10] % cause any impact for your institution?

2. The conditions set out in paragraph 1 shall be applied on a stand-alone or a consolidated basis, depending on the scope of the proposed permission.

Article 6 – Monitoring of limits and non-compliance

1. An institution shall monitor the fulfillment of the criterion specified in Article 5(1) on an ongoing basis. For each reporting period for the supervisory reporting of own funds, an institution shall calculate and report to the competent authorities, the arithmetical average of at least monthly observations of the ratios of:

    a. the number of non-IMM transactions to the total number of transactions;

    b. the individual size of each non-IMM portfolio to the total size of all portfolios; and

    c. the total size of all non-IMM portfolios to the total size of all portfolios.

2. If the criterion specified in Article 5(1) is not fulfilled for two consecutive quarters, an institution shall use the standardised method set out in Article 384 of Regulation (EU) No 575/2013 to calculate the own funds requirements for CVA risk for all of the non-IMM portfolios and notify the competent authorities.

3. Where an institution is using the standardised method for the calculation of its CVA risk pursuant to paragraph 2, it may only revert to using the advanced method for calculating the own funds requirements for CVA risk subject to permission from the competent authorities and when it fulfils the criterion specified in Article 5(1) for two consecutive quarters.

CHAPTER IV

FINAL PROVISIONS

Article 7 – Entry into force

This Regulation shall enter into force on the 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 Cost-benefit analysis / impact assessment

Introduction

As per Article 10(1) of the EBA regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any draft implementing technical standards/regulatory technical standards developed by the EBA – when submitted to the EU Commission for adoption – shall be accompanied by an Impact Assessment (IA) annex which analyses 'the potential related costs and benefits'. Such an annex shall provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problem and their potential impacts.

According to the CRR proposals, the EBA should develop draft RTS with regard to the determination of a proxy spread and the specification of a limited number of smaller portfolios in connection with own funds requirements for credit valuation adjustment ('CVA') risk related to Article 383(7). Those draft RTS should be submitted to the Commission by 1 January 2014.

Problem definition

Issues addressed by the European Commission (EC) regarding counterparty risk

The current CRD framework has some shortcomings in the treatment of counterparty risk exposures arising from derivatives, repos and securities. It effectively addresses the risk of counterparty default and credit migration risk, but not the mark-to-market variations in credit valuation adjustments (CVA). This created concern as a significant portion of institutions' losses during the financial crisis were caused by changes in the credit spreads of counterparties due to changes in their credit quality (also referred to as the market value of counterparty credit risk) reflected in mark-to-market changes in over-the-counter derivative products. To take account of this risk the CVA risk capital charge was introduced in the CRR/CRD IV proposals. In its impact assessment, the European Commission noted that the introduction of a CVA risk capital charge would contribute to enhance institutions' capital buffers and risk management.

Issues addressed by the RTS

The application of the advanced CVA method is mandatory for all institutions holding supervisory approval for estimating expected exposure with the IMM method and quantifying specific interest rate risk using the VaR model. The advanced CVA calculation uses input for each counterparty, such as interest rate spreads and LGDs. Where this input is not directly observable in the market, the institutions have to find appropriate proxies to estimate the risk with regard to this counterparty. Futhermore, the CRD IV allows institutions to include a limited number of smaller portfolios in the advanced CVA method which are not modelled using the IMM but whose expected exposure (EE) is determined using a simpler method. This RTS defines standards for the determination of proxy spreads and specifies quantitative limits for non-IMM netting sets to be accepted in the advanced CVA calculation.

Objectives of the RTS

The proposals made in these RTS will contribute to:

i. Achieve a common understanding amongst institutions and the EU's national competent authorities about:

    a. the approach to determine a proxy spread in the advanced CVA method, when the spread related to an specific counterparty is not available

    b. the extent to which institutions may include non-IMM netting sets in the advanced CVA method.

ii. Ensure harmonisation and consistent practices in these two areas.

Technical options considered

Determination of the proxy spread for the advanced method

The use of the advanced CVA method will create additional compliance costs for institutions, due to the new processes, additional IT and staff resources needed to meet the requirements of the regulation.

In order to minimise additional implementation burdens, the EBA proposes a simple approach that will define, in a harmonised way, the criterion of appropriateness with respect to the criteria of rating, industry and region. This approach should allow institutions to collect simple and granular data to conduct reliable estimations without bearing excessive burden. The proposal allows also for some flexibility for institutions but given the limited scope of application, this should not be a threat for the harmonisation of the Single Rule Book.

Text for consultation purposes:

Q7. The EBA expects that only a limited number of counterparties/names will receive a proxy spread. Do you agree with this conclusion? If not, could you explain why and state how many of your names will require a proxy spread?

Defining the criterion of a limited number of smaller portfolios

The conditions proposed will set a standard for institutions and national authorities regarding the extent to which non-IMM portfolios can be included in the advanced method for the calculation of the CVA capital charge. These conditions will ensure that the majority of the exposures included in the advanced CVA calculation are determined by the more differentiated technique of the IMM, while recognising that certain positions might be very difficult to model satisfactorily.

The EBA determined three thresholds that should be applied to non-IMM portfolios. These thresholds were calibrated using the limited data available. The underlying principle for defining these thresholds was to ensure that non-IMM portfolios remain small in absolute and relative terms, so that most transactions are estimated using the most sophisticated approach available.

The proposed conditions require that institutions calculate the exposure for both their IMM and their non-IMM portfolios using the relatively simple mark-to-market method which should minimise additional costs, and that is also required for the calculation of the leverage ratio. Furthermore, the EBA considers that exceeding the proposed thresholds should be relevant only if it persists for two consecutive quarters, therefore reducing the impact of substantial 'cliff' effects that might be caused by exceptional circumstances and allowing institutions time to take appropriate corrective actions.

Impact of the proposals

The EBA has conducted a survey with the national supervisory authorities to identify the population of institutions that are likely to be affected by the RTS and its potential impact on institutions and national supervisory authorities.

From the survey, only 20 banking groups and institutions in five jurisdictions are expected to calculate CVAs using the advanced approach and therefore be affected by the proposals presented in this RTS.13 banking groups have been formerly identified as being currently non-compliant with some of the requirements of this RTS.

Costs for institutions

For most of the institutions identified, the most important driver of cost will be the necessary strengthening of the IT infrastructure where the mark-to-market method is used to calculate the size of portfolio. The EBA does not expect these costs to be generally material. They will diverge among institutions that are using the internal model method (IMM) and depend on the coverage level of their own IMM waivers (the greater the IMM scope, the more likely these costs will be material).

Other costs are driven by the need to train existing staff or hire additional staff members. However, the EBA expect these costs to be small.

Costs for national supervisory authorities

National authorities will also bear additional costs at they will need to engage more resources to supervise compliance with new requirements, in particular to verify that the criteria for proxy spreads are met.

Benefits

By establishing harmonised criteria for some aspects of the calculation of own funds requirements for CVA risk in accordance with the advanced method, the RTS will ensure that institutions in different Member States use the same practices and reduce the burden for cross-border firms to comply with different regulatory frameworks.

Text for consultation purposes:

Q8. Do you agree with the above analysis of the costs and benefits of the proposals? If not, please provide any evidence or data that would further inform the analysis of the likely cost and benefit impacts of the proposals.

5.2 Overview of questions for Consulation

Q1. Please provide information and data concerning the availability of CDS data with respect to the minimum categories for ‘rating’, ‘industry’ and ‘region’ defined in points (b), (c) and (d).

Q2. Please provide information concerning the usefulness, appropriateness and coherence with market practices of the approach to the use of single-named proxies described in Article 3.

Q3. Paragraph 3 allows for the proxying of the spread of the subsidiary by the spread of the parent company. Where no rating is available for the subsidiary or the parent undertaking or both, should the entities be considered equal in terms of the ratings attribute? Do you think that this treatment is appropriate? Please state the reason(s) in favour and/or against.

Q4. Paragraph 4 allows for the proxing of the spread for a regional government or local authority by the spread of the relevant sovereign. Where no rating is available for the regional government or local authority, should the entities be considered equal in terms of the ratings attribute? Do you think that this treatment is appropriate? Please state the reason(s) in favour and/or against.

Q5. Please indicate other particular cases in which single named proxies might be appropriate.

Q6. Do the proposed thresholds of [15] % for the number of non-IMM portfolios, of [1] % for each individual non-IMM portfolio, and [10] % for the total size non-IMM portfolios, together with the definitions, provide an incentive for institutions to limit their portfolio exposures not covered by the IMM? Will the defined thresholds of [15] %, [1] % and [10] % cause any impact for your institution?

Q7. The EBA expects that only a limited number of counterparties/names will receive a proxy spread. Do you agree with this conclusion? If not, could you explain why and state how many of your names will require a proxy spread?

Q8. Do you agree with the above analysis of the costs and benefits of the proposals? If not, please provide any evidence or data that would further inform the analysis of the likely cost and benefit impacts of the proposals.