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EBF response to the EBA Consultation on CVA for SFTs.

General Remarks:

The European Banking Federation (EBF) welcomes the opportunity to provide feedback on the draft Regulatory Technical Standards (RTS) on Credit Valuation Adjustment (hereinafter: CVA) risk exposures arising from Securities Financing Transactions (hereinafter: SFTs).

As a general point, the EBF considers that a different approach to materiality assessment of CVA risk of fair-valued (hereinafter: FV) SFTs should be adopted.

The starting point would be to identify those transactions for which there is arguably some element of fair-value risk, even though it is not currently captured by existing capital or prudent valuation rules. We call the EBA for a more proportionate and targeted approach to long-term and illiquid collateral, given that short-dated transactions with liquid collateral have no FV risk. The proposed approach here would be to filter positions by objective criteria and assign capital to the remaining ones based on actual risk, rather than on some arbitrary measure of relative size.[1] .

This approach would be in line with the mandate given to the EBA to draft RTS in order to "*specify the conditions and the criteria that institutions are to use to assess whether the CVA risk exposures arising from fair-valued securities financing transactions are material*". Such "criteria and conditions" do not impose a quantitative approach limited to a threshold and an aggregate quantitative ratio based on own-funds requirements metrics, as outlined in the current EBA proposal.

On the application date of the draft RTS, we propose that the first reference date to apply capital consumption for SFTs purposes be set at least one year from the entry into force of these RTS to allow institutions having an appropriate capital planning and management. Institutions need to be able to have sufficient time in advance to adapt their capital budget and management to regulatory changes in general and especially in a context where they are already facing the application of the new CRR3 from 1st of January 2025 and related Level 2 mandates.

Question 1. At which level would you suggest setting the materiality threshold? When providing your answer, please provide any rationale and evidence supporting your proposal.

Fundamentally, fair-valued SFTs which structurally bear little counterparty credit risk should be considered as carrying no material CVA risk. This is notably the case for trades with short maturity and those covered by efficient risk mitigation techniques (use of liquid

[1] This is similar to the approach taken by the PRA Supervisory Statement SS12/13, para. 3.3.

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collateral, frequent margin calls with low thresholds and minimum transfer amounts, application of conservative haircuts, absence of wrong-way risk). By contrast, longer-dated SFTs, those not covered by a master agreement, poorly collateralised or subject to significant wrong-way risk may require to be included in the scope of the calculation of a specific CVA capital charge.

The methodology proposed by the EBA does not consider the above characteristics and leads to disproportionate capital requirements.

(i) The regulatory own fund requirements (hereinafter: OFR) amount does not allow for a sufficient discrimination of transactions and underlying risks and as such is not an adequate indicator of risk materiality. It is based on assumptions and simplifications that may not be in line with actual trades/exposures (e.g. risk-weight calibrated for credit spread moves over time horizons not consistent with the actual (short) maturity of SFTs, imposed minimal MPOR not reflective of the time needed to liquidate transactions in case of a default).

(ii) Comparing OFR for SFTs with the sum of OFR for FV SFTs and OFR for OTC derivatives does not reflect the intrinsic materiality of CVA risk for FV SFTs. It is largely influenced by banks business and portfolio mix. Such ratio may entail that for two banks with the same SFTs portfolio but with different size or activity, one might be material for SFTs while the other immaterial, leading to capital charges to the former and not for the latter while both carry the same economical risk.

(iii) From an operational point of view, the EBA proposal forces banks to compute OFR for SFTs which may actually turn out to be "immaterial" (and therefore not requiring any CVA capital charge and OFR calculation): this creates unnecessary operational costs. This would be particularly true for those banks that broadly choose the SA-CVA over the BA-CVA. Implementing the SA-CVA is costly, while assessing the proposed ratio using the BA-CVA for SFTs while derivatives would be under the SA-CVA would increase the chances of exceeding the ratio (since the BA-CVA is more conservative than the SA-CVA).

In the EBA approach the proposed threshold for the materiality ratio is excessively low and would be too punitive. Therefore, in case the EBA would still decide to proceed with the suggested ratio calculation, a higher threshold of 10% to address the effect of overstating the materiality should be set. In addition hedges for either fair value SFTs or derivatives should be excluded from the calculation.

Question 2. Do you have any additional comments on this consultation paper? If yes, please specify and motivate.

The draft RTS significantly depart from the approach taken in the US and the UK. We urge the EBA to consider a regulatory alignment with these major jurisdictions, taking into account the competitive disadvantage that such a divergence would entail for European banks. Any additional capital requirements for EU banks will lead to a pricing increase for SFTs in the EU market, while non-EU institutions (that are not required to meet a capital surcharge for SFTs) will attract all the SFTs business because of their lower pricing, pushing EU institutions out of the SFTs market.

In particular, sovereign bond repos and reverse repos serve multiple purposes that are fundamental for the broader economy; including, among others, liquidity and collateral management, supporting market-making in the underlying securities, and facilitating monetary policy. By imposing non-proportionate capital requirements on SFTs would compromise such objectives.