German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

on the draft RTS on procedures for excluding 3rd country NFC from CVA risk charge (EBA/CP/2015/14)

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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 on the draft RTS on procedures for excluding 3rd country NFC from CVA risk charge (EBA/CP/2015/14)

On 5 August 2015, the European Banking Authority (EBA) published the Consultation Paper "Draft RTS on the procedures for excluding transactions with non-financial counterparties (NFC) established in a 3rd country from the own funds requirement for Credit Valuation Adjustment (CVA) risk". We gladly take the opportunity to express our opinion.

I. General remarks

We, the German Banking Industry Committee (GBIC), generally welcome that the exemption from CVA risk charge according to Article 382(4)(a) of the Capital Requirements Regulation (CRR) will also apply to NFCs from third countries. We also concur with the analysis that an alignment with Regulation (EU) No 648/2012 (European Markets Infrastructure Regulation - EMIR) should be achieved. However we would like to draw EBA's attention to the fact that also the mechanisms, according to which counterparties are classified as NFC either above or below the clearing threshold, should be aligned with the current approach under EMIR.

As EBA itself states in its Q&A 2013_4723: 'The institution itself is responsible for taking the necessary steps to identify all non-financial counterparties that qualify for the exemption under Article 382(4)(a) of the CRR and calculate their own funds requirements for CVA risk with respect to those eligible non-financial counterparties accordingly (regardless of whether they are located within the EU or in a third country)'. As a result, 'institutions should define appropriate arrangements with non-financial counterparties to ensure they remain informed of their status as regards the clearing threshold on an ongoing basis'.

ESMA, with whom in cooperation EBA shall set up this RTS, states in its Q&A OTC Questions/ Answer 4 [last update 20. March 2013]: 'NFCs which trade OTC derivatives are obliged to determine their own status against the clearing threshold. FCs should obtain representations from their NFC counterparties detailing the NFC's status. FCs are not expected to conduct verifications of the representations received from NFCs detailing their status and may rely on such representations unless they are in possession of information which clearly demonstrates that those representations are incorrect.'

Based on these principles, the European FCs generally rely on representations or declarations made by their counterparties or comparable contractual means (i.e. by notification of the counterparty of the classification made on the basis of available information with the requirement to inform the notifying party if the classification is/ is no longer correct). For example under the EMIR Addendum to the German Master Agreement for Financial Derivatives Transactions, the counterparty represents in section 10 whether it is subject to the clearing obligation or not and is also contractually obligated to inform the other party of any changes to its status.

The current wording of Article 1 and 2 of the draft RTS – "document" and "ensure" – could be understood to require the European counterparty, in order to benefit from the CVA charge exemption, to verify the accuracy of the calculations made by the third country NFC whether it is below or above the clearing threshold. Such verification is impossible since the European counterparty will not have access to data needed in order to make such calculations and verifications. To avoid such a misconception, we would suggest that EBA revises its wording in order to define the obligations of the European FC more clearly. In particular, it should be clarified that the parties will need to agree on the method for the calculations to be made by the non-European counterparty, but that the European counterparty otherwise continues to be able to rely on representations or declarations made by their counterparties regarding their status (and including a declaration to the effect that the agreed calculation method has been applied in this

context by the non-European counterparty); however, that there is no obligation to verify the calculations and declarations made by the counterparty.

II. Special remarks

Q1: What are stakeholders' views on the interpretation proposed?

n/a

Q2: What are stakeholders' views on the burden this might create for NFCs established in a third country? What could be a credible alternative treatment?

n/a

Q3: What are stakeholders' views on the relevance of the inclusion of a minimum frequency? What is stakeholders' preferred option?

We welcome the institutions' right to choose to carry out the due diligence upon conclusion of a contract or quarterly. As correctly described in the draft RTS, the frequency of trading with NFCs is an important aspect. For institutions with a low volume of trading with non-EU NFCs, it is disproportionate to carry out the due diligence on a quarterly basis. Moreover, there is no risk if the due diligence is carried out upon conclusion of a contract, as the contract will remain exempt until maturity. If an NFC+ becomes NFC- during a trade, then all contracts are to be exempted from the CVA risk charge. If the contracts are not exempt, the institution's course of action is hence more conservative than required by the supervisory authorities. Nevertheless, it is disproportionate for banks with a high volume of trading with non-EU NFCs to carry out a due diligence and provide documentation each time a contract is concluded.