



**PEER REVIEW REPORT
EXCLUDING TRANSACTIONS WITH NON-FINANCIAL
COUNTERPARTIES ESTABLISHED IN A THIRD
COUNTRY FROM CREDIT VALUATION
ADJUSTMENT RISK**

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List of abbreviations

CA	Competent Authority
CRR	Capital Requirements Regulation (Regulation (EU) No 575/2013)
CRD	Capital Requirements Directive (Directive 2013/36/EU)
CVA	Credit Valuation Adjustment
EBA	European Banking Authority
ECB	European Central Bank
Exclusion RTS	Commission Delegated Regulation (EU) 2018/728 with regard to regulatory technical standards for procedures for excluding transactions with non-financial counterparties established in a third country from the own funds requirement for credit valuation adjustment risk
FTE	Full Time Equivalent
ICAAP	Internal Capital Adequacy Assessment Process
JST	Joint Supervisory Team
PRC	Peer Review Committee
SAQ	Self-Assessment Questionnaire
SFTs	Securities Financing Transactions
SREP GLs	Guidelines for common procedures and methodologies for the Supervisory Review and Evaluation Process (SREP)
SSM	Single Supervisory Mechanism
xVA	x-Valuation Adjustment (generic term referring to various valuation adjustments relating to derivatives)

Executive summary

The financial crisis 2007-2008 revealed that CVA risk was a source of unexpected losses. Robust CVA risk mitigates against losses and helps to ensure the soundness of an institution, thus it is important to ensure the harmonised implementation of the requirements in this area. This peer review analyses the effectiveness of the supervisory practices of Competent Authorities (CAs) regarding their assessment of credit valuation adjustment (CVA) risk of the institutions under their supervision with a view to strengthening consistency and effectiveness of supervision in this area.

In particular, the peer review focuses on the transactions exempted from own funds requirements for CVA risk specified in Article 382(4) of the CRR, and more specifically, on the practices employed by CAs regarding their supervision of the application of Commission Delegated Regulation (EU) 2018/728 (Exclusion RTS), which specifies the procedures for excluding transactions with non-financial counterparties established in a third country from the own funds requirement for CVA risk (the Exclusion RTS). Reviewing this area is important in ensuring alignment of treatment of non-financial counterparties established in a third country with those established in the EU, taking into account the global nature of derivative markets.

This peer review found that the CAs fully implement the relevant section of the EBA's SREP guidelines in the context of CVA risk. In terms of the actual approaches employed by CAs towards the supervision of CVA risk, the peer review found that they were fit for purpose: they satisfy the regulatory requirements and are consistent with the SREP GLs.

The Peer Review Committee (PRC) identified as best practices in this area the practice of keeping institutions informed regarding any supervisory expectations on the management of CVA risk and actions to address possible deficiencies that may have been identified, including through public communications on the CAs' websites. The PRC recommends that all CAs adopt such best practices in order to create further awareness of supervisory expectations and awareness of CVA risk more generally.

On the other hand, the PRC found a few areas where some deficiencies could usefully be addressed by CAs to strengthen supervision, while not raising concerns about the overall effectiveness of current practices.

The focus on larger institutions associated with risk-based approaches to supervision employed by some CAs could potentially overlook CVA risks stemming from smaller institutions. The PRC therefore recommends that CAs: (1) extend the scope of assessment on CVA risk to include all institutions in their jurisdiction using the categorisation set out in the Guidelines for common procedures and methodologies for the Supervisory Review and Evaluation Process (SREP GLs); and (2) subject all institutions to the level of scrutiny commensurate with their categorisation.

With regard to the scope of transactions subject to the own funds requirements for CVA risk, the PRC recommends that CAs scrutinise the CVA risk stemming from securities financing transactions

(SFTs) more closely and examine whether the SFTs should be included in the scope of the own funds requirements for CVA risk of their institutions in accordance with Article 382(3) of the CRR.

With respect to the transactions exempted from capital requirements for CVA risk in accordance with Article 382(4) of the CRR (so-called 'CVA exemptions'), the peer review found that only one of the CAs reviewed imposes Pillar II own funds requirements for the capitalisation of CVA risks stemming from those transactions. In this regard, while any legislative changes to address the issues stemming from the CVA exemptions are for the co-legislator to consider, the PRC recommends that CAs monitor the impact of CVA exemptions.

With regards to verification by CAs of the compliance of the requirements included in the Exclusion RTS, the peer review suggested that CAs may not have verified yet the compliance of those requirements for all institutions under their supervision.

As a follow-up measure, taking into account that the Exclusion RTS entered into force on 7 June 2018, and that more than four years have already passed since its entry into force, it is recommended that all CAs should ensure that they have performed a review of compliance with the requirements of the Exclusion RTS for relevant institutions under their supervision. Following that review it is recommended that CAs continue to undertake this activity with a frequency consistent with that of the SREP GLs depending on the categorisation of the institution, and at least every three years.

The peer review found that the deficiencies identified broadly related to all the CAs reviewed, and therefore the follow-up measures adopted should be implemented by all prudential supervisors. The follow-up peer review in two years' time, which may also cover CAs that were not subject of this peer review, will check what steps CAs have taken to strengthen supervision in this area.

1. Introduction

Role of peer reviews

1. One of the EBA's tasks is to conduct peer reviews of the activities of CAs, to further strengthen consistency and effectiveness in supervisory outcomes. This chapter gives an overview of how this particular peer review was conducted, and of the areas reviewed.
2. Peer review reports set out the main findings of the peer reviews. They also identify follow-up measures for CAs that are considered appropriate, proportionate and necessary as a result of the peer review. Follow up measures are of a general nature and are applicable to all CAs, including those that were not targets of this peer review, unless specified otherwise. A follow-up report undertaken two years after this report will assess the adequacy and effectiveness of the actions undertaken by CAs in response to these follow-up measures. The follow-up report could cover also CAs that were not subject of this peer review, hence all CAs are invited to consider the findings of this peer report and any suggested follow-up measures.

Topic of this peer review

3. The financial crisis 2007 – 2008 demonstrated that CVA risk can be a source of unexpected losses. Thus, robust CVA risk assessment is important for any financial institution that engages in derivative transactions or other financial instruments with counterparty credit risk. By properly accounting for this risk, financial institutions can help mitigate their exposure to credit risk and maintain a healthy balance sheet and ensuring the soundness of an institution. Thus, a consistent and harmonised implementation of the requirements in this area is of great importance. The peer review assessed CAs' supervisory practices regarding the application of the regulatory technical standards on procedures for excluding transactions with non-financial counterparties established in a third country from the own funds requirement for CVA risk (the Exclusion RTS)¹. These RTS provide requirements for the purposes of point (a) of Article 382(4) of Regulation (EU) No 575/2013 (CRR). Accordingly, the peer review focused on how CAs verify institutions' compliance with the Exclusion RTS.
4. The peer review was performed on the Exclusion RTS to ensure that the treatment of non-financial counterparties established in a third country is aligned with the treatment of non-financial counterparties established in the EU for the purposes of calculating capital requirements for CVA risk, as required in Article 382(4)(a) of the CRR. Assessing how the RTS requirements are applied is particularly relevant taking into account the global nature of derivative markets. More generally the peer review also intended to assess how CAs review the transactions in scope of the own funds requirements for CVA risk, which has a direct impact on

¹ Commission Delegated Regulation (EU) 2018/728

https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2018.123.01.0001.01.ENG&toc=OJ:L:2018:123:TOC

the quantification of those requirements. CVA risk has in particular gained further attention following the financial crisis 2007-2008, and it is hence important to ensure harmonised implementation of the requirements in this area.

5. It should be noted that the requirements included in the Exclusion RTS apply to institutions, which are required to comply at all times with them, while CAs have the duty to supervise this compliance as part of their overall supervision of institutions' compliance with the CRR.
6. This peer review therefore focused on how CAs supervise the application of the Exclusion RTS. To assess and benchmark the practices of CAs it took as a basis the supervisory expectations in the EBA's Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP GLs).
7. The peer review also assessed the practices of CAs concerning the supervision of CVA risk, as these were relevant in the context of the RTS. Accordingly, the peer review investigated the general approach employed by CAs to assess the CVA risk of institutions under their supervision, and how CAs monitor CVA risks stemming from the transactions exempted from own funds requirements for CVA risk in accordance with Article 382(4) of the CRR.

Methodology

8. The overall methodology for EBA peer reviews is set out on the EBA's website.² Annex 1 of this report sets out the members of the Peer Review Committee (PRC) which carried out the peer review and prepared this report.
9. This peer review focused on a specific set of CAs, which are reported in Annex 2 of this report. The CAs selected were the CAs of Denmark (Finanstilsynet), Hungary (Magyar Nemzeti Bank) and Sweden (Finansinspektionen) for institutions under their supervision, and the European Central Bank (ECB) for significant institutions under its direct supervision in the Single Supervisory Mechanism (SSM). The peer review did not focus on the practices of the SSM concerning 'less significant institutions' which are indirectly supervised by the ECB and continue to be supervised by their national supervisors.
10. These CAs were selected on the basis of the volume of CVA exposures to third country non-financial counterparties of institutions under the supervision of those CAs, taking into account the data collected as part of the Basel III monitoring exercise (end-December 2021 data). In addition, the selection of these CAs aimed to ensure a balance between non-SSM CAs and the SSM.
11. This report outlines the outcomes of the assessment made and the conclusions of the peer review, together with follow-up measures for CAs to apply, all of which are aimed at further

² <https://www.eba.europa.eu/supervisory-convergence/peer-reviews>

strengthening consistency and effectiveness in supervisory outcomes in the EU. The report also identifies a number of best practices whose adoption may be of benefit for other CAs.

12. The next chapter sets out the outcome of the assessment performed for the purposes of the peer review and is divided in subsections associated to the areas investigated during the peer review:

- Section 2.1 analyses how CAs implement the SREP GLs in the context of CVA risk.
- Section 2.2 analyses organisational setups and resources employed by CAs in the assessment of CVA risk.
- Section 2.3 analyses the general approach employed by CAs for the assessment of CVA risk.
- Section 2.4 analyses the approach employed by CAs to assess the transactions in scope of the own funds requirements for CVA risk.
- Section 2.5 analyses how CAs ensure institutions' compliance with the requirements of the RTS.

2. Outcome of the assessment

13. This chapter sets out the outcome of the assessment of this peer review. It is divided into subsections focusing on the implementation of the SREP GLs, the organisational setups and resources, CAs assessment of CVA risk, CAs assessments in relation of the transactions in scope of the own funds requirements for CVA risk, and, how CAs ensure institutions' compliance with the requirements of the Exclusion RTS.
14. The subsections also include conclusions regarding the assessments made, and – where appropriate - recommend follow-up measures for CAs to address any deficiencies identified. In addition, they identify best practices employed by CAs detected during the assessments that could, where appropriate, be adopted by other CAs.
15. The peer review took the SREP GLs as a basis to benchmark the practices of CAs. Two benchmarks were used: (1) the implementation of the SREP GLs in the context of CVA risk; and (2) CVA risk assessment, in particular the assessment of the compliance with requirements set out under Article 382(4) of the CRR, in accordance with those Guidelines.
16. The criteria underpinning the first benchmark were based upon the implementation of the SREP GLs in the respective jurisdictions of the CAs targeted in this review, and in particular of section 6.3 of those Guidelines.
17. The second benchmark was assessed against the supervisory expectations that: (1) the CVA risk assessment by those CAs is conducted for all institutions under their supervision, (2) the assessments include a detailed review of the compliance with all the requirements of the Exclusion RTS; and, (3) proportionality was applied in accordance with that envisaged in the SREP GLs. The figure below sets out the PRC's benchmark assessment.

Figure 1: Benchmark assessment

	DK	HU	SE	ECB
Implementation of section 6.3 of the SREP GLs in the context of CVA risk				
CVA Risk Assessment				

Legend:

Fully applied: all assessment criteria are met without significant deficiencies	
Largely applied: some of the assessment criteria are met with some deficiencies, which do not raise any concerns about the overall effectiveness of the competent authority, and no material risks are left unaddressed	
Partially applied: some of the assessment criteria are met with deficiencies affecting the overall effectiveness of the competent authority, resulting in a situation where some material risks are left unaddressed	
Not applied: the assessment criteria are not met at all or to an important degree, resulting in a significant deficiency in the application of the provision	

18. With regard to the first benchmark assessment, the peer review found that all CAs implemented the SREP GLs in the context of CVA risk.

19. With regard to the second benchmark assessment, the peer review suggested that the requirements are largely applied. The PRC considered the requirements related to CVA risk assessment as largely applied by CAs. This is based on the fact that, while all CAs have in place approaches and processes aimed at ensuring a proper supervision of CVA risk, CAs may not yet have verified the compliance of all the requirements of the Exclusion RTS for all institutions under their supervision. In those cases where CAs responded that they reviewed the application of the Exclusion RTS, the PRC considers that more detailed evidence should have been provided to demonstrate that the requirements of the Exclusion RTS are met by the institutions under the supervision of CAs at the time when the assessment was made.

20. In addition, the peer review also found that CAs may face challenges in supervising CVA risk with the same level of intensity for all institutions under their supervision, and this may potentially overlook that all the requirements on CVA risk are met at all times. Other aspects that could be improved by CAs in their supervision on CVA risk are also described below in this document.

2.1 Implementation of the SREP GLs in the context of CVA risk

21. This section examines whether and how CAs implemented the EBA SREP GLs, and in particular the elements contained in section 6.3 of those Guidelines. At the time when CAs were requested to complete the Self-Assessment Questionnaire (SAQ), the SREP GLs in force were those issued

on 19 December 2014 (EBA/GL/2014/13) and the amending GLs of 19 July 2018 (EBA/GL/2018/03)³.

22. Section 6.3 of the SREP GLs refers to the assessment of market risk, and CVA risk is included within its subcategories⁴. Section 6.3 has been subject to some amendments between the old and revised versions of the SREP GLs, however it maintained its main elements.
23. DK and SE specified that they implemented the SREP GLs through communication to the institutions or communicated publicly that the GLs are applicable. The ECB and HU indicated that they integrated them within a non-binding regulatory framework⁵. All CAs indicated that they fully applied the SREP GLs applicable at the time when the SAQ was submitted.
24. The PRC also reviewed the compliance table referring to the SREP GLs applicable at the time the SAQ was conducted (EBA/GL/2018/03), and in that document all the CAs indicated compliance with the SREP GLs⁶. With regard to the revised SREP GLs (EBA/GL/2022/03) DK, HU and SE indicated their compliance with them as of the date of notification in December 2022, whereas the ECB indicated that it intends to comply with them for significant institutions⁷.
25. The PRC also examined whether CAs faced any practical, organisational, or other types of challenges when implementing the SREP GLs in the area of CVA risk, to assess whether there were any issues in the supervision of the requirements on CVA risk including the Exclusion RTS. Only SE described challenges in implementing the GLs, related to addressing excessive CVA risk with regard to the treatment for transactions excluded from the CVA risk charge under Article 382(4) of the CRR.
26. SE stated that, not only is quantifying CVA risks stemming from such exempted transactions challenging in its own right, but also assessing them in a broader EU level playing field perspective. That is, how to deal with risks which are not covered by Pillar I capital requirements, how to define excessive CVA risks, and how to address risks in one jurisdiction compared to

³ <https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2282666/fb883094-3a8a-49d9-a3db-1d39884e2659/Guidelines%20on%20common%20procedures%20and%20methodologies%20for%20SREP%20and%20supervisory%20stress%20testing%20-%20Consolidated%20version.pdf>

The revised SREP GLs issued on 18 March 2022 (EBA/GL/2022/03) apply from 1 January 2023.

⁴ CVA is however also referred to in section 6.2 of the SREP GLs related to the assessment of credit and counterparty risk, although CVA risk is generally dealt in the context of market risk.

⁵ <https://www.retsinformation.dk/eli/retsinfo/2021/10069>

<https://www.riksdagen.se/sv/dokument-lagar/dokument/svensk-forfattningssamling/lag-2014968-om-sarskildtillsyn-over-sfs-2014-968#K6>

https://www.bankingsupervision.europa.eu/banking/srep/2022/html/ssm.srep202202_supervisorymethodology2022.en.html

<https://www.mnb.hu/en/supervision/regulation/tools-of-supervisory-regulation>

⁶

https://www.eba.europa.eu/sites/default/documents/files/document_library/963608/Compliance_EBA_GL_2018_03.pdf

⁷ https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2022/EBA-GL-2022-03%20Revised%20SREP%20Guidelines/1044528/EBA%20GL%202022%2003%20-%20GLs%20on%20common%20procedures%20and%20methodologies%20for%20the%20supervisory%20review%20and%20evaluation%20.xlsx

other EU jurisdictions without creating competitive disadvantages from a capital perspective. They also commented that prudential CVA (i.e. CVA risk from a prudential perspective) is conceptually quite different from economic CVA (accounting CVA), which complicates the implementation of the GLs.

27. In November 2015 the EBA issued a consultation paper on draft Guidelines on the treatment of CVA risk under SREP which aimed to provide a common approach to the assessment of CVA risk under SREP⁸. This included the capitalisation of excessive CVA risk that was not adequately covered by the minimum own funds requirements, in particular, due to the CVA exemptions. These guidelines were ultimately put on hold due to ongoing developments in the CVA risk framework at international level. Revisions to the CVA risk framework are expected to be introduced in the EU via the CRR3/CRD6 legislative process⁹.
28. In the context of the SREP GLs, CAs were also asked whether they apply any requirements that differ from those set out in Article 382 of the CRR and the Exclusion RTS. No CA indicated applying any different requirements and the PRC did not identify any during the peer review.

Conclusions, best practices and follow-up measures

29. On the basis of the information gathered in the assessment, all CAs indicated that they had implemented the SREP GLs applicable at the time when the SAQ was submitted, hence the supervisory approach applied by CAs should be consistent with that expected under those GLs.
30. In this context the PRC identified as a best practice of CAs the public communications related to the assessments that they perform in the context of SREP, which create awareness among institutions and stakeholders in terms of what is expected from the SREP process. This also increases transparency and provides a better understanding among institutions with regards to supervisory expectations.
31. Some CAs also developed internal guidance or procedures used by supervisors during their inspections. Not all such internal processes need to be publicly available, but the PRC considers that **CAs should as a follow-up measure publicly disclose key elements of the SREP that CAs perform, or on which they wish to stress the importance, to ensure that credit institutions are aware of supervisory expectations.** This is in particular consistent with the requirement in Article 143(1)(c) of the CRD and the requirements in Commission Implementing Regulation (EU) No 650/2014 (ITS on supervisory disclosure).

⁸ <https://www.eba.europa.eu/sites/default/documents/files/documents/10180/1270333/ec7bc109-1419-447b-91de-16823d9440a3/EBA-CP-2015-21%20%28CP%20on%20GL%20on%20Treatment%20of%20CVA%20Risk%20under%20SREP%29.pdf>

⁹ https://finance.ec.europa.eu/publications/banking-package_en.

2.2 Organisational set up and resources

32. The second aspect that was assessed as part of the peer review was the complexity of CVA risk calculations for the institutions supervised by each CA, and the adequacy of CAs' staff and resources.

33. CAs were requested to indicate how many institutions under their supervision apply the advanced method for CVA risk set out in Article 383 of the CRR, as opposed to the standardised method set out in Article 384 of the CRR, or the alternative method in Article 385 of the CRR.

34. The use of the advanced method requires the permission from the CA to use an internal model for the specific risk of debt instruments and the permission from the CA to use the internal model method for counterparty credit risk. The use of internal models is generally considered to be associated with a higher level of complexity in business model and position-taking compared to institutions not using them. Permission to use internal models is also usually sought by institutions with significant derivatives books and a higher level of CVA exposures.

35. HU and SE indicated that no institutions under their supervision applied the advanced method for CVA risk at the time of submitting the SAQ. DK indicated that one institution applied the advanced method, whereas the ECB indicated that several institutions applied the advanced method.

36. The following figure sets out the number of staff of CAs involved in the assessment of CVA risk.

Figure 1: Number of staff of CAs involved in the assessment of CVA risk expressed as full-time equivalents (FTEs)

	DK	HU	SE	ECB
Staff from the supervision areas within the CA	0.2	0.2	1	5
Legal support staff within the CA	0.1	0.1	0	0
Staff from other areas within the CA	0	0	1	0.5
Staff from other Authorities	0	0	0	0
Total number of staff involved	0.3	0.3	2	5.5

37. Regarding the teams, units, departments, divisions within the CAs involved in the assessment of CVA risk, the CAs provided the following information:

- DK explained that it has established an expert function on market and counterparty credit risk. This function also covers the assessment of CVA risk. The methods that the unit applies, when it is deemed relevant from a risk perspective, are undertaken as part of the SREP process, and include thematic on-site missions, quarterly off-site monitoring, status meetings with the systemic banks, and for the relevant banks as a part of the standard on-site missions. There is also an expert function on accounting which the expert function on market and counterparty credit risk team can rely on in relation to accounting CVA.
- HU commented that CVA risk is reviewed by the ICAAP and model validation team, which is responsible for the annual ICAAP and SREP review. However, besides the SREP and ICAAP reviews, the CA also performs on-site investigations on the supervised credit institutions including comprehensive audits in a 3-year cycle and certain thematic and targeted reviews based on pre-planned on-site examination plans as well as based on ad-hoc decisions. In addition to the on-site examination activities, the off-site supervisory area of the CA assesses the risks of the supervised institutions continuously based on periodical supervisory reporting data as well as on other information (management committee materials, oral discussions, etc.) provided by the supervised institutions. If there is an on-site supervision exercise focusing on counterparty and CVA risk besides the annual ICAAP SREP review, the ICAAP and model validation team will participate in the on-site supervision.
- SE commented that the market and counterparty credit risk team of technical risk experts is responsible for the overall supervision of CVA risk. The responsibility with regard to CVA risk (and CVA in general) includes model approval processes (if and when applicable), ongoing supervision of institutions' CVA risk development through risk review meetings and other activities, on/off site inspections and deep dives. This team is also responsible for evaluations and assessments of CVA risk used as input to the SREP, as well as responsible for the technical policy work related to CVA issues, both at international and European levels. It occasionally works together with other teams, in particular the supervisory team responsible for the SREP; the market infrastructure team; the accounting and capital expert team; and, sometimes with the IRB and credit risk team. In total, 3-4 employees are involved in the work with traded market risk, which includes CVA related issues, but not full-time allocated specifically to CVA risk.
- The ECB explained that the assessment of CVA risk is conducted by the Joint Supervisory Teams (JSTs), with the support of a horizontal team. A JST is established for each significant institution. JSTs are comprised of staff of the ECB and the relevant national supervisors, including the CAs of the countries in which the institutions of a given banking group are established. The size, overall composition and organisation of a JST is tailored to the size, business model and risk profile of the bank that it supervises¹⁰. In addition, on-site inspections are performed in accordance with the relevant inspections' plan, defined as per the risk identification performed at the level of individual institutions and at the level of the

¹⁰ <https://www.bankingsupervision.europa.eu/banking/approach/jst/html/index.en.html>

SSM. An expert division is also established in the horizontal supervision line which is dedicated to market risk, counterparty credit risk, interest rate risk in the banking book (IRRBB) and liquidity topics. The team carries out horizontal analysis on those risks including the CVA risk.

38. As regards engagement and collaboration with other CAs for the purposes of assessing CVA risk:

- DK commented to collaborate where relevant through supervisory colleges.
- HU explained that it does not engage with other domestic authorities, but that it engages in case of joint decision the co-supervisors of other countries.
- SE described that they engage, when called for, with relevant CAs through supervisory colleges. Additionally, collaboration with foreign CAs relates to the discussion of technical issues, interpretation of regulatory issues, and sharing of knowledge and experiences regarding CVA risk issues.
- ECB explained that assessments are carried out by the JSTs which are composed of both ECB and staff from national CAs.

39. DK, SE and the ECB indicated that resources are adequate for the assessment of CVA risk of the institutions under their supervision.

40. On the contrary, SE noted that it would require a moderate increase of resources allocated to the assessment of CVA risk going forward ahead of regulatory changes as part of the upcoming Basel III implementation in the EU. It commented that resources are currently deemed fully adequate if one only considers CVA risk as the prudential CVA covered in the CRR. However, since the CA currently employs a holistic approach to gain deeper insights into the institutions' exposures and general market trends with implications for CVA risk (e.g. prudent valuation, xVAs, counterparty credit risk, margin requirements), to accomplish this, SE highlighted that a moderate increase of resources would be deemed beneficial.

Conclusions, best practices and follow-up measures

41. The assessment of staff and resources employed by CAs showed that CAs apply different organisational setups in their supervision of CVA risk. For example, DK, HU and SE have a dedicated unit composed of experts that follow both the off-site supervision and policy work on CVA risk, but also join on-site supervision teams if relevant.

42. Conversely, the ECB has a separate horizontal function with policy expertise including expertise on CVA risk, that is not involved in the day-to-day supervision of institutions, which is instead performed by JST and on-site assessment teams. The different configuration of the ECB appears motivated by the need to ensure that a common supervisory approach is applied across the various JSTs for all significant institutions and the horizontal function coordinates the supervisory approaches across different CAs of the SSM. However, the views of the JST seem to

prevail over those of the horizontal function, while the Supervisory Board has the final say. This additional organisational complexity faced by the SSM is not experienced by the other CAs in the peer review.

43. However, with respect to staff and resources, an aspect that was considered somewhat surprising, was the low number of resources indicated by CAs to be involved in the assessment of CVA risk, including for example the fact that DK and HU employ less than half an FTE in the assessment of CVA risk.
44. CAs typically review CVA risk alongside other risks (such as counterparty credit risk and market risk), hence credit risk and market risk experts could also be involved in the assessment of CVA risk as appropriate, which may suggest that the actual number of resources employed in the assessment of CVA risk is eventually greater than those indicated by the CAs. Also, CVA assessments have been implemented comparatively recently as part of both international financial reporting standards and prudential regulatory frameworks. It is also a technical area which requires specific expertise. It may be the case that going forward CVA will receive additional attention from a supervisory perspective. Finally, if institutions employ standardised approaches to quantify capital requirements for CVA risk, this may also be expected to lead to a lower level of scrutiny from CAs compared to the usage of internal models, which would impact the resources of CAs needed for the model assessments.
45. Despite these considerations, the resources appear low and **CAs should as a follow-up measure review their resource allocation plans and assess whether an increase of resources allocated to CVA risk is appropriate to ensure that CVA risk is properly supervised at all times and for all institutions under their supervision.** The assessment should take into account the considerations above as well as the risk of institutions underestimating their CVA risk exposure.

2.3 Assessment of CVA risk

46. The PRC sought to understand how CAs were assessing the CVA risk of the institutions under their supervision. The PRC assessed the methodologies employed by CAs and their organisational set up and processes. CAs were requested to provide information related to their methodologies and to describe the approach and organisation that they employed for the purposes of assessing CVA risk. This took into account: whether they carry out the risk assessment of CVA risk alongside market risk, or grouped with other risks; the types of evidence examined when assessing CVA risk; and whether the CAs complement their CVA risk assessment with any other regulatory texts or standards than those set out in the CRR. The PRC also examined whether CAs employed different approaches to the assessment depending on the methods used by institutions to calculate own funds requirements for CVA risk.

Process and approaches for assessing CVA risk

47. With regard to the organisation, process and approach employed for assessing CVA risk, CAs provided the following information:

- DK described that it applies a risk-based approach to the supervision of CVA risk. The frequency of the assessment depends on the size of the bank, the method applied for calculating CVA risk, and the significance of the risk in the bank. It conducts “status meetings” with its largest institutions. The CVA risk of the institutions is discussed at these status meetings, including accounting xVAs. The frequency of these status meetings depends upon the size of the institution’s market risk, counterparty credit risk and CVA risk and upon whether the institution has approval to use internal models. In addition, DK established a quarterly data monitoring which includes the development of CVA risk and covers all institutions under its supervision.

CVA risk assessment is conducted as part of the annual SREP process. DK has also performed specific thematic on-site missions focusing on CVA risk and the accounting CVA models in selected larger institutions in order to benchmark their models for accounting CVA and to assess the CVA risk. For smaller institutions, CVA risk is part of the standard on-site missions if the CA considers market risk, counterparty credit risk and CVA risk to be material for the institution.

- HU explained that it monitors CVA risk within the framework of regular off-site supervision through predefined risk indicators, committee materials, and regular data services. Where CVA risk is relevant, the ICAAP and model validation team reviews it within the on-site supervision. As part of its off-site supervision HU monitors CVA exposures on a quarterly basis, and it conducts on-site supervision during comprehensive annual ICAAP SREP reviews where the main focus is usually on the calculation of the capital charge for CVA risk.
- SE applies an ongoing assessment of the CVA risk of the institutions under its supervision using a holistic risk-based approach. That is, the CA supervises and assesses CVA risk from many perspectives, both CVA risk (i.e., prudential CVA as covered by the CRR) and the institutions' economic, or accounting, CVA, including various related valuation topics such as xVA. The latter also includes supervising CVA related aspects as part of prudent valuation. In terms of the risk-based approach, SE supervises CVA and CVA risk development for its largest universal/trading book banks through scheduled quarterly risk review meetings, which cover CVA risk as a standing agenda topic. For these meetings, the largest banks submit a comprehensive risk package covering the most recent development within market and counterparty risk, and CVA risk. Targeted inspections and other supervisory activities are also part of the risk-based approach, where business model, exposures, and size of the institutions, are taken into consideration.

SE also conducts semi-annual sessions with the group of second largest institutions. For smaller institutions, the monitoring of CVA risk is conducted on an ad hoc basis as deemed necessary, out of risk-based considerations. Nevertheless, SE commented that 90% of the CVA risk exposures in its jurisdiction stem from the largest institutions, and that the CA could run deep dives and ad hoc inspections if considered necessary.

SE indicated that all institutions in its jurisdiction have to apply the IFRS standards¹¹, which is considered beneficial should supervision be needed with regards to any derivative-related risk also for smaller institutions. Following inspections in 2018 on four large institutions, which also covered CVA risk, SE issued comprehensive institution-specific action plans. In addition, due to the comprehensive nature of the inspection, a report summarising the identified high-level outcomes of the inspection was published on the CA's website. The purpose of this was to communicate externally the intention and ambition of the supervision of CVA risk and closely-related risks.

SE also conducts explicit assessments of CVA risk exposure and risk management as part of the yearly SREP and ICAAP evaluation. The outcome of supervisory activities with respect to CVA risk are included as an input to the SREP.

- At the ECB, CVA risk assessments are conducted in the context of the SREP, and outside of SREP exercise (including on-site inspections), using different methodologies, procedures, and policies. The off-site assessment is conducted as part of the market risk assessment. In this regard, CVA risk is one of the sub-categories of market risk that JSTs can assess and score separately and whose assessment is to be reflected when deriving the overall assessment/score for the market risk category. On-site assessments on CVA risk also take place, on an ad hoc basis and in line with the on-site assessment plan.

CVA risk is covered and assessed at least once a year as part of the SREP process carried out by the JSTs. However, outside of the SREP exercise, unless there is a specific priority set on CVA risk at horizontal level, JSTs decide whether to conduct further and in-depth assessment of the risk and the frequency of review, as part of the off-site supervisory work programme.

48. With regard to whether the assessment of CVA risk is performed alongside assessments for other risks, or independently, DK and SE indicated that they assess CVA risk alongside market risk and counterparty credit risk (including valuation aspects for SE). DK commented that this is because the underlying risk drivers are typically the same. SE explained that this enables a holistic view of the risk and avoids a "silo approach" to supervision of risks, which should promote the knowledge base and experience among staff, as well as development of internal tools and methodologies. The other CAs assess CVA risk alongside counterparty credit risk (HU) and market risk (ECB).

Methodologies and evidence examined when assessing CVA risk

49. With regard to the methodologies employed by CAs and the type of evidence sought when assessing CVA risk, the PRC found the following.

¹¹ As regulated in the 7th Ch 2§ FFFS 2008:25, the IFRS shall apply to all credit institutions in the preparation and presentation of the consolidated financial statements.

50. DK starts the assessment set out in the SREP GL by evaluating whether CVA risk is a significant risk for the institution. This is done based on the institution's reporting and its business model. If CVA risk is deemed relevant then DK assesses its evolution, source and the information provided in the ICAAP from the institution. DK also uses the knowledge from other activities to assess the risk management practices of the institution in relation to CVA risk. When approving the models for institutions seeking approval to use the Advanced Method for CVA risk, DK reviews internal documents such as internal reporting, business procedures and other governance related documents, model related documents such as validation reports and model documentation and other relevant analysis for the CVA model. After the approval it monitors the models in the quarterly status meetings and performs, if deemed relevant from a risk perspective, re-evaluations of the model. For other institutions DK takes the reporting development in the risk figures, ICAAPs and the institutions' internal documents such as internal reporting, business procedures etc. into account when assessing the CVA risk. DK also seeks to ensure that the banks themselves have robust controls, business procedures and framework for assessing CVA risk.
51. HU explained that it expects institutions, when calculating the capital requirements for CVA risk, to regularly check the exemptions under Article 382(4) of the CRR, regularly monitor the credit rating of customers and present the steps of their capital requirement calculations to the CA. Where an institution uses different methodologies for calculating capital requirements under Pillar I and Pillar II, the institution must provide a detailed description of the difference in its documentation and must be able to present the numerical differences at the customer level when calculating its capital requirements. HU also examines its ICAAP counterparty and CVA risk questionnaires, which are part of the data package provided by the relevant institution during the annual comprehensive ICAAP SREP review. The questions focus on capital requirements calculations, risk reduction measures, risk management tools and general business issues related to counterparty and CVA risk.
52. SE assesses CVA risk from different perspectives, i.e., essentially including spreads and market risk factors, aspects of PDs and LGD, and where applicable, directional risks (such as wrong/right way risks). It also includes into its supervision the positions in scope of the capital requirements for CVA risk, to secure that all non-exempted transactions are included into the calculations. In addition, SE requests the largest institutions to submit estimated risk weighted assets stemming from exempted transactions on a quarterly basis. SE also examines position data beyond COREP, including internal documentation (policies, CVA model documentation, instructions etc.) and performs interviews during the quarterly risk review sessions. CVA information is part of a standard information request package requested from significant institutions. Sometimes SE also includes thematic requests, upon specific events, such as in connection with the Covid-19 outbreak and market turbulence in March-April 2020.
53. The ECB follows the methodology set out in the SSM operational guidance on SREP for the assessment of risks to capital including market risk and CVA which is aligned with EBA SREP GLs. In the operational guidance, the elements described in the SREP GLs are developed in a structure in three 'building blocks': block 1: assessment of the risk levels and risk controls; block

2: assessment of the ICAAP; block 3: institution's capacity to cover its capital needs from a forward-looking perspective, assuming stressed economic and financial developments. This structure in three blocks is used by the JSTs to determine the best estimate of the capital needed by the institution to cover its capital-related risks.

54. According to the operational guidance each of the three blocks results in a possible range of capital requirements/guidance. The overall SREP assessment and score are prepared based on the assessments of four elements: business model and profitability, internal governance, capital-related risks, liquidity, and funding-related risks. The CA described also that in order to have a view on the relative importance of CVA risk for the institution it uses, among other risk indicators, the ratio of capital requirements for CVA risk to the total capital requirements as an indicator. Other aspects examined are the size and composition of the OTC portfolios, before and after CVA hedges are applied. The CA also seeks evidence that the institution monitors the positions exempted by the calculation of capital requirements for CVA risk. For institutions using an internal model for the own funds requirements for CVA risk the on-site inspection division of the ECB follows a methodology based on general and specific documentation. One specific methodological documentation is dedicated to the Advanced Method for CVA risk with the main objective being the verification of the proper modelling of the proxy spreads used for the CVA capital charge calculation.

Proportionate approaches for the assessment of CVA risk

55. CAs were asked whether they apply different or proportionate approaches for the assessment of CVA risk depending on the characteristics of the institution. DK and SE confirmed that they apply a risk-based approach and thus the characteristics and the level of risk the institution has, the systemic importance of the institution and whether the institution has approval to use internal models to calculate the CVA risk, all influence the approach and intensity of supervision.
56. SE stated that they experience resource challenges in supervising the CVA risk of small and mid-sized institutions with high frequency and standards i.e., in line with the holistic approach employed for significant institutions. The ambition, going forward, is to be able to find approaches to identify adverse risk effects on a broad range of credit institutions in order to pinpoint those that do not receive the same attention as the largest institutions. Nevertheless, SE noted that the largest institutions that are under close supervisory scrutiny represent the vast majority of the CVA risk exposure in its jurisdiction.
57. On the contrary, HU and the ECB commented that they do not employ different approaches for the assessment of CVA risk depending on the method employed by the institution to calculate own funds requirements for CVA risk or depending on the characteristics of the institution.

Conclusions, best practices and follow-up measures

58. There are different approaches to the assessment of CVA risk performed by CAs for the institutions under their jurisdiction. However, they are all intended to ensure that institutions appropriately identify, measure, monitor, and capitalise their CVA risks.

59. All of the approaches employed by the CAs reviewed for the supervision of CVA risk are fit for purpose, in the sense that they satisfy the regulatory requirements and are consistent with the SREP GLs. All CAs make use of both off-site and on-site assessments on CVA risk to ensure that institutions properly measure, manage and capitalise this risk. They also employ similar indicators or focus on similar aspects that are relevant in the quantification of CVA risk.
60. However, the focus on larger institutions that is usually associated with risk-based approaches to supervision could potentially overlook risks stemming from smaller institutions. While the approaches to assessment are themselves consistent with the SREP GLs, **CAs should as a follow-up measure ensure that institutions are subject to supervisory engagement consistent with the SREP GLs**, where institutions are categorised in four categories and are subject to a different intensity of supervision in accordance with their categorisation.
61. Risk-based approaches used by some CAs appear reasonable insofar as a significant part of the CVA risk is attributed to the larger and, hence, significant institutions. However, certain adverse risk developments in smaller institutions may not be sufficiently captured should the focus on the largest institutions be too dominant. Supervisors should be aware of the implications of business models of small/specialised institutions, and of temporary rises of exposure levels which may be detected only by regular horizontal reviews of tailored exposure metrics.
62. The PRC therefore recommends that **CAs should as a follow-up measure ensure they are able to identify temporary rises of exposure levels in smaller/specialised institutions and should perform CVA risk assessments on smaller institutions on a formal basis to capture those risks, in addition to performing ad hoc assessments.**
63. The outcomes and conclusions of SE FSA's thematic CCR and CVA inspection on the largest institutions in SE has been summarised in a supervisory report and published on their website.¹² SE's communication practice of publishing on its website the outcomes of its inspections, and any expectations by the CA on the management of CVA risk is considered a best practice by the PRC. Other CAs should consider adopting this approach in order to create awareness regarding CVA risk and address any issues or deficiencies identified in this area.
64. The peer review showed that CAs typically review CVA risks alongside risks of a similar nature, such as market and counterparty credit risk. The interaction with valuation practices, accounting rules and other types of adjustments, such as xVAs, is also relevant. Supervision of CVA risk which takes into account these other elements is considered a best practice, to ensure a holistic view of CVA risk.

¹² <https://www.fi.se/en/published/reports/supervision-reports/2020/fi-supervision-19-credit-institutions-management-of-counterparty-risk-and-cva-risks/> available in Swedish only

2.4 Transactions in the scope of the own funds requirements for CVA risk

65. The peer view investigated the practices of CAs regarding the supervision of the transactions in scope of the own funds requirements for CVA risk. These are specified in Article 382 of the CRR, and generally include non-centrally cleared derivatives, and securities financing transactions (SFTs) when the CVA risk arising from them is considered material by the CA.
66. Article 382(4) of the CRR lists transactions which are excluded from the own funds requirements for CVA risk, which are typically referred to as the CVA exemptions. This is a key aspect to consider when ensuring that CVA risks are appropriately capitalised because inclusion or exclusion of particular transactions has a direct impact on the quantification of those requirements.
67. All CAs indicated that they assess compliance with the requirements included in Article 382 of the CRR.
68. DK described that it applies a risk-based approach and thus its assessment is done in connection with thematic on-site inspections, and in connection with approvals of the usage of advanced methods for CVA risk. HU explained that the assessment is performed on-site based on ICAAP data request and continuous off-site supervision based on regular regulatory data requests. SE indicated that it adopts thematic inspections and requests large institutions to submit estimated risk-weighted assets stemming from exempted transactions on a quarterly basis. The ECB explained that JSTs are expected to perform the supervision of CVA risk yearly as part of the SREP process, and this should also include the review of the exempted transactions from the capital requirements for CVA risk.
69. With regard to the inclusion of SFTs in scope of the capital requirement for CVA risk, Article 382(2) of the CRR specifies that an institution shall include them if the CA determines that the institution's CVA risk exposures arising from those transactions are material. The practices of CAs in this regard were the following:
- DK commented that it starts by evaluating whether SFTs are a material part of the institution's business by looking at the part of the business volume and the amount of counterparty credit risk and market risk arising from SFTs compared to other products. It noted that SFTs are not a widely used product in its jurisdiction, and there are currently no institutions for which the CA requested to include the SFTs in scope of the capital requirement for CVA risk.
 - HU commented that in the absence of international guidelines, there are no general local rules, and that the CA takes decisions based on ad hoc evaluations. This CA also commented that in its jurisdiction the exposure arising from SFTs is marginal and, so far, it has not requested SFTs to be included under the scope of the own funds requirements for CVA risk for the institutions under its supervision.

- SE described that as part of its quarterly risk review meetings it requests from its largest institutions a comprehensive package of information which includes metrics for SFTs. This allows it to follow the development of their SFT exposures. SE does not have specific benchmarks in place yet for SFTs, it commented that this is an area which may need further attention. The CA also noted that until now it did not find any reasons to request the inclusion of SFTs in scope of the own funds requirements for CVA risk.
- The ECB explained that it employs three key risk indicators during the SREP to assess the materiality of CVA risk for both derivative transactions and SFTs. Nevertheless, those indicators are not used outside the SREP methodology for any other assessment purpose such as the inclusion of the SFTs for the computation of own funds requirement for CVA risk. The ECB did not appear to have requested the inclusion of SFTs in the scope of the own funds requirements for CVA risk of the institutions under its supervision but indicated that several institutions reported CVA risk own funds requirements for exposures to SFTs.

70. CAs were also asked to describe the approach that they employ regarding CVA risks stemming from the CVA exemptions.

71. DK indicated that it imposes Pillar II own funds requirements to capitalise CVA risks stemming from those transactions. DK described that the Pillar II own funds requirements mainly refer to non-financial counterparties, as these account for most of the risk, and these are based upon a discussion with the institution, taking into account the increase in the CVA risk if the exempted transactions are included in the scope, and the thresholds proposed in the EBA Consultation Paper on the SREP GLs on CVA risk published in November 2015, coupled with an expert overlay.

72. HU, the ECB and SE indicated that they do not impose Pillar II own funds requirements to capitalise CVA risks stemming from the CVA exemptions. In this regard, SE considered it challenging imposing such requirements as the exemptions are explicitly excluded from Pillar I own funds requirements in the CRR. The ECB explained that although there is no specific and individualised imposition of a Pillar II own fund requirement to capitalise CVA risk stemming from the CVA exemptions, whenever there is no full compliance with the Pillar I requirements, this should be taken into account in the final imposition of the Pillar II capital requirement.

73. CAs were also asked about their practices with regard to the monitoring of the impact of the CVA exemptions. All CAs indicated that they perform such monitoring, via: the SREP process for institutions with significant risk from exempted counterparties (DK); ICAAP reviews, based on on-site and off-site data requests (HU); ad hoc information requests on a quarterly basis for the group of largest banks (SE); and, as part of the assessment of market risk controls (ECB), whereby supervisory teams are expected to check whether the institution monitors the positions exempted from the calculation of capital requirements for CVA risk, and whether this control relies on manual processes.

74. The PRC also requested CAs to describe whether they faced challenges when assessing compliance with the requirements in Article 382 of Regulation (EU) 575/2013. HU explained that

there are data quality issues regarding the completion of local regulatory templates from small institutions during the ICAAP review. SE commented that the main challenges they are dealing with are risks not covered by Pillar I due to the CVA exemptions, definition of excessive CVA risk, and how to act to address those risks in one jurisdiction without creating competitive disadvantages (level playing field issues) from a capital perspective. DK and the ECB did not identify any challenges.

Conclusions, best practices and follow-up measures

75. On the basis of the above information, the peer review found that the practices employed by CAs when reviewing and supervising the transactions in scope of the own funds requirements for CVA risk aimed to achieve similar outcomes albeit using different approaches.
76. For example, DK and SE appear to focus their attention on the transactions held by the largest institutions, which are reviewed during quarterly meetings, which is consistent with their risk-based approach to supervision. In contrast, HU and the ECB did not mention a focus on the largest institutions (although the peer review itself related only to significant institutions as regards the ECB). However, all CAs rely on both on-site and off-site supervisory assessments to ensure that the institutions comply with the requirements on CVA risk.
77. With regard to the treatment for SFTs, the peer review found that CAs may rely on the decision of institutions regarding the inclusion of SFTs in scope of the capital requirement for CVA risk, and that no specific benchmark/criteria appears to be in place for this determination. This is despite Article 382(3) of the CRR requiring CAs to determine their inclusion on the basis that the CVA risks stemming from them are material. This approach was motivated in several cases by the argument that CVA risks stemming from SFTs are not material in the jurisdiction, however this may not imply that they are non-material for a particular institution.
78. The PRC notes that the CRR3 legislative proposal issued by the European Commission¹³ includes a mandate to the EBA to develop draft RTS to specify the conditions and the criteria to assess whether the CVA risk exposures arising from fair-valued SFTs are material, as well as the frequency of that assessment. If the final legislative text provides for such RTS, they should eventually foster the convergence of practices related to the inclusion of SFTs in scope of the capital requirements for CVA risk going forward.
79. In the meantime, the PRC considers that **CAs should as a follow-up measure ensure that they actively assess and examine the CVA risk stemming from SFTs and develop specific criteria/benchmarks to determine whether they should be included in scope of the own funds requirements for CVA risk.** This should ensure that a harmonised treatment for SFTs is applied in each jurisdiction across different institutions.
80. With respect to the imposition of Pillar II own funds requirements for the capitalisation of CVA risks stemming from the CVA exemptions, the peer review found that only one of the CAs

¹³ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0664>

reviewed (DK) applies them. At the same time, the peer review evidenced concern regarding potential legal issues associated with adopting such Pillar II requirements. The EBA had previously identified these issues and made policy recommendations associated to the CVA exemptions in its Report on CVA¹⁴ published in February 2015 and its policy advice on the Basel III reforms on CVA risk published in December 2019¹⁵.

81. The PRC notes that the European Commission's legislative proposal for the CRD6¹⁶ includes a mandate, in Article 104(3), for the EBA to issue Guidelines to specify how CAs identify that the CVA risks of institutions pose excessive risks to the soundness of those institutions. This mandate may provide for the development of GLs similar to those proposed by the EBA in its Consultation Paper on Guidelines on the treatment of CVA risk under SREP issued in November 2015. It would however only partially address the issues stemming from the CVA exemptions.
82. While any legislative changes to address the issues stemming from the CVA exemptions are for the co-legislator to consider, the PRC considers that **CAs should, as a follow-up measure, monitor the intrinsic risk and potential capital impact of the CVA exemptions**. This should be done both during on-site missions, but also during off-site assessments, to have precise information regarding the impact of the CVA risk arising from the CVA exemptions. Furthermore, CAs should consider monitoring the CVA risk arising from CVA exemptions for all institutions, and not only for the largest institutions.
83. For example, CAs could regularly require their institutions to submit information regarding the CVA risks arising from those exemptions. The EBA has been collecting this information for institutions participating in the Basel III monitoring exercise through an EU-specific worksheet of the template used for that exercise. CAs could use this to monitor the impact of the exemptions for institutions under their supervision.
84. The PRC also notes that the Commission's CRR3 legislative proposal included a new paragraph 4b in Article 382 of the CRR. This would require institutions to report to CAs the results of the calculations of the own funds requirements for CVA risk for all the transactions referred to in Article 382(4). Going forward, this could result in regular reporting requirements in COREP related to the CVA exemptions, which CAs would be expected to monitor.

¹⁴ <https://www.eba.europa.eu/sites/default/documents/files/documents/10180/950548/1ab4df48-03c6-431b-a754-1b5e7efdfabd/EBA%20Report%20on%20CVA.pdf>

¹⁵ https://www.eba.europa.eu/sites/default/documents/files/document_library//EBA-2019-Op-15%20-%20Policy%20Advice%20on%20the%20Basel%20III%20reforms%20on%20credit%20valuation%20adjustment%20%28CVA%29%20and%20market%20risk.pdf

¹⁶ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0663>

2.5 Transactions with non-financial counterparties exempted from the scope of the own funds requirements for CVA risk

85. The last aspect covered by the peer review concerned the practices of CAs in relation to the supervision of the requirements included in Article 382(4)(a) of the CRR and those set out in the Exclusion RTS.
86. Article 382(4)(a) excludes from the scope of the own funds requirements for CVA risk transactions with non-financial counterparties as defined in point (9) of Article 2 of Regulation (EU) No 648/2012, or with non-financial counterparties established in a third country, where those transactions do not exceed the clearing threshold as specified in Article 10(3) and (4) of that Regulation.
87. The Exclusion RTS specify the procedures for excluding transactions with non-financial counterparties established in a third country in accordance with Article 382(4)(a) of the CRR. This Delegated Regulation comprises two articles. The first specifies when a counterparty should be considered a non-financial counterparty established in a third country. The second specifies how to verify that the transactions with the counterparty do not exceed the relevant clearing threshold.
88. All CAs indicated that they assess, for the institutions under their supervision, the requirements included in Article 382(4)(a) of the CRR. DK indicated that it applies a risk-based approach and thus this assessment is done in connection with thematic on-site inspections, and with a risk-based frequency. HU indicated that compliance with the requirements is reviewed through its annual ICAAP supervision. SE indicated that this is conducted on a yearly basis as part of the SREP, and through inspection/deep dive exercises, and to some extent during quarterly risk reviews. The ECB indicated that the assessment is performed in accordance with SREP frequency.
89. CAs were also asked to describe whether they perform separate or joint assessments for transactions with non-financial counterparties established (i) in the EU and (ii) in third countries. DK, HU and SE commented that they perform the assessments jointly, whereas the ECB explained that JSTs are in charge of the supervision of particular institutions, hence the assessments could be separate or joint depending on the decision of the particular JST.
90. In terms of the evidence sought to verify the treatment of non-financial counterparties for the purposes of Article 382(4)(a) of the CRR, CAs provided the following information:
- DK considers controls, business procedures and standard operating procedures in order to assess that the institution has appropriate procedures.
 - HU gathers information from ICAAP data requests related to counterparty risk and CVA risk which contain details of the deals and also information about the counterparties.
 - SE uses mainly internal documentation, interviews and special information gathering.

- The ECB indicated that JSTs, during the SREP assessments, check that institutions monitor the positions exempted from the calculation of capital requirements for CVA risk, including whether the controls rely on manual processes.
91. CAs were also asked to describe whether they apply different approaches in the supervision of the requirements specified in Article 382(4)(a) of the CRR and in the Exclusion RTS depending on the method employed by the institution to calculate own funds requirements for CVA risk or depending on particular characteristics of the institution. In this regard, HU and the ECB indicated they do not apply different approaches. DK indicated that the assessment is performed depending on the size of the institutions' CVA risk and the method applied to calculate CVA risk. Similarly, SE indicated that it employs a risk-based approach according to the complexity of the business model and the instrument types; for instance, a credit institution with a sophisticated trading book receives more thorough supervision than an institution with a less sophisticated, small, or no trading book.
92. The peer review also examined whether CAs provided any additional guidance for the purposes of identifying the transactions with non-financial counterparties that qualify for the exemption in Article 382(4)(a) of the CRR. All CAs confirmed that they do not.
93. CAs were asked to confirm whether they verify compliance with requirements included in the two Articles of the Exclusion RTS. In the SAQ DK confirmed this, whereas HU, SE and the ECB indicated that they do not.
94. DK commented that, since it applies a risk-based approach, its assessment is done in connection with thematic on-site inspections, checking for indications that an institution is non-compliant, as well as in connection with approvals of the usage of Advanced Method for CVA risk. However, its quarterly off-site monitoring does not specifically cover the exclusion of non-financial counterparties from the CVA risk charge.
95. The other CAs provided the following information on this topic:
- HU indicated that the verification is not yet performed because exposures related to non-financial third country counterparties have been marginal in its jurisdiction. It explained that counterparty exposures related to non-financial counterparties in third countries are continuously monitored, and the verification of compliance with the Exclusion RTS is done during the annual ICAAP-SREP review of institutions.
 - SE described that verification is part of an upcoming development plan with regard to its supervision. The CA also commented that the institutions under its supervision have exposures that are mainly based in the EU/EEA.
 - The ECB explained that the assessment of CVA risk is conducted by the JSTs with the support of a horizontal team and is assessed as part of market risk in the SREP. In this regard JSTs are expected to also monitor the positions exempted by the calculation of capital requirements for CVA risk. While the ECB commented that from a horizontal perspective it

cannot indicate the status of compliance of Article 1 and 2 of the Exclusion RTS for each of the supervised institutions, it explained that it may launch a horizontal survey/questionnaire to the JSTs, to further inspect the status of compliance of those requirements.

96. With regard to cases of non-compliance by institutions related to the requirements of Article 382(a) of the CRR and the RTS, DK, HU and the ECB indicated that they had not discovered any. SE, however, identified such cases as part of on/off-site inspections. It noted that the significant cases are covered by mandatory action plans that the CA will follow up on, and that it has supervisory powers sufficient to deal with such situations. It also commented that the CA experiences that institutions adhere to the action plans.
97. No CAs identified any challenges in the supervision of the requirements specified in Article 382(4)(a) of the CRR and in the Exclusion RTS.

Conclusions, best practices and follow-up measures

98. The peer review showed that CAs employ a variety of methodologies with respect to the supervision of the requirements of the Exclusion RTS. For example, CAs make use of on-site inspections, supervisory reporting, ad-hoc data requests, review of institutions' internal documentations, and interviews. All of these approaches appear sufficient for the detection of whether an institution is compliant with the requirements included in Article 382(4)(a) of the CRR.
99. With regard to the verification of compliance of the requirements included in the Exclusion RTS, however, the information collected from CAs suggests that CAs may not have verified the compliance of the requirements of that regulation for all institutions under their supervision.
100. While there is discretion for CAs to determine the intensity of the supervision of institutions, and within it the supervision of the application of the requirements included in the Exclusion RTS, in the absence of particular requirements for CAs, the PRC considers that **CAs should as a follow-up measure apply the intensity of supervision included in the SREP GLs as a benchmark when supervising the Exclusion RTS**. In this regard, the SREP GLs require that CAs assign institutions to four different categories, depending on their size and complexity, which are associated to different levels of supervisory engagement, for proportionality purposes.
101. In conjunction with this the PRC also considers that **CAs should as a follow-up measure ensure that the assessments of risks to capital is at least as frequent as that set out in the SREP GLs, depending on the category of the institution**. This also means that CAs should be expected to supervise at least every three years whether and how institutions implemented the requirements of the Exclusion RTS.
102. Given that more than four years have passed since the entry into force of the Exclusion RTS, **all CAs should as a follow-up measure ensure that they have performed a review of compliance with the requirements of the Exclusion RTS for relevant institutions under their supervision**.

103. This could be performed for example by submitting to the institutions for completion an ad-hoc template where institutions are requested to provide information regarding the non-financial counterparties established in third countries with which they entered into non-centrally cleared derivative transactions. It could also include information concerning the gross notional value of the OTC derivative contracts of those non-financial counterparties for each of the classes of OTC derivative contracts referred to in Article 11 of Delegated Regulation (EU) No 149/2013, to ensure that they do not exceed the relevant clearing threshold. If the CA ascertained that an institution does not engage in transactions with non-financial counterparties established in third countries, the verification of compliance of the Exclusion RTS would not be needed, as the Exclusion RTS would not apply for that institution.

104. Following this ad-hoc review by CAs to ensure compliance with the Exclusion RTS for all institutions under their supervision, **CAs should as a follow-up measure continue to review the application of that Regulation by the institutions under their supervision with a frequency consistent with that of the SREP GLs, and at least every three years**, as suggested above.

3. Conclusions

105. The peer review found that section 6.3 of the SREP GLs was fully implemented in the context of CVA risk by all CAs reviewed.

106. The CAs reviewed largely assess CVA risk sufficiently, using different approaches which were fit for purpose in satisfying the regulatory requirements and SREP GLs. But the CVA risk assessment carried out by CAs in accordance with the SREP GLs, and in particular the assessment of compliance with the requirements of Article 382(4) of the CRR, lacked some elements and so was only largely in line with expectations.

107. In particular:

- while all CAs have in place approaches and processes aimed at ensuring a proper supervision of CVA risk, CAs may not yet have verified the compliance of all the requirements of the Exclusion RTS for all institutions under their supervision, or more detailed evidence should have been provided to demonstrate that all requirements of the Exclusion RTS were met; and
- CAs may face challenges in supervising CVA risk with the same level of intensity for all institutions under their supervision, and this may potentially overlook that all the requirements on CVA risk are met at all times.

108. An overview of the specific follow-up measures for CAs and best practices identified is set out below.

3.1 Follow-up measures for CAs

109. The appropriate, proportionate and necessary follow-up measures considered necessary for relevant CAs to take in order to address the issues identified in the report are set out below. These are listed following the structure of the report. Given that the peer review's findings did not relate to any particular CA reviewed and were largely common to all CAs, the follow-up measures apply to all supervisors of CRR requirements, not just to those CAs reviewed.

Implementation of the SREP GLs in the context of CVA risk

110. All CAs should publicly disclose key elements of the SREP that CAs perform, or on which they wish to stress the importance, to ensure that credit institutions are aware of supervisory expectations (paragraph 31).

Organisational set up and resources

111. All CAs should review their resource allocation plans and assess whether an increase of resources allocated to CVA risk is appropriate to ensure that CVA risk is properly supervised at all times and for all institutions under their supervision (paragraph 45).

Assessment of CVA risk

112. All CAs should ensure that institutions are subject to supervisory engagement consistent with the SREP GLs (paragraph 60).

113. All CAs should ensure they are able to identify temporary rises of exposure levels in smaller/specialised institutions and should perform CVA risk assessments on smaller institutions on a formal basis to capture those risks, in addition to performing ad hoc assessments (paragraph 62).

Transactions in the scope of the own funds requirements for CVA risk

114. All CAs should ensure that they actively assess and examine the CVA risk stemming from SFTs, and develop specific criteria/benchmarks to determine whether they should be included in scope of the own funds requirements for CVA risk (paragraph 79).

115. All CAs should monitor the intrinsic risk and potential capital impact of the CVA exemptions (paragraph 82).

Transactions with non-financial counterparties exempted from the scope of the own funds requirements for CVA risk

116. All CAs should apply the intensity of supervision included in the SREP GLs as a benchmark when supervising the Exclusion RTS (paragraph 100).

117. All CAs should ensure that the assessments of risks to capital is at least as frequent as that set out in the SREP GLs, depending on the category of the institution (paragraph 101).

118. All CAs should ensure that they have performed a review of compliance with the requirements of the Exclusion RTS for relevant institutions under their supervision (paragraph 102).

119. Following this ad-hoc review, CAs should as a follow-up measure continue to review the application of the Exclusion RTS by the institutions under their supervision with a frequency consistent with that of the SREP GLs, and at least every three years (paragraph 104).

3.2 Best practices developed by CAs

120. The PRC also identified best practices developed by some CAs that might be of benefit for other CAs to adopt. These include best practices in relation to:

- Keeping institutions informed regarding any supervisory expectations on the management of CVA risk and actions to address possible deficiencies that may have been identified, including through public communications on the CAs' websites to create further awareness of supervisory expectation and awareness of CVA risk more generally (paragraphs 30 and 63);
- Supervision of CVA risk which ensures a holistic view of the risk by taking into account risks of a similar nature, such as market and counterparty credit risk, and interaction with valuation practices, accounting rules and other types of adjustments, such as xVAs (paragraph 64).

Annex 1. Peer review committee

Peer reviews are carried out by ad hoc peer review committees composed of staff from the EBA and members of CAs and chaired by EBA staff. To avoid conflicts of interest, in accordance with Art 28(2) of the EBA Peer Review Methodology, PRC members did not participate in the review of his/her own competent authority or in the review of an authority which is in the same Member State as his/her own competent authority.

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Annex 2. List of Competent Authorities subject to the peer review

Country	Competent Authority
Denmark (DK)	Danish Financial Supervisory Authority (Finanstilsynet)
Hungary (HU)	Central Bank of Hungary (Magyar Nemzeti Bank)
Sweden (SE)	Swedish Financial Supervisory Authority (Finansinspektionen)
Banking Union	European Central Bank



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