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

The Investment Association represents UK investment managers. We have over 200 members who manage more than £5 trillion for clients around the world.

The Investment Association's purpose is to ensure that investment managers are in the best possible position to help people build resilience to financial adversity, achieve their financial objectives and maintain a decent standard of living as they get older. It is also to help investment managers maximise their contribution to economic growth through the efficient allocation of capital.

The Investment Association welcomes the opportunity to respond to EBA's proposals for guidelines on the treatment of CVA risk under the supervisory review and evaluation process.

We are mainly concerned about the legal basis on which EBA is issuing the guidelines and the conformity of the guidelines with the European System of Financial Supervision and with the legislative framework of CRR/CRD IV.

CRR and the EU's primary constitutional sources provide clear limits with regard to what parts of CRR may be amended and which institution is empowered to make those amendments.

It is EBA's responsibility to produce a report to the European Commission in which it assesses the treatment of CVA risk, the scope of the CVA risk charge including exemptions, eligible hedges and the calculation of capital requirements for CVA risk. It is the European Commission's responsibility and at the European Commission's discretion to adopt delegated acts to amend the relevant articles in CRR.

EBA has, according to Article 16 of the EBA regulation, the power to issue guidelines and recommendations where necessary for the establishment of consistent, efficient and effective supervisory practices or to ensure the common, uniform and consistent application of Union law.

There are differing views on the concrete scope and nature of EBA guidelines and the question if guidelines in accordance with Article 16 of the EBA regulation need and an additional legal

basis in sectoral legislation has not yet been subject to a review by the European Court of Justice.



The European Parliament requested in its report on the review of the European Supervisory Authorities a clarification that guidelines can be issued only based on the respective empowerment in sectoral legislation¹.

The European Commission made in its report on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision from 08 August 2014 clear that the use of the ESAs' powers must be solidly grounded on the legal basis covering their acts. In particular, that the two objectives for issuing guidelines and recommendations set out in Article 16(1) of the founding Regulations, namely to establish "consistent, efficient and effective supervisory practices" and to ensure the "common, uniform and consistent application of Union law" have to be read cumulatively².

It is safe to say that the Commission's interpretation is the least conservative position in the range of legal interpretations of Article 16 of the EBA regulation and that EBA guidelines would have at least to meet those standards.

The draft guidelines proposed in EBA's consultation paper on the treatment of CVA risk under SREP, are guidelines in an area, which is sufficiently clear and regulated by union law.

According to Article 456 Paragraph 2 CRR, EBA is tasked to monitor the own fund requirements for credit valuation adjustment risk.

CRR also provides a very clear process for any further regulatory action and the legal text is unambiguous with regard to the responsibilities of EBA and the European Commission.

It is EBA's task to monitor, not to regulate the capital requirements related to CVA risk. The European Commission is empowered to adopt a delegated act in accordance with Article 462 to amend Article 381, Article 382(1) to (3) and Articles 383 to 386, where, on the basis of the EBA's finding, it comes to the conclusion that such action is necessary.

We have serious doubts that such an empowerment of the European Commission to amend the CRR Articles 381, Article 382(1) to (3) and Articles 383 to 386 is actually covered by Article 290 TFEU. However, even if Article 456 Paragraph 2 was compliant with primary European law, there is no role at all for EBA to revoke the CVA risk exemptions which were adopted by the European Parliament and the European Council in a legislative procedure.

EBA states in its report on Credit Valuation Adjustment under Article 456(2) of CRR, that certain CVA risks are currently not covered by EU legislation due to CRR exemptions³. It is EBA's task to ensure the common, uniform and consistent application of Union law. It is not in EBA's remit to amend level I legislation which it considers not to be fit for purpose by the means of guidelines which are not subject to any democratic control.

Especially the exemption for transactions with pension schemes, which mirrors the exemption for pension schemes in EMIR was introduced by legislators for a good reason.

¹ Motion for a parliamentary resolution from 26 February 2014 with recommendations to the Commission on the European System of Financial Supervision (ESFS) Review (<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A7-2014-0133+0+DOC+XML+V0//EN&language=en>).

² Report from the Commission to the European Parliament and the Council on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (http://ec.europa.eu/finance/general-policy/docs/committees/140808-esfs-review_en.pdf).

³ EBA Report on Credit Valuation Adjustment (CVA) under Article 456(2) of Regulation (EU) No 575/2013 (Capital Requirements Regulation) (<https://www.eba.europa.eu/documents/10180/950548/EBA+Report+on+CVA.pdf>).

The guidelines now proposed by EBA are likely to impose capital requirements for CVA risk under the Pillar 2 process (ICAAP and SREP), where there is no Pillar 1 capital requirement by reason of CRR Article 382 (4). The guidelines allow Pillar 2 to eviscerate the exemptions granted by the CRR. This is objectionable on the basis that the explicit will of the co-legislators as expressed in CRR Article 382 (4) would be thwarted by supervisory action to comply with these Guidelines. In addition, the implementation of the proposed guidelines would vitiate the exemption for pension funds under EMIR.

EBA is using its powers to issue these guidelines, where the use of those powers is not grounded on any legal basis. We would urge EBA to respect the provisions and processes laid out in CRR itself and to take into account that it was the intention of the co-legislators to introduce an exemption from the own funds requirements for CVA risk for transactions with pension schemes.

It is legitimate for supervisors to issue an opinion on a legal framework, but it is not legitimate to quick-fix legislation which was agreed upon in a democratic process by issuing guidelines which are not subject to any democratic control. We will, therefore, only respond to Question 6 of the consultation because we think EBA is acting outside its remit by making one of the exemptions provided by CRR redundant.

Yours



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Question 6: Do you agree with the scope of derivative transactions to be included into the calculation of hypothetical own funds requirements for CVA risk?

Response: There are two paragraphs in Article 382 CRR granting exemptions from the own funds requirements for CVA risk. Transactions with a qualifying central counterparty are, according to Article 382 paragraph 3 CRR, excluded from the own funds requirements for CVA risk. Further exemptions are laid out in Article 382 paragraph 4. EBA proposes to prioritise one exemption over the others by excluding transactions as described in Article 382 Paragraph 3 from the scope of derivative transactions to be included in the calculation of hypothetical own funds requirements for CVA risk and including transaction as listed in Article 382 Paragraph 4. This is clearly beyond EBA's responsibility and remit.