MICHEL BARNIER
Membre de la Commission européenne

Brussels, the 04. 02. 2013
AW/cq D(2013) 35135

Dear Mr Villeneuve,

Thank you for your letter of 26 November 2012 in which you express concerns about the impact of the Commission's legislative proposals (known as CRD IV) transposing the international Basel III framework into EU law and in particular on the impact of the provisions requiring institutions to hold additional regulatory capital for the Credit Valuation Adjustment (CVA) risk on corporates and pension funds.

As you know, CVA risk is the risk that banks will incur mark-to-market losses on their derivative exposures to counterparties – financial and non-financial companies alike – due to the potential deterioration in the latter's creditworthiness. The amount of the CVA capital charge is linked to parameters that gauge the potential for deterioration in the creditworthiness of a specific counterparty and, hence, the potential for related mark-to-market losses over the time span of the contract. The treatment proposed by the Commission promotes sound practices in managing the CVA risk by recognising both single name and index credit default swap hedges, which effectively mitigate direct and indirect impacts of the CVA charge.

I want to respond in particular to the issue you raise of coherence between the Regulation on OTC derivative transactions, central counterparties and trade repositories (EMIR) and the CRR proposal. The exemption of non-financial firms from the clearing obligation and from posting collateral on bilaterally-cleared, OTC derivatives under EMIR aims to address one specific issue, namely the potential liquidity impact of requiring non-financial firms, to provide collateral. The Commission does not consider that this exemption under EMIR warrants a preferential treatment (such as no CVA capital charge at all) for bank bilaterally-cleared, OTC derivative transactions with such counterparties under CRR. Indeed, EMIR itself contains provisions that clearly indicate that there is no link between the two issues; Article 11(4) of EMIR states that *"[f]inancial counterparties shall hold an appropriate and proportionate amount of capital to manage the risk not covered by appropriate exchange of collateral."*

I would also like to bring your attention to the fact that the treatment of the CVA risk in relation to bank exposures to non-financial companies in the Commission proposal reflects the approach that has been agreed by the Basel Committee on Banking Supervision, subsequent to the G-20 mandate. The issue, therefore, would merit being raised and discussed at the global level.

Mr André VILLENEUVE
Chairman
International Regulatory Strategy Group

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As you point out in your letter, the view of the Committee on Economic and Monetary Affairs (ECON) of the European Parliament is that institutions should be exempt from the CVA capital charge for their OTC derivative transactions with pension funds and non-financial counterparties. At the same time, the general approach of the Council, as agreed on 15 May 2012, seeks to exempt transactions with sovereigns and international financial institutions (provided institutions employ the advanced method to calculate the CVA capital charge). The final scope, appropriate from a prudential and economic efficiency perspective, is being discussed jointly by the European Parliament, the Council and the Commission in the trilogue discussions.

I would like to thank you for raising your concerns about the potential implications of the CVA capital charge for non-financial companies and pension funds. In fact the Commission – through formal consultation and bilateral discussion – has been aware of these concerns since the early days of this legislative project. I believe that the treatment of the CVA risk, as outlined in our proposals, still represents the most effective and efficient solution from an EU perspective to address shortcomings in the treatment of this particular risk that transpired so clearly during the crisis.

Yours sincerely,

Michel BARNIER