



Andrea Enria
Chair
European Banking Authority

EBA Board of Supervisors

One Canada Square (Floor 46)
Canary Wharf
London E14 5AA | UK

XX November 2015

Dear Mr Enria,
Honourable Member of the EBA Board of Supervisors,

Re: CVA risk capital charge exemption for non-financial counterparties

The European Association of Corporate Treasurers and the undersigned companies representing a wide range of the EU economy are greatly concerned by the EBA's plans to impose additional capital charges on transactions by non-financial companies that have been exempted from the Credit Valuation Adjustment (CVA) risk capital charge in CRD IV¹. EBA's proposals would essentially eliminate the economic effect of the CVA exemption for non-financial companies' risk-mitigating OTC derivatives transactions. This would lead to a substantial increase in the cost of hedging and potentially to a reduced level of risk mitigation, making EU non-financial companies more risky, more volatile and less competitive - this despite the legislator's recognition of the importance of maintaining non-financial companies' ability to manage their financial risk. Therefore **we would urge the EBA to abandon the proposed measures that have no legal basis and do not measure the damaging consequences that an incomplete application of the exemption would have on the EU real economy.**

¹ Report published by the EBA on 25 February
(<https://www.eba.europa.eu/documents/10180/950548/EBA+Report+on+CVA.pdf>) recommending Pillar II capital requirements for "excessive CVA risks" and a subsequent public consultation that we understand will be published by the end of the year

We would in particular raise the following concerns:

1. **The EBA has not been legally mandated to review or propose any measures concerning the CVA exemption** for non-financial counterparties, which the EBA itself has acknowledged in its report. It is therefore totally inappropriate for an ESA to essentially amend the level 1 text by imposing supervisory measures that will not have the scrutiny of the Commission, the Parliament or the Council. **We strongly contest the legitimacy for the EBA to impose measures that will go against the level 1 text that has been democratically agreed upon by the EU legislator.**

2. **The EBA has not given any consideration in its analysis to the specific nature of the use of OTC derivatives by NFCs** (in comparison to financial counterparties). **Hedging is part of prudent company risk management which contributes to financial stability** by making these NFCs less risky to their financial counterparties, suppliers, customers, employees and to economic stability in general. If EBA even partially removes the CVA exemption, non-financial companies will become more risky to their counterparties due to decreased mitigation of financial risks.
Furthermore, there is a fundamental difference in the risks posed by NFCs compared to financial counterparties: NFCs' business and default risks are much less correlated and irrelevant from a systemic risk perspective. All other things equal, a portfolio composed of NFCs would have a much lower risk than a portfolio of the same size composed of financial counterparties, because the NFC will benefit from sectorial diversification. In addition, industrial and commercial NFCs do not transact with each other.

3. Historically the **CVA losses due to NFCs have been negligible**, as pointed out by the EBA's own figures. Most CVA losses have occurred in CDOs linked to ABSs and mono-line Insurers - instruments and sectors totally unrelated to NFCs.

4. Any deviation from the CVA exemption is also likely to impact **companies' financial position because it will either**
 - a. Force NFCs to enter into credit support enhancements agreements that the banks' own credit department did not initially deem necessary. This will ultimately divert funds from productive investments.
 - b. Increase the companies' credit spreads in the market because banks will be forced to mitigate counterparty risk by buying single-name corporate CDSs. Such an evolution would be in fundamental contradiction with the current policy objectives of facilitating companies' access to funding.

In both cases, the banks are likely to pass on costs directly or indirectly to NFCs.

For all the reasons mentioned above and to the benefit to the whole EU economy, we strongly encourage you to re-consider your approach on this topic and to abandon all

measures that would have a detrimental impact on CVA-exempted hedging transactions. We of course remain at your disposal for any further clarifications.

Yours sincerely,

Jean-Marc Servat
Chair
European Association of Corporate Treasurers

Copied to:

EBA:

Adam Farkas, Executive Director

European Commission:

Jonathan Hill, Commissioner for Financial Stability, Financial Services and Capital Markets Union

Jyrki Katainen, Commission Vice-President for Jobs, Growth, Investment and Competitiveness

Olivier Guersent, Director General, DG FISMA

Mario Nava, Director of Regulation and prudential supervision of financial institutions, DG FISMA

European Parliament:

Roberto Gualtieri, Chair ECON

Burkhard Balz, EPP Coordinator, ECON

Othmar Karas, CRD4 rapporteur, ECON

Sylvie Goulard, ALDE coordinator, ECON

Kay Swinburne, ECR coordinator, ECON

Sven Giegold, Greens coordinator, ECON

This letter is supported by the member associations of the EACT and has been signed by the following companies:

TBC