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CRR – CRD IV: The first adoption of BASEL III in national law
CVA risk capital charge 1

- **Capital Requirement Regulation ("CRR") passed by the European Parliament in Europe**
- **CRR impact on FX products**

On 16th April 2013, the European Parliament adopted the text of the Capital Requirement Regulation ("CRR"), also known as CRD IV. The European Union is the first jurisdiction in the world to pass as law the Basel III framework.

As in Basel III, CRR imposes capital charges linked for potential mark-to-market losses (ie Credit Valuation Adjustment – CVA – risk) associated with deterioration in the credit worthiness of a counterparty when dealing derivatives products.

Key features

✓ ***Cost of the CVA risk capital charge has been estimated to be 2-3 times higher than under the previous regulatory environment***

✓ ***Cleared transactions do not have CVA risk capital charge***
Following the G20 Pittsburgh resolution, the European Union adopted the European Markets Infrastructure Regulation ("EMIR") in 2012. From the summer of 2014, financial institutions will have to clear their derivative transactions in the EU through central counterparties ("CCP", i.e. clearing houses). Derivatives traded by banks with CCP will not attract CVA risk capital charges.

✓ ***For non-cleared trades, CSA will lessen the impact of the CVA risk capital charge***
CVA impact is substantially reduced when a two-way Credit Support Agreements ("CSA", as annex to an ISDA agreement) with daily exchange of collateral is in place to cover the derivative transactions. As a consequence, though the CVA risk capital charge still exists, the magnitude of it becomes much smaller.

✓ ***Exemption of CVA risk capital charge for European banks when trading with corporates, sovereigns and pension funds***

In CRR, banks are exempted from such a CVA risk capital charge when dealing with certain counterparties. These exemptions mirror the treatment of certain counterparties under the European Markets Infrastructure Regulation ("EMIR"):

- Transactions with sovereigns which are exempted from EMIR;
- Transactions with non financial counterparties, provided they are below the EMIR clearing thresholds;
- On a temporary basis, transactions with pension funds.

End of message

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