THE DIRECTOR GENERAL

Mr Othmar Karas
Member of the European Parliament
European Parliament
Rue Wiertz 60
B-1047 Brussels
BELGIUM

15 October 2020

Dear Member of the European Parliament, lieber Othmar,

Securitization Quick Fix - OTC Derivatives and Corporate Hedging

I write to you regarding current discussions on the Commission proposal *COM(2020)282final* of 24 June 2020 which contains some targeted amendments to the Securitisation Regulation and the Capital Requirements Regulation (CRR2) to use securitisation in the most efficient manner to promote the economic recovery in the coming months ("Securitization Quick Fix").

We support the proposed changes, which are part of the so-called Capital Markets Recovery Package, which we highly appreciate as it creates more flexibility for banks ensuring that they can maintain lending to companies.

However, there is an outstanding issue related to the use of 'over-the-counter' (OTC) derivatives by non-financial companies to hedge corporate risk. This issue is unrelated to the Securitisation Quick Fix proposals as such but can be addressed in the context of these proposals as it would also involve an amendment to the current CRR2.

The Standardised Approach for Counterparty Credit Risk (SA-CCR), which is part of CRR2, is a methodology to calculate the capital required to address the risk that the counterparty to a derivative contract will not live up to its contractual obligations. SA-CCR, because of its current design and calibration flaws, will lead to disproportionate increases in capital requirements for banks and significantly increased costs for end-users (e.g. corporates) who typically use non-cleared derivatives to hedge risk. This is due to the calibration of the so-called 'alpha' factor for calculating Exposure at Default (EAD) for the calculation of capital requirements for derivatives contracts entered into with commercial end-users. This calibration has the impact of increasing exposures by 40% (alpha=1.4) and was originally developed in 2005, not reflecting the current market environment, in particular the shift towards increased clearing and collateralization.

BusinessEurope is concerned that increased costs due to the described "alpha"-factor will be fully charged into end-user transactions, and hence will discourage companies from entering into OTC derivative transactions. Reduced hedging would increase not

only the financial risk for the economy as a whole but also for single corporations. Reduced hedging means more internalization of market risks in companies, which will also lead to a different risk assessment of the non-financial companies themselves by potential investors. This will negatively affect the cost of equity and debt financing.

Recognizing the above-mentioned flaws, and the described risks for "real economy" end-users, the US authorities have last November acted quickly to recalibrate SA-CCR in their jurisdiction, removing the 'alpha' factor. The Final Report of the High-Level Forum on the Capital Markets Union has also noted the significance of considering a recalibration of SA-CCR through the removal of the 'alpha' factor, as part of the implementation of SA-CCR in the EU.

We therefore ask the legislator to ensure that this important issue is considered before SA-CCR becomes applicable in June 2021.

We hope that you share these concerns and remain at your disposal should you wish to discuss this further.

Mit besten Grüßen,

Dein
Markus J. Beyrer