**SRB Q&A regarding derivative adjustments**

Questions received by the Single Resolution Board (SRB) are written in black, the answers by the SRB are written in **blue.**

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**1.1       Mark-to-market method, Article 5b of the Commission proposal**

Our understanding is that the method is intended to be used to determine the amount of liabilities arising from derivatives. The wording of Article 5b(1) of the Commission proposal is potentially misleadingly, however, as this amount is defined as the “*absolute value of the net market value of the contracts*”.

We therefore recommend adding the following wording (underlined and in bold): “*1. The current replacement cost of liabilities arising from derivative contracts at netting set level is the absolute value of the net market value of the contracts within the netting, gross of any collateral held or posted where positive and negative market values are netted in computing the net market value* **andwhere netting leads to a net obligation.**”

**Reply - We do not see the interpretative issue that you seem to see, as Article 5(b)1 already refers at the beginning of the intended provision to liabilities only, when it states: “of liabilities arising from derivative contracts at netting set level”.**

**1.2 Effects of recognition of netting as risk-reducing, Article 5e of the Commission proposal**

Article 5e regulates the effect of netting. Article 5e(1)(b) states that the **replacement cost** should be set at zero if netting leads to “*a net obligation*” (i.e. liabilities).

*(b) in the case of other netting agreements, institutions shall* ***apply Article 5b*** *as follows:*

*(1) the* ***current replacement cost*** *referred to in Article 5b(1) for the contracts included in a netting agreement shall be obtained by taking account of the actual hypothetical net replacement cost which results from the agreement; in the case* ***where netting leads to a net obligation for the institution calculating the net replacement cost, the current replacement cost is calculated as ‘0’;***

We believe this contradicts the basic objective of setting out a methodology for calculating liabilities. The proposal has evidently used the requirement from Article 298(1)(c) of the 2015 version of the CRR as a basis and has failed to take account of the fact that it is liabilities that are relevant here. In its present form, Article 5e(1)(b) would lead to the “*current replacement cost*” calculated in accordance with Article 5b being set at “0”, meaning that it would consequently not be included in the assessment basis for the bank levy. One possible interpretation is that “net assets” are meant here and not “net obligation”.

We would appreciate clarification and appropriate adjustment to Article 5e.

**Reply - Thanks for bringing this to our attention.**

**1.3       SRB requirement in Article A(2) vs. Article 5a of the Commission proposal – treatment of collateral posted**

The **SRB** states **in Article A(2)** that “*Where the provision of collateral related to derivatives contracts* ***increases*** *the amount of liabilities under the applicable accounting framework, institutions shall consider that increase.*” This requirements is evidently intended to reflect **Article 5a(2) of the Commission proposal**: “*Where the provision of collateral related to derivatives contracts* ***reduces the amount of liabilities*** *under the applicable accounting framework, institutions shall reverse that reduction*.”

We find the Commission proposal clear and readily understandable. It clarifies that, when liabilities are calculated for prudential purposes (using the so-called derivatives adjustment method), the amount of liabilities arising from derivatives used as the starting point for the calculation **may not be reduced by collateral posted**, as it possibly can in calculations for accounting purposes.

**We consider the SRB requirement unclear, by contrast**. The term “*provision of collateral*” suggests that this also covers collateral provided by the institution. But how is posted collateral supposed to increase the amount of accounting liabilities? If “cash collateral received” is meant and this is intended to be included in the calculation of the exposure from derivatives (field 2C1), we believe this item would then be counted twice when calculating the bank levy (once in field 2A1: balance-sheet liabilities, and once in field 2C1: exposure for derivatives). This double counting cannot possibly be intentional.

We would appreciate investigation of this point and would ask the SRB to explain or adjust its requirements.

**Reply - Thanks for pointing this out. Any liabilities arising from a collateral transaction should be included in data point 2A1 and should not be considered for the valuation for data point 2C1. The principle of the reversion of the reduction should guide the reporting of this item. The SRB guidance should be interpreted in light of and in accordance with the relevant provisions of the Commission Delegated Regulation.**

**1.4       Treatment of collateral received: SRB requirement in Article A(3), final sentence and Article 5a(3), final sentence of the Commission proposal**

**SRB requirement in the final sentence of Article A(3)**: “*Where under the applicable accounting framework an institution recognises the variation margin received in cash from the counterparty as a payable liability, it may exclude that liability from the exposure measure provided that the conditions in points (a) to (e) are met.*”

**Final sentence in Article 5a(3) of the Commission proposal**: “*Where under the applicable accounting framework an institution recognises the variation margin received in cash from the counterparty as a payable liability, it may exclude that liability from the exposure measure provided that the conditions in points (a) to (e) are met.”*

This regulates the treatment of **variation margin received in cash**, which has to be recognised as a liability under the accounting framework (and therefore included in field 2A1) since it is not a liability arising from derivatives and does not need to be considered in step 2 of the derivatives adjustment method (cf. SRB Guidance on field 2C1, page 9).

This requirement is consistent with the rules for calculating the exposure for the purpose of the leverage ratio and, in our view, is intended to reflect prudential netting and offsetting possibilities.

Our understanding is that, if the above requirements are met, this variation margin received in cash does not, under the derivatives adjustment method, have to be taken into account when calculating total liabilities for the purpose of determining the bank levy (field 2C6).

**Reply - For the purpose of 2C6 and the derivatives value adjustment, only the liabilities arising (directly) from derivatives are in scope as well as variation margins that relate directly to these liabilities. However, a variation margin received (booked as a liability) and that relates to a derivative with a positive value is not taken into account and remains included in total liabilities (2A1).**

**This raises the question as to the point at which total liabilities should be reduced. Since the provision is part of the derivatives adjustment method, we assume that liabilities from derivatives should be deducted from total liabilities in field 2C1**.

**Reply - The liabilities to be deducted from total liabilities in the context of the value adjustment for SRF purposes are the liabilities arising (directly) from derivative contracts. In the calculation of the ex-ante contributions, the adjusted value of 2C1 will replace the accounting value of 2C2, subject to a floor.**

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