

7. EBA shall develop draft regulatory technical standards to specify in greater detail:
- how a proxy spread is to be determined by the institution's approved internal model for the specific risk of debt instruments for the purposes of identifying s_i and LGDMKT referred to in paragraph 1;
 - the number and size of portfolios that fulfil the criterion of a limited number of smaller portfolios referred to in paragraph 4.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2014.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

Article 384

Standardised method

1. An institution which does not calculate the own funds requirements for CVA risk for its counterparties in accordance with Article 383 shall calculate a portfolio own funds requirements for CVA risk for each counterparty in accordance with the following formula, taking into account CVA hedges that are eligible in accordance with Article 386:

$$K = 2.33 \cdot \sqrt{h} \cdot \sqrt{\left(\sum_i 0.5 \cdot w_i \cdot \left(M_i \cdot EAD_i^{total} - M_i^{hedge} B_i \right) - \sum_{ind} w_{ind} \cdot M_{ind} \cdot B_{ind} \right)^2 + \sum_i 0.75 \cdot w_i^2 \cdot \left(M_i \cdot EAD_i^{total} - M_i^{hedge} B_i \right)^2}$$

where:

h = the one-year risk horizon (in units of a year); $h = 1$;

w_i = the weight applicable to counterparty "i".

Counterparty "i" shall be mapped to one of the six weights w_i based on an external credit assessment by a nominated ECAI, as set out in Table 1. For a counterparty for which a credit assessment by a nominated ECAI is not available:

- an institution using the approach in Title II, Chapter 3 shall map the internal rating of the counterparty to one of the external credit assessment;
- an institution using the approach in Title II, Chapter 2 shall assign $w_i=1.0\%$ to this counterparty. However, if an institution uses Article 128 to risk weight counterparty credit risk exposures to this counterparty, $w_i=3.0\%$ shall be assigned;

EAD_i^{total} = the total counterparty credit risk exposure value of counterparty "i" (summed across its netting sets) including the effect of collateral in accordance with the methods set out in Sections 3 to 6 of Title II, Chapter 6 as applicable to the calculation of the own funds requirements for counterparty credit risk for that counterparty. An institution using one of the methods set out in Sections 3 and 4 of Title II, Chapter 6, may use as EAD_i^{total} the fully adjusted exposure value in accordance with Article 223(5).

For an institution not using the method set out in Section 6 of Title II, Chapter 6, the exposure shall be discounted by applying the following factor:

$$\frac{1 - e^{-0.05 \cdot M_i}}{0.05 \cdot M_i}$$

B_i = the notional of purchased single name credit default swap hedges (summed if more than one position) referencing counterparty "i" and used to hedge CVA risk.

That notional amount shall be discounted by applying the following factor:

$$\frac{1 - e^{-0.05 \cdot M_i^{hedge}}}{0.05 \cdot M_i^{hedge}}$$

B_{ind} = is the full notional of one or more index credit default swap of purchased protection used to hedge CVA risk.

That notional amount shall be discounted by applying the following factor:

$$\frac{1 - e^{-0.05 \cdot M_{ind}}}{0.05 \cdot M_{ind}}$$

w_{ind} = is the weight applicable to index hedges.

An institution shall determine w_{ind} by calculating a weighted average of w_i that are applicable to the individual constituents of the index;

M_i = the effective maturity of the transactions with counterparty i .

For an institution using the method set out in Section 6 of Title II, Chapter 6, M_i shall be calculated in accordance with Article 162(2)(g). However, for that purpose, M_i shall not be capped at five years but at the longest contractual remaining maturity in the netting set.

For an institution not using the method set out in Section 6 of Title II, Chapter 6, M_i is the average notional weighted maturity as referred to in point (b) of Article 162(2). However, for that purpose, M_i shall not be capped at five years but at the longest contractual remaining maturity in the netting set.

M_i^{hedge} = the maturity of the hedge instrument with notional B_i (the quantities $M_i^{hedge} B_i$ are to be summed if these are several positions);

M_{ind} = the maturity of the index hedge.

In the case of more than one index hedge position, M_{ind} is the notional-weighted maturity.

2. Where a counterparty is included in an index on which a credit default swap used for hedging counterparty credit risk is based, the institution may subtract the notional amount attributable to that counterparty in accordance with its reference entity weight from the index CDS notional amount and treat it as a single name hedge (B_i) of the individual counterparty with maturity based on the maturity of the index.

Table 1

| Credit quality step | Weight w_i |
|---------------------|--------------|
| 1 | 0,7 % |
| 2 | 0,8 % |
| 3 | 1,0 % |
| 4 | 2,0 % |
| 5 | 3,0 % |
| 6 | 10,0 % |

Article 385

Alternative to using CVA methods to calculating own funds requirements

As an alternative to Article 384, for instruments referred to in Article 382 and subject to the prior consent of the competent authority, institutions using the Original Exposure Method as laid down in Article 275, may apply a multiplication factor of 10 to the resulting risk-weighted exposure amounts for counterparty credit risk for those exposures instead of calculating own funds requirements for CVA risk.

Article 386

Eligible hedges

1. Hedges shall be 'eligible hedges' for the purposes of the calculation of own funds requirements for CVA risk in accordance with Articles 383 and 384 only where they are used for the purpose of mitigating CVA risk and managed as such, and are one of the following:

- single-name credit default swaps or other equivalent hedging instruments referencing the counterparty directly;
- index credit default swaps, provided that the basis between any individual counterparty spread and the spreads of index credit default swap hedges is reflected, to the satisfaction of the competent authority, in the Value-at-Risk.

The requirement in point (b) that the basis between any individual counterparty spread and the spreads of index credit default swap hedges is reflected in the Value-at-Risk shall also apply to cases where a proxy is used for the spread of a counterparty.

For all counterparties for which a proxy is used, an institution shall use reasonable basis time series out of a representative group of similar names for which a spread is available.

If the basis between any individual counterparty spread and the spreads of index credit default swap hedges is not reflected to the satisfaction of the competent authority, then an institution shall reflect only 50 % of the notional amount of index hedges in the Value-at-Risk.

Over-hedging of the exposures with single name credit default swaps under the method laid out in Article 383 is not allowed.

2. An institution shall not reflect other types of counterparty risk hedges in the calculation of the own funds requirements for CVA risk. In particular, tranchés or nth-to-default credit default swaps and credit linked notes are not eligible hedges for the purposes the calculation of the own funds requirements for CVA risk.

3. Eligible hedges that are included in the calculation of the own funds requirements for CVA risk shall not be included in the calculation of the own funds requirements for specific risk as set out in Title IV or treated as credit risk mitigation other than for the counterparty credit risk of the same portfolio of transaction.