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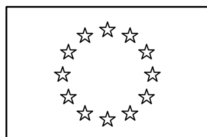

EUROPEAN COMMISSION

Brussels, 20.7.2011
COM(2011) 452 final

2011/0202 (COD)

PROPOSAL FOR A

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on prudential requirements for credit institutions and investement firms

PART I

(Text with EEA relevance)

{SEC(2011) 949 final}
{SEC(2011) 950 final}

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSED ACT

1.1. Reasons for and objectives of the proposal

The extent of the financial crisis has exposed unacceptable risks pertaining to the current regulation of financial institutions. According to IMF estimates, crisis-related losses incurred by European credit institutions between 2007 and 2010 are close to €1 trillion or 8% of the EU GDP.

In order to restore stability in the banking sector and ensure that credit continues to flow to the real economy, both the EU and its Member States adopted a broad range of unprecedented measures with the taxpayer ultimately footing the related bill. In this context, by October 2010 the Commission has approved €4.6 trillion of state aid measures to financial institutions of which more than €2 trillion were effectively used in 2008 and 2009.

The level of fiscal support provided to credit institutions needs to be matched with a robust reform addressing the regulatory shortcomings exposed during the crisis. In this regard, the Commission already proposed a number of amendments to banking legislation that entered into force in 2009 (CRD II) and 2010 (CRD III). This proposal contains globally developed and agreed elements of credit institution capital and liquidity standards known as Basel III and harmonises other provisions of the current legislation. The regulatory choices made are explained in detail in Section 5 below.

Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions and Directive contains provisions closely related to the access to the activity of the business of credit institutions (such as provisions governing the authorisation of the business, the the exercise of the freedom of establishment, the powers of supervisory authorities of home and host Member States in this regard, and the supervisory review of credit institutions). These elements are covered by the proposal for a Directive on the access to the activity of the business of credit institutions and the prudential supervision of credit institutions and investment firms with which the present proposal forms a package. However, Directive 2006/48/EC and in particular its annexes also set out prudential rules. In order to approximate further the legislative provisions that result from the transposition of Directives 2006/48/EC and 2006/49/EC into national law and in order to ensure that the same prudential rules directly apply to them, which is essential for the functioning of the internal market, these prudential rules are subject of this proposal for a Regulation.

For sake of clarity, this proposal also unifies prudential requirements on credit institutions and investment firms, the latter of which are dealt with by Directive 2006/49/EC.

1.1.1. Problems addressed – new elements under Basel III

The proposal is designed to tackle regulatory shortcomings in the following areas:

Management of liquidity risk (Part Six): Existing liquidity risk management practices were shown by the crisis to be inadequate in fully grasping risks linked to originate-to-distribute securitization, use of complex financial instruments and reliance on wholesale funding with short term maturity instruments. This contributed to a demise of several financial institutions

and strongly undermined financial health of many others, threatening the financial stability and necessitating public support. While a number of Member States currently impose some form of quantitative regulatory standard for liquidity, no harmonised sufficiently explicit regulatory treatment on the appropriate levels of short-term and long-term liquidity exists at EU level. Diversity in current national standards hampers communication between supervisory authorities and imposes additional reporting costs on cross-border institutions.

Definition of capital (Part Two Title I): Institutions entered the crisis with capital of insufficient quantity and quality. Given the risks they faced, many institutions did not posses sufficient amounts of the highest quality capital instruments that can absorb losses effectively as they arise and help to preserve an institution as a going concern. Hybrid Tier 1 capital instruments (hybrids), which had previously been considered to be loss absorbent on a going concern basis were found not to be effective in practice. Tier 2 capital instruments were not able to perform their function of absorbing losses once an institution became insolvent because institutions were often not permitted to fail. The quality of capital instruments required to absorb unexpected losses from risks in the trading book was found to be as high as that for risks in the non-trading book, and Tier 3 capital instruments we found not to be of sufficiently high quality. To safeguard financial stability, governments provided unprecedented support to the banking sector in many countries. Insufficient harmonisation in the EU of the definition of capital was a catalyst for this situation, with different Member States taking significantly different approaches to the elements of capital that should be excluded or excluded from own funds. In combination with the fact that regulatory ratios did not accurately reflect an institution's true ability to absorb losses, this undermined the ability of the market to assess accurately and consistently the solvency of EU institutions. This in turn amplified financial instability in the EU.

Counterparty credit risk (Part Three Title II Chapter 6): The crisis revealed a number of shortcomings in the current regulatory treatment of counterparty credit risk arising from derivatives, repo and securities financing activities. It showed that the existing provisions did not ensure appropriate management and adequate capitalisation for this type of risk. The current rules also did not provide sufficient incentives to move bilaterally cleared over-the-counter derivative contracts to multilateral clearing through central counterparties.

Options, discretions and harmonisation (entire Regulation): In 2000, seven banking directives were replaced by a single Directive. This directive was recast in 2006 while introducing the Basel II framework in the EU. As a result, its current provisions include a significant number of options and discretions. Moreover, Member States have been permitted to impose stricter rules than those of the Directive. As a result, there is a high level of divergence which is particularly burdensome for firms operating cross-border. It also gives rise to the lack of legal clarity and an uneven playing field.

1.1.2. Objectives of the proposal

The overarching goal of this initiative is to ensure that the effectiveness of institution capital regulation in the EU is strengthened and its adverse impacts on depositor protection and pro-cyclicality of the financial system are contained while maintaining the competitive position of the EU banking industry.

1.2. General context

The financial crisis prompted a broad EU and international effort to develop effective policies to tackle the underlying problems. A High Level Group chaired by Mr. de Larosière proposed

recommendations for reforming European financial supervision and regulation. They were further elaborated in a Commission Communication in March 2009. This proposal contains numerous policy revisions that are listed in the detailed action plan included in this Communication.

On a global level, the G-20 Declaration of 2 April 2009 conveyed the commitment to address the crisis with internationally consistent efforts to, improve the quantity and quality of capital in the banking system, introduce a supplementary non-risk based measure to contain the build-up of leverage, develop a framework for stronger liquidity buffers at financial institutions and implement the recommendations of the Financial Stability Board (FSB) to mitigate the pro-cyclicality.

In response to the mandate given by the G-20, in September 2009 the Group of Central Bank Governors and Heads of Supervision (GHOS), the oversight body of the Basel Committee on Banking Supervision (BCBS)[1], agreed on a number of measures to strengthen the regulation of the banking sector. These measures were endorsed by FSB and the G-20 leaders at their Pittsburgh Summit of 24-25 September 2009.

In December 2010, BCBS issued detailed rules of new global regulatory standards on credit institution capital adequacy and liquidity that collectively are referred to as Basel III. This proposal directly relates to the regulatory standards included in Basel III.

The Commission, in its capacity of an observer to the BCBS, was working very closely with the BCBS on developing these standards, including on assessing their impact. Consequently, the proposed measures faithfully follow the substance of the Basel III principles. In order to achieve the dual objective of improving the resilience of the global financial system and ensuring a level playing field, it is imperative that the more robust set of prudential requirements be applied consistently across the world.

At the same time, in the process of developing this legislative proposal, the Commission has made particular efforts in making sure that certain major European specificities and issues are appropriately addressed. In this context, it is worth recalling that in the EU, unlike some other major economies, the application of the regulatory principles agreed globally under the auspices of the BCBS is not restricted to only international active banks. These standards are in the EU applied across the whole banking sector, covering all credit institutions and in general also investment firms. As explained further in section 4.2, the EU has always considered that only such approach would provide for a true level playing field in the EU, while maximising the associated financial stability benefits.

This is one of the reasons why certain adaptations of the Basel III principles, which would appropriately address the European specificities and issues, appear to be warranted. However, these adaptations remain consistent with the nature and objectives of the Basel III reform.

[1] The **Basel Committee on Banking Supervision** provides a forum for regular cooperation on banking supervisory matters. It seeks to promote and strengthen supervisory and risk management practices globally. The Committee comprises representatives from Argentina, Australia, Brazil, Canada, China, Hong Kong SAR, India, Indonesia, Japan, Korea, Mexico, Russia, Saudi Arabia, Singapore, South Africa, Switzerland, Turkey, the United States and nine EU Member States: Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Spain, Sweden and the United Kingdom.

In a wider context, it should be noted that one of the priorities of the Commission in the reform of EU financial services regulation has been to ensure that the banking sector is able to fulfil its fundamental purpose, namely lending to the real economy and providing services to citizens and businesses in Europe. In this respect, the Commission has adopted on 18 July a Recommendation on access to a basic payment account[2].

2. RESULTS OF THE CONSULTATIONS WITH THE INTERESTED PARTIES AND OF THE IMPACT ASSESSMENTS

2.1. Consultation with interested parties

The Commission services have closely followed and participated in the work of international forums, particularly BCBS, which was in charge of developing the Basel III framework. The European Banking Committee (EBC) and the Committee of European Banking Supervisors (CEBS), and its successor from 2011 the European Banking Authority (EBA), have been extensively involved and consulted. Their views have contributed to the preparation of this proposal and the accompanying impact assessment.

2.1.1. CEBS

CEBS conducted a comprehensive quantitative impact study (QIS) on the impact of this legislative proposal on the EU banking industry. 246 credit institutions participated in the study. CEBS also conducted extensive public consultations and in October 2008 submitted a technical advice in the area of national options and discretions.

2.1.2. CRD Working Group

In the area of national options and discretions, between 2008 and 2011 the Commission services held six meetings of the Capital Requirements Directive Working Group (CRDWG), whose members are nominated by EBC. In addition, sub-groups of the CRDWG in the areas of liquidity, capital definition, leverage ratio and counterparty credit risk have also conducted work at an even more technical level.

2.1.3. Other public consultations

The Commission conducted four public consultations in 2009, 2010 and 2011, covering all elements of this proposal. In April 2010 the Commission services conducted an open public hearing on this proposal that was attended by all the stakeholder groups.

Responses to the public consultations and views expressed at the public hearing are reflected throughout the accompanying impact assessment report. Individual responses are available on the Commission's website.

In addition, the Commission conducted separate consultations with the industry, including the Group of Experts in Banking Issues (GEBI) set up by the Commission and various EU banking industry associations and individual institutions.

[2] C(2011)4977.

2.2. Impact assessment

Altogether, 27 policy options have been assessed and compared with a view to addressing the various issues identified[3]. The below table lists the individual options considered within each policy set and ranks them in terms of their relative effectiveness[4] and efficiency[5] with regard to achieving relevant longer term policy objectives. Preferred options, identified on the basis of this ranking, are highlighted and discussed in the rest of this section.

Policy Option Set	Policy Options	Policy Option Comparison Criteria									
		Effectiveness									Efficiency
		Enhance adequacy of capital requirements	Enhance bank risk management	Prevent regulatory arbitrage opportunities	Enhance legal clarity	Reduce compliance burden	Enhance level playing field	Enhance supervisory cooperation and convergence	Align prudential requirements for SIFIs with the risks they pose	Reduce cyclicality of provisioning and capital requirements	
Liquidity - Liquidity Coverage ratio	Retain current approach	3	3								3
	Introduce LCR as specified in Feb 2010 public consultation	2	2								1
	Introduce LCR adopted by Basel Committee subject to observation period	1	1								2
Liquidity - Net Stable Funding ratio	Retain current approach	3	3								3
	Introduce NSFR as specified in Feb 2010 public consultation	2	2								2
	Introduce NSFR adopted by Basel Committee subject to observation period	1	1								1
Eligibility of capital instruments and application of regulatory adjustments	Retain current approach	5	5	5			5		5	5	5
	Modify only the eligibility criteria as specified in Feb 2010 public consultation	4	4	4			4		4	4	4
	Modify eligibility criteria and regulatory adjustments as specified in Feb 2010 public consultation	1-3	1-3	1-3			2-3		1	1-3	3
	Modify eligibility criteria and regulatory adjustments based on Basel approach	1-3	1-3	1-3			2-3		2-3	1-3	2
	Modify eligibility criteria and regulatory adjustments based on Basel approach with some adjustments for EU specificities	1-3	1-3	1-3			1		2-3	1-3	1
Counterparty credit risk (CCR)	Retain current approach	3	3						3	3	3
	Enhance CCR requirement	2	2						2	2	2
	Enhance CCR requirements and differentiate treatment of exposures to Central Counterparties	1	1						1	1	1
Leverage ratio	Retain current approach	3	3							3	3
	Introduce leverage ratio as specified in Feb 2010 public consultation	2	2							2	2
	Conduct extensive monitoring of leverage ratio	1	1							1	1
Capital buffers	Retain current approach	4	4							4	4
	Conservation capital buffer	1-2	1-3							3	2-3
	Countercyclical capital buffer	3	1-3							1-2	2-3
	Dual capital buffer	1-2	1-3							1-2	1
Single rule book	Retain current approach			4	4	4	4	4			4
	Minimum harmonization			3	3	1-3	3	3			1-3
	Maximum harmonization			1-2	1	1-3	1	1			1-3
	Maximum harmonization with some exceptions			1-2	2	1-3	2	2			1-3
Choice of policy instrument	Amend the CRD			2	2	2		2			2
	Limit scope of the CRD and propose a regulation			1	1	1		1			1

Scale of option ranking: 1=most effective / efficient, 5=least effective / efficient

[3] For detailed discussion of all policy options please refer to the accompanying impact assessment
[4] Measures extent to which options achieve relevant objectives
[5] Measures extent to which objectives can be achieved for a given level of resources

2.2.1. *Individual policy measures*

Management of liquidity risk (Part Six): To improve short-term resilience of the liquidity risk profile of financial institutions, a Liquidity Coverage Ratio (LCR) will be introduced after an observation and review period in 2015. LCR would require institutions to match net liquidity outflows during a 30 day period with a buffer of 'high quality' liquid assets. The outflows covered (the denominator) would reflect both institution-specific and systemic shocks built upon actual circumstances experienced in the global financial crisis. The provisions on the list of high quality liquid assets (the numerator) to cover these outflows should ensure that these assets are of high credit and liquidity quality. Based on the LCR definition included in Basel III, compliance with this requirement in the EU is expected to produce net annual GDP benefits in the range of 0.1% to 0.5%, due to a reduction in the expected frequency of systemic crises.

To address funding problems arising from asset-liability maturity mismatches, the Commission will consider proposing a Net Stable Funding Ratio (NSFR) after an observation and review period in 2018. The NSFR would require institutions to maintain a sound funding structure over one year in an extended firm-specific stress scenario such as a significant decline in its profitability or solvency. To this end, assets currently funded and any contingent obligations to fund would have to be matched to a certain extent by sources of stable funding.

Definition of capital (Part Two): The proposal builds upon the changes made in CRD2 to strengthen further the criteria for eligibility of capital instruments. Furthermore, it introduces significant harmonisation of the adjustments made to accounting equity in order to determine the amount of regulatory capital that it is prudent to recognise for regulatory purposes. This new harmonised definition would significantly increase the amount of regulatory capital required to be held by institutions.

The new requirements for going concern regulatory capital - Common Equity Tier 1 and Tier 1 capital - would be implemented gradually between 2013 and 2015. The new prudential adjustments would also be introduced gradually, 20% per annum from 2014, reaching 100% in 2018. Grandfathering provisions over 10 years would also apply to certain capital instruments in order to help to ensure a smooth transition to the new rules.

Counterparty credit risk (Part Three, Title II, Chapter 6): Requirements for management and capitalisation of the counterparty credit risk will be strengthened. Institutions would be subject to an additional capital charge for possible losses associated with the deterioration in the creditworthiness of a counterparty. This would promote sound practices in managing this risk and recognise its hedging which would allow institutions to mitigate the impact of this capital charge. Risk weights on exposures to financial institutions relative to the non-financial corporate sector will be raised. This amendment is expected to encourage diversification of counterparty risk among smaller institutions and, overall, should contribute to less interconnectedness between large or systemically important institutions. The proposal would also enhance incentives for clearing over-the-counter instruments through central counterparties. These proposals are expected to affect mostly the largest EU institutions, as counterparty credit risk is relevant only for banks with significant over-the-counter derivative and securities financing activities.

Leverage ratio (Part Seven): In order to limit an excessive build-up of leverage on credit institutions' and investment firms' balance sheets and thus help containing the cyclicality of lending, the Commission also proposes to introduce a non-risk based leverage ratio. As agreed

by BCBS, it will be introduced as an instrument for the supervisory review of institutions. The impacts of the ratio will be monitored with a view to migrating it to a binding pillar one measure in 2018, based on appropriate review and calibration, in line with international agreements.

Single rule book (entire Regulation): The proposal harmonises divergent national supervisory approaches by removing options and discretions almost altogether. Some specific well defined areas, where divergences are driven by risk assessment considerations, market or product specificities and Member States' legal frameworks, are exempted, allowing Member States to adopt stricter rules.

2.2.2. Policy instrument

This proposal effectively separates prudential requirements from the other two areas of Directive 2006/48/EC and Directive 2006/49/EC, i.e. authorisation and ongoing supervision that would continue to be in the form of a directive with which this proposal forms a package. This reflects differences in subject-matter, nature and addressees.

2.2.3. Cumulative impact of the package

To supplement its own assessment of the impact of Basel III, the Commission reviewed a number of studies prepared by both public and private sectors. Their main results can be summarised as follows:

This proposal together with CRD III is estimated to increase the risk-weighted assets of large credit institutions by 24.5% and of small credit institutions by a modest 4.1%. The need to raise new own funds due to the new requirement and the conservation buffer is estimated to be €84 billion by 2015 and €460 billion by 2019.

There are clear net long term economic benefits of an annual increase in the EU GDP in the range of 0.3%-2%. They stem from a reduction in the expected frequency and probability of future systemic crises.

It is estimated that the proposal would reduce the probability of a systemic banking crisis in seven MS within the range of 29% to 89% when credit institutions recapitalise to a total capital ratio of at least 10.5%.

In addition, higher capital, including the countercyclical capital buffer, and liquidity requirements should also reduce the amplitude of normal business cycles. This is particularly relevant to small and medium enterprises that are relatively more dependent on credit institution financing throughout the economic cycle than large companies.

2.2.4. Administrative burden

Institutions with more cross-border activity would benefit from harmonisation of the current national provisions the most as the ensuing administrative burden savings are expected to reduce their burdens related to Basel III measures.

3. MONITORING AND EVALUATION

The proposed amendments are linked to the Directives 2006/48/EC and 2006/49/EC preceding this Regulation. This means that both the elements of the preceding Directive and

the new elements introduced by this Regulation will be closely monitored. The monitoring of the leverage ratio and the new liquidity measures will be subject to particular scrutiny on the basis of statistical data collected according to provisions in this proposal. The monitoring and evaluation will take place both at EU (EBA/ECB – European Central Bank) and international level (BCBS).

4. LEGAL ELEMENTS OF THE PROPOSAL

4.1. Legal basis

Article 114(1) TFEU provides a legal basis for a Regulation creating uniform provisions aimed at the functioning of the internal market. Whereas the proposal for Directive [inserted by OP] governs the access to the activity of businesses and is based on Article 53 TFEU, the need to separate these rules from the rules on how these activities are carried out warrants the use of a new legal basis for the latter.

Prudential requirements establish criteria for the evaluation of the risk linked to certain banking activities and of the funds necessary to counter-balance those risks. As such, they do not regulate access to deposit taking activities but govern the way in which such activities are carried out in order to ensure protection of depositors and financial stability. The proposed Regulation streamlines the prudential requirements for credit institutions and investment firms, which are currently set out in two different Directives (2006/48/EC and 2006/49/EC), in one legal instrument, which considerably simplifies the applicable legal framework.

As pointed out above (sections 1.1.1 and 2.2.1), the current provisions include a significant number of options and discretions and allow Member States to impose stricter rules than those of Directives 2006/48/EC and Directive 2006/49/EC. This results in a high level of divergence which can not only be problematic for financial stability purposes as set out in section 1.1.1 above, but also hampers the cross-border provision of services and the establishment in other Member States since each time an institution wishes to take up operations in another Member State it has to assess a different set of rules. This creates an unlevel playing field impeding the internal market and also hampers legal clarity. Since the previous codifications and recasts have not led to a reduction of divergence, it is necessary to adopt a Regulation in order to put in place uniform rules in all Member States with the aim of ensuring the good functioning of the internal market.

Shaping prudential requirements in the form of a Regulation would ensure that those requirements will be directly applicable to institutions. This would ensure a level-playing field by preventing diverging national requirements as a result of the transposition of a Directive. The proposed Regulation would clearly demonstrate that institutions follow the same rules in all EU markets, which would also boost confidence in the stability of institutions across the EU. A Regulation would also enable the EU to implement any future changes more quickly, as amendments can apply almost immediately after adoption. That would enable the EU to meet internationally agreed deadlines for implementation and follow significant market developments.

4.2. Subsidiarity

In accordance with the principles of subsidiarity and proportionality set out in Article 5 TFEU, the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore be better achieved by the EU. Its provisions do not go beyond what is

necessary to achieve the objectives pursued. Only EU action can ensure that institutions and investment firms operating in more than one Member State are subject to the same prudential requirements and thereby ensure a level playing field, reduce regulatory complexity, avoid unwarranted compliance costs for cross-border activities, promote further integration in the EU market and contribute to the elimination of regulatory arbitrage opportunities. EU action also ensures a high level of financial stability in the EU. This is corroborated by the fact that prudential requirements set out in the proposal have been set out in EU legislation for more than 20 years.

Article 288 TFEU leaves a choice between different legal instruments. A Regulation is therefore subject to the principle of subsidiarity in the same manner as other legal instruments. Subsidiarity must be balanced with other principles in the Treaties such as the fundamental freedoms. Directives 2006/48/EC and 2006/49/EC are formally directed at Member States but eventually addressed towards businesses. A Regulation creates a more level-playing field since it is directly applicable and there is no need to assess legislation in other Member States before starting a business since the rules are exactly the same. This is less burdensome for institutions. Delays with regard to the transposition of Directives can also be avoided by adopting a Regulation.

4.3. Role of EBA and compliance with Articles 290 and 291 TFEU

In more than 50 provisions of this proposal, EBA is requested to submit regulatory and implementing technical standards to the Commission in order to specify the criteria set out in some provisions of this Regulation and in order to ensure its consistent application. The Commission is empowered to adopt them as delegated and implementing acts.

On 23 September 2009, the Commission adopted proposals for Regulations establishing EBA, EIOPA (The European Insurance and Occupational Pensions Authority (EIOPA), and ESMA (European Securities and Markets Authority)[6]. In this respect the Commission wishes to recall the Statements in relation to Articles 290 and 291 TFEU it made at the adoption of the Regulations establishing the European Supervisory Authorities according to which: "As regards the process for the adoption of regulatory standards, the Commission emphasises the unique character of the financial services sector, following from the Lamfalussy structure and explicitly recognised in Declaration 39 to the TFEU. However, the Commission has serious doubts whether the restrictions on its role when adopting delegated acts and implementing measures are in line with Articles 290 and 291 TFEU."

4.4. Interaction and consistency between elements of the package

This Regulation forms a package with the proposed Directive [inserted by OP]. This package would replace Directives 2006/48/EC and 2006/49/EC. This means that both the Directive and the Regulation would each deal with both credit institutions and investment firms. Currently, the latter are merely 'annexed' to Directive 2006/48/EC by Directive 2006/49/EC. A large part of it merely contains references to Directive 2006/48/EC. Joining provisions applicable to both businesses in the package would therefore improve the readability of provisions governing them. Moreover, the extensive annexes of Directives 2006/48/EC and 2006/49/EC would be integrated into the enacting terms, hereby further simplifying their application.

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[6] COM(2009) 501, COM(2009) 502, COM(2009) 503.

Prudential regulations directly applicable to institutions are set out in the proposal for a Regulation. In the proposal for a Directive remain provisions concerning the authorisation of credit institutions and the exercise of the freedom of establishment and the free movement of services. This would not concern investment firms, as the corresponding rights and obligations are regulated by Directive 2004/39/EC ('MiFiD'). General principles of the supervision of institutions, which are addressed to Member States and require transposition and the exercise of discretion, would also remain in the Directive. This encompasses in particular the exchange of information, the distribution of tasks between home and host country supervisors and the exercise of sanctioning powers (which would be newly introduced). The Directive would still contain the provisions governing the supervisory review of institutions by the competent authorities of the Member States. These provisions supplement the general prudential requirements set out in the Regulation for institutions by individual arrangements that are decided by the competent authorities as a result of their ongoing supervisory review of each individual credit institution and investment firm. The range of such supervisory arrangements would be set out in the Directive since the competent authorities should be able to exert their judgment as to which arrangements should be imposed. This includes the internal processes within an institution notably concerning the management of risks and the corporate governance requirements that are newly introduced.

5. DETAILED EXPLANATION OF THE PROPOSAL AND COMPARISON WITH BASEL III

To ensure a balanced application of Basel III to EU institutions, the Commission had to make several regulatory choices, which are explained in this chapter.

5.1. Maximum harmonisation (Entire Regulation)

Maximum harmonisation is necessary to achieve a truly single rule book. Inappropriate and uncoordinated stricter requirements in individual Member States might result in shifting the underlying exposures and risks to the shadow banking sector or from one EU Member State to another.

Moreover, the impact assessments conducted by the Basel Committee and the European Commission are based on the specific capital ratios adopted. It is uncertain what the potential impact in terms of costs and growth would be in case of higher capital requirements in one or more Member States, potentially expanded through a "race to the top" mechanism across the EU.

If there is a need for more stringent prudential requirements *at the EU level*, there should be ways to temporarily modify the single rule book accordingly. The Commission could adopt a delegated act increasing for a limited period of time the level of capital requirements, the risk weights of certain exposures, or impose stricter prudential requirements, for all exposures or for exposures to one or more sectors, regions or Member States, where this is necessary to address changes in the intensity of micro-prudential and macro-prudential risks which arise from market developments emerging after the entry into force of this Regulation, in particular upon the recommendation or opinion of the ESRB.

This proposal and the accompanying proposal for the Directive contain already three possibilities for *competent authorities* to address macro-prudential concerns at national level:

– for lending secured by immovable property, Member States could adjust the capital requirements;

– Member States could impose additional capital requirements to individual institutions or groups of institutions where justified by specific circumstances under the so called 'Pillar 2';

– Member States set the level of the countercyclical capital buffer, reflecting the specific macroeconomic risks in a given Member State. This would actually modify the capital requirements to a significant extent.

Member States would furthermore be allowed to anticipate some of the new stricter rules based on Basel III during the transitional period, i.e. implement them faster than the pace set out in Basel III.

5.2. Definition of capital (Part Two)

5.2.1. Deductions of significant holdings in insurance entities and financial conglomerates

Basel III requires internationally active banks to deduct from their own funds significant investments in unconsolidated insurance companies. This is aimed at ensuring that a bank is not permitted to count in its own funds the capital used by an insurance subsidiary. For groups which include significant banking or investment business and insurance business, Directive 2002/87/EC on Financial Conglomerates, provides specific rules to address such 'double counting' of capital. Directive 2002/87/EC is based on internationally agreed principles for dealing with risk across sectors. This proposal strengthens the way these Financial Conglomerates rules shall apply to bank and investment firm groups, ensuring their robust and consistent application. Any further changes that are necessary will be addressed in the review of Directive 2002/87/EC, due in 2012.

5.2.2. Highest quality own funds – criteria, phasing out and grandfathering

Under Basel III, the highest quality own funds instruments for internationally-active banks that are joint-stock companies may comprise only "ordinary shares" that meet strict criteria. This proposal implements these Basel III strict criteria. It does not restrict the legal form of the highest quality element of capital issued by institutions structured as joint stock companies to ordinary shares. The definition of ordinary share varies according to national company law. The strict criteria set out in this proposal will ensure that only the highest quality instruments would be recognised as the highest quality form of regulatory capital. Under these criteria, only instruments that are as high quality as ordinary shares would be able to qualify for this treatment. In order to ensure full transparency of the instruments recognised, the proposal requires the EBA to compile, maintain and publish a list of the types of instrument recognised.

Basel III provides a 10-year phase out period for certain instruments issued by non-joint stock companies that do not meet the new rules. Consistent with the amendments made to own funds by Directive 2009/111/EC, and the need to ensure consistent treatment of different legal forms of company, this proposal (Part Ten, Title I, Chapter 2) affords such grandfathering also to the highest quality instruments issued by joint stock companies that are not common shares, and the related share premium accounts.

Basel III allows instruments that do not meet the new rules that are issued before 12 September 2010 to be phased out of regulatory capital, in order to ensure a smooth transition to the new rules. This is known as the 'cut off date' for the transitional arrangements. All instruments that do not meet the new rules that are issued after the cut off date would be fully

excluded from regulatory capital from 2013. This proposal sets the cut off date on the date of the adoption of this proposal by the Commission. This is necessary in order to avoid applying the requirements of the proposal retroactively, which would not be legally feasible.

5.2.3. Mutual societies, cooperative banks and similar institutions

Basel III ensures that the new rules are capable of being applied to the highest quality capital instruments of non-joint stock companies - e.g. mutuals, cooperative banks and similar institutions. This proposal specifies in greater detail the application of the Basel III definition of capital to the highest quality capital instruments issued by non-joint stock companies.

5.2.4. Minority interest and certain capital instruments issued by subsidiaries

A minority interest is the capital of certain subsidiaries that is owned by a minority shareholder from outside the group. Basel III recognises minority interest – and certain regulatory capital issued by subsidiaries - only to the extent that those subsidiaries are institutions (or subject to the same rules) and the capital is used to meet capital requirements and the new Capital Conservation Buffer, a new capital cushion which imposes new restrictions on the payment of dividends and certain coupons and bonuses. The other new capital buffer – the Countercyclical Buffer– is an important macro-prudential tool, which may be imposed by supervisors to moderate or bolster lending in different phases of the credit cycle. This proposal establishes robust EU processes for coordinating Member States' use of the Countercyclical Buffer. The approach set out in this proposal to minority interest and certain other capital issued by subsidiaries gives recognition of the Countercyclical Buffer where used. This recognises the importance of the buffer and the capital used to meet it, and removes a potential disincentive for the buffer to be required. .

5.2.5. Deduction of certain Deferred Tax Assets (DTAs)

A DTA is an asset on the balance sheet that may be used to reduce any subsequent period's income tax expense. Basel III specifies that certain DTAs do not require deduction from capital. This proposal clarifies that such DTAs include those that automatically convert into a claim on the state when a firm makes a loss would not require to be deducted, where their ability to absorb losses when needed was ensured.

5.3. Treatment of specific exposures (Part Three, Title II, Chapter 2)

5.3.1. Treatment of exposures to SMEs

Under current EU law, banks can benefit from preferential risk weights applied to exposures to SMEs. This preferential treatment will continue to be in place also under Basel III as well as under the draft proposal. More beneficial capital requirements for exposures to SMEs would require a revision to the international Basel framework in the first place. This question is subject to a review clause in the proposal.

It is crucial that risk weights of SME lending are carefully assessed. For this reason, the EBA is requested to analyse and report by 1 September 2012 on the current risk weights, testing the possibilities for a reduction, taking into consideration a scenario with a reduction by one third in relation to the current situation. In this context, the Commission intends to report to the European Parliament and the Council on this analysis and would put forward legislative proposals for the review of the SMEs' risk weight, as appropriate.

Moreover the Commission, consulting EBA, will, within 24 months after the entry into force of this Regulation, report on lending to small and medium-sized enterprises and natural persons and shall submit this report to the European Parliament and the Council together with any appropriate proposal.

5.3.2. Treatment of exposures arising from trade finance activities

BCBS is expected to finalise their view on whether more beneficial capital requirements for trade finance should be set only towards the end of 2011. Consequently, this is not reflected in this proposal, but a review clause on the treatment of these exposures has been provided for.

5.4. Counterparty credit risk (Part Three, Title II, Chapter 6)

In Basel III, banks will be required to hold additional capital against the risk that the credit quality of the counterparty could deteriorate. This proposal would introduce this new capital charge. However, Basel III recognises losses that a bank writes down upfront with immediate impact on the profit and loss account (incurred credit valuation adjustments) only to a very limited extent. On the basis of the feedback to a consultation by the Commission in February/March 2011 on this issue and with the support of a vast majority of Member States, this proposal would allow banks using the advanced approach for credit risk a greater, however prudent, recognition of such losses and therefore better reflect the common practice of provisioning for future losses exercised by many EU banks.

5.5. Liquidity (Part Six)

5.5.1. Liquidity Coverage Requirement

The Commission is firmly committed to reaching a harmonised Liquidity Coverage Requirement by 2015. At the same time, uncertainties about possible unintended consequences and the observation period of Basel III should be taken very seriously. The following elements ensure introducing a binding requirement only after an appropriate review:

– a general requirement to apply from 2013 for banks to keep appropriate liquidity coverage as a first step;

– an obligation to report to national authorities the elements needed to verify that they keep an adequate liquidity coverage on the basis of the uniform reporting formats developed by the European Banking Authority in order to test the Basel III criteria;

– a power for the Commission to further specify the Liquidity Coverage Requirement in line with the conclusions from the observation period and international developments. Avoiding the lengthy ordinary legislative procedure (via co-decision) would allow making the maximum use of the observation period and being able to defer calibration towards the end of this observation period.

The liquidity coverage requirement will, within groups of credit institutions or investment firms or both, in principle apply at the level of every individual credit institution or investment firm. By contrast to branches, which do not have a legal personality, credit institutions or investment firms are themselves subject to payment obligations that may lead to liquidity outflows under stress circumstances. It cannot be taken for granted that credit institutions or investment firms will receive liquidity support from other credit institutions or investment firms belonging to the same group when they experience difficulties to meet their

payment obligations. However, subject to stringent conditions, competent authorities will be able to waive the application to individual credit institutions or investment firms and subject those credit institutions or investment firms to a consolidated requirement. Those stringent conditions can be found in Article 7(1) and they ensure, *inter alia*, that the credit institutions or investment firms are, in a legally enforceable manner, committed to support each other and have the actual ability to do so.

In the case of a group with credit institutions or investment firms in several Member States, all competent authorities of the individual credit institutions or investment firms must, in order for the waiver of individual requirements to be available, agree *together* that the conditions for the waiver are met. In such cross-border situations, there are, in addition to the conditions in Article 7(1), further conditions in Article 7(2). Those further conditions require that all of the individual competent authorities must be satisfied with the liquidity management of the group and with how much liquidity the individual credit institutions or investment firms of the group have. In case of disagreement, each competent authority of an individual credit institution or investment firm will decide alone about whether the waiver would apply.

There is an additional possibility for EBA to mediate in case of disagreement between the competent authorities. The result of the mediation is however only binding regarding the conditions in Article 7(1). The individual competent authorities retain the last say regarding the conditions in Article 7(2), i.e. regarding the adequacy of the group's liquidity management and regarding the liquidity adequacy of the individual credit institutions or investment firms.

5.5.2. Net Stable Funding Requirement

The Commission is firmly committed to reaching a minimum standard on the Net Stable Funding Requirement by 1 January 2018. Since Basel III sets out an observation period until 2018 in this regard, there would be sufficient time to prepare a stable funding requirement in the form of a co-decision proposal to be agreed between Parliament and Council before the end of the observation period.

5.6. Leverage (Part Seven)

The Leverage Ratio is a new regulatory tool in the EU. In line with Basel III, the Commission does not propose a Leverage Ratio as a binding instrument at this stage but first as an additional feature that can be applied on individual banks at the discretion of supervisory authorities with a view to migrating to a binding ('pillar one') measure in 2018, based on appropriate review and calibration. Reporting obligations would allow a review and an informed decision on its introduction as a binding requirement in 2018. In line with the Basel III, it is proposed that institutions publish their Leverage Ratios from 2015.

5.7. Basel I limit (Part Thirteen)

Basel II requires more capital to be held for riskier business than would be required under Basel I. For less risky business, Basel II requires less capital to be held than Basel I. This is because Basel II was designed to be more risk sensitive than Basel I.

To prevent banks from being subject to inappropriately low capital requirements, Basel II does not allow a lower capital than 80% of the capital that would have been required under Basel I. This requirement expired at the end of 2009, but Directive 2010/76/EC reinstated it until the end of 2011. Based on the extension of this requirement by BCBS in July 2009, the

draft proposal reinstates it until 2015. Competent authorities may, after having consulted EBA, waive the application of the Basel I limit to an institution provided that all requirements for the use of the advanced approaches for credit and operational risks are met.

6. BUDGETARY IMPLICATIONS

EBA will play an important role in achieving the objective of this Regulation, as the proposals ask it to develop more than 50 binding technical standards (BTS) on various policy issues. BTS – which would eventually be endorsed by the Commission – will be key to ensure that provisions of highly technical nature are implemented uniformly across the EU and that the proposed policies work as intended. For this significant workload, EBA would need more resources than those already provided within the context of its establishment under Regulation (EU) 1093/2010. Further details are set out in the attached legislative financial statement.

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on prudential requirements for credit institutions and investment firms

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national Parliaments,

Having regard to the opinion of the European Economic and Social Committee[7],

Acting in accordance with the ordinary legislative procedure,

Whereas:

(1) The G20 Declaration of 2 April 2009[8] on Strengthening of the Financial System called for internationally consistent efforts that are aimed at strengthening transparency, accountability and regulation by, improving the quantity and quality of capital in the banking system once the economic recovery is assured. The declaration also called for introducing a supplementary non-risk based measure to contain the build-up of leverage in the banking system, and developing a framework for stronger liquidity buffers. In response to the mandate given by the G20, in September 2009 the Group of Central Bank Governors and Heads of Supervision (GHOS), agreed on a number of measures to strengthen the regulation of the banking sector. These measures were endorsed by the G20 leaders at their Pittsburgh Summit of 24-25 September 2009 and were set out in detail in December 2009. In July and September 2010, GHOS issued two further announcements on design and calibration of these new measures, and in December 2010, the Basel Committee on Banking Supervision (BCBS) published the final measures, that are referred to as Basel III.

(2) The High Level Group on Financial Supervision in the EU chaired by Jacques de Larosière invited the European Union to develop a more harmonised set of financial regulation. In the context of the future European supervisory architecture, the European Council of 18 and 19 June 2009 also stressed the need to establish a 'European Single Rule Book' applicable to all credit institutions and investment firms in the Single Market.

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7 OJ C , , p. .

8 http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf.

(3) Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006[9] relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006[10] on the capital adequacy of investment firms and credit institutions ("institutions") have been significantly amended on several occasions. Many provisions of Directives 2006/48/EC and 2006/49/EC are applicable to both credit institutions and investment firms. Irder to ensure a coherent application of those provisions, it would be desirable to merge these provisions into new legislation applicable to both credit institutions and investment firms. For sake of clarity, the provisions of the Annexes to those Directives should be integrated into the enacting terms of this new legislation.

(4) That new legislation should consist of two different legal instruments, a Directive and this Regulation. Together, both legal instruments should form the legal framework governing the access to the activity, the supervisory framework and the prudential rules for credit institutions and investment firms. This Regulation should therefore be read together with the Directive.

(5) Directive [inserted by OP], based on Article 53 (1) TFEU, should contain the provisions concerning the access to the activity of credit institutions and investment firms, the modalities for their governance, and their supervisory framework, such as provisions governing the authorisation of the business, the acquisition of qualifying holdings, the exercise of the freedom of establishment and of the freedom to provide services, the powers of supervisory authorities of home and host Member States in this regard and the provisions governing the initial capital and the supervisory review of credit institutions and investment firms.

(6) This Regulation should contain the prudential requirements for credit institutions and investment firms that relate strictly to the functioning of banking and financial services markets and are meant to ensure the financial stability of the operators on these markets as well as a high level of protection of investors and depositors. This directly applicable legal act aims at contributing in a determining manner to the smooth functioning of the internal market and should, consequently, be based on the provisions of Article 114 TFEU, as interpreted in accordance with the consistent case-law of the Court of Justice of the European Union .

(7) Directives 2006/48/EC and 2006/49/EC, although having harmonised the rules of Member States in the area of prudential supervision to a certain degree, include a significant number of options and discretions, and Member States are still permitted to impose stricter rules than those laid down by those Directives. This results in divergences between national rules which are such as to obstruct the fundamental freedoms and thus have a direct effect on the functioning of the internal market and cause significant distortions of competition. In particular, such divergences hamper the cross-border provision of services and the establishment in other Member since each time different rules have to be assessed and complied with by operators when doing business in another Member State. In addition, credit institutions and investment firms authorized in different Member States are often subject to different requirements, leading to significant distortions of competition. Divergent development of national laws creates potential and actual obstacles to the smooth functioning of the internal

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[9] OJ L 177, 30.6.2006, p. 1.

[10] OJ L 177, 30.6.2006, p. 201.

market due to unequal conditions of operation and difficulties for credit institutions and investment firms operating in different juridical systems across the Union.

(8) In order to remove the remaining obstacles to trade and significant distortions of competition resulting from divergences between national laws and to prevent any further likely obstacles to trade and significant distortions of competition from arising, it is therefore necessary to adopt a Regulation establishing uniform rules applicable in all Member States.

(9) Shaping prudential requirements in the form of a Regulation would ensure that those requirements will be directly applicable to them. This would ensure uniform conditions by preventing diverging national requirements as a result of the transposition of a Directive. This Regulation would entail that institutions follow the same rules in all the Union, which would also boost confidence in the stability of credit institutions and investment firms, especially in times of stress. A Regulation would also reduce regulatory complexity and firms' compliance costs, especially for credit institutions and investment firms operating on a cross-border basis, and contribute to eliminating competitive distortions. With regard to the peculiarity of immovable property markets which are characterised by economic developments and jurisdictional differences that are specific to Member States, regions or local areas, competent authorities should be allowed to set higher risks weights or to apply stricter criteria based on default experience and expected market developments to exposures secured by mortgages on immovable property in specific areas.

(10) Member States should have the power to maintain or introduce national provisions where this Regulation does not provide for uniform rules provided that those national provisions are not in contradiction with Union law or do not undermine their application.

(11) Where Member States adopt guidelines of general scope, in particular in areas where the adoption by the Commission of draft technical standards is pending, those guidelines shall neither contradict Union law nor undermine its application.

(12) This Regulation does not prevent Member States from imposing equivalent requirements on undertakings that do not fall within its scope.

(13) The general prudential requirements set out in this Regulation are supplemented by individual arrangements that are decided by the competent authorities as a result of their ongoing supervisory review of each individual credit institution and investment firm. The range of such supervisory arrangements should be set out in a Directive since the competent authorities should be able to exert their judgment as to which arrangements should be imposed.

(14) This Regulation should not affect the ability of competent authorities to impose specific requirements under the supervisory review and evaluation process set out in Directive [inserted by OP] that should be tailored to the specific risk profile of credit institutions and investment firms.

(15) Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority,[11] established the

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[11] OJ L 331, 15.12.2010, p. 12.

European Banking Authority (EBA). That Regulation aims at upgrading the quality and consistency of national supervision and strengthening oversight of cross-border groups.

(16) Regulation (EU) No 1093/2010 requires EBA to act within the scope of Directives 2006/48/EC and 2006/49/EC. EBA is also required to act in the field of activities of credit institutions and investment firms in relation to issues not directly covered in those Directives, provided that such actions are necessary to ensure the effective and consistent application of those acts. This Regulation should take into account the role and function of EBA and facilitate the exercise of EBA's powers set out in that Regulation.

(17) Equivalent financial requirements for credit institutions and investment firms are necessary to ensure similar safeguards for savers and fair conditions of competition between comparable groups of credit institutions and investment firms

(18) Since credit institutions and investment firms in the internal market are engaged in direct competition, monitoring requirements should be equivalent throughout the Union.

(19) Whenever in the course of supervision it is necessary to determine the amount of the consolidated own funds of a group of credit institutions and investment firms, the calculation should be effected in accordance with this Regulation.

(20) According to this Regulation own funds requirements apply on an individual and consolidated basis, unless competent authorities disapply supervision on an individual basis where they deem this appropriate. Individual, consolidated and cross-border consolidated supervision are useful tools in overseeing credit institutions and investment firms.

(21) In order to ensure adequate solvency of credit institutions and investment firms within a group it is essential that the capital requirements apply on the basis of the consolidated situation of these institutions in the group. In order to ensure that own funds are appropriately distributed within the group and available to protect savings where needed, the capital requirements should apply to individual credit institutions and investment firms within a group, unless this objective can be effectively otherwise achieved.

(22) The precise accounting technique to be used for the calculation of own funds, their adequacy for the risk to which a credit institution or investment firm is exposed, and for the assessment of the concentration of exposures should take account of the provisions of Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions[12], which incorporates certain adaptations of the provisions of Seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts[13] or of Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the

[12] OJ L 372, 31.12.1986, p. 1.
[13] OJ L 193, 18.7.1983, p. 1.

application of international accounting standards[14], whichever governs the accounting of the credit institutions and investment firms under national law.

(23) For the purposes of ensuring adequate solvency it is important to lay down capital requirements which weight assets and off-balance-sheet items according to the degree of risk.

(24) On 26 June 2004 the BCBS adopted a framework agreement on the international convergence of capital measurement and capital requirements ('Basel II framework'). The provisions in Directive 2006/48/EC and 2006/49/EC that this Regulation has taken over form an equivalent to the provisions of the Basel II framework agreement. Consequently, by incorporating the supplementary elements of the Basel III this Regulation forms an equivalent to the provisions of the Basel II and III agreements.

(25) It is essential to take account of the diversity of credit institutions and investment firms in the Union by providing alternative approaches to the calculation of capital requirements for credit risk incorporating different levels of risk-sensitivity and requiring different degrees of sophistication. Use of external ratings and credit institutions and investment firms' own estimates of individual credit risk parameters represents a significant enhancement in the risk-sensitivity and prudential soundness of the credit risk rules. There should be appropriate incentives for credit institutions and investment firms to move towards the more risk-sensitive approaches. In producing the estimates needed to apply the approaches to credit risk of this Regulation, credit institutions and investment firms should enhance credit risk measurement and management processes of credit institutions and investment firms to make methods for determining credit institutions and investment firms' regulatory own funds requirements available that reflect the sophistication of individual credit institutions and investment firms' processes. In this regard, the processing of data in connection with the incurring and management of exposures to customers should be considered to include the development and validation of credit risk management and measurement systems. That serves not only to fulfil the legitimate interest of credit institutions and investment firms but also the purpose of this Regulation, to use better methods for risk measurement and management and also use them for regulatory own funds purposes.

(26) The capital requirements should be proportionate to the risks addressed. In particular the reduction in risk levels deriving from having a large number of relatively small exposures should be reflected in the requirements.

(27) In line with the decision of the BCBS, as endorsed by the GHOS on 10 January 2011, all Additional Tier 1 and Tier 2 instruments of an institution should be fully and permanently written down or converted fully into Common Equity Tier 1 capital at the point of non-viability of the institution.

(28) The provisions of this Regulation respect the principle of proportionality, having regard in particular to the diversity in size and scale of operations and to the range of activities of credit institutions and investment firms. Respect of the principle of proportionality also means that the simplest possible rating procedures, even in the

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[14] OJ L 243, 11.9.2002, p. 1.

Internal Ratings Based Approach ('IRB Approach'), are recognised for retail exposures.

(29) The 'evolutionary' nature of this Regulation enables credit institutions and investment firms to choose amongst three approaches of varying complexity. In order to allow especially small credit institutions and investment firms to opt for the more risk-sensitive IRB Approach, the relevant provisions should be read as such that exposure classes include all exposures that are, directly or indirectly, put on a par with them throughout this Regulation. As a general rule, the competent authorities should not discriminate between the three approaches with regard to the Supervisory Review Process, i.e. credit institutions and investment firms operating according to the provisions of the Standardised Approach should not for that reason alone be supervised on a stricter basis.

(30) Increased recognition should be given to techniques of credit risk mitigation within a framework of rules designed to ensure that solvency is not undermined by undue recognition. The relevant Member States' current customary banking collateral for mitigating credit risks should wherever possible be recognised in the Standardised Approach, but also in the other approaches.

(31) In order to ensure that the risks and risk reductions arising from credit institutions and investment firms' securitisation activities and investments are appropriately reflected in the capital requirements of credit institutions and investment firms it is necessary to include rules providing for a risk-sensitive and prudentially sound treatment of such activities and investments.

(32) Operational risk is a significant risk faced by credit institutions and investment firms requiring coverage by own funds. It is essential to take account of the diversity of credit institutions and investment firms in the Union by providing alternative approaches to the calculation of operational risk requirements incorporating different levels of risk-sensitivity and requiring different degrees of sophistication. There should be appropriate incentives for credit institutions and investment firms to move towards the more risk-sensitive approaches. In view of the emerging state of the art for the measurement and management of operational risk the rules should be kept under review and updated as appropriate including in relation to the charges for different business lines and the recognition of risk mitigation techniques. Particular attention should be paid in this regard to taking insurance into account in the simple approaches to calculating capital requirements for operational risk.

(33) The monitoring and control of a credit institution's exposures should be an integral part of its supervision. Therefore, excessive concentration of exposures to a single client or group of connected clients may result in an unacceptable risk of loss. Such a situation can be considered prejudicial to the solvency of a credit institution.

(34) In determining the existence of a group of connected clients and thus exposures constituting a single risk, it is also important to take into account risks arising from a common source of significant funding provided by the credit institution or investment firm itself, its financial group or its connected parties.

(35) While it is desirable to base the calculation of the exposure value on that provided for the purposes of own funds requirements, it is appropriate to adopt rules for the monitoring of large exposures without applying risk weightings or degrees of risk.

Moreover, the credit risk mitigation techniques applied in the solvency regime were designed with the assumption of a well-diversified credit risk. In the case of large exposures dealing with single name concentration risk, credit risk is not well-diversified. The effects of those techniques should therefore be subject to prudential safeguards. In this context, it is necessary to provide for an effective recovery of credit protection for the purposes of large exposures.

(36) Since a loss arising from an exposure to a credit institution or an investment firm can be as severe as a loss from any other exposure, such exposures should be treated and reported in the same manner as any other exposures. However, an alternative quantitative limit has been introduced to alleviate the disproportionate impact of such an approach on smaller institutions. In addition, very short-term exposures related to money transmission including the execution of payment services, clearing, settlement and custody services to clients are exempt to facilitate the smooth functioning of financial markets and of the related infrastructure. Those services cover, for example, the execution of cash clearing and settlement and similar activities to facilitate settlement. The related exposures include exposures which might not be foreseeable and are therefore not under the full control of a credit institution, inter alia, balances on inter-bank accounts resulting from client payments, including credited or debited fees and interest, and other payments for client services, as well as collateral given or received.

(37) It is important that the misalignment between the interest of undertakings that 're-package' loans into tradable securities and other financial instruments (originators or sponsors) and undertakings that invest in these securities or instruments (investors) be removed. It is also important that the interests of the originator or sponsor and the interests of investors be aligned. To achieve this, the originator or sponsor should retain a significant interest in the underlying assets. It is therefore important for the originators or the sponsors to retain exposure to the risk of the loans in question. More generally, securitisation transactions should not be structured in such a way as to avoid the application of the retention requirement, in particular through any fee or premium structure or both. Such retention should be applicable in all situations where the economic substance of a securitisation is applicable, whatever legal structures or instruments are used to obtain this economic substance. In particular where credit risk is transferred by securitisation, investors should make their decisions only after conducting thorough due diligence, for which they need adequate information about the securitisations.

(38) There should be no multiple applications of the retention requirement. For any given securitisation it suffices that only one of the originator, the sponsor or the original lender is subject to the requirement. Similarly, where securitisation transactions contain other securitisations as an underlying, the retention requirement should be applied only to the securitisation which is subject to the investment. Purchased receivables should not be subject to the retention requirement if they arise from corporate activity where they are transferred or sold at a discount to finance such activity. Competent authorities should apply the risk weight in relation to non-compliance with due diligence and risk management obligations in relation to securitisation for non-trivial breaches of policies and procedures which are relevant to the analysis of the underlying risks.

(39) Due diligence should be used in order properly to assess the risks arising from securitisation exposures for both the trading book and the non-trading book. In

addition, due diligence obligations need to be proportionate. Due diligence procedures should contribute to building greater confidence between originators, sponsors and investors. It is therefore desirable that relevant information concerning the due diligence procedures is properly disclosed.

(40) When a credit institution or investment firm incurs an exposure to its own parent undertaking or to other subsidiaries of its parent undertaking, particular prudence is necessary. The management of exposures incurred by credit institutions and investment firms should be carried out in a fully autonomous manner, in accordance with the principles of sound management, without regard to any other considerations. In the field of large exposures, specific standards, including more stringent restrictions, should be laid down for exposures incurred by a credit institution to its own group. Such standards need not, however be applied where the parent undertaking is a financial holding company or a credit institution or where the other subsidiaries are either credit or financial institutions or undertakings offering ancillary services, provided that all such undertakings are covered by the supervision of the credit institution on a consolidated basis.

(41) In view of the risk-sensitivity of the rules relating to capital requirements, it is desirable to keep under review whether these have significant effects on the economic cycle. The Commission, taking into account the contribution of the European Central Bank should report on these aspects to the European Parliament and to the Council.

(42) The capital requirements for commodity dealers, including those dealers currently exempt from the requirements of Directive 2004/39/EC, should be reviewed.

(43) The goal of liberalisation of gas and electricity markets is both economically and politically important for the Community. With this in mind, the capital requirements and other prudential rules to be applied to firms active in those markets should be proportionate and should not unduly interfere with achievement of the goal of liberalisation. This goal should, in particular, be kept in mind when reviews of this Regulation are carried out.

(44) Credit institutions and investment firms investing in re-securitisations should exercise due diligence also with regard to the underlying securitisations and the non-securitisation exposures ultimately underlying the former. Credit institutions and investment firms should assess whether exposures in the context of asset-backed commercial paper programmes constitute re-securitisation exposures, including those in the context of programmes which acquire senior tranches of separate pools of whole loans where none of those loans is a securitisation or re-securitisation exposure, and where the first-loss protection for each investment is provided by the seller of the loans. In the latter situation, a pool- specific liquidity facility should generally not be considered a re-securitisation exposure because it represents a tranche of a single asset pool (that is, the applicable pool of whole loans) which contains no securitisation exposures. By contrast, a programme-wide credit enhancement covering only some of the losses above the seller-provided protection across the various pools generally would constitute a tranching of the risk of a pool of multiple assets containing at least one securitisation exposure, and would therefore be a re-securitisation exposure. Nevertheless, if such a programme funds itself entirely with a single class of commercial paper, and if either the programme-wide credit enhancement is not a re-securitisation or the commercial paper is fully supported by the sponsoring credit institution or investment firm, leaving the commercial paper investor effectively

exposed to the default risk of the sponsor instead of the underlying pools or assets, then that commercial paper generally should not be considered a re-securitisation exposure.

(45) The provisions on prudent valuation for the trading book should apply to all instruments measured at fair value, whether in the trading book or non- trading book of credit institutions and investment firms. It should be clarified that, where the application of prudent valuation would lead to a lower carrying value than actually recognised in the accounting, the absolute value of the difference should be deducted from own funds.

(46) Credit institutions and investment firms should have a choice whether to apply a capital requirement to or deduct from Common Equity Tier 1 items those securitisation positions that receive a 1 250 % risk weight under this Regulation, irrespective of whether the positions are in the trading or the non-trading book.

(47) Originator or sponsor institutions should not be able to circumvent the prohibition of implicit support by using their trading books in order to provide such support.

(48) Directive 2006/48/EC introduced a preferential risk weight under the standardised approach for exposures to small or medium sized enterprises or natural persons and the possibility for institutions to apply internal ratings based approaches where they themselves estimate the risk weight, reflecting the soundness of their own particular underwriting criteria. The preferential risk weights should continue to be in place also under this Regulation. However, the possible merits of lowering the risk weights or expanding their application to more exposures should be reviewed within 24 months after the entry into force of this Regulation. Such review should be evidence-based and take into account reliable data on credit losses on exposures to small or medium sized enterprises or natural persons during a full economic cycle. The impact on lending to consumers should be given particular attention in the context of this review.

(49) Without prejudice to the disclosures explicitly required by this Regulation, the aim of the disclosure requirements should be to provide market participants with accurate and comprehensive information regarding the risk profile of individual institutions. Credit institutions and investment firms should therefore be required to disclose additional information not explicitly listed in this Regulation where such disclosure is necessary to meet that aim.

(50) Where an external credit assessment for a securitisation position incorporates the effect of credit protection provided by the investing institution itself, the institution should not be able to benefit from the lower risk weight resulting from that protection. This should not lead to the deduction from capital of the securitisation if there are other ways to determine a risk weight in line with the actual risk of the position, not taking into account such credit protection.

(51) Given their recent weak performance, the standards for internal models to calculate market risk capital requirements should be strengthened. In particular, their capture of risks should be completed regarding credit risks in the trading book. Furthermore, capital charges should include a component adequate to stress conditions to strengthen capital requirements in view of deteriorating market conditions and in order to reduce the potential for pro-cyclicality. Credit institutions and investment firms should also carry out reverse stress tests to examine what scenarios could challenge the viability of

the institution unless they can prove that such a test is dispensable. Given the recent particular difficulties of treating securitisation positions using approaches based on internal models, the ability of credit institutions and investment firms to model securitisation risks in the trading book should be limited and a standardised capital charge for securitisation positions in the trading book should be required by default.

(52) This Regulation lays down limited exceptions for certain correlation trading activities, in accordance with which an institution may be permitted by its supervisor to calculate a comprehensive risk capital charge subject to strict requirements. In such cases the institution should be required to subject those activities to a capital charge equal to the higher of the capital charge in accordance with that internally developed approach and 8 % of the capital charge for specific risk in accordance with the standardised measurement method. It should not be required to subject those exposures to the incremental risk charge but they should be incorporated into both the value-at-risk measures and the stressed value-at-risk measures.

(53) In light of the nature and magnitude of unexpected losses experienced by credit institutions and investment firms during the financial and economic crisis, it is necessary to improve further the quality and harmonisation of own funds that credit institutions and investment firms are required to hold. This should include the introduction of a new definition of the core elements of capital available to absorb unexpected losses as they arise, enhancements to the definition of hybrid capital and uniform prudential adjustments to own funds. It is also necessary to raise significantly the level of own funds, including new capital ratios focusing on the core elements of own funds available to absorb losses as they arise.

(54) For the purposes of strengthening market discipline and enhancing financial stability it is necessary to introduce more detailed requirements for disclosure of the form and nature of regulatory capital and prudential adjustments made in order to ensure that investors and deposits are sufficiently well informed about the solvency of credit institutions and investment firms.

(55) The new definition of capital and regulatory capital requirements should be introduced in a manner that takes account of the fact that there are different national starting points and circumstances, with initial variance around the new standards reducing over the transition period. In order to ensure the appropriate continuity in the level of own funds, existing public sector capital injections will be grandfathered for the extent of the transition period.

(56) Directive 2006/48/EC required credit institutions to provide own funds that are at least equal to specified minimum amounts until 31 December 2011. In the light of the continuing effects of the financial crisis in the banking sector and the extension of the transitional arrangements for capital requirements adopted by the BCBS, it is appropriate to reintroduce a lower limit for a limited period of time until sufficient amounts of own funds have been established in accordance with the transitional arrangements for own funds provided for in this Regulation that will be progressively phased in from 2013 to 2019. **For groups which include significant banking or investment business and insurance business, Directive 2002/87/EC on Financial Conglomerates, provides specific rules to address such 'double counting' of capital. Directive 2002/87/EC is based on internationally agreed principles for dealing with risk across sectors. This proposal strengthens the way these Financial Conglomerates rules shall apply to bank and investment firm groups,**

ensuring their robust and consistent application. Any further changes that are necessary will be addressed in the review of Directive 2002/87/EC, due in 2012.

(57) The financial crisis highlighted that credit institutions and investment firms massively underestimated the level of counterparty credit risk associated with over-the-counter (OTC) derivatives. This prompted the G20 Leaders, in September 2009, to call for more OTC derivatives to be cleared through a Central Counterparty (CCP). Furthermore, they asked to subject those OTC derivatives that could not be cleared centrally to higher own funds requirements in order to properly reflect the higher risks associated with them.

(58) Following the G-20 Leaders' call, the BCBS, as part of Basel III, materially changed the counterparty credit risk regime. Basel III is expected to significantly increase the own fund requirements associated with credit institutions' and investment firms' OTC derivatives and securities financing transactions and to create important incentives for credit institutions and investment firms to use CCPs. Basel III is also expected to provide further incentives to strengthen the risk management of counterparty credit exposures and to revise the current regime for the treatment of counterparty credit risk exposures to CCPs.

(59) Institutions should hold additional own funds due to credit valuation adjustment risk arising from OTC derivatives. Institutions should also apply a higher asset value correlation in the calculation of the own fund requirements for counterparty credit risk exposures arising from OTC derivatives and securities-financing transactions to certain financial institutions. Credit institutions and investment firms should also considerably improve measurement and management of counterparty credit risk by better addressing wrong-way risk, highly leveraged counterparties and collateral, accompanied by the corresponding enhancements in the areas of back-testing and stress testing.

(60) Trade exposures to CCPs usually benefit from the multilateral netting and loss-sharing mechanism provided by CCPs. As a consequence, they involve a very low counterparty credit risk and should therefore be subject to a very low own funds requirement. At the same time, this requirement should be positive in order to ensure that credit institutions and investment firms track and monitor their exposures to CCPs as part of good risk management and to reflect that even trade exposures to CCPs are not risk-free.

(61) A CCP's default fund is a mechanism that allows the sharing (mutualisation) of losses among the CCP's clearing members. It is used in case the losses incurred by the CCP following the default of a clearing member are greater than the margins and default fund contributions provided by that clearing member and any other defence the CCP may use before recurring to the default fund contributions of the remaining clearing members. In view of this, the risk of loss associated with exposures from default fund contributions is higher than the one associated with trade exposures. Therefore, this type of exposures should be subject to a higher own funds requirement.

(62) The “hypothetical capital” of a CCP should be a variable needed to determine the own funds requirement for a clearing member’s exposures from its contributions to a CCP’s default fund. It should not be understood as anything else. In particular, it should not be understood as the amount of capital that a CCP is required to hold by its competent authority.

(63) The review of the treatment of counterparty credit risk, and in particular putting in place higher own funds requirements for bilateral derivative contracts in order to reflect the higher risk that such contracts pose to the financial system, forms an integral part of the Commission's efforts to ensure efficient, safe and sound derivatives markets. Consequently, this Regulation complements the Commission proposal for a Regulation on OTC derivatives, central counterparties and trade repositories, of 15 September 2010[15].

(64) The years preceding the financial crisis were characterised by an excessive build up in credit institutions' and investment firms' exposures in relation to their own funds (leverage). During the financial crisis, losses and the shortage of funding forced credit institutions and investment firms to reduce significantly their leverage over a short period of time. This amplified downward pressures on asset prices, causing further losses for both credit institutions and investment firms which in turn led to further declines in their own funds. The ultimate results of this negative spiral were a reduction in the availability of credit to the real economy and a deeper and longer crisis.

(65) Risk-based own funds requirements are essential to ensure sufficient own funds to cover unexpected losses. However, the crisis has shown that these requirements alone are not sufficient to prevent credit institutions and investment firms from taking on excessive and unsustainable leverage risk.

(66) In September 2009, G-20 leaders committed to developing internationally-agreed rules to discourage an excessive leverage. To this end, they supported the introduction of a leverage ratio as a supplementary measure to the Basel II framework.

(67) In December 2010, the BCBS published guidelines defining the methodology for calculating the leverage ratio. These rules foresee an observation period that will run from 1 January 2013 until 1 January 2017 during which the leverage ratio, its components and its behaviour relative to the risk-based requirement will be monitored. Based on the results of the observation period the BCBS intends to make any final adjustments to the definition and calibration of the leverage ratio in the first half of 2017, with a view to migrating to a binding requirement on 1 January 2018 based on appropriate review and calibration. The BCBS guidelines also foresee the disclosure of the leverage ratio and its components starting from 1 January 2015.

(68) A leverage ratio is a new regulatory and supervisory tool for the Union. In line with international agreements, it should be introduced first as an additional feature that can be applied on individual institutions at the discretion of supervisory authorities. Reporting obligations for institutions would allow appropriate review and calibration, with a view to migrating to a binding measure in 2018.

(69) When reviewing the impact of the leverage ratio on different business models, particular attention should be paid to business models which are considered to entail low risk, such as mortgage lending and specialised lending with regional governments, local authorities or public sector entities.

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15 COM/2010/0484 final.

(70) In order to facilitate the review, credit institutions and investment firms should during an observation period monitor the level and changes in the leverage ratio as well as leverage risk as part of the internal capital adequacy assessment process (ICAAP). This monitoring should be included in the supervisory review process.

(71) Restrictions on variable remuneration are an important element in ensuring that credit institutions and investment firms rebuild their capital levels when operating within the buffer range. Credit institutions and investment firms are already subject to the principle that awards and discretionary payments of variable remuneration to those categories of staff whose professional activities have a material impact on the risk profile of the institution have to be sustainable, having regard to the financial situation of the institution. In order to ensure that an institution restores its levels of own funds in a timely manner, it is appropriate to align the award of variable remuneration and discretionary pension benefits with the profit situation of the institution during any period in which the combined buffer requirement is not met.

(72) Good governance structures, transparency and disclosure are essential for sound remuneration policies. In order to ensure adequate transparency to the market of their remuneration structures and the associated risk, credit institutions and investments firms should disclose detailed information on their remuneration policies, practices and, for reasons of confidentiality, aggregated amounts for those members of staff whose professional activities have a material impact on the risk profile of the credit institution or investment firm. That information should be made available to all stakeholders.

(73) Directive 95/46 of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data[16] and Regulation (EU) No 45/2001 of the European Parliament and of the Council of 18 December 2000 on the protection of individuals with regard to the processing of personal data by the EU institutions and bodies and and on the free movement of such data[17], should be fully applicable to the processing of personal data for the purposes of this Regulation

(74) Credit institutions and investment firms should hold a stock of liquid assets that they can use to cover liquidity needs in a short term liquidity stress. When they use the stock, they should put in place a plan to restore their holdings of liquid assets and competent authorities should ensure the adequacy of the plan and its implementation.

(75) The stock of liquid assets should be available at any time to meet the liquidity outflows. The level of liquidity needs in a short term liquidity stress should be determined in a standardised manner so as to ensure a uniform soundness standard and a level playing field. It should be ensured that such a standardised determination has no unintended consequences for financial markets, credit extension and economic growth, also taking into account different business models and funding environments of credit institutions and investment firms across the Union. To this end, the liquidity coverage requirement should be subject to an observation period. Based on the observations and supported by EBA, the Commission should confirm or adjust the liquidity coverage requirement by means of a delegated act.

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[16] OJ L 281, 23.11.1995, p. 31.
[17] OJ L 8, 12.1.2001, p. 1.

(76) Apart from short-term liquidity needs, credit institutions and investment firms should also adopt funding structures that are stable at a longer term horizon. In December 2010, the BCBS agreed that the NSFR will move to a minimum standard by 1 January 2018 and that the BCBS will put in place rigorous reporting processes to monitor the ratio during a transition period and will continue to review the implications of these standards for financial markets, credit extension and economic growth, addressing unintended consequences as necessary. The BCBS thus agreed that the NSFR will be subject to an observation period and will include a review clause. In this context, EBA should, based on reporting required by this Regulation, evaluate how a stable funding requirement should be designed. Based on this evaluation, the Commission should report to Council and European Parliament together with any appropriate proposals in order to introduce such a requirement by 2018.

(77) Weaknesses in corporate governance in a number of credit institutions and investment firms have contributed to excessive and imprudent risk-taking in the banking sector which led to the failure of individual institutions and systemic problems.

(78) In order to facilitate the monitoring of institutions' corporate governance practices and improve market discipline, credit institutions and investment firms should publicly disclose their corporate governance arrangements. Their management bodies should approve and publicly disclose a statement providing assurance to the public that these arrangements are adequate and efficient.

(79) In order to ensure progressive convergence between the level of own funds and the prudential adjustments applied the definition of own funds across the Union and to the definition of own funds laid down in this Regulation during a transition period, the phasing in of the own funds requirements of this Regulation should occur gradually. It is vital to ensure that this phasing in is consistent with the recent enhancements made by Member States to the required levels of own funds and to the definition of own funds in place in the Member States. To that end, during the transition period the competent authorities should determine within defined lower and upper limits how rapidly to introduce the required level of own funds and prudential adjustments laid down in this Regulation.

(80) In order to facilitate smooth transition from divergent prudential adjustments currently applied in Member States to the set of prudential adjustments laid down in this Regulation, competent authorities should be able during a transition period to continue to require institutions, to a limited extent, to make prudential adjustments to own funds that are a derogation from this Regulation.

(81) In order to ensure that institutions have sufficient time to meet the new required levels and definition of own funds, certain capital instruments that do not comply with the definition of own funds laid down in this Regulation should be phased out between 1 January 2013 and 31 December 2021. In addition, certain state-injected instruments should be recognised fully in own funds for a limited period.

(82) In order to ensure progressive convergence towards uniform rules on disclosure by institutions to provide market participants with accurate and comprehensive information regarding the risk profile of individual institutions, disclosure requirements should be phased in gradually.

(83) In order to take account of market developments and experience in the application of this Regulation, the Commission should be required to submit to the European Parliament and the Council reports, as appropriate together with any legislative proposals, on the possible effect of capital requirements on the economic cycle of minimum, own funds requirements for exposures in the form of covered bonds, large exposures, liquidity requirements, leverage, exposures to transferred credit risk, counterparty credit risk and the original exposure method, retail exposures, on the definition of eligible capital, and the level of application of this regulation.

(84) In order to specify the requirements set out in this Regulation, the power to adopt acts in accordance with Article 290 of the TFEU should be delegated to the Commission in respect of technical adjustments to this Regulation to clarify definitions to ensure uniform application of this Regulation or to take account of developments on financial markets; to align terminology on, and frame definitions in accordance with, subsequent relevant acts; ; to adjust the provisions of that Regulation on own funds to reflect developments in accounting standards or Union legislation, or with regard to the convergence of supervisory practices; to expand the lists of exposure classes for the purposes of the Standardised Approach or the IRB Approach to take account of developments on financial markets; to adjust certain amounts relevant to those exposure classes to take into account the effects of inflation; to adjust the list and classification of off- balance sheet items; and to adjust specific provisions and technical criteria on the treatment of counterparty credit risk, the Standardised Approach and the IRB Approach, credit risk mitigation, securitisation, operational risk, market risk, liquidity, capital buffer, leverage and disclosure in order to take account of developments on financial markets or in accounting standards or Union legislation, or with regard to the convergence of supervisory practices and risk measurement and account of the outcome of the review of various matters relating to the scope of Directive 2004/39/EC.

(85) The power to adopt acts in accordance with Article 290 of the TFEU should also be delegated to the Commission in respect of prescribing a temporary reduction in the level of own funds or risk weights specified under that Regulation in order to take account of specific circumstances; to clarify the exemption of certain exposures from the application of provisions of that Regulation on large exposures; to specify amounts relevant to the calculation of capital requirements for the trading book to take account of developments in the economic and monetary field; to adjust the categories of investment firms eligible for certain derogations to required levels of own funds to take account of developments on financial markets; to clarify the requirement that investment firms hold own funds equivalent to one quarter of their fixed overheads of the preceding year to ensure uniform application of this Regulation; to determine the elements of own funds from which deductions of an institution's holdings of the instruments of relevant entities should be made; to introduce additional transitional provisions relating to the treatment of actuarial gains and losses in measuring defined benefit pension liabilities of institutions; to temporarily increase in the level of own funds; and to specify liquidity requirements.

(86) It is of particular importance that the Commission carry out appropriate consultations during its preparatory work, including at expert level. The Commission, when preparing and drawing up delegated acts, should ensure a simultaneous, timely and appropriate transmission of relevant documents to the European Parliament and Council.

(87) The Commission should also be empowered to adopt, by means of an urgency procedure, a temporary increase in the level of own funds, risk weights or any prudential requirements that is necessary to respond to market developments. Such provisions should be applicable for a period not exceeding 6 months, unless the European Parliament or the Council has objected to the delegated act within a period of six weeks. The Commission should state the reasons for the use of the urgency procedure.

(88) Technical standards in financial services should ensure harmonisation, uniform conditions and adequate protection of depositors, investors and consumers across the Union. As a body with highly specialised expertise, it would be efficient and appropriate to entrust EBA with the elaboration of draft regulatory and implementing technical standards which do not involve policy choices, for submission to the Commission.

(89) The Commission should adopt the draft regulatory technical standards developed by EBA in the areas of cooperative societies or similar institutions, certain own funds instruments, prudential adjustments, deductions from own funds, additional own funds instruments, minority interests, services ancillary to banking, the treatment of credit risk adjustment, probability of default, loss given default, corporate Governance, approaches to risk-weighting of assets, convergence of supervisory practices, liquidity, and transitional arrangements for own funds, by means of delegated acts pursuant to Article 290 TFEU and in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010. It is of particular importance that the Commission carry out appropriate consultations during its preparatory work, including at expert level.

(90) The Commission should also be empowered to adopt implementing technical standards by means of implementing acts pursuant to Article 291 TFEU and in accordance with Article 15 of Regulation (EU) No 1093/2010. EBA should be entrusted with drafting implementing technical standards for submission to the Commission with regard to consolidation, joint decisions, reporting, disclosure, exposures secured by mortgages, risk assessment, approaches to risk-weighting of assets, risk-weights and specification of certain exposures, the treatment of options and warrants, positions in equity instruments and foreign exchange, the use of internal models, leverage, and off-balance-sheet items.

(91) In order to ensure uniform conditions for the implementation of this Regulation, implementing powers should be conferred on the Commission. Those powers should be exercised in accordance with Regulation (EU) No 182/2011 of the European Parliament and of the Council on laying down the rules and general principles concerning mechanisms for control by the Member States of the Commission's exercise of implementing powers

HAVE ADOPTED THIS REGULATION:

PART ONE
GENERAL PROVISIONS

Title I
Subject matter, scope and definitions

Article 1
Scope

This Regulation lays down uniform rules concerning general prudential requirements that all institutions supervised under Directive [inserted by OP] must meet in relation to the following items:

(a) own funds requirements relating to entirely quantifiable, uniform and standardised elements of credit risk, market risk, and operational risk;

(b) requirements limiting large exposures;

(c) after the delegated act referred to in Article 444 has entered into force, liquidity requirements relating to entirely quantifiable, uniform and standardised elements of liquidity risk;

(d) reporting requirements related to points (a) to (c) and to leverage;

(e) publication requirements.

Article 299 applies to central counterparties.

This Regulation does not govern publication requirements for competent authorities in the field of prudential regulation and supervision of institutions as set out in Directive [inserted by OP].

Article 2
Supervisory powers

For the purposes of ensuring compliance with this Regulation, competent authorities shall have the powers and shall follow the procedures set out in Directive [inserted by OP].

Article 3
Application of stricter requirements by institutions

This Regulation shall not prevent institutions from holding own funds and their components in excess of, or applying measures that are stricter than those required by this Regulation.

Article 4
Definitions

For the purposes of this Regulation, the following definitions shall apply:

(1) ‘credit institution’ means an undertaking the business of which is to receive deposits or other repayable funds from the public and to grant credits for its own account;

(2) ‘competent authorities’ means public authorities or bodies officially recognized by national law, which are empowered by national law to supervise credit institutions or investment firms as part of the supervisory system in operation in the Member State concerned.

(3) ‘financial institution’ means an undertaking other than a credit institution, the principal activity of which is to acquire holdings or to pursue one or more of the activities listed in points 2 to 12 and 15 Annex I of Directive [inserted by OP];

(4) 'institution' means credit institution or investment firm.

(5) ‘consolidating supervisor’ means the competent authority responsible for the exercise of supervision on a consolidated basis of EU parent institutions and institutions controlled by EU parent financial holding companies or EU parent mixed financial holding companies.

(6) ‘recognised third-country investment firms’ means firms meeting all of the following conditions:

(a) firms which, if they were established within the Union, would be covered by the definition of investment firm;

(b) firms which are authorised in a third country;

(c) firms which are subject to and comply with prudential rules considered by the competent authorities as at least as stringent as those laid down by this Regulation or by Directive [inserted by OP];

(7) ‘local firm’ means a firm dealing for its own account on markets in financial futures or options or other derivatives and on cash markets for the sole purpose of hedging positions on derivatives markets, or dealing for the accounts of other members of those markets and being guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such a firm is assumed by clearing members of the same markets;

(8) ‘investment firms’ means institutions as defined in Article 4(1)(1*)* of Directive 2004/39/EC which are subject to the requirements imposed by that Directive, excluding the following:

(a) credit institutions;

(b) local firms;

(c) firms which are only authorised to provide the service of investment advice or receive and transmit orders from investors without holding money or securities belonging to their clients and which for that reason may not at any time place themselves in debt with

those clients;

(9) 'collective investment undertaking (CIU)' means an Alternative Investment Fund as defined by Article 4(1)(a) of Directive 2011/61/EU of the European Parliament and the Council of 8 June 2011 on Alternative Investment Fund Managers or an undertaking for collective investment in transferable securities (UCITS) as defined in Article 1 of Directive 2009/65/EU of the European Parliament and the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

(10) 'authorisation' means an instrument issued in any form by the authorities by which the right to carry on the business is granted;

(11) 'consolidated situation' means the situation that results from applying requirements of this regulation in accordance with Title II Chapter 2 to one institution as if that institution formed, together with one or more other entities, one single institution;

(12) 'consolidated basis' means on the basis of the consolidated situation;

(13) 'marking to market' means the valuation of positions at readily available close out prices that are sourced independently, including exchange prices, screen prices, or quotes from several independent reputable brokers;

(14) 'marking to model' means any valuation which has to be benchmarked, extrapolated or otherwise calculated from one or more market input;

(15) 'independent price verification' means a process by which market prices or mark-to-model inputs are regularly verified for accuracy and independence.

(16) 'branch' means a place of business which forms a legally dependent part of a credit institution and which carries out directly all or some of the transactions inherent in the business of credit institutions;

(17) 'financial institution' means an undertaking other than a credit institution, the principal activity of which is to acquire holdings or to pursue one or more of the activities listed in points 2 to 12 and 15 of Annex I to Directive [inserted by OP];

(18) 'home Member State' means the Member State in which a credit institution has been authorised;

(19) 'host Member State' means the Member State in which a credit institution has a branch or in which it provides services;

(20) 'control' means the relationship between a parent undertaking and a subsidiary, as defined in Article 1 of Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts[18], or a similar relationship between any natural or legal person and an undertaking;

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[18] OJ L 193, 18.7.1983, p. 1.

(21) ‘qualifying holding’ means a direct or indirect holding in an undertaking which represents 10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking;

(22) ‘public sector entities’ means non-commercial administrative bodies responsible to central governments, regional governments or local authorities, or authorities that exercise the same responsibilities as regional and local authorities, or non-commercial undertakings owned by central governments or regional or local authorities that have explicit guarantee arrangements, and may include self administered bodies governed by law that are under public supervision;

(23) ‘eligible capital’ for the purposes of Title IV of Part Two and Part Five means the sum of the following:

(a) Common Equity Tier 1 capital;

(b) Additional Tier 1 capital;

(c) Tier 2 capital that is equal to or less than 25 % of own funds;

(24) ‘operational risk’ means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk;

(25) ‘central banks’ means the national central banks that are members of the European System of Central Banks and the European Central Bank, unless otherwise indicated.

(26) ‘dilution risk’ means the risk that an amount receivable is reduced through cash or non-cash credits to the obligor;

(27) ‘probability of default’ means the probability of default of a counterparty over a one year period;

(28) ‘loss’, for the purposes of Part Three, Title II, means economic loss, including material discount effects, and material direct and indirect costs associated with collecting on the instrument;

(29) ‘loss given default (LGD)’ means the ratio of the loss on an exposure due to the default of a counterparty to the amount outstanding at default;

(30) ‘conversion factor’ means the ratio of the currently undrawn amount of a commitment that will be drawn and outstanding at default to the currently undrawn amount of the commitment, the extent of the commitment shall be determined by the advised limit, unless the unadvised limit is higher;

(31) ‘expected loss (EL)’, for the purposes of Part Three, Title II, means the ratio of the amount expected to be lost on an exposure from a potential default of a counterparty or dilution over a one year period to the amount outstanding at default;

(32) ‘credit risk mitigation’ means a technique used by an institution to reduce the credit risk associated with an exposure or exposures which that institution continues to hold;

(33) ‘funded credit protection’ means a technique of credit risk mitigation where the reduction of

the credit risk on the exposure of an institution derives from the right of that institution - in the event of the default of the counterparty or on the occurrence of other specified credit events relating to the counterparty - to liquidate, or to obtain transfer or appropriation of, or to retain certain assets or amounts, or to reduce the amount of the exposure to, or to replace it with, the amount of the difference between the amount of the exposure and the amount of a claim on the institution;

(34) 'unfunded credit protection' means a technique of credit risk mitigation where the reduction of the credit risk on the exposure of an institution derives from the undertaking of a third party to pay an amount in the event of the default of the borrower or on the occurrence of other specified credit events;

(35) 'repurchase transaction' means any transaction governed by an agreement falling within the definition of 'repurchase agreement' or 'reverse repurchase agreement'

(36) 'cash assimilated instrument' means a certificate of deposit, bonds including covered bonds or any other non-subordinated instrument, which has been issued by the institution, for which the institution has already received full payment and which shall be unconditionally reimbursed by the institution at its nominal value

(37) 'securitisation' means a transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranched, having both of the following characteristics:

(a) payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures;

(b) the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme;

(38) 'tranche' means a contractually established segment of the credit risk associated with an exposure or number of exposures, where a position in the segment entails a risk of credit loss greater than or less than a position of the same amount in each other such segment, without taking account of credit protection provided by third parties directly to the holders of positions in the segment or in other segments;

(39) 'securitisation position' means an exposure to a securitisation;

(40) 're-securitisation' means securitisation where the risk associated with an underlying pool of exposures is tranched and at least one of the underlying exposures is a securitisation position;

(41) 're-securitisation position' means an exposure to a re-securitisation;

(42) 'originator' means either of the following:

(a) an entity which, either itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposure being securitised;

(b) an entity which purchases a third party's exposures for its own account and then securitises them;

(43) ‘sponsor’ means an institution other than an originator institution that establishes and manages an asset-backed commercial paper programme or other securitisation scheme that purchases exposures from third party entities;

(44) ‘credit enhancement’ means a contractual arrangement whereby the credit quality of a position in a securitisation is improved in relation to what it would have been if the enhancement had not been provided, including the enhancement provided by more junior tranches in the securitisation and other types of credit protection;

(45) ‘securitisation special purpose entity (SSPE)’ means a corporation trust or other entity, other than an institution, organised for carrying on a securitisation or securitisations, the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the SSPE from those of the originator institution, and the holders of the beneficial interests in which have the right to pledge or exchange those interests without restriction;

(46) ‘group of connected clients’ means any of the following:

(a) two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others unless the treatment set out in point (c) applies;

(b) two or more natural or legal persons between whom there is no relationship of control as described in point (a) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would also be likely to encounter funding or repayment difficulties;

(c) where a central government has control over one or more entities and exposures to this central government receive a 0 % risk weight according to Article 109 and where that central government has provided an explicit guarantee for all the obligations of such entities, this control does not lead to a group of connected clients between the central government and these entities. The same applies in cases of regional governments or local authorities where exposures to the regional governments or local authority receive a 0 % risk weight according to Article 110 and where the regional governments or local authorities provided an explicit guarantee for all the obligations of such entities.

(47) ‘recognised exchanges’ means exchanges which meet all of the following conditions:

(a) they are a market referred to in the list to be published by (ESMA) according to Article 47 of Directive 2004/39/EC.

(b) they have a clearing mechanism whereby contracts listed in Annex IV are subject to daily margin requirements which, in the opinion of the competent authorities, provide appropriate protection;

(48) ‘discretionary pension benefits’ means enhanced pension benefits granted on a discretionary basis by an institution to an employee as part of that employee’s variable remuneration package, which do not include accrued benefits granted to an employee under the terms of the company pension scheme.

(49) ‘participation’ means participation within the meaning of the first sentence of Article 17 of Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies[19], or the ownership, direct or indirect, of 20 % or more of the voting rights or capital of an undertaking;

(50) ‘exposure’ for the purposes of Part Three, Title II means an asset or off-balance sheet item.

(51) ‘mortgage lending value’ means the value of the immovable property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property.

(52) ‘market value’ means for the purposes of immovable property the estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

(53) ‘relevant accounting framework' means the accounting rules to which the institution is subject under Regulation (EC) No 1606/2002[20] of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards and Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions[21].

(54) ‘one year default rate’ means the ratio between the number of defaults occurred during a period that starts from one year prior to a date T and the number of obligors assigned to this grade or pool one year prior to that date.

(55) ‘speculative immovable property financing’ means loans for the purposes of the acquisition or development or construction of land in relation to such property, with the intention of reselling for profit.

(56) ‘repurchase agreement’ and ‘reverse repurchase agreement’ mean any agreement in which an institution or its counterparty transfers securities or commodities or guaranteed rights relating to either of the following:

 (a) title to securities or commodities where that guarantee is issued by a recognised exchange which holds the rights to the securities or commodities and the agreement does not allow an institution to transfer or pledge a particular security or commodity to more than one counterparty at one time, subject to a commitment to repurchase them;

 (b) substituted securities or commodities of the same description at a specified price on a future date specified, or to be specified, by the transferor, being a repurchase agreement for the institution selling the securities or commodities and a reverse repurchase agreement for the institution buying them.

(57) 'financial instruments’ means any of the following:

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[19] OJ L 222, 14.8.1978, p. 11.
[20] OJ L 243, 11.9.2002, p. 1.
[21] OJ L 372, 31.12.1986, p. 1.

(a) a contract that gives rise to both a financial asset of one party and a financial liability or equity instrument of another party;

(b) any instrument specified in Section C of Annex I to Directive 2004/39/EC;

(c) derivative financial instrument;

(d) a primary financial instrument;

(e) a cash instrument.

The instruments referred to in points (a) to (c) are only financial instruments if their value is derived from the price of an underlying financial instrument or another underlying item, a rate, or an index.

(58) 'initial capital' means the amount and types of own funds specified in Article 12 of Directive [inserted by OP] for credit institutions and in Title IV of that Directive for investment firms.

(59) 'positions held with trading intent' means any of the following:

(a) proprietary positions and positions arising from client servicing and marking making;

(b) positions intended to be resold short term;

(c) positions intended to benefit from actual or expected short term price differences between buying and selling prices or from other price of interest rate variations;

(60) 'parent undertaking' means:

(a) a parent undertaking as defined in Articles 1 and 2 of Directive 83/349/EEC;

(b) for the purposes of Section II of Chapters 3 and 4 of Title VII, Title VIII of Directive [inserted by OP] and Part V of this Regulation a parent undertaking within the meaning of Article 1(1) of Directive 83/349/EEC and any undertaking which, effectively exercises a dominant influence over another undertaking;

(61) 'subsidiary' means:

(a) a subsidiary as defined in Articles 1 and 2 of Directive 83/349/EEC;

(b) a subsidiary within the meaning of Article 1(1) of Directive 83/349/EEC and any undertaking over which, a parent undertaking effectively exercises a dominant influence;

All subsidiaries of subsidiaries shall also be considered to be subsidiaries of the undertaking that is their original parent undertaking;

(62) 'trading book' means all positions in financial instruments and commodities held by an institution either with trading intent or in order to hedge positions held with trading intent;

(63) 'financial holding company' means a financial institution, the subsidiaries of which are either exclusively or mainly institutions or financial institutions, at least one of such subsidiaries being an institution, and which is not a mixed financial holding company within

the meaning of Article 2(15) of Directive 2002/87/EC[22];

(64) 'parent institution in a Member State' means an institution which has a institution or a financial institution as a subsidiary or which holds a participation in such an institution, and which is not itself a subsidiary of another institution authorised in the same Member State, or of a financial holding company or mixed financial holding company set up in the same Member State.

(65) 'EU parent institution' means a parent institution which is not a subsidiary of another institution authorised in any Member State, or of a financial holding company or mixed financial holding company set up in any Member State;

(66) 'parent financial holding company in a Member State' means a financial holding company which is not itself a subsidiary of an institution authorised in the same Member State, or of a financial holding company or mixed financial holding company set up in the same Member State;

(67) 'EU parent financial holding company' means a parent financial holding company which is not a subsidiary of an institution authorised in any Member State or of another financial holding company or mixed financial holding company set up in any Member State;

(68) 'parent mixed financial holding company in a Member State' means a mixed financial holding company which is not itself a subsidiary of a credit institution authorised in the same Member State, or of a financial holding company or mixed financial holding company set up in that same Member State;

(69) 'EU parent mixed financial holding company' means a parent mixed financial holding company which is not a subsidiary of a credit institution authorised in any Member State or of another financial holding company or mixed financial holding company set up in any Member State;

(70) 'multilateral trading facility' has the same meaning as under Article 4(15) of Directive 2004/39/EC;

(71) 'mixed activity holding company' means a parent undertaking, other than a financial holding company or an institution or a mixed financial holding company , the subsidiaries of which include at least one institution;

(72) 'close links' means a situation in which two or more natural or legal persons are linked in any of the following ways:

(a) participation in the form of ownership, direct or by way of control, of 20 % or more of the voting rights or capital of an undertaking;

(b) control;

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22 Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (OJ L 35, 11.2.2003, p. 1).

(c) the fact that both or all are permanently linked to one and the same third person by a control relationship

(73) ‘central counterparty (CCP)’ means a legal entity that interposes itself between the counterparties to a trade within one or more financial markets, becoming the buyer to every seller and the seller to every buyer;

(74) ‘default fund’ means a fund established by a CCP the purpose of which is to mutualise the losses the CCP incurs due to the default or insolvency of one or more of its clearing members, where the margins and default fund contributions provided by those clearing members are not sufficient to cover those losses;

(75) ‘trade exposure’ means the sum of exposures arising from assets posted to a CCP, mark-to-market exposures to a CCP and potential future exposures to a CCP;

(76) ‘insurance undertaking’ has the same meaning as under Article 13(1) of Directive 2009/138/EC;

(77) ‘mixed activity insurance holding company’ has the same meaning as under point (g) of Article 212(1) of Directive 2009/138/EC;

(78) ‘reinsurance undertaking’ has the same meaning as under Article 13(4) of Directive 2009/138/EC;

(79) ‘third country insurance undertaking’ has the same meaning as under Article 13(3) of Directive 2009/138/EC;

(80) ‘third country reinsurance undertaking’ has the same meaning as under Article 13(6) of Directive 2009/138/EC;

(81) ‘regulated market means a market referred to in the list to be published by the European Securities and Markets Authority (ESMA) according to Article 47 of Directive 2004/39/EC;

(82) ‘management body’ means the governing body of an institution, comprising the supervisory and the managerial functions, which has the ultimate decision-making authority and is empowered to set the institution's strategy, objectives and overall direction. Management body shall include persons who effectively direct the business of the institution;

(83) ‘management body in its supervisory function’ means the management body acting in its supervisory function of overseeing and monitoring management decision-making;

(84) ‘senior management’ means those individuals who exercise executive functions within a institution and who are responsible and accountable to the management body for the day-to-day management of the institution;

(85) mixed financial holding company’ shall mean a parent undertaking, other than a regulated entity, which together with its subsidiaries, at least one of which is a regulated entity which has its head office in the Community, and other entities, constitutes a financial conglomerate;

(86) ‘leverage’ means the relative size of an institution's assets, off-balance sheet obligations and contingent obligations to pay or to deliver or to provide collateral, including

obligations from received funding, made commitments, derivates or repurchase agreements, but excluding obligations which can only be enforced during the liquidation of an institution, compared to that institution's own funds.

Title II
Level of application of requirements

Chapter 1
Application of requirements on an individual basis

Article 5
General principles

1. Institutions shall comply with the obligations laid down in Parts Two to Five on an individual basis.

2. Every institution which is neither a subsidiary in the Member State where it is authorised and supervised, nor a parent undertaking, and every institution not included in the consolidation pursuant to Article 17, shall comply with the obligations laid down in Article 84 on an individual basis.

3. Every institution which is neither a parent undertaking, nor a subsidiary, and every institution not included in the consolidation pursuant to Article 17, shall comply with the obligations laid down in Part Eight on an individual basis.

4. Institutions other than investment firms that are not authorised to provide the investment services listed in points 3 and 6 of Section A of Annex I to Directive 2004/39/EC shall comply with the obligations laid down in Articles 401 and 403 on an individual basis.

5. Institutions shall comply with the obligations laid down in Part Seven on an individual basis.

Article 6
Derogation to the application of prudential requirements on an individual basis

1. Competent authorities may waive the application of Article 5(1) to any subsidiary of an institution, where both the subsidiary and the institution are subject to authorisation and supervision by the Member State concerned, and the subsidiary is included in the supervision on a consolidated basis of the institution which is the parent undertaking, and all of the following conditions are satisfied, in order to ensure that own funds are distributed adequately among the parent undertaking and the subsidiaries:

   (a) there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities by its parent undertaking;

   (b) either the parent undertaking satisfies the competent authority regarding the prudent management of the subsidiary and has declared, with the permission of the competent authority, that it guarantees the commitments entered into by the subsidiary, or the risks in the subsidiary are of negligible interest;

(c) the risk evaluation, measurement and control procedures of the parent undertaking cover the subsidiary;

(d) the parent undertaking holds more than 50 % of the voting rights attached to shares in the capital of the subsidiary or has the right to appoint or remove a majority of the members of the management body of the subsidiary.

2. Competent authorities may exercise the option provided for in paragraph 1 where the parent undertaking is a financial holding company or a mixed financial holding company set up in the same Member State as the institution, provided that it is subject to the same supervision as that exercised over institutions, and in particular to the standards laid down in Article 10(1).

3. Competent authorities may waive the application of Article 5(1) to a parent institution in a Member State where that institution is subject to authorisation and supervision by the Member State concerned, and it is included in the supervision on a consolidated basis, and all the following conditions are satisfied, in order to ensure that own funds are distributed adequately among the parent undertaking and the subsidiaries:

(a) there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities to the parent institution in a Member State;

(b) the risk evaluation, measurement and control procedures relevant for consolidated supervision cover the parent institution in a Member State.

The competent authority which makes use of this paragraph shall inform the competent authorities of all other Member States.

Article 7

Derogation to the application of liquidity requirements on an individual basis

1. The competent authorities shall waive in full or in part the application of Article 401 to a parent institution and to all or some of its subsidiaries in the European Union and supervise them as a single liquidity sub-group so long as they fulfil all of the following conditions:

(a) The parent institution complies with the obligations laid down in Articles 401 and 403 on a consolidated basis or, where the sub-group does not include the EU parent institution, on a sub-consolidated basis;

(b) The parent institution monitors and has oversight at all times over the liquidity positions of all institutions within the group or sub-group, that are subject to the waiver;

(c) The institutions have entered into contracts that provide for the free movement of funds between them to enable them to meet their individual and joint obligations as they come due;

(d) There are no current or foreseen material practical or legal impediment to the fulfilment of the contracts referred to in (c).

2. Where all institutions of the single liquidity sub-group are authorised in the

same Member State, paragraph 1 shall be applied by the competent authorities of that Member State.

Where institutions of the single liquidity sub-group are authorised in several Member States, paragraph 1 shall only be applied after following the procedure laid down in Article 19 and only to the institutions whose competent authorities agree about the following elements:

(a) the adequacy of the organisation and the treatment of liquidity risk as required by Article 84 of Directive [inserted by OP];

(b) the distribution of amounts, location and ownership of the required liquid assets to be held within the sub-group;

(c) minimum amounts of liquid assets to be held by institutions for which the application of Article 401 has been waived;

(d) the need for stricter parameters than those set out in Part Six, Title III.

Competent authorities may also apply paragraph 1 also to institutions which that are members of the same institutional protection scheme referred to in 108(7)(b), provided that they meet all the conditions laid down in Article 108(7). Competent authorities shall in that case determine one of the institutions subject to the waiver to meet Article 401on the basis of the consolidated situation of all institutions of the single liquidity sub-group.

3. Where a waiver has been granted under paragraph 1, the competent authorities may also waive the application of Article 403.

Article 8
Individual consolidation method

1. Subject to paragraphs 2 and 3 of this Article and to Article 134(3) of Directive [inserted by OP], the competent authorities may permit on a case by case basis parent institutions to incorporate in the calculation of their requirement under Article 5(1) subsidiaries which meet the conditions laid down in points (c) and (d) of Article 6(1), and whose material exposures or material liabilities are to that parent institution.

2. The treatment in paragraph 1 shall be permitted only where the parent institution demonstrates fully to the competent authorities the circumstances and arrangements, including legal arrangements, by virtue of which there is no material practical or legal impediment, and none are foreseen, to the prompt transfer of own funds, or repayment of liabilities when due by the subsidiary to its parent undertaking.

3. Where a competent authority exercises the discretion laid down in paragraph 1, it shall on a regular basis and not less than once a year inform the competent authorities of all the other Member States of the use made of paragraph 1 and of the circumstances and arrangements referred to in paragraph 2. Where the subsidiary is in a third country, the competent authorities shall provide the same information to the competent authorities of that third country as well.

Article 9
Waiver for credit institutions permanently affiliated to a central body

Competent authorities may waive the application of the requirements set out in Parts Two to Four and Six to Eight to one or more credit institutions situated in the same Member State and which are permanently affiliated to a central body which supervises them and which is established in the same Member State, if national law provides all of the following:

(a) the commitments of the central body and affiliated institutions are joint and several liabilities or the commitments of its affiliated institutions are entirely guaranteed by the central body;

(b) the solvency and liquidity of the central body and of all the affiliated institutions are monitored as a whole on the basis of consolidated accounts of these institutions;

(c) the management of the central body is empowered to issue instructions to the management of the affiliated institutions.

Chapter 2
Prudential consolidation

SECTION 1
APPLICATION OF REQUIREMENTS ON A CONSOLIDATED BASIS

Article 10
General treatment

1. Parent institutions in a Member State shall comply, to the extent and in the manner prescribed in Article16, with the obligations laid down in Parts Two to Four and Seven on the basis of their consolidated situation.

2. Institutions controlled by a parent financial holding company or a parent mixed financial holding company in a Member State shall comply, to the extent and in the manner prescribed in Article 16, with the obligations laid down in Parts Two to Four and Seven on the basis of the consolidated situation of that financial holding company or mixed financial holding company.

   Where more than one institution is controlled by a parent financial holding company or by a parent mixed financial holding company in a Member State, the first subparagraph shall apply only to the institution to which supervision on a consolidated basis applies in accordance with Article 106 of Directive [inserted by OP].

3. EU parent institutions and institutions controlled by an EU parent financial holding company and institutions controlled by an EU parent mixed financial holding company shall comply with the obligations laid down in Articles 401 and 403 on the basis of the consolidated situation of that parent institution, financial holding company or mixed financial holding company, if the group comprises one or more credit institutions or investment firms that are authorised to provide the investment services listed in points 3 and 6 of

Section A of Annex I to Directive 2004/39/EC.

4. Where Article 9 is applied, the central body referred to in that Article shall comply with the requirements of Parts Two to Four and Seven on the basis of the consolidated situation of the central body. Article 16 shall apply to the central body and the affiliated institutions shall be treated as the subsidiaries of the central body.

Article 11
Financial holding company or mixed financial holding company with both a subsidiary credit institution and a subsidiary investment firm

Where a financial holding company or a mixed financial holding company has at least one credit institution and one investment firm as subsidiaries, the requirements that apply on the basis of the consolidated situation of the financial holding company or of the mixed financial holding company shall apply to the credit institution.

Article 12
Application of disclosure requirements on a consolidated basis

1. EU parent institutions shall comply with the obligations laid down in Part Eight on the basis of their consolidated situation.

   Significant subsidiaries of EU parent institutions shall disclose the information specified in Article 424, 425, 435 and 436, on an individual or sub-consolidated basis.

2. Institutions controlled by an EU parent financial holding company or EU parent mixed financial holding company shall comply with the obligations laid down in Part Eight on the basis of the consolidated situation of that financial holding company or mixed financial holding company.

   Significant subsidiaries of EU parent financial holding companies or EU parent mixed holding companies shall disclose the information specified in Article 424 and 425, 435 and 436 on an individual or sub-consolidated basis.

3. Paragraphs 1 and 2 shall not apply in full or in part to EU parent institutions, institutions controlled by an EU parent financial holding company or EU parent mixed financial holding company, to the extent that they are included within equivalent disclosures provided on a consolidated basis by a parent undertaking established in a third country.

4. Where Article 9 is applied, the central body referred to in that Article shall comply with the requirements of Part Eight on the basis of the consolidated situation of the central body. Article 16(1) shall apply to the central body and the affiliated institutions shall be treated as the subsidiaries of the central body.

Article 13
Application of requirements of Part Five on a consolidated basis

1. Parent undertakings and their subsidiaries subject to this Regulation shall meet the obligations

laid down in Part Five on a consolidated or sub-consolidated basis, to ensure that their arrangements, processes and mechanisms required by those provisions are consistent and well-integrated and that any data and information relevant to the purpose of supervision can be produced. In particular, they shall ensure that subsidiaries not subject to this Regulation implement arrangements, processes and mechanisms to ensure compliance with those provisions.

2. Institutions shall apply an additional risk weight in accordance with Article 396 when applying Article 87 on a consolidated or sub-consolidated basis if the requirements of Articles 394 or 395 are breached at the level of an entity established in a third country included in the consolidation in accordance with Article 16 if the breach is material in relation to the overall risk profile of the group.

3. Obligations resulting from Part Five concerning subsidiaries, not themselves subject to this Regulation, shall not apply if the EU parent institution or institutions controlled by an EU parent financial holding company or EU parent mixed financial holding company, can demonstrate to the competent authorities that the application of Part Five is unlawful under the laws of the third country where the subsidiary is established.

Article 14

Derogation to the application of own funds requirements on a consolidated basis for groups of investment firms

1. The competent authorities that supervise groups on a consolidated basis may waive, on a case-by-case basis, the application of own funds requirements on a consolidated basis provided that the following conditions exist:

   (a) each EU investment firm in such a group uses the alternative calculation of total risk exposure amount referred to in Article 90(2);

   (b) all investment firms in such a group fall within the categories in Articles 90(1) and 91(1);

   (c) each EU investment firm in such a group meets the requirements imposed in Article 90 on an individual basis and at the same time deducts from its Common Equity Tier 1 items any contingent liability in favour of investment firms, financial institutions, asset management companies and ancillary services undertakings, which would otherwise be consolidated;

   (d) any financial holding company which is the parent financial holding company in a Member State of any investment firm in such a group holds, at least as much capital, defined here as the sum of the following:

      (i) the items referred to in Articles 24(1), 48(1) and 59(1);

      (ii) as the sum of the full book value of any holdings, subordinated claims and instruments referred to in Articles 33(1)(h) and (i), 53(1)(c) and (d), and 63(1)(c) and (d) in investment firms, financial institutions, asset management companies and ancillary services undertakings which would otherwise be consolidated; and

(iii) the total amount of any contingent liability in favour of investment firms, financial institutions, asset management companies and ancillary services undertakings which would otherwise be consolidated;

(e) the group does not comprise credit institutions.

Where the criteria in the first subparagraph are met, each EU investment firm shall have in place systems to monitor and control the sources of capital and funding of all financial holding companies, investment firms, financial institutions, asset management companies and ancillary services undertakings within the group.

2. The competent authorities may also apply the waiver if the financial holding companies holds a lower amount of own funds than the amount calculated under paragraph 1(d), but no lower than the sum of the own funds requirements imposed on an individual basis to investment firms, financial institutions, asset management companies and ancillary services undertakings which would otherwise be consolidated and the total amount of any contingent liability in favour of investment firms, financial institutions, asset management companies and ancillary services undertakings which would otherwise be consolidated. For the purposes of this paragraph, the own funds requirement for investment undertakings of third countries, financial institutions, asset management companies and ancillary services undertakings is a notional own funds requirement.

Article 15
Supervision of investment firms waived from the application of own funds requirements on a consolidated basis

Investment firms in a group which has been granted the waiver provided for in Article 14 shall notify the competent authorities of the risks which could undermine their financial positions, including those associated with the composition and sources of their own funds, internal capital and funding.

Where the competent authorities waive the obligation of supervision on a consolidated basis as provided for in Article 14, they shall take other appropriate measures to monitor the risks, namely large exposures, of the whole group, including any undertakings not located in a Member State.

Where the competent authorities waive the application of own funds requirements on a consolidated basis as provided for in Article14, the requirements of Part Eight shall apply on an individual basis.

SECTION 2
METHODS FOR PRUDENTIAL CONSOLIDATION

Article 16
Methods for prudential consolidation

1. The institutions that are required to comply with the requirements referred to in Section 1 on the basis of their consolidated situation shall carry out a full consolidation of all institutions and financial institutions that are its subsidiaries or, where relevant, the subsidiaries of the same parent financial holding company or mixed parent financial holding company. Paragraphs 2 to 8 of this Article shall not apply where Articles 401 and 403 apply

on the basis of an institution's consolidated situation.

2. However, the competent authorities may on a case-by-case basis permit proportional consolidation according to the share of capital that the parent undertaking holds in the subsidiary. Proportional consolidation may only be permitted where all of the following conditions are fulfilled:

   (a) the liability of the parent undertaking is limited to the share of capital that the parent undertaking holds in the subsidiary in view of the liability of the other shareholders or members;

   (b) the solvency of those other shareholder or members is satisfactory;

   (c) the liability of the other shareholders and members is clearly established in a legally binding way.

3. Where undertakings are linked by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC, the competent authorities shall determine how consolidation is to be carried out.

4. The competent authorities responsible for supervision on a consolidated basis shall require the proportional consolidation according to the share of capital held of participations in institutions and financial institutions managed by an undertaking included in the consolidation together with one or more undertakings not included in the consolidation, where those undertakings' liability is limited to the share of the capital they hold.

5. In the case of participations or capital ties other than those referred to in paragraphs 1 and 2, the competent authorities shall determine whether and how consolidation is to be carried out. In particular, they may permit or require use of the equity method. That method shall not, however, constitute inclusion of the undertakings concerned in supervision on a consolidated basis.

6. The competent authorities shall determine whether and how consolidation is to be carried out in the following cases:

   (a) where, in the opinion of the competent authorities, an institution exercises a significant influence over one or more institutions or financial institutions, but without holding a participation or other capital ties in these institutions; and

   (b) where two or more institutions or financial institutions are placed under single management other than pursuant to a contract or clauses of their memoranda or Articles of association.

   In particular, the competent authorities may permit, or require use of, the method provided for in Article 12 of Directive 83/349/EEC. That method shall not, however, constitute inclusion of the undertakings concerned in consolidated supervision.

7. EBA shall develop draft regulatory technical standards to specify conditions according to which consolidation shall be carried out in the cases referred to in paragraphs 2 to 6 of this Article.

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2016.

Powers are conferred on the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with the procedure laid down in Article 15 of Regulation (EU) No 1093/2010.

8. Where consolidated supervision is required pursuant to Article 106 of Directive [inserted by OP], ancillary services undertakings and asset management companies as defined in Directive 2002/87/EC shall be included in consolidations in the cases, and in accordance with the methods, laid down in this Article.

SECTION 3
SCOPE OF PRUDENTIAL CONSOLIDATION

Article 17
Entities excluded from the scope of prudential consolidation

1. An institution, financial institution or an ancillary services undertaking which is a subsidiary or an undertaking in which a participation is held, need not to be included in the consolidation where the total amount of assets and off-balance sheet items of the undertaking concerned is less than the smaller of the following two amounts:

   (a) EUR 10 million;

   (b) 1 % of the total amount of assets and off-balance sheet items of the parent undertaking or the undertaking that holds the participation.

2. The competent authorities responsible for exercising supervision on a consolidated basis pursuant to Article 106 of Directive [inserted by OP] may on a case-by-case basis decide in the following cases that an institution, financial institution or ancillary services undertaking which is a subsidiary or in which a participation is held need not be included in the consolidation:

   (a) where the undertaking concerned is situated in a third country where there are legal impediments to the transfer of the necessary information;

   (b) where the undertaking concerned is of negligible interest only with respect to the objectives of monitoring credit institutions;

   (c) where, in the opinion of the competent authorities responsible for exercising supervision on a consolidated basis, the consolidation of the financial situation of the undertaking concerned would be inappropriate or misleading as far as the objectives of the supervision of credit institutions are concerned.

3. Where, in the cases referred to in paragraph 1 and point (b) of paragraph 2, several undertakings meet the above criteria set out therein, they shall nevertheless be included in the consolidation where collectively they are of non-negligible interest with respect to the

specified objectives.

Article 18
Joint decisions on prudential requirements

1. The competent authorities shall work together, in full consultation:

(a) in the case of applications for the permissions referred to in Articles 138(1), 146(9), 301(2), 277, 352 of Regulation [inserted by OP], respectively, submitted by an EU parent institution and its subsidiaries, or jointly by the subsidiaries of an EU parent financial holding company or EU parent mixed financial holding company, to decide whether or not to grant the permission sought and to determine the terms and conditions, if any, to which such permission should be subject.

(b) for the purposes of applying the intra-group treatment referred to in Article 410(8) and 413(4) of this Regulation in relation to institutions that are not subject to the waiver of Article 7.

Applications shall be submitted only to the consolidating supervisor.

The application referred to in Article 301(2), shall include a description of the methodology used for allocating operational risk capital between the different entities of the group. The application shall indicate whether and how diversification effects are intended to be factored in the risk measurement system.

2. The competent authorities shall do everything within their power to reach a joint decision within six months on:

(a) the application referred to in paragraph 1(a);

(b) the liquidity intra-group treatment referred to in paragraph 1(b).

This joint decision shall be set out in a document containing the fully reasoned decision which shall be provided to the applicant by the competent authority referred to in paragraph 1.

3. The period referred to in paragraph 2 shall begin:

(a) on the date of receipt of the complete application referred to in paragraph 1(a) by the consolidating supervisor. The consolidating supervisor shall forward the complete application to the other competent authorities without delay;

(b) on the date of receipt by competent authorities of a report prepared by the consolidating supervisor analysing intra-group commitments within the group.

4. In the absence of a joint decision between the competent authorities within six months, the consolidating supervisor shall make its own decision on paragraph 1(a) and 1(b). The decision of the consolidating supervisor on paragraph 1(b) shall not limit the powers of the competent authorities under Article 102.

The decision shall be set out in a document containing the fully reasoned decision and shall

take into account the views and reservations of the other competent authorities expressed during the six months period.

The decision shall be provided to the EU parent institution, the EU parent financial holding company or to the EU parent mixed financial holding company and the other competent authorities by the consolidating supervisor.

If, at the end of the six month period, any of the competent authorities concerned has referred the matter to EBA in accordance with Article 19 of Regulation (EU) No 1093/2010, the consolidating supervisor shall defer its decision and await any decision that EBA may take in accordance with Article 19(3) of that Regulation on its decision, and shall take its decision in conformity with the decision of EBA. The six-month period shall be deemed the conciliation period within the meaning of that Regulation. EBA shall take its decision within 1 month. The matter shall not be referred to EBA after the end of the six month period or after a joint decision has been reached.

5. Where an EU parent institution and its subsidiaries, the subsidiaries of an EU parent financial holding company or an EU parent mixed financial holding company use an Advanced Measurement Approach referred to in Article 301(2) or an IRB Approach referred to in Article 138 on a unified basis, the competent authorities shall allow the qualifying criteria set out in Article 310 and 311 or in Part Three, Chapter 3, Section 6 respectively to be met by the parent and its subsidiaries considered together, in a way that is consistent with the structure of the group and its risk management systems, processes and methodologies.

6. The decisions referred to in paragraphs 2 and 4 shall be binding on the competent authorities in the Member States concerned.

7. EBA shall develop draft implementing technical standards to specify the joint decision process referred to in paragraph 1(a), with regard to the applications for permissions referred to in Articles 138(1), 146(9), 301(2), 277, 352, and for the liquidity intra-group treatment referred to in paragraph 1(b) with a view to facilitating joint decisions.

EBA shall submit those technical standards to the Commission by 31 December 2014.

Power is conferred on the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with the procedure laid down in Article 15 of Regulation (EU) No 1093/2010.

Article 19
Joint decisions on the level of application of liquidity requirements

1. Upon application of an EU parent institution or an EU parent financial holding company or EU parent mixed financial holding company, the consolidating supervisor and the competent authorities responsible for the supervision of subsidiaries of an EU parent institution or an EU parent financial holding company or EU parent mixed financial holding company in a Member State shall do everything within their power to reach a joint decision identifying a single liquidity sub-group for the application of Article 7.

This joint decision shall be reached within six months after submission by the consolidating supervisor of a report identifying single liquidity sub-groups on the basis of the criteria

laid down in Article 7. In the event of disagreement during the six months period, the consolidating supervisor shall consult EBA at the request of any of the other competent authorities concerned. The consolidating supervisor may consult EBA on its own initiative.

The joint decision may also impose constraints on the location and ownership of liquid assets and require minimum amounts of liquid assets to be held by credit institutions that are exempt from the application of Article 401.

The joint decision shall be fully reasoned and state the reasons leading to it. The consolidating supervisor shall submit the decision including the reasons to the parent institution of the liquidity subgroup.

2. In the absence of a joint decision within six months, each competent authority responsible for supervision on an individual basis shall take its own decision.

However, any competent authority may during the six months period refer to EBA the question whether the conditions of (a) to (d) of Article 7(1) are met and request its assistance in accordance with Article 19 of Regulation No (EC) 1093/2010. If at the end of the six month period any of the competent authorities concerned has done so, all the competent authorities involved shall defer their decisions pending a decision by EBA. Such decision shall be taken within three months of the request. Once EBA has taken its decision, the competent authorities shall take their decisions concerning the conditions (a) to (d) of Article 7(1), in conformity with the decision of EBA. The matter shall not be referred to EBA after the end of the six month period or after a joint decision has been reached.

The joint decision referred to in paragraph 1 and the decision referred to in the previous subparagraph shall be binding in accordance with Article 19(3) of Regulation No (EC) 1093/2010.

3. Any relevant competent authority may also during the six months period consult EBA on the question whether the conditions of (a) to (d) of Article 7(2) are met. In this case, EBA may carry out its non-binding mediation in accordance with Article 31(c) of Regulation No (EC) 1093/2010. In such case, all the competent authorities involved shall defer their decisions pending the conclusion of the non-binding mediation. Where, during the mediation, no agreement has been reached by the competent authorities within 3 months, each competent authority responsible for supervision on an individual basis shall take its own decision.

4. EBA shall develop draft implementing technical standards to specify the joint decision process referred to in this Article, with regard to the application of Article 7, with a view to facilitating joint decisions.

EBA shall submit those draft implementing technical standards to the Commission by 31 December 2016.

Powers are conferred on the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with the procedure laid down in Article 15 of Regulation (EU) No 1093/2010.

Article 20

Sub-consolidation in cases of entities in third countries

Subsidiary institutions shall apply the requirements laid down in Part Three, Article 84 and Part V on the basis of their sub-consolidated situation if those institutions, or the parent undertaking where it is a financial holding company or mixed financial holding company, have an institution or a financial institution or an asset management company as defined in Article 2(5) of Directive 2002/87/EC as a subsidiary in a third country, or hold a participation in such an undertaking.

Article 21
Undertakings in third countries

For the purposes of applying supervision on a consolidated basis in accordance with this Chapter, the terms ‘investment firm,’ 'credit institution', financial institution, and 'institution' shall also apply to undertakings established in third countries, which, were they established in the Union, would fulfil the definitions of those terms in Article 16.

PART TWO

OWN FUNDS

Title I

Definitions specific to own funds

Article 22
Definitions

(1) ‘accumulated other comprehensive income’ has the same meaning as under International Accounting Standard (IAS) 1, as applicable under Regulation (EC) No 1606/2002;

(2) 'ancillary own-fund insurance items' means own funds within the meaning of Article 89 of Directive 2009/138/EC;

(3) ‘applicable accounting standard’ means the relevant accounting standard, applicable under Directive 86/635/EEC or under Regulation (EC) No 1606/2002, that applies to the institution;

(4) 'basic own funds' means basic own funds within the meaning of Article 88 of Directive 2009/138/EC;

(5) 'Tier 1 own-fund insurance items' means basic own-fund items of undertakings subject to the requirements of Directive 2009/138/EC where those items are classified in Tier 1 within the meaning of Directive 2009/138/EC in accordance with paragraph 1 of Article 94 of that Directive;

(6) ‘additional Tier 1 own-fund insurance items' means basic own-fund items of undertakings subject to the requirements of Directive 2009/138/EC the items are classified as Tier 1 capital within the meaning of Directive 2009/138/EC in accordance with paragraph 1 of Article 94 of that Directive and the inclusion of those items is limited by the delegated acts adopted in accordance with Article 99 of that Directive;

(7) 'Tier 2 own-fund insurance items' means basic own-fund items of undertakings subject to the requirements of Directive 2009/138/EC where those items are classified as Tier 2 within the meaning of Directive 2009/138/EC in accordance with paragraph 2 of Article 94 of that Directive;

(8) 'Tier 3 own-fund insurance items' means basic own-fund insurance items of undertakings subject to the requirements of Directive 2009/138/EC where those items are classified as Tier 3 within the meaning of Directive 2009/138/EC in accordance with paragraph 3 of Article 94 of that Directive;

(9) 'deferred tax assets' has the same meaning as under the applicable accounting standard;

(10) ‘deferred tax assets that rely on future profitability’ means deferred tax assets the future value of which may be realised only in the event the institution generates taxable profit in the future;

(11) ‘deferred tax liabilities’ has the same meaning as under the applicable accounting standard;

(12) ‘defined benefit pension fund assets’ means the assets of a defined pension fund or plan, as applicable, calculated after they have been reduced by the amount of obligations under the same fund or plan;

(13) ‘distributions’ means the payment of dividends or interest in any form;

(14) 'financial undertaking' has the same meaning as under points (b) and (d) of Article 13(25) of Directive 2009/138/EC;

(15) ‘funds for general banking risk’ has the same meaning as under Article 38 of Directive 86/635/EEC;

(16) ‘goodwill’ has the same meaning as under the applicable accounting standard;

(17) ‘indirect holding’ means an investment of an institution in a third party with an exposure to a capital instrument issued by a relevant entity, where that investment is made for the purposes of incurring an exposure to that capital instrument, or an exposure to an instrument by any other means where, in the event the instrument lost value, the loss arising from the exposure would not be materially different from the loss that would be incurred by the institution from a direct holding of the instrument;

(18) ‘intangible assets’ has the same meaning as under the applicable accounting standard;

(19) 'mixed activity insurance holding company' has the same meaning as under point (g) of Article 212(1) of Directive 2009/138/EC;

(20) ‘operating entity’ means an entity established with the purpose of earning a profit in its own right;

(21) ‘other capital instruments’ means capital instruments issued by relevant entities that do not qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments or Tier 1 insurance own-fund items, additional Tier 1 own-fund insurance items, Tier 2 own-fund insurance items or Tier 3 own-fun insurance items;

(22) ‘other reserves’ means reserves within the meaning of the applicable accounting standard that are required to be disclosed under that applicable accounting standard, excluding any amounts already included in accumulated other comprehensive income or retained earnings;

(23) ‘own funds’ means the sum of Tier 1 capital and Tier 2 capital;

(24) ‘own funds instruments’ means capital instruments issued by the institution that qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments;

(25) ‘profit’ has the same meaning as under the applicable accounting standard;

(26) ‘reciprocal cross holding’ means a holding by an institution of the own funds instruments or

other capital instruments issued by relevant entities where those entities also hold own funds instruments issued by the institution;

(27) ‘relevant entity’ means any of the following:

(a) another institution;

(b) a financial institution;

(c) an insurance undertaking;

(d) a third country insurance undertaking;

(e) a reinsurance undertaking;

(f) a third country reinsurance undertaking;

(g) a financial undertaking;

(h) a mixed activity insurance holding company;

(i) an undertaking excluded from the scope of Directive 2009/138/EC in accordance with the requirements laid down in Article 4 of that Directive;

(28) ‘retained earnings’ means profits and losses brought forward as a result of the final application of profit or loss under the applicable accounting standards;

(29) ‘share premium account’ has the same meaning as under the applicable accounting standard;

(30) ‘temporary differences' has the same meaning as under the applicable accounting standard.

Title II
Elements of own funds

Chapter 1
Tier 1 capital

Article 23
Tier 1 capital

The Tier 1 capital of an institution consists of the sum of the Common Equity Tier 1 capital and Additional Tier 1 capital of the institution.

Chapter 2
Common Equity Tier 1 capital

SECTION 1
COMMON EQUITY TIER 1 ITEMS AND INSTRUMENTS

Article 24
Common Equity Tier 1 items

1. Common Equity Tier 1 items of institutions consist of the following:

   (a) capital instruments, provided the conditions laid down in Article 26 are met;

   (b) share premium accounts related to the instruments referred to in point (a);

   (c) retained earnings;

   (d) accumulated other comprehensive income;

   (e) other reserves;

   (f) funds for general banking risk.

2. For the purposes of point (c) of paragraph 1, institutions may include interim or year-end profits in Common Equity Tier 1 capital before the institution has taken a formal decision confirming the final profit or loss of the institution for the year only with the prior consent of the competent authority. The competent authority shall consent where the following conditions are met:

   (a) those profits have been reviewed by persons independent of the institution that are

responsible for the auditing of the accounts of that institution;

(b) the institution has demonstrated to the satisfaction of the competent authority that any foreseeable charge or dividend has been deducted from the amount of those profits.

A review of the interim or year-end profits of the institution shall provide an adequate level of assurance that those profits have been evaluated in accordance with the principles set out in the applicable accounting standard.

3. EBA shall develop draft regulatory technical standards to specify the meaning of foreseeable when determining whether any foreseeable charge or dividend has been deducted.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

4. EBA shall establish, maintain and publish a list of the forms of capital instrument in each Member State that qualify as Common Equity Tier 1 instruments. EBA shall establish and publish this list by 1 January 2013.

Article 25
Capital instruments of mutuals, cooperative societies or similar institutions in Common Equity Tier 1 items

1. Common Equity Tier 1 items shall include any capital instrument issued by an institution under its statutory terms provided the following conditions are met:

(a) the institution is of a type that is defined under applicable national law and which competent authorities consider to qualify as a mutual, cooperative society or a similar institution for the purposes of this Part;

(b) the conditions laid down in Articles 26 and 27 are met;

(c) the instrument does not possess features that could cause the condition of the institution to be weakened as a going concern during periods of market stress.

2. EBA shall develop draft regulatory technical standards to specify the following:

(a) the conditions according to which competent authorities may determine that a type of undertaking recognised under applicable national law qualifies as a mutual, cooperative society or similar institution for the purposes of this Part;

(b) the nature and extent of the following:

(i) the features that could cause the condition of an institution to be weakened as a going concern during periods of market stress;

(ii) the market stress under which such features could cause the condition of the institution to be weakened as a going concern.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Article 26
Common Equity Tier 1 instruments

1. Capital instruments shall qualify as Common Equity Tier 1 instruments only if all the following conditions are met:

(a) the instruments are issued directly by the institution with the prior approval of the owners of the institution or, where permitted under applicable national law, the management body of the institution;

(b) the instruments are paid up and their purchase is not funded directly or indirectly by the institution;

(c) the instruments meet all the following conditions as regards their classification:

(i) they qualify as capital within the meaning of Article 22 of Directive 86/635/EEC;

(ii) they are classified as equity within the meaning of the applicable accounting standard;

(iii) they are classified as equity capital for the purposes of determining balance sheet insolvency, where applicable under national insolvency law;

(d) the instruments are clearly and separately disclosed on the balance sheet in the financial statements of the institution;

(e) the instruments are perpetual;

(f) the principal amount of the instruments may not be reduced or repaid, except in either of the following cases:

(i) the liquidation of the institution;

(ii) discretionary repurchases of the instruments or other discretionary means of reducing capital, where the institution has received the prior consent of the competent authority in accordance with Article72;

(g) the provisions governing the instruments do not indicate expressly or implicitly that the principal amount of the instruments would or might be reduced or repaid other than in the liquidation of the institution, and the institution does not otherwise provide such an

indication prior to or at issuance of the instruments, except in the case of instruments referred to in Article 25 where the refusal by the institution to redeem such instruments is prohibited under applicable national law;

(h) the instruments meet the following conditions as regards distributions:

   (i) there are no preferential distributions, including in relation to other Common Equity Tier 1 instruments, and the terms governing the instruments do not provide preferential rights to payment of distributions;

   (ii) distributions to holders of the instruments may be paid only out of distributable items;

   (iii) the conditions governing the instruments do not include a cap or other restriction on the maximum level of distributions, except in the case of the instruments referred to in Article 25;

   (iv) the level of distributions is not determined on the basis of the amount for which the instruments were purchased at issuance, and is not otherwise determined on this basis, except in the case of the instruments referred to in Article 25;

   (v) the conditions governing the instruments do not include any obligation for the institution to make distributions to their holders and the institution is not otherwise subject to such an obligation;

   (vi) non-payment of distributions does not constitute an event of default of the institution;

(i) compared to all the capital instruments issued by the institution, the instruments absorb the first and proportionately greatest share of losses as they occur, and each instrument absorbs losses to the same degree as all other Common Equity Tier 1 instruments;

(j) the instruments rank below all other claims in the event of insolvency or liquidation of the institution;

(k) the instruments entitle their owners to a claim on the residual assets of the institution, which, in the event of its liquidation and after the payment of all senior claims, is proportionate to the amount of such instruments issued and is not fixed or subject to a cap, except in the case of the capital instruments referred to in Article 25;

(l) the instruments are not secured, or guaranteed by any of the following:

   (i) the institution or its subsidiaries;

   (ii) the parent institution or its subsidiaries;

   (iii) the parent financial holding company or its subsidiaries;

   (iv) the mixed activity holding company or its subsidiaries;

   (v) the mixed financial holding company and its subsidiaries;

(vi) any undertaking that has close links with the entities referred to in points (i) to (v);

(m) the instruments are not subject to any arrangement, contractual or otherwise, that enhances the seniority of claims under the instruments in insolvency or liquidation.

2. The conditions laid down in point (i) of paragraph 1 shall be met notwithstanding a write down on a permanent basis of the principal amount of Additional Tier 1 instruments.

3. EBA shall develop draft regulatory technical standards to specify the following:

(a) the applicable forms and nature of indirect funding of capital instruments;

(b) the meaning of distributable items for the purposes of determining the amount available to be distributed to the holders of own funds instruments of an institution.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Article 27

Capital instruments issued by mutuals, cooperative societies and similar institutions

1. Capital instruments issued by mutuals, cooperative societies and similar institutions shall qualify as Common Equity Tier 1 instruments only if the conditions laid down in Article 26 and this Article are met.

2. The following conditions shall be met as regards redemption of the capital instruments:

(a) except where prohibited under applicable national law, the institution shall be able to refuse the redemption of the instruments;

(b) where the refusal by the institution of the redemption of instruments is prohibited under applicable national law, the provisions governing the instruments shall give the institution the ability to limit their redemption;

(c) refusal to redeem the instruments, or the limitation of the redemption of the instruments where applicable, may not constitute an event of default of the institution.

3. The capital instruments may include a cap or restriction on the maximum level of distributions only where that cap or restriction is set out under applicable national law or the statute of the institution.

4. Where the capital instruments provide the owner with rights to the reserves of the institution in the event of insolvency or liquidation that are limited to the nominal value of the instruments, such a limitation shall apply to the same degree to the holders of all other Common Equity Tier 1 instruments issued by that institution.

5. Where the capital instruments entitle their owners to a claim on the assets of the institution in the event of its insolvency or liquidation that is fixed or subject to a cap, such a limitation shall apply to the same degree to all holders of all Common Equity Tier 1 instruments issued by the institution.

6. EBA shall develop draft regulatory technical standards to specify the nature of the limitations on redemption necessary where the refusal by the institution of the redemption of own funds instruments is prohibited under applicable national law.

   EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Article 28
Consequences of the conditions for Common Equity Tier 1 instruments ceasing to be met

The following shall apply where, in the case of a Common Equity Tier 1 instrument, the conditions laid down in Article 26, and Article 27 where applicable, cease to be met:

(a) that instrument shall cease to qualify as a Common Equity Tier 1 instrument;

(b) the share premium accounts that relate to that instrument shall cease to qualify as Common Equity Tier 1 items.

SECTION 2
PRUDENTIAL FILTERS

Article 29
Securitised assets

1. An institution shall exclude from any element of own funds any increase in its equity under the applicable accounting standard that results from securitised assets, including the following:

   (a) such an increase associated with future margin income that results in a gain on sale for the institution;

   (b) where the institution is the originator of a securitisation, net gains that arise from the capitalisation of future income from the securitised assets that provide credit enhancement to positions in the securitisation.

2. EBA shall develop draft regulatory technical standards to specify further the concept of a gain on sale referred to in point (a) of paragraph 1.

   EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Article 30
Cash flow hedges and changes in the value of own liabilities

Institutions shall not include the following items in any element of own funds:

(a) the fair value reserves related to gains or losses on cash flow hedges of financial instruments that are not valued at fair value, including projected cash flows;

(b) gains or losses on liabilities of the institution that are valued at fair value that result from changes in the own credit standing of the institution.

Article 31
Additional value adjustments

1. Institutions shall apply the requirements of Article 100 to all their assets measured at fair value when calculating the amount of their own funds and shall deduct from Common Equity Tier 1 capital the amount of any additional value adjustments necessary.

2. EBA shall develop draft regulatory technical standards to specify the conditions according to which the requirements of Article 100 referred shall be applied for the purposes of paragraph 1.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Article 32
Unrealised gains and losses measured at fair value

Except in the case of the items referred to in Article 30, institutions shall not make adjustments to remove from their own funds unrealised gains or losses on their assets or liabilities measured at fair value.

SECTION 3
DEDUCTIONS FROM COMMON EQUITY TIER 1 ITEMS, EXEMPTIONS AND ALTERNATIVES

SUB-SECTION 1
DEDUCTIONS FROM COMMON EQUITY TIER 1 ITEMS

Article 33
Deductions from Common Equity Tier 1 items

1. Institutions shall deduct the following from Common Equity Tier 1 items:

(a) losses for the current financial year;

(b) intangible assets;

(c) deferred tax assets that rely on future profitability;

(d) for institutions calculating risk-weighted exposure amounts using the Internal Ratings Based Approach, negative amounts resulting from the calculation of expected loss amounts laid down in Articles 154 and 155 154;

(e) defined benefit pension fund assets of the institution;

(f) direct and indirect holdings by an institution of own Common Equity Tier 1 instruments, including own Common Equity Tier 1 instruments that an institution is under an actual or contingent obligation to purchase by virtue of an existing contractual obligation;

(g) holdings of the Common Equity Tier 1 instruments of relevant entities where those entities have a reciprocal cross holding with the institution that the competent authority considers to have been designed to inflate artificially the own funds of the institution;

(h) the applicable amount of direct and indirect holdings by the institution of Common Equity Tier 1 instruments of relevant entities where the institution does not have a significant investment in those entities;

(i) the applicable amount of direct and indirect holdings by the institution of the Common Equity Tier 1 instruments of relevant entities where the institution has a significant investment in those entities;

(j) the amount of items required to be deducted from Additional Tier 1 items pursuant to Article 53 that exceeds the Additional Tier 1 capital of the institution;

(k) the exposure amount of the following items which qualify for a risk weight of 1 250 %, where the institution deducts that exposure amount from Common Equity Tier 1 capital as an alternative to applying a risk weight of 1 250 %:

   (i) qualifying holdings outside the financial sector;

   (ii) securitisation positions, in accordance with Articles 238(1)(b), 239(1)(b) and 253;

   (iii) free deliveries, in accordance with Article 369(3);

(l) any tax charge relating to Common Equity Tier 1 items foreseeable at the moment of its calculation, except where the institution suitably adjusts the amount of Common Equity Tier 1 items insofar as such tax charges reduce the amount up to which those items may be applied to cover risks or losses.

2. EBA shall develop draft regulatory technical standards to specify the following:

(a) in greater detail, the application of the deductions referred to in points (a), (c), (e) and (l) of paragraph 1;

(b) the types of capital instrument of financial institutions, third country insurance and reinsurance undertakings, and undertakings excluded from the scope of Directive 2009/138/EC in accordance with Article 4 of that Directive that shall be deducted from the following elements of own funds:

(i) Common Equity Tier 1 items;

(ii) Additional Tier 1 items;

(iii) Tier 2 items.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Article 34
Deduction of intangible assets

Institutions shall determine the intangible assets to be deducted in accordance with the following:

(a) the amount to be deducted shall be reduced by the amount of associated deferred tax liabilities that would be extinguished if the intangible assets became impaired or were derecognised under the relevant accounting standard;

(b) the amount to be deducted shall include goodwill included in the valuation of significant investments of the institution.

Article 35
Deduction of deferred tax assets that rely on future profitability

1. Institutions shall determine the amount of deferred tax assets that rely on future profitability that require deduction in accordance with this Article.

2. Except where the conditions laid down in paragraph 3 are met, the amount of deferred tax assets that rely on future profitability shall be calculated without reducing it by the amount of the associated deferred tax liabilities of the institution.

3. The amount of deferred tax assets that rely on future profitability may be reduced by the amount of the associated deferred tax liabilities of the institution, provided the following conditions are met:

(a) those deferred tax assets and associated deferred tax liabilities

both arise from the tax law of one Member State or third country;

(b) the taxation authority of that Member State or third country permits the offsetting of deferred tax assets and the associated deferred tax liabilities.

4. Associated deferred tax liabilities of the institution used for the purposes of paragraph 3 may not include deferred tax liabilities that reduce the amount of intangible assets or defined benefit pension fund assets required to be deducted.

5. The amount of associated deferred tax liabilities referred to in paragraph 4 shall be allocated between the following:

(a) deferred tax assets that rely on future profitability and arise from temporary differences that are not deducted in accordance with Article 45(1);

(b) all other deferred tax assets that rely on future profitability.

Institutions shall allocate the associated deferred tax liabilities according to the proportion of deferred tax assets that rely on future profitability that the items referred to in points (a) and (b) represent.

Article 36
Deferred tax assets that do not rely on future profitability

1. Institutions shall apply a risk weight in accordance with Chapter 2 or 3 of Title II of Part Three, as applicable, to deferred tax assets that do not rely on future profitability.

2. Deferred tax assets that do not rely on future profitability comprise the following:

(a) overpayments of tax by the institution for the current year;

(b) current year tax losses of the institution carried back to previous years that give rise to a claim on, or a receivable from, a central government, regional government or local tax authority;

(c) deferred tax assets arising from temporary differences which, in the event the institution incurs a loss, becomes insolvent or enters liquidation, are replaced, on a mandatory and automatic basis in accordance with the applicable national law, with a claim on the central government of the Member State in which the institution is incorporated which shall absorb losses to the same degree as Common Equity Tier 1 instruments on a going concern basis and in the event of insolvency or liquidation of the institution.

Article 37
Deduction of negative amounts resulting from the calculation of expected loss amounts

The amount to be deducted in accordance with point (d) of Article 33(1) shall not be reduced by a rise in the level of deferred tax assets that rely on future profitability, or other additional tax effect, that could occur if provisions were to rise to the level of expected losses referred to in Section 3 of Chapter 3 of Title II.

Article 38
Deduction of defined benefit pension fund assets

1. For the purposes of point (e) of Article 33(1), the amount of defined benefit pension fund assets to be deducted shall be reduced by the following:

   (a) the amount of any associated deferred tax liability which could be extinguished if the assets became impaired or were derecognised under the applicable accounting standard;

   (b) the amount of assets in the defined benefit pension fund which the institution has an unrestricted ability to use, provided the institution has received the prior consent of the competent authority. Those assets used to reduce the amount to be deducted shall receive a risk weight in accordance with Chapter 2 or 3 of Title II of Part Three, as applicable.

2. EBA shall develop draft regulatory technical standards to specify the criteria according to which a competent authority shall permit an institution to reduce the amount of assets in the defined benefit pension fund as specified in point (b) of paragraph 1.

   EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Article 39
Deduction of holdings of own Common Equity Tier 1 instruments

For the purposes of point (f) of Article 33(1), institutions shall calculate holdings of own Common Equity Tier 1 instruments on the basis of gross long positions subject to the following exceptions:

(a) institutions may calculate the amount of holdings of own Common Equity Tier 1 instruments in the trading book on the basis of the net long position provided the long and short positions are in the same underlying exposure and the short positions involve no counterparty risk;

(b) institutions shall determine the amount to be deducted for indirect holdings in the trading book that take the form of holdings of index securities by calculating the underlying exposure to own Common Equity Tier 1 instruments included in the indices;

(c) institutions may net gross long positions in own Common Equity Tier 1 instruments in the trading book resulting from holdings of index securities against short positions in own Common Equity Tier 1 instruments resulting from short positions in the underlying indices, including where those short positions involve counterparty risk.

Article 40
Significant investment in a relevant entity

For the purposes of deduction, a significant investment of an institution in a relevant entity shall arise

where any of the following conditions is met:

(a) the institution owns more than 10 % of the Common Equity Tier 1 instruments issued by that entity;

(b) the institution has close links with that entity and owns Common Equity Tier 1 instruments issued by that entity;

(c) the institution owns Common Equity Tier 1 instruments issued by that entity and the entity is not included in consolidation pursuant to Chapter 2 of Title II of Part One but is included in the same accounting consolidation as the institution for the purposes of financial reporting under the applicable accounting standard.

Article 41

Deduction of holdings of Common Equity Tier 1 instruments of relevant entities and where an institution has a reciprocal cross holding designed artificially to inflate own funds

Institutions shall make the deductions referred to in points (g), (h) and (i) of Article 33(1) in accordance with the following:

(a) holdings of Common Equity Tier 1 instruments and other capital instruments of relevant entities shall be calculated on the basis of the gross long positions;

(b) Tier 1 own-fund insurance items shall be treated as holdings of Common Equity Tier 1 instruments for the purposes of deduction.

Article 42

Deduction of holdings of Common Equity Tier 1 instruments of relevant entities

Institutions shall make the deductions required by points (h) and (i) of Article 33(1) in accordance with the following provisions:

(a) they may calculate holdings in the trading book of the capital instruments of relevant entities on the basis of the net long position in the same underlying exposure provided the maturity of the short position matches the maturity of the long position or has a residual maturity of at least one year;

(b) they shall determine the amount to be deducted for indirect holdings in the trading book of the capital instruments of relevant entities that take the form of holdings of index securities by calculating the underlying exposure to the capital instruments of the relevant entities in the indices.

Article 43

Deduction of holdings where an institution does not have a significant investment in a relevant entity

1. For the purposes of point (h) of Article 33(1), institutions shall calculate the applicable amount to be deducted by multiplying the amount referred to in point (a) by the factor derived from

the calculation referred to in point (b):

(a) the aggregate amount by which the direct and indirect holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of relevant entities which exceeds 10% of the Common Equity Tier 1 items of the institution calculated after applying the following to Common Equity Tier 1 items:

(i) Articles 29 to 32;

(ii) the deductions referred to in points (a) to (g) and (j) to (l) of Article 33(1), excluding the amount to be deducted for deferred tax assets that rely on future profitability and arise from temporary differences;

(iii) Articles 41 and 42;

(b) the amount of direct and indirect holdings by the institution of the Common Equity Tier 1 instruments of relevant entities divided by the aggregate amount of direct and indirect holdings by the institution of the own funds instruments of those relevant entities.

2. Institutions shall exclude underwriting positions held for 5 working days or fewer from the amount referred to in point (a) of paragraph 1 and from the calculation of the factor referred to in point (b) of paragraph 1.

3. Institutions shall determine the portion of holdings of Common Equity Tier 1 instruments that is deducted pursuant to paragraph 1 by dividing the amount specified in point (a) by the amount specified in point (b):

(a) the amount of holdings required to be deducted pursuant to paragraph 1;

(b) the aggregate amount of direct and indirect holdings by the institution of the own funds instruments of relevant entities in which the institution does not have a significant investment.

4. The amount of holdings referred to in point (h) of Article 33(1) that is equal to or less than 10 % of the Common Equity Tier 1 items of the institution after applying the provisions laid down in points (a)(i) to (iii) of paragraph 1 shall not be deducted and shall be subject to the applicable risk weights in accordance with Chapter 2 or 3 of Title II of Part Three and the requirements laid down in Title IV of Part Three, as applicable.

5. Institutions shall determine the portion of holdings of own funds instruments that is risk weighted by dividing the amount specified in point (a) by the amount specified in point (b):

(a) the amount of holdings required to be risk weighted pursuant to paragraph 4;

(b) aggregate amount of direct and indirect holdings by the institution of the own funds instruments of relevant entities in which the institution does not have a significant investment.

Article 44

Deduction of holdings of Common Equity Tier 1 instruments where an institution has a

significant investment in a relevant entity

For the purposes of point (i) of Article 33(1), the applicable amount to be deducted from Common Equity Tier 1 items shall exclude underwriting positions held for 5 working days or fewer and shall be determined in accordance with Articles 41 and 42 and Sub-Section 2.

SUB-SECTION 2
EXEMPTIONS FROM AND ALTERNATIVES TO DEDUCTION FROM COMMON EQUITY TIER 1 ITEMS

Article 45
Threshold exemptions from deduction from Common Equity Tier 1 items

1. In making the deductions required pursuant to points (c) and (i) of Article 33(1), institutions shall not deduct the items listed in points (a) and (b) which in aggregate are equal to or less than 15 % of Common Equity Tier 1 capital are exempt from deduction:

   (a) deferred tax assets that are dependent on future profitability and arise from temporary differences, and in aggregate are equal to or less than 10 % of the Common Equity Tier 1 items of the institution calculated after applying the following:

      (i) Articles 29 to 32;

      (ii) points (a) to (h) and (j) to (l) of Article 33(1), excluding deferred tax assets that rely on future profitability and arise from temporary differences.

   (b) where an institution has a significant investment in a relevant entity, the direct and indirect holdings of that institution of the Common Equity Tier 1 instruments of those entities that in aggregate are equal to or less than 10 % of the Common Equity Tier 1 items of the institution calculated after applying the following:

      (i) Article 29 to 32;

      (ii) points (a) to (h) and (j) to (l) of Article 33(1), excluding deferred tax assets that rely on future profitability and arise from temporary differences.

2. Items that are not deducted pursuant to paragraph 1 shall be risk weighted at 250 % and subject to the requirements of Title IV of Part Three, as applicable.

Article 46
Other exemptions from, and alternatives to, deduction where consolidation is applied

1. As an alternative to the deduction of holdings of an institution in the Common Equity Tier 1 instruments of insurance undertakings, reinsurance undertakings and insurance holding companies in which the institution has a significant investment, competent authorities may allow institutions to apply methods 1, 2 or 3 of Annex I to Directive 2002/87/EC. The institution shall apply the method chosen in a consistent manner over time.

An institution may apply method 1 (accounting consolidation) only if it has received the prior consent of the competent authority. The competent authority may grant such consent only if it is satisfied that the level of integrated management and internal control regarding the entities that would be included in the scope of consolidation under method 1 is adequate.

2. For the purposes of calculating own funds on a stand-alone basis, institutions subject to supervision on a consolidated basis in accordance with Chapter 2 of Title II of Part One shall not deduct holdings referred to in points (h) and (i) of Article 33(1) in relevant entities included in the scope of consolidated supervision.

3. Competent authorities may permit institutions not to deduct a holding of an item referred to in points (h) and (i) of Article 33(1) in the following cases:

(a) where the holding is in a relevant entity which is included in the same supplementary supervision as the institution in accordance with Directive 2002/87/EC;

(b) where an institution referred to in Article 25 has a holding in another such institution, or in its central or regional credit institution, and the following conditions are met:

(i) where the holding is in a central or regional credit institution, the institution with that holding is associated with that central or regional credit institution in a network subject to legal or statutory provisions and the central or regional credit institution is responsible, under those provisions, for cash-clearing operations within that network;

(ii) the institutions fall within the same institutional protection scheme referred to in Article 108(7);

(iii) the competent authorities have granted the permission referred to in Article 108(7);

(iv) the conditions laid down in Article 108(7) are satisfied;

(v) the institution draws up and reports to the competent authorities the consolidated balance sheet referred to in point (e) of Article 108(7) no less frequently than own funds requirements are required to be reported under Article 95.

(c) where a regional credit institution has a holding in its central or another regional credit institution and the conditions laid down in point (b)(i) to (v) are met.

4. EBA, EIOPA and ESMA shall, through the Joint Committee, develop draft regulatory technical standards to specify for the purposes of this Article the conditions of application of the calculation methods listed in Annex I, Part II and Article 228(1) of Directive 2002/87/EC for the purposes of the alternatives to deduction referred to in paragraph 1 and point (a) of paragraph 3.

EBA, EIOPA and ESMA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first sub-paragraph in accordance with the procedure laid down in Articles 10 to 14

of Regulation (EU) No 1093/2010.

5. EBA shall develop draft regulatory technical standards to specify the conditions of application of point (b) of paragraph 3.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

SECTION 3
COMMON EQUITY TIER 1 CAPITAL

Article 47
Common Equity Tier 1 capital

The Common Equity Tier 1 capital of an institution shall consist of Common Equity Tier 1 items after the application of the adjustments required by Article 29 to 32, the deductions pursuant to Article 33 and the exemptions and alternatives laid down in Article 45, 46 and 74.

Chapter 3
Additional Tier 1 capital

SECTION 1
ADDITIONAL TIER 1 ITEMS AND INSTRUMENTS

Article 48
Additional Tier 1 items

Additional Tier 1 items shall consist of the following:

(a) capital instruments, where the conditions laid down in Article 49(1) are met;

(b) the share premium accounts related to the instruments referred to in point (a).

Article 49
Additional Tier 1 instruments

1. Capital instruments shall qualify as Additional Tier 1 instruments only if the following conditions are met:

(a) the instruments are issued and paid up;

(b) the instruments are not purchased by any of the following:

(i) the institution or its subsidiaries;

(ii) a undertaking in which the institution has participation in the form of ownership, direct or by way of control, of 20% or more of the voting rights or capital of that undertaking;

(c) the purchase of the instruments is not funded directly or indirectly by the institution;

(d) the instruments rank below Tier 2 instruments in the event of the insolvency of the institution;

(e) the instruments are not secured, or guaranteed by any of the following:

(i) the institution or its subsidiaries;

(ii) the parent institution or its subsidiaries;

(iii) the parent financial holding company or its subsidiaries;

(iv) the mixed activity holding company or its subsidiaries;

(v) the mixed financial holding company and its subsidiaries;

(vi) any undertaking that has close links with entities referred to in points (i) to (v);

(f) the instruments are not subject to any arrangement, contractual or otherwise, that enhances the seniority of the claim under the instruments in insolvency or liquidation;

(g) the instruments are perpetual and the provisions governing them include no incentive for the institution to redeem them;

(h) where the provisions governing the instruments include one or more call options, the option to call may be exercised at the sole discretion of the issuer;

(i) the instruments may be called, redeemed or repurchased only where the conditions laid down in Article 72 are met, and not before five years after the date of issuance;

(j) the provisions governing the instruments do not indicate explicitly or implicitly that the instruments would or might be called, redeemed or repurchased and the institution does not otherwise provide such an indication;

(k) the institution does not indicate explicitly or implicitly that the competent authority would consent to a request to call, redeem or repurchase the instruments;

(l) distributions under the instruments meet the following conditions:

(i) they are paid out of distributable items;

(ii) the level of distributions made on the instruments will not be modified based on the credit standing of the institution, its parent institution or parent financial

holding company or mixed activity holding company;

(iii) the provisions governing the instruments give the institution full discretion at all times to cancel the distributions on the instruments for an unlimited period and on a non-cumulative basis, and the institution may use such cancelled payments without restriction to meet its obligations as they fall due;

(iv) cancellation of distributions does not constitute an event of default of the institution;

(v) the cancellation of distributions imposes no restrictions on the institution;

(m) the instruments do not contribute to a determination that the liabilities of an institution exceed its assets, where such a determination constitutes a test of insolvency under applicable national law;

(n) the provisions governing the instruments require the principal amount of the instruments to be written down, or the instruments to be converted to Common Equity Tier 1 instruments, upon the occurrence of a trigger event;

(o) the provisions governing the instruments include no feature that could hinder the recapitalisation of the institution;

(p) where the instruments are not issued directly by the institution or by an operating entity within the consolidation pursuant to Chapter 2 of Title II of Part One, the parent institution, the parent financial holding company, or the mixed activity holding company, the proceeds are immediately available without limitation in a form that satisfies the conditions laid down in this paragraph to any of the following:

(i) the institution;

(ii) an operating entity within the consolidation pursuant to Chapter 2 of Title II of Part One;

(iii) the parent institution;

(iv) the parent financial holding company;

(v) the mixed activity holding company.

2. EBA shall develop draft regulatory technical standards to specify all the following:

(a) the form and nature of incentives to redeem;

(b) the nature of the write down of the principal amount;

(c) the procedures and timing for the following:

(i) determining that a trigger event has occurred;

(ii) notifying the competent authority and the holders of the instrument that a trigger event has occurred and that the principal amount of the instrument will be

written down or the instrument converted to a Common Equity Tier 1 instrument, as applicable, in accordance with the provisions governing the instrument;

(iii) writing down the principal amount of the instrument, or converting it to a Common Equity Tier 1 instrument, as applicable;

(d) features of instruments that could hinder the recapitalisation of the institution;

(e) the use of special purposes entities for indirect issuance of own funds instruments.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Article 50
Restrictions on the cancellation of distributions on Additional Tier 1 instruments and features that could hinder the recapitalisation of the institution

For the purposes of points (l)(v) and (o) of Article 49(1), the provisions governing Additional Tier 1 instruments may, in particular, not include the following:

(a) a requirement for distributions on the instruments to be made in the event of a distribution being made on an instrument issued by the institution that ranks to the same degree as, or more junior than, an Additional Tier 1 instrument, including a Common Equity Tier 1 instrument;

(b) a requirement for the payment of distributions on Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments to be cancelled in the event that distributions are not made on those Additional Tier 1 instruments;

(c) an obligation to substitute the payment of interest or dividend by a payment in any other form. The institution shall not otherwise be subject to such an obligation.

Article 51
Write down or conversion of Additional Tier 1 instruments

For the purposes of point (n) of Article 49(1), the following provisions shall apply to Additional Tier 1 instruments:

(a) a trigger event occurs when the Common Equity Tier 1 capital ratio of the institution referred to in point (a) of Article 87 falls below either of the following:

(i) 5.125 %;

(ii) a level higher than 5.125 %, where determined by the institution and specified in the provisions governing the instrument;

(b) where the provisions governing the instruments require them to be converted into

Common Equity Tier 1 instruments upon the occurrence of a trigger event, those provisions shall specify either of the following:

(i) the rate of such conversion and a limit on the permitted amount of conversion;

(ii) a range within which the instruments will convert into Common Equity Tier 1 instruments;

(c) where the provisions governing the instruments require their principal amount to be written down upon the occurrence of a trigger event, the write down shall reduce all the following:

(i) the claim of the holder of the instrument in the liquidation of the institution;

(ii) the amount required to be paid in the event of the call of the instrument;

(iii) the distributions made on the instrument.

Article 52
Consequences of the conditions for Additional Tier 1 instruments ceasing to be met

The following shall apply where, in the case of an Additional Tier 1 instrument, the conditions laid down in Article 49(1) cease to be met:

(a) that instrument shall cease to qualify as an Additional Tier 1 instrument;

(b) the part of the share premium accounts that relates to that instrument shall cease to qualify as Additional Tier 1 items.

SECTION 2
DEDUCTIONS FROM ADDITIONAL TIER 1 ITEMS

Article 53
Deductions from Additional Tier 1 items

Institutions shall deduct the following from Additional Tier 1 items:

(a) direct and indirect holdings by an institution of own Additional Tier 1 instruments, including own Additional Tier 1 instruments that an institution could be obliged to purchase as a result of existing contractual obligations;

(b) holdings of the Additional Tier 1 instruments of relevant entities with which the institution has reciprocal cross holdings that the competent authority considers to have been designed to inflate artificially the own funds of the institution;

(c) the applicable amount determined in accordance with Article 57 of direct and indirect holdings of the Additional Tier 1 instruments of relevant entities, where an institution does not have a significant investment in those entities;

(d) direct and indirect holdings by the institution of the Additional Tier 1

instruments of relevant entities where the institution has a significant investment in those entities, excluding underwriting positions held for 5 working days or fewer;

(e) the amount of items required to be deducted from Tier 2 items pursuant to Article 63 that exceed the Tier 2 capital of the institution;

(f) any tax charge relating to Additional Tier 1 items foreseeable at the moment of its calculation, except where the institution suitably adjusts the amount of Additional Tier 1 items insofar as such tax charges reduce the amount up to which those items may be applied to cover risks or losses.

Article 54
Deductions of holdings of own Additional Tier 1 instruments

For the purposes of point (a) of Article 53, institutions shall calculate holdings of own Additional Tier 1 instruments on the basis of gross long positions subject to the following exceptions:

(a) institutions may calculate the amount of holdings of own Additional Tier 1 instruments in the trading book on the basis of the net long position provided the long and short positions are in the same underlying exposure and the short positions involve no counterparty risk;

(b) institutions shall determine the amount to be deducted for indirect holdings in the trading book of own Additional Tier 1 instruments that take the form of holdings of index securities by calculating the underlying exposure to own Additional Tier 1 instruments in the indices;

(c) gross long positions in own Additional Tier 1 instruments in the trading book resulting from holdings of index securities may be netted by the institution against short positions in own Additional Tier 1 instruments resulting from short positions in the underlying indices, including where those short positions involve counterparty risk.

Article 55
Deduction of holdings of Additional Tier 1 instruments of relevant entities and where an institution has a reciprocal cross holding designed artificially to inflate own funds

Institutions shall make the deductions required by points (b), (c) and (d) of Article 53 in accordance with the following:

(a) holdings of Additional Tier 1 instruments shall be calculated on the basis of the gross long positions;

(b) additional Tier 1 own-fund insurance items shall be treated as holdings of Additional Tier 1 instruments for the purposes of deduction.

Article 56
Deduction of holdings of Additional Tier 1 instruments of relevant entities

Institutions shall make the deductions required by points (c) and (d) of Article 53 in accordance with the following:

(a) they shall calculate holdings in the trading book of the capital instruments of relevant entities on the basis of the net long position in the same underlying exposure provided the maturity of the short position matches the maturity of the long position or has a residual maturity of at least one year;

(b) they shall determine the amount to be deducted for indirect holdings in the trading book of the capital instruments of relevant entities that take the form of holdings of index securities by calculating the underlying exposure to the capital instruments of the relevant entities in the indices.

Article 57
Deduction of holdings of Additional Tier 1 instruments where an institution does not have a significant investment in a relevant entity

1. For the purposes of point (c) of Article 53, institutions shall calculate the applicable amount to be deducted by multiplying the amount referred to in point (a) by the factor derived from the calculation referred to in point (b):

   (a) the aggregate amount by which the direct and indirect holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of relevant entities exceeds 10% of the Common Equity Tier 1 items of the institution calculated after applying the following:

      (i) Article 29 to 32;

      (ii) points (a) to (g) and (j) to (l) of Article 33(1), excluding deferred tax assets that rely on future profitability and arise from temporary differences;

      (iii) Articles 41 and 42;

   (b) the amount of direct and indirect holdings by the institution of the Additional Tier 1 instruments of relevant entities divided by the aggregate amount of all direct and indirect holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of those relevant entities.

2. Institutions shall exclude underwriting positions held for 5 working days or fewer from the amount referred to in point (a) of paragraph 1 and from the calculation of the factor referred to in point (b) of paragraph 1.

3. Institutions shall determine the portion of holdings of Additional Tier 1 instruments that is deducted by dividing the amount specified in point (a) by the amount specified in point (b):

   (a) the amount of holdings required to be deducted pursuant to paragraph 1;

   (b) aggregate amount of direct and indirect holdings by the institution of the own funds instruments of relevant entities in which the institution does not have a significant investment.

SECTION 3

ADDITIONAL TIER 1 CAPITAL

Article 58
Additional Tier 1 capital

The Additional Tier 1 capital of an institution shall consist of Additional Tier 1 items after the deduction of the items referred to in Article 53 and the application of Article 74.

Chapter 4
Tier 2 capital

SECTION 1
TIER 2 ITEMS AND INSTRUMENTS

Article 59
Tier 2 items

Tier 2 items shall consist of the following:

(a) capital instruments, where the conditions laid down in Article 60 are met;

(b) the share premium accounts related to the instruments referred to in point (a);

(c) for institutions calculating risk-weighted exposure amounts in accordance with Chapter 2 of Title II, general credit risk adjustments, gross of tax effects, of up to 1.25 % of risk-weighted exposure amounts calculated in accordance with Chapter 2 of Title II of Part Three;

(d) for institutions calculating risk-weighted exposure amounts under Chapter 3 of Title II, positive amounts, gross of tax effects, resulting from the calculation laid down in Article 154 and 155 up to 0,6 % of risk weighted exposure amounts calculated under Chapter 3 of Title II of Part Three.

Article 60
Tier 2 instruments

Capital instruments shall qualify as Tier 2 instruments provided the following conditions are met:

(a) the instruments are issued and fully paid-up;

(b) the instruments are not purchased by any of the following:

(i) the institution or its subsidiaries;

(ii) an undertaking in which the institution has participation in the form of ownership, direct

or by way of control, of 20% or more of the voting rights or capital of that undertaking;

(c) the purchase of the instruments is not funded directly or indirectly by the institution;

(d) the claim on the principal amount of the instruments under the provisions governing the instruments is wholly subordinated to claims of all non-subordinated creditors;

(e) the instruments are not secured, or guaranteed by any of the following:

(i) the institution or its subsidiaries;

(ii) the parent institution or its subsidiaries;

(iii) the parent financial holding company or its subsidiaries;

(iv) the mixed activity holding company or its subsidiaries;

(v) the mixed financial holding company and its subsidiaries;

(vi) any undertaking that has close links with entities referred to in points (i) to (v);

(f) the instruments are not subject to any arrangement that otherwise enhances the seniority of the claim under the instruments;

(g) the instruments have an original maturity of at least 5 years;

(h) the provisions governing the instruments do not include any incentive for them to be redeemed by the institution;

(i) where the instruments include one or more call options, the options are exercisable at the sole discretion of the issuer;

(j) the instruments may be called, redeemed or repurchased only where the conditions laid down in Article 72 are met, and not before five years after the date of issuance;

(k) the provisions governing the instruments do not indicate or suggest that the instruments would or might be redeemed or repurchased other than at maturity and the institution does not otherwise provide such an indication or suggestion;

(l) the provisions governing the instruments do not give the holder the right to accelerate the future scheduled payment of interest or principal, other than in the insolvency or liquidation of the institution;

(m) the level of interest or dividend payments due on the instruments will not be modified based on the credit standing of the institution, its parent institution or parent financial holding company or mixed activity holding company;

(n) where the instruments are not issued directly by the institution or by an operating entity within the consolidation pursuant to Chapter 2 of Title II of Part One, the parent institution, the parent financial holding company, or the mixed activity holding company, the proceeds are immediately available without limitation in a form that satisfies the conditions laid down in

this paragraph to any of the following:

(i) the institution;

(ii) an operating entity within the consolidation pursuant to Chapter 2 of Title II of Part One;

(iii) the parent institution;

(iv) the parent financial holding company;

(v) the mixed activity holding company.

Article 61
Amortisation of Tier 2 instruments

The extent to which Tier 2 instruments qualify as Tier 2 items during the final 5 years of maturity of the instruments is calculated by multiplying the result derived from the calculation in point (a) by the amount referred to in point (b) as follows:

(a) the nominal amount of the instruments or subordinated loans on the first day of the final five year period of their contractual maturity divided by the number of calendar days in that period;

(b) the number of remaining calendar days of contractual maturity of the instruments or subordinated loans.

Article 62
Consequences of the conditions for Tier 2 instruments ceasing to be met

Where in the case of a Tier 2 instrument the conditions laid down in Article 60 cease to be met, the following shall apply:

(a) that instrument shall cease to qualify as a Tier 2 instrument;

(b) the part of the share premium accounts that relate to that instrument shall cease to qualify as Tier 2 items.

SECTION 2
DEDUCTIONS FROM TIER 2 ITEMS

Article 63
Deductions from Tier 2 items

The following shall be deducted from Tier 2 items:

(a) direct and indirect holdings by an institution of own Tier 2 instruments, including own Tier 2 instruments that an institution could be obliged to purchase as a result of existing contractual obligations;

(b) holdings of the Tier 2 instruments of relevant entities with which the institution has reciprocal cross holdings that the competent authority considers to have been designed to inflate artificially the own funds of the institution;

(c) the applicable amount determined in accordance with Article 67 of direct and indirect holdings of the Tier 2 instruments of relevant entities, where an institution does not have a significant investment in those entities;

(d) direct and indirect holdings by the institution of the Tier 2 instruments of relevant entities where the institution has a significant investment in those entities, excluding underwriting positions held for fewer than 5 working days.

Article 64

Deductions of holdings of own Tier 2 instruments and subordinated loans

For the purposes of point (a) of Article 63, institutions shall calculate holdings on the basis of the gross long positions subject to the following exceptions:

(a) institutions may calculate the amount of holdings in the trading book on the basis of the net long position provided the long and short positions are in the same underlying exposure and the short positions involve no counterparty risk;

(b) institutions shall determine the amount to be deducted for indirect holdings in the trading book that take the form of holdings of index securities by calculating the underlying exposure to own Tier 2 instruments in the indices;

(c) institutions may net gross long positions in own Tier 2 instruments in the trading book resulting from holdings of index securities against short positions in own Tier 2 instruments resulting from short positions in the underlying indices, including where those short positions involve counterparty risk.

Article 65

Deduction of holdings of Tier 2 instruments and subordinated loans of relevant entities and where an institution has a reciprocal cross holding designed artificially to inflate own funds

Institutions shall make the deductions required by points (b), (c) and (d) of Article 63 in accordance with the following provisions:

(a) holdings of Tier 2 instruments, including subordinated loans, shall be calculated on the basis of the gross long positions;

(b) holdings of Tier 2 own-fund insurance items and Tier 3 own-fund insurance items shall be treated as holdings of Tier 2 instruments for the purposes of deduction.

Article 66

Deduction of holdings of Tier 2 instruments and subordinated loans of relevant entities

Institutions shall make the deductions required by points (c) and (d) of Article 63 in accordance with

the following:

(a) they may calculate holdings in the trading book of the capital instruments of relevant entities on the basis of the net long position in the same underlying exposure provided the maturity of the short position matches the maturity of the long position or has a residual maturity of at least one year;

(b) they shall determine the amount to be deducted for indirect holdings in the trading book of the capital instruments of relevant entities that take the form of holdings of index securities by looking through to the underlying exposure to the capital instruments of the relevant entities in the indices.

Article 67

Deduction of Tier 2 instruments where an institution does not have a significant investment in a relevant entity

1. For the purposes of point (c) of Article 63, institutions shall calculate the applicable amount to be deducted by multiplying the amount referred to in point (a) by the factor derived from the calculation referred to in point (b):

   (a) the aggregate amount by which the direct and indirect holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of relevant entities exceeds 10% of the Common Equity Tier 1 items of the institution calculated after applying the following:

      (i) Article 29 to 32;

      (ii) points (a) to (g) and (j) to (l) of Article 33(1), excluding the amount to be deducted for deferred tax assets that rely on future profitability and arise from temporary differences;

      (iii) Articles 41 and 42;

   (b) the amount of direct and indirect holdings by the institution of the Tier 2 instruments of relevant entities divided by the aggregate amount of all direct and indirect holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of those relevant entities.

2. Institutions shall exclude underwriting positions held for 5 working days or fewer from the amount referred to in point (a) of paragraph 1 and from the calculation of the factor referred to in point (b) of paragraph 1.

3. Institutions shall determine the portion of holdings of Tier 2 instruments that is deducted by dividing the amount specified in point (a) by the amount specified in point (b):

   (a) the total amount of holdings required to be deducted pursuant to paragraph 1;

   (b) aggregate amount of direct and indirect holdings by the institution of the own funds instruments of relevant entities in which the institution does not have a significant investment.

SECTION 3
TIER 2 CAPITAL

Article 68
Tier 2 capital

The Tier 2 capital of an institution shall consist of the Tier 2 items of the institution after the deductions referred to in Article 63 and the application of Article 74.

Chapter 5
Own funds

Article 69
Own funds

The own funds of an institution shall consist of the sum of its Tier 1 capital and Tier 2 capital.

Chapter 6
General requirements

Article 70
Holding of capital instruments of regulated entities that do not qualify as regulatory capital

Institutions shall not deduct from any element of own funds holdings of a regulated financial entity within the meaning of paragraph 2 of Article 137(4) that do not qualify as regulatory capital of that entity. Institutions shall apply a risk weight to such holdings in accordance with Chapter 2 or 3 of Title II of Part Three, as applicable.

Article 71
Indirect holdings arsing from index holdings

1. As an alternative to an institution calculating its exposure to Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of relevant entities included in indices, where the competent authority has given its prior consent an institution may use a conservative estimate of the underlying exposure of the institution to the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of relevant entities that are included in the indices.

2. A competent authority shall give its consent only where the institution has demonstrated to the satisfaction of the competent authority that it would be operationally burdensome for the institution to monitor its underlying exposure to the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of those relevant entities included in the indices.

3. EBA shall develop draft regulatory technical standards to specify:

(a) the extent of conservatism required in estimates used as an alternative to the calculation of underlying exposure referred to in paragraph 1;

(b) the meaning of operationally burdensome for the purposes of paragraph 2.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Article 72
Conditions for reducing own funds

An institution shall require the prior consent of the competent authority to do the following:

(a) reduce or repurchase Common Equity Tier 1 instruments issued by the institution in a manner that is permitted under applicable national law;

(b) effect the call, redemption or repurchase of Additional Tier 1 instruments or Tier 2 instruments prior to the date of their contractual maturity.

Article 73
Supervisory consent for reducing own funds

1. The competent authority shall grant consent for an institution to reduce, repurchase, call or redeem Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments where any of the following conditions is met:

   (a) earlier than or at the same time as the action referred to in Article 13, the institution replaces the instruments referred to in Article 72 with own funds instruments of equal or higher quality at terms that are sustainable for the income capacity of the institution;

   (b) the institution has demonstrated to the satisfaction of the competent authority that the own funds of the institution would, following the action in question, exceed the requirements laid down in Article 87(1) by a margin that the competent authority considers to be significant and appropriate and the competent authority considers the financial situation of the institution otherwise to be sound.

2. Where an institution takes an action referred to in point (a) of Article 72 and the refusal of redemption of Common Equity Tier 1 instruments referred to in Article 25 is prohibited by applicable national law, the competent authority may waive the conditions laid down in paragraph 1 of this Article provided the competent authority requires the institution to limit the redemption of such instruments on an appropriate basis.

3. EBA shall adopt draft regulatory technical standards to specify the following:

   (a) the meaning of sustainable for the income capacity of the institution;

(b) the appropriate bases of limitation of redemption referred to in paragraph 2;

(c) the process and data requirements for an application by an institution for the consent of the competent authority to carry out an action listed in Article 72, including the time period for processing such application.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Article 74
Temporary waiver from deduction from own funds

1. Where an institution holds shares that qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments in a relevant entity temporarily and the competent authority deems those holdings to be for the purposes of a financial assistance operation designed to reorganise and save that entity, the competent authority may waive on a temporary basis the provisions on deduction that would otherwise apply to those instruments.

2. EBA shall develop draft regulatory technical standards to specify the concept of temporary for the purposes of paragraph 1 and the conditions according to which a competent authority may deem the temporary holdings referred to be for the purposes of a financial assistance operation designed to reorganise and save a relevant entity.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Article 75
Continuing review of quality of own funds

1. EBA shall monitor the quality of own funds instruments issued by institutions across the Union and shall notify the Commission immediately where there is significant evidence of material deterioration in the quality of those instruments.

2. A notification shall include the following:

(a) a detailed explanation of the nature and extent of the deterioration identified;

(b) technical advice on the action by the Commission that EBA considers to be necessary.

3. EBA shall provide technical advice to the Commission on any significant changes it considers to be required to the definition of own funds as a result of any of the following:

(a) relevant developments in market standards or practice;

(b) changes in relevant legal or accounting standards;

(c) significant developments in the methodology of EBA for stress testing the solvency of institutions.

4. EBA shall provide technical advice to the Commission by 31 December 2013 on possible treatments of unrealised gains measured at fair value other than including them in Common Equity Tier 1 without adjustment. Such recommendations shall take into account relevant developments in international accounting standards and in international agreements on prudential standards for banks.

Title III
Minority interest and Additional Tier 1 and Tier 2 instruments issued by subsidiaries

Article 76

Minority interests that qualify for inclusion in consolidated Common Equity Tier 1 capital

1. Minority interests shall comprise the Common Equity Tier 1 instruments, plus the related retained earnings and share premium accounts, of a subsidiary where the following conditions are met:

   (a) the subsidiary is one of the following:

      (i) an institution;

      (ii) an undertaking that is subject by virtue of applicable national law to the requirements of this Regulation and Directive [inserted by OP],

   (c) the subsidiary is included fully in the consolidation pursuant to Chapter 2 of Title II of Part One;

   (d) those Common Equity Tier 1 instruments are owned by persons other than the undertakings included in the consolidation pursuant to Chapter 2 of Title II of Part One.

2. Minority interests that are funded directly or indirectly, through a special purpose entity or otherwise, by the parent institution, parent financial holding company, mixed activity holding company or their subsidiaries shall not qualify as consolidated Common Equity Tier 1 capital.

Article 77

Qualifying Additional Tier 1, Tier 1, Tier 2 capital and qualifying own funds

Qualifying Additional Tier 1, Tier 1, Tier 2 capital and qualifying own funds shall comprise the minority interest, Additional Tier 1, Tier 1 or Tier 2 instruments, as applicable, plus the related retained earnings and share premium accounts, of a subsidiary where the following conditions are met:

(a) the subsidiary is either of the following:

   (i) an institution;

   (ii) an undertaking that is subject by virtue of applicable national law to the requirements of this Regulation and Directive [inserted by OP];

(b) the subsidiary is included fully in the scope of consolidation pursuant to Chapter 2 of Title II of Part One;

(c) those instruments are owned by persons other than the undertakings included in the

consolidation pursuant to Chapter 2 of Title II of Part One.

Article 78
Qualifying Additional Tier 1and Tier 2 capital issued by a special purpose entity

1. Additional Tier 1 and Tier 2 instruments issued by special purpose entity, and the related retained earnings and share premium accounts, are included in qualifying Additional Tier 1, Tier 1 or Tier 2 capital or qualifying own funds, as applicable, only where the following conditions are met:

   (a) the special purpose entity issuing those instruments is included fully in the consolidation pursuant to Chapter 2 of Title II of Part One;

   (b) the instruments, and the related retained earnings and share premium accounts, are included in qualifying Additional Tier 1 capital only where the conditions laid down in Article 49(1) are satisfied;

   (c) the instruments, and the related retained earnings and share premium accounts, are included in qualifying Tier 2 capital only where the conditions laid down in Article 60 are satisfied;

   (d) the only asset of the special purpose entity is its investment in the own funds of that subsidiary, the form of which satisfies the relevant conditions laid down in Articles 49(1) or 60, as applicable.

   Where the competent authority considers the assets of a special purpose entity to be minimal and insignificant for such an entity, the competent authority may waive the condition specified in point (d).

2. EBA shall develop draft regulatory technical standards to specify the concepts of minimal and insignificant referred to in point (d) of paragraph 1.

   EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Article 79
Minority interests included in consolidated Common Equity Tier 1 capital

Institutions shall determine the amount of minority interests of a subsidiary that is included in consolidated Common Equity Tier 1 capital by subtracting from the minority interests of that undertaking the result of multiplying the amount referred to in point (a) by the percentage referred to in point (b):

(a) the Common Equity Tier 1 capital of the subsidiary minus the lower of the following:

(i) the amount of Common Equity Tier 1 capital of that subsidiary required to meet the sum of the requirement laid down in point (a) of Article 87(1) and the combined buffer referred to in Article 122(2) of Directive [inserted by OP];

(ii) the amount of consolidated Common Equity Tier 1 capital that relates to that subsidiary that is required on a consolidated basis to meet the sum of the requirement laid down in point (a) of Article 87(1) and the combined buffer referred to in Article 122(2) of Directive [inserted by OP];

(b) the minority interests of the subsidiary expressed as a percentage of all Common Equity Tier 1 instruments of that undertaking plus the related retained earnings and share premium accounts.

Article 80
Qualifying Tier 1 instruments included in consolidated Tier 1 capital

Institutions shall determine the amount of qualifying Tier 1 capital of a subsidiary that is included in consolidated Tier 1 capital by subtracting from the qualifying Tier 1 capital of that undertaking the result of multiplying the amount referred to in point (a) by the percentage referred to in point (b).

(a) the lower of the following:

(i) the amount of Tier 1 capital of the subsidiary required to meet the sum of the requirement laid down in point (b) of Article 87(1) and the combined buffer referred to in Article 122(2)of Directive [inserted by OP];

(ii) the amount of consolidated Tier 1 capital that relates to the subsidiary that is required on a consolidated basis to meet the sum of the requirement laid down in point (b) of Article 87(1) and the combined buffer referred to in Article 122(2)of Directive [inserted by OP];

(b) the qualifying Tier 1 capital of the subsidiary expressed as a percentage of all Tier 1 instruments of that undertaking plus the related retained earnings and share premium accounts

Article 81
Qualifying Tier 1 capital included in consolidated Additional Tier 1 capital

Institutions shall determine the amount of qualifying Tier 1 capital of a subsidiary that is included in consolidated Additional Tier 1 capital by subtracting from the qualifying Tier 1 capital of that undertaking included in consolidated Tier 1 capital the minority interests of that undertaking that are included in consolidated Common Equity Tier 1 capital.

Article 82
Qualifying own funds included in consolidated own funds

Institutions shall determine the amount of qualifying own funds of a subsidiary that is included in consolidated own funds by subtracting from the qualifying own funds of that undertaking the result of multiplying the amount referred to in point (a) by the percentage referred to in point (b):

(a) the lower of the following:

(i) the amount of own funds of the subsidiary required to meet the sum of the requirement laid down in point (c) of Article 87(1) and the combined buffer referred to in Article 122(2) of Directive [inserted by OP];

(ii) the amount of own funds that relates to the subsidiary that is required on a consolidated basis to meet the sum of the requirement laid down in point (c) of Article 87(1) and the combined buffer referred to in Article 122(2)of Directive [inserted by OP];

(b) the qualifying own funds of the undertaking, expressed as a percentage of all own funds instruments of the subsidiary that are included in Common Equity Tier 1, Additional Tier 1 and Tier 2 items and the related retained earnings and share premium accounts

Article 83

Qualifying own funds instruments included in consolidated Tier 2 capital

Institutions shall determine the amount of qualifying own funds of a subsidiary that is included in consolidated Tier 2 capital by subtracting from the qualifying own funds of that undertaking that are included in consolidated own funds the qualifying Tier 1 capital of that undertaking that is included in consolidated Tier 1 capital.

Title IV
Qualifying holdings outside the financial sector

Article 84
Risk weighting and prohibition of qualifying holdings outside the financial sector

1. A qualifying holding, the amount of which exceeds 15 % of the eligible capital of the institution, in an undertaking which is not one of the following shall be subject to the provisions laid down in paragraph 3:

   (a) a relevant entity;

   (b) an undertaking, that is not a relevant entity, carrying on activities which the competent authority considers to be the following:

      (i) a direct extension of banking; or

      (ii) ancillary to banking,

      (iii) leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity.

2. The total amount of the qualifying holdings of an institution in undertakings other than those referred to in (a) and (b) of paragraph 1 that exceeds 60 % of its eligible capital shall be subject to the provisions laid down in paragraph 3.

3. Competent authorities shall apply the requirements laid down in point (a) or (b) to qualifying holdings of institutions referred to in paragraphs 1 and 2:

   (a) institutions shall apply a risk weight of 1 250 % to the following:

      (i) the amount of qualifying holdings referred to in paragraph 1 in excess of 15 % of eligible capital;

      (ii) the total amount of qualifying holdings referred to in paragraph 2 that exceed 60 % of the eligible capital of the institution;

   (b) the competent authorities shall prohibit institutions from having qualifying holdings referred to in paragraphs 1 and 2 the amount of which exceeds the percentages of eligible capital laid down in those paragraphs.

4. EBA shall develop draft regulatory technical standards to specify:

   (a) activities that are a direct extension of banking;

   (b) activities that concern services ancillary to banking;

   (c) similar activities for the purposes of point (b)(iii) of paragraph 1.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Article 85
Alternative to 1 250 % risk weight

As an alternative to applying a 1 250 % risk weight to the amounts in excess of the limits specified in paragraphs 1 and 2 of Article 84, institutions may deduct those amounts from Common Equity Tier 1 items in accordance with point (k) of Article 33(1).

Article 86
Exceptions

1. Shares of undertakings not referred to in points (a) and (b) of paragraph 1 shall not be included in calculating the eligible capital limits specified in Article 84 where any of the following conditions is met:

   (a) those shares are held temporarily during a financial reconstruction or rescue operation,

   (b) the holding of the shares is an underwriting position held for 5 working days or fewer;

   (c) those shares are held the own name of the institution and on behalf of others.

2. Shares which are not financial fixed assets as defined in Article 35(2) of Directive 86/635/EEC shall not be included in the calculation specified in Article 84.

PART THREE
CAPITAL REQUIREMENTS

Title I
General Requirements, valuation and reporting

Chapter 1
Required level of own funds

SECTION 1
OWN FUNDS REQUIREMENTS FOR INSTITUTIONS

Article 87
Own funds requirements

1. Subject to Articles 88 and 89, institutions shall at all times satisfy the following own funds requirements:

   (a) a Common Equity Tier 1 capital ratio of 4.5 %;

   (b) a Tier 1 capital ratio of 6 %;

   (c) a total capital ratio of 8 %.

2. Institutions shall calculate their capital ratios as follows:

   (a) the Common Equity Tier 1 capital ratio is the Common Equity Tier 1 capital of the institution expressed as a percentage of the total risk exposure amount;

   (b) the Tier 1 capital ratio is the Tier 1 capital of the institution expressed as a percentage of the total risk exposure amount;

   (c) the total capital ratio is the own funds of the institution expressed as a percentage of the total risk exposure amount.

3. Total risk exposure amount shall be calculated as the sum of the following points (a) to (f) after taking into account the provisions laid down in paragraph 4:

   (a) the risk weighted exposure amounts for credit risk and dilution risk, calculated in accordance with Title II of Part Three, in respect of all the business activities of an institution, excluding risk weighted exposure amounts from the trading book business of the institution;

   (b) the own funds requirements, determined in accordance with Title IV of Part Three or Part Four, as applicable, for the trading-book business of an institution, for the following:

      (i) position risk;

(ii) large exposures exceeding the limits specified in Articles 384 to 390, to the extent an institution is permitted to exceed those limits;

(c) the own funds requirements determined in accordance with Title IV of Part Three or Title V of Part Three, as applicable, for the following:

(i) foreign-exchange risk;

(ii) settlement risk;

(iii) commodities risk;

(d) the own funds requirements calculated in accordance with Title VI for credit valuation adjustment risk of OTC derivative instruments other than credit derivatives recognised to reduce risk-weighted exposure amounts for credit risk;

(e) the own funds requirements determined in accordance with Title III of Part Three for operational risk;

(f) the risk weighted exposure amounts determined in accordance with Title II of Part Three for counterparty risk arising from the trading book business of the institution for the following types of transactions and agreements:

(i) OTC derivative instruments and credit derivatives;

(ii) repurchase transactions, securities or commodities lending or borrowing transactions based on securities or commodities;

(iii) margin lending transactions based on securities or commodities;

(iv) long settlement transactions.

4. The following provisions shall apply in the calculation of the total exposure amount referred to in paragraph 3:

(a) the own funds requirements referred to in points (c) to (e) of that paragraph shall include those arising from all the business activities of an institution;

(b) institutions shall multiply the own funds requirements set out in points (b) to (e) of that paragraph by 12.5.

Article 88
Initial capital requirement on going concern

1. The own funds of an institution may not fall below the amount of initial capital required at the time of its authorisation.

2. Institutions that were already in existence on 1 January 1993, the own funds of which do not attain the amount of initial capital required may continue to carry on their activities. In that event, the own funds of those institutions may not fall below the highest level reached with

effect from 22 December 1989.

3. Where control of an institution falling within the category referred to in paragraph 2 is taken by a natural or legal person other than the person who controlled the institution previously, the own funds of that institution shall attain the amount of initial capital required.

4. Where there is a merger of two or more institutions falling within the category referred to in paragraph 2, the own funds of the institution resulting from the merger shall not fall below the total own funds of the merged institutions at the time of the merger, as long as the amount of initial capital required has not been attained.

5. Where competent authorities consider it necessary to ensure the solvency of an institution that the requirement laid down in paragraph 1 is met, the provisions laid down in paragraphs 2 to 4 shall not apply.

Article 89
Derogation for small trading book business

1. Institutions may replace the capital requirement referred to in point (b) of paragraph 3 of Article 87 by a capital requirement calculated in accordance with point (a) of that paragraph in respect of their trading-book business, provided that the size of their on- and off-balance-sheet trading-book business meets the following conditions:

   (a) is normally less than 5% of the total assets and €15 million;

   (b) never exceeds 6% of total assets and €20 million.

2. In calculating the size of on- and off-balance-sheet business, debt instruments shall be valued at their market prices or their nominal values, equities at their market prices and derivatives according to the nominal or market values of the instruments underlying them. Long positions and short positions shall be summed regardless of their signs.

3. Where an institution fails to meet the condition in point (b) of paragraph 1 it shall immediately notify the competent authority. If, following assessment by the competent authority, the competent authority determines and notifies the institution that the requirement in point (a) of paragraph 1 is not met, the institution shall cease to make use of paragraph 1 from the next reporting date.

SECTION 2
OWN FUNDS REQUIREMENTS FOR INVESTMENT FIRMS WITH LIMITED AUTHORISATION TO PROVIDE INVESTMENT SERVICES

Article 90
Own funds requirements for investment firms with limited authorisation to provide investment services

1. For the purposes of Article 87(3), investment firms that are not authorised to provide the investment services listed in points 3 and 6 of Section A of Annex I to Directive 2004/39/EC

shall use the calculation of the total risk exposure amount specified in paragraph 2.

2. Investment firms referred to in paragraph 1 shall calculate the total risk exposure amount as the higher of the following:

(a) the sum of the items referred to in points (a) to (d) and (f) of Article 87(3) after applying paragraph 87(4);

(b) 12.5 multiplied by the amount specified in Article 92.

3. Investment firms referred to in paragraph 1 are subject to all other provisions regarding operational risk laid down in Title VII, Chapter 3, section II, Sub-section 1 of Directive [inserted by OP].

Article 91

Own funds requirements for investment firms which hold initial capital as laid down in Article 29 of Directive [inserted by OP]

1. For the purposes of Article 87(3), the following categories of investment firm which hold initial capital in accordance with Article 29 of Directive [inserted by OP] shall use the calculation of the total risk exposure amount specified in paragraph 2:

(a) investment firms that deal on own account only for the purpose of fulfilling or executing a client order or for the purpose of gaining entrance to a clearing and settlement system or a recognised exchange when acting in an agency capacity or executing a client order;

(b) investment firms that do not hold client money or securities;

(c) investment firms that undertake only dealing on own account;

(d) investment firms that have no external customers;

(e) investment firms for which the execution and settlement whose transactions takes place under the responsibility of a clearing institution and are guaranteed by that clearing institution.

2. For investment firms referred to in paragraph 1, total risk exposure amount shall be calculated as the sum of the following:

(a) points (a) to (d) and (f) of Article 87(3) after applying paragraph 87(4);

(b) the amount referred to in Article 92 multiplied by 12.5.

3. Investment firms referred to in paragraph 1 are subject to all other provisions regarding operational risk laid down in Title VII, Chapter 3, Section 2, Sub-section 1 of Directive [inserted by OP].

Article 92

Own Funds based on Fixed Overheads

1. In accordance with Article 90 and 91, an investment firm shall hold eligible capital of at least one quarter of the fixed overheads of the investment firm for the preceding year.

2. Where there is a change in the business of an investment firm since the preceding year that the competent authority considers to be material, the competent authority may adjust the requirement laid down in paragraph 1.

3. Where an investment firm has not completed business for one year, starting from the day it starts up, an investment firm shall hold eligible capital of at least one quarter of the fixed overheads projected in its business plan, except where the competent authority requires the business plan to be adjusted.

4. EBA shall develop draft regulatory technical standards to specify in greater detail the following:

   (a) the calculation of the requirement to hold eligible capital of at least one quarter of the fixed overheads of the previous year;

   (b) the conditions for the adjustment by the competent authority of the requirement to hold eligible capital of at least one quarter of the fixed overheads of the previous year;

   (c) the calculation of projected fixed overheads in the case of an investment firm that has not completed business for one year.

   EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Article 93

Own funds for investment firms on a consolidated basis

1. In the case of the investment firms referred to in Article 90(1) in a group, where that group does not include credit institutions, a parent investment firm in a Member State shall apply Article 87 at a consolidated level as follows:

   (a) using the calculation of total risk exposure amount specified in Article 90(2);

   (b) own funds calculated on the basis of the consolidated financial situation of the parent investment firm.

2. In the case of investment firms referred to in Article 91(1) in a group, where that group does not include credit institutions, an investment firm controlled by a financial holding company shall apply Article 87 at a consolidated level as follows:

   (a) it shall use the calculation of total risk exposure amount specified in Article 91(2);

   (b) own funds calculated on the basis of the consolidated financial situation of the parent

investment firm.

Chapter 2
Calculation and reporting requirements

Article 94
Valuation

The valuation of assets and off-balance-sheet items shall be effected in accordance with the accounting framework to which the institution is subject under Regulation (EC) No 1606/2002 and Directive 86/635/EEC.

Article 95
Reporting on own funds requirements

1. Institutions that calculate own funds requirements for position risk shall report these own funds requirements at least every 3 months.

   This reporting shall include financial information drawn up in accordance with the accounting framework to which the institution is subject under Regulation (EC) No 1606/2002 and Directive 86/635/EEC to the extent this is necessary to obtain a comprehensive view of the risk profile of an institution's activities.

   Reporting by institutions on the obligations laid down in 87 shall be carried out at least twice each year.

   Institutions shall communicate the results and any component data required to the competent authorities.

2. EBA shall develop draft implementing technical standards to specify the uniform formats, frequencies and dates of reporting and the IT solutions to be applied in the Union for such reporting. The reporting formats shall be proportionate to the nature, scale and complexity of the activities of the institutions.

   EBA shall submit those draft implementing technical standards to the Commission by 1 January 2013.

   Power is delegated to the Commission to adopt the implementing standards referred to in the first sub-paragraph in accordance with the procedure laid down in Article 15 of Regulation (EU) No 1093/2010.

Article 96
Specific reporting obligations

1. Institutions shall report the following data to the competent authorities:

   (a) losses stemming from lending collateralised, up to 80% of the

market value or 80% of the mortgage lending value in any given year unless otherwise decided under Article 119(2), by residential property;

(b) overall losses stemming from lending collateralised by residential property in any given year;

(c) losses stemming from lending collateralised, up to 50% of the market value or 60% of the mortgage lending value in any given year unless otherwise decided under Article 119(2), by commercial immovable property;

(d) overall losses stemming from lending collateralised by commercial immovable property in any given year.

2. The competent authorities shall publish annually on an aggregated basis the data specified in points (a) to (d) of paragraph 1, together with historical data, where available. A competent authority shall, upon the request of another competent authority in a Member State or the EBA provide to that competent authority or the EBA more detailed information on the condition of the residential or commercial immovable property markets in that Member State.

3. EBA shall develop draft implementing technical standards to specify the following:

(a) uniform formats, frequencies and dates of reporting of the items referred to in paragraph 1;

(b) uniform formats, frequencies and dates of publication of the aggregate data referred to in paragraph 2.

EBA shall submit those draft implementing technical standards to the Commission by 1 January 2013.

Power is delegated to the Commission to adopt the implementing technical standards referred to in the first sub-paragraph in accordance with the procedure laid down in Article 15 of Regulation (EU) No 1093/2010.

Chapter 3
Trading book

Article 97
Requirements for the Trading Book

1. Positions in the trading book shall be either free of restrictions on their tradability or able to be hedged.

2. Trading intent shall be evidenced on the basis of the strategies, policies and procedures set up by the institution to manage the position or portfolio in accordance with Article 98.

3. Institutions shall establish and maintain systems and controls to manage their trading book in accordance with Articles 99 and 100.

4. Institutions may include internal hedges in the calculation of capital requirements for position risk provided that they are held with trading intent and that the requirements of Articles 98 to 101 are met.

Article 98
Management of the trading book

In managing its positions or sets of positions in the trading book the institution shall comply with all of the following requirements:

(a) the institution shall have in place a clearly documented trading strategy for the position/instrument or portfolios, approved by senior management, which shall include the expected holding period;

(b) the institution shall have in place clearly defined policies and procedures for the active management of positions entered into on a trading desk. Those policies and procedures shall include the following:

(i) which positions may be entered into by which trading desk;

(ii) position limits are set and monitored for appropriateness;

(iii) dealers have the autonomy to enter into and manage the position within agreed limits and according to the approved strategy;

(iv) positions are reported to senior management as an integral part of the institution's risk management process;

(v) positions are actively monitored with reference to market information sources and an assessment made of the marketability or hedge-ability of the position or its component risks, including the assessment, the quality and availability of market inputs to the valuation process, level of market turnover, sizes of positions traded in the market;

(c) the institution shall have in place clearly defined policies and procedures to monitor the positions against the institution's trading strategy including the monitoring of turnover and positions for which the originally intended holding period has been exceeded.

Article 99
Inclusion in the Trading Book

1. Institutions shall have in place clearly defined policies and procedures for determining which position to include in the trading book for the purposes of calculating their capital requirements, in accordance with the requirements set out in Article T1 and the definition of trading book in accordance with Article 4, taking into account the institution's risk management capabilities and practices. The institution shall fully document its compliance with these policies and procedures and shall subject them to periodic internal audit.

2. Institutions shall have in place clearly defined policies and procedures for the overall

management of the trading book. These policies and procedures shall at least address:

(a) the activities the institution considers to be trading and as constituting part of the trading book for own funds requirement purposes;

(b) the extent to which a position can be marked-to-market daily by reference to an active, liquid two-way market;

(c) for positions that are marked-to-model, the extent to which the institution can:

(i) identify all material risks of the position;

(ii) hedge all material risks of the position with instruments for which an active, liquid two-way market exists;

(iii) derive reliable estimates for the key assumptions and parameters used in the model;

(d) the extent to which the institution can, and is required to, generate valuations for the position that can be validated externally in a consistent manner;

(e) the extent to which legal restrictions or other operational requirements would impede the institution's ability to effect a liquidation or hedge of the position in the short term;

(f) the extent to which the institution can, and is required to, actively manage the risks of positions within its trading operation;

(g) the extent to which the institution may transfer risk or positions between the non-trading and trading books and the criteria for such transfers.

Article 100
Requirements for Prudent Valuation

1. All trading book positions shall be subject to the standards for prudent valuation specified in this Article. Institutions shall in particular ensure that the prudent valuation of their trading book positions achieves an appropriate degree of certainty having regard to the dynamic nature of trading book positions, the demands of prudential soundness and the mode of operation and purpose of capital requirements in respect of trading book positions.

2. Institutions shall establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates. Those systems and controls shall include at least the following elements:

(a) documented policies and procedures for the process of valuation, including clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, guidelines for the use of unobservable inputs reflecting the institution's assumptions of what market participants would use in pricing the position, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month end and ad-hoc verification procedures;

(b) reporting lines for the department accountable for the valuation process that are clear and independent of the front office.

The reporting line shall ultimately be to a member of the management body.

3. Institutions shall revalue trading book positions at least daily.

4. Institutions shall mark their positions to market whenever possible, including when applying trading book capital treatment.

5. When marking to market, an institution shall use the more prudent side of bid and offer unless the institution is a significant market maker in the particular type of financial instrument or commodity in question and it can close out at mid market.

6. Where marking to market is not possible, institutions shall conservatively mark to model their positions and portfolios, including when calculating own funds requirements for positions in the trading book.

7. Institutions shall comply with the following requirements when marking to model:

(a) senior management shall be aware of the elements of the trading book or of other fair-valued positions which are subject to mark to model and shall understand the materiality of the uncertainty thereby created in the reporting of the risk/performance of the business;

(b) institutions shall source market inputs, where possible, in line with market prices, and shall assess the appropriateness of the market inputs of the particular position being valued and the parameters of the model on a frequent basis;

(c) where available, institutions shall use valuation methodologies which are accepted market practice for particular financial instruments or commodities;

(d) where the model is developed by the institution itself, it shall be based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process;

(e) institutions shall have in place formal change control procedures and shall hold a secure copy of the model and use it periodically to check valuations;

(f) risk management shall be aware of the weaknesses of the models used and how best to reflect those in the valuation output; and

(g) institutions shall be subject to periodic review to determine the accuracy of its performance, which shall include assessing the continued appropriateness of assumptions, analysis of profit and loss versus risk factors, and comparison of actual close out values to model outputs.

For the purposes of point (d), the model shall be developed or approved independently of the trading desk and shall be independently tested, including validation of the mathematics, assumptions and software implementation.

8. Institutions shall perform independent price verification in addition to daily marking to market or marking to model. Verification of market prices and model inputs shall be performed by a person or unit independent from persons or units that benefit from the trading book, at least monthly, or more frequently depending on the nature of the market or trading activity. Where independent pricing sources are not available or pricing sources are more subjective, prudent measures such as valuation adjustments may be appropriate.

9. Institutions shall establish and maintain procedures for considering valuation adjustments.

10. Institutions shall formally consider the following valuation adjustments unearned credit spreads, close-out costs, operational risks, early termination, investing and funding costs, future administrative costs and, where relevant, model risk.

11. Institutions shall establish and maintain procedures for calculating an adjustment to the current valuation of any less liquid positions, which can in particular arise from market events or institution-related situations such as concentrated positions and/or positions for which the originally intended holding period has been exceeded. Institutions shall, where necessary, make such adjustments in addition to any changes to the value of the position required for financial reporting purposes and shall design such adjustments to reflect the illiquidity of the position. Under those procedures, institutions shall consider several factors when determining whether a valuation adjustment is necessary for less liquid positions. Those factors include the following:

(a) the amount of time it would take to hedge out the position or the risks within the position;

(b) the volatility and average of bid/offer spreads;

(c) the availability of market quotes (number and identity of market makers) and the volatility and average of trading volumes including trading volumes during periods of market stress;

(d) market concentrations;

(e) the aging of positions;

(f) the extent to which valuation relies on marking-to-model;

(g) the impact of other model risks.

12. When using third party valuations or marking to model, institutions shall consider whether to apply a valuation adjustment. In addition, institutions shall consider the need for establishing adjustments for less liquid positions and on an ongoing basis review their continued suitability.

13. With regard to complex products, including securitisation exposures and n-th-to-default credit derivatives, institutions shall explicitly assess the need for valuation adjustments to reflect the model risk associated with using a possibly incorrect valuation methodology and the model risk associated with using unobservable (and possibly incorrect) calibration parameters in the valuation model.

Article 101
Internal Hedges

1. An internal hedge shall in particular meet the following requirements:

   (a) it shall not be primarily intended to avoid or reduce own funds requirements;

   (b) it shall be properly documented and subject to particular internal approval and audit procedures;

   (c) it shall be dealt with at market conditions;

   (d) the market risk that is generated by the internal hedge shall be dynamically managed in the trading book within the authorised limits;

   (e) it shall be carefully monitored.

   Monitoring shall be ensured by adequate procedures.

2. The requirements of paragraph 1 apply without prejudice to the requirements applicable to the hedged position in the non-trading book.

3. By way of derogation from paragraphs 1 and 2, when an institution hedges a non-trading book credit risk exposure or counterparty risk exposure using a credit derivative booked in its trading book using an internal hedge, the non-trading book or counterparty risk exposure shall not be deemed to be hedged for the purposes of calculating risk weighted exposure amounts unless the institution purchases from an eligible third party protection provider a corresponding credit derivative meeting the requirements for unfunded credit protection in the non-trading book. Without prejudice to point (i) of Article 293, where such third party protection is purchased and recognised as a hedge of a non-trading book exposure for the purposes of calculating capital requirements, neither the internal nor external credit derivative hedge shall be included in the trading book for the purposes of calculating capital requirements.

Title II
Capital requirements for credit risk

Chapter 1
General principles

Article 102
Approaches to credit risk

Institutions shall apply either the Standardised Approach provided for in Chapter 2 or, if permitted by the competent authorities in accordance with Article 138, the Internal Ratings Based Approach provided for in Chapter 3 to calculate their risk-weighted exposure amounts for the purposes of points (a) and (f) of Article 87(3).

Article 103
Use of credit risk mitigation technique under the Standardised Approach and the IRB Approach

1. For an exposure to which an institution applies the Standardised Approach under Chapter 2 or applies the IRB Approach under Chapter 3 but without using its own estimates of LGD and conversion factors under Article 146, the institution may use credit risk mitigation in accordance with Chapter 4 in the calculation of risk-weighted exposure amounts for the purposes of points (a) and (f) of Article 87(3) or, as relevant, expected loss amounts for the purposes of the calculation referred to in point (d) of Article 33(1) and point (c) of Article 59.

2. For an exposure to which an institution applies the IRB Approach by using their own estimates of LGD and conversion factors under Articles 146, the institution may use credit risk mitigation in accordance with Chapter 3.

Article 104
Treatment of securitised exposures under the Standardised Approach and the IRB Approach

1. Where an institution uses the Standardised Approach under Chapter 2 for the calculation of risk-weighted exposure amounts for the exposure class to which the securitised exposures would be assigned under Article107, it shall calculate the risk-weighted exposure amount for a securitisation position in accordance with Articles 240, 241 and 246 to 253. Institutions using the Standardised Approach may also use the internal assessment approach where this has been permitted under Article 254(3).

2. Where an institution uses the IRB Approach under Chapter 3 for the calculation of risk-weighted exposures amounts for the exposure class to which the securitised exposure would be assigned under Article 142it shall calculate the risk-weighted exposure amount in accordance with Articles 240, 241 and 254 to 261.

   Except for the internal assessment approach, where the IRB Approach is used only

for a part of the securitised exposures underlying a securitisation, the institution shall use the approach corresponding to the predominant share of securitised exposures underlying this securitisation.

Article 105
Treatment of credit risk adjustment

1. Institutions applying the Standardised Approach shall treat general credit risk adjustments in accordance with Article 59 (c).

2. Institutions applying the IRB Approach shall treat general credit risk adjustments in accordance with Article 155.

   For the purposes of this Article and Chapters 2 and 3, general and specific credit risk adjustments shall exclude funds for general banking risk.

3. Institutions using the IRB Approach that apply the Standardised Approach for a part of their exposures on consolidated or individual basis, in accordance with Article 143 and 145 shall determine the part of general credit risk adjustment that shall be assigned to the treatment of general credit risk adjustment under the Standardised Approach and to the treatment of general credit risk adjustment under the IRB Approach as follows:

   (a) where applicable when an institution included in the consolidation exclusively applies the IRB Approach, general credit risk adjustments of this institution shall be assigned to the treatment set out in paragraph 2;

   (b) where applicable, when an institution included in the consolidation exclusively applies the Standard Approach, general credit risk adjustment of this institution shall be assigned to the treatment set out in paragraph 1(a);

   (c) The remainder of credit risk adjustment shall be assigned on a pro rata basis according to the proportion of risk weighted exposure amounts subject to the Standardised Approach and subject to the IRB Approach.

4. EBA shall develop draft regulatory technical standards to specify the calculation of specific credit risk adjustments and general credit risk adjustments under the relevant accounting framework for the following:

   (a) exposure value under the Standardised Approach referred to in Articles 106 and 122;

   (b) exposure value under the IRB Approach referred to in Articles 162 to 164;

   (c) treatment of expected loss amounts referred to in Article 155;

   (d) exposure value for the calculation of the risk-weighted exposure amounts for securitisation position referred to in Article 241 and 261;

   (e) the determination of default under Article 174;

(f) information on specific and general credit risk adjustment referred to in Article 428.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

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

Chapter 2
Standardised Approach

SECTION 1
GENERAL PRINCIPLES

Article 106
Exposure value

1. The exposure value of an asset item shall be its accounting value remaining after specific credit risk adjustments have been applied. The exposure value of an off-balance sheet item listed in Annex I shall be the following percentage of its nominal value after reduction of specific credit risk adjustments:

(a) 100 % if it is a full-risk item;

(b) 50 % if it is a medium-risk item;

(c) 20 % if it is a medium/low-risk item;

(d) 0 % if it is a low-risk item.

The off-balance sheet items referred to in the second sentence of the first subparagraph shall be assigned to risk categories as indicated in Annex I.

When an institution is using the Financial Collateral Comprehensive Method under Article 218, the exposure value of securities or commodities sold, posted or lent under a repurchase transaction or under a securities or commodities lending or borrowing transaction, and margin lending transactions shall be increased by the volatility adjustment appropriate to such securities or commodities as prescribed in Articles 218 to 220.

2. The exposure value of a derivative instrument listed in Annex II shall be determined in accordance with Chapter 6 with the effects of contracts of novation and other netting agreements taken into account for the purposes of those methods in accordance with Chapter 6. The exposure value of repurchase transaction, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions may be determined either in accordance with Chapter 6 or Chapter 4.

3. Where an exposure is subject to funded credit protection, the exposure value applicable to that item may be modified in accordance with Chapter 4.

Article 107
Exposure classes

Each exposure shall be assigned to one of the following exposure classes:

(a) claims or contingent claims on central governments or central banks;

(b) claims or contingent claims on regional governments or local authorities;

(c) claims or contingent claims on public sector entities;

(d) claims or contingent claims on multilateral development banks;

(e) claims or contingent claims on international organisations;

(f) claims or contingent claims on institutions;

(g) claims or contingent claims on corporates;

(h) retail claims or contingent retail claims;

(i) claims or contingent claims secured by mortgages on immovable property;

(j) exposures in default;

(k) claims in the form of covered bonds;

(l) securitisation positions;

(m) claims on institutions and corporate with a short-term credit assessment;

(n) claims in the form of units or shares in collective investment undertakings (‘CIUs’);

(o) equity claims;

(p) other items.

Article 108
Calculation of risk weighted exposure amounts

1. To calculate risk-weighted exposure amounts, risk weights shall be applied to all exposures, unless deducted from own funds, in accordance with the provisions of Section 2. The application of risk weights shall be based on the exposure class to which the exposure is assigned and, to the extent specified in Section 2, its credit quality. Credit quality may be determined by reference to the credit assessments of External Credit Assessment Institutions (hereinafter referred to as ‘ECAIs’) as defined in Article 130 or the credit assessments of Export Credit Agencies in accordance with Section 3.

2. For the purposes of applying a risk weight, as referred to in paragraph 1, the exposure value shall be multiplied by the risk weight specified or determined in accordance with Section 2.

3. Where an exposure is subject to credit protection the risk weight applicable to that item may be modified in accordance with Chapter 4.

4. Risk-weighted exposure amounts for securitised exposures shall be calculated in accordance with Chapter 5.

5. Exposures for which no calculation is provided in Section 2 shall be assigned a risk-weight of 100 %.

6. With the exception of exposures giving rise to liabilities in the form of Common Equity Tier 1, Additional Tier 1 or Tier 2 items, an institution may, subject to the permission of the competent authorities, decide not apply the requirements of paragraph 1 of this Article to the exposures of that institution to a counterparty which is its parent undertaking, its subsidiary, a subsidiary of its parent undertaking or an undertaking linked by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC Competent authorities are empowered to authorise such an alternative method if the following conditions are fulfilled:

   (a) the counterparty is an institution, a financial holding company or a mixed financial holding company, financial institution, asset management company or ancillary services undertaking subject to appropriate prudential requirements;

   (b) the counterparty is included in the same consolidation as the institution on a full basis;

   (c) the counterparty is subject to the same risk evaluation, measurement and control procedures as the institution;

   (d) the counterparty is established in the same Member State as the institution;

   (e) there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities from the counterparty to the institution.

   Where the institution, in accordance with this paragraph, decides not to apply the requirements of paragraph 1, it shall assign a risk weight of 0 %.

7. With the exception of exposures giving rise to liabilities in the form of Common Equity Tier 1, Additional Tier 1 and Tier 2 items, institutions may, subject to the permission of the competent authorities, not apply the requirements of paragraph 1 of this Article to exposures to counterparties with which the institution has entered into an institutional protection scheme that is a contractual or statutory liability arrangement which protects those institutions and in particular ensures their liquidity and solvency to avoid bankruptcy in case it becomes necessary. Competent authorities are empowered to authorize such an alternative method if the following conditions are fulfilled:

   (a) the requirements set out in points (a), (d) and (e) of paragraph 6 are met;

   (b) the arrangements ensure that the institutional protection scheme is able to grant support necessary under its commitment from funds readily available to it;

(c) the institutional protection scheme disposes of suitable and uniformly stipulated systems for the monitoring and classification of risk, which gives a complete overview of the risk situations of all the individual members and the institutional protection scheme as a whole, with corresponding possibilities to take influence; those systems shall suitably monitor defaulted exposures in accordance with Article 174(1);

(d) the institutional protection scheme conducts its own risk review which is communicated to the individual members;

(e) the institutional protection scheme draws up and publishes on an annual basis, a consolidated report comprising the balance sheet, the profit-and-loss account, the situation report and the risk report, concerning the institutional protection scheme as a whole, or a report comprising the aggregated balance sheet, the aggregated profit-and-loss account, the situation report and the risk report, concerning the institutional protection scheme as a whole;

(f) members of the institutional protection scheme are obliged to give advance notice of at least 24 months if they wish to end the institutional protection scheme;

(g) the multiple use of elements eligible for the calculation of own funds (hereinafter referred to as 'multiple gearing') as well as any inappropriate creation of own funds between the members of the institutional protection scheme shall be eliminated;

(h) The institutional protection scheme shall be based on a broad membership of credit institutions of a predominantly homogeneous business profile;

(i) the adequacy of the systems referred to in point (d) is approved and monitored at regular intervals by the relevant competent authorities.

Where the institution, in accordance with this paragraph, decides not to apply the requirements of paragraph 1, it shall assign a risk weight of 0 %.

8. Risk weighted exposure amounts for exposures arising from an institution's pre-funded contribution to the default fund of a CCP and trade exposures with a CCP shall be determined in accordance with Articles 296 to 300 as applicable.

SECTION 2
RISK WEIGHTS

Article 109
Exposures to central governments or central banks

1. Exposures to central governments and central banks shall be assigned a 100 % risk weight, unless the treatments set out in paragraphs 2 to 5 apply.

2. Exposures to central governments and central banks for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 1 which corresponds to the credit assessment of the eligible ECAI in accordance with Article 131.

Table 1						
Credit quality step	1	2	3	4	5	6
Risk weight	0 %	20 %	50 %	100 %	100 %	150 %

3. Exposures to the European Central Bank shall be assigned a 0 % risk weight.

4. Exposures to Member States' central governments and central banks denominated and funded in the domestic currency of that central government and central bank shall be assigned a risk weight of 0 %.

5. When the competent authorities of a third country which apply supervisory and regulatory arrangements at least equivalent to those applied in the Union assign a risk weight which is lower than that indicated in paragraphs 1 to 2 to exposures to their central government and central bank denominated and funded in the domestic currency, institutions may risk weight such exposures in the same manner.

For the purposes of this paragraph, the Commission may adopt, by way of implementing acts, and subject to the examination procedure referred to in Article 447(2), a decision as to whether a third country applies supervisory and regulatory arrangements at least equivalent to those applied in the Union. In the absence of such a decision, until 1 January 2014, institutions may continue to apply the treatment set out in this paragraph to third country where the relevant competent authorities had approved the third country as eligible for this treatment before 1 January 2013.

Article 110

Exposures to regional governments or local authorities

1. Exposures to regional governments or local authorities shall be risk-weighted as exposures to institutions unless they are treated as exposures to central governments under paragraphs 2 or 4. The preferential treatment for short-term exposures specified in Articles 115(2), and 114(2) shall not be applied.

2. Exposures to regional governments or local authorities shall be treated as exposures to the central government in whose jurisdiction they are established where there is no difference in risk between such exposures because of the specific revenue-raising powers of the former, and the existence of specific institutional arrangements the effect of which is to reduce their risk of default.

EBA shall develop draft implementing technical standards to specify the exposures to regional governments and local authorities that shall be treated as exposures to central governments based on the criteria set out in the previous subparagraph.

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

Power is conferred on the Commission to adopt the implementing technical standards referred to in the second subparagraph in accordance with the procedure laid down in Article 15 of Regulation (EU) No 1093/2010.

Before the entry into force of the technical standards referred to in the previous subparagraph, institutions may continue to apply the treatment set out in the first subparagraph, where the competent authorities have applied that treatment before 1 January 2013.

3. Exposures to churches or religious communities constituted in the form of a legal person under public law shall, in so far as they raise taxes in accordance with legislation conferring on them the right to do so, be treated as exposures to regional governments and local authorities. However that paragraph 2 shall not apply. In this case for the purposes of Article 145(1)(a), permission to apply the Standardised Approach shall not be excluded.

4. When competent authorities of a third country jurisdiction which applies supervisory and regulatory arrangements at least equivalent to those applied in the Union treat exposures to regional governments or local authorities as exposures to their central government and there is no difference in risk between such exposures because of the specific revenue-raising powers of regional government or local authorities and to specific institutional arrangements to reduce the risk of default, institutions may risk weight exposures to such regional governments and local authorities in the same manner.

For the purposes of this paragraph, the Commission may adopt, by way of implementing acts, and subject to the examination procedure referred to in Article 447(2), a decision as to whether a third country applies supervisory and regulatory arrangements at least equivalent to those applied in the Union. In the absence of such a decision, until 1 January 2014, institutions may continue to apply the treatment set out in this paragraph to third country where the relevant competent authorities had approved the third country as eligible for this treatment before 1 January 2013.

5. Exposures to regional governments or local authorities of the Member States that are not referred to in paragraphs 2 to 4 and are denominated and funded in the domestic currency of that regional government and local authority shall be assigned a risk weight of 20 %.

Article 111
Exposures to public sector entities

1. Exposures to public sector entities for which a credit assessment by a nominated ECAI is not available shall be assigned a risk weight according to the credit quality step to which exposures to the central government of the jurisdiction in which the Public Sector Entity is incorporated are assigned in accordance with the following Table 2:

Table 2						
Credit quality step to which central government is assigned	1	2	3	4	5	6
Risk weight	20 %	50 %	100 %	100 %	100 %	150 %

For exposures to public sector entities incorporated in countries where the central government is unrated, the risk weight shall be 100%.

2. Exposures to public sector entities for which a credit assessment by a nominated ECAI is available shall be treated according to Article 115. The preferential treatment for short-term exposures specified in Articles 114(2) and 115(2), shall not be applied to those entities.

3. For exposures to public sector entities with an original maturity of 3 months or less, the risk weight shall be 20 %.

4. Exposures to public-sector entities may be treated as exposures to the central government in whose jurisdiction they are established where there is no difference in risk between such exposures because of the existence of an appropriate guarantee by the central government.

5. For the purposes of this paragraph, the Commission may adopt, by way of implementing acts, and subject to the examination procedure referred to in Article 447(2), a decision as to whether a third country applies supervisory and regulatory arrangements at least equivalent to those applied in the Union. In the absence of such a decision, until 1 January 2014, institutions may continue to apply the treatment set out in this paragraph to third country where the relevant competent authorities had approved the third country as eligible for this treatment before 1 January 2013.

6. EBA shall develop draft implementing technical standards to specify the public sector entities that may be treated according to paragraphs 1 and 2.

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

Power is conferred on the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with the procedure laid down in Article 15 of Regulation (EU) No 1093/2010.

Before the entry into force of the technical standards referred to in the first subparagraph, institutions may continue to apply the treatment set out in paragraph 1 that competent authorities have applied before 1 January 2013.

Article 112
Exposures to multilateral development banks

1. Exposures to multilateral development banks that are not referred to in paragraph 2 shall be treated in the same manner as exposures to institutions. The preferential treatment for short-term exposures as specified in Articles 115(2), 115(4) shall not be applied.

The Inter-American Investment Corporation, the Black Sea Trade and Development Bank and the Central American Bank for Economic Integration shall be considered Multilateral Development Banks (MDB).

2. Exposures to the following multilateral development banks shall be assigned a 0 % risk weight:

(a) the International Bank for Reconstruction and Development;

(b) the International Finance Corporation;

(c) the Inter-American Development Bank;

(d) the Asian Development Bank;

(e) the African Development Bank;

(f) the Council of Europe Development Bank;

(g) the Nordic Investment Bank;

(h) the Caribbean Development Bank;

(i) the European Bank for Reconstruction and Development;

(j) the European Investment Bank;

(k) the European Investment Fund;

(l) the Multilateral Investment Guarantee Agency;

(m) the International Finance Facility for Immunisation;

(n) the Islamic Development Bank.

3. A risk weight of 20 % shall be assigned to the portion of unpaid capital subscribed to the European Investment Fund.

Article 113
Exposures to international organisations

Exposures to the following international organisations shall be assigned a 0 % risk weight:

(a) the European Union;

(b) the International Monetary Fund;

(c) the Bank for International Settlements;

(d) the European Financial Stability Facility

(e) an international financial institution established by two or more Member States, which has the purpose to mobilise funding and provide financial assistance to the benefit of its members that are experiencing or threatened by severe financing problems.

Article 114
Exposures to institutions

1. Exposures to institutions for which a credit assessment by a nominated ECAI is available shall be risk-weighted in accordance with Article 115. Exposures to institutions for which a credit assessment by a nominated ECAI is not available shall be risk-weighted in accordance with

Article 116.

2. Exposures to institutions of a residual maturity of 3 months or less denominated and funded in the national currency shall be assigned a risk weight that is one category less favourable than the preferential risk weight, as described in Articles 109(4) and 109(5), assigned to exposures to its central government.

3. No exposures with a residual maturity of 3 months or less denominated and funded in the national currency of the borrower shall be assigned a risk weight less than 20 %.

4. Exposure to an institution in the form of minimum reserves required by the ECB or by the central bank of a Member State to be held by an institution may be risk-weighted as exposures to the central bank of the Member State in question provided:

(a) the reserves are held in accordance with Regulation (EC) No 1745/2003 of the European Central Bank of 12 September 2003 on the application of minimum reserves or a subsequent replacement regulation or in accordance with national requirements in all material respects equivalent to that Regulation;

(b) in the event of the bankruptcy or insolvency of the institution where the reserves are held, the reserves are fully repaid to the institution in a timely manner and are not made available to meet other liabilities of the institution.

5. Exposures to financial institutions authorised and supervised by the competent authorities and subject to prudential requirements equivalent to those applied to institutions shall be treated as exposures to institutions.

Article 115
Exposures to rated institutions

1. Exposures to institutions with a residual maturity of more than three months for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 3 which corresponds to the credit assessment of the eligible ECAI in accordance with Article 131.

Table 3						
Credit quality step	1	2	3	4	5	6
Risk weight	20 %	50 %	50 %	100 %	100 %	150 %

2. Exposures to an institution of up to three months residual maturity for which a credit assessment by a nominated ECAI is available shall be assigned a risk-weight according to Table 4 which corresponds to the credit assessment of the eligible ECAI in accordance with Article 131:

Table 4						
Credit quality step	1	2	3	4	5	6

Risk weight	20 %	20 %	20 %	50 %	50 %	150 %

3. The interaction between the treatment of short term credit assessment under Article 126 and the general preferential treatment for short term exposures set out in paragraph 2 shall be as follows:

   (a) If there is no short-term exposure assessment, the general preferential treatment for short-term exposures as specified in paragraph 2 shall apply to all exposures to institutions of up to three months residual maturity;

   (b) If there is a short-term assessment and such an assessment determines the application of a more favourable or identical risk weight than the use of the general preferential treatment for short-term exposures, as specified in paragraph 2, then the short-term assessment shall be used for that specific exposure only. Other short-term exposures shall follow the general preferential treatment for short-term exposures, as specified in paragraph 2;

   (c) If there is a short-term assessment and such an assessment determines a less favourable risk weight than the use of the general preferential treatment for short-term exposures, as specified in paragraph 2, then the general preferential treatment for short-term exposures shall not be used and all unrated short-term claims shall be assigned the same risk weight as that applied by the specific short-term assessment.

Article 116
Exposures to unrated institutions

1. Exposures to institutions for which a credit assessment by a nominated ECAI is not available shall be assigned a risk weight according to the credit quality step to which exposures to the central government of the jurisdiction in which the institution is incorporated are assigned in accordance with Table 5.

Table 5						
Credit quality step to which central government is assigned	1	2	3	4	5	6
Risk weight of exposure	20 %	50 %	100 %	100 %	100 %	150 %

2. For exposures to unrated institutions incorporated in countries where the central government is unrated, the risk weight shall be 100 %.

3. For exposures to unrated institutions with an original effective maturity of three months or less, the risk weight shall be 20 %.

Article 117
Exposures to corporates

1. Exposures for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 6 which corresponds to the credit assessment of the eligible ECAI in accordance with Article 131.

Table 6						
Credit quality step	1	2	3	4	5	6
Risk weight	20 %	50 %	100 %	100 %	150 %	150 %

2. Exposures for which such a credit assessment is not available shall be assigned a 100 % risk weight or the risk weight of its central government, whichever is the higher.

Article 118
Retail exposures

Exposures that comply with the following criteria shall be assigned a risk weight of 75 %:

(a) the exposure shall be either to an natural person or persons, or to a small or medium sized enterprise;

(b) the exposure shall be one of a significant number of exposures with similar characteristics such that the risks associated with such lending are substantially reduced;

(c) the total amount owed to the institution and parent undertakings and its subsidiaries, including any exposure in default, by the obligor client or group of connected clients, but excluding claims or contingent claims secured on residential property collateral, shall not, to the knowledge of the institution, exceed EUR 1 million. The institution shall take reasonable steps to acquire this knowledge.

Securities shall not be eligible for the retail exposure class.

The present value of retail minimum lease payments is eligible for the retail exposure class.

Article 119
Exposures secured by mortgages on immovable property

1. An exposure or any part of an exposure fully secured by mortgage on immovable property shall be assigned a risk weight of 100 %, where the conditions under Article 120 and Article 121 are not met, except for any part of the exposure which is assigned to another exposure class.

   The part of an exposure treated as fully and completely secured by immovable property shall not be higher than the pledged amount of the market value or in those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions, the mortgage lending value of the property in question.

2. Based on the data collected under Article 96, and any other relevant indicators, the competent authorities shall periodically, and at least annually, assess whether the risk-weight of 35% for

exposures secured by mortgages on residential property referred to in Article 120 and the risk weight of 50% for exposures secured on commercial immovable property referred to in Article 121 located in its territory are appropriate based on the default experience of exposures secured by immovable property and taking into account forward-looking immovable property markets developments, and may set a higher risk weight or stricter criteria than those set out in Article 120(2) and 121(2), where appropriate, on the basis of financial stability considerations. EBA shall coordinate the assessments carried out by the competent authorities.

The competent authorities shall consult EBA on the adjustments to the risk weights and criteria applied. EBA shall publish the risk weights and criteria that the competent authorities set for exposures referred to in Articles 120, 121 and 195.

EBA shall develop regulatory technical standards to specify the conditions that competent authorities shall take into account when determining stricter risk-weights or stricter criteria.

EBA shall submit those draft technical standards to the Commission by 31 December 2014.

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

3. The institutions of one Member State shall apply the risk-weights and criteria that have been determined by the competent authorities of another Member State to exposures secured by mortgages on commercial and residential immovable property located in that Member State.

Article 120
Exposures fully and completely secured by residential property

1. Unless otherwise decided by the competent authorities in accordance with Article 119(2), exposures fully and completely secured by mortgages on residential property shall be treated as follows:

   (a) exposures or any part of an exposure fully and completely secured by mortgages on residential property which is or shall be occupied or let by the owner, or the beneficial owner in the case of personal investment companies, shall be assigned a risk weight of 35%;

   (b) exposures fully and completely secured by shares in Finnish residential housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, in respect of residential property which is or shall be occupied or let by the owner shall be assigned a risk weight of 35 %;

   (c) exposures to a tenant under a property leasing transaction concerning residential property under which the institution is the lessor and the tenant has an option to purchase, shall be assigned a risk weight of 35 % provided that the exposure of the institution is fully and completely secured by its ownership of the property.

2. Institutions shall consider an exposure or any part of an exposure as fully and completely secured for the purposes of paragraph 1 only if the following conditions are met:

(a) the value of the property does not materially depend upon the credit quality of the borrower. Institutions may exclude situations where purely macro-economic factors affect both the value of the property and the performance of the borrower from their determination of the materiality of such dependence;

(b) the risk of the borrower does not materially depend upon the performance of the underlying property or project, but on the underlying capacity of the borrower to repay the debt from other sources, and as a consequence, the repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral. For those other sources, institutions shall determine maximum loan-to-income ratio as part of their lending policy and obtain suitable evidence of the relevant income when granting the loan.

(c) the requirements set out in Article 203 and the valuation rules set out in Article 224(1) are met;

(d) the part of the loan to which the 35% risk weight unless otherwise determined under Article 119(2) is assigned does not exceed 80% unless otherwise determined under Article 119(2) of the market value of the property in question or 80% of the mortgage lending value unless otherwise determined under Article 119(2) of the property in question in those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions.

3. Institutions may derogate from point (b) in paragraph 2 for exposures fully and completely secured by mortgages on residential property which is situated within the territory of a Member State, where the competent authority of that Member State has published evidence showing that a well-developed and long-established residential property market is present in that territory with loss rates which do not exceed the following limits:

(a) losses stemming from lending collateralised by residential property up to 80% of the market value or 80% of the mortgage lending value unless otherwise decided under Article 119(2) do not exceed 0,3% of the outstanding loans collateralised by residential property in any given year;

(b) overall losses stemming from lending collateralised by residential property do not exceed 0,5% of the outstanding loans collateralised by residential property in any given year.

4. If either of the limits referred to in paragraph 3 is not satisfied in a given year, the eligibility to use paragraph 3 shall cease and the condition contained in paragraph 2(b) shall apply until the conditions in paragraph 3 are satisfied in a subsequent year.

Article 121
Exposures fully and completely secured by mortgages on commercial immovable property

1. Unless otherwise decided by the competent authorities in accordance with Article 119(2), exposures fully and completely secured by mortgages on commercial immovable property shall be treated as follows:

(a) exposures or any part of an exposure fully and completely

secured by mortgages on offices or other commercial premises may be assigned a risk weight of 50%;

(b) exposures fully and completely secured, by shares in Finnish housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, in respect of offices or other commercial premises may be assigned a risk weight of 50 %;.

(c) exposures related to property leasing transactions concerning offices or other commercial premises under which the institution is the less or and the tenant has an option to purchase may be assigned a risk weight of 50 % provided that the exposure of the institution is fully and completely secured by its ownership of the property.

2. The application of paragraph 1 is subject to the following conditions:

(a) the value of the property shall not materially depend upon the credit quality of the borrower. Institutions may exclude situations where purely macro-economic factors affect both the value of the property and the performance of the borrower from their determination of the materiality of such dependence;

(b) the risk of the borrower shall not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources, and as a consequence, the repayment of the facility shall not materially depend on any cash flow generated by the underlying property serving as collateral;

(c) the requirements set out in Article 203 and the valuation rules set out in 224(1) are met;

(d) The 50 % risk weight unless otherwise provided under Article 119(2) shall be assigned to the part of the loan that does not exceed 50 % of the market value of the property or 60 % of the mortgage lending value unless otherwise provided under Article 119(2) of the property in question in those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions.

3. Institutions may derogate from point (b) in paragraph 2 for exposures fully and completely secured by mortgages on commercial property which is situated within the territory of a Member State, where the competent authority of that Member State has published evidence showing that a well-developed and long-established commercial immovable property market is present in that territory with loss rates which do not exceed the following limits:

(a) losses stemming from lending collateralised by commercial immovable property up to 50 % of the market value or 60 % of the mortgage lending value (unless otherwise determined under Article 119(2)) do not exceed 0,3 % of the outstanding loans collateralised by commercial immovable property in any given year;

(b) overall losses stemming from lending collateralised by commercial immovable property do not exceed 0,5 % of the outstanding loans collateralised by commercial immovable property in any given year.

4. Where either of the limits referred to in paragraph 3 is not satisfied in a given year, the eligibility to use paragraph 3 shall cease and the condition contained in paragraph

2(b) shall apply until the conditions in paragraph 3 are satisfied in a subsequent year.

Article 122
Exposures in default

1. The unsecured part of any item for which a default has occurred according to Article 174 shall be assigned a risk weight of:

 (a) 150 %, where specific credit risk adjustments are less than 20 % of the unsecured part of the exposure value if these specific credit risk adjustments were not applied;

 (b) 100 %, where specific credit risk adjustments are no less than 20 % of the unsecured part of the exposure value if these specific credit risk adjustments were not applied.

2. For the purpose of determining the secured part of the past due item, eligible collateral and guarantees shall be those eligible for credit risk mitigation purposes under Chapter 4.

3. Exposures fully and completely secured by mortgages on residential property in accordance with Article 120 shall be assigned a risk weight of 100 % net of value adjustments if a default has occurred according to Article 174

4. Exposures fully and completely secured by mortgages on commercial immovable property in accordance with Article 121 shall be assigned a risk weight of 100 % if a default has occurred according to Article 174

Article 123
Items associated with particular high risk

1. Institutions shall assign a 150% risk weight to exposures, including exposures in the form of shares or units in a Collective Investment Undertaking that are associated with particularly high risks, where appropriate.

2. Exposures with particularly high risks shall include any of the following investments:

 (a) investments in venture capital firms;

 (b) alternative investment funds as defined by Article 4(1)(1) of Directive [inserted by OP - Directive on Alternative Investment Fund Managers];

 (c) speculative immovable property financing.

3. When assessing whether an exposure other than exposures referred to in the paragraph 2 is associated with particularly high risks, institutions shall take into account the following risk characteristics:

 (a) there is a high risk of loss as a result of a default of the obligor;

 (b) it is impossible to assess adequately whether the exposure falls under point (a).

 EBA shall issue guidelines specifying which types of exposures are associated with

particularly high risk and under which circumstances.

The guidelines shall be adopted in accordance with Article 16 of Regulation (EU) No 1093/2010.

Article 124
Exposures in the form of covered bonds

1. To be eligible for the preferential treatment set out in paragraph 3, 'covered bonds' shall mean bonds as defined in Article 52(4) of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)[23] and collateralised by any of the following eligible assets:

   (a) exposures to or guaranteed by central governments, central banks, public sector entities, regional governments and local authorities in the Union;

   (b) exposures to or guaranteed by third country central governments, non-EU central banks, multilateral development banks, international organisations that qualify for the credit quality step 1 as set out in this Chapter, and exposures to or guaranteed by non-EU public sector entities, non-EU regional governments and non-EU local authorities that are risk weighted as exposures to institutions or central governments and central banks according to Articles 110(1), 110(2), 111(1), 111(2) or 111(4) respectively and that qualify for the credit quality step 1 as set out in this Chapter, and exposures in the sense of this point that qualify as a minimum for the credit quality step 2 as set out in this Chapter, provided that they do not exceed 20 % of the nominal amount of outstanding covered bonds of issuing institutions;

   (c) exposures to institutions that qualify for the credit quality step 1 as set out in this Chapter. The total exposure of this kind shall not exceed 15 % of the nominal amount of outstanding covered bonds of the issuing institution. Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by immovable property to the holders of covered bonds shall not be comprised by the 15 % limit. Exposures to institutions in the EU with a maturity not exceeding 100 days shall not be comprised by the step 1 requirement but those institutions shall as a minimum qualify for credit quality step 2 as set out in this Chapter;

      The competent authorities may, after having consulted EBA, partly waive the application of (c) and allow credit quality step 2 for up to 10 % of the total exposure of the nominal amount of outstanding covered bonds of the issuing institution, provided that significant potential concentration problems in the Member States concerned can be documented due to the application of the credit quality step 1 requirement referred to in (c);

   (d) loans secured by residential property or shares in Finnish residential housing companies as referred to in Article 120(1)(b) up to the lesser of the principal amount of the liens that are combined with any prior liens and 80 % of the value of the pledged properties or

[23] OJ L 02, 17.11.2009, p. 2.

by senior units issued by French Fonds Communs de Créances or by equivalent securitisation entities governed by the laws of a Member State securitising residential property exposures. In the event of such senior units being used as collateral, the special public supervision to protect bond holders as provided for in Article 52(4) of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) shall ensure that the assets underlying such units shall, at any time while they are included in the cover pool be at least 90 % composed of residential mortgages that are combined with any prior liens up to the lesser of the principal amounts due under the units, the principal amounts of the liens, and 80 % of the value of the pledged properties, that the units qualify for the credit quality step 1 as set out in this Chapter and that such units do not exceed 10 % of the nominal amount of the outstanding issue;

Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by pledged properties of the senior units or debt securities shall not be comprised in calculating the 90 % limit;

(e) loans secured by commercial immovable property or shares in Finnish housing companies as referred to in Article 121(1)(b) up to the lesser of the principal amount of the liens that are combined with any prior liens and 60 % of the value of the pledged properties or by senior units issued by French Fonds Communs de Créances or by equivalent securitisation entities governed by the laws of a Member State securitising commercial immovable property exposures. In the event of such senior units being used as collateral, the special public supervision to protect bond holders as provided for in Article 52(4) of Directive 2009/65/EC shall ensure that the assets underlying such units shall, at any time while they are included in the cover pool be at least 90 % composed of commercial mortgages that are combined with any prior liens up to the lesser of the principal amounts due under the units, the principal amounts of the liens, and 60 % of the value of the pledged properties, that the units qualify for the credit quality step 1 as set out in this Chapter and that such units do not exceed 10 % of the nominal amount of the outstanding issue. Loans secured by commercial immovable property are eligible where the Loan to Value ratio of 60 % is exceeded up to a maximum level of 70 % if the value of the total assets pledged as collateral for the covered bonds exceed the nominal amount outstanding on the covered bond by at least 10 %, and the bondholders' claim meets the legal certainty requirements set out in Chapter 4. The bondholders’ claim shall take priority over all other claims on the collateral. Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by pledged properties of the senior units or debt securities shall not be comprised in calculating the 90 % limit;

(f) loans secured by ships where only liens that are combined with any prior liens within 60 % of the value of the pledged ship.

the situations in points (a) to (f) also include collateral that is exclusively restricted by legislation to the protection of the bond-holders against losses.

2. Institutions shall for immovable property collateralising covered bonds meet the requirements set out in Article 203 and the valuation rules set out in Article 224(1).

3. Covered bonds for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 6a which corresponds to the credit assessment of the eligible ECAI in accordance with Article 131.

Table 6a						
Credit quality step	1	2	3	4	5	6
Risk weight	10 %	20 %	20 %	50 %	50 %	100 %

4. Covered bonds for which a credit assessment by a nominated ECAI is not available shall be assigned a risk weight on the basis of the risk weight assigned to senior unsecured exposures to the institution which issues them. The following correspondence between risk weights shall apply:

(a) if the exposures to the institution are assigned a risk weight of 20 %, the covered bond shall be assigned a risk weight of 10 %;

(b) if the exposures to the institution are assigned a risk weight of 50 %, the covered bond shall be assigned a risk weight of 20 %;

(c) if the exposures to the institution are assigned a risk weight of 100 %, the covered bond shall be assigned a risk weight of 50 %;

(d) if the exposures to the institution are assigned a risk weight of 150 %, the covered bond shall be assigned a risk weight of 100 %.

5. Covered bonds issued before 31 December 2007 are not subject to the requirements of paragraph 1 and 2. They are eligible for the preferential treatment under paragraph 3 until their maturity.

Article 125
Items representing securitisation positions

Risk weighted exposure amounts for securitisation positions shall be determined in accordance with Chapter 5.

Article 126
Exposures to institutions and corporates with a short-term credit assessment

Exposures to institutions and exposures to corporates for which a short-term credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 7 which corresponds to the credit assessment of the eligible ECAI in accordance with Article 131.

Table 7						
Credit Quality Step	1	2	3	4	5	6

Risk weight	20 %	50 %	100 %	150 %	150 %	150 %

Article 127
Exposures in the form of shares in collective investment undertakings (CIUS)

1. Exposures in the form of units or shares in collective investment undertakings (hereinafter referred to as 'CIUs') shall be assigned a risk weight of 100 %, unless the institution applies the credit risk assessment method under paragraph 2, or the look-through approach in paragraph 4 or the average risk weight approach under paragraph 5 when the conditions in paragraph 3 are met.

2. Exposures in the form of shares in CIUs for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table which corresponds to the credit assessment of the eligible ECAI in accordance with Article 131.

Table 8						
Credit quality step	1	2	3	4	5	6
Risk weight	20 %	50 %	100 %	100 %	150 %	150 %

3. Institutions may determine the risk weight for a CIU, if the following eligibility criteria are met:

(a) the CIU is managed by a company that is subject to supervision in a Member State or, in the case of third country CIU, where the following conditions are met:

(i) the CIU is managed by a company which is subject to supervision that is considered equivalent to that laid down in Union legislation;

(ii) cooperation between competent authorities is sufficiently ensured;

(b) the CIU's prospectus or equivalent document includes the following:

(i) the categories of assets in which the CIU is authorised to invest;

(ii) if investment limits apply, the relative limits and the methodologies to calculate them;

(c) the business of the CIU is reported to the competent authority on at least an annual basis to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period.

For the purposes of point (a), the Commission may adopt, by way of implementing acts, and subject to the examination procedure referred to in Article 447(2), a decision as to whether a third country applies supervisory and regulatory arrangements at least equivalent to those applied in the European Union. In the absence of such a decision, until 1 January 2014, institutions may continue to apply the treatment set out in this paragraph to third country where the relevant competent authorities had approved the third country as eligible for this

treatment before 1 January 2013.

4. Where the institution is aware of the underlying exposures of a CIU, it may look through to those underlying exposures in order to calculate an average risk weight for its exposures in the form of shares in the CIUs in accordance with the methods set out in this Chapter. Where an underlying exposure of the CIU is itself an exposure in the form of shares in another CIU which fulfils the criteria of paragraph 3, the institution may look through to the underlying exposures of that other CIU.

5. Where the institution is not aware of the underlying exposures of a CIU, it may calculate an average risk weight for its exposures in the form of a unit or share in the CIU in accordance with the methods set out in this Chapter subject to the assumption that the CIU first invests, to the maximum extent allowed under its mandate, in the exposure classes attracting the highest capital requirement, and then continues making investments in descending order until the maximum total investment limit is reached.

Institutions may rely on the following third parties to calculate and report, in accordance with the methods set out in paragraphs 4 and 5, a risk weight for the CIU:

(a) the depository institution or the depository financial institution of the CIU provided that the CIU exclusively invests in securities and deposits all securities at that depository institution or the financial institution;

(b) for CIUs not covered by point (a), the CIU management company, provided that the CIU management company meets the criteria set out in paragraph 3(a).

The correctness of the calculation referred to in the first subparagraph shall be confirmed by an external auditor.

Article 128
Equity exposures

1. The following exposures shall be considered equity exposures:

(a) non-debt exposures conveying a subordinated, residual claim on the assets or income of the issuer;

(b) debt exposures and other securities, partnerships, derivatives, or other vehicles, the economic substance of which is similar to the exposures specified in point (a).

2. Equity exposures shall be assigned a risk weight of 100 %, unless they are required to be deducted in accordance with Part Two, assigned a 250% risk weight in accordance with Article 45(2), assigned a 1 250% risk weight in accordance with Article 84(3) or treated as high risk items in accordance with Article 123.

3. Investments in equity or regulatory capital instruments issued by institutions shall be classified as equity claims, unless deducted from own funds or attracting a 250% risk weight under Article 33 1(c) or treated as high risk items in accordance with Article 123.

Article 129
Other items

1. Tangible assets within the meaning of Article 4(10) of Directive 86/635/EEC shall be assigned a risk weight of 100 %.

2. Prepayments and accrued income for which an institution is unable to determine the counterparty in accordance with Directive 86/635/EEC, shall be assigned a risk weight of 100 %.

3. Cash items in the process of collection shall be assigned a 20 % risk weight. Cash in hand and equivalent cash items shall be assigned a 0 % risk weight.

4. Gold bullion held in own vaults or on an allocated basis to the extent backed by bullion liabilities shall be assigned a 0 % risk weight.

5. In the case of asset sale and repurchase agreements and outright forward purchases, the risk weight shall be that assigned to the assets in question and not to the counterparties to the transactions.

6. Where an institution provides credit protection for a number of exposures under terms that the nth default among the exposures shall trigger payment and that this credit event shall terminate the contract, and where the product has an external credit assessment from an eligible ECAI, the risk weights prescribed in Chapter 5 shall be assigned. If the product is not rated by an eligible ECAI, the risk weights of the exposures included in the basket will be aggregated, excluding n-1 exposures, up to a maximum of 1250 % and multiplied by the nominal amount of the protection provided by the credit derivative to obtain the risk weighted asset amount. The n-1 exposures to be excluded from the aggregation shall be determined on the basis that they shall include those exposures each of which produces a lower risk-weighted exposure amount than the risk-weighted exposure amount of any of the exposures included in the aggregation.

7. The exposure value for leases shall be the discounted minimum lease payments. Minimum lease payments are the payments over the lease term that the lessee is or can be required to make and any bargain option the exercise of which is reasonably certain. A party other than the lessee may be required to make a payment related to the residual value of a leased property and that payment obligation fulfils the set of conditions in Article 197 regarding the eligibility of protection providers as well as the requirements for recognising other types of guarantees provided in Articles 208 to 210, that payment obligation may be taken into account as unfunded credit protection under Chapter 4. These exposures shall be assigned to the relevant exposure class in accordance with Article107. When the exposure is a residual value of leased assets, the risk weighted exposure amounts shall be calculated as follows: 1/t * 100 % * exposure value, where t is the greater of 1 and the nearest number of whole years of the lease remaining.

SECTION 3
RECOGNITION AND MAPPING OF CREDIT RISK ASSESSMENT

SUB-SECTION 1
RECOGNITION OF ECAIS

Article 130
ECAIs

1. An external credit assessment may be used to determine the risk weight of an exposure under this Chapter only if it has been issued by an eligible ECAI or has been endorsed by an eligible ECAI in accordance with Regulation (EC) No 1060/2009.

2. Eligible ECAIs are all credit rating agencies that have been registered or certified in accordance with Regulation (EC) No 1060/2009 and central banks issuing credit ratings which are exempt from Regulation (EC) No 1060/2009.

3. EBA shall publish a list of eligible ECAIs.

SUB-SECTION 2
MAPPING OF ECAI'S CREDIT ASSESSMENTS

Article 131
Mapping of ECAI's credit assessments

1. EBA shall develop draft implementing standards to specify for all eligible ECAIs, with which of the credit quality steps set out in Section 2 the relevant credit assessments of the eligible ECAI correspond ('mapping'). Those determinations shall be objective and consistent.

   EBA shall submit those draft implementing technical standards to the Commission by 1 January 2014 and shall submit revised draft technical standards where necessary.

   Power is conferred on the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with the procedure laid down in Article 15 of Regulation (EU) No 1093/2010.

2. When determining the mapping of credit assessments, EBA shall comply with the following requirements:

   (a) in order to differentiate between the relative degrees of risk expressed by each credit assessment, EBA shall consider quantitative factors such as the long-term default rate associated with all items assigned the same credit assessment. For recently established ECAIs and for those that have compiled only a short record of default data, EBA shall ask the ECAI what it believes to be the long-term default rate associated with all items assigned the same credit assessment;

   (b) in order to differentiate between the relative degrees of risk expressed by each credit assessment, EBA shall consider qualitative factors such as the pool of issuers that the ECAI covers, the range of credit assessments that the ECAI assigns, each credit

assessment meaning and the ECAI's definition of default;

(c) EBA shall compare default rates experienced for each credit assessment of a particular ECAI and compare them with a benchmark built on the basis of default rates experienced by other ECAIs on a population of issuers that present an equivalent level of credit risk;

(d) where the default rates experienced for the credit assessment of a particular ECAI are materially and systematically higher then the benchmark, EBA shall assign a higher credit quality step in the credit quality assessment scale to the ECAI credit assessment;

(e) where EBA has increased the associated risk weight for a specific credit assessment of a particular ECAI, and where default rates experienced for that ECAI's credit assessment are no longer materially and systematically higher than the benchmark, EBA shall decide to restore the original credit quality step in the credit quality assessment scale for the ECAI credit assessment.

3. EBA shall develop draft implementing technical standards to specify the quantitative factors referred to in point (a), the qualitative factors referred to in point (b) and the benchmark referred to in point (c) of paragraph 2.

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

Power is conferred on the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with the procedure laid down in Article 15 of Regulation (EU) No 1093/2010.

SUB-SECTION 3
USE OF CREDIT ASSESSMENTS BY EXPORT CREDIT AGENCIES

Article 132
Use of credit assessments by Export Credit Agencies

1. For the purpose of Article 109, institutions may use credit assessments of an Export Credit Agency, if either of the following conditions is met:

(a) it is a consensus risk score from Export Credit Agencies participating in the OECD 'Arrangement on Guidelines for Officially Supported Export Credits';

(b) the Export Credit Agency publishes its credit assessments, and the Export Credit Agency subscribes to the OECD agreed methodology, and the credit assessment is associated with one of the eight minimum export insurance premiums that the OECD agreed methodology establishes.

2. Exposures for which a credit assessment by an Export Credit Agency is recognised for risk weighting purposes shall be assigned a risk weight according to Table 9.

Table 9								
MEIP	0	1	2	3	4	5	6	7
Risk weight	0 %	0 %	20 %	50 %	100 %	100 %	100 %	150 %

3. EBA shall issue guidelines in accordance with Article 16 of Regulation 1093/2010 by 1 January 2014 on the Export Credit Agencies that my be used by institutions in accordance with paragraph 1.

SECTION 4
USE OF THE ECAI CREDIT ASSESSMENTS FOR THE DETERMINATION OF RISK WEIGHTS

Article 133
General requirements

An institution may nominate one or more eligible ECAIs to be used for the determination of risk weights to be assigned to asset and off-balance sheet items. Credit assessments shall not be used selectively. In using credit assessment, institutions shall comply with the following requirements:

(a) an institution which decides to use the credit assessments produced by an eligible ECAI for a certain class of items shall use those credit assessments consistently for all exposures belonging to that class;

(b) an institution which decides to use the credit assessments produced by an eligible ECAI shall use them in a continuous and consistent way over time;

(c) an institution shall only use ECAIs credit assessments that take into account all amounts both in principal and in interest owed to it;

(d) where only one credit assessment is available from a nominated ECAI for a rated item, that credit assessment shall be used to determine the risk weight for that item;

(e) where two credit assessments are available from nominated ECAIs and the two correspond to different risk weights for a rated item, the higher risk weight shall be assigned;

(f) where more than two credit assessments are available from nominated ECAIs for a rated item, the two assessments generating the two lowest risk weights shall be referred to. If the two lowest risk weights are different, the higher risk weight shall be assigned. If the two lowest risk weights are the same, that risk weight shall be assigned.

Article 134
Issuer and issue credit assessment

1. Where a credit assessment exists for a specific issuing programme or facility to which the item constituting the exposure belongs, this credit assessment shall be used to determine the risk weight to be assigned to that item.

2. Where no directly applicable credit assessment exists for a certain item, but a credit assessment exists for a specific issuing programme or facility to which the item constituting the exposure does not belong or a general credit assessment exists for the issuer, then that credit assessment shall be used in either of the following cases:

   (a) it produces a higher risk weight than would other wise be the case and the exposure in question ranks pari passu or junior in all respects to the specific issuing program or facility or to senior unsecured exposures of that issuer, as relevant;

   (b) it produces a lower risk weight and the exposure in question ranks pari passu or senior in all respects to the specific issuing programme or facility or to senior unsecured exposures of that issuer, as relevant.

   In all other cases, the exposure shall be treated as unrated.

3. Paragraph 1 and 2 are not to prevent the application of Article 124.

4. Credit assessments for issuers within a corporate group cannot be used as credit assessment of another issuer within the same corporate group.

Article 135
Long-term and short-term credit assessments

1. Short-term credit assessments may only be used for short-term asset and off-balance sheet items constituting exposures to institutions and corporates.

2. Any short-term credit assessment shall only apply to the item the short-term credit assessment refers to, and it shall not be used to derive risk weights for any other item, except in the following cases:

   (a) if a short-term rated facility is assigned a 150 % risk weight, then all unrated unsecured exposures on that obligor whether short-term or long-term shall also be assigned a 150 % risk weight;

   (b) if a short-term rated facility is assigned a 50 % risk-weight, no unrated short-term exposure shall be assigned a risk weight lower than 100 %.

Article 136
Domestic and foreign currency items

A credit assessment that refers to an item denominated in the obligor's domestic currency cannot be used to derive a risk weight for another exposure on that same obligor that is denominated in a foreign currency.

When an exposure arises through an institution's participation in a loan that has been extended by a Multilateral Development Bank whose preferred creditor status is recognised in the market, the credit assessment on the obligors' domestic currency item may be used for risk weighting purposes.

Chapter 3
Internal Ratings Based Approach

SECTION 1
PERMISSION BY COMPETENT AUTHORITIES TO USE THE IRB APPROACH

Article 137
IRB 0
Definitions

1. For the purposes of this Chapter, the following definitions shall apply:

(1) 'rating system' means all of the methods, processes, controls, data collection and IT systems that support the assessment of credit risk, the assignment of exposures to rating grades or pools, and the quantification of default and loss estimates that have been developed for a certain type of exposures;

(2) 'type of exposures' means a group of homogeneously managed exposures which are formed by a certain type of facilities and which may be limited to a single entity or a single sub-set of entities within a group provided that the same type of exposures is managed differently in other entities of the group;

(3) 'business unit' means any separate organisational or legal entities, business lines, geographical locations;

(4) ‘regulated financial entity’ means any of the following:

(a) the following entities, including third country entities, that carry out similar activities, that are subject to prudential supervision pursuant to EU legislation or to legislation of a third country which applies prudential supervisory and regulatory requirements at least equivalent to those applied in the Union:

(i) a credit institution;

(ii) an investment firm;

(iii) an insurance undertaking;

(iv) a financial holding company;

(v) a mixed activity holding company.

(b) any other entity that fulfils all of the following conditions:

(i) it performs one or more of the activities listed in Annex I of Directive [inserted by OP] or in Annex I of Directive 2004/39/EC;

(ii) it is a subsidiary of a regulated financial entity;

(iii) it is included in the prudential supervision on consolidated level of the group;

(c) any entity referred to in point (a)(i) to (v) or in point (b) which is not subject to prudential supervisory and regulatory requirements at least equivalent to those in the Union but which is part of a group that is subject to those arrangements on a consolidated basis;

(5) ‘large regulated financial entity’ means any regulated financial entity whose total assets, on the level of that individual firm or on the consolidated level of the group, are greater than or equal to the EUR 70 billion threshold, where the most recent audited financial statement of the parent company and consolidated subsidiaries shall be used in order to determine asset size;

(6) ‘unregulated financial entity’ means any other entity that is not a regulated entity but performs one or more of the activities listed in Annex I of Directive [inserted by OP] or listed in Annex I of Directive 2004/39/EC;

(7) ‘obligor grade’ means a risk category within the obligor rating scale of a rating system, to which obligors are assigned on the basis of a specified and distinct set of rating criteria, from which estimates of PD are derived;

(8) ‘facility grade’ means a risk category within a rating system's facility scale, to which exposures are assigned on the basis of a specified and distinct set of rating criteria from which own estimates of Loss Given Default are derived;

(9) ‘servicer’ means an entity that manages a pool of purchased receivables or the underlying credit exposures on a day-to-day basis.

2. EBA shall develop draft regulatory technical standards to specify the conditions according to which competent authorities shall assess the equivalence of the prudential supervisory and regulatory requirements set out in the legislation of third countries.

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 sub-paragraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1093/2010.

Article 138
Permission to use the IRB Approach

1. Where the conditions set out in this Chapter are met, the competent authority shall permit institutions to calculate their risk-weighted exposure amounts using the Internal Ratings Based Approach (hereinafter referred to as ‘IRB Approach’).

2. Permission to the use the IRB Approach, including own estimates of Loss Given

Default (hereinafter referred to as 'LGD') and conversion factors, shall be required for each and for each rating system and internal model approaches to equity exposures and approach to estimating LGDs and conversion factors used.

3. Institutions must obtain the permission of the competent authorities for the following:

(a) changes to the range of application of a rating system or an internal models approach to equity exposures that the institution has received permission to use;

(b) material changes to a rating system or an internal models approach to equity exposures that the institution has received permission to use.

The range of application of a rating system shall comprise all exposures of the relevant type of exposure for which that rating system was developed.

4. Institutions shall notify the competent authorities of all changes to rating systems and internal models approaches to equity exposures.

5. EBA shall develop draft regulatory technical standards to specify the conditions according to which institutions shall assess the materiality of the changes to rating systems or internal models approaches to equity exposures under the IRB Approach referred to in paragraph 1 that require additional permission or require notification.

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2013.

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

Article 139

Competent authorities' assessment of an application to use an IRB Approach

1. The competent authority shall grant permission pursuant to Article 138 for an institution to use the IRB Approach, including to use own estimates of LGD and conversion factors, only if the competent authority is satisfied that requirements laid down in this Chapter are met, in particular those laid down in Section 6, and that the systems of the institution for the management and rating of credit risk exposures are sound and implemented with integrity and, in particular, that the institution has demonstrated to the satisfaction of the competent authority that the following standards are met:

(a) the institution's rating systems provide for a meaningful assessment of obligor and transaction characteristics, a meaningful differentiation of risk and accurate and consistent quantitative estimates of risk;

(b) internal ratings and default and loss estimates used in the calculation of own funds requirements and associated systems and processes play an essential role in the risk management and decision-making process, and in the credit approval, internal capital allocation and corporate governance functions of the institution;

(c) the institution has a credit risk control unit responsible for its rating systems that is appropriately independent and free from undue influence;

(d) the institution collects and stores all relevant data to provide effective support to its credit risk measurement and management process;

(e) the institution documents its rating systems and the rationale for their design and validates its rating systems;

(f) the institution has validated its rating systems during an appropriate time period prior to the permission to use this rating system or internal models approach to equity exposures, has assessed during this time period whether these rating systems and internal models approaches for equity exposures are suited to the range of application of the rating system, and has made necessary changes to these rating systems and internal models approaches for equity exposures following from its assessment;

(g) the institution has calculated under the IRB Approach the own funds requirements resulting from its risk parameters estimates and is able to submit the reporting as required by Article 95.

The requirements to use an IRB Approach, including own estimates of LGD and conversion factors, apply also where an institution has implemented a rating system, or model used within a rating system, that it has purchased from a third-party vendor.

2. EBA shall develop regulatory technical standards to specify the processes competent authorities shall follow in assessing the compliance of an institution with the requirements to use the IRB Approach.

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2014.

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first sub-paragraph in accordance with the procedure laid down in Article 15 of Regulation (EU) No 1093/2010.

Article 140
Prior experience of using IRB approaches

1. An institution applying to use the IRB Approach shall have been using for the IRB exposure classes in question rating systems that were broadly in line with the requirements set out in Section 6 for internal risk measurement and management purposes for at least three years prior to its qualification to use the IRB Approach.

2. An institution applying for the use of own estimates of LGDs and conversion factors shall demonstrate to the satisfaction of the competent authorities that it has been estimating and employing own estimates of LGDs and conversion factors in a manner that was broadly consistent with the requirements for use of own estimates of those parameters set out in

Section 6 for at least three years prior to qualification to use own estimates of LGDs and conversion factors.

3. Where the institution extends the use of the IRB approach subsequent to its initial permission, the experience of the institution shall be sufficient to satisfy the requirements of paragraphs 4 and 5 in respect of the additional exposures covered. If the use of rating systems is extended to exposures that are significantly different to the scope of the existing coverage, such that the existing experience cannot be reasonably assumed to be sufficient to meet the requirements of these provisions in respect of the additional exposures, then the requirements of paragraphs 4 and 5 shall apply separately for the additional exposures.

Article 141
Measures to be taken where the requirements of this Chapter cease to be met

Where an institution ceases to comply with the requirements laid down in this Chapter, it shall notify the competent authority and do one of the following:

(a) present to the competent authority a plan for a timely return to compliance;

(b) demonstrate to the satisfaction of the competent authorities that the effect of non-compliance is immaterial.

Article 142
Methodology to assign exposure to exposures classes

1. The methodology used by the institution for assigning exposures to different exposure classes shall be appropriate and consistent over time.

2. Each exposure shall be assigned to one of the following exposure classes:

   (a) claims or contingent claims on central governments and central banks;

   (b) claims or contingent claims on institutions;

   (c) claims or contingent claims on corporates;

   (d) retail claims or contingent retail claims;

   (e) equity claims;

   (f) securitisation positions;

   (g) other non credit-obligation assets.

3. The following exposures shall be assigned to the class laid down in point (a) of paragraph 2:

   (a) exposures to regional governments, local authorities or public sector entities which are treated as exposures to central governments under Article 110 and 110;

   (b) exposures to Multilateral Development Banks referred to in

Article 112 International Organisations which attract a risk weight of 0 % under Article 113.

4. The following exposures shall be assigned to the class laid down in point (b) of paragraph 2 :

(a) exposures to regional governments and local authorities which are not treated as exposures to central governments under Article 110;

(b) exposures to Public Sector Entities which are treated as exposures to institutions under Article 110; and

(c) exposures to Multilateral Development Banks which are not assigned a 0 % risk weight under Article 112.

5. To be eligible for the retail exposure class laid down in point (d) of paragraph 2, exposures shall meet the following criteria:

(a) they shall be to one of the following:

(i) a natural person or persons;

(ii) to a small or medium sized enterprise, provided in the latter case that the total amount owed to the institution and parent undertakings and its subsidiaries, including any past due exposure, by the obligor client or group of connected clients, but excluding claims or contingent claims secured on residential property collateral, shall not, to the knowledge of the institution, which shall have taken reasonable steps to confirm the situation, exceed EUR 1 million;

(b) they are treated by the institution in its risk management consistently over time and in a similar manner;

(c) they are not managed just as individually as exposures in the corporate exposure class;

(d) they each represent one of a significant number of similarly managed exposures.

In addition to the exposures listed in the first sub-paragraph, the present value of retail minimum lease payments shall be included in the retail exposure class.

6. The following exposures shall be assigned to the equity exposure class laid down in point (e) of paragraph 2:

(a) non-debt exposures conveying a subordinated, residual claim on the assets or income of the issuer;

(b) debt exposures and other securities, partnerships, derivatives, or other vehicles, the economic substance of which is similar to the exposures specified in point (a).

7. Any credit obligation not assigned to the exposure classes laid down in points (a), (b), (d), (e) and (f) of paragraph 2 shall be assigned to the corporate exposure class referred to in point (c) of that paragraph.

8. Within the corporate exposure class laid down in point (c) of paragraph 2, institutions shall separately identify as specialised lending exposures, exposures which possess the following characteristics:

(a) the exposure is to an entity which was created specifically to finance or operate physical assets;

(b) the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate;

(c) the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.

9. The residual value of leased properties shall be assigned to the exposure class laid down in point (g) of paragraph 2, except to the extent that residual value is already included in the lease exposure laid down in Article 162(4).

Article 143
Conditions for implementing the IRB approach across different classes of exposure and business units

1. Institutions and any parent undertaking and its subsidiaries shall implement the IRB Approach for all exposures, unless they have received the permission of the competent authorities permanently use the Standardised Approach in accordance with Article 145.

Subject to the permission of the competent authorities, implementation may be carried out sequentially across the different exposure classes, referred to in Article 142, within the same business unit, across different business units in the same group or for the use of own estimates of LGDs or conversion factors for the calculation of risk weights for exposures to corporates, institutions, and central governments and central banks.

In the case of the retail exposure class referred to in Article 142(5), implementation may be carried out sequentially across the categories of exposures to which the different correlations in Article 149 correspond.

2. The competent authority shall determine the time period over which an institution any parent undertaking and its subsidiaries shall be required to implement the IRB approach for all exposures. This time period shall be one that the competent authority considers to be appropriate on the basis of the nature and scale of the institutions, any parent undertaking and its subsidiaries, and the number and nature of rating systems to be implemented.

3. Institutions shall carry out implementation of the IRB approach according to conditions determined by the competent authorities. The competent authority shall design those conditions such that they ensure that the flexibility under paragraph 1 is not used selectively for the purposes of achieving reduced own funds requirements in respect of those exposure classes or business units that are yet to be included in the IRB Approach or in the use of own estimates of LGDs and conversion factors.

4. Institutions that have begun to use of the IRB approach only after 1 January 2013 shall retain their ability to calculate capital requirements using the Standardised Approach for all their exposures during the implementation period until the competent authorities

notify them that they are satisfied that the implementation of the IRB approach will be completed with reasonable certainty.

5. An institution that is permitted to use the IRB Approach for any exposure class shall be permitted to use the IRB Approach for the equity exposure class, except where that institution is permitted to apply the Standardised Approach for equity exposures pursuant to Article 145.

6. EBA shall develop draft regulatory technical standards to specify the conditions according to which competent authorities shall determine the conditions by which they shall require institutions to implement the IRB approach in accordance with this Article.

   EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2014.

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

Article 144

Conditions to revert to the use of less sophisticated approaches

1. An institution that uses the IRB Approach shall not stop using that approach and use instead the Standardised Approach for the calculation of risk-weighted exposure amounts unless the following conditions are met:

   (a) the institution has demonstrated to the satisfaction of the competent authority that the use of the Standardised Approach is not proposed in order to reduce the own funds requirement of the institution, is necessary on the basis of nature and complexity of the institution and would not have a material adverse impact on the solvency of the institution or its ability to manage risk effectively;

   (b) the institution has received the prior permission of the competent authority.

2. Institutions which have obtained permission under Article 146(9) to use own estimates of LGDs and conversion factors, shall not revert to the use of LGD values and conversion factors referred to in Article 146(8) unless the following conditions are met:

   (a) the institution has demonstrated to the satisfaction of the competent authority that the use of the use of LGDs and conversion factors laid down in Article 146(8) is not proposed in order to reduce the own funds requirement of the institution, is necessary on the basis of nature and complexity of the institution and would not have a material adverse impact on the solvency of the institution or its ability to manage risk effectively;

   (b) the institution has received the prior permission of the competent authority.

3. The application of paragraphs 1 and 2 is subject to the conditions for rolling out the IRB approach determined by the competent authorities in accordance with Article 143 and the permission for permanent partial use referred to in Article 145.

Article 145
Conditions for permanent partial use

1. Where institutions have received the prior permission of the competent authorities, institutions permitted to use the IRB Approach in the calculation of risk-weighted exposure amounts and expected loss amounts for one or more exposure classes, they may apply the Standardised Approach for the following exposures:

(a) the exposure class laid down in 142(a), where the number of material counterparties is limited and it would be unduly burdensome for the institution to implement a rating system for these counterparties;

(b) the exposure class laid down in Article 142(b), where the number of material counterparties is limited and it would be unduly burdensome for the institution to implement a rating system for these counterparties;

(c) exposures in non-significant business units as well as exposure classes that are immaterial in terms of size and perceived risk profile;

(d) exposures to central governments of the Member States and their regional governments, local authorities and administrative bodies provided:

(i) there is no difference in risk between the exposures to that central government and those other exposures because of specific public arrangements, and

(ii) exposures to the central government are assigned a 0 % risk weight under Article 109(4);

(e) exposures of an institution to a counterparty which is its parent undertaking, its subsidiary or a subsidiary of its parent undertaking provided that the counterparty is an institution or a financial holding company, mixed financial holding company, financial institution, asset management company or ancillary services undertaking subject to appropriate prudential requirements or an undertaking linked by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC;

(f) and exposures between institutions which meet the requirements set out in Article 108(7);

(g) equity exposures to entities whose credit obligations assigned a 0 % risk weight under Chapter 2 including those publicly sponsored entities where a 0 % risk weight can be applied;

(h) equity exposures incurred under legislative programmes to promote specified sectors of the economy that provide significant subsidies for the investment to the institution and involve some form of government oversight and restrictions on the equity investments where such exposures may in aggregate be excluded from the IRB approach only up to a limit of 10 % of own funds;

(i) the exposures identified in Article 115(9) meeting the conditions specified therein;

(j) State and State-reinsured guarantees referred to in Article 210(2).

The competent authorities shall permit the application of Standardised Approach for equity exposures referred to in points (g) and (h) which have been permitted for this treatment in other Member States.

2. For the purposes of paragraph 1, the equity exposure class of an institution shall be material if their aggregate value, excluding equity exposures incurred under legislative programmes as referred to in point (g) of paragraph 1, exceeds on average over the preceding year 10 % of the own funds of the institution. Where the number of those equity exposures is less than 10 individual holdings, that threshold shall be 5 % of the own funds of the institution.

3. EBA shall develop draft regulatory technical standards to determine the conditions of application of points (a), (b) and (c).

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2013.

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

4. For the purposes of paragraph 1, the equity exposure class of an institution shall be considered material if their aggregate value, excluding equity exposures incurred under legislative programmes as referred to in paragraph 1, point (g), exceeds, on average over the preceding year, 10 % of the institution's own funds. If the number of those equity exposures is less than 10 individual holdings, that threshold shall be 5 % of the institution's own funds.

SECTION 2
CALCULATION OF RISK WEIGHTED EXPOSURE AMOUNTS

SUB-SECTION 1
TREATMENT BY TYPE OF EXPOSURE

Article 146
Treatment by exposure class

1. The risk-weighted exposure amounts for credit risk for exposures belonging to one of the exposure classes referred to in points (a) to (e) and (g) of 142(2) shall, unless deducted from own funds, be calculated in accordance with Sub-section 2 except where those exposures are deducted from Common Equity Tier 1 Additional Tier 1 items or Tier 2 items.

2. The risk-weighted exposure amounts for dilution risk for purchased receivables shall be calculated according to Article 153. Where an institution has full recourse to the seller of purchased receivables for default risk and for dilution risk, to the seller of the purchased receivables, the provisions of this Article and Articles 147 and 154(1) to (4) in relation to purchased receivables shall not apply and the exposure shall be treated as a collateralised

exposure.

3. The calculation of risk-weighted exposure amounts for credit risk and dilution risk shall be based on the relevant parameters associated with the exposure in question. These shall include probability of default (hereinafter referred to as 'PD'), LGD, maturity (hereinafter referred to as 'M') and exposure value of the exposure. PD and LGD may be considered separately or jointly, in accordance with Section 4.

4. Institutions may calculate risk-weighted exposure amounts for credit risk for all exposures belonging to the exposure class 'equity' referred to in point (e) of Article 142(2) in accordance with Article 142(2) where they have received the prior permission of the competent authorities. Competent authorities shall grant permission for an institution to use the internal models approach set out in Article 150(4) provided the institution meets the requirements set out in Sub-section 4 of Section 6.

5. The calculation of risk weighted exposure amounts for credit risk for specialised lending exposures may be calculated in accordance with Article 148(4).

6. For exposures belonging to the exposure classes referred to in points (a) to (d) of Article 142(2), institutions shall provide their own estimates of PDs in accordance with Article 138 and Section 6.

7. For exposures belonging to the exposure class referred to in point (d) of Article 142(2), institutions shall provide own estimates of LGDs and conversion factors in accordance with Article 138 and Section 6.

8. For exposures belonging to the exposure classes referred to in points (a) to (c) of Article 142(2), institutions shall apply the LGD values set out in Article 157(1), and the conversion factors set out in Article 162(8) (a) to (d), unless it has been permitted to use its own estimates of LGDs and conversion factors for those exposure classes in accordance with paragraph 9.

9. For all exposures belonging to the exposure classes referred to in points (a) to (c) of Article 142(2), the competent authority shall permit institutions to use own estimates of LGDs and conversion factors only in accordance with Article 138.

10. The risk-weighted exposure amounts for securitised exposures and for exposures belonging to the exposure class referred to in point (f) of Article 142(2) shall be calculated in accordance with Chapter 5.

Article 147
Treatment of exposures in the form of shares in collective investment undertakings (CIUs)

1. Where exposures in the form of shares in a collective investment undertakings (CIUs) meet the criteria set out in Article 127(3) and the institution is aware of all or parts of the underlying exposures of the CIU, the institution shall look through to those underlying exposures in order to calculate risk-weighted exposure amounts and expected loss amounts in accordance with the methods set out in this Chapter.

Where an underlying exposure of the CIU is itself another exposure in the form of units or

shares in another CIU, the first institution shall also look through to the underlying exposures of the other CIU.

2. Where the institution does not meet the conditions for using the methods set out in this Chapter for all or parts of the underlying exposures of the CIU, risk weighted exposure amounts and expected loss amounts shall be calculated in accordance with the following approaches:

   (a) for exposures belonging to the 'equity' exposure class referred to in Article 142(2)(e), institutions shall apply the simple risk-weight approach set out in Article 150(2);

   (b) for all other underlying exposures referred to in paragraph 1, institutions shall apply the Standardised Approach laid down in Chapter 2, subject to the following:

      (i) for exposures subject to a specific risk weight for unrated exposures or subject to the credit quality step yielding the highest risk weight for a given exposure class, the risk weight shall be multiplied by a factor of two but must not be higher than 1250 %;

      (ii) for all other exposures, the risk weight must be multiplied by a factor of 1,1 and shall be subject to a minimum of 5 %.

   Where, for the purposes of point (a), the institution is unable to differentiate between private equity, exchange-traded and other equity exposures, it shall treat the exposures concerned as other equity exposures. Where those exposures, taken together with the institution's direct exposures in that exposure class, are not material within the meaning of Article 145(2), Article 145(1) may be applied subject to the permission of the competent authorities.

3. Where exposures in the form of units or shares in a CIU do not meet the criteria set out in Article 127(3), or the institution is not aware of all of the underlying exposures of the CIU or of its underlying exposures which is itself an exposure in the form of units or shares in a CIU, the institution shall look through to those underlying exposures and calculate risk-weighted exposure amounts and expected loss amounts in accordance with the simple risk-weight approach set out in Article 150(2).

   Where the institution is unable to differentiate between private equity, exchange-traded and other equity exposures, it shall treat the exposures concerned as other equity exposures. It shall assign non equity exposures to the other equity class.

4. Alternatively to the method described in the paragraph 4, institutions may calculate themselves or may rely on the following third parties to calculate and report the average risk weighted exposure amounts based on the CIU's underlying exposures in accordance with the approaches referred to in points (a) and (b) of paragraph 2 for the following:

   (a) the depository institution or financial institution of the CIU provided that the CIU exclusively invests in securities and deposits all securities at this depository institution or financial institution;

   (b) for other CIUs, the CIU management company, provided that the CIU management company meets the criteria set out in Article 127(3)(a).

The correctness of the calculation shall be confirmed by an external auditor.

5. EBA shall develop draft regulatory technical standards to specify the conditions according to which competent authorities may permit institutions to use Article 145(1) under point (b) of paragraph 2.

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2013.

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

SUB-SECTION 2
CALCULATION OF RISK WEIGHTED EXPOSURE AMOUNTS FOR CREDIT RISK

Article 148
Risk weighted exposure amounts for exposures to corporates, institutions and central governments and central banks.

1. Subject to the application of the specific treatments laid down in paragraphs 2, 3 and 4, the risk weighted exposure amounts for exposures to corporates, institutions and central governments and central banks shall be calculated according to the following formulae:

$$Risk\text{-}weighted\ \ exposure\ \ amount = RW \cdot exposure\ \ value$$

where the risk weight RW is defined as

(i) if PD = 0, RW shall be 0;

(ii) if PD = 1, i.e., for defaulted exposures:

– where institutions apply the LGD values set out in Article 157(1), RW shall be 0;

– where institutions use own estimates of LGDs, RW shall be $RW = \max\{0, 12.5 \cdot (LGD - EL_{BE})\}$;

where the Expected Loss Best Estimate (hereinafter referred to as 'ELBE') shall be the institution's best estimate of expected loss for the defaulted exposure according to Article 177(1)(h);

(iii) if $PD \in \left]0\%;100\%\right[$, i.e., for any value other than under (i) or (ii)

$$RW = \left(LGD \cdot N\left(\frac{1}{\sqrt{1-R}} \cdot G(PD) + \sqrt{\frac{R}{1-R}} \cdot G(0.999) \right) - LGD \cdot PD \right) \cdot \frac{1+(M-2.5)\cdot b}{1-1.5\cdot b} \cdot 12.5 \cdot 1.06$$

where

N(x) = the cumulative distribution function for a standard normal random variable (i.e. the probability that a normal random variable with mean zero and variance of one is less than or equal to x);

G (Z) =denotes the inverse cumulative distribution function for a standard normal random variable (i.e. the value x such that N(x) z)

R = denotes the coefficient of correlation, is defined as

$$R = 0.12 \cdot \frac{1-e^{-50 \cdot PD}}{1-e^{-50}} + 0.24 \cdot \left(1 - \frac{1-e^{-50 \cdot PD}}{1-e^{-50}}\right)$$

b = the maturity adjustment factor, which is defined as

$$b = \left(0.11852 - 0.05478 \cdot \ln(PD)\right)^2$$

2. For all exposures to large regulated financial entities and to unregulated financial entities, the coefficient of correlation of paragraph 1(iii) is multiplied by 1.25 as follows:

$$R = 1.25 \cdot \left[0.12 \cdot \frac{1-e^{-50 \cdot PD}}{1-e^{-50}} + 0.24 \cdot \left(1 - \frac{1-e^{-50 \cdot PD}}{1-e^{-50}}\right)\right]$$

3. The risk weighted exposure amount for each exposure which meets the requirements set out in Article 198 and 212 may be adjusted according to the following formula:

$$\textit{Risk-weighted exposure amount} = RW \cdot \textit{exposure value} \cdot \left(0.15 + 160 \cdot PD_{pp}\right)$$

where:

PD_{pp} = PD of the protection provider.

RW shall be calculated using the relevant risk weight formula set out in point 3 for the exposure, the PD of the obligor and the LGD of a comparable direct exposure to the protection provider. The maturity factor (b) shall be calculated using the lower of the PD of the protection provider and the PD of the obligor.

4. For exposures to companies where the total annual sales for the consolidated group of which the firm is a part is less than EUR 50 million, institutions may use the following correlation formula in paragraph 1 (iii) for the calculation of risk weights for corporate exposures. In this formula S is expressed as total annual sales in millions of Euros with EUR 5 million ≤ S ≤ EUR 50 million. Reported sales of less than EUR 5 million shall be treated as if they were equivalent to EUR 5 million. For purchased receivables the total annual sales shall be the weighted average by individual exposures of the pool.

$$R = 0.12 \cdot \frac{1-e^{-50 \cdot PD}}{1-e^{-50}} + 0.24 \cdot \left(1 - \frac{1-e^{-50 \cdot PD}}{1-e^{-50}}\right) - 0.04 \cdot \left(1 - \frac{\min\{\max\{5, S\}, 50\} - 5}{45}\right)$$

Institutions shall substitute total assets of the consolidated group for total annual sales

when total annual sales are not a meaningful indicator of firm size and total assets are a more meaningful indicator than total annual sales.

5. For specialised lending exposures in respect of which an institution is not able to estimate PDs or the institutions' PD estimates do not meet the requirements set out in Section 6, the institution shall assign risk weights to these exposures according to Table 1, as follows:

Table 1					
Remaining Maturity	Category 1	Category 2	Category 3	Category 4	Category 5
Less than 2,5 years	50 %	70 %	115 %	250 %	0 %
Equal or more than 2,5 years	70 %	90 %	115 %	250 %	0 %

In assigning risk weights to specialised lending exposures institutions shall take into account the following factors: financial strength, political and legal environment, transaction and/or asset characteristics, strength of the sponsor and developer, including any public private partnership income stream, and security package.

6. For their purchased corporate receivables institutions shall comply with the requirements set out in Article 180. For purchased corporate receivables that comply in addition with the conditions set out in Article 149(5), and where it would be unduly burdensome for an institution to use the risk quantification standards for corporate exposures as set out in Section 6 for these receivables, the risk quantification standards for retail exposures as set out in Section 6 may be used.

7. For purchased corporate receivables, refundable purchase discounts, collateral or partial guarantees that provide first-loss protection for default losses, dilution losses, or both, may be treated as first-loss positions under the IRB securitisation framework.

8. Where an institution provides credit protection for a number of exposures under terms that the nth default among the exposures shall trigger payment and that this credit event shall terminate the contract, if the product has an external credit assessment from an eligible ECAI the risk weights set out in Chapter 5 shall be applied. If the product is not rated by an eligible ECAI, the risk weights of the exposures included in the basket will be aggregated, excluding n-1 exposures where the sum of the expected loss amount multiplied by 12,5 and the risk weighted exposure amount shall not exceed the nominal amount of the protection provided by the credit derivative multiplied by 12,5. The n-1 exposures to be excluded from the aggregation shall be determined on the basis that they shall include those exposures each of which produces a lower risk-weighted exposure amount than the risk-weighted exposure amount of any of the exposures included in the aggregation. A 1250% risk weight shall apply to positions in a basket for which an institution cannot determine the risk-weight under the IRB approach.

9. EBA shall develop draft regulatory technical standards to specify the conditions according to which institutions shall take into account the factors referred to the second subparagraph of paragraph 5 when assigning risk weights to specialised lending exposures.

EBA shall submit those draft regulatory technical standards to the Commission by 31

December 2014.

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

Article 149

Risk weighted exposure amounts for retail exposures

1. The risk-weighted exposure amounts for retail exposures shall be calculated according to the following formulae:

$$Risk\text{-}weighted\ \ exposure\ \ amount = RW \cdot exposure\ \ value$$

where the risk weight RW is defined as follows:

(i) if PD = 0, RW shall be 0;

(ii) if PD = 1, i.e., for defaulted exposures, RW shall be $RW = \max\{0, 12.5 \cdot (LGD - EL_{BE})\}$;

where EL_{BE} shall be the institution's best estimate of expected loss for the defaulted exposure according to Article 177(1)(h);

(iii) if $PD \in \left]0\%;100\%\right[$, i.e., for any value other than under (i) or (ii)

$$RW = \left(LGD \cdot N\left(\frac{1}{\sqrt{1-R}} \cdot G(PD) + \sqrt{\frac{R}{1-R}} \cdot G(0.999) \right) - LGD \cdot PD \right) \cdot 12.5 \cdot 1.06$$

where

N(x) = the cumulative distribution function for a standard normal random variable (i.e. the probability that a normal random variable with mean zero and variance of one is less than or equal to x);

G (Z) =the inverse cumulative distribution function for a standard normal random variable (i.e. the value x such that N(x) z);

R = the coefficient of correlation defined as

$$R = 0.03 \cdot \frac{1 - e^{-35 \cdot PD}}{1 - e^{-35}} + 0.16 \cdot \left(1 - \frac{1 - e^{-35 \cdot PD}}{1 - e^{-35}} \right)$$

2. The risk weighted exposure amount for each exposure to small and medium sized enterprise as defined in Article 142(5) which meets the requirements set out in Articles 198 and 212 may be calculated according to Article 148(3).

3. For retail exposures secured by immovable property collateral a coefficient of correlation *R* of

0.15 shall replace the figure produced by the correlation formula in paragraph 1.

4. For qualifying revolving retail exposures as defined in points (a) to (e), a coefficient of correlation R of 0.04 shall replace the figure produced by the correlation formula in paragraph 1.

Exposures shall qualify as qualifying revolving retail exposures if they meet the following conditions:

(a) the exposures are to individuals;

(b) the exposures are revolving, unsecured, and to the extent they are not drawn immediately and unconditionally, cancellable by the institution. In this context revolving exposures are defined as those where customers' outstanding balances are permitted to fluctuate based on their decisions to borrow and repay, up to a limit established by the institution. Undrawn commitments may be considered as unconditionally cancellable if the terms permit the institution to cancel them to the full extent allowable under consumer protection and related legislation;

(c) the maximum exposure to a single individual in the sub-portfolio is EUR 100000 or less;

(d) the use of the correlation of this paragraph is limited to portfolios that have exhibited low volatility of loss rates, relative to their average level of loss rates, especially within the low PD bands;

(e) the treatment as a qualifying revolving retail exposure shall be consistent with the underlying risk characteristics of the sub-portfolio.

By way of derogation from point (b), the requirement to be unsecured does not apply in respect of collateralised credit facilities linked to a wage account. In this case amounts recovered from the collateral shall not be taken into account in the LGD estimate.

Competent authorities shall review the relative volatility of loss rates across the qualifying revolving retail sub-portfolios, as well the aggregate qualifying revolving retail portfolio, and shall share information on the typical characteristics of qualifying revolving retail loss rates across Member States.

5. To be eligible for the retail treatment, purchased receivables shall comply with the requirements set out in Article 180 and the following conditions:

(a) The institution has purchased the receivables from unrelated, third party sellers, and its exposure to the obligor of the receivable does not include any exposures that are directly or indirectly originated by the institution itself;

(b) The purchased receivables shall be generated on an arm's-length basis between the seller and the obligor. As such, inter-company accounts receivables and receivables subject to contra-accounts between firms that buy and sell to each other are ineligible;

(c) The purchasing institution has a claim on all proceeds from the purchased receivables or a pro-rata interest in the proceeds; and

(d) The portfolio of purchased receivables is sufficiently diversified.

6. For purchased receivables, refundable purchase discounts, collateral or partial guarantees that provide first-loss protection for default losses, dilution losses, or both, may be treated as first-loss positions under the IRB securitisation framework.

7. For hybrid pools of purchased retail receivables where purchasing institutions cannot separate exposures secured by immovable property collateral and qualifying revolving retail exposures from other retail exposures, the retail risk weight function producing the highest capital requirements for those exposures shall apply.

Article 150

Risk weighted exposure amounts for equity exposures

1. Institutions shall determine their risk-weighted exposure amounts for equity exposures, excluding those deducted in accordance with Part Two or subject to a 250 % risk weight in accordance with Article 45, according to the different approaches set out in paragraphs (2), (3) and (4) and apply them to different portfolios where the institution itself uses different approaches internally. Where an institution uses different approaches, the choice shall be made consistently and shall not be determined by regulatory arbitrage considerations.

   Institutions may treat equity exposures to ancillary services undertakings according to the treatment of other non credit- obligation assets.

2. Under the Simple risk weight approach, the risk weighted exposure amount shall be calculated according to the following formula:

   Risk weight (RW) = 190 % for private equity exposures in sufficiently diversified portfolios.

   Risk weight (RW) = 290 % for exchange traded equity exposures.

   Risk weight (RW) = 370 % for all other equity exposures.

   Risk-weighted exposure amount = RW * exposure value.

   Short cash positions and derivative instruments held in the non-trading book are permitted to offset long positions in the same individual stocks provided that these instruments have been explicitly designated as hedges of specific equity exposures and that they provide a hedge for at least another year. Other short positions are to be treated as if they are long positions with the relevant risk weight assigned to the absolute value of each position. In the context of maturity mismatched positions, the method is that for corporate exposures as set out in Article 158(5).

   Institutions may recognise unfunded credit protection obtained on an equity exposure in accordance with the methods set out in Chapter IV.

3. Under the PD/LGD approach, risk weighted exposure amounts shall be calculated according to the formulas in Article 148(1). If institutions do not have sufficient information to use the definition of default set out in Article 174, a scaling factor of 1,5 shall be assigned to the risk weights.

At the individual exposure level the sum of the expected loss amount multiplied by 12,5 and the risk weighted exposure amount shall not exceed the exposure value multiplied by 12,5.

Institutions may recognise unfunded credit protection obtained on an equity exposure in accordance with the methods set out in Chapter IV. This shall be subject to an LGD of 90 % on the exposure to the provider of the hedge. For private equity exposures in sufficiently diversified portfolios an LGD of 65 % may be used. For these purposes M shall be 5 years.

4. Under the internal models approach, the risk weighted exposure amount shall be the potential loss on the institution's equity exposures as derived using internal value-at-risk models subject to the 99th percentile, one-tailed confidence interval of the difference between quarterly returns and an appropriate risk-free rate computed over a long-term sample period, multiplied by 12.5. The risk weighted exposure amounts at the equity portfolio level shall not be less than the total of the sums of the following:

   (a) the risk weighted exposure amounts required under the PD/LGD Approach; and

   (b) the corresponding expected loss amounts multiplied by 12.5.

   The amounts referred to in point (a) and (b) shall be calculated on the basis of the PD values set out in Article 161(1) and the corresponding LGD values set out in Article 161(2).

   Institutions may recognise unfunded credit protection obtained on an equity position.

Article 151
Risk weighted exposure amounts for equity exposures

Risk weighted exposure amounts for exposures arising from institution's pre-funded contribution to the default fund of a CCP and trade exposures with a CCP shall be determined in accordance with Articles 296 to 300 as applicable.

Article 152
Risk weighted exposure amounts for other non credit-obligation assets

The risk weighted exposure amounts for other non credit-obligation assets shall be calculated according to the following formula:

$$\textit{Risk-weighted exposure amount} = 100\% \cdot \textit{exposure value}$$,

except for:

(a) cash in hand and equivalent cash items as well as gold bullion held in own vault or on an allocated basis to the extent backed by bullion liabilities, in which case a 0% risk-weight shall be assigned;

(b) when the exposure is a residual value of leased assets in which case it shall be calculated as follows:

$$\frac{1}{t} \cdot 100\% \cdot exposure\ value,$$

where t is the greater of 1 and the nearest number of whole years of the lease remaining.

SUB SECTION 3
CALCULATION OF RISK WEIGHTED EXPOSURE AMOUNTS FOR DILUTION RISK OF PURCHASED RECEIVABLES

Article 153
Risk weighted exposure amounts for dilution risk of purchased receivables

1. Institutions shall calculate the risk weighted exposure amounts for dilution risk of purchased corporate and retail receivables shall be calculated according to the formula set out in Article 148(1).

2. Institutions shall determine the input parameters PD and LGD in accordance with section 4.

3. Institutions shall determine the exposure value in accordance with Section 5.

4. For the purposes of this Article, the value of M is 1 year.

5. The competent authorities shall exempt an institution from the requirements for risk weighted exposure amounts for dilution risk of purchased corporate and retail receivables where the institution has demonstrated to the satisfaction of the competent authority that dilution risk is immaterial for that institution.