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THE EUROPEAN UNION**

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**NOTE**

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From:            General Secretariat of the Council  
To:                Delegations

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Subject:        PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT  
                    AND OF THE COUNCIL on prudential requirements for credit institutions and  
                    investment firms  
                    - Presidency Compromise

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Delegations will find attached a Presidency compromise proposal following the discussions at the working party meetings in March of 2012.

Changes to the last Presidency compromise text (doc. 7042/12) are denoted by **bold underlining**. Text that has been changed or deleted is substituted by **[...]**. All amendments made in earlier versions are underlined.

**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<sup>1</sup>,

Acting in accordance with the ordinary legislative procedure,

Whereas:

- (1) The G20 Declaration of 2 April 2009<sup>2</sup> 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.

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<sup>1</sup> OJ C , , p. .

<sup>2</sup> [http://www.g20.org/Documents/Fin\\_Deps\\_Fin\\_Reg\\_Annex\\_020409\\_-\\_1615\\_final.pdf](http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf).

- (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.
- (3) Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006<sup>1</sup> 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<sup>2</sup> 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. **In order to ensure a coherent application of those provisions, it is appropriate [...] to merge these provisions into new legal acts: a Directive and this Regulation [...].** For **the** sake of clarity, the provisions of the Annexes to those Directives should be integrated into the enacting terms of **these new legal acts. [...]**
- (4) **[...]** Together, both **new** legal **[...] acts** should form the legal framework governing the access to the activity, the supervisory framework and the prudential rules for credit institutions and investment firms. **Therefore** this Regulation should **[...]** be read together with **[...]** Directive **[inserted by OP]**.
- (5) **The** Directive [inserted by OP], based on Article 53 (1) TFEU, should, **inter alia**, 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.

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<sup>1</sup> OJ L 177, 30.6.2006, p. 1.

<sup>2</sup> OJ L 177, 30.6.2006, p. 201.

- (6) This Regulation should, *inter alia*, 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 **[...] Regulation [...]** 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 **possibilities for [...]** Member States **[...]** to impose stricter rules than those laid down by those Directives. This results in divergences between national rules, which **[...]** **might** hamper the cross-border provision of services and the **freedom of** establishment **and so create obstacles to the smooth functioning of internal market. [...]**
- (8) In order to remove **[...]** obstacles to trade and **[...]** distortions of competition resulting from divergences between national laws and to prevent **[...]** 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) **[...] In areas not covered in this Regulation, including for an example dynamic provisioning, provisions on national covered bonds schemes not related to the treatment of covered bonds under the rules established by this Regulation, competent authorities or Member States should be able to impose national rules, [...] provided that they are not inconsistent with this Regulation. [...].**
- (10a) **The most important recommendations advocated in de Larosière report and later implemented in the Union were the establishment of a Single Rule Book and a European framework for macroprudential supervision where both elements were aimed in combination at ensuring financial stability. The Single Rulebook ensures a robust and uniform regulatory framework facilitating the Single Market and prevents regulatory arbitrage opportunities. Within the single market in financial services macroprudential risks may however differ in a number of ways with a range of national specificities meaning that variances for example can be observed as to the structure and size of the banking sector compared to the wider economy and the credit cycle.**

- (10b) A number of tools to prevent and mitigate macro-prudential and systemic risks have been built into the Directive and Regulation ensuring flexibility while at the same time ensuring that the use of these tools are subject to appropriate control in order not to harm the function of the internal market while also ensuring that the use of such tools are transparent and consistent.**
- (10c) Beyond the systemic risk buffer tool as included in the Directive, where Macro-prudential or systemic risks [...] concern [...] only one Member State, the designated authorities of the relevant Member State should be allowed to address those risks by certain specific individual measures, when this is considered more effective to tackle the risk. The assessment on the adequacy of those individual measures should include certain political assessments, as such risks may ultimately affect the fiscal and budgetary situation of the relevant Member State. The Commission shall therefore adopt an implementing act to allow the relevant Member States designated authority to address the threat by an individual measure.**
- (10d) Until the harmonisation of liquidity requirements in 2015 and the harmonisation of a Leverage Ratio in 2018 Member States may apply these measures as the Member States find appropriate, including mitigation of macro-prudential or systemic risk in the meaning of a risk of disruption in the financial system with the potential to have serious negative consequences to the financial system and the real economy in a specific Member State.**
- (10da) Systemic risk buffers or individual measures taken by Member States to address systemic risks concerning these Member States, can be applied to the banking sector in general or to one or more subsets of the sector, in the meaning of institutions that exhibit similar risk profiles in their business activities, or to the exposures to one or several domestic economic or geographic sectors across the banking sector.**

- (10e) If two or more Member States designated authorities identify the same changes in the intensity of systemic or macro-prudential risk posing a risk to financial stability at the national level in each Member State which the designated authorities considers would better be addressed by means of national measures, the Member States may submit a joint notification to the Commission, the Council, the ESRB and EBA. When notifying the Commission, the Council, The ESRB and EBA they shall submit relevant evidence, including a justification of the joint notification.**
- (10f) The Commission shall furthermore be empowered to adopt a temporary increase in the level of own funds, risk weights, requirements for large exposures and public disclosure. Such provisions should be applicable for a period of one year, unless the European Parliament or the Council has objected to the delegated act within a period of 2 month. The Commission shall state the reasons for the use of this [...] procedure. The Commission is only empowered to impose stricter prudential requirement for exposures which arise from market developments in at least [three] Member States or outside the Union affecting at least [three] Member States.**
- (10g) A review of the macro-prudential regulation is finally justified in order for the Commission to assess, among other things, whether the current macro-prudential tools in this Regulation or the Directive [inserted by OP] are effective, efficient and transparent, whether new instruments shall be proposed, whether the coverage and the possible degrees of overlap of the macro-prudential tools for targeting similar risks in this Regulation or the Directive [inserted by OP] [...] are adequate and how internationally agreed standards for systemic institutions interacts with the provisions in this Regulation or the Directive [inserted by OP]**
- (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 [...] individual credit institution and investment firm. The range of such supervisory arrangements should, *inter alia*, 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,<sup>1</sup> established the 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 holding money or securities belonging to their clients are necessary to ensure similar safeguards for savers and fair conditions of competition between comparable groups of credit institutions and investment firms.

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<sup>1</sup> OJ L 331, 15.12.2010, p. 12.



- (18) Since credit institutions and investment firms in the internal market are engaged in direct competition, monitoring requirements should be equivalent throughout the Union **to a sufficiently large degree**.
- (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 **do not [...]** apply 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.
- (21a) The minority interests arising from intermediate financial holding companies that are subject to the requirements of this regulation on a subconsolidated basis may also be eligible (within the relevant limits) to the CET1 of the group on a consolidated basis, as the common equity Tier 1 capital of an intermediate financial holding company attributable to minority interests and the part of that same capital attributable to the parent company support both pari passu the losses of their subsidiaries when they occur.**

- (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<sup>1</sup>, which incorporates certain adaptations of the provisions of Seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts<sup>2</sup> or of Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards<sup>3</sup>, 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.

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<sup>1</sup> OJ L 372, 31.12.1986, p. 1.

<sup>2</sup> OJ L 193, 18.7.1983, p. 1.

<sup>3</sup> OJ L 243, 11.9.2002, p. 1.

- (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. [...] Credit institutions and investment firms **should be encouraged** 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 **their** credit risk measurement and management processes [...] to make **available** methods for determining [...] regulatory own funds requirements **that would [...]** reflect the [...] **nature, scale, and complexity** 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. **This notwithstanding, the more risk-sensitive approaches require considerable expertise and resources as well as data of high quality and sufficient volume. Credit institutions and investment firms should therefore comply with high standards before applying these approaches 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 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. [...] [...] 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 interests 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) **are 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 to properly [...] 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 an [...] institution [...] incurs an exposure to its own parent undertaking or to other subsidiaries of its parent undertaking, particular prudence is necessary. The management of **such** exposures incurred by [...] institutions [...] should be carried out in a fully autonomous manner, in accordance with the principles of sound management, without regard to any other considerations. **This is especially important in case of large exposures and in cases not simply related to intra-group administration or usual intra-group transactions.** **Supervisory authorities should pay particular attention to such intra-group exposures.** [...] 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 **Union [...]**. 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 [...] **12** 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. **[...] The securitisation position should not be deducted from capital if there are other ways to determine a risk weight in line with the actual risk of the position which does not take this credit protection into account. [...]** (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. **It is expected that credit institutions or investment firms whose shares are listed on an EU regulated market should meet their capital requirements regarding the core elements of capital with these listed common shares that meet a strict set of criteria for the core capital instruments and the disclosed reserves of the institution only. In order to adequately take into account the diversity of legal forms credit institutions and investment firms in the European Union are operating under, the strict set of criteria for the core capital instruments will ensure that core capital instruments for institutions not listed on an EU regulated market are of highest quality. [...] (53a) This Regulation should not affect the ability of competent authorities to maintain pre-approval processes regarding the contracts governing Additional Tier 1 and Tier 2 capital instruments. In these cases such capital instruments may only be computed towards the institution's Additional Tier 1 capital or Tier 2 capital once they have successfully completed these approval processes.**
- (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 **depositors [...]** 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, [...] **instruments issued within the context of a recapitalisation measure pursuant to State aid-rules and issued prior to 20 July 2011 [...]** 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.
- (56a)** 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 **be required to** 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<sup>1</sup>.

**[(63a) [...] The Commission should review the rules for large exposures by 31 December 2013 at the latest. Pending the outcome of this review. Member States should continue being allowed to decide on the exemption of certain large exposures from those rules for a sufficiently long transitional period. Building on the work done in the context of the preparation and negotiation of directive 2009/111/EC and taking into account international and European developments on these issues, the Commission shall report on whether exemptions in Article 389(2) should continue to be applied in a discretionary or in a more general way and on whether the risks related to those exposures are addressed by other effective means laid down in this Regulation.**

**(63b) In order to ensure that exemptions to exposures by competent authorities do not jeopardise the coherence of the uniform rules established by this Regulation on a permanent basis, after a transitional period, and in the absence of any outcome of the above mentioned review, the competent authorities should consult EBA on whether or not it is appropriate to continue making use of this possibility.**

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<sup>1</sup> COM/2010/0484 final.

- (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.
- (70) [...] Credit institutions and investment firms should [...] 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) [...]
- (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 investment [...] 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<sup>1</sup> 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 on the free movement of such data<sup>2</sup>, 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.

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<sup>1</sup> OJ L 281, 23.11.1995, p. 31.

<sup>2</sup> OJ L 8, 12.1.2001, p. 1.

(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 **shall report together with a legislative proposal as appropriate to the European Parliament and Council to introduce the liquidity coverage requirement. [...]**.

**(75a) In order to ensure global harmonization in the area of liquidity regulation, any legislative proposal to introduce the liquidity coverage requirement (LCR) according to Article 481 should be equivalent to the LCR as set out in final international framework for liquidity risk measurement, standards and monitoring of the Basel Committee on Banking Supervision taking into account European specificities.**

**(75b) It should not 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 and the individual agreement of all competent authorities involved, competent authorities should be able to waive the application of the LCR to individual credit institutions or investment firms and subject those credit institutions or investment firms to a consolidated requirement, in order to allow institutions to manage their liquidity centrally at the group or subgroup level.**

**(75c) In the same vein, where no waiver is granted, liquidity flows between two institutions belonging to the same group and which are subject to consolidated supervision, should, when the LCR becomes a binding measure, receive preferential inflow and outflow rates only in those cases where all the necessary safeguards are in place. Such specific preferential treatments should be narrowly defined and linked to the fulfilment of a number of stringent and objective conditions. The specific treatment applicable to a given intra-group flow should be obtained through a methodology using objective criteria and parameters in order to determine specific levels of inflows and outflows between the institution and the counterparty. Based on the observations and supported by the EBA report, the Commission should, as appropriate and in accordance with article 481 of this regulation, present legislative proposals to lay down these specific intra-group treatments, the methodology together with the objective criteria to which they are linked as well as joint decision modalities for the assessment of those criteria.**

- (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 **to** 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. **Furthermore, share premium accounts related to items that qualified as own funds under national transposition measures for Directive 2006/48/EC shall under certain circumstances qualify as Common Equity Tier 1.**

- (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, [...], 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 [...] **this** Regulation in order to take account of specific circumstances; to clarify the exemption of certain exposures from the application of provisions of [...] **this** 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 [...].
- (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) [...]
- (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, [...], conditions for application of requirements for prudent valuation, 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, operational risk, and settlement risk;
- (b) requirements limiting large exposures;
- (c) after the procedure in Article 481 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) public disclosure 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 an 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 of Directive [inserted by OP], including a financial holding company, a mixed financial holding company, a payment institution within the meaning of Directive 2007/61/EC and an asset management company, but excluding insurance holding companies and mixed activity insurance holding companies;

- (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;
  - d) firms which are only authorized to provide the service of portfolio management 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. Holding money or securities means that clients' money and/or securities are deposited on accounts belonging to the firm and/or firms are mandated by clients to make transactions on cash or securities accounts belonging to the clients
- (9) 'collective investment undertaking (CIU)' means an Alternative Investment Fund as defined by Article 4(1)(a) of Directive 2011/61/EU [...], including non-EU AIF as defined in Article 4(1)(a) of that Directive, or an undertaking for collective investment in transferable securities (UCITS) as defined in Article 1 of Directive 2009/65/EU [...], including, unless otherwise provided, third country entities, that carry out similar activities, that are subject to supervision pursuant to EU legislation or to legislation of a third country which applies supervisory and regulatory requirements at least equivalent to those applied in the Union.
- (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 an institution and which carries out directly all or some of the transactions inherent in the business of institutions;
- (17)

- (18) ‘home Member State’ means the Member State in which an institution has been authorised;
- (19) ‘host Member State’ means the Member State in which an 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 [...], or a similar relationship between any natural or legal person and an undertaking;
- (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 or set up and sponsored by central governments, regional governments 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’ means the sum of the following:
- (a) Tier 1 capital as determined in Article 23;
- (b)
- (c) Tier 2 capital as determined in Article 59 that is equal to or less than one third of Tier 1 capital ;

- (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) ‘**ESCB** central banks’ means the national central banks that are members of the European System of Central Banks, and the European Central Bank. [...].
- (25a) ‘central banks’ means the ESCB central banks and central banks of third countries.**
- (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 amount that the customer could draw without the need for a further credit decision by the institution; this amount may be 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 [...] **obligation** 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 tranced, 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 tranced 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 direct control over or is directly interconnected with more than one natural or legal person, the set consisting of the central government and all of the natural or legal persons directly or indirectly controlled by the central government according to point (a) or interconnected with the central government according to point (b) is not required to be considered as a group of connected clients. Instead the existence of a group of connected clients formed by the central government and other natural or legal persons may be assessed separately for each of the persons directly controlled by the central government according to point (a) or directly interconnected with the central government according to point (b) and all of the natural and legal persons which are controlled by that person according to point (a) or interconnected with that person according to point (b), including the central government. The same applies in cases of regional governments or local authorities to which Article 110(2) applies.

- (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 II 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 , 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) ‘applicable accounting framework’ means the accounting standards to which the institution is subject under Regulation (EC) No 1606/2002<sup>1</sup> [...] or Council Directive 86/635/EEC [...]
- (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 or in relation to the acquisition or development or construction of [...] immovable 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.

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<sup>1</sup> OJ L 243, 11.9.2002, p. 1.

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

- (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)
- (d) a primary financial instrument;
- (e) a cash assimilated instrument.

The instruments referred to in points (a) to ([...] **b**) 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 [...] **market** 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 or [...] 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;

this shall include an institution, a financial holding company or a mixed financial holding company;

(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\_;
- (64) ‘parent institution in a Member State’ means an institution in a Member State 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 in a Member State 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 in a Member State 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 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 in a Member State 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;
- (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 [...];
  - (b) control;
  - (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 central counterparty as defined in Article 2(1)(1) of Regulation (EU) ... [EMIR] that has been either authorised in accordance with Article 10 of that Regulation or recognised in accordance with Article 23 of that Regulation ;
- (74) 'default fund' means a fund established by a CCP in accordance with Article 40 of Regulation (EU) ... [EMIR] and used in accordance with Article 42 of that Regulation ;
- (74a) 'pre-funded contribution to the default fund of a CCP ' means a contribution to the default fund of a CCP that is paid in by an institution;
- (74b) 'contractually committed contribution to the default fund of a CCP' means a contribution to the default fund of a CCP that an institution is contractually required to pay on a specified event, but which is not a pre-funded contribution;
- (75) 'trade exposure' means the sum of **the following:**
- i) the mark-to-market exposures to a CCP and potential future exposures to a CCP which are covered by the loss mutualisation protection scheme of the CCP;**
  - ii) the exposures arising from assets posted to a CCP in the form of initial and variation margin which are not segregated from the CCP and which are related to the exposures listed in point i) [...] [...] [...] ;**
- (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’ has the same meaning as under Article 4 of Directive [inserted by OP];
- (83)
- (84) ‘senior management’ has the same meaning as under Article 4 of Directive [inserted by OP];
- (85) mixed financial holding company’ has the same meaning as under Article 2(15) of Directive 2002/87/EC;
- (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, derivatives or repurchase agreements, but excluding obligations which can only be enforced during the liquidation of an institution, compared to that institution’s own funds;
- (87) EBA’ means the European Banking Authority established by Regulation (EU) No 1093/2010 of the European Parliament and of the Council;



- (88) 'credit risk adjustment' is the amount of specific [...] loan loss provision for credit risks that has been recognised in the financial statements of the institution in accordance with the [...] applicable accounting framework;
- (89) 'ancillary services undertaking' means an undertaking the principal activity of which consists in owning or managing property, managing data-processing services, or any other similar activity which is ancillary to the principal activity of one or more institutions;
- (90) 'internal hedge' means a position that materially offsets the component risk elements between a trading book and a non-trading book position or sets of positions;
- (91) 'asset management company' means an asset management company defined in Article 2(5) of Directive 2002/87/EC and an alternative investment fund manager within the meaning of Directive 2011/61/EC **including, unless otherwise provided, third country entities, that carry out similar activities, that are subject to legislation of a third country which applies supervisory and regulatory requirements at least equivalent to those applied in the Union;**
- (92) ' financial sector entity' means any of the following:
- (a) [...] an institution;
  - (b) a financial institution;
  - (ba) an ancillary services undertaking included in the consolidated financial situation of an institution;
  - (c) an insurance undertaking;
  - (d) a third country insurance undertaking;
  - (e) a reinsurance undertaking;
  - (f) a third country reinsurance undertaking;
  - (g) an insurance holding company ;

(93) For the purpose of this Regulation any reference to real estate or residential or commercial immovable property or mortgage on such property shall include shares in Finnish residential housing companies operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation.

(94) External Credit Assessment Institution (ECAI) means a credit rating agency that is registered or certified in accordance with Regulation (EC) No 1060/2009 or a central bank issuing credit ratings which are exempt from the application of Regulation (EC) No 1060/2009. “Nominated ECAI” means an ECAI nominated by an institution.

(95) ‘reference obligation’ means the obligation used for the purposes of determining the cash settlement value of a credit derivative

2. For the purposes of this regulation, exposures to third-country investment firms as defined in Article 4(1)(1) of Directive 2004/39/EC, exposures to third country credit institutions and exposures to third country clearing houses and exchanges shall be treated as exposures to institutions if and only if the entity is subject to legislation of a third country which applies prudential supervisory and regulatory requirements at least equivalent to those applied in the European Union.

3. For the purposes of paragraph 2, 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 prudential supervisory and regulatory requirements 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 countries where the relevant competent authorities had approved the third country as eligible for this treatment before 1 January 2013.

# 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 either a subsidiary in the Member State where it is authorised and supervised, or a parent undertaking, and every institution included in the consolidation pursuant to Article 17, does not need to comply with the obligations laid down in Article 84 to 86 on an individual basis.
3. Every institution which is either a parent undertaking, or a subsidiary, and every institution included in the consolidation pursuant to Article 17, does not need to comply with the obligations laid down in Part Eight on an individual basis.
4. Credit institutions and 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 shall comply with the obligations laid down in **Part Six [...]** on an individual basis. Pending the report from the Commission in accordance with article 480(2), competent authorities may exempt investment firms from compliance with the obligations laid down in **Part Six [...]** taking into account the nature, scale and complexity of investment firm's activities.

5. Institutions, except for investment firms referred to in Articles 90(1) and 91(1) and institutions for which competent authorities have exercised the derogation specified in Article 6(1), or Article 6(3) in relation to the requirements laid out in Articles 84 to 86, 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 may waive in full or in part the application of **[...] Part Six** to a 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 on a consolidated basis or a subsidiary institution on a sub-consolidated basis complies with the obligations laid down in **[...] Part Six** 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 on a consolidated basis or subsidiary institution on a sub-consolidated basis 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 and ensures sufficient liquidity in case of all institutions;
- (c) The institutions have entered into contracts to the satisfaction of the competent authorities 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 is no current or foreseen material practical or legal impediment to the fulfilment of the contracts referred to in (c).

2. The competent authorities may waive in full or in part the application of [...] **Part Six** to an institution and to all or some of its subsidiaries where all institutions of the single liquidity sub-group are authorized in the same Member State and provided that conditions of paragraph 1 are fulfilled.

2a. 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] across the prospective liquidity sub-group;
- (b) the distribution of amounts, location and ownership of the required liquid assets to be held within the liquidity group;
- (c) minimum amounts of liquid assets to be held by institutions for which the application of [...] **Part Six** will be waived;

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

(e) unrestricted sharing of complete information between the competent authorities.

2b. Competent authorities may also apply paragraph 1 and 4 to institutions which 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 [...] **Part Six** on the basis of the consolidated situation of all institutions of the single liquidity group.

3. \_\_\_\_\_

4. Where a waiver has been granted under paragraph 1 or paragraph 2, the competent authorities may also apply Article 84 Directive [xx], or parts thereof, at the level of the single liquidity group and waive the application of Article 84 Directive [xx], or parts thereof, on the individual basis.



## *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 partially or fully 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 the following conditions are met :

- (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 Article 16, with the obligations laid down in Parts Two to Four and Seven on the basis of their consolidated situation. The parent undertakings and their subsidiaries subject to this Regulation shall set up a proper organisational structure and appropriate internal control mechanisms in order to ensure that the data required for consolidation are duly processed and forwarded. In particular, they shall ensure that subsidiaries not subject to this Regulation implement arrangements, processes and mechanisms to ensure a proper consolidation.
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 [...] **Part Six** 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 and those subsidiaries who are of material significance for their local market shall disclose the information specified in Article 424, 425, 427, 428, 435, 436 and 438, 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, 427, 428, 435, 436 and 438 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 consolidating supervisor may waive, on a case-by-case basis, the application of Part Three and Chapter 4 of the Directive [inserted by OP] on a consolidated basis provided that the following conditions exist:
  - (a) each EU investment firm in the [...] group uses the alternative calculation of total risk exposure amount referred to in Article 90(2);
  - (b) all investment firms in [...] the group fall within the categories in Articles 90(1) and 91(1);
  - (c) each EU investment firm in [...] the 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 [...] the group holds, at least as much capital, defined here as the sum of [...] the items referred to in Articles 24(1), 48(1) and 59(1); **as to cover the sum of the following:**
    - (ii) [...] 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 include 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 14a

##### *Derogation to the application of the leverage ratio requirements on a consolidated basis for groups of investment firms*

**Where all entities in a group of investment firms, including the parent entity, are investment firms that are exempt from the application of the requirements laid down in Part Seven on an individual basis in accordance with Article 5(5), the parent investment firm may choose not to apply the requirements laid down in Part Seven on a consolidated basis.**

#### *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 responsible for the supervision of the investment firm 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, notably large exposures, of the whole group, including any undertakings not located in a Member State.

Where the competent authorities responsible for the supervision of the investment firm waive the application of own funds requirements on a consolidated basis as provided for in Article 14, 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 **Part Six [...]** 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 shareholders 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 consolidating supervisor 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(4), 146(9), 277, 301(2), 352 of this Regulation, 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 determining whether the criteria for a specific intra-group treatment as referred to in article 410(8a) and 413(4a) complemented by the EBA regulatory technical standards referred to in Article 410(9) and 413(4b) are met.

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 assessment of the criteria and the determination of the specific 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). The decision of the consolidating supervisor shall not limit the powers of the competent authorities under Article 100a of Directive [inserted by OP].

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 on paragraph 1(a) 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.

- 4a. In the absence of a joint decision between the competent authorities within six months, the competent authority [...] **responsible for the supervision of [...] the subsidiary on an individual basis** [...] shall make its own decision on paragraph 1(b).

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 consolidating supervisor that informs the EU parent institution, the EU parent financial holding company or to the EU parent mixed financial holding company.



If, at the end of the six month period, the consolidating supervisor has referred the matter to EBA in accordance with Article 19 of Regulation (EU) No 1093/2010, the **competent authority responsible for the supervision [...]** of the subsidiary **on an individual basis** shall defer its decision on paragraph 1(b) 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, Title II, 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, 4 and 4a shall be recognized as determinative and applied by 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(4), 146(9), 301(2), 277, 352 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 or a sub-consolidating subsidiary 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 **[...] Part Six**.

This joint decision shall be set out in a document containing the fully reasoned decision which shall be submitted to the parent institution of the liquidity subgroup by the consolidating supervisor.

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. 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. 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 [...].

3. Any relevant competent authority may also during the six months period consult EBA in case of disagreement on the conditions of (a) to (d) of Article 7(2). 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.

## *Article 20*

### *Sub-consolidation in cases of entities in third countries*

Subsidiary institutions shall apply the requirements laid down in Part Three, Article 84 to 86 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 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*

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

- (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)
- (3)
- (4) 'basic own funds' means 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 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)
- (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 a direct holding of capital instruments issued by an intermediate entity that has an exposure to capital instruments issued by a financial sector entity where, in the event the capital instruments issued by the financial sector entity were permanently written off, the loss that the institution would incur as a result would not be materially different from the loss the institution would incur from a direct holding of those capital instruments issued by the financial sector entity;
- (18) 'intangible assets' has the same meaning as under the applicable accounting standard, and shall also include goodwill if not already included in intangible assets under that 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 financial sector entities that do not qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments or Tier 1 own-fund insurance items, additional Tier 1 own-fund insurance items, Tier 2 own-fund insurance items or Tier 3 own-fund 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 financial sector entities where those entities also hold own funds instruments issued by the institution;
- (27)
- (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.
- (30a) 'synthetic holding' means an investment by an institution in a financial instrument the value of which is directly linked to the value of the capital instruments issued by a financial sector entity.



## **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 verified 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 **framework [...]**.

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. **On the basis of information from each Member State,** EBA shall establish, maintain and publish a list of the forms of capital instruments, **which the Member State in its jurisdiction considers [...]** as Common Equity Tier 1 instruments. **[...] [...] [...]** EBA shall establish and publish this list for the first time by 1 January 2013.

*Article 25*

*Capital instruments of mutuals, cooperative societies, savings institutions 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, savings institution or a similar institution for the purposes of this Part;
  - (b) the conditions laid down in Articles 26 **amended by Article [...]** 27 are met;
  - (c)
2. EBA shall develop draft regulatory technical standards to specify 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, savings institution or similar institution for the purposes of this Part.

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 [...] , which in the case of institutions subject to statutory audit shall be the balance sheet subject to that audit; ;
  - (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 Article 72;
- (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, which are limited to the profit of the period for which the distribution is paid plus any reserves which according to national company law may be distributed following a decision of the owners of the institution;
  - (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, 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;
- (vii) the cancellation of distributions imposes no restrictions on 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 subject to a guarantee that [...] enhances the seniority of the claim [...] by any of the following:
    - (i) the institution or its subsidiaries;
    - (ii) the parent undertaking of the institution or its subsidiaries;
    - (iii)
    - (iv)
    - (v)
    - (vi) any undertaking that has close links with the entities referred to in points (i) or (ii) ;
  - (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) .

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, savings institutions and similar institutions*

1. Capital instruments issued by mutuals, cooperative societies, savings institutions and similar institutions shall qualify as Common Equity Tier 1 instruments only if the conditions laid down in Article 26 **with modifications resulting from application of [...]** 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.

The condition laid down in the first sub-paragraph is without prejudice of the possibility for a mutual, cooperative society or a similar institution to recognize within CET1 capital instruments that do not afford voting rights to the holder and that meet all the following conditions:

(a) the claim of the holders of the non-voting instruments in the insolvency or liquidation of the institution is proportionate to the share of the total Common Equity Tier 1 instruments that those non-voting instruments represent;

(b) the instruments otherwise qualify as a Common Equity Tier 1 instruments.

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 immediately cease to qualify as a Common Equity Tier 1 instrument;
- (b) the share premium accounts that relate to that instrument shall immediately 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 except when such gains and losses are offset by a change in the fair value of another financial instrument measured at fair value resulting 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.

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

- (f) direct, indirect and synthetic 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) direct, indirect and synthetic holdings of the Common Equity Tier 1 instruments of financial sector 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, indirect and synthetic holdings by the institution of Common Equity Tier 1 instruments of financial sector entities where the institution does not have a significant investment in those entities;
- (i) the applicable amount of direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1 instruments of financial sector 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);

iv) positions in a basket for which an institution cannot determine the risk weight under the IRB approach, in accordance with Article 148(8);

(v) equity exposures under an internal models approach, in accordance with Article 150(4).

- (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 application of the deductions referred to in points (a), (c), (e), (f), (h), (i) and (l) 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.

3. EBA shall develop [...] [...] draft regulatory technical standards to specify the types of capital instruments of third country financial institutions **and, in consultation with EIOPA, of** 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 amount of 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 [...] applicable 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) the entity has the legally enforceable right under applicable national law to set off the [...] those current tax assets against current tax liabilities;
  - (b) the [...] those deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority and on the same taxable entity.
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 point (a) of 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*

*Tax overpayments, tax loss carry backs and deferred tax assets that do not rely on future profitability*

- 1.
2. The following items shall not be deducted from own funds and shall be subject to a risk weight in accordance with Chapter 2 or 3 of Title II of Part Three, as applicable.:
  - (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.
3. Deferred tax assets that do not rely on future profitability shall be limited to deferred tax assets arising from temporary differences, where all the following conditions are met:
  - (a) they are automatically and mandatorily replaced without delay with a tax credit in the event that the institution reports a loss when the annual financial statements of the institution are formally approved, or in the event of liquidation or insolvency of the institution;
  - (b) an institution shall be able under the applicable national tax law to offset a tax credit referred to in point (a ) against any tax liability of the institution or any other undertaking included in the same consolidation as the institution for tax purposes under that law or any other undertaking subject to the supervision on a consolidated basis in accordance with Chapter 2 of Title II of Part One;

(c) where the amount of tax credits referred to in point ( b) exceeds the tax liabilities referred to in that point, any such excess is replaced without delay with a direct claim on the central government of the Member State in which the institution is incorporated.

Institutions shall apply a risk weight of 100% to deferred tax assets where the conditions laid down in points a) to c) are met.

#### *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 permission 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 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 direct, indirect and synthetic holdings of index securities by calculating the underlying exposure to own Common Equity Tier 1 instruments included in those indices;
- (c) institutions may net gross long positions in own Common Equity Tier 1 instruments 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 financial sector entity*

For the purposes of deduction, a significant investment of an institution in a financial sector 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 financial sector 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 financial sector 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 financial sector 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 direct, indirect and synthetic holdings of the financial sector 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 direct, indirect and synthetic holdings of index securities by calculating the underlying exposure to the capital instruments of the financial sector entities in those indices.

#### *Article 43*

#### *Deduction of holdings where an institution does not have a significant investment in a financial sector 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, indirect and synthetic holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of financial sector entities in which the institution does not have a significant investment 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 (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, indirect and synthetic holdings by the institution of the Common Equity Tier 1 instruments of financial sector entities divided by the aggregate amount of direct, indirect and synthetic holdings by the institution of the own funds instruments of those financial sector 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. The amount to be deducted pursuant to paragraph 1 shall be apportioned across each Common Equity Tier 1 instrument held. 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, indirect and synthetic holdings by the institution of the **[...] Common Equity Tier 1 instruments** of financial sector 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. .



*Article 44*

*Deduction of holdings of Common Equity Tier 1 instruments where an institution has a significant investment in a financial sector 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:
  - (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 (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 financial sector entity, the direct, indirect and synthetic 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 [...] (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 %.

#### Article 46

#### Requirement for deduction where consolidation, supplementary supervision or institutional protection schemes are applied

1. For the purposes of calculating own funds on a stand-alone basis, a subconsolidated basis and a consolidated basis, where the competent authorities require or permit institutions to apply methods 1 or 2 of Annex I to Directive 2002/87/EC, the competent authorities may permit institutions not to deduct the holdings of own funds instruments of a financial sector entity in which the parent institution, parent financial holding company or parent mixed financial holding company or institution has a significant investment, provided that the conditions laid down in points (a) to (e) are met:
  - (a) the financial sector entity is an insurance undertaking, re-insurance undertaking or an insurance holding company;
  - (b) that insurance undertaking, re-insurance undertaking or an insurance holding company is included in the same supplementary supervision under Directive 2002/87/EC as the parent institution, parent financial holding company or parent mixed financial holding company or institution that has the holding;
  - (c) the institution has received the prior permission of the competent authorities;

(d) prior to granting the permission referred to in point (c), and on a continuing basis, the competent authorities are satisfied that the level of integrated management, risk management and internal control regarding the entities that would be included in the scope of method 1 or 2 is adequate;

(e) the **holdings in the entity belongs to [...]** one of the following:

(i) the parent credit institution;

(ii) the parent financial holding company;

(iii) the parent mixed financial holding company;

(iv) the institution;

(v) a subsidiary of one of the entities referred to in points (i) to (iv) that is included in the scope of consolidation pursuant to Chapter 2 of Title II of Part One.

The method chosen shall be applied in a consistent manner over time.

2. For the purposes of calculating own funds on a stand-alone basis and a sub-consolidated 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 financial sector 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)

(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:

(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.

(vi) the institutions included in each institutional protection scheme meet **together** on a consolidated basis the requirements laid down in Article 87, **in Article 100 of the Directive and in Title VI, Chapter 4 of the Directive;** and carry out reporting of compliance with those requirements in accordance with 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 (vi) are met.

3a. The holdings in respect of which deduction is not made in accordance with paragraphs 1, 2 or 3 shall qualify as equity exposures and be risk weighted in accordance with Chapter 2 or 3 of Title II of Part Three, as applicable.

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 paragraph 3 **to specify the conditions of application of points (v) and (vi) of paragraph 3(b).**

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

Instruments included under point (a) shall not qualify as Common Equity Tier 1 or Tier 2 items.

##### *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 a material holding or a 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 **subject to a guarantee that enhances the seniority of the claim [...]** by any of the following:
  - (i) the institution or its subsidiaries;
  - (ii) the parent undertaking of the institution or its subsidiaries;
  - (iii)
  - (iv)
  - (v)
  - (vi) any undertaking that has close links with entities referred to in points (i) or (ii) ;
- (f) the instruments are not subject to any arrangement, contractual or otherwise, that enhances the seniority of the claim under the instruments\_;
- (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 **except where the conditions laid down in Article 73(2a) are met;**

- (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) the instruments meet the following conditions as regards distributions:
  - (i) they shall be paid out of distributable items as defined in Article 26 (h) (ii);
  - (ii) the level of distributions made on the instruments will not be modified based on the credit standing of the institution or its parent undertaking;
  - (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 on a permanent or temporary basis, 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 proceeds are immediately available without limitation in a form that satisfies the conditions laid down in this paragraph to those entities.

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 any write up of the principal amount of an Additional Tier 1 instrument following a write down of its principal amount on a temporary basis;
- (c) the procedures and timing for the following:
  - (i) determining that a trigger event has occurred;
  - (ii) (iii) writing up the principal amount of an Additional Tier 1 instrument following a write down of its principal amount on a temporary basis;
- (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*

1. 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;
- (aa) institutions may specify in the provisions governing the instrument one or more trigger events in addition to that referred to in point (a);
- (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 insolvency or liquidation of the institution;

- (ii) the amount required to be paid in the event of the call or redemption of the instrument;
- (iii) the distributions made on the instrument.

2. Write down or conversion of an Additional Tier 1 instrument shall, under the [...]  
**applicable** accounting standard, generate items that qualify as Common Equity Tier 1  
items.
3. The amount of Additional Tier 1 instruments recognised in Additional Tier 1 items is  
limited to the minimum amount Common Equity Tier 1 items that would be generated if  
the principal amount of the Additional Tier 1 instruments were fully written down or  
converted into Common Equity Tier 1 instruments.
4. The aggregate amount of Additional Tier 1 instruments that is required to be written down  
or converted upon the occurrence of a trigger event shall be no less than the lower of the  
following:
  - (a) the amount required to restore fully the Common Equity Tier 1 ratio of the institution  
to 5.125%;
  - (b) the full principal amount of the instrument.
5. When a trigger event occurs institutions shall do the following without delay:
  - (a) inform the competent authorities and the holders of the Additional Tier 1  
instruments;
  - b) write down the principal amount of the instruments, or convert the instruments into  
Common Equity Tier 1 instruments without delay, in accordance with the  
requirement laid down in this Article.

*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 immediately cease to qualify as an Additional Tier 1 instrument
- (b) the part of the share premium accounts that relates to that instrument shall immediately 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, indirect and synthetic 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) direct, indirect and synthetic holdings of the Additional Tier 1 instruments of financial sector 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, indirect and synthetic holdings of the Additional Tier 1 instruments of financial sector entities, where an institution does not have a significant investment in those entities;
- (d) direct, indirect and synthetic holdings by the institution of the Additional Tier 1 instruments of financial sector 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 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 direct, indirect or synthetic holdings of index securities by calculating the underlying exposure to own Additional Tier 1 instruments in those indices;
- (c) gross long positions in own Additional Tier 1 instruments 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 financial sector 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 financial sector 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 of the capital instruments of financial sector 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 direct, indirect and synthetic holdings of index securities by calculating the underlying exposure to the capital instruments of the financial sector entities in those indices.

*Article 57*

*Deduction of holdings of Additional Tier 1 instruments where an institution does not have  
a significant investment in a financial sector 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, indirect and synthetic holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of financial sector 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 (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, indirect and synthetic holdings by the institution of the Additional Tier 1 instruments of financial sector 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 financial sector 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. The amount to be deducted pursuant to paragraph 1 shall be apportioned across each Additional Tier 1 instrument held. 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) the aggregate amount of direct, indirect and synthetic holdings by the institution of the [...] Additional Tier 1 instruments of financial sector 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 and subordinated loans where the conditions laid down in Article 60 are met;
- (b) \_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.

Items included under point (a) shall not qualify as Common Equity Tier 1 or Additional Tier 1 items.

*Article 60*  
*Tier 2 instruments*

Capital instruments **[...] including subordinated loans** 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 a material holding or 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 subject to a guarantee that enhances the seniority of the claim [...] by any of the following:
  - (i) the institution or its subsidiaries;
  - (ii) the parent undertaking of the institution or its subsidiaries;
  - (iii)
  - (iv)
  - (v)
  - (vi) any undertaking that has close links with entities referred to in points (i) or (ii);

- (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 their principal amount to be redeemed by the institution prior to their maturity;
- (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 except where the conditions laid down in Article 73(2a) are met;
- (k) the provisions governing the instruments do not indicate explicitly or implicitly that the instruments would or might be redeemed or repurchased by the institution other than in the insolvency or liquidation of the institution and the institution does not otherwise provide such an indication\_;
- (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 or its parent undertaking;
- (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 proceeds are immediately available without limitation in a form that satisfies the conditions laid down in this paragraph to those entities.



### *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 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.

### *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 immediately cease to qualify as a Tier 2 instrument;
- (b) the part of the share premium accounts that relate to that instrument shall immediately 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, indirect and synthetic 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) direct, indirect and synthetic holdings of the Tier 2 instruments of financial sector 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, indirect and synthetic holdings of the Tier 2 instruments of financial sector entities, where an institution does not have a significant investment in those entities;
- (d) direct, indirect and synthetic holdings by the institution of the Tier 2 instruments of financial sector 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*

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:

- (a) institutions may calculate the amount of holdings 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 direct, indirect and synthetic holdings of index securities by calculating the underlying exposure to own Tier 2 instruments in those indices;
- (c) institutions may net gross long positions in own Tier 2 instruments 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 of financial sector 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 [...] 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 [...] of financial sector 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 of the capital instruments [...] of financial sector 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 direct, indirect and synthetic holdings of index securities by looking through to the underlying exposure to the capital instruments of the financial sector entities in those indices.

*Article 67*

*Deduction of Tier 2 instruments where an institution does not have a significant investment in a financial sector 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, indirect and synthetic holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of financial sector 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, indirect and synthetic holdings by the institution of the Tier 2 instruments of financial sector entities divided by the aggregate amount of all direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of those financial sector 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. The amount to be deducted pursuant to paragraph 1 shall be apportioned across each Tier 2 instrument held. 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, indirect and synthetic holdings by the institution of the **[...] Tier 2** instruments of financial sector 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 69a*

##### *Distributions on own funds instruments*

1. Capital instruments for which an institution has the sole discretion to decide to pay distributions in a form other than cash or an own funds instrument shall not be capable of qualifying as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments unless the institution has received the prior permission of the competent authorities.
2. Competent authorities shall grant the permission referred to in paragraph 1 only where they consider all the following conditions to be met:
  - (a) the ability of the institution to cancel payments under the instrument would not be adversely affected by the discretion referred to in paragraph 1, or by the form in which distributions could be made;
  - (b) the ability of the instrument to absorb losses would not be adversely affected by the discretion referred to in paragraph 1, or by the form in which distributions could be made;
  - (c) the quality of the capital instrument would not otherwise be reduced by the discretion referred to in paragraph 1 or the form in which distributions could be made.



3. Capital instruments for which a legal person other than the institution issuing them has the discretion to decide or require that the payment of distributions on the instrument shall be made in a form other than cash or an own funds instrument shall not be capable of qualifying as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments.
4. Institutions may use [...] in a broad market index as one of the bases for determining the level of distributions on Additional Tier 1 and Tier 2 instruments.
5. Paragraph 4 shall not apply where the institution is a reference entity in that broad market index unless both the following conditions are met:
- (a) the institution considers movements in that broad market index not to be significantly correlated to the credit stranding of the institution, its parent institution or parent financial holding company or parent mixed financial holding company or parent mixed activity holding company;
  - (b) the competent authority has not reached a different determination from that referred to in point (a).
6. The EBA shall develop draft implementing technical standards to specify the indices that shall qualify as broad indices for the purposes of paragraph 1.

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.

## *Article 70*

### *Holding of capital instruments of financial sector entities that do not qualify as regulatory capital*

Institutions shall not deduct from any element of own funds direct, indirect or synthetic holdings of a financial sector entity within the meaning 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 70a*

### *Deduction and maturity requirements for cash equity positions in the trading book*

The maturity requirements for short positions referred to in Articles 42(a), 56(a), and 66(a) shall not apply in respect of cash equity positions held in the trading book where the following conditions are met:

- (a) the institution has the contractual right to sell on a specific future date to the counterparty providing the hedge the long position that is being hedged;
- (b) the counterparty [...] providing the hedge **to the institution** is contractually obliged to purchase from the institution on that specific future date the long position referred to in point (a).

## *Article 71*

### *Index holdings of capital instruments*

- 0. For the purposes of Articles 39(a), 42(a), 54(a), 56(a), 64(a) and 66(a), institutions may reduce the amount of a long position in a capital instrument by the portion of the index that is made up of the same underlying exposure that is being hedged, provided the following conditions are met:

- (a) the long position being hedged and the short position in an index used to hedge that long position are held in the trading book;
- (b) the positions referred to in point (a) are held at fair value on the balance sheet of the institution;
- (c) the short position referred to in point (a) qualifies as an effective hedge under the internal control processes of the institution;
- (d) the competent authorities assess the adequacy of the control processes referred to in point (c) on at least an annual basis and are satisfied with their continuing appropriateness.

1. Where the competent authority has given its prior permission, an institution may use a conservative estimate of the underlying exposure of the institution to capital instruments included in indices as an alternative to an institution calculating its exposure to the items referred to in either or both of points (a) and (b):

- (a) own Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments included in indices;
- (b) or Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments of financial sector entities, included in indices

2. Competent authorities shall grant such permission only where the institution has demonstrated to their satisfaction that it would be operationally burdensome for the institution to monitor its underlying exposure to the items referred to in one or both of points (a) or (b), as appropriate, of paragraph 1.

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 permission of the competent authority to do the following:

- (a) reduce, **redeem** 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 permission for reducing own funds*

1. The competent authority shall grant permission 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 72, 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 may consider necessary on the basis of Article 100 (2) [...] of the Directive [inserted by OP].**

When assessing under point (a) the sustainability of the replacement instruments for the income capacity of the institution, competent authorities shall consider the extent to which those replacement capital instruments would be more costly for the institution than those they would replace.

- 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.

2a. The competent authorities may permit institutions to redeem Additional Tier 1 or Tier 2 instruments before 5 years after the date of issue only where the conditions laid down in paragraph 1 and point (a) or (b) of this paragraph are met:

- (a) there is a change in the regulatory classification of those instruments that would be likely to result in their exclusion from own funds or reclassification as a lower quality form of own funds, and both the following conditions are met:
  - (i) the competent authority considers such a change to be sufficiently certain:

(ii) the institution demonstrates to the satisfaction of the competent authorities that the regulatory reclassification of those instruments was not reasonably foreseeable at the time of their issuance;

(b) there is a change in the applicable tax treatment of those instruments which the institution demonstrates to the satisfaction of the competent authorities is material and was not reasonably foreseeable at the time of their issuance.

3. EBA shall develop 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 process to be applied in the case of redemption of shares issued to members of cooperative societies, and the time period for processing such an 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 capital instruments that qualify as Common Equity Tier 1, Additional Tier 1 or Tier 2 instruments in a financial sector 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.

#### *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 held by persons other than undertakings included in consolidation**

#### *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, share premium accounts and other reserves, 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],
  - (b) the subsidiary is included fully in the consolidation pursuant to Chapter 2 of Title II of Part One;
  - (c) 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 undertaking of the institution, or its 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 1 and 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 the parent undertaking or a subsidiary thereof that is included fully in the consolidation pursuant to Chapter 2 of Title 2 of Part One, 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 other than its investment in the own funds of the parent undertaking or a subsidiary thereof that is included in the scope of consolidation pursuant to Chapter 2 of Title II of Part One, 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 types of assets that relate to the operation of the special purpose entity and the concepts of minimal and insignificant referred to in second subparagraph 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*

1. \_\_\_\_\_ 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), **the requirements referred to in Article 443 A and 443 B,** the specific own funds requirements referred to in Article 100 of Directive, the combined buffer referred to in Article 122(2) of Directive [inserted by OP] [...], the Systemic Risk Buffer requirement referred to in Article 124a of Directive [inserted by OP] **and the requirements in Article 476 [...]** ;
  - (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), **the requirements referred to in Article 443 A and 443 B,** the specific own funds requirements referred to in Article 100 of Directive, the combined buffer referred to in Article 122(2) of Directive [inserted by OP] [...], the Systemic Risk Buffer requirement referred to in Article 124a of Directive [inserted by OP] **and the requirements in Article 476 [...]** [...]

- (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, share premium accounts and other reserves.

2. The calculation referred to in paragraph 1 shall be undertaken on a sub-consolidated basis for each subsidiary referred to in Article 76(1).

An institution may choose not to undertake this calculation for a subsidiary referred to in Article 76(1). Where an institution takes such a decision, the minority interest of that subsidiary may not be included in consolidated Common Equity Tier 1.

3. EBA shall develop draft regulatory technical standards to specify the sub-consolidation calculation required in accordance with paragraph 1a of this Article, Articles 80 and 82,

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 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 own funds by subtracting from the 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 Tier 1 capital of the subsidiary minus 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), **the requirements referred to in Article 443 A and 443 B**, the specific own funds requirement referred to in Article 100 of Directive, the combined buffer referred to in Article 122(2) of Directive [inserted by OP] [...], the Systemic Risk Buffer requirement referred to in Article 124a of Directive [inserted by OP] **and the requirements in Article 476 [...]** (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), **the requirements referred to in Article 443 A and 443 B**, the specific own funds requirements referred to in Article 100 of Directive, the combined buffer referred to in Article 122(2) of Directive [inserted by OP] [...], the Systemic Risk Buffer requirement referred to in Article 124a of Directive [inserted by OP] **and the requirements in Article 476 [...]**;
  - (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, share premium accounts and other reserves.

2. The calculation referred to in paragraph 1 shall be undertaken on a sub-consolidated basis for each subsidiary referred to in Article 76(1).

An institution may choose not to undertake this calculation for a subsidiary referred to in Article 76(1). Where an institution takes such a decision, the qualifying Tier 1 capital of that subsidiary may not be included in consolidated Tier 1 capital.

*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*

1. 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 own funds of the subsidiary minus 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), **the requirements referred to in Article 443 A and 443 B**, the specific own funds requirement referred to in Article 100 of Directive, the combined buffer referred to in Article 122(2) of Directive [inserted by OP] [...], the Systemic Risk Buffer requirement referred to in Article 124a of Directive [inserted by OP] **and the requirements in Article 476 [...]**

(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), **the requirements referred to in Article 443 A and 443 B, the specific own funds requirements referred to in Article 100 of Directive, the combined buffer referred to in Article 122(2) of Directive [inserted by OP] [...], the Systemic Risk Buffer requirement referred to in Article 124a of Directive [inserted by OP] and the requirements in Article 476 [...]**

(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, share premium accounts and other reserves.

2. The calculation referred to in paragraph 1 shall be undertaken on a sub-consolidated basis for each subsidiary referred to in Article 76(1).

An institution may choose not to undertake this calculation for a subsidiary referred to in Article 76(1). Where an institution takes such a decision, the qualifying own funds of that subsidiary may not be included in consolidated own funds.

### *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 financial sector entity;
  - (b) an undertaking, that is not a financial sector 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) for the purpose of calculating the minimum capital requirement in accordance with Part Three of this Regulation, institutions shall apply a risk weight of 1 250 % to the greater of 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.

(c) competent authorities shall publish their choice of (a) or (b).

4. EBA shall issue guidelines specifying the following concepts:

- (a) activities that are a direct extension of banking;
- (b) activities that concern services that are ancillary to banking;
- (c) similar activities for the purposes of point (b)(iii) of paragraph 1.

The guidelines shall be adopted in accordance with Article 16 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 Article 84 paragraph 1 shall not be included in calculating the eligible capital limits specified in that Article where any of the following conditions is met:
  - (a) those shares are held temporarily during a financial reconstruction or rescue operation, as referred to in Article 74;
  - (b) the holding of those shares is an underwriting position held for 5 working days or fewer;
  - (c) those shares are held in 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 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 and Article 369, 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 with the exception of Article 369, 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. Credit institutions that were already in existence on 1 January 1993, the amount of own funds of which do not attain the amount of initial capital required may continue to carry on their activities. In that event, the amount of own funds of those institutions may not fall below the highest level reached with effect from 22 December 1989.

- 2a. [...] **Authorised** investment firms and firms covered by Article 6 of the Directive 2004/39/EC which were in existence before 31 December 1995, the amount of own funds of which do not attain the amount of initial capital required [...], **may** continue to carry on their activities. The own funds of such firms or investment firms shall not fall below the highest reference level calculated after the date of notification contained in Directive 93/6/EEC. That reference level shall be the average daily level of own funds calculated over a six-month period preceding the date of calculation. It shall be calculated every six months in respect of the corresponding preceding period.
3. Where control of an institution falling within the category referred to in paragraph 2 or 2a is taken by a natural or legal person other than the person who controlled the institution previously, the amount of 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 or 2a, the amount of 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 28(2) 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 28(2) 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:
    - (i) \_\_\_\_\_ that do not hold client money or securities;
    - (ii) that undertake only dealing on own account;
    - (iii) that have no external customers;
    - (iv) 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 in consultation with ESMA 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 2014.**

*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, a parent investment firm in a Member State and 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) it shall use own funds calculated on the basis of the consolidated financial situation of the parent investment firm or that of the financial holding company, as applicable, and in compliance with Chapter 2 of Part One.

## Chapter 2

### Calculation and reporting requirements

#### *Article 94*

##### *Valuation*

1. Save where otherwise provided, the valuation of assets and off-balance-sheet items shall be effected in accordance with the applicable accounting framework.
2. By derogation to paragraph 1, competent authorities may require that institutions effect the valuation of assets and off-balance-sheet items in accordance with International Accounting Standards as applicable under Regulation (EC) No 1606/2002.

#### *Article 95*

##### *Reporting on own funds requirements and financial information*

1. Reporting by institutions to the competent authorities on the obligations laid down in Article 87 shall be carried out at least on a **[...] semiannual** basis.

This reporting shall also include financial information to the extent that:

a) the competent authorities considers this is necessary to obtain a comprehensive view of the risk profile of an institution's activities.

b) the competent authorities considers this information necessary to obtain a view on the systemic risks posed by institutions to the financial sector or the real economy in accordance with Regulation (EU) No 1093/2010.

2. EBA shall develop draft implementing technical standards to specify the uniform formats, frequencies and dates of reporting, definitions and the IT solutions to be applied in the Union for **[...] the reporting in paragraph 1.** Regarding the financial information, the scope of the implementing technical standard shall be limited to institutions that are subject to article 4 in Regulation (EC) No 1606/2002 and those credit institutions, other than those referred to in Article 4, that prepare their consolidated accounts in conformity with the international accounting standards adopted in accordance with the procedure laid down in Article 6(2).

The reporting formats shall be proportionate to the nature, scale and complexity of the activities of the institutions.

Regarding the financial information, the scope and level of application of the reporting shall be proportionate 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 on a [...] semiannual basis the following data to the competent authorities for each national property market to which they are [...] exposed:
  - (a) losses stemming from exposures for which an institution has recognised immovable residential property as collateral, up to the lower of the pledged amount and 80% of the market value or 80% of the mortgage lending value unless otherwise decided under Article 119(2),;
  - (b) overall losses stemming from exposures for which an institution has recognised immovable by residential property as collateral, up to the part of the exposure treated as fully secured by immovable residential property according to Article 119(1) ;
  - (ba) the exposure value of all outstanding exposures for which an institution has recognised immovable residential property as collateral limited to the part treated as fully secured by immovable residential property according to Article 119(1);
  - (c) losses stemming from exposures for which an institution has recognised immovable commercial property as collateral, up to the lower of the pledged amount and 50% of the market value or 60% of the mortgage lending value unless otherwise decided under Article 119(2)
  - (d) overall losses stemming from [...] exposures for which an institution has recognised immovable commercial property as collateral, up to the part of the exposure treated as fully secured by immovable commercial property according to Article 119(1).
  - (e) the exposure value of all outstanding exposures for which an institution has recognised immovable commercial property as collateral limited to the part treated as fully secured by immovable commercial property according to Article 119(1).



The data shall be reported

(i) to the competent authority of the home member state of the relevant institution, in case of an institution having a branch in another Member State, the data relating to that branch shall also be reported to the competent authority of the host Member State,

(ii) [...]

(iii) separately for each property market within the EEA to which the relevant institution is exposed to.

[...]

2. The competent authorities shall publish annually on an aggregated basis the data specified in points (a) to (e) 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, definitions, frequencies and dates of reporting, and the IT solutions of the items referred to in paragraph 1;
  - (b) uniform formats, definitions, frequencies and dates of reporting, and the IT solutions, of the aggregate data referred to in paragraph 2.

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 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 may only be included in the trading book provided that they are either free of restrictions on their tradability or [...] can 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 is 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 97 and the definition of trading book in accordance with Article 4(62), 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 fair valued 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 fair valued 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 fair valued 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.
- 3. Institutions shall revalue fair valued 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 can close out at mid market.
- 6. Where marking to market is not possible, institutions shall use a demonstrably prudent valuation approach to 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' models shall be subject to periodic review to determine the accuracy of their 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, market price uncertainty, 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 ageing 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. Institutions shall also explicitly assess the need for valuation adjustments relating to the uncertainty of parameter inputs used by models.

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

#### *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 exposure 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 (h) 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).

For trade exposures to a central counterparty and for default fund contributions to a central counterparty, institutions shall apply the treatment specified in Chapter 6, Section 9 to calculate their risk-weighted exposure amounts for the purposes of points (a) and (f) of Article 87(3). For all other types of exposures to a central counterparty, institutions should treat those exposures as exposures to institutions.

### *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 (d) 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 Article 107, 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 142, it 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, Article 59 (d) and Article 33 (1)(d) [...].

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 Standardised Approach, general credit risk adjustment of this institution shall be assigned to the treatment set out in paragraph 1;

(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 [...] **applicable** accounting framework for the following:

- (a) exposure value under the Standardised Approach referred to in Article 106;
- (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) [...]

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, additional value adjustments in accordance with Article 31 and 105 and other own funds reductions related to the asset item 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) exposures to central governments or central banks
- (b) exposures to regional governments or local authorities;
- (c) exposures to public sector entities;
- (d) exposures to multilateral development banks;
- (e) exposures to international organisations;
- (f) exposures to institutions;

- (g) exposures to corporates;
- (h) retail exposures;
- (i) exposures secured by mortgages on immovable property;
- (j) exposures in default;
- (ja) items associated with particularly high risk
- (k) exposures in the form of covered bonds
- (l) items representing securitisation positions
- (m) exposures to institutions and corporates with a short-term credit assessment
- (n) exposures in the form of units or shares in collective investment undertakings ('CIUs');
- (o) equity exposures
- (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 [...] 4(95) 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 Common Equity Tier 1, Additional Tier 1 or Tier 2 items, an institution may, subject to the **prior approval** of the competent authorities, decide not to 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 **[...] grant approval** 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, is authorised not to apply the requirements of paragraph 1, it may assign a risk weight of 0 %.

7. With the exception of exposures giving rise to Common Equity Tier 1, Additional Tier 1 and Tier 2 items, institutions may, subject to the prior approval of the competent authorities, not to 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 grant approval 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 (c) 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 [...] 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 the exposures to the central government or central bank of the 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 or receive a risk weight as specified in paragraph 5. 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.

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. 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 the 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. In exceptional circumstances, exposures to public-sector entities may be treated as exposures to the central government, regional government or local authority in whose jurisdiction they are established where in the opinion of the competent authorities of this jurisdiction there is no difference in risk between such exposures because of the existence of an appropriate guarantee by the central government, regional government or local authority
5. When competent authorities of a third country jurisdiction, which apply supervisory and regulatory arrangements at least equivalent to those applied in the Union, treat exposures to public sector entities according to paragraph 1 or 2, institutions may risk weight exposures to such public sector entities in the same manner. Otherwise the institutions shall apply a risk weight of 100%.

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 the third country where the relevant competent authorities had approved the third country as eligible for this treatment before 1 January 2013.

6.

*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 114(2) and 115(2) 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 of the borrower 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 the central government in which the institution is incorporated.
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 comparable to those applied to institutions in terms of robustness 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 [...] 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 [...] 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 [...] 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 exposures to the central government of the jurisdiction in which the corporate is incorporated, 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 [...] exposures fully secured on residential property collateral that have been assigned to the exposure class laid down in Article 107 (i), 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.

Exposures that do not comply with the criteria (a) to (c) shall not be eligible for the retail exposures 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 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 their territory are appropriately based on
- (a) the loss experience of exposures secured by immovable property;
  - (b) forward-looking immovable property markets developments ;

Competent authorities 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.

For exposures secured by mortgages on residential property, the competent authority shall set the risk weight **at a percentage from [...] 35% [...] through 150 [...] %, including both.**

For exposures secured on commercial immovable property, the competent authority shall set the risk weight **[...] at a percentage from 50% [...] through [...] 150%, including both.**

Within these ranges, the higher risk weight shall be set based on loss experience and taking into account forward-looking markets developments and financial stability considerations. Where the assessment demonstrates that the risk weights set out in Article 120(2) and 121(2) do not reflect the actual risks related to one or more property segments of such exposures, fully secured by mortgages on residential property or on commercial immovable property located in one or more parts of its territory, the competent authorities shall set, for those property segments of exposures, a higher risk weight corresponding to the actual risks. The higher risk weight shall not exceed the risk weight set in Article 120 and 121, as applicable.

The competent authorities shall consult EBA on the adjustments to the risk weights and criteria applied, which will be calculated in accordance with the criteria set out above as specified by the regulatory technical standards referred to in paragraph 2b of this Article. EBA shall publish the risk weights and criteria that the competent authorities set for exposures referred to in Articles 120, 121 and 195.

2b. EBA shall develop regulatory technical standards to specify

(a) the rigorous criteria for the assessment of the mortgage lending value referred to in paragraph 1;

(b) the conditions referred to in paragraph 2 that competent authorities shall take into account when determining higher risk-weights, in particular the term of "financial stability considerations".

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 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)
  - (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 [...] 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 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. For those other sources, institutions shall determine maximum loan-to-income ratios 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 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)
  - (c) exposures related to property leasing transactions concerning offices or other commercial premises under which the institution is the lessor 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. **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 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 [...] 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 article 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 where the obligor has defaulted according to Article 174, or in the case of retail exposures, the unsecured part of any credit facility which has defaulted 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 % **to the exposure value remaining after [...] specific credit risk 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 exposures:
  - (a) investments in venture capital firms;
  - (b) **[...] investments in** alternative investment funds as defined by Article 4(1)(**a [...]**) of Directive 2011/61/EU (OJ L 174/1, 1.7.2011) that are leveraged;
  - (ba) **investments in private equity [...]**;
  - (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 **and 4**, ‘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)<sup>1</sup> and collateralised by any of the following eligible assets:
  - (a) exposures to or guaranteed by central governments, **ESCB** central banks, public sector entities, regional governments and local authorities in the Union;

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<sup>1</sup> OJ L 02, 17.11.2009, p. 2.

- (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 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 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 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 (maritime liens) up to 60 % of the value of the pledged ship minus any prior maritime lien.

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 [...] 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 **and 4** 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 [...] 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 units or 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 units or shares in CIUs for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 8 which corresponds to the credit assessment of the [...] 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 according to paragraphs 4 and 5, 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 [...] 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 exposures in the form of units or shares of CIUs from third countries 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 units or 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).

(c)            [...]

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.

2a.            [...]

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 45(2) 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  $n$ th 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 ...ECAI, the risk weights prescribed in Chapter 5 shall be assigned. If the product is not rated by an ...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 Article 107. When the exposure is a residual value of leased assets, the risk weighted exposure amounts shall be calculated as follows:  $1/t * 100 \% * \text{residual value } \dots$ , 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**

**ECAIs**

*Article 130*

*Use of credit assessments by 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 [...]ECAI or has been endorsed by an [...]ECAI in accordance with Regulation (EC) No 1060/2009.
- 2.
3. EBA shall publish the list of ECAIs in accordance with Article 2(4) and 18(3) of Regulation (EC) No 1060/2009 on its website.

## SUB-SECTION 2

### MAPPING OF ECAI'S CREDIT ASSESSMENTS

#### *Article 131*

#### *Mapping of ECAI's credit assessments*

1. The ESAs Joint Committee shall develop draft implementing standards to specify for all [...] ECAIs, with which of the credit quality steps set out in Section 2 the relevant credit assessments of the [...] ECAI correspond ('mapping'). Those determinations shall be objective and consistent.

The ESAs Joint Committee 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, [...] the ESA's Joint Committee shall comply with the following requirements:
  - (a) in order to differentiate between the relative degrees of risk expressed by each credit assessment, [...] the ESA's Joint Committee 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, the ESA's Joint Committee [...] 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, **the ESA's Joint Committee [...]** 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) **the ESA's Joint Committee [...]** 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 than the benchmark, **the ESA's Joint Committee [...]** shall assign a higher credit quality step in the credit quality assessment scale to the ECAI credit assessment;
- (e) where **the ESA's Joint Committee [...]** 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, **the ESA's Joint Committee [...]** may restore the original credit quality step in the credit quality assessment scale for the ECAI credit assessment.

3. **The ESA's Joint Committee [...]** 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.

**The ESA's Joint Committee [...]** 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 that the institution has nominated, 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. An institution may revoke its nomination of an Export Credit Agency. An institution must substantiate the revocation if there are concrete indications that the intention underlying the revocation is to reduce the capital adequacy requirements.
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.

## 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 [...]ECAIs to be used for the determination of risk weights to be assigned to assets and off-balance sheet items. An institution may revoke its nomination of an [...] ECAI. An institution must substantiate the revocation if there are concrete indications that the intention underlying the revocation is to reduce the capital adequacy requirements. Credit assessments shall not be used selectively. An institution shall use solicited credit assessments. However it may use unsolicited credit assessments if EBA has confirmed that unsolicited credit assessments of an [...] ECAI do not differ in quality from solicited credit assessments of this ECAI. EBA shall refuse or revoke this confirmation in particular if the ECAI has used an unsolicited credit assessment to put pressure on the rated entity to place an order for a credit assessment or other services. In using credit assessment, institutions shall comply with the following requirements:

- (a) an institution which decides to use the credit assessments produced by an [...]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 [...]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 otherwise 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*

##### *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)

- (5) ‘large financial sector entity’ means any financial sector entity whose total assets calculated on an individual **or** consolidated basis, are greater than or equal to the EUR 70 billion threshold, where the most recent audited financial statement or consolidated financial statement shall be used in order to determine asset size;
- (6) ‘unregulated financial entity’ means any other entity that is not a financial sector entity but performs, as its main business, 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. For the purposes of point 4 of paragraph 1, 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 a third country where the relevant competent authorities had approved the third country as eligible for this treatment before 1 January 2013..

### *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 exposure class and for each rating system and internal model approaches to equity exposures and for each approach to estimating LGDs and conversion factors used.
3. Institutions must obtain the permission of the competent authorities for the following:
  - (a) material 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 for assessing the materiality of **the use of an existing rating system for other additional exposures not already covered by that rating system [...]** and changes to rating systems or internal models approaches to equity exposures under the IRB Approach.



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 each rating system and each internal models approach for equity exposures 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 the rating system or internal models approaches for equity exposures is suited to the range of application of the rating system or internal models approach for equity exposures, and has made necessary changes to these rating systems or 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.
- (h) the institution has assigned and continues with assigning each exposure in the range of application of a rating system to a rating grade or pool of this rating system; the institution has assigned and continues with assigning each exposure in the range of application of an approach for equity exposures to this internal models approach.

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 assessment methodology 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 1 and 2 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 ... **1** and ... **2** 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 satisfaction of the competent authority a plan for a timely return to compliance and realise this plan within a period agreed with the competent authority ...;
- (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) [...] exposures to central governments and central banks;
  - (b) exposures to [...] on institutions;
  - (c) [...] exposures to corporates;
  - (d) retail [...] exposures;
  - (e) equity exposures [...];
  - (f) items representing 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 Article 111;
  - (b) exposures to Multilateral Development Banks referred to in Article 112(2)
  - (c) exposures to 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 according to Article 110(2) and (4) ;
  - (b) exposures to Public Sector Entities which are not treated as exposures to central governments according to Article 111(4);
  - (c) exposures to Multilateral Development Banks which are not assigned a 0 % risk weight under Article 112; and
  - (d) exposures to financial institutions which are treated as exposures to institutions according to Article 114(5).
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 that 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 [...] exposures 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 or is an economically comparable exposure;
  - (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).
10. The exposure from providing protection under an nth-to-default basket credit derivative shall be assigned to the same class laid down in paragraph 2 to which the exposures in the basket would be assigned, except if the individual exposures in the basket would be assigned to various exposure classes in which case the exposure shall be assigned to the corporates exposure class laid down in point (c) of paragraph 2.

### *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 to permanently use the Standardised Approach in accordance with Article 145.

Subject to the prior 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. Competent authorities shall determine the time period over which an institution and any parent undertaking and its subsidiaries shall be required to implement the IRB approach for all exposures. This time period shall be one that competent authorities consider to be appropriate on the basis of the nature and scale of the activities of the institutions, or 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 or have until this date been required by the competent authorities to be able to calculate their capital requirements using the Standardised approach 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 use the IRB Approach for the equity exposure class laid down in paragraph 2 point (e) of Article 142, except where that institution is permitted to apply the Standardised Approach for equity exposures pursuant to Article 145 and for the other non credit-obligation assets exposure class laid down in paragraph 2 point (g) of Article 142.

6. EBA shall develop draft regulatory technical standards to specify the conditions according to which competent authorities shall determine the appropriate nature and timing of the sequential roll out of IRB across exposure classes referred to in paragraph 3.

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 for a particular exposure class or type of exposure 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's total exposures of this type 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 LGDs and conversion factors laid down in Article 146(8) for a certain exposure class or type of exposure 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's total exposures of this type 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 may apply the Standardised Approach for the following exposures:
  - (a) the exposure class laid down in 142(2)(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(2)(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 or types of exposures that are immaterial in terms of size and perceived risk profile;

- (d) exposures to central governments and central banks of the Member States and their regional governments, local authorities and administrative bodies and public sector entities provided:
  - (i) there is no difference in risk between the exposures to that central government and central bank and those other exposures because of specific public arrangements, and
  - (ii) exposures to the central government and central bank are assigned a 0 % risk weight under Article 109~~(2)~~ **(2)** and (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) exposures between institutions which meet the requirements set out in Article 108(7);
- (g) equity exposures to entities whose credit obligations are 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 114(4) 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. EBA shall publish on its website and regularly update a list with the exposures recognised under points (g) and (h) of Article 145(1) to be treated according to the standardised approach.

- 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) of paragraph 1.

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.

- 4.

**SECTION 2**  
**CALCULATION OF RISK WEIGHTED EXPOSURE AMOUNTS**

**SUB-SECTION 1**  
**TREATMENT BY TYPE OF EXPOSURE CLASS**

*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, 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 shall 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 150. Institutions may use the approaches set out in Article 150(3) and (4) 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(5).
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 in accordance with Article 138 and Section 6.
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 units or shares in collective investment undertakings (CIUs)*

1. Where exposures in the form of units or 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 3, 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. .

## 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:

$$\text{Risk - weighted exposure amount} = RW \cdot \text{exposure value}$$

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 'EL<sub>BE</sub>') shall be the institution's best estimate of expected loss for the defaulted exposure according to Article 177(1)(h);

(iii) if  $PD \in ]0\%;100\%[$ , 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

$$b = (0.11852 - 0.05478 \cdot \ln(PD))^2$$

2. For all exposures to large financial sector 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:

$$\text{Risk-weighted exposure amount} = RW \cdot \text{exposure value} \cdot (0.15 + 160 \cdot PD_{pp})$$

where:

$PD_{pp}$  = PD of the protection provider.

RW shall be calculated using the relevant risk weight formula set out in point 1 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  $EUR\ 5\ \text{million} \leq S \leq EUR\ 50\ \text{million}$ . 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  $n$ th 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 [...] ECAI the risk weights set out in Chapter 5 shall be applied. If the product is not rated by an [...] 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 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:

$$\text{Risk - weighted exposure amount} = RW \cdot \text{exposure value}$$

where the risk weight RW is defined as follows:

- (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  $PD \in ]0\%;100\%[$ , i.e., for any possible value for PD other than under (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 approaches set out in paragraphs (2), (3) and (4) of this Article. An institution may apply different approaches to different equity portfolios where the institution itself uses different approaches for internal risk management purposes. Where an institution uses different approaches, the choice of the PD / LGD approach or the internal models approach shall be made consistently, including over time and with the approach used for the internal risk management of the relevant equity exposure, 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 4.

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 pre-funded default fund contributions of a CCP*

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:

$$\text{Risk-weighted exposure amount} = 100\% \cdot \text{exposure value} ,$$

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:

$$\frac{1}{t} \cdot 100\% \cdot \text{exposure value} ,$$

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 **calculating and recognising [...]** risk weighted exposure amounts for dilution risk of **a type of exposures caused by** purchased corporate **[...] or** retail receivables where the institution has demonstrated to the satisfaction of the competent authority that dilution risk **for that institution** is immaterial for **this type of exposures [...]**.

### SECTION 3

#### EXPECTED LOSS AMOUNTS

##### *Article 154*

##### *Treatment by exposure type*

1. The calculation of expected loss amounts shall be based on the same input figures of PD, LGD and the exposure value for each exposure as being used for the calculation of risk-weighted exposure amounts in accordance with Article 146.

2. The expected loss amounts for securitised exposures shall be calculated in accordance with Chapter 5.
3. The expected loss amount for exposures belonging to the 'other non credit obligations assets' exposure class referred to in point (g) of Article 142(2) shall be zero.
4. The expected loss amounts for exposures in the form of shares or units of a collective investment undertaking referred to in Article 147 shall be calculated in accordance with the methods set out in this Article.
5. The expected loss (EL) and expected loss amounts for exposures to corporates, institutions, central governments and central banks and retail exposures shall be calculated according to the following formulae:

$$\text{Expected loss (EL)} = PD \cdot LGD$$

$$\text{Expected loss amount} = EL \cdot \text{exposure value}$$

For defaulted exposures (PD = 100 %) where institutions use own estimates of LGDs, EL shall be  $EL_{BE}$ , the institution's best estimate of expected loss for the defaulted exposure according to Article 177(1)(h).

For exposures subject to the treatment set out in Article 148(3), EL shall be 0 %.

6. The EL values for specialised lending exposures where institutions use the methods set out in Article 148(5) for assigning risk weights shall be assigned according to Table 2.

Table 2					
Remaining Maturity	Category 1	Category 2	Category 3	Category 4	Category 5
Less than 2,5 years	0 %	0,4 %	2,8 %	8 %	50 %
Equal to or more than 2,5 years	0,4 %	0,8 %	2,8 %	8 %	50 %



7. The expected loss amounts for equity exposures where the risk weighted exposure amounts are calculated according to simple risk weight approach shall be calculated according to the following formula:

$$\text{Expected loss amount} = EL \cdot \text{exposure value}$$

The EL values shall be the following:

Expected loss (EL) = 0,8 % for private equity exposures in sufficiently diversified portfolios

Expected loss (EL) = 0,8 % for exchange traded equity exposures

Expected loss (EL) = 2,4 % for all other equity exposures.

8. The expected loss and expected loss amounts for equity exposures where the risk weighted exposure amounts are calculated according to the PD/LGD approach shall be calculated according to the following formulae:

$$\text{Expected loss (EL)} = PD \cdot LGD$$

$$\text{Expected loss amount} = EL \cdot \text{exposure value}$$

9. The expected loss amounts for equity exposures where the risk weighted exposure amounts are calculated according to the internal models approach shall be zero.
10. The expected loss amounts for dilution risk of purchased receivables shall be calculated according to the following formula:

$$\text{Expected loss (EL)} = PD \cdot LGD$$

$$\text{Expected loss amount} = EL \cdot \text{exposure value}$$

11. For exposures arising from OTC derivatives, an institution calculating the risk-weighted exposure amounts in accordance with this Chapter may reduce the exposure values across all netting sets with a given counterparty by the sum of credit valuation adjustments for that counterparty which has already been recognised by the institution as an incurred write-down. The credit valuation adjustments shall be calculated without taking into account the amount of debit value adjustment attributed to the own credit risk of the firm that has already been deducted from the capital under Article 30(b).

*Article 155*

*Treatment of expected loss amounts*

Institutions shall subtract the expected loss amounts calculated in accordance with Article 154 (5), (6) and (10) from [...] credit risk adjustments **and additional value adjustments in accordance with Articles 31 and 105 and other own funds reductions** related to these exposures. Discounts on balance sheet exposures purchased when in default according to Article 162(1) shall be treated in the same manner as specific credit risk adjustments. Specific credit risk adjustments on exposures in default shall not be used to cover expected loss amounts on other exposures. Expected loss amounts for securitised exposures and general and specific credit risk adjustments related to these exposures shall not be included in this calculation.

**SECTION 4**  
**PD, LGD AND MATURITY**

**SUB-SECTION 1**  
**EXPOSURES TO CORPORATES, INSTITUTIONS AND CENTRAL GOVERNMENTS AND**  
**CENTRAL BANKS**

*Article 156*  
*Probability of default (PD)*

1. The PD of an exposure to a corporate or an institution shall be at least 0,03 %.
2. For purchased corporate receivables in respect of which an institution is not able to estimate PDs or institution's PD estimates do not meet the requirements set out in Section 6, the PDs for these exposures shall be determined according to the following methods:
  - (a) for senior claims on purchased corporate receivables PD shall be the institutions estimate of EL divided by LGD for these receivables;
  - (b) for subordinated claims on purchased corporate receivables PD shall be the institution's estimate of EL;

- (c) an institution that has received the permission of the competent authority to use own LGD estimates for corporate exposures pursuant to Article 138 and that can decompose its EL estimates for purchased corporate receivables into PDs and LGDs in a manner that the competent authority considers to be reliable, may use PD estimate that results from this decomposition.
- 3. The PD of obligors in default shall be 100 %.
- 4. Institutions may take into account unfunded credit protection in the PD in accordance with the provisions of Chapter 4. For dilution risk, in addition to the protection providers referred to in Article 197(1)(g) the seller of the purchased receivables is eligible if the following conditions are met:
  - (a) the corporate entity has a credit assessment by a recognised ECAI which has been determined by the EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to corporates under Chapter 2;
  - (b) the corporate entity, in the case of institutions calculating risk-weighted exposure amounts and expected loss amounts under the IRB Approach, does not have a credit assessment by a recognised ECAI and is internally rated as having a PD equivalent to that associated with the credit assessments of ECAIs determined by EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to corporate under Chapter 2.
- 5. Institutions using own LGD estimates may recognise unfunded credit protection by adjusting PDs subject to Article 157(3).

6. For dilution risk of purchased corporate receivables, PD shall be set equal to the EL estimate of the institution for dilution risk. An institution that has received permission from the competent authority pursuant to Article 138 to use own LGD estimates for corporate exposures that can decompose its EL estimates for dilution risk of purchased corporate receivables into PDs and LGDs in a manner that the competent authority considers to be reliable, may use the PD estimate that results from this decomposition. Institutions may recognise unfunded credit protection in the PD in accordance with the provisions of Chapter 4. For dilution risk, in addition to the protection providers referred to in Article 197(1)(g), the seller of the purchased receivables is eligible provided that the conditions set out in paragraph 4 are met.
7. By derogation to Article 197(1)(g), the corporate entities that meet the conditions set out in paragraph 4 are eligible

An institution that has received the permission of the competent authority pursuant to Article 138 to use own LGD estimates for dilution risk of purchased corporate receivables, may recognise unfunded credit protection by adjusting PDs subject to Article 157(3).

#### *Article 157*

##### *Loss Given Default (LGD)*

1. Institutions shall use the following LGD values [...]:
- (a) senior exposures without eligible collateral: 45 %;
  - (b) subordinated exposures without eligible collateral: 75 %;
  - (c) institutions may recognise funded and unfunded credit protection in the LGD in accordance with Chapter 4;
  - (d) covered bonds as defined in Article 124 may be assigned an LGD value of 11,25 %;

- (e) for senior purchased corporate receivables exposures where an institution is not able to estimate PDs or the institution's PD estimates do not meet the requirements set out in Section 6: 45 %;
  - (f) for subordinated purchased corporate receivables exposures where an institution is not able to estimate PDs or the institution's PD estimates do not meet the requirements set out in Section 6: 100 %;
  - (g) For dilution risk of purchased corporate receivables: 75 %.
2. For dilution and default risk if an institution has received permission from the competent authority to use own LGD estimates for corporate exposures pursuant to Article 138 and it can decompose its EL estimates for purchased corporate receivables into PDs and LGDs in a manner the competent authority considers to be reliable, the LGD estimate for purchased corporate receivables may be used.
  3. If an institution has received the permission of the competent authority to use own LGD estimates for exposures to corporates, institutions, central governments and central banks pursuant to Article 138, unfunded credit protection may be recognised by adjusting PD or LGD subject to requirements as specified in Section 6 and permission of the competent authorities. An institution shall not assign guaranteed exposures an adjusted PD or LGD such that the adjusted risk weight would be lower than that of a comparable, direct exposure to the guarantor.
  4. For the purposes of the undertakings referred to in Article 148(3), the LGD of a comparable direct exposure to the protection provider shall either be the LGD associated with an unhedged facility to the guarantor or the unhedged facility of the obligor, depending upon whether in the event both the guarantor and obligor default during the life of the hedged transaction, available evidence and the structure of the guarantee indicate that the amount recovered would depend on the financial condition of the guarantor or obligor, respectively.

## Article 158

### Maturity

1. Institutions that have not received permission to use own LGDs and conversion factor for exposures to corporates, institutions or central governments and central banks shall assign to exposures arising from repurchase transactions or securities or commodities lending or borrowing transactions a maturity value (M) of 0.5 years and to all other exposures an M of 2,5 years.

Alternatively, as part of the permission referred to in Article 138, the competent authorities shall decide on whether the institution shall use maturity (M) for each exposure as set out under paragraph 2.

2. Institutions that have received the permission of the competent authority to use own LGDs and own conversion factors for exposures to corporates, institutions or central governments and central banks pursuant to Article 138 shall calculate M for each of these exposures as set out in (a) to (e) and subject to paragraphs 3 to 5. In all cases, **except the ones specified in Article 374 (1),** M shall be no greater than 5 years:

- (a) for an instrument subject to a cash flow schedule, M shall be calculated according to the following formula:

$$M = \max \left\{ 1, \min \left\{ \frac{\sum_t t \cdot CF_t}{\sum_t CF_t}, 5 \right\} \right\}$$

where  $CF_t$  denotes the cash flows (principal, interest payments and fees) contractually payable by the obligor in period  $t$ ;

- (b) for derivatives subject to a master netting agreement, M shall be the weighted average remaining maturity of the exposure, where M shall be at least 1 year, and the notional amount of each exposure shall be used for weighting the maturity;

- (c) for exposures arising from fully or nearly-fully collateralised derivative instruments (listed in Annex II) transactions and fully or nearly-fully collateralised margin lending transactions which are subject to a master netting agreement, M shall be the weighted average remaining maturity of the transactions where M shall be at least 10 days;
- (d) for repurchase transactions or securities or commodities lending or borrowing transactions which are subject to a master netting agreement, M shall be the weighted average remaining maturity of the transactions where M shall be at least 5 days. The notional amount of each transaction shall be used for weighting the maturity;
- (e) an institution that has received the permission of the competent authority pursuant to Article 138 to use own PD estimates for purchased corporate receivables, for drawn amounts M shall equal the purchased receivables exposure weighted average maturity, where M shall be at least 90 days. This same value of M shall also be used for undrawn amounts under a committed purchase facility provided the facility contains effective covenants, early amortisation triggers, or other features that protect the purchasing institution against a significant deterioration in the quality of the future receivables it is required to purchase over the facility's term. Absent such effective protections, M for undrawn amounts shall be calculated as the sum of the longest-dated potential receivable under the purchase agreement and the remaining maturity of the purchase facility, where M shall be at least 90 days;
- (f) for any other instrument than those mentioned in this point or when an institution is not in a position to calculate M as set out in (a), M shall be the maximum remaining time (in years) that the obligor is permitted to take to fully discharge its contractual obligations, where M shall be at least 1 year;



- (g) for institutions using the Internal Model Method set out in Section 6 of Chapter 6 to calculate the exposure values, M shall be calculated for exposures to which they apply this method and for which the maturity of the longest-dated contract contained in the netting set is greater than one year according to the following formula:

$$M = \min \left\{ \frac{\sum_k EffectiveEE_{t_k} \cdot \Delta t_k \cdot df_{t_k} \cdot s_{t_k} + \sum_k EE_{t_k} \cdot \Delta t_k \cdot df_{t_k} \cdot (1 - s_{t_k})}{\sum_k EffectiveEE_{t_k} \cdot \Delta t_k \cdot df_{t_k} \cdot s_{t_k}}, 5 \right\}$$

where:

$s_{t_k}$  = a dummy variable whose value at future period  $t_k$  is equal to 0 if  $t_k > 1$  year and to 1 if  $t_k \leq 1$

$EE_{t_k}$  = the expected exposure at the future period  $t_k$ ;

$EffectiveEE_{t_k}$  = the effective expected exposure at the future period  $t_k$ ;

$df_{t_k}$  = the risk-free discount factor for future time period  $t_k$ ;

$\Delta t_k = t_k - t_{k-1}$

- (h) an institution that uses an internal model to calculate a one-sided credit valuation adjustment (CVA) may use, subject to the permission of the competent authorities, the effective credit duration estimated by the internal model as M.

Subject to paragraph 2, for netting sets in which all contracts have an original maturity of less than one year the formula in point (a) shall apply;

- (i) for institutions using the Internal Model Method set out in Section 6 of Chapter 6, to calculate the exposure values and having an internal model permission for specific risk associated with traded debt positions in accordance with Part Three, Title IV, Chapter 5, M shall be set to 1 in the formula laid out in Article 148(1), provided that an institution can demonstrate to the competent authorities that its internal model for Specific risk associated with traded debt positions applied in Article 373 contains effects of rating migrations;
- (j) for the purposes of Article 148(3), M shall be the effective maturity of the credit protection but at least 1 year.

3. Where the documentation requires daily re-margining and daily revaluation and includes provisions that allow for the prompt liquidation or set off of collateral in the event of default or failure to remargin, M shall be at least one-day for:

- (a) fully or nearly-fully collateralised derivative instruments listed in Annex II;
- (b) fully or nearly-fully collateralised margin lending transactions;
- (c) repurchase transactions, securities or commodities lending or borrowing transactions.

In addition, for qualifying short-term exposures which are not part of the institution's ongoing financing of the obligor, M shall be at least one-day. Qualifying short term exposures shall include the following:

- (a) exposures to institutions arising from settlement of foreign exchange obligations;
- (b) self-liquidating short-term trade financing transactions, import and export letters of credit and similar transactions with a residual maturity of up to one year;
- (c) exposures arising from settlement of securities purchases and sales within the usual delivery period or two business days;

(d) exposures arising from cash settlements by wire transfer and settlements of electronic payment transactions and prepaid cost, including overdrafts arising from failed transactions that do not exceed a short, fixed agreed number of business days.

4. For exposures to corporates situated in the Union and having consolidated sales and consolidated assets of less than EUR 500 million, institutions may choose to consistently set M as set out in paragraph 1 instead of applying paragraph 2. Institutions may replace EUR 500 million total assets with EUR 1000 million total assets for corporates which primarily own and let non-speculative residential property.

5. Maturity mismatches shall be treated as specified in Chapter 4.

## **SUB-SECTION 2**

### **RETAIL EXPOSURES**

#### *Article 159*

#### *Probability of default*

1. PD of an exposure shall be at least 0.03 %.
2. The PD of obligors or, where an obligation approach is used, of exposures in default shall be 100 %.
3. For dilution risk of purchased receivables PD shall be set equal to EL estimates for dilution risk. If an institution can decompose its EL estimates for dilution risk of purchased receivables into PDs and LGDs in a manner the competent authorities consider to be reliable, the PD estimate may be used.

4. Unfunded credit protection may be taken into account by adjusting PDs subject to Article 160(2). For dilution risk, in addition to the protection providers referred to in Article 197(1)(g), the seller of the purchased receivables is eligible if the conditions set out in Article 156(4) are met.

#### *Article 160*

#### *Loss Given Default (LGD)*

1. Institutions shall provide own estimates of LGDs subject to requirements as specified in Section 6 and permission of the competent authorities granted in accordance with Article 138. For dilution risk of purchased receivables, an LGD value of 75 % shall be used. If an institution can decompose its EL estimates for dilution risk of purchased receivables into PDs and LGDs in a reliable manner, the institution may use its own LGD estimate.
2. Unfunded credit protection may be recognised as eligible by adjusting PD or LGD estimates subject to requirements as specified in Article 179(1)(2) and (3) and permission of the competent authorities either in support of an individual exposure or a pool of exposures. An institution shall not assign guaranteed exposures an adjusted PD or LGD such that the adjusted risk weight would be lower than that of a comparable, direct exposure to the guarantor.
3. For the purposes of Article 149(2), the LGD of a comparable direct exposure to the protection provider referred to in article 148(3) shall either be the LGD associated with an unhedged facility to the guarantor or the unhedged facility of the obligor, depending upon whether, in the event both the guarantor and obligor default during the life of the hedged transaction, available evidence and the structure of the guarantee indicate that the amount recovered would depend on the financial condition of the guarantor or obligor, respectively.

4. The exposure weighted average LGD for all retail exposures secured by residential property and not benefiting from guarantees from central governments shall not be lower than 10%

The exposure weighted average LGD for all **retail** exposures secured by commercial immovable property and not benefiting from guarantees from central governments shall not be lower than 15%.

5. Based on the data collected under Article 96 and taking into account forward-looking property market developments and any other relevant indicators, the competent authorities shall periodically, and at least annually, assess whether the minimum LGD values in paragraph 4 are appropriate for exposures secured by residential or commercial immovable property located in their territory. Competent authorities may, where appropriate on the basis of financial stability considerations, set higher minimum values of exposure weighted average LGD for exposures secured by property in their territory.

Competent authorities shall notify EBA of any changes to the minimum LGD values that they make in accordance with the first subparagraph and EBA shall publish these LGD values.

EBA shall develop regulatory technical standards to specify the conditions that competent authorities shall take into account when determining higher minimum LGD values.

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 in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1093/2010.

6. The institutions of one Member State shall apply the higher minimum LGD values that have been determined by the competent authorities of another Member State to exposures secured by property located in that Member State.

**SUB-SECTION 3**  
**EQUITY EXPOSURES SUBJECT TO PD/LGD METHOD**

*Article 161*

*Equity exposures subject to the PD/LGD method*

1. PDs shall be determined according to the methods for corporate exposures.

The following minimum PDs shall apply:

- (a) 0.09 % for exchange traded equity exposures where the investment is part of a long-term customer relationship;
  - (b) 0.09 % for non-exchange traded equity exposures where the returns on the investment are based on regular and periodic cash flows not derived from capital gains;
  - (c) 0.40 % for exchange traded equity exposures including other short positions as set out in Article 150(2);
  - (d) 1.25 % for all other equity exposures including other short positions as set out in Article 150(2).
2. Private equity exposures in sufficiently diversified portfolios may be assigned an LGD of 65 %. All other such exposures shall be assigned an LGD of 90 %.
3. M assigned to all exposures shall be 5 years.

## SECTION 5

### EXPOSURE VALUE

#### *Article 162*

#### *Exposures to corporates, institutions, central governments and central banks and retail exposures*

1. Unless noted otherwise, the exposure value of on-balance sheet exposures shall be the accounting value measured without taking into account any credit risk adjustments made.

This rule also applies to assets purchased at a price different than the amount owed.

For purchased assets, the difference between the amount owed and the accounting value remaining after specific credit risk adjustments have been applied that has been recorded on the balance-sheet of the institutions when purchasing the asset is denoted discount if the amount owed is larger, and premium if it is smaller.

2. Where institutions use Master netting agreements in relation to repurchase transactions or securities or commodities lending or borrowing transactions, the exposure value shall be calculated in accordance with Chapter 4.
3. For on-balance sheet netting of loans and deposits, institutions shall apply for the calculation of the exposure value the methods set out in Chapter 4.
4. The exposure value for leases shall be the discounted minimum lease payments. Minimum lease payments shall comprise the payments over the lease term that the lessee is or can be required to make and any bargain option (i.e. option the exercise of which is reasonably certain). If a party other than the lessee may be required to make a payment related to the residual value of a leased asset and this 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 Article 208, the payment obligation may be taken into account as unfunded credit protection in accordance with Chapter 4.

5. In the case of any item listed in Annex II, the exposure value shall be determined by the methods set out in Chapter 6 and shall not take into account any credit risk adjustment made.
6. The exposure value for the calculation of risk weighted exposure amounts of purchased receivables shall be the value according to paragraph 1 minus the own funds requirements for dilution risk prior to credit risk mitigation.
7. Where an exposure takes the form of securities or commodities sold, posted or lent under repurchase transactions or securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions, the exposure value shall be the value of the securities or commodities determined in accordance with Article 94. Where the Financial Collateral Comprehensive Method as set out under Article 218 is used, the exposure value shall be increased by the volatility adjustment appropriate to such securities or commodities, as set out therein. The exposure value of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions may be determined either in accordance with Chapter 6 or Article 215(2).
8. The exposure value for the following items shall be calculated as the committed but undrawn amount multiplied by a conversion factor. Institutions shall use the following conversion factors in accordance with Article 146(8) for exposures to corporates, institutions, central governments and central banks :
  - (a) for credit lines that are unconditionally cancellable at any time by the institution without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's credit worthiness, a conversion factor of 0 % shall apply. To apply a conversion factor of 0 %, institutions shall actively monitor the financial condition of the obligor, and their internal control systems shall enable them to immediately detect deterioration in the credit quality of the obligor. Undrawn credit lines 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;



- (b) for short-term letters of credit arising from the movement of goods, a conversion factor of 20 % shall apply for both the issuing and confirming institutions;
  - (c) for undrawn purchase commitments for revolving purchased receivables that are able to be unconditionally cancelled or that effectively provide for automatic cancellation at any time by the institution without prior notice, a conversion factor of 0 % shall apply. To apply a conversion factor of 0 %, institutions shall actively monitor the financial condition of the obligor, and their internal control systems shall enable them to immediately detect a deterioration in the credit quality of the obligor;
  - (d) for other credit lines, note issuance facilities (NIFs), and revolving underwriting facilities (RUFs), a conversion factor of 75 % shall apply;
  - (e) institutions which meet the requirements for the use of own estimates of conversion factors as specified in Section 6 may use their own estimates of conversion factors across different product types as mentioned in points (a) to (d), subject to permission of the competent authorities.
9. Where a commitment refers to the extension of another commitment, the lower of the two conversion factors associated with the individual commitment shall be used.
10. For all off-balance sheet items other than those mentioned in points 1 to 8, the exposure value shall be the following percentage of its value:
- (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.

For the purposes of this paragraph the off-balance sheet items shall be assigned to risk categories as indicated in Annex I.

*Article 163*

*Equity exposures*

1. The exposure value of equity exposures shall be the accounting value remaining after specific credit risk adjustment have been applied.
2. The exposure value of off-balance sheet equity exposures shall be its nominal value after reducing its nominal value by specific credit risk adjustments for this exposure.

*Article 164*

*Other non credit-obligation assets*

The exposure value of other non credit-obligation assets shall be the accounting value remaining after specific credit risk adjustment have been applied

**SECTION 6**  
**REQUIREMENTS FOR THE IRB APPROACH**

**SUB-SECTION 1**  
**RATING SYSTEMS**

*Article 165*  
*General principles*

1. Where an institution uses multiple rating systems, the rationale for assigning an obligor or a transaction to a rating system shall be documented and applied in a manner that appropriately reflects the level of risk.
2. Assignment criteria and processes shall be periodically reviewed to determine whether they remain appropriate for the current portfolio and external conditions.
3. Where an institution uses direct estimates of risk parameters for individual obligors or exposures these may be seen as estimates assigned to grades on a continuous rating scale.

## *Article 166*

### *Structure of rating systems*

1. The structure of rating systems for exposures to corporates, institutions and central governments and central banks shall comply with the following requirements:
  - (a) a rating system shall take into account obligor and transaction risk characteristics;
  - (b) a rating system shall have an obligor rating scale which reflects exclusively quantification of the risk of obligor default. The obligor rating scale shall have a minimum of 7 grades for non-defaulted obligors and one for defaulted obligors;
  - (c) an institution shall document the relationship between obligor grades in terms of the level of default risk each grade implies and the criteria used to distinguish that level of default risk;
  - (d) institutions with portfolios concentrated in a particular market segment and range of default risk shall have enough obligor grades within that range to avoid undue concentrations of obligors in a particular grade. Significant concentrations within a single grade shall be supported by convincing empirical evidence that the obligor grade covers a reasonably narrow PD band and that the default risk posed by all obligors in the grade falls within that band;
  - (e) to be permitted by the competent authority to use own estimates of LGDs for own funds requirement calculation, a rating system shall incorporate a distinct facility rating scale which exclusively reflects LGD related transaction characteristics. The facility grade definition shall include both a description of how exposures are assigned to the grade and of the criteria used to distinguish the level of risk across grades;
  - (f) significant concentrations within a single facility grade shall be supported by convincing empirical evidence that the facility grade covers a reasonably narrow LGD band, respectively, and that the risk posed by all exposures in the grade falls within that band.

2. Institutions using the methods set out in 148(5) for assigning risk weights for specialised lending exposures are exempt from the requirement to have an obligor rating scale which reflects exclusively quantification of the risk of obligor default for these exposures. These institutions shall have for these exposures at least 4 grades for non-defaulted obligors and at least one grade for defaulted obligors.
3. The structure of rating systems for retail exposures shall comply with the following requirements:
  - (a) rating systems shall reflect both obligor and transaction risk, and shall capture all relevant obligor and transaction characteristics;
  - (b) the level of risk differentiation shall ensure that the number of exposures in a given grade or pool is sufficient to allow for meaningful quantification and validation of the loss characteristics at the grade or pool level. The distribution of exposures and obligors across grades or pools shall be such as to avoid excessive concentrations;
  - (c) the process of assigning exposures to grades or pools shall provide for a meaningful differentiation of risk, for a grouping of sufficiently homogenous exposures, and shall allow for accurate and consistent estimation of loss characteristics at grade or pool level. For purchased receivables the grouping shall reflect the seller's underwriting practices and the heterogeneity of its customers;
4. Institutions shall consider the following risk drivers when assigning exposures to grades or pools.
  - (a) obligor risk characteristics;
  - (b) transaction risk characteristics, including product or collateral types or both. Institutions shall explicitly address cases where several exposures benefit from the same collateral [...]
  - (c) delinquency, except where an institution demonstrates to the satisfaction of its competent authority that delinquency is not a material driver of risk for the exposure.

*Article 167*

*Assignment to grades or pools*

1. An institution shall have specific definitions, processes and criteria for assigning exposures to grades or pools within a rating system that comply with the following requirements:
  - (a) the grade or pool definitions and criteria shall be sufficiently detailed to allow those charged with assigning ratings to consistently assign obligors or facilities posing similar risk to the same grade or pool. This consistency shall exist across lines of business, departments and geographic locations;
  - (b) the documentation of the rating process shall allow third parties to understand the assignments of exposures to grades or pools, to replicate grade and pool assignments and to evaluate the appropriateness of the assignments to a grade or a pool;
  - (c) the criteria shall also be consistent with the institution's internal lending standards and its policies for handling troubled obligors and facilities.
2. An institution shall take all relevant information into account in assigning obligors and facilities to grades or pools. Information shall be current and shall enable the institution to forecast the future performance of the exposure. The less information an institution has, the more conservative shall be its assignments of exposures to obligor and facility grades or pools. If an institution uses an external rating as a primary factor determining an internal rating assignment, the institution shall ensure that it considers other relevant information.

*Article 168*  
*Assignment of exposures*

1. For exposures to corporates, institutions and central governments and central banks, and for equity exposures where an institution uses the PD/LGD approach set out in Article 150(3), assignment of exposures shall be carried out in accordance with the following criteria:
  - (a) each obligor shall be assigned to an obligor grade as part of the credit approval process;
  - (b) for those exposures for which an institution has received the permission of the competent authority to use own estimates of LGDs and conversion factors pursuant to Article 138, each exposure shall also be assigned to a facility grade as part of the credit approval process;
  - (c) institutions using the methods set out in Article 148(5) for assigning risk weights for specialised lending exposures shall assign each of these exposures to a grade in accordance with Article 166(2);
  - (d) each separate legal entity to which the institution is exposed shall be separately rated. An institution shall have appropriate policies regarding the treatment of individual obligor clients and groups of connected clients;
  - (e) separate exposures to the same obligor shall be assigned to the same obligor grade, irrespective of any differences in the nature of each specific transaction. However, where separate exposures are allowed to result in multiple grades for the same obligor, the following shall apply:
    - (i) country transfer risk, this being dependent on whether the exposures are denominated in local or foreign currency;

- (ii) the treatment of associated guarantees to an exposure may be reflected in an adjusted assignment to an obligor grade;
- (iii) consumer protection, bank secrecy or other legislation prohibit the exchange of client data.

2. For retail exposures, each exposure shall be assigned to a grade or a pool as part of the credit approval process.
3. For grade and pool assignments institutions shall document the situations in which human judgement may override the inputs or outputs of the assignment process and the personnel responsible for approving these overrides. Institutions shall document these overrides and note down the personnel responsible. Institutions shall analyse the performance of the exposures whose assignments have been overridden. This analysis shall include an assessment of the performance of exposures whose rating has been overridden by a particular person, accounting for all the responsible personnel.

#### *Article 169*

##### *Integrity of assignment process*

1. For exposures to corporates, institutions and central governments and central banks, and for equity exposures where an institution uses the PD/LGD approach set out in Article 150(3), the assignment process shall meet the following requirements of integrity:
  - (a) Assignments and periodic reviews of assignments shall be completed or approved by an independent party that does not directly benefit from decisions to extend the credit;



- (b) Institutions shall review assignments at least annually and adjust the assignment where the result of the review does not justify carrying forward the current assignment. High risk obligors and problem exposures shall be subject to more frequent review. Institutions shall undertake a new assignment if material information on the obligor or exposure becomes available;
- (c) An institution shall have an effective process to obtain and update relevant information on obligor characteristics that affect PDs, and on transaction characteristics that affect LGDs or conversion factors.

- 2. For retail exposures, an institution shall at least annually review obligor and facility assignments and adjust the assignment where the result of the review does not justify carrying forward the current assignment, or review the loss characteristics and delinquency status of each identified risk pool, whichever applicable. An institution shall also at least annually review in a representative sample the status of individual exposures within each pool as a means of ensuring that exposures continue to be assigned to the correct pool, and adjust the assignment where the result of the review does not justify carrying forward the current assignment.
- 3. EBA shall develop regulatory technical standards for [...] the methodologies of the competent authorities to assess the integrity of the assignment process and the regular and independent assessment of risks.

EBA shall submit the draft regulatory technical standards referred to in the first sub-paragraph 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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

*Article 170*  
*Use of models*

If an institution uses statistical models and other mechanical methods to assign exposures to obligors or facilities grades or pools, the following requirements shall be met:

- (a) the model shall have good predictive power and capital requirements shall not be distorted as a result of its use. The input variables shall form a reasonable and effective basis for the resulting predictions. The model shall not have material biases;
- (b) the institution shall have in place a process for vetting data inputs into the model, which includes an assessment of the accuracy, completeness and appropriateness of the data;
- (c) the data used to build the model shall be representative of the population of the institution's actual obligors or exposures;
- (d) the institution shall have a regular cycle of model validation that includes monitoring of model performance and stability; review of model specification; and testing of model outputs against outcomes;
- (e) the institution shall complement the statistical model by human judgement and human oversight to review model-based assignments and to ensure that the models are used appropriately. Review procedures shall aim at finding and limiting errors associated with model weaknesses. Human judgements shall take into account all relevant information not considered by the model. The institution shall document how human judgement and model results are to be combined.

## *Article 171*

### *Documentation of rating systems*

1. The institutions shall document the design and operational details of its rating systems. The documentation shall provide evidence of compliance with the requirements in this Section, and address topics including portfolio differentiation, rating criteria, responsibilities of parties that rate obligors and exposures, frequency of assignment reviews, and management oversight of the rating process.
2. The institution shall document the rationale for and analysis supporting its choice of rating criteria. An institution shall document all major changes in the risk rating process, and such documentation shall support identification of changes made to the risk rating process subsequent to the last review by the competent authorities. The organisation of rating assignment including the rating assignment process and the internal control structure shall also be documented.
3. The institutions shall document the specific definitions of default and loss used internally and ensure consistency with the definitions set out in this Regulation.
4. Where the institution employs statistical models in the rating process, the institution shall document their methodologies. This material shall:
  - (a) provide a detailed outline of the theory, assumptions and mathematical and empirical basis of the assignment of estimates to grades, individual obligors, exposures, or pools, and the data source(s) used to estimate the model;
  - (b) establish a rigorous statistical process including out-of-time and out-of-sample performance tests for validating the model;
  - (c) indicate any circumstances under which the model does not work effectively.

5. An institution shall demonstrate to the satisfaction of the competent authority that the requirements of this Article are met, where an institution has obtained a rating system, or model used within a rating system, from a third-party vendor and that vendor refuses or restricts the access of the institution to information pertaining to the methodology of that rating system or model, or underlying data used to develop that methodology or model, on the basis that such information is proprietary.

## *Article 172*

### *Data maintenance*

1. Institutions shall collect and store data on aspects of their internal ratings as required under Part Eight.
2. For exposures to corporates, institutions and central governments and central banks, and for equity exposures where an institution uses the PD/LGD approach set out in Article 150(3), institutions shall collect and store:
  - (a) complete rating histories on obligors and recognised guarantors;
  - (b) the dates the ratings were assigned;
  - (c) the key data and methodology used to derive the rating;
  - (d) the person responsible for the rating assignment;
  - (e) the identity of obligors and exposures that defaulted;
  - (f) the date and circumstances of such defaults;
  - (g) data on the PDs and realised default rates associated with rating grades and ratings migration.

3. Institutions not using own estimates of LGDs and conversion factors shall collect and store data on comparisons of realised LGDs to the values as set out in Article 157(1) and realised conversion factors to the values as set out in Article 162(8).
4. Institutions using own estimates of LGDs and conversion factors shall collect and store:
  - (a) complete histories of data on the facility ratings and LGD and conversion factor estimates associated with each rating scale;
  - (b) the dates the ratings were assigned and the estimates were done;
  - (c) the key data and methodology used to derive the facility ratings and LGD and conversion factor estimates;
  - (d) the person who assigned the facility rating and the person who provided LGD and conversion factor estimates;
  - (e) data on the estimated and realised LGDs and conversion factors associated with each defaulted exposure;
  - (f) data on the LGD of the exposure before and after evaluation of the effects of a guarantee/or credit derivative, for those institutions that reflect the credit risk mitigating effects of guarantees or credit derivatives through LGD;
  - (g) data on the components of loss for each defaulted exposure.
5. For retail exposures, institutions shall collect and store:
  - (a) data used in the process of allocating exposures to grades or pools;
  - (b) data on the estimated PDs, LGDs and conversion factors associated with grades or pools of exposures;
  - (c) the identity of obligors and exposures that defaulted;

- (d) for defaulted exposures, data on the grades or pools to which the exposure was assigned over the year prior to default and the realised outcomes on LGD and conversion factor;
- (e) data on loss rates for qualifying revolving retail exposures.

### *Article 173*

#### *Stress tests used in assessment of capital adequacy*

1. An institution shall have in place sound stress testing processes for use in the assessment of its capital adequacy. Stress testing shall involve identifying possible events or future changes in economic conditions that could have unfavourable effects on an institution's credit exposures and assessment of the institution's ability to withstand such changes.
2. An institution shall regularly perform a credit risk stress test to assess the effect of certain specific conditions on its total capital requirements for credit risk. The test shall be one chosen by the institution, subject to supervisory review. The test to be employed shall be meaningful and consider the effects of severe, but plausible, recession scenarios. An institution shall assess migration in its ratings under the stress test scenarios. Stressed portfolios shall contain the vast majority of an institution's total exposure.
3. Institutions using the treatment set out in Article 148(3) shall consider as part of their stress testing framework the impact of a deterioration in the credit quality of protection providers, in particular the impact of protection providers falling outside the eligibility criteria.
4. .

## SUB-SECTION 2

### RISK QUANTIFICATION

#### *Article 174*

#### *Default of an obligor*

1. A default shall be considered to have occurred with regard to a particular obligor when either or both of the following have taken place:
  - (a) the institution considers that the obligor is unlikely to pay its credit obligations to the institution, the parent undertaking or any of its subsidiaries in full, without recourse by the institution to actions such as realising security;
  - (b) the obligor is past due more than 90 days on any material credit obligation to the institution, the parent undertaking or any of its subsidiaries.

In the case of retail exposures, institutions may apply the definition of default laid down in points (a) and (b) at the level of an individual credit facility rather than in relation to the total obligations of a borrower.

1a. The following shall apply for the purposes of point (b) of paragraph 1:

- (a) for overdrafts, days past due commence once an obligor has breached an advised limit, has been advised a limit smaller than current outstandings, or has drawn credit without authorisation and the underlying amount is material;
- (b) for the purposes of point (a), an advised limit comprises any credit limit determined by the institution and about which the obligor has been informed by the institution;
- (c) days past due for credit cards commence on the minimum payment due date.
- (d) materiality of a credit obligation past due shall be [...] assessed against a threshold, defined by the competent authorities. This threshold shall reflect a level of risk that the competent authority considers to be reasonable;
- (e) institutions shall have documented policies in respect of the counting of days past due, in particular in respect of the re-ageing of the facilities and the granting of extensions, amendments or deferrals, renewals, and netting of existing accounts. These policies shall be applied consistently over time, and shall be in line with the internal risk management and decision processes of the institution.

2. For the purpose of point (a) of the paragraph 1, elements to be taken as indications of unlikelihood to pay shall include the following:

- (a) the institution puts the credit obligation on non-accrued status;
- (b) the institution recognises a specific credit adjustment resulting from a significant perceived decline in credit quality subsequent to the institution taking on the exposure;
- (c) the institution sells the credit obligation at a material credit-related economic loss;



- (d) the institution consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or, where relevant fees. This includes, in the case of equity exposures assessed under a PD/LGD Approach, distressed restructuring of the equity itself; [...]
  - (e) the institution has filed for the obligor's bankruptcy or a similar order in respect of an obligor's credit obligation to the institution, the parent undertaking or any of its subsidiaries;
  - (f) the obligor has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of a credit obligation to the institution, the parent undertaking or any of its subsidiaries.
3. Institutions that use external data that is not itself consistent with the definition of default laid down in paragraph 1, shall make appropriate adjustments to achieve broad equivalence with the definition of default.
4. If the institution considers that a previously defaulted exposure is such that no trigger of default continues to apply, the institution shall rate the obligor or facility as they would for a non-defaulted exposure. Should the definition of default subsequently be triggered, another default would be deemed to have occurred.
5. EBA shall develop draft regulatory technical standards to specify the conditions according to which a competent authority shall set the threshold referred to in paragraph 1a, point d.

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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

6. EBA shall issue guidelines on the application of this Article. Those guidelines shall be adopted in accordance with Article 16 of Regulation (EU) No 1093/2010.

#### *Article 175*

##### *Overall requirements for estimation*

1. In quantifying the risk parameters to be associated with rating grades or pools, institutions shall apply the following requirements:
- (a) an institution's own estimates of the risk parameters PD, LGD, conversion factor and EL shall incorporate all relevant data, information and methods. The estimates shall be derived using both historical experience and empirical evidence, and not based purely on judgemental considerations. The estimates shall be plausible and intuitive and shall be based on the material drivers of the respective risk parameters. The less data an institution has, the more conservative it shall be in its estimation;
  - (b) an institution shall be able to provide a breakdown of its loss experience in terms of default frequency, LGD, conversion factor, or loss where EL estimates are used, by the factors it sees as the drivers of the respective risk parameters. The institution's estimates shall be representative of long run experience;
  - (c) any changes in lending practice or the process for pursuing recoveries over the observation periods referred to in Articles 176(1)(h), 176(2)(e [...]), 177(1)(j), 177(2), 178(2) and 178(3) shall be taken into account. An institution's estimates shall reflect the implications of technical advances and new data and other information, as it becomes available. Institutions shall review their estimates when new information comes to light but at least on an annual basis;

- (d) the population of exposures represented in the data used for estimation, the lending standards used when the data was generated and other relevant characteristics shall be comparable with those of the institution's exposures and standards. The economic or market conditions that underlie the data shall be relevant to current and foreseeable conditions. The number of exposures in the sample and the data period used for quantification shall be sufficient to provide the institution with confidence in the accuracy and robustness of its estimates;
- (e) for purchased receivables the estimates shall reflect all relevant information available to the purchasing institution regarding the quality of the underlying receivables, including data for similar pools provided by the seller, by the purchasing institution, or by external sources. The purchasing institution shall evaluate any data relied upon which is provided by the seller;
- (f) an institution shall add to its estimates a margin of conservatism that is related to the expected range of estimation errors. Where methods and data are considered to be less satisfactory, the expected range of errors is larger, the margin of conservatism shall be larger.

Where institutions use different estimates for the calculation of risk weights and for internal purposes, it shall be documented and be reasonable. If institutions can demonstrate to their competent authorities that for data that have been collected prior to 1 January 2007 appropriate adjustments have been made to achieve broad equivalence with the definition of default laid down in Article 174 or with loss, competent authorities may permit the institutions some flexibility in the application of the required standards for data.

2. Where an institution uses data that is pooled across institutions it shall meet the following requirements :
  - (a) the rating systems and criteria of other institutions in the pool are similar with its own;
  - (b) the pool is representative of the portfolio for which the pooled data is used;

- (c) the pooled data is used consistently over time by the institution for its estimates;
- (d) the institution shall remain responsible for the integrity of its rating systems;
- (e) the institution shall maintain sufficient in-house understanding of its rating systems, including the ability to effectively monitor and audit the rating process.

## *Article 176*

### *Requirements specific to PD estimation*

1. In quantifying the risk parameters to be associated with rating grades or pools, institutions shall apply the following requirements specific to PD estimation to exposures to corporates, institutions and central governments and central banks and for equity exposures where an institution uses the PD/LGD approach set out in Article 150(3):
  - (a) institutions shall estimate PDs by obligor grade from long run averages of one-year default rates. PD estimates for obligors that are highly leveraged or for obligors whose assets are predominantly traded assets shall reflect the performance of the underlying assets based on periods of stressed volatilities;
  - (b) for purchased corporate receivables institutions may estimate the [...] EL [...] by obligor grade from long run averages of one-year realised default rates;
  - (c) if an institution derives long run average estimates of PDs and LGDs for purchased corporate receivables from an estimate of EL, and an appropriate estimate of PD or LGD, the process for estimating total losses shall meet the overall standards for estimation of PD and LGD set out in this part, and the outcome shall be consistent with the concept of LGD as set out in Article 177(1)(a);
  - (d) institutions shall use PD estimation techniques only with supporting analysis. Institutions shall recognise the importance of judgmental considerations in combining results of techniques and in making adjustments for limitations of techniques and information;

- (e) to the extent that an institution uses data on internal default experience for the estimation of PDs, the estimates shall be reflective of underwriting standards and of any differences in the rating system that generated the data and the current rating system. Where underwriting standards or rating systems have changed, the institution shall add a greater margin of conservatism in its estimate of PD;
- (f) to the extent that an institution associates or maps its internal grades to the scale used by an ECAI or similar organisations and then attributes the default rate observed for the external organisation's grades to the institution's grades, mappings shall be based on a comparison of internal rating criteria to the criteria used by the external organisation and on a comparison of the internal and external ratings of any common obligors. Biases or inconsistencies in the mapping approach or underlying data shall be avoided. The criteria of the external organisation underlying the data used for quantification shall be oriented to default risk only and not reflect transaction characteristics. The analysis undertaken by the institution shall include a comparison of the default definitions used, subject to the requirements in Article 174. The institution shall document the basis for the mapping;
- (g) to the extent that an institution uses statistical default prediction models it is allowed to estimate PDs as the simple average of default-probability estimates for individual obligors in a given grade. The institution's use of default probability models for this purpose shall meet the standards specified in Article 170;

- (h) irrespective of whether an institution is using external, internal, or pooled data sources, or a combination of the three, for its PD estimation, the length of the underlying historical observation period used shall be at least five years for at least one source. If the available observation period spans a longer period for any source, and this data is relevant, this longer period shall be used. This point also applies to the PD/LGD Approach to equity. Subject to the permission of competent authorities, institutions which have not received the permission of the competent authority pursuant to Article 138 to use own estimates of LGDs or conversion factors may use, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered shall increase by one year each year until relevant data cover a period of five years.

2. For retail exposures, the following requirements shall apply:

- (a) institutions shall estimate PDs by obligor grade or pool from long run averages of one-year default rates;
- (b) PD estimates may also be derived from an estimate of total losses and appropriate estimates of LGDs;
- (c) institutions shall regard internal data for assigning exposures to grades or pools as the primary source of information for estimating loss characteristics. Institutions may use external data (including pooled data) or statistical models for quantification provided the following strong links **both exist**:
- (i) between the institution's process of assigning exposures to grades or pools and the process used by the external data source; and
- (ii) between the institution's internal risk profile and the composition of the external data;

- (d) if an institution derives long run average estimates of PD and LGD for retail from an estimate of total losses and an appropriate estimate of PD or LGD, the process for estimating total losses shall meet the overall standards for estimation of PD and LGD set out in this part, and the outcome shall be consistent with the concept of LGD as set out in point (a) of Article 177(1);
- (e) irrespective of whether an institution is using external, internal or pooled data sources or a combination of the three, for their estimation of loss characteristics, the length of the underlying historical observation period used shall be at least five years for at least one source. If the available observation spans a longer period for any source, and these data are relevant, this longer period shall be used. An institution need not give equal importance to historic data if more recent data is a better predictor of loss rates. Subject to the permission of the competent authorities, institutions may use, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered shall increase by one year each year until relevant data cover a period of five years;
- (f) institutions shall identify and analyse expected changes of risk parameters over the life of credit exposures (seasoning effects).

For purchased retail receivables, institutions may use external and internal reference data. Institutions shall use all relevant data sources as points of comparison.

- 3. EBA shall develop draft regulatory technical standards to specify the following:
  - (a) the conditions according to which competent authorities may grant the permissions referred to in point (h) of paragraph 1 and point (e) of paragraph 2;
  - (b) the methodologies according to which competent authorities shall assess the methodology of an institution for estimating PD pursuant to Article 138.

EBA shall submit the draft regulatory technical standards referred to in the first subparagraph 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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

#### *Article 177*

##### *Requirements specific to own-LGD estimates*

1. In quantifying the risk parameters to be associated with rating grades or pools, institutions shall apply the following requirements specific to own-LGD estimates:
  - (a) institutions shall estimate LGDs by facility grade or pool on the basis of the average realised LGDs by facility grade or pool using all observed defaults within the data sources (default weighted average);
  - (b) institutions shall use LGD estimates that are appropriate for an economic downturn if those are more conservative than the long-run average. To the extent a rating system is expected to deliver realised LGDs at a constant level by grade or pool over time, institutions shall make adjustments to their estimates of risk parameters by grade or pool to limit the capital impact of an economic downturn;
  - (c) an institution shall consider the extent of any dependence between the risk of the obligor with that of the collateral or collateral provider. Cases where there is a significant degree of dependence shall be addressed in a conservative manner;
  - (d) currency mismatches between the underlying obligation and the collateral shall be treated conservatively in the institution's assessment of LGD;
  - (e) to the extent that LGD estimates take into account the existence of collateral, these estimates shall not solely be based on the collateral's estimated market value. LGD estimates shall take into account the effect of the potential inability of institutions to expeditiously gain control of their collateral and liquidate it;



- (f) to the extent that LGD estimates take into account the existence of collateral, institutions shall establish internal requirements for collateral management, legal certainty and risk management that are generally consistent with those set out in Chapter 4, Section 3;
- (g) to the extent that an institution recognises collateral for determining the exposure value for counterparty credit risk according to Chapter 6, Section 5 or 6, any amount expected to be recovered from the collateral shall not be taken into account in the LGD estimates;
- (h) for the specific case of exposures already in default, the institution shall use the sum of its best estimate of expected loss for each exposure given current economic circumstances and exposure status and its estimate of the increase of loss rate caused by possible additional unexpected losses during the recovery period, i.e. between date of default and final liquidation of the exposure;
- (i) to the extent that unpaid late fees have been capitalised in the institution's income statement, they shall be added to the institution's measure of exposure and loss;
- (j) for exposures to corporates, institutions and central governments and central banks, estimates of LGD shall be based on data over a minimum of five years, increasing by one year each year after implementation until a minimum of seven years is reached, for at least one data source. If the available observation period spans a longer period for any source, and the data is relevant, this longer period shall be used.

2. For retail exposures, institutions may do the following:
- (a) derive LGD estimates from realised losses and appropriate estimates of PDs;
  - (b) reflect future drawings either in their conversion factors or in their LGD estimates;
  - (c) For purchased retail receivables use external and internal reference data to estimate LGDs.

For retail exposures, estimates of LGD shall be based on data over a minimum of five years. An institution needs not give equal importance to historic data if more recent data is a better predictor of loss rates. Subject to the permission of the competent authorities, institutions may use, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered shall increase by one year each year until relevant data cover a period of five years.

3. EBA shall develop draft regulatory technical standards to specify the following:
- (a) the nature, severity and duration of an economic downturn referred to in paragraph 1;
  - (b) the conditions according to which a competent authority may permit and institution pursuant to paragraph 3 to use relevant data covering a period of two years when the institution implements the IRB approach.

EBA shall submit the draft regulatory technical standards referred to in the first subparagraph 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 178*

### *Requirements specific to own-conversion factor estimates*

1. In quantifying the risk parameters to be associated with rating grades or pools, institutions shall apply the following requirements specific to own-conversion factor estimates:
  - (a) institutions shall estimate conversion factors by facility grade or pool on the basis of the average realised conversion factors by facility grade or pool using the default weighted average resulting from all observed defaults within the data sources;
  - (b) institutions shall use conversion factor estimates that are appropriate for an economic downturn if those are more conservative than the long-run average. To the extent a rating system is expected to deliver realised conversion factors at a constant level by grade or pool over time, institutions shall make adjustments to their estimates of risk parameters by grade or pool to limit the capital impact of an economic downturn;
  - (c) institutions' estimates of conversion factors shall reflect the possibility of additional drawings by the obligor up to and after the time a default event is triggered. The conversion factor estimate shall incorporate a larger margin of conservatism where a stronger positive correlation can reasonably be expected between the default frequency and the magnitude of conversion factor;
  - (d) in arriving at estimates of conversion factors institutions shall consider their specific policies and strategies adopted in respect of account monitoring and payment processing. Institutions shall also consider their ability and willingness to prevent further drawings in circumstances short of payment default, such as covenant violations or other technical default events;
  - (e) institutions shall have adequate systems and procedures in place to monitor facility amounts, current outstandings against committed lines and changes in outstandings per obligor and per grade. The institution shall be able to monitor outstanding balances on a daily basis;

(f) if institutions use different estimates of conversion factors for the calculation of risk weighted exposure amounts and internal purposes it shall be documented and be reasonable.

2. For exposures to corporates, institutions and central governments and central banks, estimates of conversion factors shall be based on data over a minimum of five years, increasing by one year each year after implementation until a minimum of seven years is reached, for at least one data source. If the available observation period spans a longer period for any source, and the data is relevant, this longer period shall be used.
3. For retail exposures, institutions may reflect future drawings either in their conversion factors or in their LGD estimates.

For retail exposures, estimates of conversion factors shall be based on data over a minimum of five years. As an exemption to paragraph 1(a), an institution need not give equal importance to historic data if more recent data is a better predictor of draw downs. Subject to the permission of competent authorities, institutions may use, when they implement the IRB Approach, relevant data covering a period of two years. The period to be covered shall increase by one year each year until relevant data cover a period of five years.

4. EBA shall develop draft regulatory technical standards to specify the following:
  - (a) the nature, severity and duration of an economic downturn referred to in paragraph 1;
  - (b) conditions according to which a competent authority may permit and institution to use relevant data covering a period of two years at the time an institution first implements the IRB approach.

EBA shall submit the draft regulatory technical standards referred to in the first subparagraph 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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

#### *Article 179*

*Requirements for assessing the effect of guarantees and credit derivatives for exposures to corporates, institutions and central governments and central banks where own estimates of LGD are used and retail exposures*

1. The following requirements shall apply in relation to eligible guarantors and guarantees:
  - (a) institutions shall have clearly specified criteria for the types of guarantors they recognise for the calculation of risk weighted exposure amounts;
  - (b) for recognised guarantors the same rules as for obligors as set out in Articles 167, 168 and 169 shall apply;
  - (c) the guarantee shall be evidenced in writing, non-cancellable on the part of the guarantor, in force until the obligation is satisfied in full (to the extent of the amount and tenor of the guarantee) and legally enforceable against the guarantor in a jurisdiction where the guarantor has assets to attach and enforce a judgement. Conditional guarantees prescribing conditions under which the guarantor may not be obliged to perform may be recognised subject to permission of the competent authorities. The assignment criteria shall adequately address any potential reduction in the risk mitigation effect.

2. An institution shall have clearly specified criteria for adjusting grades, pools or LGD estimates, and, in the case of retail and eligible purchased receivables, the process of allocating exposures to grades or pools, to reflect the impact of guarantees for the calculation of risk weighted exposure amounts. These criteria shall comply with the requirements set out in Articles 167 to 169.

The criteria shall be plausible and intuitive. They shall address the guarantor's ability and willingness to perform under the guarantee, the likely timing of any payments from the guarantor, the degree to which the guarantor's ability to perform under the guarantee is correlated with the obligor's ability to repay, and the extent to which residual risk to the obligor remains.

3. The requirements for guarantees in this Article shall apply also for single-name credit derivatives. In relation to a mismatch between the underlying obligation and the reference obligation of the credit derivative or the obligation used for determining whether a credit event has occurred, the requirements set out under Article 211(2) shall apply. For retail exposures and eligible purchased receivables, this paragraph applies to the process of allocating exposures to grades or pools.

The criteria shall address the payout structure of the credit derivative and conservatively assess the impact this has on the level and timing of recoveries. The institution shall consider the extent to which other forms of residual risk remain.

4. The requirements set out in paragraphs 1 to 3 shall not apply for guarantees provided by institutions, central governments and central banks, and corporate entities which meet the requirements laid down in Article 197(1)(g) if the institution has received permission to apply the Standardised Approach for exposures to such entities pursuant to Article 143 and 145. In this case the requirements of Chapter 4 shall apply.
5. For retail guarantees, the requirements set out in paragraphs 1 to 3 also apply to the assignment of exposures to grades or pools, and the estimation of PD.

6. EBA shall develop draft regulatory technical standards to specify the conditions according to which competent authorities may permit conditional guarantees to be recognised.

EBA shall submit the draft regulatory technical standards referred to in the first sub-paragraph 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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

#### *Article 180*

##### *Requirements for purchased receivables*

1. In quantifying the risk parameters to be associated with rating grades or pools for purchased receivables, institutions shall ensure the conditions laid down in paragraphs 2 to 6 are met.
2. The structure of the facility shall ensure that under all foreseeable circumstances the institution has effective ownership and control of all cash remittances from the receivables. When the obligor makes payments directly to a seller or servicer, the institution shall verify regularly that payments are forwarded completely and within the contractually agreed terms. Institutions shall have procedures to ensure that ownership over the receivables and cash receipts is protected against bankruptcy stays or legal challenges that could materially delay the lender's ability to liquidate or assign the receivables or retain control over cash receipts.

3. The institution shall monitor both the quality of the purchased receivables and the financial condition of the seller and servicer. The following shall apply:
- (a) the institution shall assess the correlation among the quality of the purchased receivables and the financial condition of both the seller and servicer, and have in place internal policies and procedures that provide adequate safeguards to protect against any contingencies, including the assignment of an internal risk rating for each seller and servicer;
  - (b) the institution shall have clear and effective policies and procedures for determining seller and servicer eligibility. The institution or its agent shall conduct periodic reviews of sellers and servicers in order to verify the accuracy of reports from the seller or servicer, detect fraud or operational weaknesses, and verify the quality of the seller's credit policies and servicer's collection policies and procedures. The findings of these reviews shall be documented;
  - (c) the institution shall assess the characteristics of the purchased receivables pools, including over-advances; history of the seller's arrears, bad debts, and bad debt allowances; payment terms, and potential contra accounts;
  - (d) the institution shall have effective policies and procedures for monitoring on an aggregate basis single-obligor concentrations both within and across purchased receivables pools;
  - (e) the institution shall ensure that it receives from the servicer timely and sufficiently detailed reports of receivables ageings and dilutions to ensure compliance with the institution's eligibility criteria and advancing policies governing purchased receivables, and provide an effective means with which to monitor and confirm the seller's terms of sale and dilution.



4. The institution shall have systems and procedures for detecting deteriorations in the seller's financial condition and purchased receivables quality at an early stage, and for addressing emerging problems pro-actively. In particular, the institution shall have clear and effective policies, procedures, and information systems to monitor covenant violations, and clear and effective policies and procedures for initiating legal actions and dealing with problem purchased receivables.
5. The institution shall have clear and effective policies and procedures governing the control of purchased receivables, credit, and cash. In particular, written internal policies shall specify all material elements of the receivables purchase programme, including the advancing rates, eligible collateral, necessary documentation, concentration limits, and the way cash receipts are to be handled. These elements shall take appropriate account of all relevant and material factors, including the seller and servicer's financial condition, risk concentrations, and trends in the quality of the purchased receivables and the seller's customer base, and internal systems shall ensure that funds are advanced only against specified supporting collateral and documentation.
6. The institution shall have an effective internal process for assessing compliance with all internal policies and procedures. The process shall include regular audits of all critical phases of the institution's receivables purchase programme, verification of the separation of duties between firstly the assessment of the seller and servicer and the assessment of the obligor and secondly between the assessment of the seller and servicer and the field audit of the seller and servicer, and evaluations of back office operations, with particular focus on qualifications, experience, staffing levels, and supporting automation systems.

### SUB-SECTION 3

#### VALIDATION OF INTERNAL ESTIMATES

##### *Article 181*

##### *Validation of internal estimates*

Institutions shall validate their internal estimates subject to the following requirements:

- (a) institutions shall have robust systems in place to validate the accuracy and consistency of rating systems, processes, and the estimation of all relevant risk parameters. The internal validation process shall enable the institution to assess the performance of internal rating and risk estimation systems consistently and meaningfully;
- (b) institutions shall regularly compare realised default rates with estimated PDs for each grade and, where realised default rates are outside the expected range for that grade, institutions shall specifically analyse the reasons for the deviation. Institutions using own estimates of LGDs and conversion factors shall also perform analogous analysis for these estimates. Such comparisons shall make use of historical data that cover as long a period as possible. The institution shall document the methods and data used in such comparisons. This analysis and documentation shall be updated at least annually;
- (c) institutions shall also use other quantitative validation tools and comparisons with relevant external data sources. The analysis shall be based on data that are appropriate to the portfolio, are updated regularly, and cover a relevant observation period. Institutions' internal assessments of the performance of their rating systems shall be based on as long a period as possible;

- (d) the methods and data used for quantitative validation shall be consistent through time. Changes in estimation and validation methods and data (both data sources and periods covered) shall be documented;
- (e) institutions shall have sound internal standards for situations where deviations in realised PDs, LGDs, conversion factors and total losses, where EL is used, from expectations, become significant enough to call the validity of the estimates into question. These standards shall take account of business cycles and similar systematic variability in default experience. Where realised values continue to be higher than expected values, institutions shall revise estimates upward to reflect their default and loss experience;

## SUB-SECTION 4

### REQUIREMENTS FOR EQUITY EXPOSURES UNDER THE INTERNAL MODELS APPROACH

#### *Article 182*

#### *Own funds requirement and risk quantification*

For the purpose of calculating own funds requirements institutions shall meet the following standards:

- (a) the estimate of potential loss shall be robust to adverse market movements relevant to the long-term risk profile of the institution's specific holdings. The data used to represent return distributions shall reflect the longest sample period for which data is available and meaningful in representing the risk profile of the institution's specific equity exposures. The data used shall be sufficient to provide conservative, statistically reliable and robust loss estimates that are not based purely on subjective or judgmental considerations. The shock employed shall provide a conservative estimate of potential losses over a relevant long-term market or business cycle. The institution shall combine empirical analysis of available data with adjustments based on a variety of factors in order to attain model outputs that achieve appropriate realism and conservatism. In constructing Value at Risk (VaR) models estimating potential quarterly losses, institutions may use quarterly data or convert shorter horizon period data to a quarterly equivalent using an analytically appropriate method supported by empirical evidence and through a well-developed and documented thought process and analysis. Such an approach shall be applied conservatively and consistently over time. Where only limited relevant data is available the institution shall add appropriate margins of conservatism;

- (b) the models used shall capture adequately all of the material risks embodied in equity returns including both the general market risk and specific risk exposure of the institution's equity portfolio. The internal models shall adequately explain historical price variation, capture both the magnitude and changes in the composition of potential concentrations, and be robust to adverse market environments. The population of risk exposures represented in the data used for estimation shall be closely matched to or at least comparable with those of the institution's equity exposures;
- (c) the internal model shall be appropriate for the risk profile and complexity of an institution's equity portfolio. Where an institution has material holdings with values that are highly non-linear in nature the internal models shall be designed to capture appropriately the risks associated with such instruments;
- (d) mapping of individual positions to proxies, market indices, and risk factors shall be plausible, intuitive, and conceptually sound;
- (e) institutions shall demonstrate through empirical analyses the appropriateness of risk factors, including their ability to cover both general and specific risk;
- (f) the estimates of the return volatility of equity exposures shall incorporate relevant and available data, information, and methods. Independently reviewed internal data or data from external sources including pooled data shall be used;
- (g) a rigorous and comprehensive stress-testing programme shall be in place.

### *Article 183*

#### *Risk management process and controls*

With regard to the development and use of internal models for own funds requirement purposes, institutions shall establish policies, procedures, and controls to ensure the integrity of the model and modelling process. These policies, procedures, and controls shall include the following:

- (a) full integration of the internal model into the overall management information systems of the institution and in the management of the non-trading book equity portfolio. Internal models shall be fully integrated into the institution's risk management infrastructure if they are particularly used in measuring and assessing equity portfolio performance including the risk-adjusted performance, allocating economic capital to equity exposures and evaluating overall capital adequacy and the investment management process;
- (b) established management systems, procedures, and control functions for ensuring the periodic and independent review of all elements of the internal modelling process, including approval of model revisions, vetting of model inputs, and review of model results, such as direct verification of risk computations. These reviews shall assess the accuracy, completeness, and appropriateness of model inputs and results and focus on both finding and limiting potential errors associated with known weaknesses and identifying unknown model weaknesses. Such reviews may be conducted by an internal independent unit, or by an independent external third party;
- (c) adequate systems and procedures for monitoring investment limits and the risk exposures of equity exposures;
- (d) the units responsible for the design and application of the model shall be functionally independent from the units responsible for managing individual investments;
- (e) parties responsible for any aspect of the modelling process shall be adequately qualified. Management shall allocate sufficient skilled and competent resources to the modelling function.

#### *Article 184*

##### *Validation and documentation*

Institutions shall have robust systems in place to validate the accuracy and consistency of their internal models and modelling processes. All material elements of the internal models and the modelling process and validation shall be documented.

The validation and documentation of institutions' internal models and modelling processes shall be subject to the following requirements:

- (a) institutions shall use the internal validation process to assess the performance of its internal models and processes in a consistent and meaningful way;
- (b) the methods and data used for quantitative validation shall be consistent through time. Changes in estimation and validation methods and data both data sources and periods covered shall be documented;
- (c) institutions shall regularly compare actual equity returns computed using realised and unrealised gains and losses with modelled estimates. Such comparisons shall make use of historical data that cover as long a period as possible. The institution shall document the methods and data used in such comparisons. This analysis and documentation shall be updated at least annually;
- (d) institutions shall make use of other quantitative validation tools and comparisons with external data sources. The analysis shall be based on data that are appropriate to the portfolio, are updated regularly, and cover a relevant observation period. Institutions' internal assessments of the performance of their models shall be based on as long a period as possible;
- (e) institutions shall have sound internal standards for addressing situations where comparison of actual equity returns with the models estimates calls the validity of the estimates or of the models as such into question. These standards shall take account of business cycles and similar systematic variability in equity returns. All adjustments made to internal models in response to model reviews shall be documented and consistent with the institution's model review standards;
- (f) the internal model and the modelling process shall be documented, including the responsibilities of parties involved in the modelling, and the model approval and model review processes.

**SUB-SECTION 5**  
**INTERNAL GOVERNANCE AND OVERSIGHT**

*Article 185*

*Corporate Governance*

1. All material aspects of the rating and estimation processes shall be approved by the institution's management body or a designated committee thereof and senior management. These parties shall possess a general understanding of the rating systems of the institution and detailed comprehension of its associated management reports.
2. Senior management shall be subject to the following requirements:
  - (a) they shall provide notice to the management body or a designated committee thereof of material changes or exceptions from established policies that will materially impact the operations of the institution's rating systems;
  - (b) they shall have a good understanding of the rating systems designs and operations;
  - (c) they shall ensure, on an ongoing basis that the rating systems are operating properly;

Senior management shall be regularly informed by the credit risk control units about the performance of the rating process, areas needing improvement, and the status of efforts to improve previously identified deficiencies.
3. Internal ratings-based analysis of the institution's credit risk profile shall be an essential part of the management reporting to these parties. Reporting shall include at least risk profile by grade, migration across grades, estimation of the relevant parameters per grade, and comparison of realised default rates, and to the extent that own estimates are used of realised LGDs and realised conversion factors against expectations and stress-test results. Reporting frequencies shall depend on the significance and type of information and the level of the recipient.
- 4.



*Article 186*  
*Credit risk control*

1. The credit risk control unit shall be independent from the personnel and management functions responsible for originating or renewing exposures and report directly to senior management. The unit shall be responsible for the design or selection, implementation, oversight and performance of the rating systems. It shall regularly produce and analyse reports on the output of the rating systems.
2. The areas of responsibility for the credit risk control unit or units shall include:
  - (a) testing and monitoring grades and pools;
  - (b) production and analysis of summary reports from the institution's rating systems;
  - (c) implementing procedures to verify that grade and pool definitions are consistently applied across departments and geographic areas;
  - (d) reviewing and documenting any changes to the rating process, including the reasons for the changes;
  - (e) reviewing the rating criteria to evaluate if they remain predictive of risk. Changes to the rating process, criteria or individual rating parameters shall be documented and retained;
  - (f) active participation in the design or selection, implementation and validation of models used in the rating process;
  - (g) oversight and supervision of models used in the rating process;
  - (h) ongoing review and alterations to models used in the rating process.

3. Institutions using pooled data according to Articles 175(2) may outsource the following tasks:
- (a) production of information relevant to testing and monitoring grades and pools;
  - (b) production of summary reports from the institution's rating systems;
  - (c) production of information relevant to review of the rating criteria to evaluate if they remain predictive of risk;
  - (d) documentation of changes to the rating process, criteria or individual rating parameters;
  - (e) production of information relevant to ongoing review and alterations to models used in the rating process.
4. Institutions making use of paragraph 3 shall ensure that the competent authorities have access to all relevant information from the third party that is necessary for examining compliance with the requirements and that the competent authorities may perform on-site examinations to the same extent as within the institution.

#### *Article 187*

#### *Internal Audit*

Internal audit or another comparable independent auditing unit shall review at least annually the institution's rating systems and its operations, including the operations of the credit function and the estimation of PDs, LGDs, ELs and conversion factors. Areas of review shall include adherence to all applicable requirements.

## **Chapter 4**

### **Credit risk mitigation**

#### **SECTION 1**

#### **DEFINITIONS AND GENERAL REQUIREMENTS**

##### *Article 188*

##### *Definitions*

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

- (1) 'lending institution' means the institution which has the exposure in question;
- (2) 'secured lending transaction' means any transaction giving rise to an exposure secured by collateral which does not include a provision conferring upon the institution the right to receive margin at least daily;
- (3) 'capital market-driven transaction' means any transaction giving rise to an exposure secured by collateral which includes a provision conferring upon the institution the right to receive margin at least daily;
- (4) 'underlying collective investment undertaking' means a collective investment undertaking in the shares or units of which another collective investment undertaking has invested.
- (5)            [...]

## *Article 189*

### *Principles for recognising the effect of credit risk mitigation techniques*

1. No exposure in respect of which an institution obtains credit risk mitigation shall produce a higher risk-weighted exposure amount or expected loss amount than an otherwise identical exposure in respect of which an institution has no credit risk mitigation.
2. Where the risk-weighted exposure amount already takes account of credit protection under Chapter 2 or Chapter 3, as relevant, institutions shall not take into account that credit protection in the calculations under this Chapter.
3. Where the provisions in Sections 2 and 3 are met, institutions may modify the calculation of risk-weighted exposure amounts under the Standardised Approach and the calculation of risk-weighted exposure amounts and expected loss amounts under the IRB Approach in accordance with the provisions of Sections 4, 5 and 6.
4. Institutions shall treat cash, securities or commodities purchased, borrowed or received under a repurchase transaction or securities or commodities lending or borrowing transaction as collateral.
5. Where an institution calculating risk-weighted exposure amounts under the Standardised Approach has more than one form of credit risk mitigation covering a single exposure it shall do both of the following:
  - (a) subdivide the exposure into parts covered by each type of credit risk mitigation tool;
  - (b) calculate the risk-weighted exposure amount for each part obtained in point (a) separately in accordance with the provisions of Chapter 2 and this Chapter.

6. When an institution calculating risk-weighted exposure amounts under the Standardised Approach covers a single exposure with credit protection provided by a single protection provider and that protection has differing maturities, it shall do both of the following:
- (a) subdivide the exposure into parts covered by each credit risk mitigation tool;
  - (b) calculate the risk-weighted exposure amount for each part obtained in point (a) separately in accordance with the provisions of Chapter 2 and this Chapter.

#### *Article 190*

##### *Principles governing the eligibility of credit risk mitigation techniques*

1. The technique used [...] to provide the credit protection together with the actions and steps taken and procedures and policies implemented by [...] **the** lending institution shall be such as to result in credit protection arrangements which are legally effective and enforceable in all relevant jurisdictions.

**The lending institution shall provide, upon request of the competent authority, the most recent version of the independent, written and reasoned legal opinion or opinions that it used to establish whether its credit protection arrangement or arrangements meet the condition laid down in the first subparagraph**

2. The lending institution shall take all appropriate steps to ensure the effectiveness of the credit protection arrangement and to address the risks related to that arrangement.

3. In the case of funded credit protection, the assets relied upon for protection shall **only be recognised in the calculation of the effects [...]** of credit risk mitigation [...] where [...] **the assets** are **eligible according to [...]** Articles 193 to 196, as applicable;

\_\_\_\_\_ [...]

4. In the case of funded credit protection, the lending institution [...] **has** the right to liquidate or retain, in a timely manner, the assets from which the protection derives in the event of the default, insolvency or bankruptcy — or other credit event set out in the transaction documentation — of the obligor and, where applicable, of the custodian holding the collateral. The degree of correlation between the value of the assets relied upon for protection and the credit quality of the obligor shall not be too high.
5. In the case of unfunded credit protection, a protection provider shall qualify as an eligible protection provider only where [...] the protection provider is included in the list of eligible protection providers set out in **Articles 197 [...] or 198, as applicable;**

\_\_\_\_\_ [...]

6. In the case of unfunded credit protection, a protection agreement shall qualify as an eligible protection agreement only where it meets both the following conditions:
- (a) it is included in the list of eligible protection agreements set out in Articles 198a to 199(1) ;
  - (b) it is legally effective and enforceable in the relevant jurisdictions, to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate risk-weighted exposure amounts and to the degree of recognition allowed.
  - (c) the protection provider meets both the criteria laid down in paragraph 5.

7. Credit protection shall comply with the requirements set out in Section 3, as applicable.
8. An institution shall be able to demonstrate to competent authorities that it has adequate risk management processes to control those risks to which it may be exposed as a result of carrying out credit risk mitigation practices.
9. Notwithstanding the presence of credit risk mitigation taken into account for the purposes of calculating risk-weighted exposure amounts and, where relevant, expected loss amounts, institutions shall continue to undertake a full credit risk assessment of the underlying exposure and be in a position to demonstrate the fulfilment of this requirement to the competent authorities. In the case of repurchase transactions and securities or commodities lending or borrowing transactions the underlying exposure shall, for the purposes of this paragraph only, be deemed to be the net amount of the exposure.
- 10.

**SECTION 2**  
**ELIGIBLE FORMS OF CREDIT RISK MITIGATION**

**SUB-SECTION 1**  
**FUNDED CREDIT PROTECTION**

*Article 191*

*On-balance sheet netting*

An institution may use on-balance sheet netting of mutual claims between itself and its counterparty as an eligible form of credit risk mitigation.

Without prejudice to Article 192, eligibility is limited to reciprocal cash balances between the institution and the counterparty. Institutions may modify risk-weighted exposure amounts and, as relevant, expected loss amounts only for loans and deposits that they have received themselves and that are subject to an on-balance sheet netting agreement.

*Article 192*

*Master netting agreements covering repurchase transactions or securities or commodities lending or borrowing transactions or other capital market-driven transactions*

Institutions adopting the Financial Collateral Comprehensive Method set out in Article 218 may take into account the effects of bilateral netting contracts covering repurchase transactions, securities or commodities lending or borrowing transactions, or other capital market-driven transactions with a counterparty. Without prejudice to Article 293 and Title V, the collateral taken and securities or commodities borrowed within such agreements or transactions shall comply with the eligibility requirements for collateral set out in Articles 193 and 194.



*Article 193*

*Eligibility of collateral under all approaches and methods*

1. Institutions may use the following items as eligible collateral under all approaches and methods:
  - (a) cash on deposit with, or cash assimilated instruments held by, the lending institution;
  - (b) debt securities issued by central governments or central banks, which securities have a credit assessment by an ECAI or export credit agency recognised as eligible for the purposes of Chapter 2 which has been determined by EBA to be associated with credit quality step 4 or above under the rules for the risk weighting of exposures to central governments and central banks under Chapter 2;
  - (c) debt securities issued by institutions, which securities have a credit assessment by an [...] ECAI which has been determined by EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to institutions under Chapter 2;
  - (d) debt securities issued by other entities which securities have a credit assessment by an [...] ECAI which has been determined by EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to corporates under Chapter 2;
  - (e) debt securities with a short-term credit assessment by an [...] ECAI which has been determined by EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of short term exposures under Chapter 2;
  - (f) equities or convertible bonds that are included in a main index;
  - (g) gold;

- (h) securitisation positions that are not re-securitisation positions, which have an external credit assessment by an [...] ECAI which has been determined by EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of securitisation exposures under the approach specified in Chapter 5, Section 3, Sub-section 3.

2. For the purposes of point (b) of paragraph 1, ‘debt securities issued by central governments or central banks’ shall include all the following:

- (a) debt securities issued by regional governments or local authorities, exposures to which are treated as exposures to the central government in whose jurisdiction they are established under Article 110(2);
- (b) debt securities issued by public sector entities which are treated as exposures to central governments in accordance with Article 111(4);
- (c) debt securities issued by multilateral development banks to which a 0 % risk weight is assigned under Article 112(2);
- (d) debt securities issued by international organisations which are assigned a 0 % risk weight under Article 113.

3. For the purposes of point (c) of paragraph 1, ‘debt securities issued by institutions’ shall include all the following:

- (a) debt securities issued by regional governments or local authorities other than those debt securities referred to in point (a) of paragraph 2;
- (b) debt securities issued by public sector entities, exposures to which are treated according to Article 111(1) and (2);
- (c) debt securities issued by multilateral development banks other than those to which a 0 % risk weight is assigned under Article 112(2).

4. An institution may use debt securities that are issued by other institutions and that do not have a credit assessment by an [...] ECAI as eligible collateral where those debt securities fulfil all the following criteria:
- (a) they are listed on a recognised exchange;
  - (b) they qualify as senior debt;
  - (c) all other rated issues by the issuing institution of the same seniority have a credit assessment by an [...] ECAI which has been determined by the EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to institutions or short term exposures under Chapter 2;
  - (d) the lending institution has no information to suggest that the issue would justify a credit assessment below that indicated in (c);
  - (e) the market liquidity of the instrument is sufficient for these purposes.
5. Institutions may use units or shares in collective investment undertakings as eligible collateral where [...] **all** the following conditions are satisfied:
- (a) the units or shares have a daily public price quote;
  - (b) the collective investment undertakings are limited to investing in instruments that are eligible for recognition under paragraphs 1 and 2.
  - (c) the collective investment undertakings meet the conditions laid down in Article 127(3).**

Where a CIU invests in shares or units of another CIU, conditions laid down in points (a) **to [...]** (c) of the first subparagraph shall apply equally to any such underlying CIU.

The use by a collective investment undertaking of derivative instruments to hedge permitted investments shall not prevent units or shares in that undertaking from being eligible as collateral.

6. For the purposes of paragraph 5, where a collective investment undertaking (**'the original CIU'**) or any of its underlying collective investment undertakings are not limited to investing in instruments that are eligible under paragraphs 1 and 4, institutions may use units or shares in that CIU as collateral to an amount equal to the value of the eligible assets held by that CIU under the assumption that that CIU or any of its underlying collective investment undertakings have invested in non-eligible assets to the maximum extent allowed under their respective mandates.

**Where any underlying collective investment undertaking has underlying collective investment undertakings of its own, institutions may use units or shares in the original CIU as eligible collateral provided that they apply the methodology laid down in the first subparagraph**

Where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, institutions shall do both of the following:

- (a) calculate the total value of the non-eligible assets;
- (b) where the amount obtained under point (a) is negative, subtract the absolute value of that amount from the total value of the eligible assets.

7. With regard to points (b) to (e) of paragraph 1, where a security has two credit assessments by [...]ECAIs, institutions shall apply the less favourable assessment. Where a security has more than two credit assessments by [...]ECAIs, institutions shall apply the two most favourable assessments. Where the two most favourable credit assessments are different, institutions shall apply the less favourable of the two.

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10. ESMA shall develop draft implementing technical standards to specify the following:
- (a) the main indices referred to in point (f) of paragraph 1, in point (a) of Article 194(1), in Article 219(1) and (4), and in point (e) of Article 293(2);
  - (b) the recognised exchanges referred to in point (a) of paragraph 4 and of Article 194(1), in Article 219(1) and (4), in point (e) of Article 293(2), in point (k) of Article 389(2), in point (d) of Article 404(3), in point (c) of Article 415(1), and in point 17 of Annex IV, Part 3.

ESMA shall submit those draft implementing 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 1095/2010.

#### *Article 194*

##### *Additional eligibility of collateral under the Financial Collateral Comprehensive Method*

1. In addition to the collateral established in Article 193, where an institution uses the Financial Collateral Comprehensive Method set out in Article 218, that institution may use the following items as eligible collateral:
- (a) equities or convertible bonds not included in a main index but traded on a recognised exchange;
  - (b) units or shares in collective investment undertakings where both the following conditions are met:
    - (i) the units or shares have a daily public price quote;

- (ii) the collective investment undertaking is limited to investing in instruments that are eligible for recognition under Article 193(1) and (4) and the items mentioned in point (a) of this subparagraph.

In the case a CIU invests in units or shares of another CIU, conditions (a) and (b) of this paragraph equally apply to any such underlying CIU.

The use by a collective investment undertaking of derivative instruments to hedge permitted investments shall not prevent units or shares in that undertaking from being eligible as collateral.

2. Where the collective investment undertaking or any underlying collective investment undertaking are not limited to investing in instruments that are eligible for recognition under Article 193(1) and (4) and the items mentioned in point (a) of paragraph 1, institutions may use units or shares in that CIU as collateral to an amount equal to the value of the eligible assets held by that CIU under the assumption that that CIU or any of its underlying collective investment undertakings have invested in non-eligible assets to the maximum extent allowed under their respective mandates.

Where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, institutions shall do both of the following:

- (a) calculate the total value of the non-eligible assets;
- (b) where the amount obtained under point (a) is negative, subtract the absolute value of that amount from the total value of the eligible assets.

## *Article 195*

### *Additional eligibility for collateral under the IRB Approach*

1. In addition to the collateral referred to in Articles 193 and 194, institutions that calculate risk-weighted exposure amounts and expected loss amounts under the IRB Approach may also use the following forms of collateral:
  - (a) immovable property collateral in accordance with paragraphs 2 to 6;
  - (b) receivables in accordance with paragraph 7;
  - (c) other physical collateral in accordance with paragraphs 8 and 10;
  - (d) leasing in accordance with paragraph 9.
2. Unless otherwise specified under Article 119(2), institutions may use as eligible collateral residential property which is or will be occupied or let by the owner, or the beneficial owner in the case of personal investment companies, and commercial immovable property, including offices and other commercial premises, where both the following conditions are met:
  - (a) the value of the property does not materially depend upon the credit quality of the obligor. 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.
- 3.
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5. Institutions may derogate from point (b) of paragraph 2 for exposures secured by residential property 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 that do not exceed any of the following limits:
- (a) losses stemming from loans collateralised by residential property up to 80 % of the market value or 80 % of the mortgage-lending-value, unless otherwise provided 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 loans collateralised by residential property do not exceed 0.5 % of the outstanding loans collateralised by residential property in any given year.

**Where either of the conditions in points (a) and (b) of the first subparagraph is not met in a given year, institutions shall not use the treatment specified in that subparagraph until both conditions are satisfied in a subsequent year.**

6. Institutions may derogate from point (b) of paragraph 2 for commercial immovable property 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 property market is present in that territory with loss rates that do not exceed any of the following limits:
- (a) losses stemming from loans collateralised by commercial immovable property up to 50 % of the market value or 60 % of the mortgage-lending-value do not exceed 0.3 % of the outstanding loans collateralised by commercial immovable property in any given year;
  - (b) overall losses stemming from loans collateralised by commercial immovable property do not exceed 0.5 % of the outstanding loans collateralised by commercial immovable property in any given year.



Where either of the conditions in points (a) and (b) of the first subparagraph is not met in a given year, institutions shall not use the treatment specified in that subparagraph until both conditions are satisfied in a subsequent year.

7. Institutions may use as eligible collateral amounts receivable linked to a commercial transaction or transactions with an original maturity of less than or equal to one year. Eligible receivables do not include those associated with securitisations, sub-participations or credit derivatives or amounts owed by affiliated parties.
8. Competent authorities shall permit an institution to use as eligible collateral physical collateral of a type other than those indicated in paragraphs 2 to 6 where all the following conditions are met:
  - (a) there are liquid markets, evidenced by frequent transactions, for the disposal of the collateral in an expeditious and economically efficient manner. Institutions shall carry out the assessment of this condition periodically and where information indicates material changes in the market;
  - (b) there are well-established, publicly available market prices for the collateral. Institutions may consider market prices as well-established where they come from reliable sources of information such as public indices and reflect the price of the transactions under normal conditions. Institutions may consider market prices as publicly available, where these prices are disclosed, easily accessible, and obtainable regularly and without any undue administrative or financial burden;
  - (c) the institution analyses the market prices, time and costs required to realise the collateral and the realised proceeds from the collateral;
  - (d) the institution demonstrates that the realised proceeds from the collateral are not below 70% of the collateral value in more than 10% of all liquidations for a given type of collateral. Where there is material volatility in the market prices, the institution demonstrates to the satisfaction of the competent authorities that its valuation of the collateral is sufficiently conservative.

Institutions shall document the fulfilment of the conditions specified in points (a) to (d) of the first subparagraph and those specified in Article 205.

9. Subject to the provisions of Article 225(2), where the requirements set out in Article 206 are met, exposures arising from transactions whereby an institution leases property to a third party may be treated in the same manner as loans collateralised by the type of property leased.
10. EBA shall disclose a list of types of physical collateral for which institutions can assume that the conditions referred to in points (a) and (b) of paragraph 8 are met.

#### *Article 196*

##### *Other funded credit protection*

Institutions may use the following other funded credit protection as eligible collateral:

- (a) cash on deposit with, or cash assimilated instruments held by, a third party institution in a non-custodial arrangement and pledged to the lending institution;
- (b) life insurance policies pledged to the lending institution;
- (c) instruments issued by third party institutions which will be repurchased by that institution on request.

## SUB-SECTION 2

### UNFUNDED CREDIT PROTECTION

#### *Article 197*

#### *Eligibility of protection providers under all approaches*

1. Institutions may use the following parties as eligible providers of unfunded credit protection:
  - (a) central governments and central banks;
  - (b) regional governments or local authorities;
  - (c) multilateral development banks;
  - (d) international organisations exposures to which a 0 % risk weight under Article 112 is assigned;
  - (e) public sector entities, claims on which are treated in accordance with Article 111;
  - (f) institutions and financial institutions for which exposures to the financial institution are treated as exposures to institutions according to Article 114(5) ;
  - (g) other corporate entities, including parent, subsidiary and affiliate corporate entities of the institution, where either of the following conditions is met:
    - (i) those other corporate entities have a credit assessment by a recognised ECAI
    - (ii) in the case of institutions calculating risk-weighted exposure amounts and expected loss amounts under the IRB Approach, those other corporate entities do not have a credit assessment by a recognised ECAI and are internally rated by the institution.
  - (h) central counterparties.**

2. Where institutions calculate risk-weighted exposure amounts and expected loss amounts under the IRB Approach, to be eligible as a provider of unfunded credit protection a guarantor shall be internally rated by the institution in accordance with the provisions of Section 6 of Chapter 3.
- 3. In addition to the parties listed in paragraph 1,** institutions may use as eligible providers of unfunded credit protection other financial institutions authorised and supervised by the competent authorities responsible for the authorisation and supervision of institutions and subject to **the same** prudential requirements **[...] as** those applied to institutions.

Competent authorities shall publish and maintain the list of those other eligible providers of unfunded credit protection, or the guiding criteria for identifying such other eligible providers of unfunded credit protection, together with a description of the applicable prudential requirements, and share their list with other competent authorities in accordance with Article 112 of Directive [inserted by OP].

#### *Article 198*

*Eligibility of protection providers under the IRB Approach which qualify for the treatment set out in*

#### *Article 148(3)*

An institution may use institutions, insurance and reinsurance undertakings and export credit agencies as eligible providers of unfunded credit protection which qualify for the treatment set out in Article 148(3) where they meet all the following conditions:

- (a) they have sufficient expertise in providing unfunded credit protection;
- (b) they are regulated in a manner equivalent to the rules laid down in this Regulation, or had, at the time the credit protection was provided, a credit assessment by a recognised ECAI which had been determined by EBA to be associated with credit quality step 3, or above, in accordance with the rules for the risk weighting of exposures to corporates set out in Chapter 2;

- (c) they had, at the time the credit protection was provided, or for any period of time thereafter, an internal rating with a PD equivalent to or lower than that associated with credit quality step 2 or above in accordance with the rules for the risk weighting of exposures to corporates set out in Chapter 2;
- (d) they have an internal rating with a PD equivalent to or lower than that associated with credit quality step 3 or above in accordance with the rules for the risk weighting of exposures to corporates set out in Chapter 2.

For the purpose of this Article, credit protection provided by export credit agencies shall not benefit from any explicit central government counter-guarantee.

*Article 198a*

**[...] Eligibility of guarantees as unfunded credit protection**

Institutions may use guarantees as eligible unfunded credit protection.

**SUB-SECTION 3**  
**TYPES OF DERIVATIVES**

*Article 199*

*Eligible types of credit derivatives*

1. Institutions may use the following types of credit derivatives, and instruments that may be composed of such credit derivatives or that are economically effectively similar, as eligible credit protection:

- (a) credit default swaps;
- (b) total return swaps;
- (c) credit linked notes to the extent of their cash funding.

Where an institution buys credit protection through a total return swap and records the net payments received on the swap as net income, but does not record the offsetting deterioration in the value of the asset that is protected either through reductions in fair value or by an addition to reserves, that credit protection does not qualify as eligible credit protection.

2. Where an institution conducts an internal hedge using a credit derivative, in order for the credit protection to qualify as eligible credit protection for the purposes of this Chapter, the credit risk transferred to the trading book shall be transferred out to a third party or parties.

Where an internal hedge has been conducted in accordance with the first subparagraph and the requirements in this Chapter have been met, institutions shall apply the rules set out in Sections 4 to 6 for the calculation of risk-weighted exposure amounts and expected loss amounts where they acquire unfunded credit protection.

## SECTION 3 REQUIREMENTS

### SUB-SECTION 1 FUNDED CREDIT PROTECTION

#### *Article 200*

*Requirements for on-balance sheet netting agreements (other than master netting agreements covering repurchase transactions, securities or commodities lending or borrowing transactions or other capital market-driven transactions)*

On-balance sheet netting agreements, other than master netting agreements covering repurchase transactions, securities or commodities lending or borrowing transactions or other capital market-driven transactions, shall qualify as an eligible form of credit risk mitigation where all the following conditions are met:

- (a) those agreements are legally effective and enforceable in all relevant jurisdictions, including in the event of the insolvency or bankruptcy of a counterparty;
- (b) institutions are able to determine at any time the assets and liabilities that are subject to those agreements;
- (c) institutions monitor and control the risks associated with the termination of the credit protection on an ongoing basis;
- (d) institutions monitor and control the relevant exposures on a net basis and do so on an ongoing basis.

## *Article 201*

### *Requirements for master netting agreements covering repurchase transactions or securities or commodities lending or borrowing transactions or other capital market driven transactions*

Master netting agreements covering repurchase transactions, securities or commodities lending or borrowing transactions or other capital market driven transactions shall qualify as an eligible form of credit risk mitigation where the collateral provided under those agreements meets all the requirements laid down in Article 202(2) to (4) and where all the following conditions are met:

- (a) they are legally effective and enforceable in all relevant jurisdictions, including in the event of the bankruptcy or insolvency of the counterparty;
- (b) they give the non-defaulting party the right to terminate and close-out in a timely manner all transactions under the agreement upon the event of default, including in the event of the bankruptcy or insolvency of the counterparty;
- (c) they provide for the netting of gains and losses on transactions closed out under an agreement so that a single net amount is owed by one party to the other.

## *Article 202*

### *Requirements for financial collateral*

1. Under all approaches and methods, financial collateral and gold shall qualify as eligible collateral where all the requirements laid down in paragraphs 2 to 4 are met.
2. The credit quality of the obligor and the value of the collateral shall not have a material positive correlation. **Should the value of the collateral be reduced significantly, this shall not alone imply a significant deterioration of the credit quality of the obligor. Should the credit quality of the obligor become critical, this shall not alone imply a significant reduction in the value of the collateral.**



Securities issued by the obligor, or any related group entity, shall not qualify as eligible collateral. This notwithstanding, the obligor's own issues of covered bonds falling within the terms of Article 124 qualify as eligible collateral when they are posted as collateral for a repurchase transaction, provided that they comply with the condition set out in the first subparagraph.

3. Institutions shall fulfil any contractual and statutory requirements in respect of, and take all steps necessary to ensure, the enforceability of the collateral arrangements under the law applicable to their interest in the collateral.

Institutions shall have conducted sufficient legal review confirming the enforceability of the collateral arrangements in all relevant jurisdictions. They shall re-conduct such review as necessary to ensure continuing enforceability.

4. Institutions shall fulfil all the following operational requirements:
  - (a) they shall properly document the collateral arrangements and have in place clear and robust procedures for the timely liquidation of collateral;
  - (b) they shall use robust procedures and processes to control risks arising from the use of collateral, including risks of failed or reduced credit protection, valuation risks, risks associated with the termination of the credit protection, concentration risk arising from the use of collateral and the interaction with the institution's overall risk profile;
  - (c) they shall have in place documented policies and practices concerning the types and amounts of collateral accepted;
  - (d) they shall calculate the market value of the collateral, and revalue it accordingly, at least once every six months and whenever they have reason to believe that a significant decrease in the market value of the collateral has occurred;

- (e) where the collateral is held by a third party, they shall take reasonable steps to ensure that the third party segregates the collateral from its own assets;
- (f) they shall ensure that they devote sufficient resources to the orderly operation of margin agreements with OTC derivatives and securities-financing counterparties, as measured by the timeliness and accuracy of their outgoing margin calls and response time to incoming margin calls;
- (g) they shall have in place collateral management policies to control, monitor and report the following:
  - (i) the risks to which margin agreements expose them;
  - (ii) the concentration risk to particular types of collateral assets;
  - (iii) the reuse of collateral including the potential liquidity shortfalls resulting from the reuse of collateral received from counterparties;
  - (iv) the surrender of rights on collateral posted to counterparties.

5. In addition to meeting all the requirements set out in paragraphs 2 to 4, for financial collateral to qualify as eligible collateral under the Financial Collateral Simple Method the residual maturity of the protection shall be at least as long as the residual maturity of the exposure.

## *Article 203*

### *Requirements for immovable property collateral*

1. Immovable property shall qualify as eligible collateral only where all the requirements laid down in paragraphs 2 to 5 are met.
2. The following requirements on legal certainly shall be met:
  - (a) a mortgage or charge is enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement and shall be properly filed on a timely basis;
  - (b) all legal requirements for establishing the pledge have been fulfilled;
  - (c) the protection agreement and the legal process underpinning it enable the institution to realise the value of the protection within a reasonable timeframe.
3. The following requirements on monitoring of property values and on property valuation shall be met:
  - (a) institutions monitor the value of the property on a frequent basis and at a minimum once every year for commercial immovable property and once every three years for residential real estate. Institutions carry out more frequent monitoring where the market is subject to significant changes in conditions;
  - (b) the property valuation is reviewed when information available to institutions indicates that the value of the property may have declined materially relative to general market prices and that review is carried out by a valuer who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process. For loans exceeding EUR 3 million or 5 % of the own funds of an institution, the property valuation shall be reviewed by such valuer at least every three years.

Institutions may use statistical methods to monitor the value of the property and to identify property that needs revaluation.

4. Institutions shall clearly document the types of residential and commercial immovable property they accept and their lending policies in this regard.
5. Institutions shall have in place procedures to monitor that the property taken as credit protection is adequately insured against the risk of damage.

#### *Article 204*

##### *Requirements for receivables*

1. Receivables shall qualify as eligible collateral where all the requirements laid down in paragraphs 2 and 3 are met.
2. The following requirements on legal certainty shall be met:
  - (a) the legal mechanism by which the collateral is provided to a lending institution shall be robust and effective and ensure that that institution has clear rights over the [...] **collateral**;
  - (b) institutions shall take all steps necessary to fulfil local requirements in respect of the enforceability of security interest. Lending institutions shall have a first priority claim over the collateral although such claims may still be subject to the claims of preferential creditors provided for in legislative provisions;
  - (c) institutions shall have conducted sufficient legal review confirming the enforceability of the collateral arrangements in all relevant jurisdictions;
  - (d) institutions shall properly document their collateral arrangements and shall have in place clear and robust procedures for the timely collection of collateral;
  - (e) institutions shall have in place procedures that ensure that any legal conditions required for declaring the default of a borrower and timely collection of collateral are observed;

- (f) in the event of a borrower's financial distress or default, institutions shall have legal authority to sell or assign the receivables to other parties without consent of the receivables obligors.

3. The following requirements on risk management shall be met:

- (a) an institution shall have in place a sound process for determining the credit risk associated with the receivables. Such a process shall include analyses of a borrower's business and industry and the types of customers with whom that borrower does business. Where the institution relies on its borrowers to ascertain the credit risk of the customers, the institution shall review the borrowers' credit practices to ascertain their soundness and credibility;
- (b) the difference between the amount of the exposure and the value of the receivables shall reflect all appropriate factors, including the cost of collection, concentration within the receivables pool pledged by an individual borrower, and potential concentration risk within the institution's total exposures beyond that controlled by the institution's general methodology. Institutions shall maintain a continuous monitoring process appropriate to the receivables. They shall also review, on a regular basis, compliance with loan covenants, environmental restrictions, and other legal requirements;
- (c) receivables pledged by a borrower shall be diversified and not be unduly correlated with that borrower. Where there is material positive correlation, institutions shall take into account the attendant risks in the setting of margins for the collateral pool as a whole;

- (d) institutions shall not use receivables from affiliates of a borrower, including subsidiaries and employees, as eligible credit protection;
- (e) institution shall have in place a documented process for collecting receivable payments in distressed situations. Institutions shall have in place the requisite facilities for collection even when they normally rely on their borrowers for collections.

#### *Article 205*

##### *Requirements for other physical collateral*

Physical collateral other than immovable property collateral shall qualify as eligible collateral under the IRB Approach where all the following conditions are met:

- (a) the collateral arrangement under which the physical collateral is provided to an institution shall be legally effective and enforceable in all relevant jurisdictions and shall enable that institution to realise the value of the collateral within a reasonable timeframe;
- (b) with the sole exception of permissible first priority claims referred to in Article 204(2)(b), only first liens on, or charges over, collateral shall qualify as eligible collateral and an institution shall have priority over all other lenders to the realised proceeds of the collateral;
- (c) institutions shall monitor the value of the collateral on a frequent basis and at least once every year. Institutions shall carry out more frequent monitoring where the market is subject to significant changes in conditions;
- (d) the loan agreement shall include detailed descriptions of the collateral as well as detailed specifications of the manner and frequency of revaluation;

- (e) institutions shall clearly document in internal credit policies and procedures available for examination the types of physical collateral they accept and the policies and practices they have in place in respect of the appropriate amount of each type of collateral relative to the exposure amount ;
- (f) institutions' credit policies with regard to the transaction structure shall address the following:
  - (i) appropriate collateral requirements relative to the exposure amount;
  - (ii) the ability to liquidate the collateral readily;
  - (iii) the ability to establish objectively a price or market value;
  - (iv) the frequency with which the value can readily be obtained, including a professional appraisal or valuation;
  - (v) the volatility or a proxy of the volatility of the value of the collateral.
- (g) when conducting valuation and revaluation, institutions shall take fully into account any deterioration or obsolescence of the collateral, paying particular attention to the effects of the passage of time on fashion- or date-sensitive collateral;
- (h) institutions shall have the right to physically inspect the collateral. They shall also have in place policies and procedures addressing their exercise of the right to physical inspection;
- (i) the collateral taken as protection shall be adequately insured against the risk of damage and institutions shall have in place procedures to monitor this.

## *Article 206*

### *Requirements for treating lease exposures as collateralised*

Institutions shall treat exposures arising from leasing transactions as collateralised by the type of property leased, where all the following conditions are met:

- (a) the conditions set out in Articles 203 or 205, as appropriate, for the type of property leased to qualify as eligible collateral are met;
- (b) the lessor has in place robust risk management with respect to the use to which the leased asset is put, its location, its age and the planned duration of its use, including appropriate monitoring of the value of the security;
- (c) the lessor has legal ownership of the asset and is able to exercise its rights as owner in a timely fashion;
- (d) where this has not already been ascertained in calculating the LGD level, the difference between the value of the unamortised amount and the market value of the security is not so large as to overstate the credit risk mitigation attributed to the leased assets.

## *Article 207*

### *Requirements for other funded credit protection*

1. Cash on deposit with, or cash assimilated instruments held by, a third party institution shall be eligible for the treatment set out in Article 227(1), where both the following conditions are met:
  - (a) the borrower's claim against the third party institution is openly pledged or assigned to the lending institution and such pledge or assignment is legally effective and enforceable in all relevant jurisdictions and is unconditional and irrevocable;
  - (b) the third party institution is notified of the pledge or assignment and,



- (c) as a result of the notification, the third party institution is able to make payments solely to the lending institution or to other parties only with the lending institution's prior consent.
- (d) 2. Life insurance policies pledged to the lending institution shall qualify as eligible collateral where all the following conditions are met:
  - (a) the life insurance policy is openly pledged or assigned to the lending institution;
  - (b) the company providing the life insurance is notified of the pledge or assignment and, as a result of the notification, may not pay amounts payable under the contract without the prior consent of the lending institution;
  - (c) the lending institution has the right to cancel the policy and receive the surrender value in the event of the default of the borrower;
  - (d) the lending institution is informed of any non-payments under the policy by the policy-holder;
  - (e) the credit protection is provided for the maturity of the loan. Where this is not possible because the insurance relationship ends before the loan relationship expires, the institution shall ensure that the amount deriving from the insurance contract serves the institution as security until the end of the duration of the credit agreement;
  - (f) the pledge or assignment is legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement;
  - (g) the surrender value is declared by the company providing the life insurance and is non-reducible;
  - (h) the surrender value is to be paid by the company providing the life insurance in a timely manner upon request;
  - (i) the surrender value shall not be requested without the prior consent of the institution;

- (j) the company providing the life insurance is subject to Directive 2009/138/EC of the European Parliament and of the Council or is subject to supervision by a competent authority of a third country which applies supervisory and regulatory arrangements at least equivalent to those applied in the Union.

## **SUB-SECTION 2**

### **UNFUNDED CREDIT PROTECTION AND CREDIT LINKED NOTES**

#### *Article 208*

##### *Requirements common to guarantees and credit derivatives*

1. Subject to Article 209(1), credit protection deriving from a guarantee or credit derivative shall qualify as eligible unfunded credit protection where all the following conditions are met:
  - (a) the credit protection is direct;
  - (b) the extent of the credit protection is clearly defined and incontrovertible;
  - (c) the credit protection contract does not contain any clause, the fulfilment of which is outside the direct control of the lender, that:
    - (i) would allow the protection provider to cancel the protection unilaterally;
    - (ii) would increase the effective cost of protection as a result of deteriorating credit quality of the protected exposure;

- (iii) could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original obligor fails to make any payments due, or when the leasing contract has expired for the purposes of recognising guaranteed residual value under Articles 129(7) and 162(4);
  - (iv) could allow the maturity of the credit protection to be reduced by the protection provider;
  - (d) is legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement.
2. An institution shall demonstrate to competent authorities that it has in place systems to manage potential concentration of risk arising from its use of guarantees and credit derivatives. An institution shall be able to demonstrate to the satisfaction of the competent authorities how its strategy in respect of its use of credit derivatives and guarantees interacts with its management of its overall risk profile.
3. An institution shall fulfil any contractual and statutory requirements in respect of, and take all steps necessary to ensure, the enforceability of its unfunded credit protection under the law applicable to its interest in the credit protection.

Institutions shall have conducted sufficient legal review confirming the enforceability of the unfunded credit protection in all relevant jurisdictions. They shall repeat such review as necessary to ensure continuing enforceability.

#### *Article 209*

##### *Sovereign and other public sector counter-guarantees*

1. Institutions may treat the exposures referred to in paragraph 2 as protected by a guarantee provided by the entities listed in that paragraph, provided all the following conditions are satisfied:
- (a) the counter-guarantee covers all credit risk elements of the claim;

- (b) both the original guarantee and the counter-guarantee meet the requirements for guarantees set out in Articles 208 and 210(1), except that the counter-guarantee need not be direct;
  - (c) the cover is robust and nothing in the historical evidence suggests that the coverage of the counter-guarantee is less than effectively equivalent to that of a direct guarantee by the entity in question.
2. The treatment laid down in paragraph 1 shall apply to exposures protected by a guarantee which is counter-guaranteed by any of the following entities:
- (a) a central government or central bank;
  - (b) a regional government or local authority;
  - (c) a public sector entity, claims on which are treated as claims on the central government in accordance with Article 111(4);
  - (d) a multilateral development bank or an international organisation, to which a 0 % risk weight is assigned under or by virtue of Articles 112(2) and 113 respectively;
  - (e) a public sector entity, claims on which are treated in accordance with Article 111(1) and 111(2).
3. Institutions shall apply the treatment set out in paragraph 1 also to an exposure which is not counter-guaranteed by any entity listed in paragraph 2 where that exposure's counter-guarantee is in turn directly guaranteed by one of those entities and the conditions listed in paragraph 1 are satisfied.

## *Article 210*

### *Additional requirements for guarantees*

1. Guarantees shall qualify as eligible unfunded credit protection where all the conditions in Article 208 and all the following conditions are met:

- (a) on the qualifying default of or non-payment by the counterparty, the lending institution has the right to pursue, in a timely manner, the guarantor for any monies due under the claim in respect of which the protection is provided and the payment by the guarantor shall not be subject to the lending institution first having to pursue the obligor;

In the case of unfunded credit protection covering residential mortgage loans, the requirements in Article 208(1)(c)(iii) and in the first subparagraph have only to be satisfied within 24 months;

- (b) the guarantee is an explicitly documented obligation assumed by the guarantor;
- (c) either of the following conditions is met:
  - (i) the guarantee covers all types of payments the obligor is expected to make in respect of the claim;
  - (ii) where certain types of payment are excluded from the guarantee, the lending institution has adjusted the value of the guarantee to reflect the limited coverage.

2. In the case of guarantees provided in the context of mutual guarantee schemes or provided by or counter-guaranteed by entities listed in Article 209(2), the requirements in point (a) of paragraph 1 shall be considered to be satisfied where either of the following conditions is met:

- (a) the lending institution has the right to obtain in a timely manner a provisional payment by the guarantor that meets both the following conditions:

- (i) it represents a robust estimate of the amount of the loss, including losses resulting from the non-payment of interest and other types of payment which the borrower is obliged to make, that the lending institution is likely to incur;
  - (ii) it is proportional to the coverage of the guarantee;
- (b) the lending institution can demonstrate to the satisfaction of the competent authorities that the effects of the guarantee, which shall also cover losses resulting from the non-payment of interest and other types of payments which the borrower is obliged to make, justify such treatment.

#### *Article 211*

##### *Additional requirements for credit derivatives*

1. Credit derivative shall qualify as eligible unfunded credit protection where all the conditions in Article 208 and all the following conditions are met:
  - (a) the credit events specified in the credit derivative contract include:
    - (i) the failure to pay the amounts due under the terms of the underlying obligation that are in effect at the time of such failure, with a grace period that is equal to or shorter than the grace period in the underlying obligation;
    - (ii) the bankruptcy, insolvency or inability of the obligor to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and analogous events;
    - (iii) the restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that results in a credit loss event;

- (b) where credit derivatives allow for cash settlement:
  - (i) institutions have in place a robust valuation process in order to estimate loss reliably;
  - (ii) there is a clearly specified period for obtaining post-credit-event valuations of the underlying obligation;
- (c) where the protection purchaser's right and ability to transfer the underlying obligation to the protection provider is required for settlement, the terms of the underlying obligation provide that any required consent to such transfer shall not be unreasonably withheld;
- (d) the identity of the parties responsible for determining whether a credit event has occurred is clearly defined;
- (e) the determination of the credit event is not the sole responsibility of the protection provider;
- (f) the protection buyer has the right or ability to inform the protection provider of the occurrence of a credit event.

Where the credit events do not include restructuring of the underlying obligation as described in point (a)(iii), the credit protection may nonetheless be eligible subject to a reduction in the value as specified in Article 228(2);

2. A mismatch between the underlying obligation and the reference obligation under the credit derivative or between the underlying obligation and the obligation used for purposes of determining whether a credit event has occurred is permissible only where both the following conditions are met:
  - (a) the reference obligation or the obligation used for the purpose of determining whether a credit event has occurred, as the case may be, ranks 'pari passu' with or is junior to the underlying obligation;

- (b) the underlying obligation and the reference obligation or the obligation used for the purpose of determining whether a credit event has occurred, as the case may be, share the same obligor and legally enforceable cross-default or cross-acceleration clauses are in place.

#### *Article 212*

##### *Requirements to qualify for the treatment set out in Article 148(3)*

1. To be eligible for the treatment set out in Article 148(3), credit protection deriving from a guarantee or credit derivative shall meet the following conditions:
  - (a) the underlying obligation is to one of the following exposures:
    - (i) a corporate exposure as defined in Article 142, excluding insurance and reinsurance undertakings;
    - (ii) an exposure to a regional government, local authority or public sector entity which is not treated as an exposure to a central government or a central bank according to Article 142;
    - (iii) an exposure to a small or medium sized enterprise, classified as a retail exposure according to Article 142(5);
  - (b) the underlying obligors are not members of the same group as the protection provider;
  - (c) the exposure is hedged by one of the following instruments:
    - (i) single-name unfunded credit derivatives or single-name guarantees;
    - (ii) first-to-default basket products;
    - (iii) nth-to-default basket products;



- (d) the credit protection meets the requirements set out in Articles 208, 210 and 211, as applicable;
- (e) the risk weight that is associated with the exposure prior to the application of the treatment in Article 148(3), does not already factor in any aspect of the credit protection;
- (f) an institution has the right and expectation to receive payment from the protection provider without having to take legal action in order to pursue the counterparty for payment. To the extent possible, the institution shall take steps to satisfy itself that the protection provider is willing to pay promptly should a credit event occur;
- (g) the purchased credit protection absorbs all credit losses incurred on the hedged portion of an exposure that arise due to the occurrence of credit events outlined in the contract;
- (h) where the payout structure of the credit protection provides for physical settlement, there is legal certainty with respect to the deliverability of a loan, bond, or contingent liability;
- (i) where an institution intends to deliver an obligation other than the underlying exposure, it shall ensure that the deliverable obligation is sufficiently liquid so that the institution would have the ability to purchase it for delivery in accordance with the contract;
- (j) the terms and conditions of credit protection arrangements are legally confirmed in writing by both the protection provider and the institution;
- (k) institutions have in place a process to detect excessive correlation between the creditworthiness of a protection provider and the obligor of the underlying exposure due to their performance being dependent on common factors beyond the systematic risk factor;

- (l) in the case of protection against dilution risk, the seller of purchased receivables is not a member of the same group as the protection provider.
2. For the purpose of point (c)(ii) of paragraph 1, institutions shall apply the treatment set out in Article 148(3) to the asset within the basket with the lowest risk-weighted exposure amount.
3. For the purpose of point (c)(iii) of paragraph 1, the protection obtained is only eligible for consideration under this framework where eligible (n-1)th default protection has also been obtained or where (n-1) of the assets within the basket has or have already defaulted. Where this is the case, institutions shall apply the treatment set out in Article 148(3) to the asset within the basket with the lowest risk-weighted exposure amount.

## **SECTION 4**

### **CALCULATING THE EFFECTS OF CREDIT RISK MITIGATION**

#### **SUB-SECTION 1**

#### **FUNDED CREDIT PROTECTION**

##### *Article 213*

##### *Credit linked notes*

Investments in credit linked notes issued by the lending institution may be treated as cash collateral for the purpose of calculating the effect of funded credit protection in accordance with this Sub-section, provided that the credit default swap embedded in the credit linked note qualifies as eligible unfunded credit protection. For the purpose of determining, whether the credit default swap embedded in a credit linked note qualifies as eligible unfunded credit protection, it is to be assumed that such credit default swap has been concluded with an eligible provider

## Article 214

### *On-balance sheet netting*

Loans and deposits with the lending institution subject to on-balance sheet netting are to be treated by that institution as cash collateral for the purpose of calculating the effect of funded credit protection for those loans and deposits of the lending institution subject to on-balance sheet netting which are denominated in the same currency.

## Article 215

### *Using the Supervisory Volatility Adjustments Approach or the Own Estimates Volatility Adjustments Approach for master netting agreements*

1. When institutions calculate the 'fully adjusted exposure value' ( $E^*$ ) for the exposures subject to an eligible master netting agreement covering repurchase transactions or securities or commodities lending or borrowing transactions or other capital market-driven transactions, they shall calculate the volatility adjustments that they need to apply either by using the Supervisory Volatility Adjustments Approach or the Own Estimates Volatility Adjustments Approach ('Own Estimates Approach') as set out in Articles 218 to 221 for the Financial Collateral Comprehensive Method.

The use of the Own Estimates Approach shall be subject to the same conditions and requirements as apply under the Financial Collateral Comprehensive Method.

2. For the purpose of calculating  $E^*$ , institutions shall do the following:
  - (a) institutions shall calculate the net position in each group of securities or in each type of commodity by subtracting the amount in point (ii) from the amount in point (i):
    - (i) the total value of a group of securities or of commodities of the same type lent, sold or provided under the master netting agreement;

- (ii) the total value of a group of securities or of commodities of the same type borrowed, purchased or received under the master netting agreement;
- (b) institutions shall calculate the net position in each currency, other than the settlement currency of the master netting agreement, by subtracting the amount in point (ii) from the amount in point (i):
  - (i) the sum of the total value of securities denominated in that currency lent, sold or provided under the master netting agreement and the amount of cash in that currency lent or transferred under that agreement;
  - (ii) the sum of the total value of securities denominated in that currency borrowed, purchased or received under the master netting agreement and the amount of cash in that currency borrowed or received under that agreement;
- (c) institutions shall apply the volatility adjustment appropriate to a given group of securities or to a cash position to the absolute value of the positive or negative net position in the securities in that group;
- (d) institutions shall apply the foreign exchange risk (fx) volatility adjustment to the net positive or negative position in each currency other than the settlement currency of the master netting agreement.

3. Institutions shall calculate  $E^*$  according to the following formula:

$$E^* = \max \left\{ 0, \left( \sum_i E_i - \sum_i C_i \right) + \sum_j |E_j^{sec}| \cdot H_j^{sec} + \sum_k |E_k^{fx}| \cdot H_k^{fx} \right\}$$

where:

$E_i$  = the exposure value for each separate exposure  $i$  under the agreement that would apply in the absence of the credit protection, where institutions calculate risk-weighted exposure amounts under the Standardised Approach or where they calculate the risk-weighted exposure amounts and expected loss amounts under the IRB Approach;

$C_i$  = the value of securities in each group or commodities of the same type borrowed, purchased or received or the cash borrowed or received in respect of each exposure  $i$ ;

$E_j^{sec}$  = the net position (positive or negative) in a given group of securities  $j$ ;

$E_k^{fx}$  = the net position (positive or negative) in a given currency  $k$  other than the settlement currency of the agreement as calculated under point (b) of paragraph 2;

$H_j^{sec}$  = the volatility adjustment appropriate to a particular group of securities  $j$ ;

$H_k^{fx}$  = the foreign exchange volatility adjustment for currency  $k$ .

4. For the purpose of calculating risk-weighted exposure amounts and expected loss amounts for repurchase transactions or securities or commodities lending or borrowing transactions or other capital market-driven transactions covered by master netting agreements, institutions shall use  $E^*$  as calculated under paragraph 3 as the exposure value of the exposure to the counterparty arising from the transactions subject to the master netting agreement for the purposes of Article 108 under the Standardised Approach or Chapter 3 under the IRB Approach.

5. For the purposes of paragraphs 2 and 3, 'group of securities' means securities which are issued by the same entity, have the same issue date, the same maturity, are subject to the same terms and conditions, and are subject to the same liquidation periods as indicated in Articles 219 and 220, as applicable.

#### *Article 216*

##### *Using the Internal Models Approach for Master netting agreements*

1. Subject to permission of competent authorities, institutions may, as an alternative to using the Supervisory Volatility Adjustments Approach or the Own Estimates Approach in calculating the fully adjusted exposure value ( $E^*$ ) resulting from the application of an eligible master netting agreement covering repurchase transactions, securities or commodities lending or borrowing transactions, or other capital market driven transactions other than derivative transactions, use an internal models approach which takes into account correlation effects between security positions subject to the master netting agreement as well as the liquidity of the instruments concerned.
2. Subject to the permission of the competent authorities, institutions may also use their internal models for margin lending transactions, where the transactions are covered under a bilateral master netting agreement that meets the requirements set out in Chapter 6, Section 7.

3. An institution may choose to use an internal models approach independently of the choice it has made between the Standardised Approach and the IRB Approach for the calculation of risk-weighted exposure amounts. However, where an institution seeks to use an internal models approach, it shall do so for all counterparties and securities, excluding immaterial portfolios where it may use the Supervisory Volatility Adjustments Approach or the Own Estimates Approach as laid down in Article 215.

Institutions that have received permission for an internal risk-management model under Title IV, Chapter 5 may use the internal models approach. Where an institution has not received such permission, it may still apply for permission to the competent authorities to use an internal models approach for the purposes of this Article.

4. Competent authorities shall permit an institution to use an internal models approach only where they are satisfied that the institution's system for managing the risks arising from the transactions covered by the master netting agreement is conceptually sound and implemented with integrity and where the following qualitative standards are met:
- (a) the internal risk-measurement model used for calculating the potential price volatility for the transactions is closely integrated into the daily risk-management process of the institution and serves as the basis for reporting risk exposures to the senior management of the institution;
  - (b) the institution has a risk control unit that meets all the following requirements:
    - (i) it is independent from business trading units and reports directly to senior management;
    - (ii) it is responsible for designing and implementing the institution's risk-management system;
    - (iii) it produces and analyses daily reports on the output of the risk-measurement model and on the appropriate measures to be taken in terms of position limits;

- (c) the daily reports produced by the risk-control unit are reviewed by a level of management with sufficient authority to enforce reductions of positions taken and of overall risk exposure;
- (d) the institution has sufficient staff skilled in the use of sophisticated models in the risk control unit;
- (e) the institution has established procedures for monitoring and ensuring compliance with a documented set of internal policies and controls concerning the overall operation of the risk-measurement system;
- (f) the institution's models have a proven track record of reasonable accuracy in measuring risks demonstrated through the back-testing of its output using at least one year of data;
- (g) the institution frequently conducts a rigorous programme of stress testing and the results of these tests are reviewed by senior management and reflected in the policies and limits it sets;
- (h) the institution conducts, as part of its regular internal auditing process, an independent review of its risk-measurement system. This review shall include both the activities of the business trading units and of the independent risk-control unit;
- (i) at least once a year, the institution conducts a review of its risk-management system;
- (j) the internal model meets the requirements set out in Article 286(8) and (9) and in Article 288.

5. An institution's internal risk-measurement model shall capture a sufficient number of risk factors in order to capture all material price risks.

An institution may use empirical correlations within risk categories and across risk categories where its system for measuring correlations is sound and implemented with integrity.



6. Institutions using the internal models approach shall calculate  $E^*$  according to the following formula:

$$E^* = \max \left\{ 0, \left( \sum_i E_i - \sum_i C_i \right) + \text{potential change in value} \right\}$$

where:

$E_i$  = the exposure value for each separate exposure  $i$  under the agreement that would apply in the absence of the credit protection, where institutions calculate the risk-weighted exposure amounts under the Standardised Approach or where they calculate risk-weighted exposure amounts and expected loss amounts under the IRB Approach;

$C_i$  = the value of the securities borrowed, purchased or received or the cash borrowed or received in respect of each such exposure  $i$ .

When calculating risk-weighted exposure amounts using internal models, institutions shall use the previous business day's model output.

7. The calculation of the potential change in value referred to in paragraph 6 shall be subject to all the following standards:
- (a) it shall be carried out at least daily;
  - (b) it shall be based on a 99th percentile, one-tailed confidence interval;
  - (c) it shall be based on a 5-day equivalent liquidation period, except in the case of transactions other than securities repurchase transactions or securities lending or borrowing transactions where a 10-day equivalent liquidation period shall be used;
  - (d) it shall be based on an effective historical observation period of at least one year except where a shorter observation period is justified by a significant upsurge in price volatility;

- (e) the data set used in the calculation shall be updated every three months.

Where an institution has a repurchase transaction, a securities or commodities lending or borrowing transaction and margin lending or similar transaction or netting set which meets the criteria set out in Article 279(2) and (3), the minimum holding period shall be brought in line with the margin period of risk that would apply under those paragraphs, in combination with Article 279(4).

8. For the purpose of calculating risk-weighted exposure amounts and expected loss amounts for repurchase transactions or securities or commodities lending or borrowing transactions or other capital market-driven transactions covered by master netting agreements, institutions shall use  $E^*$  as calculated under paragraph 6 as the exposure value of the exposure to the counterparty arising from the transactions subject to the master netting agreement for the purposes of Article 108 under the Standardised Approach or Chapter 3 under the IRB Approach.
- 9.

#### *Article 217*

##### *Financial Collateral Simple Method*

1. Institutions may use the Financial Collateral Simple Method only where they calculate risk-weighted exposure amounts under the Standardised Approach. Institution shall not use both the Financial Collateral Simple Method and the Financial Collateral Comprehensive Method, except for the purposes of Articles 143(1) and 145(1). Institutions shall not use this exception selectively with the purpose of achieving reduced own funds requirements or with the purpose of conducting regulatory arbitrage.
2. Under the Financial Collateral Simple Method institutions shall assign to eligible financial collateral a value equal to its market value as determined in accordance with point (d) of Article 202(4).

3. Institutions shall assign to those portions of exposure values that are collateralised by the market value of eligible collateral the risk weight that they would assign under Chapter 2 where the lending institution had a direct exposure to the collateral instrument. For this purpose, the exposure value of an off-balance sheet item listed in Annex I shall be equal to 100 % of the item's value rather than the exposure value indicated in Article 106(1).

The risk weight of the collateralised portion shall be at least 20 % except as specified in paragraphs 4 to 6. Institutions shall apply to the remainder of the exposure value the risk weight that they would assign to an unsecured exposure to the counterparty under Chapter 2.

4. Institutions shall assign a risk weight of 0 % to the collateralised portion of the exposure arising from repurchase transaction and securities lending or borrowing transactions which fulfil the criteria in Article 222. Where the counterparty to the transaction is not a core market participant, institutions shall assign a risk weight of 10 %.
5. Institutions shall assign a risk weight of 0 %, to the extent of the collateralisation, to the exposure values determined under Chapter 6 for the derivative instruments listed in Annex II and subject to daily marking-to-market, collateralised by cash or cash-assimilated instruments where there is no currency mismatch.

Institutions shall assign a risk weight of 10 %, to the extent of the collateralisation, to the exposure values of such transactions collateralised by debt securities issued by central governments or central banks which are assigned a 0 % risk weight under Chapter 2.

6. For transactions other than those referred to in paragraphs 4 and 5, institutions may assign a 0 % risk weight where the exposure and the collateral are denominated in the same currency, and either of the following conditions is met:
- (a) the collateral is cash on deposit or a cash assimilated instrument;
  - (b) the collateral is in the form of debt securities issued by central governments or central banks eligible for a 0 % risk weight under Article 109, and its market value has been discounted by 20 %.

7. For the purpose of paragraphs 5 and 6 debt securities issued by central governments or central banks shall include:
- (a) debt securities issued by regional governments or local authorities exposures to which are treated as exposures to the central government in whose jurisdiction they are established under Article 110;
  - (b) debt securities issued by multilateral development banks to which a 0 % risk weight is assigned under or by virtue of Article 112(2);
  - (c) debt securities issued by international organisations which are assigned a 0 % risk weight under Article 113;
  - (d) debt securities issued by public sector entities which are treated as exposures to central governments in accordance with Article 111(4).

#### *Article 218*

##### *Financial Collateral Comprehensive Method*

1. In order to take account of price volatility, institutions shall apply volatility adjustments to the market value of collateral, as set out in Articles 219 to 222, when valuing financial collateral for the purposes of the Financial Collateral Comprehensive Method.

Where collateral is denominated in a currency that differs from the currency in which the underlying exposure is denominated, institutions shall add an adjustment reflecting currency volatility to the volatility adjustment appropriate to the collateral as set out in Articles 219 to 222.

In the case of OTC derivatives transactions covered by netting agreements recognised by the competent authorities under Chapter 6, institutions shall apply a volatility adjustment reflecting currency volatility when there is a mismatch between the collateral currency and the settlement currency. Even where multiple currencies are involved in the transactions covered by the netting agreement, institutions shall apply a single volatility adjustment.

2. Institutions shall calculate the volatility-adjusted value of the collateral ( $C_{VA}$ ) they need to take into account as follows:

$$C_{VA} = C \cdot (1 - H_C - H_{fx})$$

where:

$C$  = the value of the collateral;

$H_C$  = the volatility adjustment appropriate to the collateral, as calculated under Articles 219 and 222;

$H_{fx}$  = the volatility adjustment appropriate to currency mismatch, as calculated under Articles 219 and 222.

Institutions shall use the formula in this paragraph when calculating the volatility-adjusted value of the collateral for all transactions except for those transactions subject to recognised master netting agreements to which the provisions set out in Articles 215 and 216 apply.

3. Institutions shall calculate the volatility-adjusted value of the exposure ( $E_{VA}$ ) they need to take into account as follows:

$$E_{VA} = E \cdot (1 + H_E)$$

where:

$E$  = the exposure value as would be determined under Chapter 2 or Chapter 3 as appropriate where the exposure was not collateralised;

$H_E$  = the volatility adjustment appropriate to the exposure, as calculated under Articles 219 and 222.

In the case of OTC derivative transactions institutions shall calculate  $E_{VA}$  as follows:

$$E_{VA} = E .$$

4. For the purpose of calculating E in paragraph 3, the following shall apply:
  - (a) for institutions calculating risk-weighted exposure amounts under the Standardised Approach, the exposure value of an off-balance sheet item listed in Annex I shall be 100 % of that item's value rather than the exposure value indicated in Article 106(1);
  - (b) for institutions calculating risk-weighted exposure amounts under the IRB Approach, they shall calculate the exposure value of the items listed in Article 162(8) to (10) by using a conversion factor of 100 % rather than the conversion factors or percentages indicated in those paragraphs.
5. Institutions shall calculate the fully adjusted value of the exposure ( $E^*$ ), taking into account both volatility and the risk-mitigating effects of collateral as follows:

$$E^* = \max \{0, E_{VA} - C_{VAM}\}$$

where:

$E_{VA}$  = the volatility adjusted value of the exposure as calculated in paragraph 3;

$C_{VAM}$  =  $C_{VA}$  further adjusted for any maturity mismatch in accordance with the provisions of Section 5;

6. Institutions may calculate volatility adjustments either by using the Supervisory Volatility Adjustments Approach referred to in Article 219 or the Own Estimates Approach referred to in Article 220.

An institution may choose to use the Supervisory Volatility Adjustments Approach or the Own Estimates Approach independently of the choice it has made between the Standardised Approach and the IRB Approach for the calculation of risk-weighted exposure amounts.

However, where an institution uses the Own Estimates Approach, it shall do so for the full range of instrument types, excluding immaterial portfolios where it may use the Supervisory Volatility Adjustments Approach.

7. Where the collateral consists of a number of eligible items, institutions shall calculate the volatility adjustment (H) as follows:

$$H = \sum_i a_i H_i$$

where:

$a_i$  = the proportion of the value of an eligible item i in the total value of collateral;

$H_i$  = the volatility adjustment applicable to eligible item i.

#### *Article 219*

##### *Supervisory volatility adjustment under the Financial Collateral Comprehensive Method*

1. The volatility adjustments to be applied by institutions under the Supervisory Volatility Adjustments Approach, assuming daily revaluation, shall be those set out in Tables 1 to 4 of this paragraph.

## VOLATILITY ADJUSTMENTS

Table 1										
Credit quality step with which the credit assessment of the debt security is associated	Residual Maturity	Volatility adjustments for debt securities issued by entities described in <u>Article 193(1)(b)</u>			Volatility adjustments for debt securities issued by entities described in <u>Article 193(1)(c)</u> and (d)			Volatility adjustments for securitisation positions and meeting the criteria in <u>Article 193(1)(h)</u>		
		20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)	20-day liquidation period (%)	10-day liquidation period (%)	5-day liquidation period (%)
1	≤ 1 year	0.707	0.5	0.354	1.414	1	0.707	2.829	2	1.414
	>1 ≤ 5 years	2.828	2	1.414	5.657	4	2.828	11.314	8	5.657
	> 5 years	5.657	4	2.828	11.314	8	5.657	22.628	16	11.313
2-3	≤ 1 year	1.414	1	0.707	2.828	2	1.414	5.657	4	2.828
	>1 ≤ 5 years	4.243	3	2.121	8.485	6	4.243	16.971	12	8.485
	> 5 years	8.485	6	4.243	16.971	12	8.485	33.942	24	16.970
4	≤ 1 year	21.213	15	10.607	N/A	N/A	N/A	N/A	N/A	N/A
	>1 ≤ 5 years	21.213	15	10.607	N/A	N/A	N/A	N/A	N/A	N/A
	> 5 years	21.213	15	10.607	N/A	N/A	N/A	N/A	N/A	N/A



<u>Table 2</u>									
<u>Credit quality step with which the credit assessment of a short term debt security is associated</u>	<u>Volatility adjustments for debt securities issued by entities described in Article 193(1)(b) with short-term credit assessments</u>			<u>Volatility adjustments for debt securities issued by entities described in Article 193(1) [...] (c) and (d) with short-term credit assessments</u>			<u>Volatility adjustments for securitisation positions and meeting the criteria in Article 193(1)(h)</u>		
	<u>20-day liquidation period (%)</u>	<u>10-day liquidation period (%)</u>	<u>5-day liquidation period (%)</u>	<u>20-day liquidation period (%)</u>	<u>10-day liquidation period (%)</u>	<u>5-day liquidation period (%)</u>	<u>20-day liquidation period (%)</u>	<u>10-day liquidation period (%)</u>	<u>5-day liquidation period (%)</u>
<u>1</u>	<u>0.707</u>	<u>0.5</u>	<u>0.354</u>	<u>1.414</u>	<u>1</u>	<u>0.707</u>	<u>2.829</u>	<u>2</u>	<u>1.414</u>
<u>2-3</u>	<u>1.414</u>	<u>1</u>	<u>0.707</u>	<u>2.828</u>	<u>2</u>	<u>1.414</u>	<u>5.657</u>	<u>4</u>	<u>2.828</u>

<u>Table 3</u>			
<u>Other collateral or exposure types</u>			
	<u>20-day liquidation period ( %)</u>	<u>10-day liquidation period ( %)</u>	<u>5-day liquidation period ( %)</u>
Main Index Equities, Main Index Convertible Bonds	21.213	15	10.607
Other Equities or Convertible Bonds listed on a recognised exchange	35.355	25	17.678
Cash	0	0	0
Gold	21.213	15	10.607

Table 4		
Volatility adjustment for currency mismatch		
20-day liquidation period ( %)	10-day liquidation period ( %)	5-day liquidation period (%)
11.314	8	5.657

2. The calculation of volatility adjustments in accordance with paragraph 1 shall be subject to the following conditions:
- (a) for secured lending transactions the liquidation period shall be 20 business days;
  - (b) for repurchase transactions, except insofar as such transactions involve the transfer of commodities or guaranteed rights relating to title to commodities, and securities lending or borrowing transactions the liquidation period shall be 5 business days;
  - (c) for other capital market driven transactions, the liquidation period shall be 10 business days.

Where an institution has a transaction or netting set which meets the criteria set out in of Article 279(2) and (3), the minimum holding period shall be brought in line with the margin period of risk that would apply under those paragraphs.

3. In Tables 1 to 4 of paragraph 1 and in paragraphs 4 to 6, the credit quality step with which a credit assessment of the debt security is associated is the credit quality step with which the credit assessment is determined by EBA to be associated under Chapter 2.

For the purpose of determining the credit quality step with which a credit assessment of the debt security is associated referred to in the first subparagraph, Article 193(7) also applies.

4. For non-eligible securities or for commodities lent or sold under repurchase transactions or securities or commodities lending or borrowing transactions, the volatility adjustment is the same as for non-main index equities listed on a recognised exchange.

5. For eligible units in collective investment undertakings the volatility adjustment is the weighted average volatility adjustments that would apply, having regard to the liquidation period of the transaction as specified in paragraph 2, to the assets in which the fund has invested.

Where the assets in which the fund has invested are not known to the institution, the volatility adjustment is the highest volatility adjustment that would apply to any of the assets in which the fund has the right to invest.

6. For unrated debt securities issued by institutions and satisfying the eligibility criteria in Article 193(4) the volatility adjustments is the same as for securities issued by institutions or corporates with an external credit assessment associated with credit quality steps 2 or 3.

#### *Article 220*

##### *Own estimates of volatility adjustments under the Financial Collateral Comprehensive Method*

1. The competent authorities shall permit institutions to use their own volatility estimates for calculating the volatility adjustments to be applied to collateral and exposures where those institutions comply with the requirements set out in paragraphs 2 and 3. Institutions which have obtained permission to use their own volatility estimates shall not revert to the use of other methods except for demonstrated good cause and subject to the permission of the competent authorities.

For debt securities that have a credit assessment from a recognised ECAI equivalent to investment grade or better, institutions may calculate a volatility estimate for each category of security.

For debt securities that have a credit assessment from a recognised ECAI equivalent to below investment grade, and for other eligible collateral, institutions shall calculate the volatility adjustments for each individual item.

Institutions using the Own Estimates Approach shall estimate volatility of the collateral or foreign exchange mismatch without taking into account any correlations between the unsecured exposure, collateral or exchange rates.

In determining relevant categories, institutions shall take into account the type of issuer of the security, the external credit assessment of the securities, their residual maturity, and their modified duration. Volatility estimates shall be representative of the securities included in the category by the institution.

2. The calculation of the volatility adjustments shall be subject to all the following criteria:
  - (a) institutions shall base the calculation on a 99th percentile, one-tailed confidence interval;
  - (b) institutions shall base the calculation on the following liquidation periods:
    - (i) 20 business days for secured lending transactions;
    - (ii) 5 business days for repurchase transaction, except insofar as such transactions involve the transfer of commodities or guaranteed rights relating to title to commodities and securities lending or borrowing transactions;
    - (iii) 10 business days for other capital market driven transactions;
  - (c) institutions may use volatility adjustment numbers calculated according to shorter or longer liquidation periods, scaled up or down to the liquidation period set out in point (b) for the type of transaction in question, using the square root of time formula:

$$H_M = H_N \cdot \sqrt{\frac{T_M}{T_N}}$$

where:

$T_M$  = the relevant liquidation period;

$H_M$  = the volatility adjustment based on the liquidation period  $T_M$ ;

$H_N$  = the volatility adjustment based on the liquidation period  $T_N$ .

- (d) institutions shall take into account the illiquidity of lower-quality assets. They shall adjust the liquidation period upwards in cases where there is doubt concerning the liquidity of the collateral. They shall also identify where historical data may understate potential volatility. Such cases shall be dealt with by means of a stress scenario;
- (e) the length of the historical observation period institutions use for calculating volatility adjustments shall be at least one year. For institutions that use a weighting scheme or other methods for the historical observation period, the length of the effective observation period shall be at least one year. The competent authorities may also require an institution to calculate its volatility adjustments using a shorter observation period where, in the competent authorities' judgement, this is justified by a significant upsurge in price volatility;
- (f) institutions shall update their data sets and calculate volatility adjustments at least once every three months. They shall also reassess their data sets whenever market prices are subject to material changes.

3. The estimation of volatility adjustments shall meet all the following qualitative criteria:

- (a) an institutions shall use the volatility estimates in the day-to-day risk management process including in relation to its internal exposure limits;
- (b) where the liquidation period used by an institution in its day-to-day risk management process is longer than that set out in this Section for the type of transaction in question, that institution shall scale up its volatility adjustments in accordance with the square root of time formula set out in point (c) of paragraph 2;

- (c) an institution shall have in place established procedures for monitoring and ensuring compliance with a documented set of policies and controls for the operation of its system for the estimation of volatility adjustments and for the integration of such estimations into its risk management process;
- (d) an independent review of the institution's system for the estimation of volatility adjustments shall be carried out regularly within the institution's own internal auditing process. A review of the overall system for the estimation of volatility adjustments and for the integration of those adjustments into the institution's risk management process shall take place at least once a year. The subject of that review shall include at least the following:
  - (i) the integration of estimated volatility adjustments into daily risk management;
  - (ii) the validation of any significant change in the process for the estimation of volatility adjustments;
  - (iii) the verification of the consistency, timeliness and reliability of data sources used to run the system for the estimation of volatility adjustments, including the independence of such data sources;
  - (iv) the accuracy and appropriateness of the volatility assumptions.

## Article 221

### *Scaling up of volatility adjustment under the Financial Collateral Comprehensive method*

The volatility adjustments set out in Article 219 are the volatility adjustments an institution shall apply where there is daily revaluation. Similarly, where an institution uses its own estimates of the volatility adjustments in accordance with Article 220, it shall calculate them in the first instance on the basis of daily revaluation. Where the frequency of revaluation is less than daily, institutions shall apply larger volatility adjustments. Institutions shall calculate them by scaling up the daily revaluation volatility adjustments, using the following square-root-of-time formula:

$$H = H_M \cdot \sqrt{\frac{N_R + (T_M - 1)}{T_M}}$$

where:

$H$  = the volatility adjustment to be applied;

$H_M$  = the volatility adjustment where there is daily revaluation;

$N_R$  = the actual number of business days between revaluations;

$T_M$  = the liquidation period for the type of transaction in question.

## *Article 222*

### *Conditions for applying a 0% volatility adjustment under the Financial Collateral Comprehensive method*

1. In relation to repurchase transactions and securities lending or borrowing transactions, where an institution uses the Supervisory Volatility Adjustments Approach under Article 219 or the Own Estimates Approach under Article 220 and where the conditions set out in points (a) to (h) of paragraph 2 are satisfied, institutions may, instead of applying the volatility adjustments calculated under Articles 219 to 221, apply a 0 % volatility adjustment. Institutions using the internal models approach set out in Article 216 shall not use the treatment laid down in this Article.
2. Institutions may apply a 0% volatility adjustment where all the following conditions are met:
  - (a) both the exposure and the collateral are cash or debt securities issued by central governments or central banks within the meaning of Article 193(1)(b) and eligible for a 0 % risk weight under Chapter 2;
  - (b) both the exposure and the collateral are denominated in the same currency;
  - (c) either the maturity of the transaction is no more than one day or both the exposure and the collateral are subject to daily marking-to-market or daily re-margining;
  - (d) the time between the last marking-to-market before a failure to re-margin by the counterparty and the liquidation of the collateral is no more than four business days;
  - (e) the transaction is settled in a settlement system proven for that type of transaction;
  - (f) the documentation covering the agreement or transaction is standard market documentation for repurchase transactions or securities lending or borrowing transactions in the securities concerned;



- (g) the transaction is governed by documentation specifying that where the counterparty fails to satisfy an obligation to deliver cash or securities or to deliver margin or otherwise defaults, then the transaction is immediately terminable;
- (h) the counterparty is considered a core market participant by the competent authorities.

3. The core market participants referred to in point (h) of paragraph 2 shall include the following entities:

- (a) the entities mentioned in Article 193(1)(b) exposures to which are assigned a 0 % risk weight under Chapter 2;
- (b) institutions;
- (c) other financial **[...] undertakings** exposures to which are assigned a 20 % risk weight under the Standardised Approach or which, in the case of institutions calculating risk-weighted exposure amounts and expected loss amounts under the IRB Approach, do not have a credit assessment by a recognised ECAI and are internally rated by the institution.
- (d) **regulated collective investment undertakings [...]** that are subject to capital or leverage requirements;
- (e) regulated pension funds;
- (f) recognised clearing organisations.

### Article 223

#### *Calculating risk-weighted exposure amounts and expected loss amounts under the Financial Collateral Comprehensive method*

1. Under the Standardised Approach, institutions shall use  $E^*$  as calculated under Article 218(5) as the exposure value for the purposes of Article 108. In the case of off-balance sheet items listed in Annex I, institutions shall use  $E^*$  as the value to which the percentages indicated in Article 106(1) shall be applied to arrive at the exposure value.
2. Under the IRB Approach, institutions shall use the effective LGD ( $LGD^*$ ) as the LGD for the purposes of Chapter 3. Institutions shall calculate  $LGD^*$  as follows:

$$LGD^* = LGD \cdot \frac{E^*}{E}$$

where:

$LGD$  = the LGD that would apply to the exposure under Chapter 3 where the exposure was not collateralised;

$E$  = the exposure value as described under Article 218(3);

$E^*$  = the fully adjusted exposure value as calculated under Article 218(5).

### Article 224

#### *Valuation principles for other eligible collateral under the IRB Approach*

1. For immovable property collateral, the collateral shall be valued by an independent valuer at or less than the market value. An institution shall require the independent valuer to document the market value in a transparent and clear manner.

In those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions the property may instead be valued by an independent valuer at or less than the mortgage lending value. Institutions shall require the independent valuer not to take into account speculative elements in the assessment of the mortgage lending value and [...] to document that value in a transparent and clear manner.

The value of the collateral shall be the market value or mortgage lending value reduced as appropriate to reflect the results of the monitoring required under Article 203(3) and to take account of any prior claims on the property.

2. For receivables, the value of receivables shall be the amount receivable.
3. Institutions shall value physical collateral other than immovable property at its market value. For the purposes of this Article, the market value is the estimated amount for which the property would exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction.

#### *Article 225*

#### *Calculating risk-weighted exposure amounts and expected loss amounts for other eligible collateral under the IRB Approach*

1. Institutions shall use LGD\* calculated in accordance with this paragraph and paragraph 2 as the LGD for the purposes of Chapter 3.

Where the ratio of the value of the collateral (C) to the exposure value (E) is below the required minimum collateralisation level of the exposure ( $C^*$ ) as laid down in Table 5, LGD\* shall be the LGD laid down in Chapter 3 for uncollateralised exposures to the counterparty. For this purpose, institutions shall calculate the exposure value of the items listed in Articles 162(8) to (10) by using a conversion factor or percentage of 100 % rather than the conversion factors or percentages indicated in those points.

Where the ratio of the value of the collateral to the exposure value exceeds a second, higher threshold level of  $C^{**}$  as laid down in Table 5,  $LGD^*$  shall be that prescribed in Table 5.

Where the required level of collateralisation  $C^{**}$  is not achieved in respect of the exposure as a whole, institutions shall consider the exposure to be two exposures — one corresponding to the part in respect of which the required level of collateralisation  $C^{**}$  is achieved and one corresponding to the remainder.

2. The applicable  $LGD^*$  and required collateralisation levels for the secured parts of exposures are set out in Table 5 of this paragraph.

Table 5				
Minimum LGD for secured parts of exposures				
	LGD* for senior [...] <u>exposure</u>	LGD* for subordinated [...] <u>exposures</u>	Required minimum collateralisation level of the exposure ( $C^*$ )	Required minimum collateralisation level of the exposure ( $C^{**}$ )
Receivables	35 %	65 %	0 %	125 %
Residential real estate/commercial real estate	35 %	65 %	30 %	140 %
Other collateral	40 %	70 %	30 %	140 %

3. As an alternative to the treatment in paragraphs 1 and 2, and subject to Article 119(2), institutions may assign a 50 % risk weight to the part of the exposure that is, within the limits set out in Articles 120(2)(d) and 121(2)(d) respectively, fully collateralised by residential property or commercial immovable property situated within the territory of a Member State where all the conditions in Article 195(6) are met.

#### *Article 226*

#### *Calculating risk-weighted exposure amounts and expected loss amounts in the case of mixed pools of collateral*

1. An institution shall calculate the value of LGD\* that it shall use as the LGD for the purposes of Chapter 3 in accordance with paragraphs 2 and 3 where both the following conditions are met:
  - (a) the institution uses the IRB Approach to calculate risk-weighted exposure amounts and expected loss amounts;
  - (b) an exposure is collateralised by both financial collateral and other eligible collateral.
2. Institutions shall be required to subdivide the volatility-adjusted value of the exposure, obtained by applying the volatility adjustment as set out in Article 218(5) to the value of the exposure, into parts so as to obtain a part covered by eligible financial collateral, a part covered by receivables, a part covered by commercial immovable property collateral or residential property collateral, a part covered by other eligible collateral, and the unsecured part, as relevant.
3. Institutions shall calculate LGD\* for each part of the exposure obtained in paragraph 2 separately in accordance with the relevant provisions of this Chapter.

## *Article 227*

### *Other funded credit protection*

1. Where the conditions set out in Article 207(1) are met, deposits with third party institutions may be treated as a guarantee by the third party institution.
2. Where the conditions set out in Article 207(2) are met, institutions shall subject the portion of the exposure collateralised by the current surrender value of life insurance policies pledged to the lending institution to the following treatment:
  - (a) where the exposure is subject to the Standardised Approach, it shall be risk-weighted by using the risk weights specified in paragraph 3;
  - (b) where the exposure is subject to the IRB Approach but not subject to the institution's own estimates of LGD, it shall be assigned an LGD of 40 %.

In case of a currency mismatch, institutions shall reduce the current surrender value in accordance with Article 228(3), the value of the credit protection being the current surrender value of the life insurance policy.

3. For purposes of point (a) of paragraph 2, institutions shall assign the following risk weights on the basis of the risk weight assigned to a senior unsecured exposure to the undertaking providing the life insurance:
  - (a) a risk weight of 20 %, where the senior unsecured exposure to the company providing the life insurance is assigned a risk weight of 20 %;
  - (b) a risk weight of 35 %, where the senior unsecured exposure to the company providing the life insurance is assigned a risk weight of 50 %;
  - (c) a risk weight of 70 %, where the senior unsecured exposure to the company providing the life insurance is assigned a risk weight of 100 %;
  - (d) a risk weight of 150 %, where the senior unsecured exposure to the company providing the life insurance is assigned a risk weight of 150 %.

4. Institutions may treat instruments repurchased on request that are eligible under Article 196(c) as a guarantee by the issuing institution. The value of the eligible credit protection shall be the following:
- (a) where the instrument will be repurchased at its face value, the value of the protection shall be that amount;
  - (b) where the instrument will be repurchased at market price, the value of the protection shall be the value of the instrument valued in the same way as the debt securities **that meet the conditions of [...]** Article 193(4).

## SUB-SECTION 2

### UNFUNDED CREDIT PROTECTION

#### *Article 228*

#### *Valuation*

1. For the purpose of calculating the effects of unfunded credit protection in accordance with this Sub-section, the value of unfunded credit protection (G) shall be the amount that the protection provider has undertaken to pay in the event of the default or non-payment of the borrower or on the occurrence of other specified credit events.
2. In the case of credit derivatives which do not include as a credit event restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that result in a credit loss event the following shall apply:
  - (a) where the amount that the protection provider has undertaken to pay is not higher than the exposure value, institutions shall reduce the value of the credit protection calculated under paragraph 1 by 40 %;

(b) where the amount that the protection provider has undertaken to pay is higher than the exposure value, the value of the credit protection shall be no higher than 60 % of the exposure value.

3. Where unfunded credit protection is denominated in a currency different from that in which the exposure is denominated, institutions shall reduce the value of the credit protection by the application of a volatility adjustment as follows:

$$G^* = G \cdot (1 - H_{fx})$$

where:

$G^*$  = the amount of credit protection adjusted for foreign exchange risk,

$G$  = the nominal amount of the credit protection;

$H_{fx}$  = the volatility adjustment for any currency mismatch between the credit protection and the underlying obligation determined in accordance with paragraph 4.

Where there is no currency mismatch  $H_{fx}$  is equal to zero.

4. Institutions shall base the volatility adjustments for any currency mismatch on a 10 business day liquidation period, assuming daily revaluation, and may calculate them based on the Supervisory Volatility Adjustments approach or the Own Estimates Approach as set out in Articles 219 and 220 respectively. Institutions shall scale up the volatility adjustments in accordance with Article 221.



## Article 229

### *Calculating risk-weighted exposure amounts and expected loss amounts in case of partial protection and tranching*

Where an institution transfers a part of the risk of a loan in one or more tranches, the rules set out in Chapter 5 shall apply. Institutions may consider materiality thresholds on payments below which no payment shall be made in the event of loss to be equivalent to retained first loss positions and to give rise to a tranching transfer of risk.

## Article 230

### *Calculating risk-weighted exposure amounts under the Standardised Approach*

1. For the purposes of Article 108(3) institutions shall calculate the risk-weighted exposure amounts in accordance with the following formula:

$$\max\{0, E - G_A\} \cdot r + G_A \cdot g$$

where:

- $E$  = the exposure value according to Article 106; for this purpose, the exposure value of an off-balance sheet item listed in Annex I shall be 100 % of its value rather than the exposure value indicated in Article 106(1);
- $G_A$  = the amount of credit risk protection as calculated under Article 228(3) ( $G^*$ ) further adjusted for any maturity mismatch as laid down in Section 5;
- $r$  = the risk weight of exposures to the obligor as specified under Chapter 2;
- $g$  = the risk weight of exposures to the protection provider as specified under Chapter 2.

2. Where the protected amount ( $G_A$ ) is less than the exposure ( $E$ ), institutions may apply the formula specified in paragraph 1 only where the protected and unprotected parts of the exposure are of equal seniority.
3. Institutions may extend the treatment provided for in Article 109(4) and (5) to exposures or parts of exposures guaranteed by the central government or central bank, where the guarantee is denominated in the domestic currency of the borrower and the exposure is funded in that currency.

#### *Article 231*

##### *Calculating risk-weighted exposure amounts and expected loss amounts under the IRB Approach*

1. For the covered portion of the exposure value ( $E$ ), based on the adjusted value of the credit protection  $G_A$ , the PD for the purposes of Section [...] 4 of Chapter 3 may be the PD of the protection provider, or a PD between that of the borrower and that of the guarantor where a full substitution is deemed not to be warranted. In the case of subordinated exposures and non-subordinated unfunded protection, the LGD to be applied by institutions for the purposes of Section [...] 4 of Chapter 3 may be that associated with senior claims.
2. For any uncovered portion of the exposure value ( $E$ ) the PD shall be that of the borrower and the LGD shall be that of the underlying exposure.
3. For the purposes of this Article,  $G_A$  is the value of  $G^*$  as calculated under Article 228(3) further adjusted for any maturity mismatch as laid down in Section 5.  $E$  is the exposure value according to Section [...] 5 of Chapter 3. For this purpose, institutions shall calculate the exposure value of the items listed in Article 162(8) to (10) by using a conversion factor or percentage of 100 % rather than the conversion factors or percentages indicated in those paragraphs.

## SECTION 5

### MATURITY MISMATCHES

#### *Article 232*

##### *Maturity mismatch*

1. For the purpose of calculating risk-weighted exposure amounts, a maturity mismatch occurs when the residual maturity of the credit protection is less than that of the protected exposure. Where protection has a residual maturity of less than three months and the maturity of the protection is less than the maturity of the underlying exposure that protection does not qualify as eligible credit protection.
2. Where there is a maturity mismatch the credit protection shall not qualify as eligible where either of the following conditions is met:
  - (a) the original maturity of the protection is less than 1 year;
  - (b) the exposure is a short term exposure specified by the competent authorities as being subject to a one-day floor rather than a one-year floor in respect of the maturity value (M) under Article 158(3).

#### *Article 233*

##### *Maturity of credit protection*

1. Subject to a maximum of 5 years, the effective maturity of the underlying shall be the longest possible remaining time before the obligor is scheduled to fulfil its obligations. Subject to paragraph 2, the maturity of the credit protection shall be the time to the earliest date at which the protection may terminate or be terminated.

2. Where there is an option to terminate the protection which is at the discretion of the protection seller, institutions shall take the maturity of the protection to be the time to the earliest date at which that option may be exercised. Where there is an option to terminate the protection which is at the discretion of the protection buyer and the terms of the arrangement at origination of the protection contain a positive incentive for the institution to call the transaction before contractual maturity, an institution shall take the maturity of the protection to be the time to the earliest date at which that option may be exercised; otherwise the institution may consider that such an option does not affect the maturity of the protection.
3. Where a credit derivative is not prevented from terminating prior to expiration of any grace period required for a default on the underlying obligation to occur as a result of a failure to pay institutions shall reduce the maturity of the protection by the length of the grace period.

#### *Article 234*

##### *Valuation of protection*

1. For transactions subject to funded credit protection under the Financial Collateral Simple Method, where there is a mismatch between the maturity of the exposure and the maturity of the protection, the collateral does not qualify as eligible funded credit protection.
2. For transactions subject to funded credit protection under the Financial Collateral Comprehensive Method, institutions shall reflect the maturity of the credit protection and of the exposure in the adjusted value of the collateral according to the following formula:

$$C_{VAM} = C_{VA} \cdot \frac{t - t^*}{T - t^*}$$

where:

$C_{VA}$  = the volatility adjusted value of the collateral as specified in Article 218(2) or the amount of the exposure, whichever is lower;

$t$  = the number of years remaining to the maturity date of the credit protection calculated in accordance with Article 233, or the value of  $T$ , whichever is lower;

$T$  = the number of years remaining to the maturity date of the exposure calculated in accordance with Article 233, or 5 years, whichever is lower;

$t^* = 0.25$ .

Institutions shall use  $C_{VAM}$  as  $C_{VA}$  further adjusted for maturity mismatch in the formula for the calculation of the fully adjusted value of the exposure ( $E^*$ ) set out in Article 218(5).

3. For transactions subject to unfunded credit protection, institutions shall reflect the maturity of the credit protection and of the exposure in the adjusted value of the credit protection according to the following formula:

$$G_A = G^* \cdot \frac{t - t^*}{T - t^*}$$

where:

$G_A$  =  $G^*$  adjusted for any maturity mismatch;

$G^* =$  the amount of the protection adjusted for any currency mismatch;

$t$  = is the number of years remaining to the maturity date of the credit protection calculated in accordance with Article 233, or the value of  $T$ , whichever is lower;

$T =$  is the number of years remaining to the maturity date of the exposure calculated in accordance with Article 233, or 5 years, whichever is lower;

$t^* =$  0.25.

Institutions shall use  $G_A$  as the value of the protection for the purposes of Articles 228 to 231.

## SECTION 6

### BASKET CRM TECHNIQUES

#### *Article 235*

#### *First-to-default credit derivatives*

Where an institution obtains credit protection for a number of exposures under terms that the first default among the exposures shall trigger payment and that this credit event shall terminate the contract, the institution may modify the calculation of the risk-weighted exposure amount and, as relevant, the expected loss amount of the exposure which would, in the absence of the credit protection, produce the lowest risk weighted exposure amount in accordance with this Chapter:

- (a) for institutions using the Standardised Approach, the risk-weighted exposure amount shall be the one calculated under the Standardised Approach;
- (b) for institutions using the IRB Approach, the risk-weighted exposure amount shall be the sum of the risk-weighted exposure amount calculated under the IRB Approach and 12.5 times the expected loss amount.

The treatment laid out in this Article applies only where the exposure [...] value is less than or equal to the value of the credit protection.

## Article 236

### *Nth-to-default credit derivatives*

Where the *n*th default among the exposures triggers payment under the credit protection, the institution purchasing the protection may only recognise the protection for the calculation of risk-weighted exposure amounts and, as relevant, expected loss amounts where protection has also been obtained for defaults 1 to *n*-1 or when *n*-1 defaults have already occurred. In such cases, the institution may modify the calculation of the risk-weighted exposure amount and, as relevant, the expected loss amount of the exposure which would, in the absence of the credit protection, produce the *n*-th lowest risk-weighted exposure amount in accordance with this Chapter. Institutions shall calculate the *n*th lowest amount as specified in points (a) and (b) in Article 235.

The treatment laid out in this Article applies only where the exposure [...] value is less than or equal to the value of the credit protection.

All exposures in the basket shall meet the requirements laid down in Article 199(2) and 211(1)(d).

# **Chapter 5**

## **Securitisation**

### **SECTION 1**

#### **DEFINITIONS**

#### *Article 237*

#### *Definitions*

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

- (1) ‘excess spread’ means finance charge collections and other fee income received in respect of the securitised exposures net of costs and expenses;
- (2) ‘clean-up call option’ means a contractual option for the originator to repurchase or extinguish the securitisation positions before all of the underlying exposures have been repaid, when the amount of outstanding exposures falls below a specified level;
- (3) ‘liquidity facility’ means the securitisation position arising from a contractual agreement to provide funding to ensure timeliness of cash flows to investors;
- (4) ‘ $K_{IRB}$ ’ means 8 % of the risk-weighted exposure amounts that would be calculated under Chapter 3 in respect of the securitised exposures, had they not been securitised, plus the amount of expected losses associated with those exposures calculated under that Chapter;
- (5) ‘ratings based method’ means the method of calculating risk-weighted exposure amounts for securitisation positions in accordance with Article 256;
- (6) ‘supervisory formula method’ means the method of calculating risk-weighted exposure amounts for securitisation positions in accordance with Article 257;
- (7) ‘unrated position’ means a securitisation position which does not have an eligible credit assessment by an [...] ECAI as defined in Section 4;



- (8) 'rated position' means a securitisation position which has an eligible credit assessment by an [...]ECAI as defined in Section 4;
- (9) 'asset-backed commercial paper (ABCP) programme' means a programme of securitisations the securities issued by which predominantly take the form of commercial paper with an original maturity of one year or less;
- (10) 'traditional securitisation' means a securitisation involving the economic transfer of the exposures being securitised. This shall be accomplished by the transfer of ownership of the securitised exposures from the originator institution to an SSPE or through sub-participation by an SSPE. The securities issued do not represent payment obligations of the originator institution;
- (11) 'synthetic securitisation' means a securitisation where the transfer of risk is achieved by the use of credit derivatives or guarantees, and the exposures being securitised remain exposures of the originator institution;
- (12) 'revolving exposure' means an exposure whereby customers' outstanding balances are permitted to fluctuate based on their decisions to borrow and repay, up to an agreed limit;
- (12a) 'revolving securitisation' means a securitisation where the securitisation structure itself revolves (i.e. exposures are added or removed to the pool of exposures) and the underlying exposures may or may not revolve'
- (13) 'early amortisation provision' means a contractual clause in a securitisations of revolving exposures or a revolving securitisation which requires, on the occurrence of defined events, investors' positions to be redeemed before the originally stated maturity of the securities issued;
- (14) 'first loss tranche' means the most subordinated tranche in a securitisation that is the first tranche to bear losses incurred on the securitised exposures and thereby provides protection to the second loss and, where relevant, higher ranking tranches.

## SECTION 2

### RECOGNITION OF SIGNIFICANT RISK TRANSFER

#### *Article 238*

##### *Traditional securitisation*

1. The originator institution of a traditional securitisation may exclude securitised exposures from the calculation of risk-weighted exposure amounts and expected loss amounts if either of the following conditions is fulfilled:
  - (a) significant credit risk associated with the securitised exposures is considered to have been transferred to third parties;
  - (b) the originator institution applies a 1250 % risk weight to all securitisation positions it holds in this securitisation or deducts these securitisation positions from Common Equity Tier 1 items in accordance with Article 33(1)(k).
2. Significant credit risk shall be considered to have been transferred in the following cases:
  - (a) the risk-weighted exposure amounts of the mezzanine securitisation positions held by the originator institution in this securitisation do not exceed 50 % of the risk weighted exposure amounts of all mezzanine securitisation positions existing in this securitisation;
  - (b) where there are no mezzanine securitisation positions in a given securitisation and the originator can demonstrate that the exposure value of the securitisation positions that would be subject to deduction from Common Equity Tier 1 or a 1250 % risk weight exceeds a reasoned estimate of the expected loss on the securitised exposures by a substantial margin, the originator institution does not hold more than 20 % of the exposure values of the securitisation positions that would be subject to deduction from Common Equity Tier 1 or a 1250 % risk weight.

Where the possible reduction in risk weighted exposure amounts, which the originator institution would achieve by this securitisation is not justified by a commensurate transfer of credit risk to third parties, competent authority may decide on a case-by-case basis that significant credit risk shall not be considered to have been transferred to third parties.

3. For the purposes of paragraph 2, mezzanine securitisation positions mean securitisation positions to which a risk weight lower than 1250 % applies and that are more junior than the most senior position in this securitisation and more junior than any securitisation position in this securitisation to which either of the following is assigned in accordance with Section 4:
  - (a) in the case of a securitisation position subject to Section 3, Sub-section 3 a credit quality step 1;
  - (b) in the case of a securitisation position subject to points Section 3, Sub-section 4 a credit quality step 1 or 2.
4. As an alternative to paragraphs 2 and 3, competent authorities shall grant permission to originator institutions to consider significant credit risk as having been transferred where the originator institution is able to demonstrate, in every case of a securitisation, that the reduction of own funds requirements which the originator achieves by the securitisation is justified by a commensurate transfer of credit risk to third parties.

Permission shall be granted only where the institution meets all of the following conditions:

- (a) the institution has appropriately risk-sensitive policies and methodologies in place to assess the transfer of risk;
- (b) the institution has also recognised the transfer of credit risk to third parties in each case for purposes of the institution's internal risk management and its internal capital allocation.

5. In addition to the requirements set out in paragraphs 1 to 4, as applicable, all the following conditions shall be met:
- (a) the securitisation documentation reflects the economic substance of the transaction;
  - (b) the securitised exposures are put beyond the reach of the originator institution and its creditors, including in bankruptcy and receivership. This shall be supported by the opinion of qualified legal counsel;
  - (c) the securities issued do not represent payment obligations of the originator institution;
  - (d) the originator institution does not maintain effective or indirect control over the transferred exposures. An originator shall be considered to have maintained effective control over the transferred exposures if it has the right to repurchase from the transferee the previously transferred exposures in order to realise their benefits or if it is obligated to re-assume transferred risk. The originator institution's retention of servicing rights or obligations in respect of the exposures shall not of itself constitute indirect control of the exposures;
  - (e) the securitisation documentation meets all the following conditions:
    - (i) it does not contain clauses that other than in the case of early amortisation provisions, require positions in the securitisation to be improved by the originator institution including but not limited to altering the underlying credit exposures or increasing the yield payable to investors in response to a deterioration in the credit quality of the securitised exposures;
    - (ii) it does not contain clauses that increase the yield payable to holders of positions in the securitisation in response to a deterioration in the credit quality of the underlying pool;

- (iii) it makes it clear, where applicable, that any purchase or repurchase of securitisation positions by the originator or sponsor beyond its contractual obligations is exceptional and may only be made at arms' lengths conditions;
  - (f) where there is a clean-up call option, that option shall also meet the following conditions:
    - (i) it is exercisable at the discretion of the originator institution;
    - (ii) it may only be exercised when 10 % or less of the original value of the exposures securitised remains unamortised;
    - (iii) it is not structured to avoid allocating losses to credit enhancement positions or other positions held by investors and is not otherwise structured to provide credit enhancement.
6. The competent authorities shall keep EBA informed about the specific cases, referred to in paragraph 2, where the possible reduction in risk-weighted exposure amounts is not justified by a commensurate transfer of credit risk to third parties, and the use institutions make of paragraph 4. EBA shall monitor the range of practices in this area and shall, in accordance with Article 16 of Regulation (EU) No. 1093/2010, issue guidelines.

#### *Article 239*

##### *Synthetic securitisation*

1. An originator institution of a synthetic securitisation may calculate risk-weighted exposure amounts, and, as relevant, expected loss amounts, for the securitised exposures in accordance with Article 244, if either of the following is met:
- (a) significant credit risk is considered to have been transferred to third parties either through funded or unfunded credit protection;

- (b) the originator institution applies a 1250 % risk weight to all securitisation positions it holds in this securitisation or deducts these securitisation positions from Common Equity Tier 1 items in accordance with Article 33(1)(k).
2. Significant credit risk shall be considered to have been transferred if either of the following conditions is met:
- (a) the risk-weighted exposure amounts of the mezzanine securitisation positions which are held by the originator institution in this securitisation do not exceed 50 % of the risk weighted exposure amounts of all mezzanine securitisation positions existing in this securitisation;
  - (b) where there are no mezzanine securitisation positions in a given securitisation and the originator can demonstrate that the exposure value of the securitisation positions that would be subject to deduction from Common Equity Tier 1 or a 1250 % risk weight exceeds a reasoned estimate of the expected loss on the securitised exposures by a substantial margin, the originator institution does not hold more than 20 % of the exposure values of the securitisation positions that would be subject to deduction from Common Equity Tier 1 or a 1250 % risk weight;
  - (c) where the possible reduction in risk weighted exposure amounts, which the originator institution would achieve by this securitisation, is not justified by a commensurate transfer of credit risk to third parties, competent authority may decide on a case- by-case basis that significant credit risk shall not be considered to have been transferred to third parties.
3. For the purposes of paragraph 2, mezzanine securitisation positions means securitisation positions to which a risk weight lower than 1250 % applies and that are more junior than the most senior position in this securitisation and more junior than any securitisation positions in this securitisation to which either of the following is assigned in accordance with Section 4:

- (a) in the case of a securitisation position subject to Section 3, Sub-section 3 a credit quality step 1;
- (b) in the case of a securitisation position subject to Section 3, Sub-section 4 a credit quality step 1 or 2.

4. As an alternative to paragraphs 2 and 3, competent authorities shall grant permission to originator institutions to consider significant credit risk as having been transferred where the originator institution is able to demonstrate, in every case of a securitisation, that the reduction of own funds requirements which the originator achieves by the securitisation is justified by a commensurate transfer of credit risk to third parties.

Permission shall be granted only where the institution meets all of the following conditions:

- (a) the institution has appropriately risk-sensitive policies and methodologies in place to assess the transfer of risk;
- (b) the institution has also recognised the transfer of credit risk to third parties in each case for purposes of the institution's internal risk management and its internal capital allocation.

5. In addition to the requirements set out in paragraphs 1 to 4, as applicable, the transfer shall comply with the following conditions:

- (a) the securitisation documentation reflects the economic substance of the transaction;
- (b) the credit protection by which the credit risk is transferred complies with Article 242(2);

- (c) the instruments used to transfer credit risk do not contain terms or conditions that:
  - (i) impose significant materiality thresholds below which credit protection is deemed not to be triggered if a credit event occurs;
  - (ii) allow for the termination of the protection due to deterioration of the credit quality of the underlying exposures;
  - (iii) other than in the case of early amortisation provisions, require positions in the securitisation to be improved by the originator institution;
  - (iv) increase the institution's cost of credit protection or the yield payable to holders of positions in the securitisation in response to a deterioration in the credit quality of the underlying pool;
- (d) an opinion is obtained from qualified legal counsel confirming the enforceability of the credit protection in all relevant jurisdictions;
- (e) the securitisation documentation shall make clear, where applicable, that any purchase or repurchase of securitisation positions by the originator or sponsor beyond its contractual obligations may only be made at arms' lengths conditions;
- (f) where there is a clean-up call option, that option meets all the following conditions:
  - (i) it is exercisable at the discretion of the originator institution;
  - (ii) it may only be exercised when 10 % or less of the original value of the exposures securitised remains unamortised;
  - (iii) it is not structured to avoid allocating losses to credit enhancement positions or other positions held by investors and is not otherwise structured to provide credit enhancement.



6. The competent authorities shall keep EBA informed about the specific cases, referred to in paragraph 2, where the possible reduction in risk-weighted exposure amounts is not justified by a commensurate transfer of credit risk to third parties, and the use institutions make of paragraph 4. The European Banking Authority shall monitor the range of practices in this area and shall, in accordance with Article 16 of Regulation (EU) No. 1093/2010, issue guidelines.

### **SECTION 3**

#### **CALCULATION OF THE RISK WEIGHTED EXPOSURE AMOUNTS**

##### **SUB-SECTION 1**

##### **PRINCIPLES**

###### *Article 240*

###### *Calculation of risk-weighted exposure amounts*

1. Where an originator institution has transferred significant credit risk associated with securitised exposures in accordance with Section 2, that institution may:
- (a) in the case of a traditional securitisation, exclude from its calculation of risk-weighted exposure amounts, and, as relevant, expected loss amounts, the exposures which it has securitised;
  - (b) in the case of a synthetic securitisation, calculate risk-weighted exposure amounts, and, as relevant, expected loss amounts, in respect of the securitised exposures in accordance with Articles 244 and 245.

2. Where the originator institution has decided to apply paragraph 1, it shall calculate the risk-weighted exposure amounts prescribed in this Chapter for the positions that it may hold in the securitisation.

Where the originator institution has not transferred significant credit risk or has decided not to apply paragraph 1, it need not calculate risk-weighted exposure amounts for any positions it may have in the securitisation in question but shall continue including the securitised exposures in its calculation of risk-weighted exposure amounts as if they had not been securitised.

3. Where there is an exposure to different tranches in a securitisation, the exposure to each tranche shall be considered a separate securitisation position. The providers of credit protection to securitisation positions shall be considered to hold positions in the securitisation. Securitisation positions shall include exposures to a securitisation arising from interest rate or currency derivative contracts.
4. Unless a securitisation position is deducted from Common Equity Tier 1 items pursuant to Article 33(1)(k), the risk-weighted exposure amount shall be included in the institution's total of risk-weighted exposure amounts for the purposes of Article 87(3).
5. The risk-weighted exposure amount of a securitisation position shall be calculated by applying to the exposure value of the position, calculated as set out in Article 241, the relevant total risk weight.
6. The total risk weight shall be determined as the sum of the risk weight set out in this Chapter and any additional risk weight in accordance with Article 396.

*Article 241*  
*Exposure value*

1. The exposure value shall be calculated as follows:
  - (a) where an institution calculates risk-weighted exposure amounts under Sub-section 3, the exposure value of an on-balance sheet securitisation position shall be its accounting value remaining after specific credit risk adjustments and additional value adjustments treated in accordance with Article 31 and Article 105 have been applied;
  - (b) where an institution calculates risk-weighted exposure amounts under Sub-section 4, the exposure value of an on-balance sheet securitisation position shall be the accounting value measured without taking into account any credit risk adjustments or additional value adjustments treated in accordance with Article 31 and Article 105 made;
  - (c) where an institution calculates risk-weighted exposure amounts under Sub-section 3, the exposure value of an off-balance sheet securitisation position shall be its nominal value, less any specific credit risk adjustment of that securitisation position, multiplied by a conversion factor as prescribed in this Chapter. The conversion factor shall be 100 % unless otherwise specified;
  - (d) where an institution calculates risk-weighted exposure amounts under Sub-section 4, the exposure value of an off-balance sheet securitisation position shall be its nominal value multiplied by a conversion factor as prescribed in this Chapter. The conversion factor shall be 100 % unless otherwise specified;
  - (e) The exposure value for the counterparty credit risk of a derivative instrument listed in Annex II, shall be determined in accordance with Chapter 6.

2. Where an institution has two or more overlapping positions in a securitisation, it shall, to the extent that they overlap include in its calculation of risk-weighted exposure amounts only the position or portion of a position producing the higher risk-weighted exposure amounts. The institution may also recognise such overlap between specific risk own funds requirements for positions in the trading book and own funds requirements for securitisation positions in the non-trading book, provided that the institution is able to calculate and compare the own funds requirements for the relevant positions. For the purpose of this paragraph, overlapping occurs when the positions, wholly or partially, represent an exposure to the same risk such that, to the extent of the overlap, there is a single exposure.
3. Where Article 263(c) applies to positions in the ABCP, the institution may, use the risk-weight assigned to a liquidity facility in order to calculate the risk-weighted exposure amount for the ABCP provided that 100 % of the ABCP issued by the programme is covered by this or other liquidity facilities and all of those liquidity facilities rank pari passu with the ABCP so that they form overlapping positions.

The institution shall notify to the competent authorities the use it makes of this treatment.

#### *Article 242*

##### *Recognition of credit risk mitigation for securitisation positions*

1. An institution may recognise funded or unfunded credit protection obtained in respect of a securitisation position in accordance with Chapter 4 and subject to the requirements laid down in this Chapter and in Chapter 4.

Eligible funded credit protection is limited to financial collateral which is eligible for the calculation of risk-weighted exposure amounts under Chapter 2 as laid down under Chapter 4 and recognition is subject to compliance with the relevant requirements as laid down under Chapter 4.

2. Eligible unfunded credit protection and unfunded credit protection providers are limited to those which are eligible under Chapter 4 and recognition is subject to compliance with the relevant requirements laid down under that Chapter 4.
3. By derogation from paragraph 2, the eligible providers of unfunded credit protection listed in Article 197 paragraph 1 (a) to (g) shall have a credit assessment by a recognised ECAI which has been determined to be associated with credit quality step 3 or above under Article 131 and shall have been associated with credit quality step 2 or above at the time the credit protection was first recognised. Institutions that have a permission to apply the IRB approach to a direct exposure to the protection provider may assess eligibility according to the first sentence based on the equivalence of the PD for the protection provider to the PD associated with the credit quality steps referred to in Article 131.
4. By derogation from paragraph 2, SSPEs are eligible protection providers where they own assets that qualify as eligible financial collateral and to which there are no rights or contingent rights preceding or ranking pari passu to the contingent rights of the institution receiving unfunded credit protection and all requirements for the recognition of financial collateral in Chapter 4 are fulfilled. In those cases, GA (the amount of the protection adjusted for any currency mismatch and maturity mismatch in accordance with the provisions of Chapter 4) shall be limited to the volatility adjusted market value of those assets and g (the risk weight of exposures to the protection provider as specified under the Standardised Approach) shall be determined as the weighted-average risk weight that would apply to those assets as financial collateral under the Standardised Approach.

*Article 243*  
*Implicit support*

1. A sponsor institution, or an originator institution which in respect of a securitisation has made use of Article 240(1) and (2) in the calculation of risk-weighted exposure amounts or has sold instruments from its trading book to the effect that it is no longer required to hold own funds for the risks of those instruments shall not, with a view to reducing potential or actual losses to investors, provide support to the securitisation beyond its contractual obligations. A transaction shall not be considered to provide support if it is executed at arm's length conditions and taken into account in the assessment of significant risk transfer. Any such transaction shall be, regardless of whether it provides support, notified to the competent authorities and subject to the institution's credit review and approval process. The institution shall, when assessing whether the transaction is not structured to provide support, adequately consider at least all the following:
  - (a) the price of the repurchase;
  - (b) the institution's ... capital and liquidity position before and after repurchase;
  - (c) the performance of the securitised exposures;
  - (d) the performance of the securitisation positions;
  - (e) the impact of support on the losses expected to be incurred by the originator relative to investors.
2. EBA shall issue, in accordance with Article 16 of Regulation (EU) No 1093/2010, guidelines on what constitutes arm's length conditions and when a transaction is not structured to provide support.
3. If an originator institution or a sponsor institution fails to comply with paragraph 1 in respect of a securitisation this institution shall at a minimum hold own funds against all of the securitised exposures as if they had not been securitised.

**SUB-SECTION 2**  
**ORIGINATOR INSTITUTIONS' CALCULATION OF RISK-WEIGHTED EXPOSURE**  
**AMOUNTS SECURITISED IN A SYNTHETIC SECURITISATION**

*Article 244*

*General treatment*

In calculating risk-weighted exposure amounts for the securitised exposures, where the conditions in Article 239 are met, the originator institution of a synthetic securitisation shall, subject to Article 245, use the relevant calculation methodologies set out in this Section and not those set out in Chapter 2. For institutions calculating risk-weighted exposure amounts and expected loss amounts under Chapter 3, the expected loss amount in respect of such exposures shall be zero.

The requirements set out in the first subparagraph apply to the entire pool of exposures included in the securitisation. Subject to Article 245, the originator institution shall calculate risk-weighted exposure amounts in respect of all tranches in the securitisation in accordance with the provisions of this Section including those for which the institution recognises credit risk mitigation in accordance with Article 242, in which case the risk-weight to be applied to that position may be modified in accordance with Chapter 4, subject to the requirements laid down in this Chapter.

*Article 245*

*Treatment of maturity mismatches in synthetic securitisations*

For the purposes of calculating risk-weighted exposure amounts in accordance with Article 244, any maturity mismatch between the credit protection by which the transfer of risk is achieved and the securitised exposures shall be taken into consideration as follows:

- (a) the maturity of the securitised exposures shall be taken to be the longest maturity of any of those exposures. The maturity of the credit protection shall be determined in accordance with Chapter 4;

- (b) an originator institution shall ignore any maturity mismatch in calculating risk-weighted exposure amounts for tranches appearing pursuant to this Section with a risk weighting of 1250 %. For all other tranches, the maturity mismatch treatment set out in Chapter 4 shall be applied in accordance with the following formula:

$$RW^* = RW_{SP} \cdot \frac{t - t^*}{T - t^*} + RW_{Ass} \cdot \frac{T - t}{T - t^*}$$

where:

$RW^*$  = risk-weighted exposure amounts for the purposes of Article 87(3)(a);

$RW_{Ass}$  = risk-weighted exposure amounts for exposures if they had not been securitised, calculated on a pro-rata basis;

$RW_{SP}$  = risk-weighted exposure amounts calculated under Article 244 if there was no maturity mismatch;

$T$  = maturity of the underlying exposures expressed in years;

$t$  = maturity of credit protection. expressed in years;

$t^*$  = 0.25.



### SUB-SECTION 3

## CALCULATION OF RISK-WEIGHTED EXPOSURE AMOUNTS UNDER THE STANDARDISED APPROACH

### *Article 246*

### *Risk-weights*

Subject to Article 247, the institution shall calculate the risk-weighted exposure amount of a rated securitisation or re-securitisation position by applying the relevant risk weight to the exposure value.

The relevant risk weight shall be the risk weight as laid down in Table 1, with which the credit assessment of the position is associated in accordance with Section 4.

Table 1					
Credit Quality Step	1	2	3	4 (only for credit assessments other than short-term credit assessments )	all other credit quality steps
Securitisation positions	20%	50%	100%	350%	1250%
Re-securitisation positions	40%	100%	225%	650%	1250%

Subject to Articles 247 to 250, the risk-weighted exposure amount of an unrated securitisation position shall be calculated by applying a risk weight of 1250 %.

#### *Article 247*

##### *Originator and sponsor institutions*

For an originator institution or sponsor institution, the risk-weighted exposure amounts calculated in respect of its securitisation positions in any one securitisation may be limited to the risk-weighted exposure amounts which would currently be calculated for the securitised exposures had they not been securitised subject to the presumed application of a 150 % risk weight to the following:

- (a) all items currently in default;
- (b) all items associated with particularly high risk in accordance with Article 123 amongst the securitised exposures.

#### *Article 248*

##### *Treatment of unrated positions*

1. For the purpose of calculating the risk-weighted exposure amount of an unrated securitisation position an institution may apply the weighted-average risk weight that would be applied to the securitised exposures under Chapter 2 by an institution holding the exposures, multiplied by the concentration ratio referred to in paragraph 2. For this purpose, the institution shall know the composition of the pool of securitised exposures securitised at all times.

2. The concentration ratio shall be equal to the sum of the nominal amounts of all the tranches divided by the sum of the nominal amounts of the tranches junior to or pari passu with the tranche in which the position is held including that tranche itself. The resulting risk weight shall not be higher than 1250 % or lower than any risk weight applicable to a rated more senior tranche. Where the institution is unable to determine the risk weights that would be applied to the securitised exposures under Chapter 2, it shall apply a risk weight of 1250 % to the position.

#### *Article 249*

##### *Treatment of securitisation positions in a second loss tranche or better in an ABCP programme*

Subject to the availability of a more favourable treatment for unrated liquidity facilities under Article 250 an institution may apply to securitisation positions meeting the following conditions a risk weight that is the greater of 100 % or the highest of the risk weights that would be applied to any of the securitised exposures under Chapter 2 by an institution holding the exposures:

- (a) the securitisation position shall be in a tranche which is economically in a second loss position or better in the securitisation and the first loss tranche shall provide meaningful credit enhancement to the second loss tranche;
- (b) the quality of the securitisation position shall be equivalent to credit quality step 3 under the Standardised approach or better;
- (c) the securitisation position shall be held by an institution which does not hold a position in the first loss tranche.

## *Article 250*

### *Treatment of unrated liquidity facilities*

1. Institutions may apply a conversion factor of 50 % to the nominal amount of an unrated liquidity facility in order to determine its exposure value when the following conditions are met:
  - (a) the liquidity facility documentation shall clearly identify and limit the circumstances under which the facility may be drawn;
  - (b) it shall not be possible for the facility to be drawn so as to provide credit support by covering losses already incurred at the time of draw and in particular not so as to provide liquidity in respect of exposures in default at the time of draw or so as to acquire assets at more than fair value;
  - (c) the facility shall not be used to provide permanent or regular funding for the securitisation;
  - (d) repayment of draws on the facility shall not be subordinated to the claims of investors other than to claims arising in respect of interest rate or currency derivative contracts, fees or other such payments, nor be subject to waiver or deferral;
  - (e) it shall not be possible for the facility to be drawn after all applicable credit enhancements from which the liquidity facility would benefit are exhausted;
  - (f) the facility shall include a provision that results in an automatic reduction in the amount that can be drawn by the amount of exposures that are in default, where 'default' has the meaning given to it under Chapter 3, or where the pool of securitised exposures consists of rated instruments, that terminates the facility if the average quality of the pool falls below investment grade.

The risk weight to be applied shall be the highest risk weight that would be applied to any of the securitised exposures under Chapter 2 by an institution holding the exposures.

2. To determine the exposure value of cash advance facilities, a conversion factor of 0 % may be applied to the nominal amount of a liquidity facility that is unconditionally cancellable provided that the conditions set out in paragraph 1 are satisfied and that repayment of draws on the facility are senior to any other claims on the cash flows arising from the securitised exposures.

#### *Article 251*

#### *Additional own funds requirements for securitisations of revolving exposures with early amortisation provisions*

1. Where there is a securitisation of revolving exposures subject to an early amortisation provision, the originator institution shall calculate an additional risk-weighted exposure amount in respect of the risk that the levels of credit risk to which it is exposed may increase following the operation of the early amortisation provision, according to this Article.
2. The institution shall calculate a risk-weighted exposure amount in respect of the sum of the exposure values of the originator's interest and the investors' interest.

For securitisation structures where the securitised exposures comprise revolving and non-revolving exposures, an originator institution shall apply the treatment set out in paragraphs 3 to 6 to that portion of the underlying pool containing revolving exposures.

The exposure value of the originator's interest shall be the exposure value of that notional part of a pool of drawn amounts sold into a securitisation, the proportion of which in relation to the amount of the total pool sold into the structure determines the proportion of the cash flows generated by principal and interest collections and other associated amounts which are not available to make payments to those having securitisation positions in the securitisation. The originator's interest shall not be subordinate to the investors' interest. The exposure value of the investors' interest shall be the exposure value of the remaining notional part of the pool of drawn amounts.

The risk-weighted exposure amount in respect of the exposure value of the originator's interest shall be calculated as that for a pro rata exposure to the securitised exposures as if they had not been securitised.

3. Originators of the following types of securitisation are exempt from the calculation of an additional risk-weighted exposure amount in paragraph 1:
  - (a) securitisations of revolving exposures whereby investors remain fully exposed to all future draws by borrowers so that the risk on the underlying facilities does not return to the originator institution even after an early amortisation event has occurred;
  - (b) securitisations where any early amortisation provision is solely triggered by events not related to the performance of the securitised assets or the originator institution, such as material changes in tax laws or regulations.
4. For an originator institution subject to the calculation of an additional risk-weighted exposure amount according to paragraph 1 the total of the risk-weighted exposure amounts in respect of its positions in the investors' interest and the risk-weighted exposure amounts calculated under paragraph 1 shall be no greater than the greater of:
  - (a) the risk-weighted exposure amounts calculated in respect of its positions in the investors' interest;
  - (b) the risk-weighted exposure amounts that would be calculated in respect of the securitised exposures by an institution holding the exposures as if they had not been securitised in an amount equal to the investors' interest.

Deduction of net gains, if any, arising from the capitalisation of future income required under Article 29(1), shall be treated outside the maximum amount indicated in the preceding sub-paragraph.

5. The risk-weighted exposure amount to be calculated in accordance with paragraph 1 shall be determined by multiplying the exposure value of the investors' interest by the product of the appropriate conversion factor as indicated in paragraphs 6 to 9 and the weighted average risk weight that would apply to the securitised exposures if the exposures had not been securitised.

An early amortisation provision shall be considered to be controlled where all of the following conditions are met:

- (a) the originator institution has an appropriate own funds/liquidity plan in place to ensure that it has sufficient own funds and liquidity available in the event of an early amortisation;
  - (b) throughout the duration of the transaction there is pro-rata sharing between the originator's interest and the investor's interest of payments of interest and principal, expenses, losses and recoveries based on the balance of receivables outstanding at one or more reference points during each month;
  - (c) the amortisation period is considered sufficient for 90 % of the total debt (originator's and investors' interest) outstanding at the beginning of the early amortisation period to have been repaid or recognised as in default;
  - (d) the speed of repayment is no more rapid than would be achieved by straight-line amortisation over the period set out in point (c).
6. In the case of securitisations subject to an early amortisation provision of retail exposures which are uncommitted and unconditionally cancellable without prior notice, where the early amortisation is triggered by the excess spread level falling to a specified level, institutions shall compare the three-month average excess spread level with the excess spread levels at which excess spread is required to be trapped.

Where the securitisation does not require excess spread to be trapped, the trapping point is deemed to be 4.5 percentage points greater than the excess spread level at which an early amortisation is triggered.

The conversion factor to be applied shall be determined by the level of the actual three month average excess spread in accordance with Table 2.

Table 2		
	Securitisations subject to a controlled early amortisation provision	Securitisations subject to a non-controlled early amortisation provision
3 months average excess spread	Conversion factor	Conversion factor
Above level A	0 %	0 %
Level A	1 %	5 %
Level B	2 %	15 %
Level C	10 %	50 %
Level D	20 %	100 %
Level E	40 %	100 %

Where:

- (a) ‘Level A’ refers to levels of excess spread less than 133.33 % of the trapping level of excess spread but not less than 100 % of that trapping level;
- (b) ‘Level B’ refers to levels of excess spread less than 100 % of the trapping level of excess spread but not less than 75 % of that trapping level;



- (c) 'Level C' refers to levels of excess spread less than 75 % of the trapping level of excess spread but not less than 50 % of that trapping level;
- (d) 'Level D' refers to levels of excess spread less than 50 % of the trapping level of excess spread but not less than 25 % of that trapping level;
- (e) 'Level E' refers to levels of excess spread less than 25 % of the trapping level of excess spread.

7. In the case of securitisations subject to an early amortization provision of retail exposures which are uncommitted and unconditionally cancellable without prior notice and where the early amortization is triggered by a quantitative value in respect of something other than the three months average excess spread, subject to permission by the competent authorities, institutions may apply a treatment which approximates closely to that prescribed in paragraph 6 for determining the conversion factor indicated. The competent authority shall grant permission, if the following conditions are met:
- (a) this treatment is more appropriate because the firm can establish a quantitative measure equivalent, in relation to the quantitative value triggering early amortisation, to the trapping level of excess spread;
  - (b) this treatment leads to a measure of the risk that the credit risk to which the institution is exposed may increase following the operation of the early amortisation provision that is as prudent as that calculated in accordance with paragraph 6.
8. All other securitisations subject to a controlled early amortisation provision of revolving exposures shall be subject to a conversion factor of 90 %.
9. All other securitisations subject to a non-controlled early amortisation provision of revolving exposures shall be subject to a conversion factor of 100 %.

## *Article 252*

### *Credit risk mitigation for securitisation positions subject to the Standardised Approach*

Where credit protection is obtained on a securitisation position, the calculation of risk-weighted exposure amounts may be modified in accordance with Chapter 4.

## *Article 253*

### *Reduction in risk-weighted exposure amounts*

Where a securitisation position is assigned a 1250 % risk weight, institutions may in accordance with Article 33(1)(k), as an alternative to including the position in their calculation of risk-weighted exposure amounts, deduct from Common Equity Tier 1 capital the exposure value of the position. For these purposes, the calculation of the exposure value may reflect eligible funded credit protection in a manner consistent with Article 252.

Where an originator institution makes use of this alternative, it may subtract 12.5 times the amount deducted in accordance with Article 33(1)(k) from the amount specified in Article 247 as the risk-weighted exposure amount which would currently be calculated for the securitised exposures had they not been securitised.

**SUB-SECTION 4**  
**CALCULATION OF RISK-WEIGHTED EXPOSURE AMOUNTS UNDER THE IRB**  
**APPROACH**

*Article 254*  
*Hierarchy of methods*

1. Institutions shall use the methods in accordance with the following hierarchy:
  - (a) for a rated position or a position in respect of which an inferred rating may be used, the Ratings Based Method set out in Article 256 shall be used to calculate the risk-weighted exposure amount;
  - (b) for an unrated position the institution may use the Supervisory Formula Method set out in Article 257 where it can produce estimates of PD, and where applicable exposure value and LGD as inputs into the Supervisory Formula Method in accordance with the requirements for the estimation of those parameters under the Internal Ratings Based approach in accordance with Section 3. An institution other than the originator institution may only use the Supervisory Formula Method subject to the approval of the competent authorities, which shall only be granted if the institution fulfils the condition provided in the previous sentence;
  - (c) as an alternative to point (b) and only for unrated positions in ABCP programmes, the institution may use the Internal Assessment Approach as set out in paragraph 4 if the competent authorities have permitted it to do so;
  - (d) in all other cases, a risk weight of 1250 % shall be assigned to securitisation positions which are unrated.

(e) notwithstanding point (d), an institution may calculate the risk weight for an unrated position in an ABCP programme according to articles 248 or 249, if the unrated position is not a commercial paper and falls within the scope of application of an Internal Assessment Approach for which approval is being sought. An institution may invoke this exception only with the permission of the competent authority. The permission should only be given, if the aggregated exposure treated by this exception is not material.

2. For the purposes of using inferred ratings, an institution shall attribute to an unrated position an inferred credit assessment equivalent to the credit assessment of a rated reference position which is the most senior position which is in all respects subordinate to the unrated securitisation position in question and meets all of the following conditions:
  - (a) the reference positions must be subordinate in all respects to the unrated securitisation position;
  - (b) the maturity of the reference positions shall be equal to or longer than that of the unrated position in question;
  - (c) on an ongoing basis, any inferred rating shall be updated to reflect any changes in the credit assessment of the reference positions.
3. The competent authorities shall grant institutions permission to use the ‘Internal Assessment Approach’ as set out in paragraph 4 where all of the following conditions are met:
  - (a) positions in the commercial paper issued from the ABCP programme shall be rated positions;
  - (b) the internal assessment of the credit quality of the position shall reflect the publicly available assessment methodology of one or more [...]ECAIs, for the rating of securities backed by the exposures of the type securitised;

- (c) the ECAIs, the methodology of which shall be reflected as required by point (b), shall include those ECAIs which have provided an external rating for the commercial paper issued from the ABCP programme. Quantitative elements, such as stress factors, used in assessing the position to a particular credit quality shall be at least as conservative as those used in the relevant assessment methodology of the ECAIs in question;
- (d) in developing its internal assessment methodology the institution shall take into consideration relevant published ratings methodologies of the [...] ECAIs that rate the commercial paper of the ABCP programme. This consideration shall be documented by the institution and updated regularly, as outlined in point (g);
- (e) the institution's internal assessment methodology shall include rating grades. There shall be a correspondence between such rating grades and the credit assessments of [...] ECAIs. This correspondence shall be explicitly documented;
- (f) the internal assessment methodology shall be used in the institution's internal risk management processes, including its decision making, management information and internal capital allocation processes;
- (g) internal or external auditors, an ECAI, or the institution's internal credit review or risk management function shall perform regular reviews of the internal assessment process and the quality of the internal assessments of the credit quality of the institution's exposures to an ABCP programme. If the institution's internal audit, credit review, or risk management functions perform the review, then these functions shall be independent of the ABCP programme business line, as well as the customer relationship;
- (h) the institution shall track the performance of its internal ratings over time to evaluate the performance of its internal assessment methodology and shall make adjustments, as necessary, to that methodology when the performance of the exposures routinely diverges from that indicated by the internal ratings;

- (i) the ABCP programme shall incorporate underwriting standards in the form of credit and investment guidelines. In deciding on an asset purchase, the ABCP programme administrator shall consider the type of asset being purchased, the type and monetary value of the exposures arising from the provision of liquidity facilities and credit enhancements, the loss distribution, and the legal and economic isolation of the transferred assets from the entity selling the assets. A credit analysis of the asset seller's risk profile shall be performed and shall include analysis of past and expected future financial performance, current market position, expected future competitiveness, leverage, cash flow, interest coverage and debt rating. In addition, a review of the seller's underwriting standards, servicing capabilities, and collection processes shall be performed;
- (j) the ABCP programme's underwriting standards shall establish minimum asset eligibility criteria that, in particular:
  - (i) exclude the purchase of assets that are significantly past due or defaulted;
  - (ii) limit excess concentration to individual obligor or geographic area;
  - (iii) limits the tenor of the assets to be purchased;
- (k) the ABCP programme shall have collections policies and processes that take into account the operational capability and credit quality of the servicer. The ABCP programme shall mitigate risk relating to the performance of the seller and the servicer through various methods, such as triggers based on current credit quality that would preclude commingling of funds;

- (l) the aggregated estimate of loss on an asset pool that the ABCP programme is considering purchasing shall take into account all sources of potential risk, such as credit and dilution risk. If the seller-provided credit enhancement is sized based only on credit-related losses, then a separate reserve shall be established for dilution risk, if dilution risk is material for the particular exposure pool. In addition, in sizing the required enhancement level, the program shall review several years of historical information, including losses, delinquencies, dilutions, and the turnover rate of the receivables;
  - (m) the ABCP programme shall incorporate structural features, such as wind-down triggers, into the purchase of exposures in order to mitigate potential credit deterioration of the underlying portfolio.
- 4. Under the Internal Assessment Approach, the unrated position shall be assigned by the institution to one of the rating grades laid down in point (e) paragraph 3. The position shall be attributed a derived rating the same as the credit assessments corresponding to that rating grade as laid down in point (e) of paragraph 3. Where this derived rating is, at the inception of the securitisation, at the level of investment grade or better, it shall be considered the same as an eligible credit assessment by an [...]ECAI for the purposes of calculating risk-weighted exposure amounts.
- 5. Institutions which have obtained permission to use the Internal Assessment Approach shall not revert to the use of other methods unless all of the following conditions are met:
  - (a) the institution has demonstrated to the satisfaction of the competent authority that the institution has good cause to do so;
  - (b) the institution has received the prior permission of the competent authority.

## *Article 255*

### *Maximum risk-weighted exposure amounts*

An originator institution, a sponsor institution, or other institutions which can calculate  $K_{IRB}$ , may limit the risk-weighted exposure amounts calculated in respect of its positions in a securitisation to that which would produce a own funds requirement under Article 87(3) equal to the sum of 8 % of the risk-weighted exposure amounts which would be produced if the securitised assets had not been securitised and were on the balance sheet of the institution plus the expected loss amounts of those exposures.

## *Article 256*

### *Ratings Based Method*

1. Under the Ratings Based Method, the institution shall calculate the risk-weighted exposure amount of a rated securitisation or re-securitisation position by applying the relevant risk weight to the exposure value and multiplying the result by 1.06.

The relevant risk weight shall be the risk weight as laid down in Table 4, with which the credit assessment of the position is associated in accordance with Section 4.



Table 4

Credit Quality Step		Securitisation Positions			Re-securitisation Positions	
Credit assessments other than short term	Short term credit assessments	A	B	C	D	E
1	1	7%	12%	20%	20%	30%
2		8%	15%	25%	25%	40%
3		10%	18%	35%	35%	50%
4	2	12%	20%		40%	65%
5		20%	35%		60%	100%
6		35%	50%		100%	150%
7	3	60%	75%		150%	225%
8		100%			200%	350%
9		250%			300%	500%
10		425%			500%	650%
11		650%			750%	850%
all other and unrated		1250%				

The weightings in column C of Table 4 shall be applied where the securitisation position is not a re-securitisation position and where the effective number of exposures securitised is less than six.

For the remainder of the securitisation positions that are not re-securitisation positions, the weightings in column B shall be applied unless the position is in the most senior tranche of a securitisation, in which case the weightings in column A shall be applied.

For re-securitisation positions the weightings in column E shall be applied unless the re-securitisation position is in the most senior tranche of the re-securitisation and none of the underlying exposures are themselves re-securitisation exposures, in which case column D shall be applied.

When determining whether a tranche is the most senior, it is not required to take into consideration amounts due under interest rate or currency derivative contracts, fees due, or other similar payments.

In calculating the effective number of exposures securitised multiple exposures to one obligor shall be treated as one exposure. The effective number of exposures is calculated as:

$$N = \frac{\left( \sum_i EAD_i \right)^2}{\sum_i EAD_i^2}$$

where EAD<sub>i</sub> represents the sum of the exposure values of all exposures to the *i*th obligor. If the portfolio share associated with the largest exposure, C<sub>1</sub>, is available, the institution may compute N as 1/C<sub>1</sub>.

2. Credit risk mitigation on securitisation positions may be recognised in accordance with Articles 259(1) and (4), subject to the conditions in Article 242.

*Supervisory Formula Method*

1. Under the Supervisory Formula Method, the risk weight for a securitisation position shall be calculated as follows subject to a floor of 20 % for re-securitisation positions and 7 % for all other securitisation positions:

$$12.5 \cdot \frac{S[L+T] - S[L]}{T}$$

where:

$$S[x] = \begin{cases} x, & \text{when } x \leq K_{IRBR} \\ K_{IRBR} + K[x] - K[K_{IRBR}] + \left( 1 - \exp\left( \frac{\omega \cdot (K_{IRBR} - x)}{K_{IRBR}} \right) \right) \cdot \frac{d \cdot K_{IRBR}}{\omega}, & \text{when } x > K_{IRBR} \end{cases}$$

where:

$$h = \left( 1 - \frac{K_{IRBR}}{ELGD} \right)^N;$$

$$c = \frac{K_{IRBR}}{1-h};$$

$$v = \frac{(ELGD - K_{IRBR}) \cdot K_{IRBR} + 0.25 \cdot (1 - ELGD) \cdot K_{IRBR}}{N};$$

$$f = \left( \frac{v + K_{IRBR}^2}{1-h} - c^2 \right) + \frac{(1 - K_{IRBR}) \cdot K_{IRBR} - v}{(1-h) \cdot \tau};$$

$$g = \frac{(1-c) \cdot c}{f} - 1;$$

$$a = g \cdot c;$$

$$b = g \cdot (1 - c);$$

$$d = 1 - (1 - h) \cdot (1 - \text{Beta}[K_{IRBR}; a, b]);$$

$$K[x] = (1 - h) \cdot ((1 - \text{Beta}[x; a, b]) \cdot x + \text{Beta}[x; a + 1, b] \cdot c);$$

$$\tau = 1000;$$

$$\omega = 20;$$

Beta [x; a, b] = the cumulative beta distribution with parameters a and b evaluated at x;

T = the thickness of the tranche in which the position is held, measured as the ratio of (a) the nominal amount of the tranche to (b) the sum of the nominal amounts of the exposures that have been securitised. For derivative instruments listed in Annex II, the sum of the current replacement cost and the potential future credit exposure calculated in accordance with Chapter 6 shall be used in place of the nominal amount;

$K_{IRBR}$  = the ratio of (a)  $K_{IRB}$  to (b) the sum of the exposure values of the exposures that have been securitised, and is expressed in decimal form;

L = the credit enhancement level, measured as the ratio of the nominal amount of all tranches subordinate to the tranche in which the position is held to the sum of the nominal amounts of the exposures that have been securitised. Capitalised future income shall not be included in the measured L. Amounts due by counterparties to derivative instruments listed in Annex II that represent tranches more junior than the tranche in question may be measured at their current replacement cost, without the potential future credit exposures, in calculating the enhancement level;

N = the effective number of exposures calculated in accordance with Article 256. In the case of re-securitisations, the institution shall look at the number of securitisation exposures in the pool and not the number of underlying exposures in the original pools from which the underlying securitisation exposures stem;

ELGD = the exposure-weighted average loss-given-default, calculated as follows:

$$ELGD = \frac{\sum_i LGD_i \cdot EAD_i}{\sum_i EAD_i}$$

where:

$LGD_i$  = the average LGD associated with all exposures to the  $i^{th}$  obligor, where LGD is determined in accordance with Chapter 3. In the case of resecuritisation, an LGD of 100 % shall be applied to the securitised positions. When default and dilution risk for purchased receivables are treated in an aggregate manner within a securitisation, the  $LGD_i$  input shall be constructed as a weighted average of the LGD for credit risk and the 75 % LGD for dilution risk. The weights shall be the stand-alone own funds charges for credit risk and dilution risk respectively.

2. Where the nominal amount of the largest securitised exposure,  $C_1$ , is no more than 3 % of the sum of the nominal amount of the securitised exposures, then, for the purposes of the Supervisory Formula Method, the institution may set  $LGD = 50\%$  in the case of securitisations, which are no re-securitisations, and N equal to either of the following:

$$N = \left( C_1 \cdot C_m + \left( \frac{C_m - C_1}{m - 1} \right) \cdot \max\{1 - m \cdot C_1, 0\} \right)^{-1}$$

$$N = \frac{1}{C_1}$$

where:

$C_m$  = the ratio of the sum of the nominal amounts of the largest 'm' exposures to the sum of the nominal amounts of the exposures securitised. The level of 'm' may be set by the institution.

For securitisations in which materially all securitised exposures are retail exposures, institutions may, subject to permission by the competent authority, use the Supervisory Formula Method using the simplifications  $h=0$  and  $v=0$ , provided that the effective number of exposures is not low and that the exposures are not highly concentrated.

3. The competent authorities shall keep the EBA informed about the use institutions make of the previous paragraph. EBA shall monitor the range of practices in this area and shall, in accordance with Article 16 of Regulation (EU) No. 1093/2010, issue guidelines.
4. Credit risk mitigation on securitisation positions may be recognised in accordance with paragraphs 2 to 4 of Article 259, subject to the conditions in Article 242.

#### *Article 258*

##### *Liquidity Facilities*

1. For the purposes of determining the exposure value of an unrated securitisation position in the form of cash advance facilities, a conversion factor of 0 % may be applied to the nominal amount of a liquidity facility that meets the conditions set out in Article 250(2).

2. When it is not practical for the institution to calculate the risk-weighted exposure amounts for the securitised exposures as if they had not been securitised, an institution may, on an exceptional basis and subject to the permission of the competent authorities, temporarily apply the method set out in paragraph 3 for the calculation of risk-weighted exposure amounts for an unrated securitisation position in the form of a liquidity facility that meets the conditions in Article 250(1). Institutions shall notify the use they make of the first sentence to the competent authorities, together with its reasons and the intended time period of use.

The calculation of risk-weighted exposure amounts should in general be deemed to be not practical if an inferred rating, the Internal Assessment Approach and the supervisory Formula Approach are not at the institution's disposal.

3. The highest risk weight that would be applied under Chapter 2 to any of the securitised exposures, had they not been securitised, may be applied to the securitisation position represented by a liquidity facility that meets the conditions in Article 250(1). To determine the exposure value of the position a conversion factor of 100 % shall be applied.

#### *Article 259*

##### *Credit risk mitigation for securitisation positions subject to the IRB approach*

1. Where risk-weighted exposure amounts are calculated using the Ratings Based Method, the exposure value or the risk-weight for a securitisation position in respect of which credit protection has been obtained may be modified in accordance with the provisions of Chapter 4 as they apply for the calculation of risk-weighted exposure amounts under Chapter 2.

2. In case of full credit protection, where risk-weighted exposure amounts are calculated using the Supervisory Formula Method, the following requirements shall apply:
- (a) the institution shall determine the ‘effective risk weight’ of the position. It shall do this by dividing the risk-weighted exposure amount of the position by the exposure value of the position and multiplying the result by 100;
  - (b) in the case of funded credit protection, the risk-weighted exposure amount of the securitisation position shall be calculated by multiplying the funded protection-adjusted exposure amount of the position ( $E^*$ ), as calculated under Chapter 4 for the calculation of risk-weighted exposure amounts under Chapter 2 taking the amount of the securitisation position to be  $E$ , by the effective risk weight;
  - (c) in the case of unfunded credit protection, the risk-weighted exposure amount of the securitisation position shall be calculated by multiplying the amount of the protection adjusted for any currency mismatch and maturity mismatch ( $G_A$ ) in accordance with the provisions of Chapter 4 by the risk weight of the protection provider; and adding this to the amount arrived at by multiplying the amount of the securitisation position minus  $G_A$  by the effective risk weight.
3. In case of partial protection, where risk-weighted exposure amounts are calculated using the Supervisory Formula Method, the following requirements shall apply:
- (a) if the credit risk mitigation covers the first loss or losses on a proportional basis on the securitisation position, the institution may apply paragraph 2;



(b) in other cases, the institution shall treat the securitisation position as two or more positions with the uncovered portion being considered the position with the lower credit quality. For the purposes of calculating the risk-weighted exposure amount for this position, the provisions in Article 257 shall apply subject to the modifications that  $T$  shall be adjusted to  $e^*$  in the case of funded credit protection; and to  $T-g$  in the case of unfunded credit protection, where  $e^*$  denotes the ratio of  $E^*$  to the total notional amount of the underlying pool, where  $E^*$  is the adjusted exposure amount of the securitisation position calculated in accordance with the provisions of Chapter 4 as they apply for the calculation of risk-weighted exposure amounts under Chapter 2 taking the amount of the securitisation position to be  $E$ ; and  $g$  is the ratio of the nominal amount of credit protection, adjusted for any currency or maturity mismatch in accordance with the provisions of Chapter 4, to the sum of the exposure amounts of the securitised exposures. In the case of unfunded credit protection the risk weight of the protection provider shall be applied to that portion of the position not falling within the adjusted value of  $T$ .

4. Where, in case of unfunded credit protection, competent authorities have granted the institution permission to calculate risk-weighted exposure amounts for comparable direct exposures to the protection provider in accordance with Chapter 3, the risk weight  $g$  of exposures to the protection provider according to Article 230 shall be determined as specified in Chapter 3.

#### *Article 260*

#### *Additional own funds requirements for securitisations of revolving exposures with early amortisation provisions*

1. In addition to the risk-weighted exposure amounts calculated in respect of its securitisation positions, an originator institution shall calculate a risk-weighted exposure amount according to the methodology set out in Article 251 when it sells revolving exposures into a securitisation that contains an early amortisation provision.

2. By derogation from Article 251, the exposure value of the originators interest shall be the sum of the following items:
- (a) the exposure value of that notional part of a pool of drawn amounts sold into a securitisation, the proportion of which in relation to the amount of the total pool sold into the structure determines the proportion of the cash flows generated by principal and interest collections and other associated amounts which are not available to make payments to those having securitisation positions in the securitisation;
  - (b) the exposure value of that part of the pool of undrawn amounts of the credit lines, the drawn amounts of which have been sold into the securitisation, the proportion of which to the total amount of such undrawn amounts is the same as the proportion of the exposure value described in point (a) to the exposure value of the pool of drawn amounts sold into the securitisation.

The originator's interest shall not be subordinate to the investors' interest.

The exposure value of the Investors' interest shall be the exposure value of the notional part of the pool of drawn amounts not falling within point (a) plus the exposure value of that part of the pool of undrawn amounts of credit lines, the drawn amounts of which have been sold into the securitisation, not falling within point (b).

3. The risk-weighted exposure amount in respect of the exposure value of the originator's interest according to point (a) of paragraph 2 shall be calculated as that for a pro-rata exposure to the securitised drawn amounts exposures as if they had not been securitised and a pro rata exposure to the undrawn amounts of the credit lines, the drawn amounts of which have been sold into the securitisation.

## *Article 261*

### *Reduction in risk-weighted exposure amounts*

1. The risk-weighted exposure amount of a securitisation position to which a 1250 % risk weight is assigned may be reduced by 12.5 times the amount of any specific credit risk adjustments and additional value adjustments treated in accordance with Article 31 and Article 105 made by the institution in respect of the securitised exposures. To the extent that specific credit adjustments are taken account of for this purpose they shall not be taken account of for the purposes of the calculation laid down in Article 155.
2. The risk-weighted exposure amount of a securitisation position may be reduced by 12.5 times the amount of any specific credit risk adjustments made by the institution in respect of the position.
3. As provided in Article 33(1)(k) in respect of a securitisation position in respect of which a 1250 % risk weight applies, institutions may, as an alternative to including the position in their calculation of risk-weighted exposure amounts, deduct from own funds the exposure value of the position subject to the following:
  - (a) the exposure value of the position may be derived from the risk-weighted exposure amounts taking into account any reductions made in accordance with paragraphs 1 and 2;
  - (b) the calculation of the exposure value may reflect eligible funded protection in a manner consistent with the methodology prescribed in Articles 242 and 259;
  - (c) where the Supervisory Formula Method is used to calculate risk-weighted exposure amounts and  $L < K_{IRBR}$  and  $[L+T] > K_{IRBR}$  the position may be treated as two positions with  $L$  equal to  $K_{IRBR}$  for the more senior of the positions.
4. Where an institution makes use of the option in paragraph 3 it may subtract 12.5 times the amount deducted in accordance with that paragraph from the amount specified in Article 255 as the amount to which the risk-weighted exposure amount in respect of its positions in a securitisation may be limited.

## SECTION 4

### EXTERNAL CREDIT ASSESSMENTS

#### *Article 262*

#### *Use of Credit Assessments by ECAIs*

1. Institutions may use credit assessments to determine the risk weight of a securitisation position only where the credit assessment has been issued or has been endorsed by an ECAI in accordance with Regulation (EC) No 1060/2009.
- 2.
- 3.

#### *Article 263*

#### *Requirements to be met by the credit assessments of ECAIs*

For the purposes of calculating risk-weighted exposure amounts according to Section 3, institutions shall only use a credit assessment of an [...] ECAI if the following conditions are met:

- (a) there shall be no mismatch between the types of payments reflected in the credit assessment and the types of payment to which the institution is entitled under the contract giving rise to the securitisation position in question;
- (b) Loss and cash-flow analysis as well as sensitivity of ratings to changes in the underlying ratings assumptions, including the performance of pool assets, shall be published by the ECAI, as well as the credit assessments, procedures, methodologies, assumptions, and the key elements underpinning the assessments in accordance with Regulation (EC) No. 1060/2009. Information that is made available only to a limited number of entities shall not be considered to have been published. The credit assessments shall be included in the ECAI's transition matrix;

- (c) the credit assessment shall not be based or partly based on unfunded support provided by the institution itself. In such case, the institution shall consider the relevant position for the purposes of calculating risk-weighted exposure amounts for this position according to Section 3 as if it were not rated.

The ECAI shall be committed to publish explanations how the performance of pool assets affects this credit assessment.

#### *Article 264*

##### *Use of credit assessments*

1. An institution may nominate one or more [...] ECAIs the credit assessments of which shall be used in the calculation of its risk-weighted exposure amounts under this Chapter (a ‘nominated ECAI’).
2. An institution shall use credit assessments consistently and not selectively in respect of its securitisation positions, in accordance with the following principles:
  - (a) an institution may not use an ECAI's credit assessments for its positions in some tranches and another ECAI's credit assessments for its positions in other tranches within the same securitisation that may or may not be rated by the first ECAI;
  - (b) where a position has two credit assessments by nominated ECAIs, the institution shall use the less favourable credit assessment;
  - (c) where a position has more than two credit assessments by nominated ECAIs, the two most favourable credit assessments shall be used. If the two most favourable assessments are different, the less favourable of the two shall be used.
  - (d) an institution shall not actively solicit the withdrawal of less favourable ratings.
  - (e) \_\_\_\_\_

3. Where credit protection eligible under Chapter 4 is provided directly to the SSPE, and that protection is reflected in the credit assessment of a position by a nominated ECAI, the risk weight associated with that credit assessment may be used. Where the protection is not eligible under Chapter 4, the credit assessment shall not be recognised. Where the credit protection is not provided to the SSPE but directly to a securitisation position, the credit assessment shall not be recognised.

#### *Article 265*

##### *Mapping*

EBA shall develop draft implementing technical standards to determine, for all [...] ECAIs, which of the credit quality steps set out in this Chapter are associated with the relevant credit assessments of an [...] ECAI. Those determinations shall be objective and consistent, and carried out in accordance with the following principles:

- (a) EBA shall differentiate between the relative degrees of risk expressed by each assessment;
- (b) EBA shall consider quantitative factors, such as default and/or loss rates and the historical performance of credit assessments of each ECAI across different asset classes;
- (c) EBA shall consider qualitative factors such as the range of transactions assessed by the ECAI, its methodology and the meaning of its credit assessments, in particular whether based on expected loss or first Euro loss, and to timely payment of interest or to ultimate payment of interest;
- (d) EBA shall seek to ensure that securitisation positions to which the same risk weight is applied on the basis of the credit assessments of [...] ECAIs are subject to equivalent degrees of credit risk. EBA shall consider modifying its determination as to the credit quality step with which a particular credit assessment shall be associated, as appropriate.

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.

## **Chapter 6**

### **Counterparty credit risk**

#### **SECTION 1**

#### **DEFINITIONS**

##### *Article 266*

##### *Determination of the exposure value*

1. An institution shall determine the exposure value of derivative instruments listed in Annex II in accordance with this Chapter.
2. An institution may determine the exposure value of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions in accordance with this Chapter instead of making use of Chapter 4.

For the purposes of this Chapter and Title VI, the following definitions shall apply:

General terms

- (1) ‘counterparty credit risk’ (hereinafter referred to as ‘CCR’) means the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows;

Transaction types

- (2) ‘long settlement transactions’ means transactions where a counterparty undertakes to deliver a security, a commodity, or a foreign exchange amount against cash, other financial instruments, or commodities, or vice versa, at a settlement or delivery date specified by contract that is later than the market standard for this particular type of transaction or five business days after the date on which the institution enters into the transaction, whichever is earlier;
- (3) ‘margin lending transactions’ means transactions in which an institution extends credit in connection with the purchase, sale, carrying or trading of securities. Margin lending transactions do not include other loans that are secured by collateral in the form of securities;

Netting set, hedging sets, and related terms

- (4) ‘netting set’ means a group of transactions between an institution and a single counterparty that is subject to a legally enforceable bilateral netting arrangement that is recognised under Section 7 and Chapter 4;

Each transaction that is not subject to a legally enforceable bilateral netting arrangement which is recognised under Section 7 shall be treated as its own netting set for the purposes of this Chapter;



Under the Internal Model Method set out in Section 6, all netting sets with a single counterparty may be treated as a single netting set if negative simulated market values of the individual netting sets are set to 0 in the estimation of expected exposure (hereinafter referred to as ‘EE’);

- (5) ‘risk position’ means a risk number that is assigned to a transaction under the Standardised Method set out in Section 5 following a predetermined algorithm;
- (6) ‘hedging set’ means a group of risk positions arising from the transactions within a single netting set, where only the balance of those risk positions is used for determining the exposure value under the Standardised Method set out in Section 5;
- (7) ‘margin agreement’ means an agreement or provisions of an agreement under which one counterparty must supply collateral to a second counterparty when an exposure of that second counterparty to the first counterparty exceeds a specified level;
- (8) ‘margin threshold’ means the largest amount of an exposure that remains outstanding before one party has the right to call for collateral;
- (9) ‘margin period of risk’ means the time period from the most recent exchange of collateral covering a netting set of transactions with a defaulting counterparty until the transactions are closed out and the resulting market risk is re-hedged;
- (10) ‘effective maturity under the Internal Model Method for a netting set with maturity greater than one year’ means the ratio of the sum of expected exposure over the life of the transactions in the netting set discounted at the risk-free rate of return, divided by the sum of expected exposure over one year in a netting set discounted at the risk-free rate;

This effective maturity may be adjusted to reflect rollover risk by replacing expected exposure with effective expected exposure for forecasting horizons under one year;

- (11) ‘cross-product netting’ means the inclusion of transactions of different product categories within the same netting set pursuant to the Cross-Product Netting rules set out in this Chapter;

- (12) ‘Current Market Value’ (hereinafter referred to as ‘CMV’) for the purposes of Section 5 refers to the net market value of the portfolio of transactions within a netting set, where both positive and negative market values are used in computing the CMV;

#### Distributions

- (13) ‘distribution of market values’ means the forecast of the probability distribution of net market values of transactions within a netting set for a future date (the forecasting horizon), given the realised market value of those transactions at the date of the forecast;
- (14) ‘distribution of exposures’ means the forecast of the probability distribution of market values that is generated by setting forecast instances of negative net market values equal to zero;
- (15) ‘risk-neutral distribution’ means a distribution of market values or exposures over a future time period where the distribution is calculated using market implied values such as implied volatilities;
- (16) ‘actual distribution’ means a distribution of market values or exposures at a future time period where the distribution is calculated using historic or realised values such as volatilities calculated using past price or rate changes;

#### Exposure measures and adjustments

- (17) ‘current exposure’ means the larger of zero and the market value of a transaction or portfolio of transactions within a netting set with a counterparty that would be lost upon the default of the counterparty, assuming no recovery on the value of those transactions in insolvency or liquidation;
- (18) ‘peak exposure’ means a high percentile of the distribution of exposures at particular future date before the maturity date of the longest transaction in the netting set;
- (19) ‘expected exposure’ (hereinafter referred to as ‘EE’) means the average of the distribution of exposures at a particular future date before the longest maturity transaction in the netting set matures;

- (20) ‘effective expected exposure at a specific date’ (hereinafter referred to as ‘Effective EE’) means the maximum expected exposure that occurs at that date or any prior date.  
Alternatively, it may be defined for a specific date as greater of the expected exposure at that date or the effective expected exposure at the prior date;
- (21) ‘expected positive exposure’ (hereinafter referred to as ‘EPE’) means the weighted average over time of expected exposures, where the weights are the proportion of the entire time period that an individual expected exposure represents;
- When calculating the own funds requirement, institutions shall take the average over the first year or, if all the contracts within the netting set mature within less than one year, over the time period until the contract with the longest maturity in the netting set has matured.
- (22) ‘effective expected positive exposure’ (hereinafter referred to as ‘Effective EPE’) means the weighted average of effective expected exposure over the first year of a netting set or, if all the contracts within the netting set mature within less than one year, over the time period of the longest maturity contract in the netting set, where the weights are the proportion of the entire time period that an individual expected exposure represents;

#### CCR related risks

- (23) ‘rollover risk’ means the amount by which EPE is understated when future transactions with a counterparty are expected to be conducted on an ongoing basis;
- The additional exposure generated by those future transactions is not included in calculation of EPE;
- (24) ‘counterparty’ for the purposes of Section 7 means any legal or natural person that enters into a netting agreement, and has the contractual capacity to do so;

- (25) ‘contractual cross product netting agreement’ means a written bilateral contractual agreement between an institution and a counterparty which creates a single legal obligation (based on netting of covered transactions) covering all bilateral master agreements and transactions belonging to different product categories that are included within the agreement;

For the purposes of this definition, ‘different product categories’ means:

- (a) repurchase transactions, securities and commodities lending and borrowing transactions;
  - (b) margin lending transactions;
  - (c) the contracts listed in Annex II;
- (26) ‘payment leg’ means the payment agreed in an OTC derivative transaction with a linear risk profile which stipulates the exchange of a financial instrument for a payment.

In the case of transactions that stipulate the exchange of payment against payment, those two payment legs shall consist of the contractually agreed gross payments, including the notional amount of the transaction.

## SECTION 2

### METHODS FOR CALCULATING THE EXPOSURE VALUE

#### *Article 268*

##### *Methods for calculating the exposure value*

1. Institutions shall determine the exposure value for the contracts listed in Annex II on the basis of one of the methods set out in Sections 3 to 6 in accordance with this Article.

An institution which is not eligible for the treatment set out in Article 89 shall not use the method set out in Section 4. To determine the exposure value for the contracts listed in point 3 of Annex II an institution shall not use the method set out in Section 4. Institutions may use in combination the methods set out in Sections 3 to 6 on a permanent basis within a group. A single institution shall not use in combination the methods set out in Sections 3 and 5 unless one of the methods is used for the cases set out in Article 276(6).

2. Where permitted by the competent authorities in accordance with paragraphs 1 and 2 of Article 277, an institution may determine the exposure value for the following items using the Internal Model Method set out in Section 6:
  - (a) the contracts listed in Annex II;
  - (b) repurchase transactions;
  - (c) securities or commodities lending or borrowing transactions;
  - (d) margin lending transactions;
  - (e) long settlement transactions.

3. When an institution purchases protection through a credit derivative against a non-trading book exposure or against a counterparty risk exposure, it may calculate its own funds requirement for the hedged exposure in accordance with either of the following:
- (a) Article 228 to 231;
  - (b) in accordance with Article 148(3), or Article 179, where permission has been granted in accordance with Article 138.

The exposure value for CCR for those credit derivatives shall be zero, unless an institution applies the approach (ii) in point (h) of Article 293(2).

4. Notwithstanding paragraph 3, an institution may choose consistently to include for the purposes of calculating own funds requirements for counterparty credit risk all credit derivatives not included in the trading book and purchased as protection against a non-trading book exposure or against a counterparty credit risk exposure where the credit protection is recognised under this Regulation.
5. Where credit default swaps sold by an institution are treated by an institution as credit protection provided by that institution and are subject to own funds requirement for credit risk of the underlying for the full notional amount, their exposure value for the purposes of CCR in the non-trading book shall be zero.
6. Under all methods set out in Sections 3 to 6, the exposure value for a given counterparty shall be equal to the sum of the exposure values calculated for each netting set with that counterparty.

For a given counterparty, the exposure value for a given netting set of OTC derivative instruments listed in Annex II calculated in accordance with this Chapter shall be the greater of zero and the difference between the sum of exposure values across all netting sets with the counterparty and the sum of CVA for that counterparty being recognised by the institution as an incurred write-down. The credit valuation adjustments shall be calculated without taking into account any offsetting debit value adjustment attributed to the own credit risk of the firm.

7. Institutions shall determine the exposure value for exposures arising from long settlement transactions by any of the methods set out in Sections 3 to 6, regardless of which method the institution has chosen for treating OTC derivatives and repurchase transactions, securities or commodities lending or borrowing transactions, and margin lending transactions. In calculating the own funds requirements for long settlement transactions, an institution that uses the approach set out in Chapter 3 may assign the risk weights under the approach set out in Chapter 2 on a permanent basis and irrespective of the materiality of such positions.
8. For the methods set out in Sections 3 and 4, the institution shall adopt a consistent methodology for determining the notional amount for different product types, and shall ensure that the notional amount to be taken into account provides an appropriate measure of the risk inherent in the contract. Where the contract provides for a multiplication of cash flows, the notional amount shall be adjusted by an institution to take into account the effects of the multiplication on the risk structure of that contract.

### **SECTION 3**

#### **MARK – TO – MARKET METHOD**

##### *Article 269*

##### *Mark-to-market Method*

1. In order to determine the current replacement cost of all contracts with positive values, institutions shall attach the current market values to the contracts.
2. In order to determine the potential future credit exposure, institutions shall multiply the notional amounts or underlying values, as applicable, by the percentages in Table 1 and in accordance with the following principles:

- (a) contracts which do not fall within one of the five categories indicated in Table 1 shall be treated as contracts concerning commodities other than precious metals;
- (b) for contracts with multiple exchanges of principal, the percentages shall be multiplied by the number of remaining payments still to be made in accordance with the contract;
- (c) for contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset so that the market value of the contract is zero on those specified dates, the residual maturity shall be equal to the time until the next reset date. In the case of interest-rate contracts that meet those criteria and have a remaining maturity of over one year, the percentage shall be no lower than 0.5 %.

Table 1					
Residual maturity	Interest-rate contracts	Contracts concerning foreign-exchange rates and gold	Contracts concerning equities	Contracts concerning precious metals except gold	Contracts concerning commodities other than precious metals
One year or less	0 %	1 %	6 %	7 %	10 %
Over one year, not exceeding five years	0.5 %	5 %	8 %	7 %	12 %
Over five years	1.5 %	7.5 %	10 %	8 %	15 %



3. For contracts relating to commodities other than gold, which are referred to in point 3 of Annex II, an institution may, as an alternative to applying the percentages in Table 1, apply the percentages in Table 2 provided that that institution follows the extended maturity ladder approach set out in Article 350 for those contracts.

Table 2				
Residual maturity	Precious metals (except gold)	Base metals	Agricultural products (softs)	Other, including energy products
One year or less	2 %	2,5 %	3 %	4 %
Over one year, not exceeding five years	5 %	4 %	5 %	6 %
Over five years	7,5 %	8 %	9 %	10 %

4. The sum of current replacement cost and potential future credit exposure is the exposure value.

**SECTION 4**  
**ORIGINAL EXPOSURE METHOD**

*Article 270*

*Original Exposure Method*

1. The exposure value is the notional amount of each instrument multiplied by the percentages set out in Table 3.

Table 3		
Original maturity	Interest-rate contracts	Contracts concerning foreign-exchange rates and gold
One year or less	0,5 %	2 %
Over one year, not exceeding two years	1 %	5 %
Additional allowance for each additional year	1 %	3 %

2. For calculating the exposure value of interest-rate contracts, an institution may choose to use either the original or residual maturity.

## SECTION 5

### STANDARDISED METHOD

#### *Article 271*

#### *Standardised Method*

1. Institutions may use the Standardised Method (hereinafter referred to as ‘SM’) only for calculating the exposure value for OTC derivatives and long settlement transactions.
2. When applying the SM, institutions shall calculate the exposure value separately for each netting set, net of collateral, as follows:

$$\text{Exposure value} = \beta \cdot \max \left\{ CMV - CMC, \sum_j \left| \sum_i RPT_{ij} - \sum_l RPC_{lj} \right| \cdot CCRM_j \right\}$$

where:

CMV = current market value of the portfolio of transactions within the netting set with a counterparty gross of collateral, where:

$$CMV = \sum_i CMV_i$$

where:

CMV<sub>i</sub> = the current market value of transaction i;

CMC = the current market value of the collateral assigned to the netting set, where:

$$CMC = \sum_l CMC_l$$

where

CMC<sub>l</sub> = the current market value of collateral l;

$i =$  index designating transaction;

$l =$  index designating collateral;

$j =$  index designating hedging set category;

The hedging sets for this purpose correspond to risk factors for which risk positions of opposite sign can be offset to yield a net risk position on which the exposure measure is then based.

$RPT_{ij}$  = risk position from transaction  $i$  with respect to hedging set  $j$ ;

$RPC_{lj}$  = risk position from collateral  $l$  with respect to hedging set  $j$ ;

$CCRM_j$  = CCR Multiplier set out in Table 5 with respect to hedging set  $j$ ;

$\beta =$  1.4.

3. For the purposes of the calculation under paragraph 2:
  - (a) eligible collateral received from a counterparty shall have a positive sign and collateral posted to a counterparty shall have a negative sign;
  - (b) only collateral that is eligible under Article 193, Article 194 and Article 293(2)(d) shall be used for the SM;
  - (c) an institution may disregard the interest rate risk from payment legs with a remaining maturity of less than one year;
  - (d) an institution may treat transactions that consist of two payment legs that are denominated in the same currency as a single aggregate transaction. The treatment for payment legs applies to the aggregate transaction.

*Article 272*

*Transactions with a linear risk profile*

1. Institutions shall map transactions with a linear risk profile to risk positions in accordance with the following provisions:
  - (a) transactions with a linear risk profile with equities (including equity indices), gold, other precious metals or other commodities as the underlying shall be mapped to a risk position in the respective equity (or equity index) or commodity and an interest rate risk position for the payment leg;
  - (b) transactions with a linear risk profile with a debt instrument as the underlying instrument shall be mapped to an interest rate risk position for the debt instrument and another interest rate risk position for the payment leg;
  - (c) transactions with a linear risk profile that stipulate the exchange of payment against payment, including foreign exchange forwards, shall be mapped to an interest rate risk position for each of the payment legs.

Where, under a transaction mentioned in point (a), (b) or (c), a payment leg or the underlying debt instrument is denominated in foreign currency, that payment leg or underlying instrument shall also be mapped to a risk position in that currency.

2. For the purposes of paragraph 1, the size of a risk position from a transaction with linear risk profile shall be the effective notional value (market price multiplied by quantity) of the underlying financial instruments or commodities converted to the institution's domestic currency by multiplication with the relevant exchange rate, except for debt instruments.

3. For debt instruments and for payment legs, the size of the risk position shall be the effective notional value of the outstanding gross payments (including the notional amount) converted to the currency of the home Member State of the institution, multiplied by the modified duration of the debt instrument or payment leg, as the case may be.
4. The size of a risk position from a credit default swap shall be the notional value of the reference debt instrument multiplied by the remaining maturity of the credit default swap.

### *Article 273*

#### *Transactions with a non-linear risk profile*

1. Institutions shall determine the size of the risk positions for transactions with a non-linear risk profile in accordance with the following paragraphs.
2. The size of a risk position from an OTC derivative with a non-linear risk profile, including options and swaptions, of which the underlying is not a debt instrument or a payment leg shall be equal to the delta equivalent effective notional value of the financial instrument that underlies the transaction in accordance with Article 274(1).
3. The size of a risk position from an OTC derivative with a non-linear risk profile, including options and swaptions, of which the underlying is a debt instrument or a payment leg, shall be equal to the delta equivalent effective notional value of the financial instrument or payment leg multiplied by the modified duration of the debt instrument or payment leg, as the case may be.
4. For the determination of risk positions, institutions shall treat collateral as follows:
  - (a) collateral received from a counterparty shall be treated as a claim on the counterparty under a derivative contract (long position) that is due on the day the determination is made;
  - (b) collateral it has posted with the counterparty shall be treated as an obligation to the counterparty (short position) that is due on the day the determination is made.

*Article 274*

*Calculation of risk positions*

1. An institution shall determine the size and sign of a risk position as follows:
  - (a) for all instruments other than debt instruments:
    - (i) as the effective notional value in the case of a transaction with a linear risk profile;
    - (ii) as the delta equivalent notional value,  $P_{ref} \cdot \frac{\partial V}{\partial p}$ , in the case of a transaction with a non-linear risk profile,

where:

$P_{ref}$  = price of the underlying instrument, expressed in the reference currency;

$V$  = value of the financial instrument (in the case of an option, the value is the option price);

$p$  = price of the underlying instrument, expressed in the same currency as  $V$ ;

- (b) for debt instruments and the payment legs of all transactions:
  - (i) as the effective notional value multiplied by the modified duration in the case of a transaction with a linear risk profile;
  - (ii) as the delta equivalent in notional value multiplied by the modified duration,  $\frac{\partial V}{\partial r}$ , in the case of a transaction with a non-linear risk profile,

where:

$V$  = value of the financial instrument (in the case of an option this is the option price);

$r$  = interest rate level.

If V is denominated in a currency other than the reference currency, the derivative shall be converted into the reference currency by multiplication with the relevant exchange rate.

2. Institutions shall group the risk positions into hedging sets. The absolute value amount of the sum of the resulting risk positions shall be calculated for each hedging set. The net risk position shall be the result of that calculation and shall be calculated for the purposes of Article 271(2) as follows:

$$\left| \sum_i RPT_{ij} - \sum_l RPC_{lj} \right|.$$

#### *Article 275*

##### *Interest rate risk positions*

1. In order to calculate interest rate risk position, institutions shall apply the following provisions.
2. For interest rate risk positions from the following:
  - (a) money deposits received from the counterparty as collateral;
  - (b) a payment legs;
  - (c) underlying debt instruments,

to which in each case a capital charge of 1,60 % or less applies in accordance with Table 1 of Article 325, institutions shall assign those positions to one of the six hedging sets for each currency set out in Table 4.



Table 4		
	Government referenced interest rates	Non-government referenced interest rates
Maturity	$< 1$ year $>1 \leq 5$ years $> 5$ years	$< 1$ year $>1 \leq 5$ years $> 5$ years

3. For interest rate risk positions from underlying debt instruments or payment legs for which the interest rate is linked to a reference interest rate that represents a general market interest level, the remaining maturity shall be the length of the time interval up to the next re-adjustment of the interest rate. In all other cases, it shall be the remaining life of the underlying debt instrument or, in the case of a payment leg, the remaining life of the transaction.

*Article 276*

*Hedging sets*

1. Institutions shall establish hedging sets in accordance with paragraphs (2) to (5).
2. There shall be one hedging set for each issuer of a reference debt instrument that underlies a credit default swap.

N-th to default basket credit default swaps shall be treated as follows:

- (a) the size of a risk position in a reference debt instrument in a basket underlying an n-th to default credit default swap shall be the effective notional value of the reference debt instrument, multiplied by the modified duration of the n-th to default derivative with respect to a change in the credit spread of the reference debt instrument;
- (b) there shall be one hedging set for each reference debt instrument in a basket underlying a given 'nth to default' credit default swap. Risk positions from different n-th to default credit default swaps shall not be included in the same hedging set;
- (c) the CCR multiplier applicable to each hedging set created for one of the reference debt instruments of an n-th to default derivative shall be as follows:
  - (i) 0.3% for reference debt instruments that have a credit assessment from a recognised ECAI equivalent to credit quality step 1 to 3;
  - (ii) 0.6 % for other debt instruments.

3. For interest rate risk positions from:

- (a) money deposits that are posted with a counterparty as collateral when that counterparty does not have debt obligations of low specific risk outstanding;
- (b) underlying debt instruments, to which according to Table 1 of Article 325 a capital charge of more than 1.60 % applies;

[...] There shall be one hedging set for each issuer [...].

When a payment leg emulates such a debt instrument, there shall also be one hedging set for each issuer of the reference debt instrument.

An institution may assign risk positions that arise from debt instruments of a particular issuer, or from reference debt instruments of the same issuer that are emulated by payment legs, or that underlie a credit default swap, to the same hedging set.

4. Underlying financial instruments other than debt instruments shall be assigned to the same hedging sets only if they are identical or similar instruments. In all other cases they shall be assigned to separate hedging sets.

For the purposes of this paragraph institutions shall determine whether underlying instruments are similar in accordance with the following principles:

- (a) for equities, the underlying is similar if it is issued by the same issuer. An equity index shall be treated as a separate issuer;
- (b) for precious metals, the underlying is similar if it is the same metal. A precious metal index shall be treated as a separate precious metal;
- (c) for electric power, the underlying is similar if the delivery rights and obligations refer to the same peak or off-peak load time interval within any 24-hour interval;
- (d) for commodities, the underlying is similar if it is the same commodity. A commodity index shall be treated as a separate commodity.

5. The CCR multipliers (hereinafter referred to as ‘CCRM’) for the different hedging set categories are set out in the following table:

Table 5		
	Hedging set categories	CCRM
1.	Interest Rates	0.2 %
2.	Interest Rates for risk positions from a reference debt instrument that underlies a credit default swap and to which a capital charge of 1.60 %, or less, applies under Table 1 of Chapter 2 of Title IV.	0.3 %
3.	Interest Rates for risk positions from a debt instrument or reference debt instrument to which a capital charge of more than 1.60 % applies under Table 1 of Chapter 2 of Title IV.	0.6 %
4.	Exchange Rates	2.5 %
5.	Electric Power	4 %
6.	Gold	5 %
7.	Equity	7 %
8.	Precious Metals (other than gold)	8.5 %
9.	Other Commodities (excluding precious metals and electricity power)	10 %
10.	Underlying instruments of OTC derivatives that are not in any of the above categories	10 %

Underlying instruments of OTC derivatives, as referred to in point 10 of Table 5, shall be assigned to separate individual hedging sets for each category of underlying instrument.

6. For transactions with a non-linear risk profile or for payment legs and transactions with debt instruments as underlying for which the institution cannot determine the delta or the modified duration, as the case may be, with an instrument model that the competent authority has approved for the purposes of determining the own funds requirements for market risk, the competent authority shall either determine the size of the risk positions and the applicable CCRM<sub>s</sub> conservatively, or require the institution to use of the method set out in Section 3. Netting shall not be recognised (that is, the exposure value shall be determined as if there were a netting set that comprises just an individual transaction).
7. An institution shall have internal procedures to verify that, prior to including a transaction in a hedging set, the transaction is covered by a legally enforceable netting contract that meets the requirements set out in Section 7.
8. An institution that makes use of collateral to mitigate its CCR shall have internal procedures to verify that, prior to recognising the effect of collateral in its calculations, the collateral meets the legal certainty standards set out in Chapter 4.

## SECTION 6

### INTERNAL MODEL METHOD

#### *Article 277*

#### *Permission to use the Internal Model Method*

1. Provided that the competent authorities are satisfied that the requirement in paragraph 2 have been met by an institution, they shall permit that institution to use the Internal Model Method (IMM) to calculate the exposure value for any of the following transactions:
  - (a) transactions in Article 268(2)(a);
  - (b) transactions in Article 268(2)(b), (c) and (d);
  - (c) transactions in Article 268(2)(a) to (d).

Where an institution is permitted to use the IMM to calculate exposure value for any of the transactions mentioned in points (a) to (c) of the preceding sub-paragraph, it may also use the IMM for the transactions in Article 268(2)(e).

Notwithstanding Article 268(1), third sub-paragraph, an institution may choose not to apply this method to exposures that are immaterial in size and risk. In such case, an institution shall apply one of the methods set out in Sections 3 to 5 to these exposures where the relevant requirements for each approach are met.

2. Competent authorities shall permit institutions to use IMM for the calculations referred to in paragraph 1 only if the institution has demonstrated that it complies with the requirements set out in this Section, and the competent authorities verified that the systems for the management of CCR maintained by the institution are sound and properly implemented.

3. The competent authorities may permit institutions for a limited period to implement the IMM sequentially across different transaction types. During this period of sequential implementation institutions may use the methods set out in Section 3 or Section 5 for transaction type for which they do not use the IMM.
4. For all OTC derivative transactions and for long settlement transactions for which an institution has not received permission under paragraph 1 to use the IMM, the institution shall use the methods set out in Section 3 or Section 5.

Those methods may be used in combination on a permanent basis within a group. Within an institution those methods may be used in combination only where one of the methods is used for the cases set out in Article 276(6)

5. An institution which is permitted in accordance with paragraph 1 to use the IMM shall not revert to the use of the methods set out in Section 3 or Section 5 unless it is permitted by the competent authority to do so. Competent authorities shall give such permission if the institution demonstrates good cause.
6. If an institution ceases to comply with the requirements laid down in this Section, 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 authority that the effect of non-compliance is immaterial.

*Article 278*  
*Exposure value*

1. Where an institution is permitted, in accordance with Article 277(1), to use the IMM to calculate the exposure value of some or all transactions mentioned in that paragraph, it shall measure the exposure value of those transactions at the level of the netting set.

The model used by the institution for that purpose shall:

- (a) specify the forecasting distribution for changes in the market value of the netting set attributable to joint changes in relevant market variables, such as interest rates, foreign exchange rates;
  - (b) calculate the exposure value for the netting set at each future dates on the basis of the joint changes in the market variables.
  - (c)
2. In order for the model to capture the effects of margining, the model of the collateral value shall meet the quantitative, qualitative and data requirements for the IMM model in accordance with this Section and the institution may include in its forecasting distributions for changes in the market value of the netting set only eligible financial collateral as defined in Article 193 , Article 194 and Article 293(2) (c) and d.
3. The own funds requirement for counterparty credit risk with respect to the CCR exposures to which an institution applies the IMM, shall be the higher of the following:
  - (a) the own funds requirement for those exposures calculated on the basis of Effective EPE using current market data;



(b) the own funds requirement for those exposures calculated on the basis of Effective EPE using a single consistent stress calibration for all CCR exposures to which they apply the IMM.

4. Except for counterparties identified as having Specific Wrong-Way Risk that fall within the scope of paragraphs 4 and 5 of Article 285, institutions shall calculate the exposure value as the product of alpha ( $\alpha$ ) times Effective EPE, as follows:

$$\text{Exposure value} = \alpha \cdot \text{Effective EPE}$$

where:

$\alpha = 1.4$ , unless competent authorities require a higher  $\alpha$  or permit institutions to use their own estimates in accordance with paragraph 9;

Effective EPE shall be calculated by estimating expected exposure ( $EE_t$ ) as the average exposure at future date  $t$ , where the average is taken across possible future values of relevant market risk factors.

The model shall estimate  $EE$  at a series of future dates  $t_1, t_2, t_3$ , etc.

5. Effective  $EE$  shall be calculated recursively as:

$$\text{Effective } EE_{t_k} = \max \{ \text{Effective } EE_{t_{k-1}}, EE_{t_k} \}$$

where:

the current date is denoted as  $t_0$ ;

Effective  $EE_{t_0}$  equals current exposure.

6. Effective EPE is the average Effective EE during the first year of future exposure. If all contracts in the netting set mature within less than one year, EPE shall be the average of EE until all contracts in the netting set mature. Effective EPE shall be calculated as a weighted average of Effective EE:

$$\text{Effective EPE} = \sum_{k=1}^{\min\{1, \text{year}, \text{maturity}\}} \text{Effective EE}_{t_k} \cdot \Delta t_k$$

where the weights  $\Delta t_k = t_k - t_{k-1}$  allow for the case when future exposure is calculated at dates that are not equally spaced over time.

7. Institutions shall calculate EE or peak exposure measures on the basis of a distribution of exposures that accounts for the possible non-normality of the distribution of exposures.
8. An institution may use a measure of the distribution calculated by the model that is more conservative than  $\alpha$  multiplied by Effective EPE as calculated in accordance with the equation in paragraph 4 for every counterparty.
9. Notwithstanding paragraph 4, competent authorities may permit institutions to use their own estimates of alpha, where:
- (a) alpha shall equal the ratio of internal capital from a full simulation of CCR exposure across counterparties (numerator) and internal capital based on EPE (denominator);
  - (b) in the denominator, EPE shall be used as if it were a fixed outstanding amount.

When estimated in accordance with this paragraph, alpha shall be no lower than 1.2.

10. For the purposes of an estimate of alpha under paragraph 9, an institution shall ensure that the numerator and denominator are calculated in a manner consistent with the modelling methodology, parameter specifications and portfolio composition. The approach used to estimate  $\alpha$  shall be based on the institution's internal capital approach, be well documented and be subject to independent validation. In addition, an institution shall review its estimates of alpha on at least a quarterly basis, and more frequently when the composition of the portfolio varies over time. An institution shall also assess the model risk.
11. An institution shall demonstrate to the satisfaction of the competent authorities that its internal estimates of alpha capture in the numerator material sources of dependency of distribution of market values of transactions or of portfolios of transactions across counterparties. Internal estimates of alpha shall take account of the granularity of portfolios.
12. In supervising the use of estimates under paragraph 9, competent authorities shall have regard to the significant variation in estimates of alpha that arises from the potential for mis-specification in the models used for the numerator, especially where convexity is present.
13. Where appropriate, volatilities and correlations of market risk factors used in the joint modelling of market and credit risk shall be conditioned on the credit risk factor to reflect potential increases in volatility or correlation in an economic downturn.

*Article 279*

*Exposure value for netting sets subject to a margin agreement*

1. If the netting set is subject to a margin agreement and daily mark-to-market valuation, an institution may use one of the following EPE measures:
  - (a) Effective EPE, without taking into account any collateral held or posted by way of margin plus any collateral that has been posted to the counterparty independent of the daily valuation and margining process or current exposure;
  - (b) An add-on that reflects the potential increase in exposure over the margin period of risk, plus the larger of:
    - (i) the current exposure including all collateral currently held or posted, other than collateral called or in dispute;
    - (ii) the largest net exposure, including collateral under the margin agreement, that would not trigger a collateral call. This amount shall reflect all applicable thresholds, minimum transfer amounts, independent amounts and initial margins under the margin agreement;
  - (c) If the model captures the effects of margining when estimating EE, the institution may, subject to the permission of the competent authority, use the model's EE measure directly in the equation in Article 278(5). Competent authorities shall grant such permission only if they verify that the model properly captures the effects of margining when estimating EE.

For the purposes of point (b), institutions shall calculate the add-on as the expected positive change of the mark-to-market value of the transactions during the margin period of risk. Changes in the value of collateral shall be reflected using the supervisory volatility adjustments in accordance with Section 3 of Chapter 4 or the own estimates of volatility adjustments of the Financial Collateral Comprehensive Method, but no collateral payments shall be assumed during the margin period of risk. The margin period of risk is subject to the minimum periods set out in paragraphs 2 to 4.

2. For transactions subject to daily re-margining and mark-to-market valuation, the margin period of risk used for the purpose of modelling the exposure value with margin agreements shall not be less than:
- (a) 5 business days for netting sets consisting only of repurchase transactions, securities or commodities lending or borrowing transactions and margin lending transactions;
  - (b) 10 business days for all other netting sets.

Points (a) and (b) shall be subject to the following exceptions:

- (i) for all netting sets where the number of trades exceeds 5,000 at any point during a quarter, the margin period of risk for the following quarter shall not be less than 20 business days. This exception shall not apply to institutions' trade exposures;
- (ii) for netting sets containing one or more trades involving either illiquid collateral, or an OTC derivative that cannot be easily replaced, the margin period of risk shall not be less than 20 business days.

An institution shall determine whether collateral is illiquid or whether OTC derivatives cannot be easily replaced in the context of stressed market conditions, characterised by the absence of continuously active markets where a counterparty would, within two days or fewer, obtain multiple price quotations that would not move the market or represent a price reflecting a market discount (in the case of collateral) or premium (in the case of an OTC derivative).

An institution shall consider whether trades or securities it holds as collateral are concentrated in a particular counterparty and if that counterparty exited the market precipitously whether the institution would be able to replace those trades or securities.

3. If an institution has been involved in more than two margin call disputes on a particular netting set over the immediately preceding two quarters that have lasted longer than the applicable margin period of risk under paragraph 2, the institution shall use a margin period of risk that is at least double the period specified in paragraph 2 for that netting set for the subsequent two quarters.
4. For re-margining with a periodicity of N days, the margin period of risk shall be at least equal to the period specified in paragraph 2, F, plus N days minus one day. That is:  
  
$$\text{Margin Period of Risk} = F + N - 1$$
5. If the internal model includes the effect of margining on changes in the market value of the netting set, an institution shall model collateral, other than cash of the same currency as the exposure itself, jointly with the exposure in its exposure value calculations for OTC derivatives and securities-financing transactions.
6. If an institution is not able to model collateral jointly with the exposure, it shall not recognise in its exposure value calculations for OTC derivatives and securities-financing transactions the effect of collateral other than cash of the same currency as the exposure itself, unless it uses either volatility adjustments that meet the standards of the financial collateral comprehensive method with own volatility adjustments estimates or the standard supervisory volatility adjustments in accordance with Chapter 4.
7. An institution using the IMM shall ignore in its models the effect of a reduction of the exposure value due to any clause in a collateral agreement that requires receipt of collateral when counterparty credit quality deteriorates.

*Article 280*

*Management of CCR – Policies, processes and systems*

1. An institution shall establish and maintain a CCR management framework, consisting of:
  - (a) policies, processes and systems to ensure the identification, measurement, management, approval and internal reporting of CCR;
  - (b) procedures for ensuring that those policies, processes and systems are complied with.

Those policies, processes and systems shall be conceptually sound, implemented with integrity and documented. The documentation shall include an explanation of the empirical techniques used to measure CCR.

2. The CCR risk management framework required by paragraph 1 shall take account of market, liquidity, and legal and operational risks that are associated with CCR. In particular, the framework shall ensure that the institution complies with the following principles:
  - (a) it does not undertake business with a counterparty without assessing its creditworthiness;
  - (b) it takes due account of settlement and pre-settlement credit risk;
  - (c) it manages such risks as comprehensively as practicable at the counterparty level by aggregating CCR exposures with other credit exposures and at the firm-wide level.
3. An institution using the IMM shall ensure that its CCR risk management framework accounts to the satisfaction of the competent authority for the liquidity risks of all of the following:
  - (a) potential incoming margin calls in the context of exchanges of variation margin or other margin types, such as initial or independent margin, under adverse market shocks;

- (b) potential incoming calls for the return of excess collateral posted by counterparties;
- (c) calls resulting from a potential downgrade of its own external credit quality assessment.

An institution shall ensure that the nature and horizon of collateral re-use is consistent with its liquidity needs and does not jeopardise its ability to post or return collateral in a timely manner.

4. An institution's management body and senior management shall be actively involved in, and ensure that adequate resources are allocated to, the management of CCR. Senior management shall be aware of the limitations and assumptions of the model used and the impact those limitations and assumptions can have on the reliability of the output through a formal process. Senior management shall be also aware of the uncertainties of the market environment and operational issues and of how these are reflected in the model.
5. The daily reports prepared on an institution's exposures to CCR in accordance with Article 281(2)(b) shall be reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual credit managers or traders and reductions in the institution's overall CCR exposure.
6. An institution's CCR management framework established in accordance with paragraph 1 shall be used in conjunction with internal credit and trading limits. Credit and trading limits shall be related to the institution's risk measurement model in a manner that is consistent over time and that is well understood by credit managers, traders and senior management. An institution shall have a formal process to report breaches of risk limits to the appropriate level of management.



7. An institution's measurement of CCR shall include measuring daily and intra-day use of credit lines. The institution shall measure current exposure gross and net of collateral. At portfolio and counterparty level, the institution shall calculate and monitor peak exposure or potential future exposure at the confidence interval chosen by the institution. The institution shall take account of large or concentrated positions, including by groups of related counterparties, by industry and by market.
8. An institution shall establish and maintain a routine and rigorous program of stress testing. The results of that stress testing shall be reviewed regularly and at least quarterly by senior management and shall be reflected in the CCR policies and limits set by the management body or senior management. Where stress tests reveal particular vulnerability to a given set of circumstances, the institution shall take prompt steps to manage those risks.

#### *Article 281*

##### *Organisation structures for CCR risk management*

1. An institution using the IMM shall establish and maintain:
  - (a) a risk control unit that complies with paragraph 2;
  - (b) a collateral management unit that complies with paragraph 3.
2. The risk control unit shall be responsible for the design and implementation of its CCR management, including the initial and on-going validation of the model, and shall carry out the following functions and meet the following requirements:
  - (a) it shall be responsible for the design and implementation of the CCR management system of the institution;
  - (b) it shall produce daily reports on and analyse the output of the institution's risk measurement model. That analysis shall include an evaluation of the relationship between measures of CCR exposure values and trading limits;

- (c) it shall control input data integrity and produce and analyse reports on the output of the institution's risk measurement model, including an evaluation of the relationship between measures of risk exposure and credit and trading limits;
- (d) it shall be independent from units responsible for originating, renewing or trading exposures and free from undue influence;
- (e) it shall be adequately staffed;
- (f) it shall report directly to the senior management of the institution;
- (g) its work shall be closely integrated into the day-to-day credit risk management process of the institution;
- (h) its output shall be an integral part of the process of planning, monitoring and controlling the institution's credit and overall risk profile.

3. The collateral management unit shall carry out the following tasks and functions:

- (a) calculating and making margin calls, managing margin call disputes and reporting levels of independent amounts, initial margins and variation margins accurately on a daily basis;
- (b) controlling the integrity of the data used to make margin calls, and ensuring that it is consistent and reconciled regularly with all relevant sources of data within the institution;
- (c) tracking the extent of re-use of collateral and any modification of the rights of the institution to or in connection with the collateral that it posts;
- (d) reporting to the appropriate level of management the types of collateral assets that are reused, and the terms of such reuse including instrument, credit quality and maturity;
- (e) tracking concentration to individual types of collateral assets accepted by the institution;

(f) reporting collateral management information on a regular basis, but at least quarterly, to senior management, including information on the type of collateral received and posted, the size, aging and cause for margin call disputes. That internal reporting shall also reflect trends in these figures.

4. Senior management shall allocate sufficient resources to the collateral management unit required under paragraph 1(b) to ensure that its systems achieve an appropriate level of operational performance, as measured by the timeliness and accuracy of margin calls by the institution and the timeliness of the response of the institution to margin calls by its counterparties. Senior management shall ensure that the unit is adequately staffed to process calls and disputes in a timely manner even under severe market crisis, and to enable the institution to limit its number of large disputes caused by trade volumes.

#### *Article 282*

##### *Review of CCR risk management system*

An institution shall regularly conduct an independent review of its CCR management system through its internal auditing process. That review shall include both the activities of the control and collateral management units required by Article 281 and shall specifically address, as a minimum:

- (a) the adequacy of the documentation of the CCR management system and process required by Article 280;
- (b) the organisation of the CCR control unit required by Article 281(1)(a);
- (c) the organisation of the collateral management unit required by Article 281(1)(b);
- (d) the integration of CCR measures into daily risk management;
- (e) the approval process for risk pricing models and valuation systems used by front and back-office personnel;
- (f) the validation of any significant change in the CCR measurement process;

- (g) the scope of CCR captured by the risk measurement model;
- (h) the integrity of the management information system;
- (i) the accuracy and completeness of CCR data;
- (j) the accurate reflection of legal terms in collateral and netting agreements into exposure value measurements;
- (k) the verification of the consistency, timeliness and reliability of data sources used to run models, including the independence of such data sources;
- (l) the accuracy and appropriateness of volatility and correlation assumptions;
- (m) the accuracy of valuation and risk transformation calculations;
- (n) the verification of the model's accuracy through frequent back-testing as set out in points (b) to (e) of Article 287(1);
- (o) the compliance of the CCR control unit and collateral management unit with the relevant regulatory requirements.

### *Article 283*

#### *Use test*

1. Institutions shall ensure that the distribution of exposures generated by the model used to calculate effective EPE is closely integrated into the day-to-day CCR management process of the institution, and that the output of the model is taken into account in the process of credit approval, CCR management, internal capital allocation and corporate governance.

2. The institution shall demonstrate to the satisfaction of the competent authorities that it has been using a model to calculate the distribution of exposures upon which the EPE calculation is based that meets, broadly, the requirements set out in this Section for at least one year prior to permission to use the IMM by the competent authorities in accordance with Article 277.
3. The model used to generate a distribution of exposures to CCR shall be part of the CCR management framework required by Article 280. This framework shall include the measurement of usage of credit lines, aggregating CCR exposures with other credit exposures and internal capital allocation.
4. In addition to EPE, an institution shall measure and manage current exposures. Where appropriate, the institution shall measure current exposure gross and net of collateral. The use test is satisfied if an institution uses other CCR measures, such as peak exposure, based on the distribution of exposures generated by the same model to compute EPE.
5. An institution shall have the systems capability to estimate EE daily if necessary, unless it demonstrates to the satisfaction of its competent authorities that its exposures to CCR warrant less frequent calculation. The institution shall estimate EE along a time profile of forecasting horizons that adequately reflects the time structure of future cash flows and maturity of the contracts and in a manner that is consistent with the materiality and composition of the exposures.
6. Exposure shall be measured, monitored and controlled over the life of all contracts in the netting set and not only to the one year horizon. The institution shall have procedures in place to identify and control the risks for counterparties where the exposure rises beyond the one-year horizon. The forecast increase in exposure shall be an input into the institution's internal capital model.

## *Article 284*

### *Stress testing*

1. An institution shall have a comprehensive stress testing programme for CCR, including for use in assessment of own funds requirements for CCR, which complies with the requirements laid down in paragraphs 2 to 10.
2. It shall identify possible events or future changes in economic conditions that could have unfavourable effects on an institution's credit exposures and assess the institution's ability to withstand such changes.
3. The stress measures under the programme shall be compared against risk limits and considered by the institution as part of the process set out in Article 79 of Directive [inserted by OP].
4. The programme shall comprehensively capture trades and aggregate exposures across all forms of counterparty credit risk at the level of specific counterparties in a sufficient time frame to conduct regular stress testing.
5. It shall provide for at least monthly exposure stress testing of principal market risk factors such as interest rates, FX, equities, credit spreads, and commodity prices for all counterparties of the institution, in order to identify, and enable the institution when necessary to reduce outsized concentrations in specific directional risks. Exposure stress testing -including single factor, multifactor and material non-directional risks- and joint stressing of exposure and creditworthiness shall be performed at the counterparty-specific, counterparty group and aggregate institution-wide CCR levels.
6. It shall apply at least quarterly multifactor stress testing scenarios and assess material non-directional risks including yield curve exposure and basis risks. Multiple-factor stress tests shall, at a minimum, address the following scenarios in which the following occurs:
  - (a) severe economic or market events have occurred;

- (b) broad market liquidity has decreased significantly;
- (c) a large financial intermediary is liquidating positions.

7. The severity of the shocks of the underlying risk factors shall be consistent with the purpose of the stress test. When evaluating solvency under stress, the shocks of the underlying risk factors shall be sufficiently severe to capture historical extreme market environments and extreme but plausible stressed market conditions. The stress tests shall evaluate the impact of such shocks on own funds, own funds requirements and earnings. For the purpose of day-to-day portfolio monitoring, hedging, and management of concentrations the testing programme shall also consider scenarios of lesser severity and higher probability.
8. The programme shall include provision, where appropriate, for reverse stress tests to identify extreme, but plausible, scenarios that could result in significant adverse outcomes. Reverse stress testing shall account for the impact of material non-linearity in the portfolio.
9. The results of the stress testing under the programme shall be reported regularly, at least on a quarterly basis, to senior management. The reports and analysis of the results shall cover the largest counterparty-level impacts across the portfolio, material concentrations within segments of the portfolio (within the same industry or region), and relevant portfolio and counterparty specific trends.
10. Senior management shall take a lead role in the integration of stress testing into the risk management framework and risk culture of the institution and ensure that the results are meaningful and used to manage CCR. The results of stress testing for significant exposures shall be assessed against guidelines that indicate the institution's risk appetite, and referred to senior management for discussion and action when excessive or concentrated risks are identified.

*Article 285*  
*Wrong-Way Risk*

1. For the purposes of this Article:
  - (a) 'General Wrong-Way risk' arises when the likelihood of default by counterparties is positively correlated with general market risk factors;
  - (b) 'Specific Wrong-Way risk' arises when future exposure to a specific counterparty is positively correlated with the counterparty's probability of default due to the nature of the transactions with the counterparty. A credit institution shall be considered to be exposed to Specific Wrong-Way Risk if the future exposure to a specific counterparty is expected to be high when the counterparty's **probability of a default** [...] is also high.
2. An institution shall give due consideration to exposures that give rise to a significant degree of Specific and General Wrong-Way Risk.
3. In order to identify General Wrong-Way Risk, an institution shall design stress testing and scenario analyses to stress risk factors that are adversely related to counterparty credit worthiness. Such testing shall address the possibility of severe shocks occurring when relationships between risk factors have changed. An institution shall monitor General Wrong Way Risk by product, by region, by industry, or by other categories that are relevant to the business.
4. An institution shall maintain procedures to identify, monitor and control cases of Specific Wrong-Way risk for each legal entity, beginning at the inception of a transaction and continuing through the life of the transaction.



5. Institutions shall calculate the own funds requirements for CCR in relation to transactions where Specific Wrong-Way risk has been identified and where there exists a legal connection between the counterparty and the securities financing transaction or the issuer of the OTC derivative [...], in accordance with the following principles:
- (a) the instruments where Specific Wrong-Way risk exists shall not be included in the same netting set as other transactions with the counterparty, and shall each be treated as a separate netting set;
  - (b) within any such separate netting set, for single-name credit default swaps the exposure value equals the full expected loss in the value of the remaining fair value of the underlying instruments based on the assumption that the underlying issuer is in liquidation;
  - (c) LGD for an institution using the approach set out in Chapter 3 shall be 100% for such swap transactions;
  - (d) for an institution using the approach set out in Chapter 2, the applicable risk weight shall be that of an unsecured transaction;
  - (e) for all other transactions referencing a single name in any such separate netting set, the exposure value equals the value of the transaction under the assumption of a jump-to-default of the underlying obligation;
  - (f) to the extent that this uses existing market risk calculations for own funds requirements for incremental default and migration risk as set out in Title IV, Chapter 5, Section 4 that already contain an LGD assumption, the LGD in the formula used shall be 100%.
6. Institutions shall provide senior management and the appropriate committee of the management body with regular reports on both Specific and General Wrong-Way risks and the steps being taken to manage those risks.

*Article 286*

*Integrity of the modelling process*

1. An institution shall ensure the integrity of modelling process as set out in Article 278 by adopting at least the following measures:
  - (a) the model shall reflect transaction terms and specifications in a timely, complete, and conservative fashion;
  - (b) those terms shall include at least contract notional amounts, maturity, reference assets, margining arrangements and netting arrangements;
  - (c) those terms and specifications shall be maintained in a database that is subject to formal and periodic audit;
  - (d) a process for recognising netting arrangements that requires legal staff to verify that netting under those arrangements is legally enforceable;
  - (e) the verification required by point (d) shall be entered into the database mentioned in point (c) by an independent unit;
  - (f) the transmission of transaction terms and specification data to the EPE model shall be subject to internal audit;
  - (g) there shall be processes for formal reconciliation between the model and source data systems to verify on an ongoing basis that transaction terms and specifications are being reflected in EPE correctly or at least conservatively.

2. Current market data shall be used to determine current exposures. An institution may calibrate its EPE model using either historic market data or market implied data to establish parameters of the underlying stochastic processes, such as drift, volatility and correlation. If an institution uses historical data, it shall use at least three years of such data. The data shall be updated at least quarterly, and more frequently if necessary to reflect market conditions.

To calculate the Effective EPE using a stress calibration, an institution shall calibrate Effective EPE using either three years of data that includes a period of stress to the credit default spreads of its counterparties or market implied data from such a period of stress.

The requirements in paragraphs 3, 4 and 5 shall be applied by the institution for that purpose.

3. An institution shall demonstrate to the satisfaction of the competent authority, at least quarterly, that the stress period used for the calculation under this paragraph coincides with a period of increased credit default swap or other credit (such as loan or corporate bond) spreads for a representative selection of its counterparties with traded credit spreads. In situations where the institution does not have adequate credit spread data for a counterparty, it shall map that counterparty to specific credit spread data based on region, internal rating and business types.
4. The EPE model for all counterparties shall use data, either historic or implied, that include the data from the stressed credit period and shall use such data in a manner consistent with the method used for the calibration of the EPE model to current data.
5. To evaluate the effectiveness of its stress calibration for EEPE, an institution shall create several benchmark portfolios that are vulnerable to the main risk factors to which the institution is exposed. The exposure to these benchmark portfolios shall be calculated using (a) a stress methodology, based on current market values and model parameters calibrated to stressed market conditions, and (b) the exposure generated during the stress period, but applying the method set out in this Section (end of stress period market value, volatilities, and correlations from the 3-year stress period).

The competent authorities shall require an institution to adjust the stress calibration if the exposures of those benchmark portfolios deviate substantially from each other.

6. An institution shall subject the model to a validation process that is clearly articulated in the institutions' policies and procedures. That validation process shall:
  - (a) specify the kind of testing needed to ensure model integrity and identify conditions under which the assumptions underlying the model are inappropriate and may therefore result in an understatement of EPE;
  - (b) include a review of the comprehensiveness of the model.
7. An institution shall monitor the relevant risks and have processes in place to adjust its estimation of EEPE when those risks become significant. In complying with this paragraph, the institution shall:
  - (a) identify and manage its exposures to Specific Wrong-Way risk arising as specified in Article 285(1)(b) and exposures to General Wrong-Way risk arising as specified in Article 285(1)(a);
  - (b) for exposures with a rising risk profile after one year, compare on a regular basis the estimate of a relevant measure of exposure over one year with the same exposure measure over the life of the exposure;
  - (c) for exposures with a residual maturity below one year, compare on a regular basis the replacement cost (current exposure) and the realised exposure profile, and store data that would allow such a comparison.
8. An institution shall have internal procedures to verify that, prior to including a transaction in a netting set, the transaction is covered by a legally enforceable netting contract that meets the requirements set out in Section 7.

9. An institution that uses collateral to mitigate its CCR shall have internal procedures to verify that, prior to recognising the effect of collateral in its calculations, the collateral meets the legal certainty standards set out in Chapter 4 .
10. EBA shall monitor the range of practices in this area and shall, in accordance with Article 16 of Regulation (EU) No 1093/2010, issue guidelines on the application of this Article.

#### *Article 287*

##### *Requirements for the risk management system*

1. An institution shall comply with the following requirements:
  - (a) it shall meet the qualitative requirements set out in Part Three, Title IV, Chapter 5;
  - (b) it shall conduct a regular programme of back-testing, comparing the risk measures generated by the model with realised risk measures, and hypothetical changes based on static positions with realised measures;
  - (c) it shall carry out an initial validation and an on-going periodic review of its CCR exposure model and the risk measures generated by it. The validation and review shall be independent of the model development;
  - (d) the management body and senior management shall be involved in the risk control process and shall ensure that adequate resources are devoted to credit and counterparty credit risk control. In this regard, the daily reports prepared by the independent risk control unit established in accordance Article 281(1)(a) shall be reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual traders and reductions in the overall risk exposure of the institution;
  - (e) the internal risk measurement exposure model shall be integrated into the day-to-day risk management process of the institution;

- (f) the risk measurement system shall be used in conjunction with internal trading and exposure limits. In this regard, exposure limits shall be related to the institution's risk measurement model in a manner that is consistent over time and that is well understood by traders, the credit function and senior management;
- (g) an institution shall ensure that its risk management system is well documented. In particular, it shall maintain a documented set of internal policies, controls and procedures concerning the operation of the risk measurement system, and arrangements to ensure that those policies are complied with;
- (h) an independent review of the risk measurement system shall be carried out regularly in the institution's own internal auditing process. This review shall include both the activities of the business trading units and of the independent risk control unit. A review of the overall risk management process shall take place at regular intervals (and no less than once a year) and shall specifically address, as a minimum, all items referred to in Article 282;
- (i) the on-going validation of counterparty credit risk models, including back-testing, shall be reviewed periodically by a level of management with sufficient authority to decide the action that will be taken to address weaknesses in the models.

2. Competent authorities shall take into account the extent to which an institution meets the requirements of paragraph 1 when setting the level of alpha, as set out in Article 278(4). Only those institutions that comply fully with those requirements shall be eligible for application of the minimum multiplication factor.
3. An institution shall document the process for initial and on-going validation of its CCR exposure model and the calculation of the risk measures generated by the models to a level of detail that would enable a third party to recreate, respectively, the analysis and the risk measures. That documentation shall set out the frequency with which back testing analysis and any other on-going validation will be conducted, how the validation is conducted with respect to data flows and portfolios and the analyses that are used.

4. An institution shall define criteria with which to assess its CCR exposure models and the models that input into the calculation of exposure and maintain a written policy that describes the process by which unacceptable performance will be identified and remedied.
5. An institution shall define how representative counterparty portfolios are constructed for the purposes of validating an CCR exposure model and its risk measures.
6. The validation of CCR exposure models and their risk measures that produce forecast distributions shall consider more than a single statistic of the forecast distribution.

#### *Article 288*

##### *Validation requirements for counterparty credit risk exposure models*

1. As part of the initial and on-going validation of its CCR exposure model and its risk measures, an institution shall ensure that the following requirements are met:
  - (a) the institution shall carry out back-testing using historical data on movements in market risk factors prior to the permission by the competent authorities in accordance with Article 277(1). That back-testing shall consider a number of distinct prediction time horizons out to at least one year, over a range of various initialisation dates and covering a wide range of market conditions;
  - (b) the institution using the approach set out in paragraph 12(b) of Article 278 shall regularly validate its model to test whether realised current exposures are consistent with prediction over all margin periods within one year. If some of the trades in the netting set have a maturity of less than one year, and the netting set has higher risk factor sensitivities without these trades, the validation shall take this into account;
  - (c) it shall back-test the performance of its CCR exposure model and the model's relevant risk measures as well as the market risk factor predictions. For collateralised trades, the prediction time horizons considered shall include those reflecting typical margin periods of risk applied in collateralised or margined trading;

- (d) if the model validation indicates that effective EPE is underestimated, the institution shall take the action necessary to address the inaccuracy of the model;
- (e) it shall test the pricing models used to calculate CCR exposure for a given scenario of future shocks to market risk factors as part of the initial and on-going model validation process. Pricing models for options shall account for the nonlinearity of option value with respect to market risk factors;
- (f) the CCR exposure model shall capture the transaction-specific information necessary to be able to aggregate exposures at the level of the netting set. An institution shall verify that transactions are assigned to the appropriate netting set within the model;
- (g) the CCR exposure model shall include transaction-specific information to capture the effects of margining. It shall take into account both the current amount of margin and margin that would be passed between counterparties in the future. Such a model shall account for the nature of margin agreements that are unilateral or bilateral, the frequency of margin calls, the margin period of risk, the minimum threshold of un-margined exposure the institution is willing to accept, and the minimum transfer amount. Such a model shall either estimate the mark-to-market change in the value of collateral posted or apply the rules set out in Chapter 4;
- (h) the model validation process shall include static, historical back-testing on representative counterparty portfolios. An institution shall conduct such back-testing on a number of representative counterparty portfolios that are actual or hypothetical at regular intervals. Those representative portfolios shall be chosen on the basis of their sensitivity to the material risk factors and combinations of risk factors to which the institution is exposed;
- (i) an institution shall conduct back-testing that is designed to test the key assumptions of the CCR exposure model and the relevant risk measures, including the modelled relationship between tenors of the same risk factor, and the modelled relationships between risk factors;



- (j) the performance of CCR exposure models and its risk measures shall be subject to appropriate back-testing practice. The back testing programme shall be capable of identifying poor performance in an EPE model's risk measures;
- (k) an institution shall validate its CCR exposure models and all risk measures out to time horizons commensurate with the maturity of trades covered by the IMM waiver in accordance to the Article 277;
- (l) an institution shall regularly test the pricing models used to calculate counterparty exposure against appropriate independent benchmarks as part of the on-going model validation process;
- (m) the on-going validation of an institution's CCR exposure model and the relevant risk measures shall include an assessment of the adequacy of the recent performance;
- (n) the frequency with which the parameters of an CCR exposure model are updated shall be assessed by an institution as part of the initial and on-going validation process;
- (o) the initial and on-going validation of CCR exposure models shall assess whether or not the counterparty level and netting set exposure calculations of exposure are appropriate.

2. A measure that is more conservative than the metric used to calculate regulatory exposure value for every counterparty may be used in place of alpha multiplied by Effective EPE with the prior permission of the competent authorities. The degree of relative conservatism will be assessed upon initial approval by the competent authorities and at the regular supervisory reviews of the EPE models. An institution shall validate the conservatism regularly. The on-going assessment of model performance shall cover all counterparties for which the models are used.
3. If back-testing indicates that a model is not sufficiently accurate, the competent authorities shall revoke its permission for the model, or impose appropriate measures to ensure that the model is improved promptly.

## SECTION 7

### CONTRACTUAL NETTING

#### *Article 289*

#### *Recognition of contractual netting as risk-reducing*

1. Institutions may treat as risk reducing in accordance with Article 292 only the following types of contractual netting agreements where the netting agreement has been recognised by competent authorities in accordance with Article 290 and where the institution meets the requirements set out in Article 291:
  - (a) bilateral contracts for novation between an institution and its counterparty under which mutual claims and obligations are automatically amalgamated in such a way that the novation fixes one single net amount each time it applies so as to create a single new contract that replaces all former contracts and all obligations between parties pursuant to those contracts and is binding on the parties;
  - (b) other bilateral agreements between an institution and its counterparty;
  - (c) contractual cross-product netting agreements for institutions that have received the approval to use the method set out in Section 6 for transactions falling under the scope of that method.

Netting across transactions entered into by different legal entities of a group shall not be recognised for the purposes of calculating the own funds requirements.

## *Article 290*

### *Recognition of contractual netting agreements*

1. Competent authorities shall recognise a contractual netting agreement only where the conditions in paragraph 2 and, where relevant, 3 are fulfilled.
2. The following conditions shall be fulfilled by all contractual netting agreements used by an institution for the purposes of determining exposure value in this Part:
  - (a) the institution has concluded a contractual netting agreement with its counterparty which creates a single legal obligation, covering all included transactions, such that, in the event of default by the counterparty it would be entitled to receive or obliged to pay only the net sum of the positive and negative mark-to-market values of included individual transactions;
  - (b) the institution has made available to the competent authorities written and reasoned legal opinions to the effect that, in the event of a legal challenge of the netting agreement, the institution's claims and obligations would not exceed those referred to in point (a). The legal opinion shall refer to the applicable law:
    - (i) the jurisdiction in which the counterparty is incorporated;
    - (ii) if a branch of an undertaking is involved, which is located in another country than the one where the undertaking is incorporated, the jurisdiction in which the branch is located;
    - (iii) the jurisdiction whose law governs the individual transactions included in the netting agreement;
    - (iv) the jurisdiction whose law governs any contract or agreement necessary to effect the contractual netting;
  - (c) credit risk to each counterparty is aggregated to arrive at a single legal exposure across transactions with each counterparty. This aggregation shall be factored into credit limit purposes and internal capital purposes;

- (d) the contract shall not contain any clause which, in the event of default of a counterparty, permits a non-defaulting counterparty to make limited payments only, or no payments at all, to the estate of the defaulting party, even if the defaulting party is a net creditor (i.e. walk away clause).

If any of the competent authorities are not satisfied that the contractual netting is legally valid and enforceable under the law of each of the jurisdictions referred to in point (b) the contractual netting agreement shall not be recognised as risk-reducing for either of the counterparties. Competent authorities shall inform each other accordingly.

- 3. The legal opinions referred to in point (b) may be drawn up by reference to types of contractual netting. The following additional conditions shall be fulfilled by contractual cross-product netting agreements:
  - (a) the net sum referred to in Article 290(2)(a) is the net sum of the positive and negative close out values of any included individual bilateral master agreement and of the positive and negative mark-to-market value of the individual transactions (the ‘Cross-Product Net Amount’);
  - (b) the legal opinions referred to in Article 290(2)(b) shall address the validity and enforceability of the entire contractual cross-product netting agreement under its terms and the impact of the netting arrangement on the material provisions of any included individual bilateral master agreement.

*Article 291*  
*Obligations of institutions*

1. An institution shall establish and maintain procedures to ensure that the legal validity and enforceability of its contractual netting is reviewed in the light of changes in the law of relevant jurisdictions referred to in Article 290(2)(b).
2. The institution shall maintain all required documentation relating to its contractual netting in its files.
3. The institution shall factor the effects of netting into its measurement of each counterparty's aggregate credit risk exposure and the institution shall manage its CCR on the basis of those effects of that measurement.
4. In case of contractual cross-product netting agreements referred to in Article 289, the institution shall maintain procedures under Article 290(2)(c) to verify that any transaction which is to be included in a netting set is covered by a legal opinion referred to in Article 290(2)(b).

Taking into account the contractual cross-product netting agreement, the institution shall continue to comply with the requirements for the recognition of bilateral netting and the requirements of Chapter 4 for the recognition of credit risk mitigation, as applicable, with respect to each included individual bilateral master agreement and transaction.

## *Article 292*

### *Effects of recognition of netting as risk-reducing*

1. The following treatment applies to contractual netting agreements:

- (a) netting for the purposes of Sections 5 and 6 shall be recognised as set out in those Sections;
- (b) in the case of contracts for novation, the single net amounts fixed by such contracts rather than the gross amounts involved, may be weighted.

In the application of Section 3, institutions may take the contract for novation into account when determining:

- (i) the current replacement cost referred to in Article 269(1);
- (ii) the notional principal amounts or underlying values referred to in Article 269(2).

In the application of Section 4, in determining the notional amount referred to in Article 270(1) institutions may take into account the contract for novation for the purposes of calculating the notional principal amount. In such cases, institutions shall apply the percentages of Table 3.

- (c) In the case of other netting agreements, institutions shall apply Section 3 as follows:
  - (i) the current replacement cost referred to in Article 269(1) for the contracts included in a netting agreement shall be obtained by taking account of the actual hypothetical net replacement cost which results from the agreement; in the case where netting leads to a net obligation for the institution calculating the net replacement cost, the current replacement cost is calculated as '0';

- (ii) the figure for potential future credit exposure referred to in Article 269(2) for all contracts included in a netting agreement shall be reduced in accordance with the following formula:

$$PCE_{red} = 0.4 \cdot PCE_{gross} + 0.6 \cdot NGR \cdot PCE_{gross}$$

where:

$PCE_{red}$  = the reduced figure for potential future credit exposure for all contracts with a given counterparty included in a legally valid bilateral netting agreement;

$PCE_{gross}$  = the sum of the figures for potential future credit exposure for all contracts with a given counterparty which are included in a legally valid bilateral netting agreement and are calculated by multiplying their notional principal amounts by the percentages set out in Table 1;

$NGR$  = the net-to-gross ratio calculated as the quotient of the net replacement cost for all contracts included in a legally valid bilateral netting agreement with a given counterparty (numerator) and the gross replacement cost for all contracts included in a legally valid bilateral netting agreement with that counterparty (denominator).

2. When carrying out the calculation of the potential future credit exposure in accordance with the above formula, institutions may treat perfectly matching contracts included in the netting agreement as if they were a single contract with a notional principal equivalent to the net receipts.

In the application of Article 270(1) institutions may treat perfectly matching contracts included in the netting agreement as if they were a single contract with a notional principal equivalent to the net receipts, and the notional principal amounts shall be multiplied by the percentages given in Table 3.

For the purposes of this paragraph, perfectly matching contracts are forward foreign-exchange contracts or similar contracts in which a notional principal is equivalent to cash flows if the cash flows fall due on the same value date and fully in the same currency.

3. For all other contracts included in a netting agreement, the percentages applicable may be reduced as indicated in Table 6:

Table 6		
Original maturity	Interest-rate contracts	Foreign-exchange contracts
One year or less	0,35 %	1,50 %
More than one year but not more than two years	0,75 %	3,75 %
Additional allowance for each additional year	0,75 %	2,25 %

4. In the case of interest-rate contracts, institutions may, subject to the consent of their competent authorities, choose either original or residual maturity.



## SECTION 8

### ITEMS IN THE TRADING BOOK

#### *Article 293*

#### *Items in the trading book*

1. For the purposes of the application of this Article, Annex II shall include a reference to derivative instruments for the transfer of credit risk as mentioned in point (8) of Section C of Annex I to Directive 2004/39/EC.
2. When calculating risk-weighted exposure amounts for counterparty risk of items in the trading book, institutions shall comply with the following principles:
  - (a) in the case of total return swap credit derivatives and credit default swap credit derivatives, to obtain a figure for potential future credit exposure under the method set out in Section 3, the nominal amount of the instrument shall be multiplied by the following percentages:
    - (i) 5%, where the reference obligation is one that, if it gave rise to a direct exposure of the institution, would be a qualifying item for the purposes of Part Three, Title IV, Chapter 2;
    - (ii) 10%, where the reference obligation is one that, if it gave rise to a direct exposure of the institution, would not be a qualifying item for the purposes of Part Three, Title IV, Chapter 2.

In the case of an institution whose exposure arising from a credit default swap represents a long position in the underlying, the percentage for potential future credit exposure may be 0%, unless the credit default swap is subject to close-out upon the insolvency of the entity whose exposure arising from the swap represents a short position in the underlying, even though the underlying has not defaulted.

Where the credit derivative provides protection in relation to ‘nth to default’ amongst a number of underlying obligations, an institution shall determine which of the percentage figures prescribed above applies by reference to the obligation with the nth lowest credit quality which, if incurred by the institution, would be a qualifying item for the purposes of Part Three, Title IV, Chapter 2;

- (b) institutions shall not use the Financial Collateral Simple Method set out in Article 217 for the recognition of the effects of financial collateral;
- (c) in the case of repurchase transactions and securities or commodities lending or borrowing transactions booked in the trading book, institutions may recognise as eligible collateral all financial instruments and commodities that are eligible to be included in the trading book;
- (d) for exposures arising from OTC derivative instruments booked in the trading book, institutions may recognise commodities that are eligible to be included in the trading book as eligible collateral;
- (e) for the purposes of calculating volatility adjustments where such financial instruments or commodities which are not eligible under Chapter 4 are lent, sold or provided, or borrowed, purchased or received by way of collateral or otherwise under such a transaction, and an institution is using the Supervisory volatility adjustments approach under Section 3 of Chapter 4, institutions shall treat such instruments and commodities in the same way as non-main index equities listed on a recognised exchange;
- (f) where an institution is using the Own Estimates of Volatility adjustments approach under Section 3 of Chapter 4 in respect of financial instruments or commodities which are not eligible under Chapter 4, it shall calculate volatility adjustments for each individual item. Where an institution has obtained the approval to use the Internal Models Approach defined in Chapter 4, it may also apply that approach in the trading book;

- (g) in relation to the recognition of master netting agreements covering repurchase transactions, securities or commodities lending or borrowing transactions, or other capital market-driven transactions, institutions shall only recognise netting across positions in the trading book and the non-trading book when the netted transactions fulfil the following conditions:
  - (i) all transactions are marked to market daily;
  - (ii) any items borrowed, purchased or received under the transactions may be recognised as eligible financial collateral under Chapter 4 without the application of points (c) to (f) of this paragraph;
- (h) where a credit derivative included in the trading book forms part of an internal hedge and the credit protection is recognised under this Regulation in accordance with Article 199, institutions shall apply one of the following approaches:
  - (i) treat it as if there were no counterparty risk arising from the position in that credit derivative;
  - (ii) consistently include for the purpose of calculating the own funds requirements for counterparty credit risk all credit derivatives in the trading book forming part of internal hedges or purchased as protection against a CCR exposure where the credit protection is recognised as eligible under Chapter 4.

## SECTION 9

### OWN FUNDS REQUIREMENTS FOR EXPOSURES TO A CENTRAL COUNTERPARTY

#### *Article 294*

#### *Definitions*

The following definitions shall apply for the purposes of this Section:

- (1) 'bankruptcy remote', in relation to client assets, means that effective arrangements exist which ensure that those assets will not be available to the creditors of a CCP or of a clearing member in the event of the insolvency of that CCP or clearing member or that the assets will not be available to the clearing member to cover losses it incurred following the default of a client or clients other than the ones that provided those assets;
- (2) 'CCP-related transaction' means a contract or a transaction listed in Article 295(1) between a client and a clearing member that is directly related to a contract or a transaction listed in Article 295(1) between that clearing member and a CCP;
- (3) 'clearing member' means clearing member as defined in Article 2(1)(11) of Regulation (EU) ... [EMIR] ;
- (4) 'client' means client as defined in Article 2(1)(12) of Regulation (EU) ... [EMIR] or indirect clearing member according to Article 3(2)(2) of that Regulation;
- (5) 'pre-funded contribution' means a contribution to the default fund of a CCP that is paid by an institution.

## *Article 295*

### *Material scope*

1. This section applies to the following contracts and transactions for as long as they are outstanding with a CCP:
  - (a) the contracts listed in Annex II and credit derivatives;
  - (b) repurchase transactions;
  - (c) securities or commodities lending or borrowing transactions;
  - (d) long settlement transactions;
  - (e) margin lending transactions;
2. **Institutions shall apply the treatment specified in Articles 297 and 298 to the contracts and transactions outstanding with a CCP listed in paragraph 1, provided that all the following conditions [...] of Article 10 and 23 of Regulation (EU) [EMIR] are met and that the contracts or transactions have not been rejected by the CCP.**
- 3.

## *Article 296*

### *Treatment of clearing members' and clients' transactions*

1. Institutions shall monitor all their exposures to CCPs and shall regularly report information on those exposures to their senior management and appropriate committee or committees of the management body.
2. Where an institution acts as a clearing member, either for its own purposes or as a financial intermediary between a client and a CCP, it shall calculate the own funds requirements for its exposures to a CCP in accordance with Articles 297 and 298.

3. Where an institution acts as a clearing member and, in that capacity, acts as a financial intermediary between a client and a CCP, it shall calculate the own funds requirements for its CCP-related transactions with the client in accordance with the previous Sections of this Chapter, as applicable.
4. Where an institution is a client of a clearing member, it shall calculate the own funds requirements for its CCP-related transactions with the clearing member in accordance with the other Sections of this Chapter, as applicable.
5. As an alternative to the approach specified in paragraph 4, where an institution is a client, it may calculate the own funds requirements for its trade exposures for CCP-related transactions with the clearing member in accordance with Articles 297 provided that both of the following conditions are met:
  - (a) the positions and assets of that institution related to those transactions are distinguished and segregated, at the level of both the clearing member and the CCP, from the positions and assets of both the clearing member and the other clients of that clearing member and as a result of that segregation those positions and assets are bankruptcy remote in the event of the default or insolvency of the clearing member or one or more of its other clients;
  - (b) relevant laws, regulations, rules and contractual arrangements applicable to or binding that institution or the CCP facilitate transfer of the client's positions relating to those contracts and transactions and of the corresponding collateral to another clearing member within the relevant margin period of risk in the event of default or insolvency of the original clearing member.
6. Where an institution acting as a clearing member enters into a contractual arrangement with a client of another clearing member that facilitates the portability of assets and positions referred to in point (b) of paragraph 5 for that client, and that contractual agreement gives rise to a contingent obligation for that institution, that institution shall apply the treatment specified in this Regulation to that contingent obligation,

7. ESMA shall develop, in consultation with EBA, implementing technical standards to specify the meaning of ‘facilitate’ for the purposes of paragraphs 5 and 6.

ESMA shall submit those draft implementing technical standards to the Commission by [1 January 2013].

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 1092/2010.

#### *Article 297*

##### *Own funds requirements for trade exposures*

1. An institution shall apply a risk weight of 2% to the exposure values of all its trade exposures with CCPs.
2. Notwithstanding paragraph 1, where assets posted as collateral to a CCP or a clearing member are bankruptcy remote in the event that the CCP, the clearing member or one or more of the other clients of the clearing member becomes insolvent, an institution may attribute an exposure value of zero to the counterparty credit risk exposures for those assets.
3. An institution shall calculate exposure values of its trade exposures with a CCP in accordance with the other Sections of this Chapter, as applicable.
4. An institution shall calculate the risk weighted exposure amounts for its trade exposures with CCPs for the purposes of Articles 108(8) and 151 as the sum of the exposure values of its trade exposures with CCPs, calculated in accordance with paragraphs 2 and 3, multiplied by the risk weight determined in accordance with paragraph 1.

5. Notwithstanding paragraphs 1 and 2, where an institution posts assets as collateral to a CCP in a manner that is not bankruptcy remote, it shall apply to those assets a risk weight that otherwise applies under Chapters 2 to 4 to the exposure values calculated in accordance with paragraph 3.

#### *Article 298*

##### *Own funds requirements for default fund contributions*

1. Institutions acting as clearing members shall hold own funds to cover the exposures arising from their contributions to the default fund of a CCP. They shall calculate the own funds requirement for those exposures in accordance with the methodology set out in this Article.

Where a CCP does not have separate default funds for transactions in products with settlement risks only as set out in Title V and for contracts and transactions listed in Article 295(1), but uses instead the same default fund to mutualise losses associated with all those transactions and contracts, institutions shall apply the methodology set out in this Article to all their contributions to that default fund.

- 1a. The exposure value for an institution's pre-funded contribution to the default fund of a CCP ( $DF_i$ ) shall be the amount paid in reflecting any losses of the CCP already absorbed.**

2. An institution shall calculate the own funds requirement ( $K_i$ ) to cover the exposure arising from its pre-funded contribution ( $DF_i$ ) as follows:

$$K_i = \left( (1 + \beta) \cdot \frac{N}{N - 2} \right) \cdot \frac{DF_i}{DF_{CM}} \cdot K_{CM}$$

where:

$\beta$ = the concentration factor communicated to the institution by the CCP;

$N$ = the number of clearing members communicated to the institution by the CCP;



$DF_{CM}$  = the sum of pre-funded contributions of all clearing members of the CCP ( $\sum_i DF_i$ )

communicated to the institution by the CCP;

$K_{CM}$  = the sum of the own funds requirements of all clearing members of the CCP calculated in accordance with the applicable formula specified in paragraph 3

$$\left( \sum_i K_i \right).$$

3. Institutions shall calculate  $K_{CM}$  as follows:

(a) where  $K_{CCP} \leq DF_{CCP}$  institutions shall use the following formula:

$$K_{CM} = c_1 \cdot DF_{CM}^* ;$$

(b) where  $DF_{CCP} < K_{CCP} \leq DF^*$  institutions shall use the following formula:

$$K_{CM} = c_2 \cdot (K_{CCP} - DF_{CCP}) + c_1 \cdot (DF^* - K_{CCP}) ;$$

(c) where  $DF^* < K_{CCP}$  institutions shall use the following formula:

$$K_{CM} = c_2 \cdot \mu \cdot (K_{CCP} - DF^*) + c_2 \cdot DF_{CM}^*$$

where:

$DF_{CCP}$  = the pre-funded financial resources of the CCP communicated to the institution by the CCP;

$K_{CCP}$  = the hypothetical capital of the CCP communicated to the institution by the CCP;

$DF$  = the total pre-funded contributions

$$DF^* = DF_{CCP} + DF_{CM}^* ;$$

$$DF_{CM}^* = DF_{CM} - 2 \cdot \overline{DF_i};$$

$\overline{DF_i}$  = the average pre-funded contribution,  $\frac{1}{N} \cdot DF_{CM}$ , communicated to the institution by the CCP;

$$c_1 = \text{a capital factor equal to } \max \left\{ \frac{1.6\%}{\sqrt{\frac{DF^*}{K_{CCP}}}}, 0.16\% \right\};$$

$c_2$  = a capital factor equal to 100%;

$\mu = 1.2$ .

4. Institutions acting as clearing members shall calculate the own funds requirement ( $K_i^c$ ) for the exposure arising from their contractually committed contributions ( $DF_i^c$ ) as follows:

(a) where  $DF^* \geq K_{CCP}$ , institutions shall use the following formula:

$$K_i^c = c_1 \cdot DF_i^c$$

where:

$$c_1 = \text{a capital factor equal to } \max \left\{ \frac{1.6\%}{\sqrt{\frac{DF^* + DF_{CM}^c}{K_{CCP}}}}, 0.16\% \right\};$$

$DF_{CM}^c$  = the sum of all of the contractually committed contributions ( $\sum_i DF_i^c$ ),

communicated to the institution by the CCP;

(b) where  $DF^* < K_{CCP}$ , institutions shall use the following formula:

$$K_i^c = c_2 \cdot \mu \cdot \max \{0, DF_i^c - \alpha(K_{CCP} - DF^*)\}$$

where  $\alpha = \left( (1 + \beta) \cdot \frac{N}{N - 2} \right) \cdot \frac{DF_i}{DF_{CM}}$

5. Risk weighted exposure amounts for exposures arising from an institution's pre-funded contribution for the purposes of Article 108(8) and Article 151 shall be calculated as the own funds requirement ( $K_i$ ) determined in accordance with paragraphs 2 multiplied by 12.5.
- 5a. Risk weighted exposure amounts for exposures arising from an institution's contractually committed contribution for the purposes of Article 108(8) and Article 151 shall be calculated as the own funds requirement ( $K_i$ ) determined in accordance with paragraphs 4 multiplied by 12.5.
6. 'Contractually committed contribution' means a contribution to the default fund of a CCP that an institution is contractually required to pay on a specified event, but which is not a pre-funded contribution.
- 7.
8. Where  $K_{CCP}$  is equal to zero, institutions shall use the value for  $c_1$  of 0.16% for the purpose of the calculation in paragraphs 3 and 4.

## Article 299

### Calculation of the hypothetical capital of a CCP

1. For contracts and transactions listed in Article 295(1), a CCP shall calculate the hypothetical capital needed by its clearing members for the purposes of this Section as follows:

$$K_{CCP} = \sum_i \max\{EBRM_i - VM_i - IM_i - DF_i, 0\} \cdot RW \cdot capital\ ratio$$

where:

$EBRM_i$ = exposure value before risk mitigation that is equal to the exposure value of the CCP to clearing member i arising from the contracts and transactions listed in Article 295(1) calculated without taking into account the collateral posted by that clearing member;

$VM_i$ = the variation margin associated with clearing member i;

$IM_i$ = the initial margin posted to the CCP by clearing member i;

$DF_i$ = the pre-funded contribution of clearing member i;

$RW$ = a risk weight of 20%;

$capital\ ratio$ = 8%.

2. For the purposes of the calculation required by paragraph 1, the following shall apply:
- (a) a CCP shall calculate the value of the exposures it has to its clearing members in accordance with the Mark-to-Market Method specified in Article 269. When calculating those values, the CCP shall subtract from its exposures the collateral posted by its clearing members, appropriately reduced by the supervisory volatility adjustments in accordance with the Financial Collateral Comprehensive Method specified in Article 219. A CCP shall calculate its [...] **Securities Financing Transaction** exposure in accordance with the Financial Collateral Comprehensive method (with supervisory volatility adjustments) specified in Article 218-219;
  - (b) where the clearing member is entitled to receive - but has not yet received - the variation margin from the CCP, the CCP shall enter the corresponding amount of  $VM_i$  into the equation with a positive sign. Conversely, where the CCP is entitled to receive - but has not yet received - the variation margin from the clearing member, the CCP shall enter the corresponding amount of  $VM_i$  into the equation with a negative sign;
  - (c) where a CCP has exposures to one or more CCPs it shall treat any such exposures as if they were exposures to clearing members and include any margin or pre-funded contributions received from those CCPs in the calculation of  $K_{CCP}$ ;
  - (d) where a CCP's financial resources are used in parallel, and on a pro-rata basis, to the pre-funded contributions of its clearing members, the CCP shall add the corresponding amount of those resources to  $DF_{CM}$ ;
  - (e)

- (f) A CCP shall replace the formula in point (c)(ii) of Article 292(1) with the following one:

$$PCE_{red} = 0.3 \cdot PCE_{gross} + 0.7 \cdot NGR \cdot PCE_{gross} ;$$

- (g) where a CCP cannot calculate the value of NGR as defined in point (c)(ii) of Article 292(1), it shall do the following:
- (i) notify those of its clearing members which are institutions about its inability to calculate NGR;
  - (ii) for a period of 3 months, it may use a value of NGR of 0.3 to perform the calculation of  $PCE_{red}$  specified in point (f);
- (h) where, at the end of the period specified in point (ii) of point (g), the CCP would still be unable to calculate the value of NGR, it shall do the following:
- (i) stop calculating  $K_{CCP}$ ;
  - (ii) notify those of its clearing members which are institutions that it has stopped calculating  $K_{CCP}$ ;
- (i) for the purpose of calculating the potential future exposure for options and swaptions under the Mark-to-Market Method specified in Article 269, a CCP shall multiply the notional amount of the contract by the absolute value of the option's delta ( $\partial V / \partial p$ ) as defined in point (a) of Article 274(1);

- (j) where the rules of a CCP foresee that it shall use part of its financial resources to cover its losses due to the default of one or more of its clearing members after it has depleted its default fund, but before it calls on the contractually committed contributions of its clearing members, the CCP shall add the amount of those additional financial resources ( $DF_{CCP}^a$ ) to the total amount of pre-funded contributions (DF):

$$DF = DF_{CCP} + DF_{CM} + DF_{CCP}^a.$$

3. A CCP shall undertake the calculation required by paragraph 1 at least quarterly or more frequently where required by the competent authorities of those of its clearing members which are institutions.
4. A CCP shall notify the following information to those of its clearing members which are institutions and to their competent authorities:
- (a) the hypothetical capital ( $K_{CCP}$ );
  - (b) the sum of pre-funded contributions ( $DF_{CM}$ );
  - (c) the amount of its pre-funded financial resources that it is required to use - by law or due to a contractual agreement with its clearing members - to cover its losses following the default of one or more of its clearing members before using the default fund contributions of the remaining clearing members ( $DF_{CCP}$ );
  - (d)
  - (e) the total number of its clearing members (N);
  - (f) the concentration factor ( $\beta$ ), as defined in paragraph 5;
  - (g) the sum of all of the contractually committed contributions ( $DF_{CM}^c$ ).

The CCP shall notify those of its clearing members which are institutions at least quarterly or more frequently where required by the competent authorities of those clearing members.

5. A CCP shall calculate the concentration factor ( $\beta$ ) according to the following formula:

$$\beta = \frac{\max_i \{PCE_{red,i}\}}{\sum_i PCE_{red,i}}$$

where:

$PCE_{red,i}$  = the reduced figure for potential future credit exposure for all contracts and transaction of a CCP with clearing member i.

6. Institutions shall inform their competent authorities about the receipt of the notifications referred to in point (i) of point (g) and (h)(ii) of paragraph 2 and in paragraph 4.
7. EBA, in close cooperation with the competent authorities for supervision and oversight of CCPs, shall develop implementing technical standards to specify the following:
- (a) the frequency and dates of the calculations specified in paragraph 1;
  - (b) the frequency, dates and uniform format of the notification specified in paragraph 4;
  - (c) the situations in which the competent authority of an institution acting as a clearing member may require higher frequencies of calculation and reporting than the ones set out in points a and b.

EBA, in close cooperation with the competent authorities for supervision and oversight of CCPs, 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.

#### *Article 300*



## **Title III**

### **Own funds requirements for operational risk**

#### **Chapter 1**

#### **General principles governing the use of the different approaches**

##### *Article 301*

##### *Permission and notification*

1. To qualify for use of the Standardised Approach, institutions shall meet the criteria set out in Article 309, in addition to meeting the general risk management standards set out in Articles 73 and 83 of Directive [inserted by OP]. Institutions shall notify the competent authorities prior to using the Standardised Approach.

Competent authorities shall permit institutions to use an alternative relevant indicator for the business lines "retail banking" and "commercial banking" where the conditions set out in Articles 308(2) and 309 are met.

2. Competent authorities shall permit institutions to use Advanced Measurement Approaches based on their own operational risk measurement systems, where all the qualitative and quantitative standards set out in Articles 310 and 311 respectively are met and where institutions meet the general risk management standards set out in Articles 73 and 83 of Directive [inserted by OP] and Section II, Chapter 3, Title VII of that Directive.

Institutions shall also apply for permission from their competent authorities where they want to implement material extensions and changes to those Advanced Measurement Approaches. Competent authorities shall grant the permission only where institutions would continue to meet the standards specified in the first subparagraph following those material extensions and changes.

3. EBA shall develop draft regulatory technical standards to specify the following:
- (a) the conditions for assessing the materiality of extensions and changes to the Advanced Measurement Approaches ;
  - (b) the assessment methodology [...] under which the competent authorities permit institutions to use Advanced Measurement Approaches; including the methodology used to assess the conditions set out in paragraph 2 to 5 of Article 312.

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 302*

##### *Reverting to the use of less sophisticated approaches*

- 1. Institutions that use the Standardised Approach shall not revert to the use of the Basic Indicator Approach unless the conditions in paragraph 3 are met.
- 2. Institutions that use the Advanced Measurement Approaches shall not revert to the use of the Standardised Approach or the Basic Indicator Approach unless the conditions in paragraph 3 are met.

3. An institution may only revert to the use of a less sophisticated approach for operational risk where both the following conditions are met:
  - (a) the institution has demonstrated to the satisfaction of the competent authority that the use of a less sophisticated approach is not proposed in order to reduce the operational risk related own funds requirements 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 operational risk effectively;
  - (b) the institution has received the prior permission of the competent authority.

### *Article 303*

#### *Combined used of different approaches*

1. Institutions may use a combination of approaches provided that they obtain permission from the competent authorities. Competent authorities shall grant such permission where the requirements set out in paragraphs 2 to 4, as applicable, are met.
2. An institution may use an Advanced Measurement Approach in combination with either the Basic Indicator Approach or the Standardised Approach, where both the following conditions are met:
  - (a) the combination of Approaches used by the institution captures all its operational risks and competent authorities are satisfied with the methodology used by the institution to cover different activities, geographical locations, legal structures or other relevant divisions determined on an internal basis;
  - (b) the criteria set out in Article 309 and the standards set out in Articles 310 and 311 are fulfilled for the part of activities covered by the Standardised Approach and the Advanced Measurement Approaches respectively.

3. For institutions that want to use an Advanced Measurement Approach in combination with either the Basic Indicator Approach or the Standardised Approach competent authorities shall, impose the following additional conditions for granting permission:
- (c) on the date of implementation of an Advanced Measurement Approach, a significant part of the institution's operational risks are captured by that Approach;
  - (d) the institution takes a commitment to apply the Advanced Measurement Approach across a material part of its operations within a time schedule that was submitted to and approved by its competent authorities.
4. An institution may request permission from a competent authority to use a combination of the Basic Indicator Approach and the Standardised Approach only in exceptional circumstances such as the recent acquisition of new business which may require a transition period for the application of the Standardised Approach.

A competent authority shall grant such permission only where the institution has committed to apply the Standardised Approach within a time schedule that was submitted to and approved by the competent authority.

5. EBA shall develop draft regulatory technical standards to specify the following:
- (a) the conditions that competent authorities shall use when assessing the methodology referred to in point (a) of paragraph 2;
  - (b) the conditions that the competent authorities shall use when deciding whether to impose the additional conditions referred to in paragraph 3.

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

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.

## Chapter 2

### Basic indicator approach

#### *Article 304*

#### *Capital requirement*

Under the Basic Indicator Approach, the own funds requirement for operational risk is equal to 15 % of the average over three years of the relevant indicator as defined in Article 305.

Institutions shall calculate the average over three years of the relevant indicator on the basis of the last three twelve-monthly observations at the end of the financial year. When audited figures are not available, institutions may use business estimates.

Where an institution has been in operation for less than three years it may use forward-looking business estimates in calculating the relevant indicator, provided that it starts using historical data as soon as it is available.

**Where an institution can prove to its competent authority that [...] - due to [...] a merger or a disposal of entities or activities - [...] using a three year average to calculate the relevant indicator would lead to a biased estimation for the own funds requirement for operational risk, the competent authority may permit [...] institutions to modify the calculation in a way that would take into account such events. In such circumstances, the competent authority may, on its own initiative, also require an institution to modify the calculation.**

Where for any given observation, the relevant indicator is negative or equal to zero, institutions shall not take into account this figure in the calculation of the average over three years. Institutions shall calculate the average over three years as the sum of positive figures divided by the number of positive figures.

*Article 305*  
*Relevant indicator*

1. For institutions applying accounting standards established by Directive 86/635/EEC, based on the accounting categories for the profit and loss account of institutions under Article 27 of that Directive, the relevant indicator is the sum of the elements listed in Table 1 of this paragraph. Institutions shall include each element in the sum with its positive or negative sign.

Table 1
1 Interest receivable and similar income
2 Interest payable and similar charges
3 Income from shares and other variable/fixed-yield securities
4 Commissions/fees receivable
5 Commissions/fees payable
6 Net profit or net loss on financial operations
7 Other operating income

Institutions shall adjust these elements to reflect the following qualifications:

- (a) institutions shall calculate the relevant indicator before the deduction of any provisions and operating expenses. Institutions shall include in operating expenses fees paid for outsourcing services rendered by third parties which are not a parent or subsidiary of the institution or a subsidiary of a parent which is also the parent of the institution. Institutions may use expenditure on the outsourcing of services rendered by third parties to reduce the relevant indicator where the expenditure is incurred from an undertaking subject to rules under, or equivalent to, this Regulation;
  - (b) institutions shall not use the following elements in the calculation of the relevant indicator:
    - (i) realised profits/losses from the sale of non-trading book items;
    - (ii) income from extraordinary or irregular items;
    - (iii) income derived from insurance.
  - (c) when revaluation of trading items is part of the profit and loss statement, institutions may include revaluation. When institutions apply Article 36(2) of Directive 86/635/EEC, they shall include revaluation booked in the profit and loss account.
2. When institutions apply accounting standards different from the ones established by Directive 86/635/EEC, they shall calculate the relevant indicator on the basis of data that best reflect the definition set out in this Article.
3. EBA shall develop draft regulatory technical standards to determine the methodology to calculate the relevant indicator referred to in paragraph 2.

EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2017.

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.

## Chapter 3

### Standardised approach

#### *Article 306*

#### *Own funds requirement*

1. Under the Standardised Approach, institutions shall divide their activities into the business lines set out in Table 2 of paragraph 4 and in accordance with the principles set out in Article 307.
2. Institutions shall calculate the own funds requirement for operational risk as the average over three years of the sum of the annual own funds requirements across all business lines referred to in Table 2 of paragraph 4. The annual own funds requirement of each business line is equal to the product of the corresponding beta factor referred to in that Table and the part of the relevant indicator mapped to the respective business line.
3. In any given year, institutions may offset negative own funds requirements resulting from a negative part of the relevant indicator in any business line with positive own funds requirements in other business lines without limit. However, where the aggregate own funds requirement across all business lines within a given year is negative, institutions shall use the value zero as the input to the numerator for that year.
4. Institutions shall calculate the average over three years of the sum referred to in paragraph 2 on the basis of the last three twelve-monthly observations at the end of the financial year. When audited figures are not available, institutions may use business estimates.



**Where an institution can prove to its competent authority that [...] - due to [...] a merger or a disposal of entities or activities- [...] using a three year average to calculate the relevant indicator would lead to a biased estimation for the own funds requirement for operational risk, the competent authority may permit [...] institutions to modify the calculation in a way that would take into account such events. In such circumstances, the competent authority may, on its own initiative, also require an institution to modify the calculation.**

Where an institution has been in operation for less than three years it may use forward-looking business estimates in calculating the relevant indicator, provided that it starts using historical data as soon as it is available.

Table 2		
Business line	List of activities	Percentage (beta factor)
Corporate finance	<p>Underwriting of financial instruments or placing of financial instruments on a firm commitment basis</p> <p>Services related to underwriting</p> <p>Investment advice</p> <p>Advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to the mergers and the purchase of undertakings</p> <p>Investment research and financial analysis and other forms of general recommendation relating to transactions in financial instruments</p>	18 %

Trading and sales	Dealing on own account  Money broking  Reception and transmission of orders in relation to one or more financial instruments  Execution of orders on behalf of clients  Placing of financial instruments without a firm commitment basis  Operation of Multilateral Trading Facilities	18 %
Retail brokerage  (Activities with a individual natural persons or with small and medium sized enterprises meeting the criteria set out in Article 79 for the retail exposure class)	Reception and transmission of orders in relation to one or more financial instruments  Execution of orders on behalf of clients  Placing of financial instruments without a firm commitment basis	12 %
Commercial banking	Acceptance of deposits and other repayable funds  Lending  Financial leasing  Guarantees and commitments	15 %

Retail banking  (Activities with a individual natural persons or with small and medium sized enterprises meeting the criteria set out in Article 79 for the retail exposure class)	Acceptance of deposits and other repayable funds  Lending  Financial leasing  Guarantees and commitments	12 %
Payment and settlement	Money transmission services,  Issuing and administering means of payment	18 %
Agency services	Safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management	15 %
Asset management	Portfolio management  Managing of UCITS  Other forms of asset management	12 %

## *Article 307*

### *Principles for business line mapping*

1. Institutions shall develop and document specific policies and criteria for mapping the relevant indicator for current business lines and activities into the standardised framework set out in Article 306. They shall review and adjust those policies and criteria as appropriate for new or changing business activities and risks.
2. Institutions shall apply the following principles for business line mapping:
  - (a) institutions shall map all activities into the business lines in a mutually exclusive and jointly exhaustive manner;
  - (b) institutions shall allocate any activity which cannot be readily mapped into the business line framework, but which represents an ancillary activity to an activity included in the framework, to the business line it supports. Where more than one business line is supported through the ancillary activity, institutions shall use an objective-mapping criterion;
  - (c) where an activity cannot be mapped into a particular business line then institutions shall use the business line yielding the highest percentage. The same business line equally applies to any ancillary activity associated with that activity;
  - (d) institutions may use internal pricing methods to allocate the relevant indicator between business lines. Costs generated in one business line which are imputable to a different business line may be reallocated to the business line to which they pertain;
  - (e) the mapping of activities into business lines for operational risk capital purposes shall be consistent with the categories institutions use for credit and market risks;

- (f) senior management shall be responsible for the mapping policy under the control of the management body of the institution;
  - (g) institutions shall subject the mapping process to business lines to independent review.
3. EBA shall develop draft implementing technical standards to determine the conditions of application of the principles for business line mapping provided in this Article.

EBA shall submit those draft implementing technical standards to the Commission by 31 December 2017.

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 308*

##### *Alternative Standardised Approach*

1. Under the Alternative Standardised Approach, for the business lines "retail banking" and "commercial banking", institutions shall apply the following:
- (a) the relevant indicator is a normalised income indicator equal to the nominal amount of loans and advances multiplied by 0.035;
  - (b) the loans and advances consist of the total drawn amounts in the corresponding credit portfolios. For the "commercial banking" business line, institutions shall also include securities held in the non trading book in the nominal amount of loans and advances.
2. To be permitted to use the Alternative Standardised Approach, the institution shall meet all the following conditions:
- (a) its retail or commercial banking activities shall account for at least 90 % of its income;

- (b) a significant proportion of its retail or commercial banking activities shall comprise loans associated with a high probability of default;
- (c) the alternative standardised approach provides an appropriate basis for calculating its own funds requirement for operational risk.

3.

#### *Article 309*

##### *Criteria for the standardised approach*

The criteria referred to in subparagraph 1 of Article 301(1) are the following:

- (a) institutions shall have in place a well-documented assessment and management system for operational risk with clear responsibilities assigned for this system. They shall identify their exposures to operational risk and track relevant operational risk data, including material loss data. This system shall be subject to regular independent review carried out by an internal or external party possessing the necessary knowledge to carry out such review;
- (b) an institutions operational risk assessment system shall be closely integrated into the risk management processes of the institution. Its output shall be an integral part of the process of monitoring and controlling the institution's operational risk profile;
- (c) institutions shall implement a system of reporting to senior management that provides operational risk reports to relevant functions within the institutions. Institutions shall have in place procedures for taking appropriate action according to the information within the reports to management.

## **Chapter 4**

### **Advanced measurement approaches**

#### **SECTION 1**

#### **QUALIFYING CRITERIA**

##### *Article 310*

##### *Qualitative standards*

The qualitative standards referred to in Article 301(2) are the following:

- (a) an institution's internal operational risk measurement system shall be closely integrated into its day-to-day risk management processes;
- (b) institutions shall have an independent risk management function for operational risk;
- (c) institutions shall have in place regular reporting of operational risk exposures and loss experience and shall have in place procedures for taking appropriate corrective action;
- (d) an institution's risk management system shall be well documented. Institution shall have in place routines for ensuring compliance and policies for the treatment of non-compliance;
- (e) institution shall subject their operational risk management processes and measurement systems to regular reviews performed by internal or external auditors;
- (f) an institution's internal validation processes shall operate in a sound and effective manner;
- (g) data flows and processes associated with an institution's the risk measurement system shall be transparent and accessible.

*Article 311*  
*Quantitative Standards*

1. The quantitative standards referred to in Article 301(2) include the standards relating to process, to internal data, to external data, to scenario analysis, to business environment and to internal control factors referred to in paragraphs 2 to 6 respectively.
2. The standards relating to process are the following:
  - (a) institutions shall calculate their own funds requirement as comprising both expected loss and unexpected loss, unless expected loss is adequately captured in their internal business practices. The operational risk measure shall capture potentially severe tail events, achieving a soundness standard comparable to a 99.9 % confidence interval over a one year period;
  - (b) an institutions operational risk measurement system shall include the use of internal data, external data, scenario analysis and factors reflecting the business environment and internal control systems as set out in paragraphs 3 to 6. An institution shall have in place a well documented approach for weighting the use of these four elements in its overall operational risk measurement system;
  - (c) an institution's risk measurement system shall capture the major drivers of risk affecting the shape of the tail of the estimated distribution of losses;
  - (d) institutions may recognise correlations in operational risk losses across individual operational risk estimates only where their systems for measuring correlations are sound, implemented with integrity, and take into account the uncertainty surrounding any such correlation estimates, particularly in periods of stress. Institutions shall validate their correlation assumptions using appropriate quantitative and qualitative techniques;
  - (e) an institution's risk measurement system shall be internally consistent and shall avoid the multiple counting of qualitative assessments or risk mitigation techniques recognised in other areas of this Regulation.



3. The standards relating to internal data are the following:
- (a) institutions shall base their internally generated operational risk measures on a minimum historical observation period of five years. When an institution first moves to an Advanced Measurement Approach, it may use a three-year historical observation period;
  - (b) institutions shall be able to map their historical internal loss data into the business lines defined in Article 306 and into the event types defined in Article 313, and to provide these data to competent authorities upon request. In exceptional circumstances, an institution may allocate loss events which affect the entire institution to an additional business line "corporate items". Institutions shall have in place documented, objective criteria for allocating losses to the specified business lines and event types. Institutions shall record the operational risk losses that are related to credit risk and that institutions have historically included in the internal credit risk databases in the operational risk databases and shall identify them separately. Such losses shall not be subject to the operational risk charge, as long as institutions continue to treat them as credit risk for the purposes of calculating own funds requirements. Institutions shall include operational risk losses that are related to market risks in the scope of the own funds requirement for operational risk;
  - (c) an institution's internal loss data shall be comprehensive in that it captures all material activities and exposures from all appropriate sub-systems and geographic locations. Institutions shall be able to justify that any excluded activities or exposures, both individually and in combination, would not have a material impact on the overall risk estimates. Institutions shall define appropriate minimum loss thresholds for internal loss data collection;
  - (d) aside from information on gross loss amounts, institutions shall collect information about the date of the loss event, any recoveries of gross loss amounts, as well as descriptive information about the drivers or causes of the loss event;

- (e) institutions shall have in place specific criteria for assigning loss data arising from a loss event in a centralised function or an activity that spans more than one business line, as well as from related loss events over time;
- (f) institutions shall have in place documented procedures for assessing the on-going relevance of historical loss data, including those situations in which judgement overrides, scaling, or other adjustments may be used, to what extent they may be used and who is authorised to make such decisions.

4. The qualifying standards relating to external data are the following:

- (a) an institution's operational risk measurement system shall use relevant external data, especially when there is reason to believe that the institution is exposed to infrequent, yet potentially severe, losses. An institution shall have a systematic process for determining the situations for which external data shall be used and the methodologies used to incorporate the data in its measurement system;
- (b) institutions shall regularly review the conditions and practices for external data and shall document them and subject them to periodic independent review.

5. An institution shall use scenario analysis of expert opinion in conjunction with external data to evaluate its exposure to high severity events. Over time, the institution shall validate and reassess such assessments through comparison to actual loss experience to ensure their reasonableness.

6. The qualifying standards relating to business environment and internal control factors are the following:

- (a) an institution's firm-wide risk assessment methodology shall capture key business environment and internal control factors that can change the institutions operational risk profile;

- (b) institutions shall justify the choice of each factor as a meaningful driver of risk, based on experience and involving the expert judgment of the affected business areas;
- (c) institutions shall be able to justify to competent authorities the sensitivity of risk estimates to changes in the factors and the relative weighting of the various factors. In addition to capturing changes in risk due to improvements in risk controls, an institution's risk measurement framework shall also capture potential increases in risk due to greater complexity of activities or increased business volume;
- (d) an institution shall document its risk measurement framework and shall subject it to independent review within the institution and by competent authorities. Over time, institutions shall validate and reassess the process and the outcomes through comparison to actual internal loss experience and relevant external data.

7.

#### *Article 312*

##### *Impact of insurance and other risk transfer mechanisms*

1. The competent authorities shall permit institutions to recognise the impact of insurance subject to the conditions set out in paragraphs 2 to 5 and other risk transfer mechanisms where the institution can demonstrate that a noticeable risk mitigating effect is achieved.
2. The insurance provider shall be authorised to provide insurance or re-insurance and shall have a minimum claims paying ability rating by an [...] ECAI which has been determined by EBA to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to institutions under Part Three, Title II, Chapter 2

3. The insurance and the institutions' insurance framework shall meet all the following conditions:
- (a) the insurance policy has an initial term of no less than one year. For policies with a residual term of less than one year, an institution shall make appropriate haircuts reflecting the declining residual term of the policy, up to a full 100 % haircut for policies with a residual term of 90 days or less;
  - (b) the insurance policy has a minimum notice period for cancellation of the contract of 90 days;
  - (c) the insurance policy has no exclusions or limitations triggered by supervisory actions or, in the case of a failed institution, that preclude the institution's receiver or liquidator from recovering the damages suffered or expenses incurred by the institution, except in respect of events occurring after the initiation of receivership or liquidation proceedings in respect of the institution. However, the insurance policy may exclude any fine, penalty, or punitive damages resulting from actions by the competent authorities;
  - (d) the risk mitigation calculations shall reflect the insurance coverage in a manner that is transparent in its relationship to, and consistent with, the actual likelihood and impact of loss used in the overall determination of operational risk capital;
  - (e) the insurance is provided by a third party entity. In the case of insurance through captives and affiliates, the exposure has to be laid off to an independent third party entity that meets the eligibility criteria set out in paragraph 2;
  - (f) the framework for recognising insurance is well reasoned and documented.

4. The methodology for recognising insurance shall capture all the following elements through discounts or haircuts in the amount of insurance recognition:
- (a) the residual term of the insurance policy, where less than one year;
  - (b) the policy's cancellation terms, where less than one year;
  - (c) the uncertainty of payment as well as mismatches in coverage of insurance policies.
5. The reduction in own funds requirements from the recognition of insurances and other risk transfer mechanisms shall not exceed 20 % of the own funds requirement for operational risk before the recognition of risk mitigation techniques.

*Article 313*

*Loss event type classification*

The loss events types referred to in point (b) of Article 311(3) are the following:

Table 3	
Event-Type Category	Definition
Internal fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/discrimination events, which involves at least one internal party
External fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party
Employment Practices and Workplace Safety	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity/discrimination events
Clients, Products & Business Practices	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product
Damage to Physical Assets	Losses arising from loss or damage to physical assets from natural disaster or other events
Business disruption and system failures	Losses arising from disruption of business or system failures
Execution, Delivery & Process Management	Losses from failed transaction processing or process management, from relations with trade counterparties and vendors

# **Title IV**

## **Own funds requirements for market risk**

### **Chapter 1**

#### **General Provisions**

##### *Article 314*

##### *Allowances for consolidated requirements*

1. Subject to paragraph 2 and only for the purpose of calculating net positions and own funds requirements in accordance with this Title on a consolidated basis, institutions may use positions in one institution or undertaking to offset positions in another institution or undertaking.
2. Institutions may apply paragraph 1 only subject to the permission of the competent authorities, which shall be granted if all of the following conditions are met:
  - (a) there is a satisfactory allocation of own funds within the group;
  - (b) the regulatory, legal or contractual framework in which the institutions operate is such as to guarantee mutual financial support within the group.
3. Where there are undertakings located in third countries all of the following conditions shall be met in addition to those in paragraph 2:
  - (a) such undertakings have been authorised in a third country and either satisfy the definition of a credit institution or are recognised third-country investment firms;
  - (b) such undertakings comply, on an individual basis, with own funds requirements equivalent to those laid down in this Regulation;
  - (c) no regulations exist in the third countries in question which might significantly affect the transfer of funds within the group.

## Chapter 2

### Own funds requirements for position risk

#### SECTION 1

#### GENERAL PROVISIONS AND SPECIFIC INSTRUMENTS

##### *Article 315*

##### *Own funds requirements for position risk*

The institution's own funds requirement for position risk shall be the sum of the own funds requirements for the general and specific risk of its positions in debt and equity instruments. Securitisation positions in the trading book shall be treated as debt instruments. The specific-risk component is the risk of a price change in the instrument concerned due to factors related to its issuer or, in the case of a derivative, the issuer of the underlying instrument. The general risk component is the risk of a price change in the instrument due (in the case of a traded debt instrument or debt derivative) to a change in the level of interest rates or (in the case of an equity or equity derivative) to a broad equity market movement unrelated to any specific attributes of individual securities.

##### *Article 316*

##### *Netting*

1. The absolute value of the excess of an institution's long (short) positions over its short (long) positions in the same equity, debt and convertible issues and identical financial futures, options, warrants and covered warrants shall be its net position in each of those different instruments. In calculating the net position, positions in derivative instruments shall be treated as laid down in Articles 317 to 319. Institutions' holdings of their own debt instruments shall be disregarded in calculating specific risk capital requirements under Article 325.



2. No netting shall be allowed between a convertible and an offsetting position in the instrument underlying it, unless the competent authorities adopt an approach under which the likelihood of a particular convertible's being converted is taken into account or require an own funds requirement to cover any loss which conversion might entail. Such approaches or own funds requirements shall be notified to the EBA. EBA shall monitor the range of practices in this area and shall, in accordance with Article 16 of Regulation (EU) No. 1093/2010, issue guidelines.
3. All net positions, irrespective of their signs, must be converted on a daily basis into the institution's reporting currency at the prevailing spot exchange rate before their aggregation.

#### *Article 317*

##### *Interest rate futures and forwards*

1. Interest-rate futures, forward-rate agreements (FRAs) and forward commitments to buy or sell debt instruments shall be treated as combinations of long and short positions. Thus a long interest-rate futures position shall be treated as a combination of a borrowing maturing on the delivery date of the futures contract and a holding of an asset with maturity date equal to that of the instrument or notional position underlying the futures contract in question. Similarly a sold FRA will be treated as a long position with a maturity date equal to the settlement date plus the contract period, and a short position with maturity equal to the settlement date. Both the borrowing and the asset holding shall be included in the first category set out in Table 1 in Article 325 in order to calculate the own funds requirement for specific risk for interest-rate futures and FRAs. A forward commitment to buy a debt instrument shall be treated as a combination of a borrowing maturing on the delivery date and a long (spot) position in the debt instrument itself. The borrowing shall be included in the first category set out in Table 1 in Article 325 for purposes of specific risk, and the debt instrument under whichever column is appropriate for it in the same table.

2. For the purposes of this Article, ‘long position’ means a position in which an institution has fixed the interest rate it will receive at some time in the future, and ‘short position’ means a position in which it has fixed the interest rate it will pay at some time in the future.

### *Article 318*

#### *Options and warrants*

1. Options and warrants on interest rates, debt instruments, equities, equity indices, financial futures, swaps and foreign currencies shall be treated as if they were positions equal in value to the amount of the underlying instrument to which the option refers, multiplied by its delta for the purposes of this Chapter. The latter positions may be netted off against any offsetting positions in the identical underlying securities or derivatives. The delta used shall, where relevant, be that of the exchange concerned, that calculated by the competent authorities or, subject to permission by the competent authorities, where that is not available or for OTC-options, that calculated by the institution itself using an appropriate model. Permission shall be granted if the model appropriately estimates the rate of change of the option's or warrant's value with respect to small changes in the market price of the underlying.
2. Institutions shall adequately reflect other risks, apart from the delta risk, associated with options in the own funds requirements.
3. EBA shall develop draft regulatory technical standards defining a range of methods to reflect in the own funds requirements other risks, apart from delta risk, referred to in paragraph 2 in a manner proportionate to the scale and complexity of institutions' activities in options and warrants.

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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

## *Article 319*

### *Swaps*

Swaps shall be treated for interest-rate risk purposes on the same basis as on-balance-sheet instruments. Thus, an interest-rate swap under which an institution receives floating-rate interest and pays fixed-rate interest shall be treated as equivalent to a long position in a floating-rate instrument of maturity equivalent to the period until the next interest fixing and a short position in a fixed-rate instrument with the same maturity as the swap itself.

## *Article 320*

### *Interest rate risk on derivative instruments*

1. Institutions which mark to market and manage the interest-rate risk on the derivative instruments covered in Articles 317 to 319 on a discounted-cash-flow basis may, subject to permission by the competent authorities, use sensitivity models to calculate the positions referred to in those Articles and may use them for any bond which is amortised over its residual life rather than via one final repayment of principal. Permission shall be granted if these models generate positions which have the same sensitivity to interest-rate changes as the underlying cash flows. This sensitivity shall be assessed with reference to independent movements in sample rates across the yield curve, with at least one sensitivity point in each of the maturity bands set out in Table 2 in Article 328. The positions shall be included in the calculation of own funds requirements for general risk of debt instruments.
2. Institutions which do not use models under paragraph 1 may, treat as fully offsetting any positions in derivative instruments covered in Articles 317 to 319 which meet the following conditions at least:
  - (a) the positions are of the same value and denominated in the same currency;
  - (b) the reference rate (for floating-rate positions) or coupon (for fixed-rate positions) is closely matched;

- (c) the next interest-fixing date or, for fixed coupon positions, residual maturity corresponds with the following limits:
  - (i) less than one month hence: same day;
  - (ii) between one month and one year hence: within seven days;
  - (iii) over one year hence: within 30 days.

### *Article 321*

#### *Credit Derivatives*

1. When calculating the own funds requirement for general and specific risk of the party who assumes the credit risk (the 'protection seller'), unless specified differently, the notional amount of the credit derivative contract shall be used. Notwithstanding the first sentence, the institution may elect to replace the notional value by the notional value plus the net market value change of the credit derivative since trade inception, a net downward change from the protection seller's perspective carrying a negative sign. For the purpose of calculating the specific risk charge, other than for total return swaps, the maturity of the credit derivative contract, rather than the maturity of the obligation, shall apply. Positions are determined as follows:
  - (a) a total return swap creates a long position in the general risk of the reference obligation and a short position in the general risk of a government bond with a maturity equivalent to the period until the next interest fixing and which is assigned a 0 % risk weight under Title II, Chapter 2. It also creates a long position in the specific risk of the reference obligation;
  - (b) a credit default swap does not create a position for general risk. For the purposes of specific risk, the institution must record a synthetic long position in an obligation of the reference entity, unless the derivative is rated externally and meets the conditions for a qualifying debt item, in which case a long position in the derivative is recorded. If premium or interest payments are due under the product, these cash flows must be represented as notional positions in government bonds;

- (c) a single name credit linked note creates a long position in the general risk of the note itself, as an interest rate product. For the purpose of specific risk, a synthetic long position is created in an obligation of the reference entity. An additional long position is created in the issuer of the note. Where the credit linked note has an external rating and meets the conditions for a qualifying debt item, a single long position with the specific risk of the note need only be recorded;
- (d) in addition to a long position in the specific risk of the issuer of the note, a multiple name credit linked note providing proportional protection creates a position in each reference entity, with the total notional amount of the contract assigned across the positions according to the proportion of the total notional amount that each exposure to a reference entity represents. Where more than one obligation of a reference entity can be selected, the obligation with the highest risk weighting determines the specific risk.
- (e) A first-asset-to-default credit derivative creates a position for the notional amount in an obligation of each reference entity. If the size of the maximum credit event payment is lower than the own funds requirement under the method in the first sentence of this point, the maximum payment amount may be taken as the own funds requirement for specific risk.

a -n-th-asset-to-default credit derivative creates a position for the notional amount in an obligation of each reference entity less the n-1 reference entities with the lowest specific risk own funds requirement. If the size of the maximum credit event payment is lower than the own funds requirement under the method in the first sentence of this point, this amount may be taken as the own funds requirement for specific risk.

Where an n-th-to-default credit derivative is externally rated, the protection seller shall calculate the specific risk own funds requirement using the rating of the derivative and apply the respective securitisation risk weights as applicable;

2. For the party who transfers credit risk (the protection buyer), the positions are determined as the mirror principle of the protection seller, with the exception of a credit linked note (which entails no short position in the issuer). When calculating the own funds requirement for the 'protection buyer', the notional amount of the credit derivative contract shall be used. Notwithstanding the first sentence, the institution may elect to replace the notional value by the notional value minus the net market value change of the credit derivative since trade inception, a net downward change from the protection buyer's perspective carrying a negative sign. If at a given moment there is a call option in combination with a step-up, such moment is treated as the maturity of the protection.
3. Credit derivatives according to Article 327 (1) or (3) shall be included only in the determination of the specific risk own funds requirement according to Article 327 (4).

#### *Article 322*

##### *Securities sold under a repurchase agreement or lent*

The transferor of securities or guaranteed rights relating to title to securities in a repurchase agreement and the lender of securities in a securities lending shall include these securities in the calculation of its own funds requirement under this Chapter provided that such securities are trading book positions.

## **SECTION 2**

### **DEBT INSTRUMENTS**

#### *Article 323*

##### *Net positions in debt instruments*

Net positions shall be classified according to the currency in which they are denominated and shall calculate the own funds requirement for general and specific risk in each individual currency separately.

#### **SUB-SECTION 1**

##### **SPECIFIC RISK**

#### *Article 324*

##### *Cap on the own funds requirement for a net position*

The institution may cap the own funds requirement for specific risk of a net position in a debt instrument at the maximum possible default-risk related loss. For a short position, that limit may be calculated as a change in value due to the instrument or, where relevant, the underlying names immediately becoming default risk-free.

#### *Article 325*

##### *Own funds requirement for non-securitisation debt instruments*

1. The institution shall assign its net positions in the trading book in instruments that are not securitisation positions as calculated in accordance with Article 316 to the appropriate categories in Table 1 on the basis of their issuer or obligor, external or internal credit assessment, and residual maturity, and then multiply them by the weightings shown in that table. It shall sum its weighted positions resulting from the application of this Article regardless of whether they are long or short in order to calculate its own funds requirement against specific risk.

<i>Table 1</i>	
Categories	Specific risk own funds requirement
Debt securities which would receive a 0 % risk weight under the Standardised approach for credit risk.	0 %
Debt securities which would receive a 20% or 50% risk weight under the Standardised approach for credit risk and other qualifying items as defined in paragraph 4.	0,25 % (residual term to final maturity six months or less)  1,00 % (residual term to final maturity greater than six months and up to and including 24 months)  1,60 % (residual term to maturity exceeding 24 months)
Debt securities which would receive a 100% risk weight under the Standardised approach for credit risk.	8,00 %
Debt which would receive a 150% risk weight under the Standardised approach for credit risk.	12,00 %

2. For institutions which apply the IRB approach to the exposure class of which the issuer of the debt instrument forms part, to qualify for a risk weight under the Standardised approach for credit risk as referred to in paragraph 1, the issuer of the exposure shall have an internal rating with a PD equivalent to or lower than that associated with the appropriate credit quality step under the Standardised approach.



3. Institutions may calculate the specific risk requirements for any bonds that qualify for a 10% risk weight in accordance with the treatment in Article 124(3), Article 124(4) and Article 124(5) as half of the applicable specific risk own funds requirement for the second category in Table 1.
4. Other qualifying items are:
- (a)
  - (b)
  - (c) long and short positions in assets for which a credit assessment by a nominated external credit assessment institution is not available and which meet all of the following conditions:
    - (i) they are considered by the institution concerned to be sufficiently liquid;
    - (ii) their investment quality is, according to the institution's own discretion, at least equivalent to that of the assets referred to under point Table 1 second row;
    - (iii) they are listed on at least one regulated market in a Member State or on a stock exchange in a third country provided that the exchange is recognised by the competent authorities of the relevant Member State;
  - (d) long and short positions in assets issued by institutions subject to the own funds requirements set out in this Regulation which are considered by the institution concerned to be sufficiently liquid and whose investment quality is, according to the institution's own discretion, at least equivalent to that of the assets referred to under Table 1 second row;

- (e) securities issued by institutions that are deemed to be of equivalent, or higher, credit quality than those associated with credit quality step 2 under the Standardised approach for credit risk of exposures to institutions and that are subject to supervisory and regulatory arrangements comparable to those under this Regulation and Directive [to be inserted by OP].

Institutions that make use of points (c) or (d) shall have a documented methodology in place to assess whether assets meet the requirements in those points and shall notify this methodology to the competent authorities.

### *Article 326*

#### *Own funds requirement for securitisation instruments*

1. For instruments in the trading book that are securitisation positions, the institution shall weight with the following its net positions as calculated in accordance with Article 316(1):
  - (a) for securitisation positions that would be subject to the Standardised Approach for credit risk in the same institution's non-trading book, 8 % of the risk weight under the Standardised Approach as set out in Chapter 5;
  - (b) for securitisation positions that would be subject to the Internal Ratings Based Approach in the same institution's non-trading book, 8 % of the risk weight under the Internal Ratings Based Approach as set out in Chapter 5.
2. The Supervisory Formula Method set out in Article 257 may be used where the institution can produce estimates of PD, and where applicable exposure value and LGD as inputs into the Supervisory Formula Method in accordance with the requirements for the estimation of those parameters under the Internal Ratings Based approach in accordance with Chapter 2, Section 3.

An institution other than an originator institution that could apply it for the same securitisation position in its non-trading book may only use that method subject to permission by the competent authorities, which shall be granted where the institution fulfils the condition in the previous sentence.

Estimates of PD and LGD as inputs to the Supervisory Formula Method may alternatively also be determined based on estimates that are derived from an IRC approach of an institution that has been granted permission to use an internal model for specific risk of debt instruments. The latter alternative may be used only subject to permission by the competent authorities, which shall be granted if those estimates meet the quantitative requirements for the Internal Ratings Based Approach set out in Chapter 2, Section 3.

In accordance with Article 16 of Regulation (EU) No. 1093/2010, EBA shall issue guidelines on the use of estimates of PD and LGD as inputs when those estimates are based on an IRC approach.

3. For securitisation positions that are subject to an additional risk weight in accordance with Article 396, 8 % of the total risk weight shall be applied.
4. Except for securitisation positions according to Article 327, the institution shall sum its weighted positions resulting from the application of this Article (regardless of whether they are long or short) in order to calculate its own funds requirement against specific risk.
5. By way of derogation from paragraph 4, for a transitional period ending 31 December 2013, the institution shall sum separately its weighted net long positions and its weighted net short positions. The larger of those sums shall constitute the specific risk own funds requirement. The institution shall, however, quarterly report to the home Member State competent authority the total sum of its weighted net long and net short positions, broken down by types of underlying assets.

#### *Article 327*

##### *Own funds requirement for the correlation trading portfolio*

1. The correlation trading portfolio shall consist of securitisation positions and n-th-to-default credit derivatives that meet all of the following criteria:
  - (a) the positions are neither re-securitisation positions, nor options on a securitisation tranche, nor any other derivatives of securitisation exposures that do not provide a pro-rata share in the proceeds of a securitisation tranche;

- (b) all reference instruments are either of the following:
  - (i) single-name instruments, including single-name credit derivatives, for which a liquid two-way market exists;
  - (ii) commonly-traded indices based on those reference entities.

A two-way market is deemed to exist where there are independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined within one day and settled at such price within a relatively short time conforming to trade custom.

- 2. Positions which reference any of the following shall not be part of the correlation trading portfolio:
  - (a) an underlying that is capable of being assigned to the exposure class 'retail claims or contingent retail claims' or to the exposure class '[...] exposures secured by mortgages on immovable property' under the Standardised approach for credit risk in an institution's non-trading book;
  - (b) a claim on a special purpose entity, collateralised, directly or indirectly, by a position that would itself not be eligible for inclusion in the correlation trading portfolio according to points (1) and (2) of this article 327.
- 3. An institution may include in the correlation trading portfolio positions which are neither securitisation positions nor n-th-to-default credit derivatives but which hedge other positions of that portfolio, provided that a liquid two-way market as described in the last subparagraph of paragraph 1 exists for the instrument or its underlyings .
- 4. An institution shall determine the larger of the following amounts as the specific risk own funds requirement for the correlation trading portfolio:
  - (a) the total specific risk own funds requirement that would apply just to the net long positions of the correlation trading portfolio;
  - (b) the total specific risk own funds requirement that would apply just to the net short positions of the correlation trading portfolio.

## **SUB-SECTION 2**

### **GENERAL RISK**

#### *Article 328*

#### *Maturity-based calculation of general risk*

1. In order to calculate own funds requirements against general risk all positions shall be weighted according to maturity as explained in paragraph 2 in order to compute the amount of own funds required against them. This requirement shall be reduced when a weighted position is held alongside an opposite weighted position within the same maturity band. A reduction in the requirement shall also be made when the opposite weighted positions fall into different maturity bands, with the size of this reduction depending both on whether the two positions fall into the same zone, or not, and on the particular zones they fall into.
2. The institution shall assign its net positions to the appropriate maturity bands in column 2 or 3, as appropriate, in Table 2 in paragraph 4. It shall do so on the basis of residual maturity in the case of fixed-rate instruments and on the basis of the period until the interest rate is next set in the case of instruments on which the interest rate is variable before final maturity. It shall also distinguish between debt instruments with a coupon of 3 % or more and those with a coupon of less than 3 % and thus allocate them to column 2 or column 3 in Table 2. It shall then multiply each of them by the weighing for the maturity band in question in column 4 in Table 2.
3. The institution shall then work out the sum of the weighted long positions and the sum of the weighted short positions in each maturity band. The amount of the former which are matched by the latter in a given maturity band shall be the matched weighted position in that band, while the residual long or short position shall be the unmatched weighted position for the same band. The total of the matched weighted positions in all bands shall then be calculated.

4. The institution shall compute the totals of the unmatched weighted long positions for the bands included in each of the zones in Table 2 in order to derive the unmatched weighted long position for each zone. Similarly, the sum of the unmatched weighted short positions for each band in a particular zone shall be summed to compute the unmatched weighted short position for that zone. That part of the unmatched weighted long position for a given zone that is matched by the unmatched weighted short position for the same zone shall be the matched weighted position for that zone. That part of the unmatched weighted long or unmatched weighted short position for a zone that cannot be thus matched shall be the unmatched weighted position for that zone.

Table 2				
Zone	Maturity band			
	Coupon of 3 % or more	Coupon of less than 3 %		
One	$0 \leq 1$ month	$0 \leq 1$ month	0,00	—
	$> 1 \leq 3$ months	$> 1 \leq 3$ months	0,20	1,00
	$> 3 \leq 6$ months	$> 3 \leq 6$ months	0,40	1,00
	$> 6 \leq 12$ months	$> 6 \leq 12$ months	0,70	1,00
Two	$> 1 \leq 2$ years	$> 1,0 \leq 1,9$ years	1,25	0,90
	$> 2 \leq 3$ years	$> 1,9 \leq 2,8$ years	1,75	0,80
	$> 3 \leq 4$ years	$> 2,8 \leq 3,6$ years	2,25	0,75
Three	$> 4 \leq 5$ years	$> 3,6 \leq 4,3$ years	2,75	0,75
	$> 5 \leq 7$ years	$> 4,3 \leq 5,7$ years	3,25	0,70
	$> 7 \leq 10$ years	$> 5,7 \leq 7,3$ years	3,75	0,65
	$> 10 \leq 15$ years	$> 7,3 \leq 9,3$ years	4,50	0,60

	> 15 ≤ 20 years	> 9,3 ≤ 10,6 years	5,25	0,60
	> 20 years	> 10,6 ≤ 12,0 years	6,00	0,60
		> 12,0 ≤ 20,0 years	8,00	0,60
		> 20 years	12,50	0,60

5. The amount of the unmatched weighted long or short position in zone one which is matched by the unmatched weighted short or long position in zone two shall then be the matched weighted position between zones one and two. The same calculation shall then be undertaken with regard to that part of the unmatched weighted position in zone two which is left over and the unmatched weighted position in zone three in order to calculate the matched weighted position between zones two and three.
6. The institution may reverse the order in paragraph 5 so as to calculate the matched weighted position between zones two and three before calculating that position between zones one and two.
7. The remainder of the unmatched weighted position in zone one shall then be matched with what remains of that for zone three after the latter's matching with zone two in order to derive the matched weighted position between zones one and three.
8. Residual positions, following the three separate matching calculations in paragraph 5, 6 and 7 shall be summed.

9. The institution's own funds requirement shall be calculated as the sum of:
- (a) 10 % of the sum of the matched weighted positions in all maturity bands;
  - (b) 40 % of the matched weighted position in zone one;
  - (c) 30 % of the matched weighted position in zone two;
  - (d) 30 % of the matched weighted position in zone three;
  - (e) 40 % of the matched weighted position between zones one and two and between zones two and three;
  - (f) 150 % of the matched weighted position between zones one and three;
  - (g) 100 % of the residual unmatched weighted positions.

*Article 329*

*Duration-based calculation of general risk*

1. Institutions may use an approach for calculating the own funds requirement for the general risk on debt instruments which reflects duration, instead of the approach set out in Article 328, provided that the institution does so on a consistent basis.
2. Under the duration-based approach referred to in paragraph 1, the institution shall take the market value of each fixed-rate debt instrument and hence calculate its yield to maturity, which is implied discount rate for that instrument. In the case of floating-rate instruments, the institution shall take the market value of each instrument and hence calculate its yield on the assumption that the principal is due when the interest rate can next be changed.
3. The institution shall then calculate the modified duration of each debt instrument on the basis of the following formula:

$$\text{modified duration} = \frac{D}{1 + R}$$



where:

$D$  = duration calculated according to the following formula:

$$D = \frac{\sum_{t=1}^M \frac{t \cdot C_t}{(1+R)^t}}{\sum_{t=1}^M \frac{C_t}{(1+R)^t}}$$

where:

$R$  = yield to maturity

$C_t$  = cash payment in time  $t$ ;

$M$  = total maturity

Correction shall be made to the calculation of the modified duration for debt instruments which are subject to prepayment risk. EBA shall, in accordance with Article 16 of Regulation (EU) No. 1093/2010, issue guidelines about how to apply such corrections.

4. The institution shall then allocate each debt instrument to the appropriate zone in Table 3. It shall do so on the basis of the modified duration of each instrument.

Table 3		
Zone	Modified duration (in years)	Assumed interest (change in %)
One	$> 0 \leq 1,0$	1,0
Two	$> 1,0 \leq 3,6$	0,85
Three	$> 3,6$	0,7

5. The institution shall then calculate the duration-weighted position for each instrument by multiplying its market price by its modified duration and by the assumed interest-rate change for an instrument with that particular modified duration (see column 3 in Table 3).
6. The institution shall calculate its duration-weighted long and its duration-weighted short positions within each zone. The amount of the former which are matched by the latter within each zone shall be the matched duration-weighted position for that zone.

The institution shall then calculate the unmatched duration-weighted positions for each zone. It shall then follow the procedures laid down for unmatched weighted positions in Article 328, paragraphs 5 to 8.

7. The institution's own funds requirement shall then be calculated as the sum of the following:
  - (a) 2 % of the matched duration-weighted position for each zone;
  - (b) 40 % of the matched duration-weighted positions between zones one and two and between zones two and three;
  - (c) 150 % of the matched duration-weighted position between zones one and three;
  - (d) 100 % of the residual unmatched duration-weighted positions.

## SECTION 3

### EQUITIES

#### *Article 330*

##### *Net positions in equity instruments*

1. The institution shall separately sum all its net long positions and all its net short positions in accordance with Article 316. The sum of the absolute values of the two figures shall be its overall gross position.
2. The institution shall calculate, separately for each market, the difference between the sum of the net long and the net short positions. The sum of the absolute values of those differences shall be its overall net position.
3. EBA shall develop draft regulatory technical standards defining the term market referred to in 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 previous sub-paragraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1093/2010.

#### *Article 331*

##### *Specific risk of equity instruments*

The institution shall multiply its overall gross position by 8 % in order to calculate its own funds requirement against specific risk.

*Article 332*  
*General risk of equity instruments*

The own funds requirement against general risk shall be its overall net position multiplied by 8 %.

*Article 333*  
*Stock indices*

1. EBA shall develop draft implementing technical standards listing the stock indices for which one or more of the treatments in paragraphs 3 and 4 is available.

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.

2. Before the entry into force of the technical standards referred to in paragraph 1, institutions may continue to apply the treatment set out in paragraphs 3 and 4, where the competent authorities have applied that treatment before 1 January 2013.
3. Stock-index futures, the delta-weighted equivalents of options in stock-index futures and stock indices collectively referred to hereafter as ‘stock-index futures’, may be broken down into positions in each of their constituent equities. These positions may be treated as underlying positions in the equities in question, and may, be netted against opposite positions in the underlying equities themselves. Institutions shall notify the competent authority of the use they make of this treatment.
4. Where a stock-index future is not broken down into its underlying positions, it shall be treated as if it were an individual equity. However, the specific risk on this individual equity can be ignored if the stock-index future in question is exchange traded and represents an appropriately diversified index.

## SECTION 4

### UNDERWRITING

#### *Article 334*

#### *Reduction of net positions*

1. In the case of the underwriting of debt and equity instruments, an institution may use the following procedure in calculating its own funds requirements. The institution shall first calculate the net positions by deducting the underwriting positions which are subscribed or sub-underwritten by third parties on the basis of formal agreements. The institution shall then reduce the net positions by the reduction factors in Table 4 and calculate its own funds requirements using the reduced underwriting positions.

Table 4	
working day 0:	100 %
working day 1:	90 %
working days 2 to 3:	75 %
working day 4:	50 %
working day 5:	25 %
after working day 5:	0 %.

‘Working day zero’ shall be the working day on which the institution becomes unconditionally committed to accepting a known quantity of securities at an agreed price.

2. The institutions shall notify to the competent authorities the use they make of paragraph 1.

**SECTION 5**  
**SPECIFIC RISK OWN FUNDS REQUIREMENTS FOR POSITIONS HEDGED BY CREDIT**  
**DERIVATIVES**

*Article 335*

*Allowance for hedges by credit derivatives*

1. An allowance shall be given for hedges provided by credit derivatives, in accordance with the principles set out in paragraphs 2 to 6.
2. Institutions shall treat the position in the credit derivative as one 'leg' and the hedged position that has the same nominal, or, where applicable, notional amount, as the other 'leg'.
3. Full allowance shall be given when the values of the two legs always move in the opposite direction and broadly to the same extent. This will be the case in the following situations:
  - (a) the two legs consist of completely identical instruments;
  - (b) a long cash position is hedged by a total rate of return swap (or vice versa) and there is an exact match between the reference obligation and the underlying exposure (i.e., the cash position). The maturity of the swap itself may be different from that of the underlying exposure.

In these situations, a specific risk own funds requirement shall not be applied to either side of the position.

4. An 80 % offset will be applied when the values of the two legs always move in the opposite direction and where there is an exact match in terms of the reference obligation, the maturity of both the reference obligation and the credit derivative, and the currency of the underlying exposure. In addition, key features of the credit derivative contract shall not cause the price movement of the credit derivative to materially deviate from the price movements of the cash position. To the extent that the transaction transfers risk, an 80 % specific risk offset will be applied to the side of the transaction with the higher own funds requirement, while the specific risk requirements on the other side shall be zero.

5. Partial allowance shall be given, absent the situations in paragraphs 3 and 4, in the following situations:
- (a) the position falls under paragraph 3(b) but there is an asset mismatch between the reference obligation and the underlying exposure. However, the positions meet the following requirements:
    - (i) the reference obligation ranks *pari passu* with or is junior to the underlying obligation;
    - (ii) the underlying obligation and reference obligation share the same obligor and have legally enforceable cross-default or cross-acceleration clauses;
  - (b) the position falls under paragraph 3(a) or 4 but there is a currency or maturity mismatch between the credit protection and the underlying asset. Such currency mismatch shall be included in the own funds requirement for foreign exchange risk;
  - (c) the position falls under paragraph 4 but there is an asset mismatch between the cash position and the credit derivative. However, the underlying asset is included in the (deliverable) obligations in the credit derivative documentation.

In order to give partial allowance, rather than adding the specific risk own funds requirements for each side of the transaction, only the higher of the two own funds requirements shall apply.

6. In all situations not falling under paragraphs 3 to 5, an own funds requirement for specific risk shall be calculated for both sides of the positions separately.

### *Article 336*

#### *Allowance for hedges by first and nth-to default credit derivatives*

In the case of first-to-default credit derivatives and nth-to-default credit derivatives, the following treatment applies for the allowance to be given according to Article 335:

- (a) where an institution obtains credit protection for a number of reference entities underlying a credit derivative under the terms that the first default among the assets shall trigger payment and that this credit event shall terminate the contract, the institution may offset specific risk for the reference entity to which the lowest specific risk percentage charge among the underlying reference entities applies according to Table 1 in Article 325;
- (b) where the nth default among the exposures triggers payment under the credit protection, the protection buyer may only offset specific risk if protection has also been obtained for defaults 1 to n-1 or when n-1 defaults have already occurred. In such cases, the methodology set out above for first-to-default credit derivatives shall be followed appropriately modified for nth-to-default products.

## **SECTION 6**

### **OWN FUNDS REQUIREMENTS FOR CIUs**

### *Article 337*

#### *Own funds requirements for CIUs*

1. Without prejudice to other provisions in this section, positions in CIUs shall be subject to an own funds requirement for position risk, comprising specific and general risk, of 32 %. Without prejudice to Article 342 taken together with the modified gold treatment set out in Article 341 (4) and Article 356(2)(b) positions in CIUs shall be subject to an own funds requirement for position risk, comprising specific and general risk, and foreign-exchange risk of 40 %.
2. Unless noted otherwise in Article 339, no netting is permitted between the underlying investments of a CIU and other positions held by the institution.



*Article 338*  
*General criteria for CIUs*

CIUs shall be eligible for the approach set out in Article 339, where all the following conditions are met:

- (a) the CIU's prospectus or equivalent document shall include all of the following:
  - (i) the categories of assets the CIU is authorised to invest in;
  - (ii) where investment limits apply, the relative limits and the methodologies to calculate them;
  - (iii) where leverage is allowed, the maximum level of leverage;
  - (iv) where concluding OTC financial derivatives transactions or repurchase transactions or securities borrowing or lending is allowed, a policy to limit counterparty risk arising from these transactions;
- (b) the business of the CIU shall be reported in half-yearly and annual reports to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period;
- (c) the shares or units of the CIU are redeemable in cash, out of the undertaking's assets, on a daily basis at the request of the unit holder;
- (d) investments in the CIU shall be segregated from the assets of the CIU manager;
- (e) there shall be adequate risk assessment of the CIU, by the investing institution;
- (f) CIUs shall be managed by persons supervised according to Directive (UCITS) or equivalent legislation.

*Article 339*

*Specific methods for CIUs*

1. Where the institution is aware of the underlying investments of the CIU on a daily basis, the institution may look through to those underlying investments in order to calculate the own funds requirements for position risk, comprising specific and general risk. Under this approach, positions in CIUs shall be treated as positions in the underlying investments of the CIU. Netting shall be permitted between positions in the underlying investments of the CIU and other positions held by the institution, as long as the institution holds a sufficient quantity of shares or units to allow for redemption/creation in exchange for the underlying investments.
2. Institutions may calculate the own funds requirements for position risk, comprising specific and general risk, for positions in CIUs by assuming positions representing those necessary to replicate the composition and performance of the externally generated index or fixed basket of equities or debt securities referred to in point (a), subject to the following conditions:
  - (a) purpose of the CIU's mandate is to replicate the composition and performance of an externally generated index or fixed basket of equities or debt securities;
  - (b) a minimum correlation of 0.9 between daily price movements of the CIU and the index or basket of equities or debt securities it tracks can be clearly established over a minimum period of six months. 'Correlation' in this context means the correlation coefficient between daily returns on the CIU and the index or basket of equities or debt securities it tracks.
3. Where the institution is not aware of the underlying investments of the CIU on a daily basis, the institution may calculate the own funds requirements for position risk, comprising specific and general risk, subject to the following conditions:
  - (a) it will be assumed that the CIU first invests to the maximum extent allowed under its mandate in the asset classes attracting the highest own funds requirement for specific and general risk separately, and then continues making investments in descending order until the maximum total investment limit is reached. The position in the CIU will be treated as a direct holding in the assumed position;

- (b) institutions shall take account of the maximum indirect exposure that they could achieve by taking leveraged positions through the CIU when calculating their own funds requirement for specific and general risk separately, by proportionally increasing the position in the CIU up to the maximum exposure to the underlying investment items resulting from the mandate;
- (c) if the own funds requirement for specific and general risk together according to this paragraph exceed that set out in Article 337(1) the own funds requirement shall be capped at that level.

4. Institutions may rely on the following third parties to calculate and report own funds requirements for position risk for positions in CIUs falling under paragraphs 1 to 4, in accordance with the methods set out in this Chapter:

- (a) the depository of the CIU provided that the CIU exclusively invests in securities and deposits all securities at this depository;
- (b) for other CIUs, the CIU management company, provided that the CIU management company meets the criteria set out in paragraph 3(a) of Article 127.

The correctness of the calculation shall be confirmed by an external auditor.

## Chapter 3

### Own funds requirements for foreign-exchange risk

#### *Article 340*

##### *De minimis and weighting for foreign exchange risk*

If the sum of an institution's overall net foreign-exchange position and its net gold position, calculated in accordance with the procedure set out in Article 341, including for any foreign exchange and gold positions for which own funds requirements are calculated using an internal model, exceeds 2 % of its total own funds, the institution shall calculate an own funds requirement for foreign exchange risk. The own funds requirement for foreign exchange risk shall be the sum of its overall net foreign-exchange position and its net gold position in the reporting currency, multiplied by 8 %.

#### *Article 341*

##### *Calculation of the overall net foreign exchange position*

1. The institution's net open position in each currency (including the reporting currency) and in gold shall be calculated as the sum of the following elements (positive or negative):
  - (a) the net spot position (i.e. all asset items less all liability items, including accrued interest, in the currency in question or, for gold, the net spot position in gold);
  - (b) the net forward position, which are all amounts to be received less all amounts to be paid under forward exchange and gold transactions, including currency and gold futures and the principal on currency swaps not included in the spot position;
  - (c) irrevocable guarantees and similar instruments that are certain to be called and likely to be irrecoverable;
  - (d) the net delta, or delta-based, equivalent of the total book of foreign-currency and gold options;
  - (e) the market value of other options.

The delta used for purposes of point (d) shall be, where relevant, that of the exchange concerned, or, where that is not available, subject to permission by the competent authorities [...] or, for OTC options, that calculated by the institution itself using an appropriate model. Permission shall be granted if the model appropriately estimates the rate of change of the option's or warrant's value with respect to small changes in the market price of the underlying.

The institution may include net future income/expenses not yet accrued but already fully hedged if it does so consistently.

The institution may break down net positions in composite currencies into the component currencies according to the quotas in force.

2. Any positions which an institution has deliberately taken in order to hedge against the adverse effect of the exchange rate on its ratios in according to Article 87(1) may, subject to permission by the competent authorities, be excluded from the calculation of net open currency positions. Such positions shall be of a non-trading or structural nature and any variation of the terms of their exclusion, subject to separate permission by the competent authorities. The same treatment subject to the same conditions as above may be applied to positions which an institution has which relate to items that are already deducted in the calculation of own funds.
3. An institution may use the net present value when calculating the net open position in each currency and in gold provided that the institution applies this approach consistently.
4. Net short and long positions in each currency other than the reporting currency and the net long or short position in gold shall be converted at spot rates into the reporting currency. They shall then be summed separately to form the total of the net short positions and the total of the net long positions respectively. The higher of these two totals shall be the institution's overall net foreign-exchange position.
5. Institutions shall adequately reflect other risks associated with options, apart from the delta risk, in the own funds requirements.

6. EBA shall develop draft regulatory technical standards defining a range of methods to reflect in the own funds requirements other risks, apart from delta risk, in a manner proportionate to the scale and complexity of institutions' activities in options.

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 previous sub-paragraph in accordance with the procedure laid down in Articles 10 to 14 of Regulation (EU) No 1093/2010.

#### *Article 342*

##### *Foreign exchange risk of CIUs*

1. For the purposes of Article 341, in respect of CIUs the actual foreign exchange positions of the CIU shall be taken into account.
2. Institutions may rely on the following third parties' reporting of the foreign exchange positions in the CIU:
  - (a) the depository institution of the CIU provided that the CIU exclusively invests in securities and deposits all securities at this depository institution;
  - (b) for other CIUs, the CIU management company, provided that the CIU management company meets the criteria set out in point (a) of paragraph 3.

The correctness of the calculation shall be confirmed by an external auditor.

3. Where an institution is not aware of the foreign exchange positions in a CIU, it shall be assumed that the CIU is invested up to the maximum extent allowed under the CIU's mandate in foreign exchange and institutions shall, for trading book positions, take account of the maximum indirect exposure that they could achieve by taking leveraged positions through the CIU when calculating their own funds requirement for foreign exchange risk. This shall be done by proportionally increasing the position in the CIU up to the maximum exposure to the underlying investment items resulting from the investment mandate. The assumed position of the CIU in foreign exchange shall be treated as a separate currency according to the treatment of investments in gold, subject to the modification that, where the direction of the CIU's investment is available, the total long position may be added to the total long open foreign exchange position and the total short position may be added to the total short open foreign exchange position. There shall be no netting allowed between such positions prior to the calculation.

#### *Article 343*

##### *Closely correlated currencies*

1. Institutions may provide lower own funds requirements against positions in closely correlated currencies. A pair of currencies is deemed to be closely correlated only if the likelihood of a loss — calculated on the basis of daily exchange-rate data for the preceding three or five years — occurring on equal and opposite positions in such currencies over the following 10 working days, which is 4 % or less of the value of the matched position in question (valued in terms of the reporting currency) has a probability of at least 99 %, when an observation period of three years is used, or 95 %, when an observation period of five years is used. The own-funds requirement on the matched position in two closely correlated currencies shall be 4 % multiplied by the value of the matched position.
2. In calculating the requirements of this chapter, institutions may disregard positions in currencies, which are subject to a legally binding intergovernmental agreement to limit its variation relative to other currencies covered by the same agreement. Institutions shall calculate their matched positions in such currencies and subject them to an own funds requirement no lower than half of the maximum permissible variation laid down in the intergovernmental agreement in question in respect of the currencies concerned.

3. EBA shall develop draft implementing technical standards listing the currencies which meet the requirements set out in paragraph 1.

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 third subparagraph in accordance with the procedure laid down in Article 15 of Regulation (EU) No 1093/2010.

4. The own funds requirement on the matched positions in currencies of Member States participating in the second stage of the economic and monetary union may be calculated as 1,6 % of the value of such matched positions.
5. Only the unmatched positions in currencies referred to in this Article shall be incorporated into the overall net open position according to Article 341(4).

## **Chapter 4**

### **Own funds requirements for commodities risk**

#### *Article 344*

#### *Choice of method for commodities risk*

Subject to Articles 345 to 347, institutions shall calculate the own funds requirement for commodities risk with one of the methods set out in Articles 348, 349 or 350.



## *Article 345*

### *Ancillary commodities business*

1. Institutions with ancillary agricultural commodities business may determine the own funds requirements for their physical commodity stock at the end of each year for the following year where all of the following conditions are met:
  - (a) at any time of the year it holds own funds for this risk which are not lower than the average own funds requirement for that risk estimated on a conservative basis for the coming year;
  - (b) it estimates on a conservative basis the expected volatility for the figure calculated under point (a);
  - (c) its average own funds requirement for this risk does not exceed 5% of its own funds or 1 million EUR and, taking into account the volatility estimated in accordance with (b), the expected peak own funds requirements do not exceed 6.5% of its own funds;
  - (d) the institution monitors on an ongoing basis whether the estimates carried out under points (a) and (b) still reflect the reality.
2. Institutions shall notify to the competent authorities the use they make of the option provided in paragraph 1.

## *Article 346*

### *Positions in commodities*

1. Each position in commodities or commodity derivatives shall be expressed in terms of the standard unit of measurement. The spot price in each commodity shall be expressed in the reporting currency.
2. Positions in gold or gold derivatives shall be considered as being subject to foreign-exchange risk and treated according to Chapter 3 or 5, as appropriate, for the purpose of calculating commodities risk.

3. For the purposes of this Chapter, positions which are purely stock financing may be excluded.
4. For the purpose of Article 349(1), the excess of an institution's long positions over its short positions, or vice versa, in the same commodity and identical commodity futures, options and warrants shall be its net position in each commodity. Derivative instruments shall be treated, as laid down in Article 347, as positions in the underlying commodity.
5. For the purposes of calculating a position in a commodity, the following positions shall be treated as positions in the same commodity:
  - (a) positions in different sub-categories of commodities in cases where the sub-categories are deliverable against each other;
  - (b) positions in similar commodities if they are close substitutes and where a minimum correlation of 0.9 between price movements can be clearly established over a minimum period of one year.

#### *Article 347*

##### *Particular instruments*

1. Commodity futures and forward commitments to buy or sell individual commodities shall be incorporated in the measurement system as notional amounts in terms of the standard unit of measurement and assigned a maturity with reference to expiry date.
2. Commodity swaps where one side of the transaction is a fixed price and the other the current market price shall be treated, as a series of positions equal to the notional amount of the contract, with, where relevant, one position corresponding with each payment on the swap and slotted into the maturity bands in Article 348(1). The positions shall be long positions if the institution is paying a fixed price and receiving a floating price and short positions if the institution is receiving a fixed price and paying a floating price. Commodity swaps where the sides of the transaction are in different commodities are to be reported in the relevant reporting ladder for the maturity ladder approach.

3. Options and warrants on commodities or on commodity derivatives shall be treated as if they were positions equal in value to the amount of the underlying to which the option refers, multiplied by its delta for the purposes of this Chapter. The latter positions may be netted off against any offsetting positions in the identical underlying commodity or commodity derivative. The delta used shall, where relevant, be that of the exchange concerned, **or, where that is not available,** subject to permission by the competent authorities [...] or, for OTC options, that calculated by the institution itself using an appropriate model. Permission shall be granted if the model appropriately estimates the rate of change of the option's or warrant's value with respect to small changes in the market price of the underlying.

Institutions shall adequately reflect other risks associated with options, apart from the delta risk, in the own funds requirements.

4. EBA shall develop draft regulatory technical standards defining a range of methods to reflect in the own funds requirements other risks, apart from delta risk, in a manner proportionate to the scale and complexity of institutions' activities in options.

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 Articles 10 to 14 of Regulation (EU) No 1093/2010.

5. Where an institution is either of the following, it shall include the commodities concerned in the calculation of its own funds requirement for commodities risk:
- (a) the transferor of commodities or guaranteed rights relating to title to commodities in a repurchase agreement;
  - (b) the lender of commodities in a commodities lending agreement.

*Article 348*

*Maturity ladder approach*

1. The institution shall use a separate maturity ladder in line with Table 1 for each commodity. All positions in that commodity shall be assigned to the appropriate maturity bands. Physical stocks shall be assigned to the first maturity band between 0 and up to and including 1 month.

Table 1	
Maturity band (1)	Spread rate (in %) (2)
$0 \leq 1$ month	1,50
$> 1 \leq 3$ months	1,50
$> 3 \leq 6$ months	1,50
$> 6 \leq 12$ months	1,50
$> 1 \leq 2$ years	1,50
$> 2 \leq 3$ years	1,50
$> 3$ years	1,50

2. Positions in the same commodity may be offset and assigned to the appropriate maturity bands on a net basis for the following:
  - (a) positions in contracts maturing on the same date;
  - (b) positions in contracts maturing within 10 days of each other if the contracts are traded on markets which have daily delivery dates.

3. The institution shall then calculate the sum of the long positions and the sum of the short positions in each maturity band. The amount of the former which are matched by the latter in a given maturity band shall be the matched positions in that band, while the residual long or short position shall be the unmatched position for the same band.
4. That part of the unmatched long position for a given maturity band that is matched by the unmatched short position, or vice versa, for a maturity band further out shall be the matched position between two maturity bands. That part of the unmatched long or unmatched short position that cannot be thus matched shall be the unmatched position.
5. The institution's own funds requirement for each commodity shall be calculated on the basis of the relevant maturity ladder as the sum of the following:
  - (a) the sum of the matched long and short positions, multiplied by the appropriate spread rate as indicated in the second column of Table 1 for each maturity band and by the spot price for the commodity;
  - (b) the matched position between two maturity bands for each maturity band into which an unmatched position is carried forward, multiplied by 0,6 %, which is the carry rate and by the spot price for the commodity;
  - (c) the residual unmatched positions, multiplied by 15 % which is the outright rate and by the spot price for the commodity.
6. The institution's overall own funds requirement for commodities risk shall be calculated as the sum of the own funds requirements calculated for each commodity according to paragraph 5.

*Article 349*  
*Simplified approach*

1. The institution's own funds requirement for each commodity shall be calculated as the sum of the following:
  - (a) 15 % of the net position, long or short, multiplied by the spot price for the commodity;
  - (b) 3 % of the gross position, long plus short, multiplied by the spot price for the commodity.
2. The institution's overall own funds requirement for commodities risk shall be calculated as the sum of the own funds requirements calculated for each commodity according to paragraph 1.

*Article 350*

*Extended maturity ladder approach*

Institutions may use the minimum spread, carry and outright rates set out in the following table 2 instead of those indicated in Article 348 provided that the institutions:

- (a) undertake significant commodities business;
- (b) have an appropriately diversified commodities portfolio;
- (c) are not yet in a position to use internal models for the purpose of calculating the own funds requirement for commodities risk.

Institutions shall notify the use they make of this Article to their competent authorities together with evidence of their efforts to implement an internal model for the purpose of calculating the own funds requirement for commodities risk.

Table 2				
	Precious metals (except gold)	Base metals	Agricultural products (softs)	Other, including energy products
Spread rate ( %)	1,0	1,2	1,5	1,5
Carry rate ( %)	0,3	0,5	0,6	0,6
Outright rate ( %)	8	10	12	15

## **Chapter 5**

### **Use of internal models to calculate own funds requirements**

#### **Section 1**

#### **Permission and own funds requirements**

##### *Article 351*

##### *Specific and general risks*

Position risk on a traded debt instrument or equity instrument or derivative thereof may be divided into two components for purposes of this chapter. The first shall be its specific risk component and shall encompass the risk of a price change in the instrument concerned due to factors related to its issuer or, in the case of a derivative, the issuer of the underlying instrument. The general risk component shall encompass the risk of a price change in the instrument due in the case of a traded debt instrument or debt derivative to a change in the level of interest rates or in the case of an equity or equity derivative to a broad equity-market movement unrelated to any specific attributes of individual securities.

##### *Article 352*

##### *Permission to use internal models*

1. After having verified an institution's compliance with the requirements of sections 2, 3 and 4 as relevant, competent authorities shall grant permission to institutions to calculate their own funds requirements for one or more of the following risk categories by using their internal models instead of or in combination with the methods in Chapters 2 to 4:
  - (a) general risk of equity instruments;
  - (b) specific risk of equity instruments;



- (c) general risk of debt instruments;
  - (d) specific risk of debt instruments;
  - (e) foreign-exchange risk;
  - (f) commodities risk.
2. For risk categories for which the institution has not been granted the permission referred to in paragraph 1 to use its internal models, that institution shall continue to calculate own funds requirements in accordance with those Chapters 2, 3 and 4 as relevant. Permission by the competent authorities for the use of internal models shall be required for each risk category and shall be granted only if the internal model covers all positions of a certain risk category. Material changes to the use of internal models, the extension of the use of internal models, in particular to additional risk categories, and the initial calculation of stressed value-at-risk according to Article 354(2) require a separate permission by the competent authority.
3. EBA shall develop draft regulatory technical standards to specify the following:
- (a) the conditions for assessing materiality of extensions and changes to the use of internal models;
  - (b) the assessment methodology under which competent authorities permit institutions to use internal models.

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 353

### *Own funds requirements when using internal models*

1. Each institution using an internal model shall fulfil, in addition to own funds requirements calculated according to Chapters 2, 3 and 4 for those risk categories for which permission to use an internal model has not been granted, an own funds requirement expressed as the sum of points (a) and (b):
  - (a) the higher of the following values:
    - (i) its previous day's value-at-risk number calculated in accordance with Article 354(1) ( $VaR_{t-1}$ );
    - (ii) an average of the daily value-at-risk numbers calculated in accordance with Article 354(1) on each of the preceding sixty business days ( $VaR_{avg}$ ), multiplied by the multiplication factor ( $mc$ ) according to Article 355;
  - (b) the higher of the following values:
    - (i) its latest available stressed-value-at-risk number calculated in accordance with Article 354(2) ( $sVaR_{t-1}$ ); and
    - (ii) an average of the stressed value-at-risk numbers calculated in the manner and frequency specified in Article 354(2) during the preceding sixty business days ( $sVaR_{avg}$ ), multiplied by the multiplication factor ( $ms$ ) according to Article 355;
2. Institutions that use an internal model to calculate their own funds requirement for specific risk of debt instruments shall fulfil an additional own funds requirement expressed as the sum of the following points (a) and (b):

- (a) the own funds requirement calculated in accordance with Article 326 and 327 for the specific risk of securitisation positions and nth to default credit derivatives in the trading book with the exception of those incorporated in an own funds requirement for the specific risk of the correlation trading portfolio in accordance with Section 5 and, where applicable, the own funds requirement for specific risk in accordance with Chapter 2, Section 6, for those positions in CIUs for which neither the conditions in Article 339(1) nor Article 339(2) are fulfilled;
- (b) the higher of:
  - (i) the most recent risk number for the incremental default and migration risk calculated in accordance with Section 3;
  - (ii) the average of this number over the preceding 12 weeks.

3. Institutions that have a correlation trading portfolio, which meets the requirements in Article 327(1) to (3), may choose to fulfil an additional own funds requirement calculated as the higher of the following:

- (a) the most recent risk number for the correlation trading portfolio calculated in accordance with Section 5;
- (b) the average of this number over the preceding 12-weeks;
- (c) 8 % of the own funds requirement that would, at the time of calculation of the most recent risk number referred to in point (a), be calculated in accordance with Article 327(4) for all those positions incorporated into the internal model for the correlation trading portfolio.

## SECTION 2

### GENERAL REQUIREMENTS

#### *Article 354*

#### *VaR and stressed VaR Calculation*

1. The calculation of the value-at-risk number referred to in Article 353 shall be subject to the following requirements:
  - (a) daily calculation of the value-at-risk number;
  - (b) a 99<sup>th</sup> percentile, one-tailed confidence interval;
  - (c) a 10-day holding period;
  - (d) an effective historical observation period of at least one year except where a shorter observation period is justified by a significant upsurge in price volatility;
  - (e) at least monthly data set updates.

The institution may use value-at-risk numbers calculated according to shorter holding periods than 10 days scaled up to 10 days by an appropriate methodology that is reviewed periodically.

2. In addition, the institution shall at least weekly calculate a 'stressed value-at-risk' of the current portfolio, in accordance with the requirements set out in the first paragraph, with value-at-risk model inputs calibrated to historical data from a continuous 12-month period of significant financial stress relevant to the institution's portfolio. The choice of such historical data shall be subject to at least annual review by the institution, which shall notify the outcome to the competent authorities. EBA shall monitor the range of practices for calculating stressed value at risk and shall, in accordance with Article 16 of Regulation (EU) No. 1093/2010, issue guidelines on such practices.

*Article 355*

*Regulatory backtesting and multiplication factors*

1. The results of the calculations referred to in Article 354 shall be scaled up by the multiplication factors ( $m_c$ ) and ( $m_s$ ).
2. Each of the multiplication factors ( $m_c$ ) and ( $m_s$ ) shall be the sum of at least 3 and an addend between 0 and 1 in accordance with Table 1. That addend shall depend on the number of overshootings for the most recent 250 business days as evidenced by the institution's back-testing of the value-at-risk number as set out in Article 354(1).

Table 1	
Number of overshootings	addend
Fewer than 5	0,00
5	0,40
6	0,50
7	0,65
8	0,75
9	0,85
10 or more	1,00

3. The institutions shall count daily overshootings on the basis of back-testing on hypothetical and actual changes in the portfolio's value. An overshooting is a one-day change in the portfolio's value that exceeds the related one-day value-at-risk number generated by the institution's model. For the purpose of determining the addend the number of overshootings shall be assessed at least quarterly and shall be equal to the higher of the number of overshootings under hypothetical and actual changes in the value of the portfolio.

Back-testing on hypothetical changes in the portfolio's value shall be based on a comparison between the portfolio's end-of-day value and, assuming unchanged positions, its value at the end of the subsequent day.

Back-testing on actual changes in the portfolio's value shall be based on a comparison between the portfolio's end-of-day value and its actual value at the end of the subsequent day excluding fees [...] commissions [...] and net interest income.;

4. The competent authorities may in individual cases limit the addend to that resulting from overshootings under hypothetical changes, where the number of overshootings under actual changes does not result from deficiencies in the internal model.
5. In order to allow competent authorities to monitor the appropriateness of the multiplication factors on an ongoing basis, institutions shall notify promptly, and in any case no later than within five working days, the competent authorities of overshootings that result from their back-testing programme.

### *Article 356*

#### *Requirements on risk measurement*

1. Any internal model used to calculate capital requirements for position risk, foreign exchange risk, commodities risk and any internal model for correlation trading shall meet all of the following requirements:
- (a) the model shall capture accurately all material price risks;

- (b) the model shall capture a sufficient number of risk factors, depending on the level of activity of the institution in the respective markets. Where a risk factor is incorporated into the institution's pricing model but not into the risk-measurement model, the institution shall be able to justify such an omission to the satisfaction of the competent authority. [...]. The risk-measurement model shall capture nonlinearities for options and other products as well as correlation risk and basis risk. Where proxies for risk factors are used they shall show a good track record for the actual position held.

2. Any internal model used to calculate capital requirements for position risk, foreign exchange risk or commodities risk shall meet all of the following requirements:

- (a) the model shall incorporate a set of risk factors corresponding to the interest rates in each currency in which the institution has interest rate sensitive on- or off-balance sheet positions. The institution shall model the yield curves using one of the generally accepted approaches. For material exposures to interest-rate risk in the major currencies and markets, the yield curve shall be divided into a minimum of six maturity segments, to capture the variations of volatility of rates along the yield curve. The model shall also capture the risk of less than perfectly correlated movements between different yield curves;
- (b) the model shall incorporate risk factors corresponding to gold and to the individual foreign currencies in which the institution's positions are denominated. For CIUs the actual foreign exchange positions of the CIU shall be taken into account. Institutions may rely on third party reporting of the foreign exchange position of the CIU, where the correctness of this report is adequately ensured. If an institution is not aware of the foreign exchange positions of a CIU, this position shall be carved out and treated in accordance with Article 342(3);
- (c) the model shall use a separate risk factor at least for each of the equity markets in which the institution holds significant positions;

- (d) the model shall use a separate risk factor at least for each commodity in which the institution holds significant positions. The model must also capture the risk of less than perfectly correlated movements between similar, but not identical, commodities and the exposure to changes in forward prices arising from maturity mismatches. It shall also take account of market characteristics, notably delivery dates and the scope provided to traders to close out positions;
  - (e) the institution's internal model shall conservatively assess the risk arising from less liquid positions and positions with limited price transparency under realistic market scenarios. In addition, the internal model shall meet minimum data standards. Proxies shall be appropriately conservative and shall be used only where available data is insufficient or is not reflective of the true volatility of a position or portfolio.
3. Institutions may, in any internal model used for purposes of this Chapter, use empirical correlations within risk categories and across risk categories only if the institution's approach for measuring correlations is sound and implemented with integrity.

#### *Article 357*

##### *Qualitative requirements*

1. Any internal model used for purposes of this Chapter shall be conceptually sound and implemented with integrity and, in particular, all of the following qualitative requirements shall be met:
- (a) any internal model used to calculate capital requirements for position risk, foreign exchange risk or commodities risk shall be closely integrated into the daily risk-management process of the institution and serve as the basis for reporting risk exposures to senior management;



- (b) the institution shall have a risk control unit that is independent from business trading units and reports directly to senior management. The unit shall be responsible for designing and implementing any internal model used for purposes of this Chapter. The unit shall conduct the initial and on-going validation of any internal model used for purposes of this Chapter, being responsible for the overall risk management system. The unit shall produce and analyse daily reports on the output of any internal model used for calculating capital requirements for position risk, foreign exchange risk and commodities risk, and on the appropriate measures to be taken in terms of trading limits;
- (c) the institution's management body and senior management shall be actively involved in the risk-control process and the daily reports produced by the risk-control unit are reviewed by a level of management with sufficient authority to enforce both reductions of positions taken by individual traders as well as in the institution's overall risk exposure;
- (d) the institution shall have sufficient numbers of staff skilled in the use of sophisticated internal models, and including the ones used for purposes of this Chapter, in the trading, risk-control, audit and back-office areas;
- (e) the institution shall have established procedures for monitoring and ensuring compliance with a documented set of internal policies and controls concerning the overall operation of its internal models, and including the ones used for purposes of this Chapter;
- (f) any internal model used for purposes of this Chapter shall have a proven track record of reasonable accuracy in measuring risks;

- (g) the institution shall frequently conduct a rigorous programme of stress testing, including reverse stress tests, which encompasses any internal model used for purposes of this Chapter and the results of these stress tests shall be reviewed by senior management and reflected in the policies and limits it sets. This process shall particularly address illiquidity of markets in stressed market conditions, concentration risk, one way markets, event and jump-to-default risks, non-linearity of products, deep out-of-the-money positions, positions subject to the gapping of prices and other risks that may not be captured appropriately in the internal models. The shocks applied shall reflect the nature of the portfolios and the time it could take to hedge out or manage risks under severe market conditions;
- (h) the institution shall conduct, as part of its regular internal auditing process, an independent review of its internal models, and including the ones used for purposes of this Chapter.

2. The review referred to in point (h) of the first paragraph shall include both the activities of the business trading units and of the independent risk-control unit. At least once a year, the institution shall conduct a review of its overall risk-management process. The review shall consider the following:

- (a) the adequacy of the documentation of the risk-management system and process and the organisation of the risk-control unit;
- (b) the integration of risk measures into daily risk management and the integrity of the management information system;
- (c) the process the institution employs for approving risk-pricing models and valuation systems that are used by front and back-office personnel;
- (d) the scope of risks captured by the risk-measurement model and the validation of any significant changes in the risk-measurement process;
- (e) the accuracy and completeness of position data, the accuracy and appropriateness of volatility and correlation assumptions, and the accuracy of valuation and risk sensitivity calculations;

- (f) the verification process the institution employs to evaluate the consistency, timeliness and reliability of data sources used to run internal models, including the independence of such data sources;
  - (g) the verification process the institution uses to evaluate back-testing that is conducted to assess the models' accuracy.
3. As techniques and best practices evolve, institutions shall apply those new techniques and practices in any internal model used for purposes of this Chapter.

### *Article 358*

#### *Internal Validation*

1. Institutions shall have processes in place to ensure that all their internal models used for purposes of this Chapter have been adequately validated by suitably qualified parties independent of the development process to ensure that they are conceptually sound and adequately capture all material risks. The validation shall be conducted when the internal model is initially developed and when any significant changes are made to the internal model. The validation shall also be conducted on a periodic basis but especially where there have been any significant structural changes in the market or changes to the composition of the portfolio which might lead to the internal model no longer being adequate. As techniques and best practices for internal validation evolve, institutions shall apply these advances. Internal model validation shall not be limited to back-testing, but shall, at a minimum, also include the following:
- (a) tests to demonstrate that any assumptions made within the internal model are appropriate and do not underestimate or overestimate the risk;
  - (b) in addition to the regulatory back-testing programmes, institutions shall carry out their own internal model validation tests, including back-testing, in relation to the risks and structures of their portfolios;

- (c) the use of hypothetical portfolios to ensure that the internal model is able to account for particular structural features that may arise, for example material basis risks and concentration risk.
2. The institution shall perform back-testing on both actual and hypothetical changes in the portfolio's value.

### **SECTION 3**

#### **REQUIREMENTS PARTICULAR TO SPECIFIC RISK MODELLING**

##### *Article 359*

##### *Requirements for modelling specific risk*

An internal model used for calculating own funds requirements for specific risk and an internal model for correlation trading shall meet the following additional requirements:

- (a) it explains the historical price variation in the portfolio;
- (b) it captures concentration in terms of magnitude and changes of composition of the portfolio;
- (c) it is robust to an adverse environment;
- (d) it is validated through back-testing aimed at assessing whether specific risk is being accurately captured. If the institution performs such back-testing on the basis of relevant sub-portfolios, these must be chosen in a consistent manner;
- (e) it captures name-related basis risk and shall in particular be sensitive to material idiosyncratic differences between similar but not identical positions;
- (f) it captures event risk.

## *Article 360*

### *Exclusions from specific risk models*

1. An institution may choose to exclude from the calculation of its specific risk own funds requirement using an internal model those positions for which it fulfils an own funds requirement for specific risk in accordance with Article 321(1)(e) or Article 326 with exception of those positions that are subject to the approach set out in Article 367.
2. An institution may choose not to capture default and migration risks for traded debt instruments in its internal model where it is capturing those risks through the requirements set out in Section 4.

## **SECTION 4**

### **INTERNAL MODEL FOR INCREMENTAL DEFAULT AND MIGRATION RISK**

## *Article 361*

### *Requirement to have an internal IRC model*

An institution that use an internal model for calculating own funds requirements for specific risk of traded debt instruments shall also have an internal incremental default and migration risk (IRC) model in place to capture the default and migration risks of its trading book positions that are incremental to the risks captured by the value-at-risk measure as specified in Article 354(1). The institution shall demonstrate that its internal model meets the following standards under the assumption of a constant level of risk, and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging and optionality:

- (a) the internal model provides a meaningful differentiation of risk and accurate and consistent estimates of incremental default and migration risk;
- (b) the internal model's estimates for potential losses play an essential role in the risk management of the institution;
- (c) the market and position data used for the internal model are up-to-date and subject to an appropriate quality assessment;

(d) the requirements in Articles 356(3), 357, 358 (1) and 359(b), (c), (e) and (f) are met.

EBA shall issue guidelines on the requirements of Articles 362, 363, 364 and 365.

#### *Article 362*

##### *Scope of the internal IRC model*

The internal IRC model shall cover all positions subject to an own funds requirement for specific interest rate risk, including those subject to a 0% specific risk capital charge under Article 325, but shall not cover securitisation positions and n-th-to-default credit derivatives.

The institution may, subject to permission by the competent authorities, choose to consistently include all listed equity positions and derivatives positions based on listed equities. The permission shall be granted if such inclusion is consistent with how the institution internally measures and manages risk.

#### *Article 363*

##### *Parameters of the internal IRC model*

1. Institutions shall use the internal model to calculate a number which measures losses due to default and internal or external ratings migration at the 99,9 % confidence interval over a time horizon of one year. Institutions shall calculate this number at least weekly.
2. Correlation assumptions shall be supported by analysis of objective data in a conceptually sound framework. The internal model shall appropriately reflect issuer concentrations. Concentrations that can arise within and across product classes under stressed conditions shall also be reflected.
3. The internal IRC model shall reflect the impact of correlations between default and migration events. The impact of diversification between, on the one hand, default and migration events and, on the other hand, other risk factors shall not be reflected.

4. The internal model shall be based on the assumption of a constant level of risk over the one-year time horizon, implying that given individual trading book positions or sets of positions that have experienced default or migration over their liquidity horizon are re-balanced at the end of their liquidity horizon to attain the initial level of risk. Alternatively, an institution may choose to consistently use a one-year constant position assumption.
5. The liquidity horizons shall be set according to the time required to sell the position or to hedge all material relevant price risks in a stressed market, having particular regard to the size of the position. Liquidity horizons shall reflect actual practice and experience during periods of both systematic and idiosyncratic stresses. The liquidity horizon shall be measured under conservative assumptions and shall be sufficiently long that the act of selling or hedging, in itself, would not materially affect the price at which the selling or hedging would be executed.
6. The determination of the appropriate liquidity horizon for a position or set of positions is subject to a floor of three months.
7. The determination of the appropriate liquidity horizon for a position or set of positions shall take into account an institution's internal policies relating to valuation adjustments and the management of stale positions. When an institution determines liquidity horizons for sets of positions rather than for individual positions, the criteria for defining sets of positions shall be defined in a way that meaningfully reflects differences in liquidity. The liquidity horizons shall be greater for positions that are concentrated, reflecting the longer period needed to liquidate such positions. The liquidity horizon for a securitisation warehouse shall reflect the time to build, sell and securitise the assets, or to hedge the material risk factors, under stressed market conditions.

## *Article 364*

### *Recognition of hedges in the internal IRC model*

1. Hedges may be incorporated into an institution's internal model to capture the incremental default and migration risks. Positions may be netted when long and short positions refer to the same financial instrument. Hedging or diversification effects associated with long and short positions involving different instruments or different securities of the same obligor, as well as long and short positions in different issuers, may only be recognised by explicitly modelling gross long and short positions in the different instruments. Institutions shall reflect the impact of material risks that could occur during the interval between the hedge's maturity and the liquidity horizon as well as the potential for significant basis risks in hedging strategies by product, seniority in the capital structure, internal or external rating, maturity, vintage and other differences in the instruments. An institution shall reflect a hedge only to the extent that it can be maintained even as the obligor approaches a credit or other event.
2. For positions that are hedged via dynamic hedging strategies, a rebalancing of the hedge within the liquidity horizon of the hedged position may be recognised provided that the institution:
  - (a) chooses to model rebalancing of the hedge consistently over the relevant set of trading book positions;
  - (b) demonstrates that the inclusion of rebalancing results in a better risk measurement;
  - (c) demonstrates that the markets for the instruments serving as hedges are liquid enough to allow for such rebalancing even during periods of stress. Any residual risks resulting from dynamic hedging strategies must be reflected in the own funds requirement.



*Article 365*

*Particular requirements for the internal IRC model*

1. The internal model to capture the incremental default and migration risks shall reflect the nonlinear impact of options, structured credit derivatives and other positions with material nonlinear behaviour with respect to price changes. The institution shall also have due regard to the amount of model risk inherent in the valuation and estimation of price risks associated with such products.
2. The internal model shall be based on data that are objective and up-to-date.
3. As part of the independent review and validation of their internal models used for purposes of this Chapter, inclusively for purposes of the risk measurement system, an institution shall in particular do all of the following:
  - (a) validate that its modelling approach for correlations and price changes is appropriate for its portfolio, including the choice and weights of its systematic risk factors;
  - (b) perform a variety of stress tests, including sensitivity analysis and scenario analysis, to assess the qualitative and quantitative reasonableness of the internal model, particularly with regard to the treatment of concentrations. Such tests shall not be limited to the range of events experienced historically;
  - (c) apply appropriate quantitative validation including relevant internal modelling benchmarks.
4. The internal model shall be consistent with the institution's internal risk management methodologies for identifying, measuring, and managing trading risks.

5. Institutions shall document their internal models so that its correlation and other modelling assumptions are transparent to the competent authorities.
6. The internal model shall conservatively assess the risk arising from less liquid positions and positions with limited price transparency under realistic market scenarios. In addition, the internal model shall meet minimum data standards. Proxies shall be appropriately conservative and may be used only where available data is insufficient or is not reflective of the true volatility of a position or portfolio.

#### *Article 366*

### **SECTION 5**

#### **INTERNAL MODEL FOR CORRELATION TRADING**

#### *Article 367*

##### *Requirements for an internal model for correlation trading*

1. Competent authorities shall grant permission to use an internal model for the own funds requirement for the correlation trading portfolio instead of the own funds requirement according to Article 327 to institutions that are allowed to use an internal model for specific risk of debt instruments and that meet the requirements in paragraphs 2 to 6 and in Articles 356(1), 356(3), 357, 358 (1) and 359 (a), (b), (c), (e) and (f).
2. Institutions shall use this internal model to calculate a number which adequately measures all price risks at the 99,9 % confidence interval over a time horizon of one year under the assumption of a constant level of risk, and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging and optionality. Institutions shall calculate this number at least weekly.

3. The following risks shall be adequately captured by the model referred to in paragraph 1:

- (a) the cumulative risk arising from multiple defaults, including different ordering of defaults, in tranching products;
- (b) credit spread risk, including the gamma and cross-gamma effects;
- (c) volatility of implied correlations, including the cross effect between spreads and correlations;
- (d) basis risk, including both of the following:
  - (i) the basis between the spread of an index and those of its constituent single names;
  - (ii) the basis between the implied correlation of an index and that of bespoke portfolios;
- (e) recovery rate volatility, as it relates to the propensity for recovery rates to affect tranche prices;
- (f) to the extent the comprehensive risk measure incorporates benefits from dynamic hedging, the risk of hedge slippage and the potential costs of rebalancing such hedges;
- (g) any other material price risks of positions in the correlation trading portfolio.

4. An institution shall use sufficient market data within the model referred to in paragraph 1 in order to ensure that it fully captures the salient risks of those exposures in its internal approach in accordance with the requirements set out in this Article. It shall be able to demonstrate to the competent authority through back testing or other appropriate means that its model can appropriately explain the historical price variation of those products.

The institution shall have appropriate policies and procedures in place in order to separate the positions for which it holds permission to incorporate them in the own funds requirement in accordance with this Article from other positions for which it does not hold such permission.

5. With regard to the portfolio of all the positions incorporated in the model referred to in paragraph 1, the institution shall regularly apply a set of specific, predetermined stress scenarios. Such stress scenarios shall examine the effects of stress to default rates, recovery rates, credit spreads, basis risk, correlations and other relevant risk factors on the correlation trading portfolio. The institution shall apply stress scenarios at least weekly and report at least quarterly to the competent authorities the results, including comparisons with the institution's own funds requirement in accordance with this Article. Any instances where the stress test results materially exceed the own funds requirement for the correlation trading portfolio shall be reported to the competent authorities in a timely manner. EBA shall develop guidelines on the application of stress scenarios for the correlation trading portfolio.
6. The internal model shall conservatively assess the risk arising from less liquid positions and positions with limited price transparency under realistic market scenarios. In addition, the internal model shall meet minimum data standards. Proxies shall be appropriately conservative and may be used only where available data is insufficient or is not reflective of the true volatility of a position or portfolio.

# Title V

## Own Funds Requirements for Settlement Risk

### *Article 368*

#### *Settlement/delivery risk*

In the case of transactions in which debt instruments, equities, foreign currencies and commodities excluding repurchase transactions and securities or commodities lending and securities or commodities borrowing are unsettled after their due delivery dates, an institution shall calculate the price difference to which it is exposed.

The price is calculated as difference between the agreed settlement price for the debt instrument, equity, foreign currency or commodity in question and its current market value, where the difference could involve a loss for the credit institution.

The institution shall multiply that price difference by the appropriate factor in the right column of the following Table 1 in order to calculate the institution's own funds requirement for settlement risk.

Table 1	
Number of working days after due settlement date	( %)
5 — 15	8
16 — 30	50
31 — 45	75
46 or more	100

*Article 369*  
*Free deliveries*

1. An institution shall be required to hold own funds, as set out in Table 2, where the following occurs:
- (a) it has paid for securities, foreign currencies or commodities before receiving them or it has delivered securities, foreign currencies or commodities before receiving payment for them;
  - (b) in the case of cross-border transactions, one day or more has elapsed since it made that payment or delivery.

Table 2			
Capital treatment for free deliveries			
Column 1	Column 2	Column 3	Column 4
Transaction Type	Up to first contractual payment or delivery leg	From first contractual payment or delivery leg up to four days after second contractual payment or delivery leg	From 5 business days post second contractual payment or delivery leg until extinction of the transaction
Free delivery	No capital charge	Treat as an exposure	Treat as an exposure risk weighted at 1 250 %

2. In applying a risk weight to free delivery exposures treated according to Column 3 of Table 2, an institution using the Internal Ratings Based approach set out in Part Three, Title II, Chapter 3 may assign PDs to counterparties, for which it has no other non-trading book exposure, on the basis of the counterparty's external rating. Institutions using own estimates of 'LGDs' may apply the LGD set out in Article 157(1) to free delivery exposures treated according to Column 3 of Table 2 provided that they apply it to all such exposures. Alternatively, an institution using the Internal Ratings Based approach set out in Part Three, Title II, Chapter 3 may apply the risk weights of the Standardised Approach, as set out in Part Three, Title II, Chapter 2 provided that it applies them to all such exposures or may apply a 100 % risk weight to all such exposures.

If the amount of positive exposure resulting from free delivery transactions is not material, institutions may apply a risk weight of 100 % to these exposures, except where a risk weight of 1 250% in accordance with Column 4 of Table 2 in paragraph 1 is required.

3. As an alternative to applying a risk weight of 1 250 % to free delivery exposures according to Column 4 of Table 2 in paragraph 1, institutions may deduct the value transferred plus the current positive exposure of those exposures from Common Equity Tier 1 items in accordance with point (k) of Article 33(1).

#### *Article 370*

##### *Waiver*

Where a system wide failure of a settlement or clearing system occurs, competent authorities may waive the own funds requirements calculated as set out in Article 368 and 369 until the situation is rectified. In this case, the failure of a counterparty to settle a trade shall not be deemed a default for purposes of credit risk.

## Title VI

### Own funds requirements for credit valuation adjustment risk

#### *Article 371*

##### *Meaning of Credit Valuation Adjustment*

For the purposes of this Title and Chapter 6 of Title II, 'Credit Valuation Adjustment' or 'CVA' means an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty. That adjustment reflects the current market value of the credit risk of the counterparty to the institution, but does not reflect the current market value of the credit risk of the institution to the counterparty.

#### *Article 372*

##### *Scope*

1. . An institution shall calculate the own funds requirements for CVA risk in accordance with this title for all OTC derivative instruments in respect of all of its business activities, other than credit derivatives recognised to reduce risk weighted exposure amounts for credit risk.
2. An institution shall include securities financing transactions in the calculation of own funds required by paragraph 1 if the competent authority determines that the institution's CVA risk exposures arising from those transactions are material.
3. Trade exposures with a central counterparty which fulfil the conditions laid down in Article 295(2) are excluded from the own funds requirements for CVA risk.



- 3a [...] Transactions [...] between counterparties referred to in Article 1 paragraph 4 and 4a of the Regulation (EMIR number) and institutions using the advanced method in 373 [...] [...] on OTC derivative transactions cleared through a [...] central counterparties [...] (cf. “EMIR”) shall be excluded from the own funds requirements for CVA risk.
4. Transactions that qualify for treatment under Article 108(6) and (7) in correlation with Article 145(1)(e) and (f) may be excluded from the own funds requirements for CVA risk.

*Article 373*

*Advanced method*

1. An institution which has permission to use an internal model for the specific risk of debt instruments in accordance with Article 352 (1)(d) shall, for all transactions for which it has permission to use the IMM for determining the exposure value for the associated counterparty credit risk exposure in accordance with Article 277, determine the own funds requirements for CVA risk by modelling the impact of changes in the counterparties' credit spreads on the CVAs of all counterparties of these transactions, taking into account CVA hedges that are eligible in accordance with Article 375.

An institution shall use its internal model for determining the own funds requirements for specific risk associated with traded debt positions and shall apply a 99 percent confidence interval and a 10 day equivalent holding period. The internal model shall be used in such way that it simulates changes in the credit spreads of counterparties, but does not model the sensitivity of CVA to changes in other market factors, including changes in the value of the reference asset, commodity, currency or interest rate of a derivative.

The own funds requirements for CVA risk for each counterparty shall be calculated in accordance with the following formula:

$$CVA = LGD_{MKT} \cdot \sum_{i=1}^T \max \left\{ 0, \exp \left( -\frac{s_{i-1} \cdot t_{i-1}}{LGD_{MKT}} \right) - \exp \left( -\frac{s_i \cdot t_i}{LGD_{MKT}} \right) \right\} \cdot \frac{EE_{i-1} \cdot D_{i-1} - EE_i \cdot D_i}{2}$$

(EE<sub>i-1</sub> \* D<sub>i-1</sub> + EE<sub>i</sub> \* D<sub>i</sub>) / 2

where:

$t_i$  = the time of the i-th revaluation, starting from  $t_0=0$ ;

$t_T$  = the longest contractual maturity across the netting sets with the counterparty;

$s_i$  = is the credit spread of the counterparty at tenor  $t_i$ , used to calculate the CVA of the counterparty. Where the credit default swap spread of the counterparty is available, an institution shall use that spread. Where such a credit default swap spread is not available, an institution shall use a proxy spread that is appropriate having regard to the rating, industry and region of the counterparty;

$LGD_{MKT}$  = the loss given default of the counterparty that shall be based on the spread of a market instrument of the counterparty if a counterparty instrument is available. Where a counterparty instrument is not available, it shall be based on the proxy spread that is appropriate having regard to the rating, industry and region of the counterparty. The first factor within the sum represents an approximation of the market implied marginal probability of a default occurring between times  $t_{i-1}$  and  $t_i$ ;

$EE_i$  = the expected exposure to the counterparty at revaluation time  $t_i$ , as defined in point 19 of Article 267, where exposures of different netting sets for such counterparty are added, and where the longest maturity of each netting set is given by the longest contractual maturity inside the netting set; An institution shall apply the treatment referred to in paragraph 3 in the case of margined trading, if the institution uses the EPE measure referred to in point (a) or (b) of Article 279(1) for margined trades;

$D_i$  = the default risk-free discount factor at time  $t_i$ , where  $D_0 = 1$ .

2. When calculating the own funds requirements for CVA risk for a counterparty, an institution shall base all inputs into its internal model for specific risk of debt instruments on the following formulae (whichever is appropriate):

(a0) where the model is based on full repricing, the formula in paragraph 1 must be used directly.

- (a) where the model is based on credit spread sensitivities for specific tenors, an institution shall base each credit spread sensitivity ('Regulatory CS01') on the following formula:

$$Regulatory\ CS01_i = 0.0001 \cdot t_i \cdot \exp\left(-\frac{s_i \cdot t_i}{LGD_{MKT}}\right) \cdot \frac{EE_{i-1} \cdot D_{i-1} + EE_{i+1} \cdot D_{i+1}}{2};$$

For the final time bucket  $i=T$ , the corresponding formula is

$$Regulatory\ CS01_T = 0.0001 \cdot t_T \cdot \exp\left(-\frac{s_T \cdot t_T}{LGD_{MKT}}\right) \cdot \left(\frac{EE_{T-1} \cdot D_{T-1} + EE_T \cdot D_T}{2}\right)$$

- (b) where the model uses credit spread sensitivities to parallel shifts in credit spreads, an institution shall use the following formula:

$$Regulatory\ CS01 = 0.0001 \cdot \sum_{i=1}^T \left( t_i \cdot \exp\left(-\frac{S_i \cdot t_i}{LGD_{MKT}}\right) - t_{i-1} \cdot \exp\left(-\frac{S_{i-1} \cdot t_{i-1}}{LGD_{MKT}}\right) \right) \cdot \frac{EE_{i-1} \cdot D_{i-1} - EE_i \cdot D_i}{2}$$

;

- (c) where the model uses second-order sensitivities to shifts in credit spreads (spread gamma), the gammas shall be calculated based on the formula in paragraph 1.

3. An institution using the EPE measure for collateralised OTC derivatives referred to in point (a) or (b) of Article 279(1) shall, when determining the own funds requirements for CVA risk in accordance with paragraph 1, do both of the following:

- (a) assume a constant EE profile;
- (b) set EE equal to the effective expected exposure as calculated under Article 279(1)(b) for a maturity equal to the greater of the following:
  - (i) half of the longest maturity occurring in the netting set;
  - (ii) the notional weighted average maturity of all transactions inside the netting set.

4. An institution which is permitted by the competent authority in accordance with Article 277 to use IMM to calculate exposure values in relation to the majority of its business, but which uses the method set out in Section 3, Section 4 or Section 5 of Title II, Chapter 6 for smaller portfolios, and which is permitted to use the market risk internal models approach for specific risk of traded debt instruments in accordance with Article 352 may, subject to permission from the competent authorities, calculate the own funds requirements for CVA risk in accordance with paragraph 1 for the non-IMM netting sets. Competent authorities shall grant this permission only if the institution uses the method set out in Section 3, [...] Section 4 or Section 5 of Title II, Chapter 6 for a limited number of smaller portfolios.

For the purposes of a calculation under the preceding subparagraph and where the IMM model does not produce an expected exposure profile, an institution shall do both of the following:

- (a) assume a constant EE profile;
  - (b) set EE equal to the exposure value as computed under the methods set out in Section 3, Section 4 or Section 5 of Title II, Chapter 6, or IMM for a maturity equal to the greater of:
    - (i) half of the longest maturity occurring in the netting set;
    - (ii) the notional weighted average maturity of all transactions inside the netting set.
5. An institution shall determine the own funds requirements for CVA risk in accordance with Articles 353(1), 354, 355 and 356 as the sum of non-stressed and stressed Value-at-Risk, which shall be calculated as follows:
- (a) for the non-stressed Value-at-Risk, current parameter calibrations for expected exposure as set out in Article 286(2), first subparagraph shall be used;

- (b) for the stressed Value-at-Risk, future counterparty EE profiles using a stressed calibration as set out in Article 286(2), second sub-paragraph shall be used. The period of stress for the credit spread parameters shall be the most severe one-year stress period contained within the three-year stress period used for the exposure parameters.

**(c) the three-times multiplier inherent in the calculation of a bond VaR and a stressed VaR shall apply to these calculations.**

6. EBA shall develop draft regulatory technical standards to specify in greater detail:
- (a) how a proxy spread should be determined for the purposes of identifying LGD<sub>MKT</sub> for the purposes of the calculation required by paragraph 1;
  - (b) the number and size of portfolios that fulfil the criterion of a limited number of smaller portfolios referred to in paragraph 4.

EBA shall submit those draft regulatory technical standards to the Commission by 1 January 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 374

Standardised method

1. An institution which does not calculate the own funds requirements for CVA risk for its counterparties in accordance with Article 373 shall calculate a portfolio own funds requirements for CVA risk for each counterparty in accordance with the following formula, taking into account CVA hedges that are eligible in accordance with Article 375:

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

where:

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

$w_i$  = the weight applicable to counterparty "i".

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

- (a) an institution using the approach in Title II, Chapter 3 shall map the internal rating of the counterparty to one of the external credit assessment;
- (b) an institution using the approach in Title II, Chapter 2 shall assign  $w_i=1.0\%$  to this counterparty;

$EAD_i^{total}$  = the total counterparty credit risk exposure value of counterparty "i" (summed across its netting sets) including the effect of collateral in accordance with the methods set out in Sections 3 to 6 of Title II, Chapter 6 as applicable to the calculation of the own funds requirements for counterparty credit risk for that counterparty. **An institution using one of the methods set out in Sections 3 and 4 of Title II, Chapter 6, may use as  $EAD_i^{total}$  the fully adjusted exposure value in accordance with Article 218(5).**

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

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

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

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

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

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

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

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

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

An institution shall map indices to one of the ... **six** weights  $w_i$  based on the average spread of index 'ind';

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

For an institution using the method set out in Section 6 of Title II, Chapter 6,  $M_i$  shall be calculated in accordance with Article 158(2)(g). **However, for this purpose,  $M_i$  is not capped at 5 years but at the longest contractual remaining maturity in the netting set;**



For an institution not using the method set out in Section 6 of Title II, Chapter 6,  $M_i$  is the average notional weighted maturity as referred to in point (b) of Article 158(2); However, for this purpose,  $M_i$  is not capped at 5 years **but at the longest contractual remaining maturity in the netting set**.

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

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

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

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

Table 1	
Credit quality step	Weight $w_i$
1	0.7%
2	0.8%
3	1.0%
4	2.0%
5	3.0%
6	10.0%

***Article 374a***

***Alternative to using CVA methods to calculating own funds requirements***

As an alternative to Article 374, for instruments referred to in Article 372(1) and subject to the prior consent of the competent authority, institutions using the Original Exposure Method as laid down in Article 270, may apply a multiplication factor of 5 to the resulting risk-weighted exposure amounts for credit risk for those exposures instead of calculating own funds requirements for CVA risk.

*Article 375*  
*Eligible hedges*

1. Hedges shall be 'eligible hedges' for the purposes of the calculation of own funds requirements for CVA risk in accordance with Article 373 and Article 374 only where they are used for the purpose of mitigating CVA risk and managed as such, and are one of the following:
  - (a) single-name credit default swaps or other equivalent hedging instruments referencing the counterparty directly;
  - (b) index credit default swaps, provided that the basis between any individual counterparty spread and the spreads of index credit default swap hedges is reflected in the Value-at-Risk.

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

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

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

2. An institution shall not reflect other types of counterparty risk hedges in the calculation of the own funds requirements for CVA risk. In particular, tranching or nth-to-default credit default swaps and credit linked notes are not eligible hedges for the purposes of the calculation of the own funds requirements for CVA risk.
3. Eligible hedges that are included in the calculation of the own funds requirements for CVA risk shall not be included in the calculation of the own funds requirements for specific risk as set out in Title IV or treated as credit risk mitigation other than for the counterparty credit risk of the same portfolio of transaction.

# **PART FOUR**

## **LARGE EXPOSURES**

### **SECTION I**

#### **LARGE EXPOSURE REGIME**

##### *Article 376*

##### *Subject matter*

Institutions shall monitor and control their large exposures in accordance with this Part.

##### *Article 377*

##### *Negative Scope*

This Part shall not apply to investment firms that fulfil the criteria set out in Article 90(1) or Article 91(1).

This part shall not apply to a consolidated group that only includes investment firms referred to in Article 90(1) or Article 91(1) and ancillary companies and where that group does not include credit institutions.

##### *Article 378*

##### *Definition*

The following definition applies for the purposes of this Part:

‘Exposures’, for the purposes of this Part means any asset or off-balance-sheet item referred to in Part Three, Title II, Chapter 2, without application of the risk weights or degrees of risk.

## *Article 379*

### *Calculation of the exposure value*

1. Exposures arising from the items referred to in Annex II shall be calculated in accordance with one of the methods set out in Part Three, Title II, Chapter 6.
2. Institutions with a permission to use the Internal Model Method in accordance with Article 277 may use the Internal Model Method for calculating the exposure value for repurchase transactions, securities or commodities lending or borrowing transactions, margin lending transactions and long settlement transactions.
3. The exposures to individual clients which arise on the trading book shall be calculated by those institutions that calculate the own funds requirements for their trading-book business in accordance with Part Three, Title IV, Chapter 2, Article 293 and Part Three, Title V and, as appropriate, with Part Three, Title IV, Chapter 5, by summing the following items:
  - (a) the positive excess of an institution's long positions over its short positions in all the financial instruments issued by the client in question, the net position in each of the different instruments being calculated according to the methods laid down in Part Three, Title IV, Chapter 2;
  - (b) the net exposure, in the case of the underwriting of a debt or an equity instrument;
  - (c) the exposures due to the transactions, agreements and contracts referred to in Articles 293 and 368 to 370 with the client in question, such exposures being calculated in the manner laid down in those Articles, for the calculation of exposure values.

For the purposes of point (b), the net exposure is calculated by deducting those underwriting positions which are subscribed or sub-underwritten by third parties on the basis of a formal agreement reduced by the factors set out in Article 334.

For the purposes of point (b), institutions shall set up systems to monitor and control their underwriting exposures between the time of the initial commitment and the next business day in the light of the nature of the risks incurred in the markets in question.

For the purposes of point (c), Part Three, Title II, Chapter 3 shall be excluded from the reference in Article 293.

4. The overall exposures to individual clients or groups of connected clients shall be calculated by summing the exposures of the trading book and those of the non-trading book.
5. The exposures to groups of connected clients shall be calculated by summing the exposures to individual clients in a group.
6. Exposures shall not include any of the following:
  - (a) in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement during the two working days following payment;
  - (b) in the case of transactions for the purchase or sale of securities, exposures incurred in the ordinary course of settlement during five working days following payment or delivery of the securities, whichever the earlier;
  - (c) in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking or financial instruments clearing, settlement and custody services to clients, delayed receipts in funding and other exposures arising from client activity which do not last longer than the following business day;
  - (d) in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking, intra-day exposures to institutions providing those services;
  - (e) exposures deducted from own funds in accordance with Articles 33, 53 and 63.

7. In order to determine the **overall exposure to a client or [...]** a group of connected clients, in respect of **clients to which the institution has** exposures **through transactions** referred to in points (l) and (n) of Article 107 **or through other transactions** where there is an exposure to underlying assets, [...], an institution shall assess [...] its underlying exposures **[...] taking into account** the economic substance **of the structure of the transaction** and the risks inherent in the structure of the transaction **itself, in order to determine whether it constitutes an additional exposure.**

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

(**[...] b)** **the conditions under which the structure of the transaction laid down in paragraph 7 does not constitute an additional exposure [...]**;

(**[...] a)** the conditions and methodologies used to determine **the overall exposure to a client or [...]** a group of connected clients in respect of **[...] the types of** exposures **referred to in paragraph 7.**

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

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

*Article 380*

**[...]**

### *Article 381*

#### *Definition of a large exposure*

An institution's exposure to a client or group of connected clients shall be considered a large exposure where its value is equal to or exceeds 10 % of its eligible capital.

### *Article 382*

#### *Capacity to identify and manage large exposures*

An institution shall have sound administrative and accounting procedures and adequate internal control mechanisms for the purposes of identifying, managing, monitoring, reporting and recording all large exposures and subsequent changes to them, in accordance with this Regulation

### *Article 383*

#### *Reporting requirements*

1. An institution shall report the following information about every large exposure to the competent authorities, including large exposures exempted from the application of Article 384(1)
  - (a) the identification of the client or the group of connected clients to which an institution has a large exposure;
  - (b) the exposure value before taking into account the effect of the credit risk mitigation, when applicable;
  - (c) where used, the type of funded or unfunded credit protection;
  - (d) the exposure value after taking into account the effect of the credit risk mitigation calculated for the purpose of Article 384(1).



Where an institution is subject to Part Three, Title II, Chapter 3 its 20 largest exposures on a consolidated basis, excluding those exempted from the application of Article 384(1) shall be made available to the competent authorities.

2. Reporting shall be carried out at least twice a year.
3. EBA shall develop draft implementing technical standards to specify the following:
  - (a) the uniform formats for the reporting referred to in paragraph 2 which shall be proportionate to the nature, scale and complexity of institutions' activities and the instructions for using those formats;
  - (b) the frequencies and dates of the reporting referred to in paragraph 2;
  - (c) the IT solutions to be applied for the reporting referred to in paragraph 2.

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

Power is conferred to 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 384*

### *Large exposures limit*

1. An institution shall not incur an exposure, after taking into account the effect of the credit risk mitigation in accordance with Articles 388 to 392, to a client or group of connected clients the value of which exceeds 25 % of its eligible capital. Where that client is an institution or where a group of connected clients includes one or more institutions, that value shall not exceed 25 % of the institution's eligible capital or EUR 150 million, whichever the higher, provided that the sum of exposure values, after taking into account the effect of the credit risk mitigation in accordance with Articles 388 to 392, to all connected clients that are not institutions does not exceed 25 % of the institution's eligible capital.

Where the amount of EUR 150 million is higher than 25 % of the institution's eligible capital the value of the exposure, after taking into account the effect of credit risk mitigation in accordance with Articles 388 to 392 shall not exceed a reasonable limit in terms of the institution's eligible capital. That limit shall be determined by the institution in accordance with the policies and procedures referred to in Article 79 of Directive [inserted by OP], to address and control concentration risk. This limit shall not exceed 100 % of the institution's eligible capital.

Competent authorities may set a lower limit than EUR 150 million and shall inform EBA and the Commission thereof.

2. Subject to Article 385, an institution shall at all times comply with the relevant limit laid down in paragraph 1.
3. Assets constituting claims and other exposures onto recognised third country investment firms may be subject to the same treatment as laid down in paragraph 1.
4. The limits laid down in this Article may be exceeded for the exposures on the institution's trading book if the following conditions are met:
  - (a) the exposure on the non-trading book to the client or group of clients in question does not exceed the limit laid down in paragraph 1, this limit being calculated with reference to eligible capital, so that the excess arises entirely on the trading book;
  - (b) the institution meets an additional own funds requirement on the excess in respect of the limit laid down in paragraph 1 which is calculated in accordance with Articles 386 and 387;
  - (c) where 10 days or less have elapsed since the excess occurred, the trading-book exposure to the client or group of connected clients in question shall not exceed 500 % of the institution's eligible capital;
  - (d) any excesses that have persisted for more than 10 days do not, in aggregate, exceed 600 % of the institution's eligible capital.

In each case in which the limit has been exceeded, the institution shall report the amount of the excess and the name of the client concerned without delay to the competent authorities.

## *Article 385*

### *Compliance with Large exposures requirements*

1. If, in an exceptional case, exposures exceed the limit set out in Article 384(1), the institution shall report the value of the exposure without delay to the competent authorities which may, where the circumstances warrant it, allow the credit institution a limited period of time in which to comply with the limit.

Where the amount of EUR 150 million referred to in Article 384(1) is applicable, the competent authorities may allow on a case-by-case basis the 100 % limit in terms of the institution's own funds to be exceeded.

2. Where compliance by a institution on an individual or sub-consolidated basis with the obligations imposed in this Part is disapplied under Article 6(1), or the provisions of Article 8 are applied in the case of parent institutions in a Member State, measures must be taken to ensure the satisfactory allocation of risks within the group.

## *Article 386*

### *Calculating additional own funds requirements for large exposures in the trading book*

1. The excess referred to in Article 384(4)(b) shall be calculated by selecting those components of the total trading exposure to the client or group of clients in question which attract the highest specific-risk requirements in Part Three, Title IV, Chapter 2 and/or requirements in Article 293 and Part Three, Title V, the sum of which equals the amount of the excess referred to in point (a) of Article 384(4).
2. Where the excess has not persisted for more than 10 days, the additional capital requirement shall be 200 % of the requirements referred to in paragraph 1, on these components.

3. As from 10 days after the excess has occurred, the components of the excess, selected in accordance with paragraph 1, shall be allocated to the appropriate line in Column 1 of Table 1 in ascending order of specific-risk requirements in Part Three, Title IV, Chapter 2 and/or requirements in Article 293 and Part Three, Title V. The additional own funds requirement shall be equal to the sum of the specific-risk requirements in Part Three, Title IV, Chapter 2 and/or the Article 293 and Part Three, Title V requirements on these components, multiplied by the corresponding factor in Column 2 of Table 1.

Table 1	
Column 1: Excess over the limits  (on the basis of a percentage of eligible capital)	Column 2: Factors
Up to 40 %	200 %
From 40 % to 60 %	300 %
From 60 % to 80 %	400 %
From 80 % to 100 %	500 %
From 100 % to 250 %	600 %
Over 250 %	900 %

## *Article 387*

### *Procedures to prevent avoiding the additional own funds requirement*

Institutions shall not deliberately avoid the additional own funds requirements set out in Article 386 that they would otherwise incur, on exposures exceeding the limit laid down in Article 384(1) once those exposures have been maintained for more than 10 days, by means of temporarily transferring the exposures in question to another company, whether within the same group or not, and/or by undertaking artificial transactions to close out the exposure during the 10-day period and create a new exposure.

Institutions shall maintain systems which ensure that any transfer which has the effect referred to in the first subparagraph is immediately reported to the competent authorities.

## *Article 388*

### *Eligible credit mitigation techniques*

1. For the purposes of Articles 389 to 392 the term ‘guarantee’ shall include credit derivatives recognised under Part Three, Title II, Chapter 4 other than credit linked notes.
2. Subject to paragraph 3 of this Article, where, under Articles 389 to 392 the recognition of funded or unfunded credit protection is permitted, this shall be subject to compliance with the eligibility requirements and other requirements set out in Part Three, Title II, Chapter 4.
3. Where an institution relies upon Article 390(2), the recognition of funded credit protection shall be subject to the relevant requirements under Part Three, Title II, Chapter 3. For the purposes of this Section, a credit institution shall not take into account the collateral referred to in Article 195, paragraphs 7 to 9, unless permitted under Article 391.
4. Institutions shall analyse, to the extent possible, their exposures to collateral issuers, providers of unfunded credit protection and underlying assets pursuant to Article 379(7) for possible concentrations and where appropriate take action and report any significant findings to their competent authority.

*Article 389*

*Exemptions*

1. The following exposures shall be exempted from the application of Article 384(1):
  - (a) asset items constituting claims on central governments, central banks or public sector entities which, unsecured, would be assigned a 0 % risk weight under Part Three, Title II, Chapter 2;
  - (b) asset items constituting claims on international organisations or multilateral development banks which, unsecured, would be assigned a 0 % risk weight under Part Three, Title II, Chapter 2;
  - (c) asset items constituting claims carrying the explicit guarantees of central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity providing the guarantee would be assigned a 0 % risk weight under Part Three, Title II, Chapter 2;
  - (d) other exposures attributable to, or guaranteed by, central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity to which the exposure is attributable or by which it is guaranteed would be assigned a 0 % risk weight under Part Three, Title II, Chapter 2;
  - (e) asset items constituting claims on regional governments or local authorities of Member States where those claims would be assigned a 0 % risk weight under Part Three, Title II, Chapter 2 and other exposures to or guaranteed by those regional governments or local authorities, claims on which would be assigned a 0 % risk weight under Part Three, Title II, Chapter 2;

- (f) exposures to counterparties referred to in Article 108(6) or Article 108(7) if they would be assigned a 0 % risk weight under Part Three, Title II, Chapter 2. Exposures that do not meet those criteria, whether or not exempted from Article 384(1) shall be treated as exposures to a third party;
- (g) asset items and other exposures secured by collateral in the form of cash deposits placed with the lending institution or with an institution which is the parent undertaking or a subsidiary of the lending institution;
- (h) asset items and other exposures secured by collateral in the form of certificates of deposit issued by the lending institution or by an institution which is the parent undertaking or a subsidiary of the lending institution and lodged with either of them;
- (i) exposures arising from undrawn credit facilities that are classified as low-risk off-balance sheet items in Annex I and provided that an agreement has been concluded with the client or group of connected clients under which the facility may be drawn only if it has been ascertained that it will not cause the limit applicable under Article 384(1) to be exceeded;
- (j) trade exposures to central counterparties and default fund contributions to central counterparties;
- (k) exposures to deposit guarantee schemes under Directive 94/19/EC arising from the funding of those schemes, if the member institutions of the scheme have a legal or contractual obligation to fund the scheme.

Cash received under a credit linked note issued by the institution and loans and deposits of a counterparty to or with the institution which are subject to an on-balance sheet netting agreement recognised under Part Three, Title II, Chapter 4 shall be deemed to fall under point (g).



2. **Competent authorities may [...]** fully or partially exempt the following exposures **[...]**:
- (a) covered bonds falling within the terms Article 124(1), Article 124(2) and 124(5);
  - (b) asset items constituting claims on regional governments or local authorities of Member States where those claims would be assigned a 20 % risk weight under Part Three, Title II, Chapter 2 and other exposures to or guaranteed by those regional governments or local authorities, claims on which would be assigned a 20 % risk weight under Part Three, Title II, Chapter 2;
  - (c) exposures, including participations or other kinds of holdings, incurred by an institution to its parent undertaking, to other subsidiaries of that parent undertaking or to its own subsidiaries, in so far as those undertakings are covered by the supervision on a consolidated basis to which the institution itself is subject, in accordance with this Regulation, Directive 2002/87/EC or with equivalent standards in force in a third country; exposures that do not meet these criteria, whether or not exempted from Article 384(1) shall be treated as exposures to a third party;
  - (d) asset items constituting claims on and other exposures, including participations or other kinds of holdings, to regional or central credit institutions with which the credit institution is associated in a network in accordance with legal or statutory provisions and which are responsible, under those provisions, for cash-clearing operations within the network;
  - (e) asset items constituting claims on and other exposures to credit institutions incurred by credit institutions, one of which operates on a non-competitive basis and provides or guarantees loans under legislative programmes or its statutes, to promote specified sectors of the economy under some form of government oversight and restrictions on the use of the loans, provided that the respective exposures arise from such loans that are passed on to the beneficiaries via credit institutions or from the guarantees of these loans;

- (f) asset items constituting claims on and other exposures to institutions, provided that those exposures do not constitute such institutions' own funds, do not last longer than the following business day;
- (g) asset items constituting claims on central banks in the form of required minimum reserves held at those central banks which are denominated in their national currencies;
- (h) asset items constituting claims on central governments in the form of statutory liquidity requirements held in government securities which are denominated and funded in their national currencies provided that, at the discretion of the competent authority, the credit assessment of those central governments assigned by a nominated ECAI is investment grade;
- (i) 50 % of medium/low risk off-balance-sheet documentary credits and of medium/low risk off-balance sheet undrawn credit facilities referred to in Annex I and subject to the competent authorities' agreement, 80 % of guarantees other than loan guarantees which have a legal or regulatory basis and are given for their members by mutual guarantee schemes possessing the status of credit institutions;
- (j) legally required guarantees used when a mortgage loan financed by issuing mortgage bonds is paid to the mortgage borrower before the final registration of the mortgage in the land register, provided the guarantee is not used as reducing the risk in calculating the risk weighted assets;
- (k) assets constituting claims and other exposures to recognised exchanges.

**Competent authorities may only make use of the exemption provided for in the first sentence where the following conditions are met:**

- (a) the specific nature of the exposure, the counterparty or the relationship between the institution and the counterparty eliminate or reduce the risk of the exposure; and**
- (b) any remaining concentration risk can be addressed by other equally effective means such as the arrangements, processes and mechanisms provided for in Article 79 of Directive .../... [inserted by OPL]**

**Competent authorities shall inform EBA whether or not they intend to use any of the exemptions listed in the first sentence in accordance with the criteria set out above and shall consult EBA on this choice.**

#### *Article 390*

##### *Calculating the effect of the use of credit risk mitigation techniques*

1. For the purposes of calculating the value of exposures for the purposes of Article 384(1) an institution may use the ‘fully adjusted exposure value’ as calculated under Part Three, Title II, Chapter 4 taking into account the credit risk mitigation, volatility adjustments, and any maturity mismatch (E\*).
2. An institution permitted to use own estimates of LGDs and conversion factors for an exposure class under Part Three, Title II, Chapter 3 may, subject to a permission by the competent authorities recognise the effects of financial collateral in calculating the value of exposures for the purposes of Article 384(1).

Competent authorities shall grant the permission referred to in preceding subparagraph only if the institution can estimate the effects of financial collateral on their exposures separately from other LGD-relevant aspects.

An institution shall apply such procedures so that its produced estimates are suitable for reducing the exposure value for the purposes of compliance with the provisions of Article 384.

Where an institution is permitted to use its own estimates of the effects of financial collateral, it shall do so on a basis consistent with the approach adopted in the calculation of the own funds requirements in accordance with this Regulation.

Institutions permitted to use own estimates of LGDs and conversion factors for an exposure class under Part Three, Title II, Chapter 3, which do not calculate the value of their exposures using the method referred to in the first subparagraph of this paragraph, may use the Financial Collateral Comprehensive Method or the approach set out in Article 392(1)(b) for calculating the value of exposures.

3. An institution that makes use of the Financial Collateral Comprehensive Method or is permitted to use the method described in paragraph 2 of this Article in calculating the value of exposures for the purposes of Article 384(1) shall conduct periodic stress tests of their credit-risk concentrations, including in relation to the realisable value of any collateral taken.

These periodic stress tests referred to in the first subparagraph shall address risks arising from potential changes in market conditions that could adversely impact the institutions' adequacy of own funds and risks arising from the realisation of collateral in stressed situations.

The stress tests carried out shall be adequate and appropriate for the assessment of such risks.

In the event that the period stress test indicates a lower realisable value of collateral taken than would be permitted to be taken into account while making use of the Financial Collateral Comprehensive Method or the method described in paragraph 2 as appropriate, the value of collateral permitted to be recognised in calculating the value of exposures for the purposes of Article 384(1) shall be reduced accordingly.

Institutions referred to in the first subparagraph shall include the following in their strategies to address concentration risk:

- (a) policies and procedures to address risks arising from maturity mismatches between exposures and any credit protection on those exposures;
- (b) policies and procedures in the event that a stress test indicates a lower realisable value of collateral than taken into account while making use of the Financial Collateral Comprehensive Method or the method described in paragraph 2;
- (c) policies and procedures relating to concentration risk arising from the application of credit risk mitigation techniques, and in particular large indirect credit exposures, for example to a single issuer of securities taken as collateral.

#### *Article 391*

##### *Exposures arising from mortgage lending*

1. For the calculation of exposure values for the purposes of Article 384, an institution may reduce the value of an exposure or any part of an exposure fully secured by real estate property in accordance with Article 120(1) by the pledged amount of the market or mortgage lending value of the property concerned but not more than 50 % of the market or 60% of the mortgage lending value in those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions, if all of the following conditions are met:
  - (a) The competent authority of the Member State has not set a higher risk weight than 35% for exposures or parts of exposures secured by residential real estate in accordance with Article 119(2);

- (b) the exposure or part of the exposure is fully secured by
  - (i) mortgages on residential property; or
  - (ii) residential properties which are leased for as long as the lessee has not exercised his option to purchase and the exposure relates to a leasing transaction under which the lessor retains full ownership of the residential property
- (c) The requirements in Articles 203 and 224(1) are met.

2. For the calculation of exposure values for the purposes of Article 384, an institution may reduce the value of an exposure or any part of an exposure fully secured by real estate property in accordance with Article 121(1) by the pledged amount of the market or mortgage lending value of the property concerned but not more than 50 % of the market or 60% of the mortgage lending value in those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions, if all of the following conditions are met:

- (a) The competent authority of the Member State has not set a higher risk weight than 50% for exposures or parts of exposures secured by commercial real estate in accordance with Article 119(2);
- (b) the exposure is fully secured by:
  - (i) mortgages on offices or other commercial premises; or
  - (ii) offices or other commercial premises and the exposures related to property leasing transactions.
- (c) The requirements in Articles 121(2)(a), 203 and 224(1) are met;
- (d) the commercial property shall be fully constructed.

*Article 392*  
*Substitution approach*

1. Where an exposure to a client is guaranteed by a third party, or secured by collateral issued by a third party, an institution may:
  - (a) treat the portion of the exposure which is guaranteed as having been incurred to the guarantor rather than to the client provided that the unsecured exposure to the guarantor would be assigned an equal or lower risk weight than a risk weight of the unsecured exposure to the client under Part Three, Title II, Chapter 2;
  - (b) treat the portion of the exposure collateralised by the market value of recognised collateral as having been incurred to the third party rather than to the client, if the exposure is secured by collateral and provided that the collateralised portion of the exposure would be assigned an equal or lower risk weight than a risk weight of the unsecured exposure to the client under Part Three, Title II, Chapter 2.

The approach referred to in point (b) of the first subparagraph shall not be used by an institution where there is a mismatch between the maturity of the exposure and the maturity of the protection.

For the purpose of this Part, an institution may use both the Financial Collateral Comprehensive Method and the treatment provided for in point (b) of the first subparagraph only where it is permitted to use both the Financial Collateral Comprehensive Method and the Financial Collateral Simple Method for the purposes of Article 87.

2. Where an institution applies point (a) of paragraph 1:
- (a) where the guarantee is denominated in a currency different from that in which the exposure is denominated the amount of the exposure deemed to be covered shall be calculated in accordance with the provisions on the treatment of currency mismatch for unfunded credit protection in Part Three, Title II, Chapter 4;
  - (b) a mismatch between the maturity of the exposure and the maturity of the protection shall be treated in accordance with the provisions on the treatment of maturity mismatch in Part Three, Title II, Chapter 4;
  - (c) partial coverage may be recognised in accordance with the treatment set out in Part Three, Title II, Chapter 4.



# **PART FIVE**

## **EXPOSURES TO TRANSFERRED CREDIT RISK**

### **Title I**

#### **General provisions for this Part**

##### *Article 393*

##### *Scope of application*

Titles II and III shall apply to new securitisations issued on or after 1 January 2011. Titles II and III shall, after 31 December 2014, apply to existing securitisations where new underlying exposures are added or substituted after that date.

## Title II

### Requirements for investor institutions

#### *Article 394*

##### *Retained interest of the issuer*

1. An institution, other than when acting as an originator, a sponsor or original lender, shall be exposed to the credit risk of a securitisation position in its trading book or non-trading book only if the originator, sponsor or original lender has explicitly disclosed to the institution that it will retain, on an ongoing basis, a material net economic interest which, in any event, shall not be less than 5 %.

Only any of the following qualifies as retention of a material net economic interest of not less than 5%:

- (a) retention of no less than 5 % of the nominal value of each of the tranches sold or transferred to the investors;
- (b) in the case of securitisations of revolving exposures, retention of the originator's interest of no less than 5 % of the nominal value of the securitised exposures;
- (c) retention of randomly selected exposures, equivalent to no less than 5 % of the nominal value of the securitised exposures, where such exposures would otherwise have been securitised in the securitisation, provided that the number of potentially securitised exposures is no less than 100 at origination;
- (d) retention of the first loss tranche and, if necessary, other tranches having the same or a more severe risk profile than those transferred or sold to investors and not maturing any earlier than those transferred or sold to investors, so that the retention equals in total no less than 5 % of the nominal value of the securitised exposures.

(e) retention of a first loss exposure not less than 5 % of every securitised exposure in the securitisation

Net economic interest is measured at the origination and shall be maintained on an ongoing basis. The net economic interest, including retained positions, interest or exposures, shall not be subject to any credit risk mitigation or any short positions or any other hedge and shall not be sold. The net economic interest shall be determined by the notional value for off-balance sheet items.

There shall be no multiple applications of the retention requirements for any given securitisation.

2. Where an EU parent credit institution, an EU financial holding company, an EU mixed financial holding company or one of its subsidiaries, as an originator or a sponsor, securitises exposures from several credit institutions, investment firms or other financial institutions which are included in the scope of supervision on a consolidated basis, the requirement referred to in paragraph 1 may be satisfied on the basis of the consolidated situation of the related EU parent credit institution, EU financial holding company, or EU mixed financial holding company.

The first subparagraph shall apply only where credit institutions, investment firms or financial institutions which created the securitised exposures have committed themselves to adhere to the requirements set out in Article 397 and deliver, in a timely manner, to the originator or sponsor and to the EU parent credit institution or an EU financial holding company the information needed to satisfy the requirements referred to in Article 398.

3. Paragraph 1 shall not apply where the securitised exposures are [...] exposures on or fully, unconditionally and irrevocably guaranteed by the following entities:
  - (a) central governments or central banks;
  - (b) regional governments, local authorities and public sector entities of Member States;

- (c) institutions to which a 50 % risk weight or less is assigned under Part Three, Title II, Chapter 2;
- (d) multilateral development banks.

4. Paragraph 1 shall not apply to:

- (a) transactions based on a clear, transparent and accessible index, where the underlying reference entities are identical to those that make up an index of entities that is widely traded, or are other tradable securities other than securitisation positions;
- (b)

#### *Article 395*

#### *Due diligence*

1. Before becoming exposed to the credit risk of a securitisation, and as appropriate thereafter, institutions, shall be able to demonstrate to the competent authorities for each of their individual securitisation positions, that they have a comprehensive and thorough understanding of and have implemented formal policies and procedures appropriate to their trading book and non-trading book and commensurate with the risk profile of their investments in securitised positions for analysing and recording:
  - (a) information disclosed under Article 394(1), by originators or sponsors to specify the net economic interest that they maintain, on an ongoing basis, in the securitisation;
  - (b) the risk characteristics of the individual securitisation position;
  - (c) the risk characteristics of the exposures underlying the securitisation position;
  - (d) the reputation and loss experience in earlier securitisations of the originators or sponsors in the relevant exposure classes underlying the securitisation position;

- (e) the statements and disclosures made by the originators or sponsors, or their agents or advisors, about their due diligence on the securitised exposures and, where applicable, on the quality of the collateral supporting the securitised exposures;
- (f) where applicable, the methodologies and concepts on which the valuation of collateral supporting the securitised exposures is based and the policies adopted by the originator or sponsor to ensure the independence of the valuer;
- (g) all the structural features of the securitisation that can materially impact the performance of the institution's securitisation position, such as the contractual waterfall and waterfall related triggers, credit enhancements, liquidity enhancements, market value triggers, and deal-specific definitions of default.

Institutions shall regularly perform their own stress tests appropriate to their securitisation positions. To this end, institutions may rely on financial models developed by an ECAI provided that institutions can demonstrate, when requested, that they took due care prior to investing to validate the relevant assumptions in and structuring of the models and to understand methodology, assumptions and results.

2. Institutions, other than when acting as originators or sponsors or original lenders, shall establish formal procedures appropriate to their trading book and non-trading book and commensurate with the risk profile of their investments in securitised positions to monitor on an ongoing basis and in a timely manner performance information on the exposures underlying their securitisation positions. Where relevant, this shall include the exposure type, the percentage of loans more than 30, 60 and 90 days past due, default rates, prepayment rates, loans in foreclosure, collateral type and occupancy, and frequency distribution of credit scores or other measures of credit worthiness across underlying exposures, industry and geographical diversification, frequency distribution of loan to value ratios with band widths that facilitate adequate sensitivity analysis. Where the underlying exposures are themselves securitisation positions, institutions shall have the information set out in this subparagraph not only on the underlying securitisation tranches, such as the issuer name and credit quality, but also on the characteristics and performance of the pools underlying those securitisation tranches.

Institutions shall also apply the same standards of analysis to participations or underwritings in securitisation issues purchased from third parties whether such participations or underwritings are to be held on their trading or non-trading book.

*Article 396*

*Additional risk weight*

Where an institution does not meet the requirements in Articles 394, 395 or 398 in any material respect by reason of the negligence or omission of the institution, the competent authorities shall impose a proportionate additional risk weight of no less than 250 % of the risk weight (capped at 1250 %) which shall apply to the relevant securitisation positions in the manner specified in Articles 240(6) or 326(3) respectively. The additional risk weight shall progressively increase with each subsequent infringement of the due diligence provisions.

The competent authorities shall take into account the exemptions for certain securitisations provided in Article 394(3) by reducing the risk weight it would otherwise impose under this Article in respect of a securitisation to which Article 394(3) applies.

## Title III

### Requirements for sponsor and originator institutions

#### *Article 397*

##### *Criteria for credit granting*

Sponsor and originator institutions shall apply the same sound and well-defined criteria for credit-granting in accordance with the requirements of Article 77 of Directive [inserted by OP] to exposures to be securitised as they apply to exposures to be held in their own non-trading book. To this end the same processes for approving and, where relevant, amending, renewing and re-financing credits shall be applied by the originator and sponsor institutions.

Where the requirements referred to in the first subparagraph of this Article are not met, Article 240(1) shall not be applied by an originator institution and that originator institution shall not be allowed to exclude the securitised exposures from the calculation of its capital requirements under this Regulation.

#### *Article 398*

##### *Disclosure to investors*

Institutions acting as an originator, a sponsor or original lender shall disclose to investors the level of their commitment under Article 394 to maintain a net economic interest in the securitisation. Sponsor and originator institutions shall ensure that prospective investors have readily available access to all materially relevant data on the credit quality and performance of the individual underlying exposures, cash flows and collateral supporting a securitisation exposure as well as such information that is necessary to conduct comprehensive and well informed stress tests on the cash flows and collateral values supporting the underlying exposures. For that purpose, materially relevant data shall be determined as at the date of the securitisation and where appropriate due to the nature of the securitisation thereafter.

*Article 399*

*Uniform condition of application*

1. EBA shall report to the Commission annually on measures taken by the competent authorities in order to ensure the compliance with the requirements of Titles II and III by institutions.
2. EBA shall develop draft implementing technical standards for facilitating the convergence of supervisory practices with regard to Articles 394 to 398, including the measures to be taken in case of breach of the due diligence and risk management obligations.

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 Articles 15 of Regulation (EU) No 1093/2010.



# PART SIX

## LIQUIDITY

### Title I

#### Definitions and liquidity coverage requirement

##### *Article 400*

##### *Definitions*

For the purposes of this Part, the following definitions apply:

- (1) 'Financial customer' means a [...] customer that performs one or more of the activities listed in Annex I of Directive [inserted by OP] as their main business [...] or is one of the following:
- (a) a credit institution;**
  - (b) an investment firm;**
  - (c) an SSPE ;**
  - (d) a CIU;**
  - (e) a non-open ended investment scheme;**
  - (f) an insurance undertaking;**
  - (g) a financial holding company or mixed-activity holding company.**
- (2) 'Retail deposit' means a liability to a natural person or to a small and medium sized enterprise if the natural person or enterprise would qualify for the retail exposure class under the Standardised or IRB approaches for credit risk and where the aggregate liability to such clients or group of connected clients shall not exceed 1 million EUR.

*Article 401*

*Liquidity reporting [...]*

[...] [...] The provisions set out in Title II shall apply exclusively for the purposes of specifying reporting obligations set out in Article 403 which apply only until the legislative proposal referred to in article 481 has entered into force [...] .

*Article 402*

## [...] Title II

### Liquidity reporting

#### *Article 403*

##### *Reporting obligation and reporting format*

1. Institutions shall report in a single currency, regardless of the actual denomination to the competent authorities the items referred to in Title II and their components, including the composition of their liquid assets according to Article 404. Until the liquidity coverage requirement in [...] Part Six is fully specified and implemented as a minimum standard according to Article 481 (2a ), institutions shall at least report the items set in Title II and Annex III. The reporting frequency shall not be less than monthly for the requirement in Title II and Annex III and not less than quarterly for items referred to in Title III.
2. When an institution has aggregate liabilities in a currency different from the reporting currency as defined in paragraph 1 amounting to or exceeding 5% of the institution's or liquidity subgroup's total liabilities, or has a significant branch as defined in Article 52 of Directive [inserted by OP] in a host Member State using a different currency than its home Member State, the institution shall separately report to the competent authorities of the home Member States the items referred to in paragraph 1 in that currency.
3. EBA shall develop draft implementing technical standards to specify the following:
  - (a) uniform formats and IT solutions with associated instructions for and frequencies, dates and delays of reporting. The reporting formats and frequencies shall be proportionate to the nature, scale and complexity of the different [...] activities of the institutions and shall comprise the reporting required according to paragraphs 1 and 2;

- (b) additional liquidity monitoring metrics required, to allow competent authorities to obtain a comprehensive view of the liquidity risk profile, proportionate to the nature, scale and complexity of an institution's activities;
- (c) EBA shall submit those draft technical standards for those items specified in point (a) to the Commission by 1 January 2013 and point (b) to the Commission by 1 January 2015.

Competent authorities can continue to collect monitoring tools for the purpose of monitoring compliance with existing liquidity standards. [...]

Power is conferred on the Commission to adopt the draft implementing technical standards referred to in the first sub-paragraph in accordance with Article 15 of Regulation (EU) No. 1093/2010.

- 4. Competent authorities of the home Member State shall upon request provide the competent authorities and the national central bank of the host Member States and EBA with timely access to the individual reporting in accordance with this Article.
- 5. Competent authorities that exercise supervision on a consolidated basis according to Article 107 of Directive [inserted by OP] shall immediately provide upon request the following authorities with all reporting submitted by the institution in accordance with the uniform formats referred to in paragraph 3
  - (a) the competent authorities and the national central bank of the host Member States in which there are significant branches as defined in Article 52 of Directive [inserted by OP] of the parent institution or institutions controlled by the same parent financial holding company;
  - (b) the competent authorities that have authorised subsidiaries of the parent institution or institutions controlled by the same parent financial holding company and the national central bank of the same Member State;
  - (c) EBA;
  - (d) ECB.

6. The competent authorities that have authorised an institution that is a subsidiary of a parent institution or parent financial holding company shall **immediately** provide upon request the competent authorities that shall exercise supervision on a consolidated basis according to Article 106 of Directive [inserted by OP], the central bank of the Member State where the institution is authorised and EBA with all reporting submitted by the institution in accordance with the uniform formats referred to in paragraph 3.

**7. Institutions shall not report double liquidity inflows and liquid assets.**

*Article 404*

*Reporting on liquid assets*

1. Institutions shall report the following as liquid assets :
- (a) cash and exposures to central banks to the extent that these exposures can be withdrawn at any time in times of stress;
  - (b) other transferable assets that are of extremely high liquidity and credit quality;
  - (c) transferable assets representing claims on or guaranteed by central government or central banks issued in the domestic currency [...] of the central government or central bank , to the extent that the holding of such transferable assets matches the liquidity needs of the institution's operations in that currency;
  - (d) transferable assets that are of high liquidity and credit quality.

As regards deposits held with central banks as referred to in Article 404(1)(b), the competent authority and the central bank shall aim at reaching a common understanding regarding the extent to which these deposits can be withdrawn in times of stress.

Pending a uniform definition in accordance with Article 481(2) of high and extremely high liquidity and credit quality, institutions shall identify themselves in a given currency transferable assets that are respectively of high or extremely high liquidity and credit quality. Pending a uniform definition, competent authorities may, taking into account the criteria listed in Article 481(2), provide general guidance that institutions shall follow in identifying assets of high and extremely high liquidity and credit quality. In the absence of such guidance, institutions shall use transparent and objective criteria to this end, including some or all of the criteria listed in Article 481(2).

2. The following shall not be considered liquid assets:

(a) assets that are issued by a credit institution unless they fulfil one of the following conditions:

(i) they are bonds eligible for the treatment set out in Article 124(3) or (4);

(ii) they are bonds as defined in Article 52(4) of Directive 2009/65/EC other than those referred to in (i);

(iia)

(iii) the credit institution has been set up by a Member State central or regional government and that government has an obligation to protect the economic basis of the institution and maintain its viability throughout its lifetime; or the asset is explicitly guaranteed by that government; and the asset is predominantly used to fund promotional loans granted on a non-competitive, not for profit basis in order to promote that government's public policy objectives;

(b) assets issued by **any of the following [...]**

**(i) an investment firm;**

**(ii) an insurance undertaking;**

**(iii) a financial holding company;**

**(iv) a mixed-financial holding companies;**

**(v) any other entity that performs one or more of the activities listed in Annex I of Directive [inserted by OP] as its main business.**

3. For the purposes of points (b) to (d) of paragraph 1, institutions shall only report as liquid assets that are eligible collateral for intraday liquidity needs and overnight liquidity facilities where the credit institution is operationally capable and entitled to use them for immediate access to those facilities or if the liquid assets are held to meet liquidity outflows in the currency of a third country, of the central bank of that third country;

This condition shall not apply in case of liquid assets held to meet liquidity outflows in a currency in which there is an extremely narrow definition of central bank eligibility. In case of liquid assets denominated in currencies of third countries, this exception shall apply and only apply if the competent authorities of the third country apply an equivalent exception [...]

3a. For the purposes of points (b) and (d) of paragraph 1, institutions shall only report as liquid assets that fulfil each of the following conditions: (a) they are not issued by the institution itself or its parent institution or subsidiary institutions or another subsidiary of its parent institutions or parent financial holding company;

(b)

(c) their price is generally agreed upon by markets participants and can easily be observed in the market, or their price can be determined by a formula that is easy to calculate based on publicly available inputs and does not depend on strong assumptions as is typically the case for structured or exotic products;

(d) they are listed on a recognised exchange;

- (e) they are tradable on active outright sale or repurchase agreement markets. These criteria **shall be assessed** [...] separately for each market considering whether there is a sufficient demand to generate funds without incurring large discounts due to fire-sales even in times of stress.

3b For the purpose of Article 481(2), institutions shall additionally report on other non-central bank eligible but tradable assets such as equities and gold.

4. EBA shall develop draft implementing technical standards listing the currencies which meet the conditions referred to in the second sub-paragraph of paragraph 3.

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 previous subparagraph, institutions may continue to apply the treatment set out in the second subparagraph of paragraph 3, where the competent authorities have applied that treatment before 1 January 2013.

5. Shares or units in CIUs may be treated as liquid assets up to an absolute amount of 250 million EUR in the portfolio of liquid assets of each institution provided that the requirements in Article 127(3) are met and that the CIU, apart from derivatives to mitigate interest rate or credit or currency risk, only invests in liquid assets as defined in paragraph 1.



6. Where a liquid asset ceases to be eligible for paragraph 1 or shares or units in CIUs cease to be eligible for the treatment set out in paragraph 5, an institution may nevertheless continue to consider it a liquid asset for an additional period of 30 calendar days.

#### *Article 405*

##### *Operational requirements for holdings of liquid assets*

The institution shall only report as liquid assets those holdings of liquid assets that meet the following conditions:

- (a) they are appropriately diversified;
- (b)
- (c) they are legally and practically readily available at any time during the next 30 days to be liquidated via outright sale or repurchase agreements in order to meet obligations coming due. Liquid assets referred to in point (c) of Paragraph 1 of Article 404 which are held in third countries where there are transfer restrictions or which are denominated in non-convertible currencies shall be considered available only to the extent that they correspond to outflows in the third country or currency in question;
- (d) the liquid assets are controlled by a liquidity management function;
- (e) a portion of the liquid assets except those in Article 404(1)(a) and (c), is periodically and at least annually liquidated via outright sale or repurchase agreements for the following purposes:
  - (i) to test the access to the market for these assets,
  - (ii) to test the effectiveness of its processes for the liquidation of assets
  - (iii) to test the usability of the assets,
  - (iv) to minimise the risk of negative signalling during a period of stress;

- (f) price risks associated with the assets may be hedged but the liquid assets are subject to appropriate internal arrangements that ensure that they will not be used in other ongoing operations, including:
  - (i) hedging or other trading strategies;
  - (ii) providing credit enhancements in structured transactions;
  - (iii) to cover operational costs.
- (g) the denomination of the liquid assets is consistent with the distribution by currency of liquidity outflows after the deduction of inflows.

#### *Article 406*

##### *Valuation of liquid assets*

1. The value of a liquid asset to be reported shall be its market value, subject to appropriate haircuts that reflect at least the duration, the credit and liquidity risk and typical repo haircuts in periods of general market stress. The haircuts shall not be less than 15% for the assets in point (d) of Article 404(1). If the institution hedges the price risk associated with an asset, it shall take into account the cash flow resulting from the potential close-out of the hedge.
2. Shares or units in CIUs as referred to in Article 404(5) shall be subject to haircuts, looking through to the underlying assets as follows:
  - (a)
  - (b) 5% for the assets in points (b) and (c) of Article 404(1) ;
  - (c) 20% for the assets in point (d) of Article 404(1).

The look-through approach shall be applied as follows:

- (a) where the institution is aware of the underlying exposures of a CIU, it may look through to those underlying exposures in order to assign them to point (a) to (d) of Article 404(1);

(b) where the institution is not aware of the underlying exposures of a CIU, it shall be assumed that the CIU invests, to the maximum extent allowed under its mandate, in descending order in the asset types referred to in points (a) to (d) of Article 404(1) until the maximum total investment limit is reached.

3. Institutions may rely on the following third parties to calculate and report the haircuts for shares or units in CIUs, in accordance with the methods set out in points (a) and (b) in the second subparagraph of paragraph 2:

- (a) the depository institution of the CIU provided that the CIU exclusively invests in securities and deposits all securities at this depository 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 calculations by the depository institution or the CIU management company shall be confirmed by an external auditor.

#### *Article 407*

*Article 408*  
*Liquidity outflows*

1. Liquidity outflows to be reported shall be calculated as the sum of the following items:
  - (a) the percentages of the current amount outstanding for retail deposits as set out in Article 409;
  - (b) the percentages of the current amounts outstanding of other liabilities that come due, can be called for payout by the issuing institutes or by the provider of the funding or entail an implicit expectation of the provider of the funding that the institution would repay the liability during the next 30 days as set out in Article 410;
  - (c) the additional outflows referred to in Article 411;
  - (d) the percentage of the maximum amount that can be drawn during the next 30 days from undrawn credit and liquidity facilities that qualify as medium or medium to low risk under Annex I, as set out in Article 412;
  - (e) the additional outflows identified in the assessment according to paragraph 2.
2. Institutions shall regularly assess the likelihood and potential volume of liquidity outflows during the next 30 days as far as products or services are concerned, which are not captured in Articles 410 to 412 and which they offer or sponsor or which potential purchasers would consider to be associated with them including any contractual arrangements such as other off balance sheet and contingent funding obligations. These outflows shall be assessed under the assumption of a combined idiosyncratic and market-wide stress scenario.

For this assessment, institutions shall take particular account of material reputational damages that could result from them not providing liquidity support to such products or services. Institutions shall report not less than yearly to the competent authorities those products and services the likelihood and volume referred to in the first subparagraph **of which** is material and the competent authorities shall determine the outflows to be assigned.

The competent authorities shall at least annually report to EBA the types of products or services for which they have determined outflows on the basis of the reports from institutions. They shall in this report also explain the methodology applied to determine the outflows.

3. .

#### *Article 409*

##### *Outflows on retail deposits*

1. Institutions shall multiply the amount of retail deposits that are covered by a Deposit Guarantee Scheme according to Directive 94/19/EC or an equivalent deposit guarantee scheme in a third country by at least 5% where the deposit is either
  - (a) part of an established relationship making withdrawal highly unlikely;
  - (b) held in a transactional account, including accounts to which salaries are regularly credited.
2. Institutions shall multiply other retail deposits not referred to in paragraph 1 by at least 10%.
3. Taking into account the behaviour of local depositors as advised by national competent authorities, EBA shall publish guidelines by 30 June 2013 on the criteria to determine the conditions of application of paragraphs 1 and 2 in relation to the identification of retail deposits subject to higher outflows than specified in paragraph 1 or 2 and the definitions of those products and the appropriate outflows for purposes of this Title. These guidelines shall take account of the likelihood of these deposits to lead to outflows of liquidity during the next 30 days. These outflows shall be assessed under the assumption of a combined idiosyncratic and market-wide stress scenario.

4. Institutions shall multiply retail deposits that they have taken in third countries by a higher percentage than provided for in paragraphs 1 and 2 if such percentage is provided by comparable third country reporting requirements.
5. [...] Institutions may exclude from the calculation of outflows certain clearly circumscribed categories of retail deposits as long as in each and every instance the institution rigorously applies the following for the whole category of those deposits, unless in individually justified circumstances of hardship for the depositor:
  - (a) within 30 days, the depositor is not allowed to withdraw the deposit;
  - (b) for early withdrawals within 30 days, the depositor has to pay a penalty that includes the loss of interests between the date of withdrawal and the contractual maturity date plus a material penalty that does not have to exceed the interest due for the time elapsed between the date of deposit and the date of withdrawal.

#### *Article 410*

##### *Outflows on other liabilities*

1. Institutions shall multiply liabilities resulting from the institution's own operating expenses by 0%.
2. Institutions shall multiply liabilities resulting from secured lending and capital market driven transactions as defined in Article 188 by:
  - (a) 0% up to the value of the liquid assets according to Article 406 if they are collateralised by assets that would qualify as liquid assets according to Article 404;
  - (b) 100% over the value of the liquid assets according to Article 406, if they are collateralized by assets that would qualify as liquid assets according to Article 404;
  - (c) 25% if the assets would not qualify as liquid assets according to Article 404 and the lender is the central government, the central bank or another public sector entity of the Member State in which the credit institution has been authorised or has established a branch.

3.

4. Institutions shall multiply liabilities resulting from deposits that have to be maintained:

- (a) by the depositor in order to obtain clearing, custody or cash management services from the institution;
- (b) in the context of common task sharing within an institutional protection scheme meeting the requirements of Article 108(7) or as a legal or statutory minimum deposit by another entity being a Member of the same institutional protection scheme;
- (c) by the [...] **non-financial customer** in the context of an established operational relationship other than that mentioned under point (a);

by 5% in the case of point (a) to the extent to which they are covered by a Deposit Guarantee Scheme according to Directive 94/19/EC or an equivalent deposit guarantee scheme in a third country and by 25% otherwise.

Clearing, custody or cash management services referred to in point (a) only covers such services to the extent that they are rendered in the context of an established relationship on which the depositor has substantial dependency. They shall not consist in correspondent banking or prime brokerage services and the institution shall have evidence that the client is unable to withdraw amounts legally due over a 30 day horizon without compromising its operational functioning.

Pending a uniform definition of an established relationship as referred to in letter c above, the institutions shall identify themselves the criteria to identify established relationship for which they have evidence that the client is unable to withdraw amounts legally due over a 30 day horizon without compromising its operational functioning and shall report these criteria to the competent authorities. Competent authorities may in the absence of a uniform definition provide general guidance that institutions shall follow in identifying deposits maintained by the depositor in a context of an established operational relationship.

5. Institutions shall multiply liabilities resulting from deposits by clients that are not financial customers by 75% to the extent they do not fall under paragraph 4.
6. Institutions shall take payables and receivables expected over the 30 day horizon from the contracts listed in Annex II into account on a net basis across counterparties and shall multiply them by 100% in case of a net amount payable. Net basis shall mean also net of collateral to be received that qualifies as liquid assets under Article 404.
7. Institutions shall multiply other liabilities that do not fall under paragraphs 1 to 5 by 100%.
8. By derogation from paragraph 7, competent authorities may grant the permission to apply a lower outflow percentage on a case-by-case basis when all of the following conditions are fulfilled:
  - (a) the depositor is a parent or subsidiary institution of the institution or another subsidiary of the same parent institution or linked to the institution by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC;
  - (b) there are reasons to expect a lower outflow over the next 30 days even under combined idiosyncratic and market-wide stress scenario;
  - (c) a corresponding symmetric or more conservative inflow is applied by the depositor by derogation from Article 413;
  - (d) the institution and the depositor are established in the same Member State.
- 8a. Competent authorities may waive the conditions set out in point (d) of paragraph 8 where Article 18 (1) point (b) is applied. In that case additional objective criteria as set out in the legislative act referred to in article 481 have to be met. Where such lower outflow is permitted to be applied, the competent authorities shall inform EBA about result of the process referred to in Article 18 (1) point (b). Fulfilment of the conditions for such lower outflows shall be regularly reviewed by the competent authorities.



9. By 1 January 2015, EBA shall develop draft regulatory technical standards to further specify the objective criteria referred to in paragraph 8a.

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

#### *Article 411*

##### *Additional Outflows*

1. Collateral which is posted by the institution for contracts listed in Annex II, shall be subject to an additional outflow of the haircut that would be applicable to those assets according to Article 406 for the assets corresponding to Article 404(1) and 20% of the market value of other assets.
2. Institutions shall notify to the competent authorities all contracts entered into the contractual conditions of which lead to a liquidity outflows or additional collateral needs following a material deterioration of the credit quality of the institution. If the competent authority considers such contracts material in relation to the potential liquidity outflows of the institution, it shall require the institution shall to add an additional outflow for those contracts, including corresponding to the additional collateral needs resulting, from a material deterioration in the credit quality of the institution such as a downgrade in its external credit assessment by three notches. The institution shall regularly review the extent of this material deterioration in light of what is relevant under the contracts it has entered into and shall notify the result of its review to the competent authority.
3. The institution shall add an additional outflow corresponding to collateral needs that would result from the impact of an adverse market scenario on the institution's derivatives transactions, financing transactions and other contracts if material.

EBA shall develop draft regulatory technical standards to determine the conditions of application in relation to the notion of materiality and methods for the measurement of this additional outflow.

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

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

4. The institution shall add an additional outflow corresponding to the market value of securities or other assets sold short and to be delivered within the 30 days horizon unless the institution owns the securities to be delivered or has borrowed them at terms requiring their return only after the 30 day horizon and the securities do not form part of the institutions liquid assets.

#### *Article 412*

##### *Outflows from credit and liquidity facilities*

1. Institutions shall report outflows from committed credit and liquidity facilities, which shall be determined as a percentage of the maximum amount that can be drawn. This maximum amount that can be drawn may be assessed net of the value according to Article 406 of collateral to be provided if the institution can reuse the collateral and if the collateral is held in the form of liquid assets in accordance with Article 404. The collateral to be provided shall not be assets issued by the counterparty of the facility or one of its affiliated entities. If the necessary information is available to the institution, the maximum amount that can be drawn for credit and liquidity facilities shall be determined as the maximum amount that could be drawn given the counterparty's own obligations or given the pre-defined contractual drawing schedule coming due over the next 30 days.
2. The maximum amount that can be drawn of undrawn committed credit and liquidity facilities shall be multiplied by 5% if they qualify for the retail exposure class under the Standardised or IRB approaches for credit risk.

3. The maximum amount that can be drawn of undrawn committed credit and liquidity facilities shall be multiplied by 10% where they meet the following conditions:
- (a) they do not qualify for the retail exposure class under the Standardised or IRB approaches for credit risk;
  - (b) they have been provided to clients that are not financial customers\_;
  - (c) they have not been provided for the purpose of replacing funding of the client in situations where he is unable to obtain its funding requirements in the financial markets\_)
- 3a. The committed amount of a liquidity facility that has been provided to an SSPE for the purpose of enabling such SSPE to purchase assets other than securities from clients that are not financial customers shall be multiplied by 10% to the extent that it exceeds the amount of assets currently purchased from clients and where the maximum amount that can be drawn is contractually limited to the amount of assets currently purchased.
4. The maximum amount that can be drawn of other undrawn committed credit and liquidity facilities shall be multiplied by 100%. This applies in particular to the following:
- (a) liquidity facilities that the institution has granted to SSPEs other than described in paragraph 3(b) above ;
  - (b) arrangements under which the institution is required to buy or swap assets from an SSPE.

5. Institutions, which have been set up and are sponsored by a Member State central or regional government may apply the treatments in paragraphs 2 and 3 by derogation from paragraph 4 also to credit and liquidity facilities that are provided to institutions for the sole purpose of directly or indirectly funding promotional loans qualifying for the exposure classes referred to in those paragraphs. If those promotional loans are extended via another institution as intermediary (pass through loans), a symmetric 0% in and outflow may be applied by institutions, which disburse those promotional loans to the final beneficiary, by derogation of paragraph 2(c) of Article 413. Those promotional loans shall be available only to persons who are not financial customers on a non-competitive, not for profit basis in order to promote public policy objectives of that Member State central or regional government. It shall only be possible to draw on such facilities following a request for a promotional loan and up to the amount of such request.

#### *Article 413*

##### *Inflows*

1. Institutions shall report their liquidity inflows.
2. The liquidity inflows shall be measured over the next 30 days. They shall comprise contractual inflows from exposures that are not past due and for which the institution has no reason to expect non-performance within the 30-day time horizon. The inflow shall be taken into account in full with the exception of the following:
  - (a) monies due from customers that are not central banks or financial customers for the purposes of principal payment shall be reduced by 50% of their value or by the contractual commitments to those customers to extend funding, whichever is higher. This does not apply to monies due from secured lending and capital market driven transactions as defined in Article 188 that are collateralised by liquid assets according to Article 404 and to monies due from trade financing transactions referred to in point (b) in the second subparagraph of Article 158(3) with a residual maturity of up to 30 days, which shall be taken into account in full as inflows;

- (b) monies due from secured lending and capital market driven transactions as defined in Article 188 if they are collateralised by liquid assets as defined in Article 404(1), shall not be taken into account up to the value net of haircuts of the liquid assets and shall be taken into account in full for the remaining monies due;
  - (c) monies due that the institution owing those monies treats according to Article 410(4) shall be multiplied by a corresponding symmetrical inflow.
  - (d) any undrawn credit or liquidity facilities and any other commitments received shall not be taken into account. By derogation institutions that have received a commitment referred to in Article 412(5) in order for them to disburse a promotional loan to a final recipient may take an inflow into account up to the amount of the outflow they apply to the corresponding commitment to extend those promotional loans.
3. Payables and receivables expected over the 30 day horizon from the contracts listed in Annex II shall be reflected on a net basis across counterparties and shall be multiplied by 100% of a net amount receivable. Net basis shall mean also net of collateral to be received that qualifies as liquid assets under Article 404.
4. Competent authorities may grant the permission to apply, by derogation from paragraph 2 point [...] d), a higher inflow on a case by case basis when all of the following conditions are fulfilled:
- (a) there are reasons to expect a higher inflow even under a combined market and idiosyncratic stress of the provider;
  - (b) the counterparty is a parent or subsidiary institution of the institution or another subsidiary of the same parent institution or linked to the institution by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC or a member of the same institutional protection scheme referred to in Article 108(7);

(ba) a corresponding symmetric or more conservative outflow is applied by the counterparty by derogation from Article 410 [...] ;

(c) the institution and the counterparty shall be established in the same Member State.

4a. Competent authorities may waive the condition set out in point (c) where article 18 (1) point (b) is applied. In that case additional objective criteria as set out in the legislative act referred to in article 481 have to be met. Where such higher inflow is permitted to be applied, the competent authorities shall inform EBA about the result of the process referred to in article 18 (1) point b. Fulfilment of the conditions for such higher inflows shall be regularly reviewed by the competent authorities.

4b. By 1 January 2015, EBA shall develop draft regulatory technical standards to determine the percentages to further specify the objective criteria referred to in paragraph 4a.

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

5. Institutions shall not report inflows from any of the liquid assets reported in accordance with Article 404 other than payments due on the assets that are not reflected in the market value of the asset.

6. Institutions shall not report inflows from any new obligations entered into.

7. Institutions shall take liquidity inflows which are to be received in third countries where there are transfer restrictions or which are denominated in non-convertible currencies into account only to the extent that they correspond to outflows in the third country or currency in question.

## Title III

### Reporting on stable funding

#### *Article 414*

##### *Items providing stable funding*

1. Institutions shall report quarterly to the competent authorities in their domestic currency the following items and their [...] components in order to allow an assessment of the availability of stable funding:
  - (a) own funds;
  - (b) the following liabilities not included in point (a):
    - (i) retail deposits as defined in Article 400(2) that qualify for the treatment in Article 409(1);
    - (ii) retail deposits as defined in Article 400(2) that qualify for the treatment in Article 409(2).
    - (iii) deposits that qualify for the treatment in Article 410(34)
    - (iv) of the deposits in (iii), those that are subject to a deposit guarantee according to Directive 94/19/EC or an equivalent deposit guarantee scheme in a third country;
    - (v) of the deposits in (iii), those that fall under point (b) in Article 410(4)
    - (vi) amounts deposited not falling under (i) or (iii) if they are not deposited by financial customers;
    - (vii) all funding obtained from financial customers;

(viii) separately for amounts falling under (vi) and (vii) respectively, funding from secured lending and capital market driven transactions as defined in Article 188

- collateralised by liquid assets as set out in Article 404;
- collateralised by any other assets;

(ix) liabilities resulting from securities issued qualifying for the treatment in Article 124 or as defined in Article 52(4) of Directive 2009/65/EC;

(x) other liabilities resulting from securities issued;

(xi) any other liabilities.

2. Where applicable, all items shall be presented in the following five buckets according to the closer of their maturity date and the earliest date at which they can contractually be called:

- (a) within 3 months
- (b) between 3 and 6 months
- (c) between 6 and 9 months;
- (d) between 9 and 12 months;
- (e) after 12 months.

#### *Article 415*

##### *Items requiring stable funding*

1. Unless deducted from own funds, the following items shall be reported to competent authorities separately in order to allow an assessment of the needs for stable funding:

- (a) the assets referred to in Article 404, broken down by asset type;



- (b) securities and money market instruments not included in (a);
- (c) equity securities of non-financial entities listed on a major index in a recognised exchange;
- (d) other equity securities;
- (e) gold;
- (f) other precious metals;
- (g) non-renewable loans and receivables, and thereof separately those the borrowers of which are:
  - (i) natural persons other than commercial sole proprietor and partnerships;
  - (ia) small and medium sized enterprises where the aggregate deposit placed by that client or group of connected clients is less than 1 million EUR;
  - (ii) sovereigns, central banks and PSEs;
  - (iii) clients not referred to in (i) and (ii) other than financial customers;
  - (iv)
  - (v) collateralized by commercial real estate (CRE);
  - (vi) collateralized by residential real estate (RRE);
  - (vii) match funded via bond issuance.
- (h) derivatives receivables;
- (i) any other assets;
- (j) undrawn credit facilities that qualify as 'medium risk' or 'medium/low risk' under Annex I.

2. Where applicable, all items shall be presented in the five buckets described in Article 414(2).

## PART SEVEN

### LEVERAGE

#### *Article 416*

#### *Calculation of the leverage ratio*

1. Institutions shall calculate their leverage ratio according to the methodology set out in paragraphs 2 to 10.
2. The leverage ratio shall be calculated as an institution's capital measure divided by that institution's total exposure measure and shall be expressed as a percentage.

Institutions shall calculate the leverage ratio as the simple arithmetic mean of the monthly leverage ratios over a quarter.

3. For the purposes of paragraph 2, the capital measure shall be the Tier 1 capital as defined in Article 23.
4. The total exposure measure is the sum of the exposure values of all assets and off-balance sheet items not deducted when determining the capital measure referred to in paragraph 3.

Where institutions include financial sector entities in which they hold significant investments in their consolidation according to the **[...] applicable** accounting framework, but not in their prudential consolidation according to Chapter 2 of Title II of Part One, they shall reduce their exposure measure by the amount that is obtained by multiplying the amount defined in point (a) with the factor defined in point (b):

- (a) the sum of the exposure values of all the assets of those financial sector entities which are included in the consolidation according to the **[...] applicable** accounting framework, but not in the prudential consolidation according to Chapter 2 of Title II of Part One;

- (b) the sum of the deductions from Tier 1 items specified in point (i) of Article 33(1) and in point (d) of Article 53 divided by the total amount of Tier 1 items.

Institutions shall effect the valuation of assets and off-balance sheet items in accordance with Article 94.

5. Without prejudice to paragraphs 6 and 7, institutions shall determine the exposure value of assets in accordance with the following principles:

- (a) the exposure values of assets, excluding items listed in Annex II and credit derivatives, means exposure values as defined in Article 106(1);
- (b) physical or financial collateral, guarantees or credit risk mitigation purchased shall not be used to reduce exposure values of assets;
- (c) loans shall not be netted with deposits

6. Without prejudice to paragraph 6b [...] . institutions shall determine the exposure value of contracts listed in Annex II and [...] of credit derivatives in accordance with [...] the Mark-to-Market Method set out in Article 269

**In determining the exposure value of those contracts institutions shall take into account the effects of contracts for novation and other netting agreements, except contractual cross-product netting agreements, in accordance with Article 289.**

- 6aa. As a derogation from paragraph 6, institutions may use [...] the Original Exposure Method set out in Article 270 [...] determine the exposure value of contracts listed in points 1 and 2 of Annex II [...] only if they also use this method for determining the exposure value of these contracts for the purposes of meeting the own funds requirements set out in Article 87.**

- [...] 6a. When determining the potential future credit exposure of credit derivatives, institutions shall apply the principles laid down in Article 293(2) to all their credit derivatives, not just those assigned to the trading book.

7. Institutions shall determine the exposure value of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions in accordance with Article 215(1) to (3) and Article 217, and shall take into account the effects of master netting agreements, except contractual cross-product netting agreements, in accordance with Article 201.
8. Institutions shall determine the exposure value of off-balance sheet items, except the items referred to in paragraphs 6 and 7, in accordance with Article 106(1), subject to the following modifications to the percentages listed in that Article:
- (a) the percentage to be applied to the nominal value for undrawn credit facilities, which may be cancelled unconditionally at any time without notice, referred to in the first indent of paragraph 4 of Annex I, is 10%;
  - (b) percentage to be applied to the nominal value for all other off-balance-sheet items listed in Annex I is 100%.
9. Institutions shall determine the exposure values of items listed in Annex II and of credit derivatives that are off-balance sheet items in accordance with the approach set out in paragraph 6.
- Institutions shall determine the exposure values of repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions that are off-balance sheet items in accordance with the approach set out in paragraph 7.
- 10.
11. Where national GAAP recognises fiduciary assets on balance sheet, in accordance with article 10 of Council Directive 86/635/EEC<sup>1</sup>, they can be excluded from the leverage ratio total exposure measure provided the assets meet the criteria in IAS 39 for non- recognition and, where applicable, IFRS 10 for non-consolidation. [...]

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<sup>1</sup> OJ L 372, 31.12.1986, p. 1

## *Article 417*

### *Reporting requirement*

1. Institutions shall submit to the competent authorities all necessary information on the leverage ratio and its components as determined in Article 416. Competent authorities shall take into account this information when undertaking the supervisory review referred to in Article 92 of Directive [inserted by OP].

Competent authorities shall submit the information received from institutions to EBA upon its request to facilitate the review referred to in Article 482.

2. EBA shall develop draft implementing technical standards to determine **the uniform [...] template, [...] the instructions on how to use such template, the frequencies and dates of reporting, and the IT solutions, for the purposes of the reporting requirement laid down in [...] paragraph 1 [...].**

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

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.

# **PART EIGHT**

## **DISCLOSURE BY INSTITUTIONS**

### **Title I**

#### **General Principles**

##### *Article 418*

##### *Scope of disclosure requirements*

1. Institutions shall publicly disclose the information laid down in Title II, subject to the provisions laid down in Article 419.
2. Permission by the competent authorities under Part three of the instruments and methodologies referred to in Title III shall be subject to the public disclosure by institutions of the information laid down therein.
3. Institutions shall adopt a formal policy to comply with the disclosure requirements laid down in this Part, and have policies for assessing the appropriateness of their disclosures, including their verification and frequency. Institutions shall also have policies for assessing whether their disclosures convey their risk profile comprehensively to market participants.

Where those disclosures do not convey the risk profile comprehensively to market participants, institutions shall publicly disclose the information necessary in addition to that required in accordance with paragraph 1. However, they shall only be required to disclose information which is material and not proprietary or confidential in accordance with Article 419.

4. Institutions shall, if requested, explain their rating decisions to small and medium-size enterprises and other corporate applicants for loans, providing an explanation in writing when asked. The administrative costs of the explanation shall be proportionate to the size of the loan.

## *Article 419*

### *Non-material, proprietary or confidential information*

1. Institutions may omit one or more of the disclosures listed in Title II if the information provided by such disclosures is not regarded as material, except for the disclosures laid down in Article 424.

Information shall be regarded as material in disclosures if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.

2. Institutions may also omit one or more items of information included in the disclosures listed in Titles II and III if those items include information which is regarded as proprietary or confidential in accordance with the second and third subparagraphs, except for the disclosures laid down in Article 424.

Information shall be regarded as proprietary to an institution if disclosing it publicly would undermine its competitive position. It may include information on products or systems which, if shared with competitors, would render an institution's investments therein less valuable.

Information shall be regarded as confidential if there are obligations to customers or other counterparty relationships binding an institution to confidentiality.

3. In the cases referred to in paragraph 2, the institution concerned shall state in its disclosures the fact that the specific items of information are not disclosed, the reason for non-disclosure, and publish more general information about the subject matter of the disclosure requirement, except where these are to be classified as proprietary or confidential.

## *Article 420*

### *Frequency of disclosure*

Institutions shall publish the disclosures required by this Part at least on an annual basis.

Annual disclosures shall be published in conjunction with the date of publication of the financial statements.

Institutions shall assess the need to publish some or all disclosures more frequently than annually in the light of the relevant characteristics of their business such as scale of operations, range of activities, presence in different countries, involvement in different financial sectors, and participation in international financial markets and payment, settlement and clearing systems. That assessment shall pay particular attention to the possible need for more frequent disclosure of items of information laid down in Article 424, and points (b) to (e) of Article 425, and information on risk exposure and other items prone to rapid change.

## *Article 421*

### *Means of disclosures*

1. Institutions may determine the appropriate medium, location and means of verification to comply effectively with the disclosure requirements laid down in this Part. To the degree feasible, all disclosures shall be provided in one medium or location. If a similar piece of information is disclosed in two or more medias, a reference to the synonymous information in the other medias shall be included within each media.
2. Equivalent disclosures made by institutions under accounting, listing or other requirements may be deemed to constitute compliance with this Part. If disclosures are not included in the financial statements, institutions shall unambiguously indicate in the financial statements where they can be found.



## Title II

### Technical criteria on transparency and disclosure

#### *Article 422*

##### *Risk management objectives and policies*

1. Institutions shall disclose their risk management objectives and policies for each separate category of risk, including the risks referred to under this Title. These disclosures shall include:
  - (a) the strategies and processes to manage those risks;
  - (b) the structure and organisation of the relevant risk management function including information on its authority and statute, or other appropriate arrangements;
  - (c) the scope and nature of risk reporting and measurement systems;
  - (d) the policies for hedging and mitigating risk, and the strategies and processes for monitoring the continuing effectiveness of hedges and mitigants;
  - (e) a declaration approved by the management body on the adequacy of risk management arrangements of the institution providing assurance that the risk management systems put in place are adequate with regard to institution's profile and strategy;
  - (f) a concise risk statement approved by the management body succinctly describing the institution's overall risk profile associated with the business strategy. This statement shall include key ratios and figures providing external stakeholders with a concise but comprehensive view of how risk profile of the institution interacts with the risk tolerance set by the management body.

2. Institutions shall disclose the following information, including regular, at least annual updates, regarding governance arrangements:

- (a) the number of directorships held by members of the management body;
- (b) the recruitment policy for the selection of members of the management body and their actual knowledge, skills and expertise;
- (c) whether the institution has a policy on diversity with regard to selection of members of the management body, objectives and any relevant targets set out in that policy, and the extent to which these objectives and targets have been achieved;
- (d) whether or not the institution has set up a separate risk committee and the number of times the risk committee has met;
- (e) the description of the information flow on risk to the management body\_.

#### *Article 423*

##### *Scope of application*

Institutions shall disclose the following information regarding the scope of application of the requirements of this Regulation in accordance with Directive [inserted by OP]:

- (a) the name of the institution to which the requirements of this Regulation apply;
- (b) an outline of the differences in the basis of consolidation for accounting and prudential purposes, with a brief description of the entities therein, explaining whether they are:
  - (i) fully consolidated;
  - (ii) proportionally consolidated;
  - (iii) deducted from own funds;
  - (iv) neither consolidated nor deducted;

- (c) any current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities among the parent undertaking and its subsidiaries;
- (d) the aggregate amount by which the actual own funds are less than required in all subsidiaries not included in the consolidation, and the name or names of such subsidiaries;
- (e) if applicable, the circumstances of making use of the provisions laid down in Articles 6 and 8

#### *Article 424*

##### *Own funds*

1. Institutions shall disclose the following information regarding their own funds:
  - (a) a full reconciliation of Common Equity Tier 1 items, Additional Tier 1 items, Tier 2 items and filters and deductions applied pursuant to Articles 29 to 32, 33, 53, 63 and 74 to own funds of the institution and the balance sheet in the audited financial statements of the institution;
  - (b) a description of the main features of the Common Equity Tier 1 and Additional Tier 1 instruments and Tier 2 instruments issued by the institution;
  - (c) the full terms and conditions of all Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments;
  - (d) separate disclosure of the nature and amounts of the following:
    - (i) each prudential filter applied pursuant to Articles 29 to 32;
    - (ii) each deduction made pursuant to Articles 33, 53 and 63;
    - (iii) items not deducted in accordance with Articles 44, 45, 53, 63 and 74;
  - (e) a description of all restrictions applied to the calculation of own funds in accordance with this Regulation and the instruments, prudential filters and deductions to which those restrictions apply;

(f) where institutions disclose capital ratios calculated using elements of own funds determined on a basis other than that laid down in this Regulation, a comprehensive explanation of the basis on which those capital ratios are calculated.

2. EBA shall develop draft implementing technical standards to specify uniform templates for disclosure under points (a), (b), (c), (d) and (e) of paragraph 1.

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

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

#### *Article 425*

##### *Capital requirements*

Institutions shall disclose the following information regarding the compliance by the institution with the requirements laid down in Articles 87 and Article 72 of Directive [inserted by OP]:

- (a) a summary of the institution's approach to assessing the adequacy of its internal capital to support current and future activities;
- (aa) upon demand from the Member State, the result of the institution's approach to assessing the adequacy of its internal capital to support current and future activities
- (b) for institutions calculating the risk-weighted exposure amounts in accordance with Chapter 2 of Part Three, Title II, 8% of the risk-weighted exposure amounts for each of the exposure classes specified in Article 107;
- (c) for institutions calculating risk-weighted exposure amounts in accordance with Chapter 3 of Part Three, Title II, 8% of the risk-weighted exposure amounts for each of the exposure classes specified in Article 142. For the retail exposure class, this requirement applies to each of the categories of exposures to which the different correlations in Article 149(1) to (4) correspond. For the equity exposure class, this requirement applies to:

- (i) each of the approaches provided in Article 150;
- (ii) exchange traded exposures, private equity exposures in sufficiently diversified portfolios, and other exposures;
- (iii) exposures subject to supervisory transition regarding own funds requirements;
- (iv) exposures subject to grandfathering provisions regarding own funds requirements;
- (d) own funds requirements calculated in accordance with points (b) and (c) of Article 87;
- (e) own funds requirements calculated in accordance with Part Three, Title III, Sections 2 to 4 and disclosed separately.

The institutions calculating the risk-weighted exposure amounts in accordance with Article 148(5) or 150(2) shall disclose the exposures assigned to each category in Table 1 in paragraph 5 of Article 148, or to each risk weight mentioned in Article 150(2).

#### *Article 426*

##### *Exposure to counterparty credit risk*

Institutions shall disclose the following information regarding the institution's exposure to counterparty credit risk as defined in Title III, Chapter 6:

- (a) a discussion of the methodology used to assign internal capital and credit limits for counterparty credit exposures;
- (b) a discussion of policies for securing collateral and establishing credit reserves;
- (c) a discussion of policies with respect to wrong-way risk exposures;
- (d) a discussion of the impact of the amount of collateral the institution would have to provide given a downgrade in its credit rating;

- (e) gross positive fair value of contracts, netting benefits, netted current credit exposure, collateral held and net derivatives credit exposure. Net derivatives credit exposure is the credit exposure on derivatives transactions after considering both the benefits from legally enforceable netting agreements and collateral arrangements;
- (f) measures for exposure value under the methods set out in Sections 3 to 6 of Title III, Chapter 6 whichever method is applicable;
- (g) the notional value of credit derivative hedges, and the distribution of current credit exposure by types of credit exposure;
- (h) the notional amounts of credit derivative transactions, segregated between use for the institution's own credit portfolio, as well as in its intermediation activities, including the distribution of the credit derivatives products used, broken down further by protection bought and sold within each product group;
- (i) the estimate of  $\alpha$  if the institution has received the permission of the competent authorities to estimate  $\alpha$ .

#### *Article 427*

#### *Capital buffers*

1. An institution shall disclose the following information in relation to its compliance with the requirement for a countercyclical capital buffer referred to in Title VII, Chapter 4 of Directive [inserted by OP]:
  - (a) the geographical distribution of its credit exposures relevant for the calculation of its countercyclical capital buffer;
  - (b) the amount of its institution specific countercyclical capital buffer.

2. EBA shall develop draft regulatory technical standards specifying the disclosure requirements set out in paragraph 1.

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 428*

##### *Credit risk adjustments*

Institutions shall disclose the following information regarding the institution's exposure to credit risk and dilution risk:

- (a) the definitions for accounting purposes of 'past due' and 'impaired';
- (b) a description of the approaches and methods adopted for determining specific and general credit risk adjustments;
- (c) the total amount of exposures after accounting offsets and without taking into account the effects of credit risk mitigation, and the average amount of the exposures over the period broken down by different types of exposure classes;
- (d) the geographic distribution of the exposures, broken down in significant areas by material exposure classes, and further detailed if appropriate;
- (e) the distribution of the exposures by industry or counterparty type, broken down by exposure classes, and further detailed if appropriate;
- (f) the residual maturity breakdown of all the exposures, broken down by exposure classes, and further detailed if appropriate;

- (g) by significant industry or counterparty type, the amount of:
  - (i) impaired exposures and past due exposures, provided separately;
  - (ii) Specific and general credit risk adjustments;
  - (iii) charges for specific and general credit risk adjustments during the reporting period;
- (h) the amount of the impaired exposures and past due exposures, provided separately, broken down by significant geographical areas including, if practical, the amounts of specific and general credit risk adjustments related to each geographical area;
- (i) the reconciliation of changes in the specific and general credit risk adjustments for impaired exposures, shown separately. The information shall comprise:
  - (i) a description of the type of specific and general credit risk adjustments;
  - (ii) the opening balances;
  - (iii) the amounts taken against the credit risk adjustments during the reporting period;
  - (iv) the amounts set aside or reversed for estimated probable losses on exposures during the reporting period, any other adjustments including those determined by exchange rate differences, business combinations, acquisitions and disposals of subsidiaries, and transfers between credit risk adjustments;
  - (v) the closing balances.

Specific credit risk adjustments and recoveries recorded directly to the income statement shall be disclosed separately.



### *Article 429*

#### *Use of ECAIs*

For institutions calculating the risk-weighted exposure amounts in accordance with Part Three, Title II, Chapter 2, the following information shall be disclosed for each of the exposure classes specified in Article 107:

- (a) the names of the nominated ECAIs and ECAs and the reasons for any changes;
- (b) the exposure classes for which each ECAI or ECA is used;
- (c) a description of the process used to transfer the issuer and issue credit assessments onto items not included in the trading book;
- (d) the association of the external rating of each nominated ECAI or ECA with the credit quality steps prescribed in Part Three, Title II, Chapter 2, taking into account that this information needs not be disclosed if the institution complies with the standard association published by EBA;
- (e) the exposure values and the exposure values after credit risk mitigation associated with each credit quality step prescribed in Part Three, Title II, Chapter 2 as well as those deducted from own funds.

### *Article 430*

#### *Exposure to market risk*

The institutions calculating their own funds requirements in accordance with points (b) and (c) of Article 87(3) shall disclose those requirements separately for each risk referred to in those provisions. In addition, the own funds requirement for specific interest rate risk of securitisation positions shall be disclosed separately.

*Article 431*  
*Operational risk*

Institutions shall disclose the approaches for the assessment of own funds requirements for operational risk that the institution qualifies for; a description of the methodology set out in Article 301(2), if used by the institution, including a discussion of relevant internal and external factors considered in the institution's measurement approach, and in the case of partial use, the scope and coverage of the different methodologies used.

*Article 432*  
*Exposures in equities not included in the trading book*

Institutions shall disclose the following information regarding the exposures in equities not included in the trading book:

- (a) the differentiation between exposures based on their objectives, including for capital gains relationship and strategic reasons, and an overview of the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation and any significant changes in these practices;
- (b) the balance sheet value, the fair value and, for those exchange-traded, a comparison to the market price where it is materially different from the fair value;
- (c) the types, nature and amounts of exchange-traded exposures, private equity exposures in sufficiently diversified portfolios, and other exposures;
- (d) the cumulative realised gains or losses arising from sales and liquidations in the period;  
and
- (e) the total unrealised gains or losses, the total latent revaluation gains or losses, and any of these amounts included in the original or additional own funds.

### *Article 433*

#### *Exposure to interest rate risk on positions not included in the trading book*

Institutions shall disclose the following information on their exposure to interest rate risk on positions not included in the trading book:

- (a) the nature of the interest rate risk and the key assumptions (including assumptions regarding loan prepayments and behaviour of non-maturity deposits), and frequency of measurement of the interest rate risk;
- (b) the variation in earnings, economic value or other relevant measure used by the management for upward and downward rate shocks according to management's method for measuring the interest rate risk, broken down by currency.

### *Article 434*

#### *Exposure to securitisation positions*

Institutions calculating risk weighted exposure amounts in accordance with Part Three, Title II, Chapter 5 or own funds requirements in accordance with Article 326 or Article 327 shall disclose the following information, where relevant, separately for their trading and non-trading book:

- (a) a description of the institution's objectives in relation to securitisation activity;
- (b) the nature of other risks including liquidity risk inherent in securitised assets;
- (c) the type of risks in terms of seniority of underlying securitisation positions and in terms of assets underlying those latter securitisation positions assumed and retained with re-securitisation activity;
- (d) the different roles played by the institution in the securitisation process;
- (e) an indication of the extent of the institution's involvement in each of the roles referred to in point (d);

- (f) a description of the processes in place to monitor changes in the credit and market risk of securitisation exposures including, how the behaviour of the underlying assets impacts securitisation exposures and a description of how those processes differ for re-securitisation exposures;
- (g) a description of the institution's policy governing the use of hedging and unfunded protection to mitigate the risks of retained securitisation and re-securitisation exposures, including identification of material hedge counterparties by relevant type of risk exposure;
- (h) the approaches to calculating risk weighted exposure amounts that the institution follows for its securitisation activities including the types of securitisation exposures to which each approach applies;
- (i) the types of SSPE that the institution, as sponsor, uses to securitise third-party exposures including whether and in what form and to what extent the institution has exposures to those SSPEs, separately for on- and off-balance sheet exposures, as well as a list of the entities that the institution manages or advises and that invest in either the securitisation positions that the institution has securitised or in SSPEs that the institution sponsors;
- (j) a summary of the institution's accounting policies for securitisation activities, including:
  - (i) whether the transactions are treated as sales or financings;
  - (ii) the recognition of gains on sales;
  - (iii) the methods, key assumptions, inputs and changes from the previous period for valuing securitisation positions;
  - (iv) the treatment of synthetic securitisations if not covered by other accounting policies;
  - (v) how assets awaiting securitisation are valued and whether they are recorded in the institution's non-trading book or the trading book;
  - (vi) policies for recognising liabilities on the balance sheet for arrangements that could require the institution to provide financial support for securitised assets;

- (k) the names of the ECAs used for securitisations and the types of exposure for which each agency is used;
- (l) where applicable, a description of the Internal Assessment Approach as set out in Part Three, Title II, Chapter 5, Section 3, including the structure of the internal assessment process and relation between internal assessment and external ratings, the use of internal assessment other than for IAA capital purposes, the control mechanisms for the internal assessment process including discussion of independence, accountability, and internal assessment process review, the exposure types to which the internal assessment process is applied and the stress factors used for determining credit enhancement levels, by exposure type;
- (m) an explanation of significant changes to any of the quantitative disclosures in points (n) to (q) since the last reporting period;
- (n) separately for the trading and the non-trading book, the following information broken down by exposure type:
  - (i) the total amount of outstanding exposures securitised by the institution, separately for traditional and synthetic securitisations and securitisations for which the institution acts only as sponsor;
  - (ii) the aggregate amount of on-balance sheet securitisation positions retained or purchased and off-balance sheet securitisation exposures;
  - (iii) the aggregate amount of assets awaiting securitisation;
  - (iv) for securitised facilities subject to the early amortisation treatment, the aggregate drawn exposures attributed to the originator's and investors' interests respectively, the aggregate capital requirements incurred by the institution against the originator's interest and the aggregate capital requirements incurred by the institution against the investor's shares of drawn balances and undrawn lines;
  - (v) the amount of securitisation positions that are deducted from own funds or risk-weighted at 1250 %;

- (vi) a summary of the securitisation activity of the current period, including the amount of exposures securitised and recognised gain or loss on sale;
- (o) separately for the trading and the non-trading book, the following information:
  - (i) the aggregate amount of securitisation positions retained or purchased and the associated capital requirements, broken down between securitisation and re-securitisation exposures and further broken down into a meaningful number of risk-weight or capital requirement bands, for each capital requirements approach used;
  - (ii) the aggregate amount of re-securitisation exposures retained or purchased broken down according to the exposure before and after hedging/insurance and the exposure to financial guarantors, broken down according to guarantor credit worthiness categories or guarantor name;
- (p) for the non-trading book and regarding exposures securitised by the institution, the amount of impaired/past due assets securitised and the losses recognised by the institution during the current period, both broken down by exposure type;
- (q) for the trading book, the total outstanding exposures securitised by the institution and subject to a capital requirement for market risk, broken down into traditional/synthetic and by exposure type;
- (r) where applicable, whether the institution has provided support within the terms of Article 243(1) and the impact on own funds.

#### *Article 435*

##### *Remuneration policy*

1. Institutions shall disclose the following information, regarding the remuneration policy and practices of the institution for those categories of staff whose professional activities have a material impact on its risk profile:

- (a) information concerning the decision-making process used for determining the remuneration policy, including if applicable, information about the composition and the mandate of a remuneration committee, the external consultant whose services have been used for the determination of the remuneration policy and the role of the relevant stakeholders;
- (b) information on link between pay and performance;
- (c) the most important design characteristics of the remuneration system, including information on the criteria used for performance measurement and risk adjustment, deferral policy and vesting criteria;
- (d) information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based;
- (e) the main parameters and rationale for any variable component scheme and any other non-cash benefits;
- (f) aggregate quantitative information on remuneration, broken down by business area;
- (g) aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the institution, indicating the following:
  - (i) the amounts of remuneration for the financial year, split into fixed and variable remuneration, and the number of beneficiaries;
  - (ii) the amounts and forms of variable remuneration, split into cash, shares, share-linked instruments and other types;
  - (iii) the amounts of outstanding deferred remuneration, split into vested and unvested portions;
  - (iv) the amounts of deferred remuneration awarded during the financial year, paid out and reduced through performance adjustments;

- (v) new sign-on and severance payments made during the financial year, and the number of beneficiaries of such payments;
- (vi) the amounts of severance payments awarded during the financial year, number of beneficiaries and highest such award to a single person.
- (h) the number of individuals being remunerated EUR 1 million or more per financial year, for remuneration between EUR 1 million and EUR 5 million broken down into pay bands of EUR 500,000 and for remuneration of EUR 5 million and above broken down into pay bands of EUR 1 million.

2. For institutions that are significant in terms of their size, internal organisation and the nature, scope and the complexity of their activities, the quantitative information referred to in this Article shall also be made available to the public at the level of persons who effectively direct the business of the institution within the meaning of Article 13(1) of Directive [inserted by OP] and Article 9(1) of Directive 2004/39/EC.

Institutions shall comply with the requirements set out in this Article in a manner that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities and without prejudice to Directive 95/46/EC.

### *Article 436*

#### *Leverage*

1. Institutions shall disclose the following information regarding their leverage ratio as defined in Article 416 and their management of the risk of excessive leverage as defined in point (B) of Article 4(2) of Directive [inserted by OP]:
  - (a) the leverage ratio and how the institution applied Article 475, paragraph 2 and 3;
  - (b) a breakdown of the total exposure measure

**(ba) where applicable, the amount of derecognised fiduciary items according to Article 416 paragraph 11;**



- (c) a description of the processes used to manage the risk of excessive leverage;
- (d) a description of the factors that had an impact on the leverage ratio during the period to which the disclosed leverage ratio refers.

2. EBA shall develop draft implementing technical standards to determine the uniform disclosure template for the disclosure referred to in paragraph 1 and the instructions on how to use such template.

EBA shall submit those draft implementing technical standards to the Commission by 30 June 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.

# Title III

## Qualifying requirements for the use of particular instruments or methodologies

### *Article 437*

#### *Use of the IRB Approach to credit risk*

Institutions calculating the risk-weighted exposure amounts under the IRB Approach shall disclose the following information

- (a) the competent authority's permission of the approach or approved transition;
- (b) an explanation and review of:
  - (i) the structure of internal rating systems and relation between internal and external ratings;
  - (ii) the use of internal estimates other than for calculating risk-weighted exposure amounts in accordance with Part Three, Title II, Chapter 3;
  - (iii) the process for managing and recognising credit risk mitigation;
  - (iv) the control mechanisms for rating systems including a description of independence, accountability, and rating systems review;
- (c) a description of the internal ratings process, provided separately for the following exposure classes:
  - (i) central governments and central banks;
  - (ii) institutions;
  - (iii) corporate, including SMEs, specialised lending and purchased corporate receivables;

- (iv) retail, for each of the categories of exposures to which the different correlations in Article 149(1) to 149(4) correspond;
  - (v) equities;
- (d) the exposure values for each of the exposure classes specified in Article 142. Exposures to central governments and central banks, institutions and corporates where institutions use own estimates of LGDs or conversion factors for the calculation of risk-weighted exposure amounts shall be disclosed separately from exposures for which the institutions do not use such estimates;
- (e) for each of the exposure classes central governments and central banks, institutions, corporate and equity, and across a sufficient number of obligor grades (including default) to allow for a meaningful differentiation of credit risk, institutions shall disclose:
- (i) the total exposures, including for the exposure classes central governments and central banks, institutions and corporate, the sum of outstanding loans and exposure values for undrawn commitments; and for equities the outstanding amount;
  - (ii) the exposure-weighted average risk weight;
  - (iii) for the institutions using own estimates of conversion factors for the calculation of risk-weighted exposure amounts, the amount of undrawn commitments and exposure-weighted average exposure values for each exposure class;
- (f) For the retail exposure class and for each of the categories as defined under point (c)(iv), either the disclosures outlined under (e) above (if applicable, on a pooled basis), or an analysis of exposures (outstanding loans and exposure values for undrawn commitments) against a sufficient number of EL grades to allow for a meaningful differentiation of credit risk (if applicable, on a pooled basis);
- (g) the actual specific credit risk adjustments in the preceding period for each exposure class (for retail, for each of the categories as defined under point (c)(iv) and how they differ from past experience;

- (h) a description of the factors that impacted on the loss experience in the preceding period (for example, has the institution experienced higher than average default rates, or higher than average LGDs and conversion factors);
- (i) the institution's estimates against actual outcomes over a longer period. At a minimum, this shall include information on estimates of losses against actual losses in each exposure class (for retail, for each of the categories as defined under point (c)(iv) over a period sufficient to allow for a meaningful assessment of the performance of the internal rating processes for each exposure class (for retail for each of the categories as defined under point (c)(iv). Where appropriate, the institutions shall further decompose this to provide analysis of PD and, for the institutions using own estimates of LGDs and/or conversion factors, LGD and conversion factor outcomes against estimates provided in the quantitative risk assessment disclosures above.
- (j) for all exposure classes specified in Article 142 and for each category of exposure to which the different correlations in Article 149 (1) to 149(4) correspond:
  - (i) for the institutions using own LGD estimates for the calculation of risk-weighted exposure amounts, the exposure-weighted average LGD and PD in percentage for each relevant geographical location of credit exposures;
  - (ii) for the institutions that do not use own LGD estimates, the exposure-weighted average PD in percentage for each relevant geographical location of credit exposures.

For the purposes of point (c), the description shall include the types of exposure included in the exposure class, the definitions, methods and data for estimation and validation of PD and, if applicable, LGD and conversion factors, including assumptions employed in the derivation of these variables, and the descriptions of material deviations from the definition of default as set out in Article 174, including the broad segments affected by such deviations.

For the purposes of point (j), the relevant geographical location of credit exposures means exposures in the Member States in which the institution has been authorised and Member States or third countries in which institutions carry out activities through a branch or a subsidiary.

## *Article 438*

### *Use of credit risk mitigation techniques*

The institutions applying credit risk mitigation techniques shall disclose the following information:

- (a) the policies and processes for, and an indication of the extent to which the entity makes use of, on- and off-balance sheet netting;
- (b) the policies and processes for collateral valuation and management;
- (c) a description of the main types of collateral taken by the institution;
- (d) the main types of guarantor and credit derivative counterparty and their creditworthiness;
- (e) information about market or credit risk concentrations within the credit mitigation taken;
- (f) for institutions calculating risk-weighted exposure amounts under the Standardised Approach or the IRB Approach, but not providing own estimates of LGDs or conversion factors in respect of the exposure class, separately for each exposure class, the total exposure value (after, where applicable, on- or off-balance sheet netting) that is covered — after the application of volatility adjustments — by eligible financial collateral, and other eligible collateral;
- (g) for institutions calculating risk-weighted exposure amounts under the Standardised Approach or the IRB Approach, separately for each exposure class, the total exposure (after, where applicable, on- or off-balance sheet netting) that is covered by guarantees or credit derivatives. For the equity exposure class, this requirement applies to each of the approaches provided in Article 150.

## *Article 439*

### *Use of the Advanced Measurement Approaches to operational risk*

The institutions using the Advanced Measurement Approaches set out in Articles 310 to 313 for the calculation of their own funds requirements for operational risk shall disclose a description of the use of insurances and other risk transfer mechanisms for the purpose of mitigation of this risk.

*Article 440*  
*Use of Internal Market Risk Models*

Institutions calculating their capital requirements in accordance with Article 352 shall disclose the following information:

- (a) for each sub-portfolio covered:
  - (i) the characteristics of the models used;
  - (ii) where applicable, for the internal models for incremental default and migration risk and for correlation trading, the methodologies used and the risks measured through the use of an internal model including a description of the approach used by the institution to determine liquidity horizons, the methodologies used to achieve a capital assessment that is consistent with the required soundness standard and the approaches used in the validation of the model;
  - (iii) a description of stress testing applied to the sub-portfolio;
  - (iv) a description of the approaches used for back-testing and validating the accuracy and consistency of the internal models and modelling processes;
- (b) the scope of permission by the competent authority;
- (c) a description of the extent and methodologies for compliance with the requirements set out in Articles 99 and 100;
- (d) the highest, the lowest and the mean of the following:
  - (i) the daily value-at-risk measures over the reporting period and as per the period end;
  - (ii) the stressed value-at-risk measures over the reporting period and as per the period end;
  - (iii) the risk numbers for incremental default and migration risk and for the specific risk of the correlation trading portfolio over the reporting period and as per the period-end;

- (e) the elements of the own funds requirement as specified in Article 353;
- (f) the weighted average liquidity horizon for each sub-portfolio covered by the internal models for incremental default and migration risk and for correlation trading;
- (g) a comparison of the daily end-of-day value-at-risk measures to the one-day changes of the portfolio's value by the end of the subsequent business day together with an analysis of any important overshooting during the reporting period.

## PART NINE

### DELEGATED AND IMPLEMENTING ACTS

#### *Article 441*

#### *Delegated Acts*

**1.** The Commission shall be empowered to adopt delegated acts in accordance with Article 445, concerning the following aspects:

- (a) clarification of the definitions set out in Articles 4, 22, 137, 148, 188, 237, 267, 294, 371 and 400 to ensure uniform application of this Regulation
- (b) clarification of the definitions set out in Articles 4, 22, 137, 148, 188, 237, 267, 294, 371 and 400 in order to take account, in the application of this Regulation of developments on financial markets;
- (c) amendment of the list of exposure classes in Articles 107 and 142 in order to take account of developments on financial markets;
- (d) the amount specified in point c of Article 118, Article 142(5)(a), Article 148(4) and Article 158(4), to take into account the effects of inflation;
- (e) the list and classification of the [...] off-balance sheet items in Annexes I and II, in order to take account of developments on financial markets:
- (f) adjustment of the categories of investment firms in Article 90(1) and Article 91(1) to take account of developments on financial markets;
- (g) clarification of the requirement laid down in Article 92 to ensure uniform application of this Regulation.
- (h) a clarification of the terms referred to in the exemptions provided for in Article 389;



(i)

- (j) the modification of the capital measure and the total exposure measure of the leverage ratio referred to in Article 416(2) in order to correct any shortcomings discovered on the basis of the reporting referred to in Article 417(1) before the leverage ratio has to be published by institutions as set out in Article 436(1)(a). This delegation of power shall be subject to the procedure referred to in Article 446. [...] **2. By 31 December 2013 EBA and ESMA shall report to the Commission whether modifications on international standards in relation to the own funds requirements for exposures to central counterparties would justify a change in Part Three, Title II, chapter 6, Section 9. If appropriate, the Commission shall be empowered to adopt a delegated act to amend Part Three, Title II, chapter 6, Section 9 in accordance with Article 445 [...]**

- 3. By 30 June 2014 EBA shall submit a report to the Commission relating to the own fund requirements for credit valuation adjustment risk. In particular, the report shall assess: the treatment of CVA risk as a stand-alone charge versus an integrated component of the market risk framework**

- i) the scope of the CVA risk charge;**
- ii) eligible hedges;**
- iii) calculation of capital requirements of CVA risk.**

**If appropriate, the Commission shall be empowered to adopt a delegated act in accordance with Article 445 to amend the provisions in Articles 371 to 375 concerning those items.**

## Article 442

### *Technical adjustments and corrections*

The Commission shall be empowered to adopt delegated acts in accordance with Article 445, to make technical adjustment and corrections of non-essential elements in the following provisions in order to take account of new developments in new financial products or activities, to make adjustments to developments after the adoption of this Regulation in other EU legislative acts on financial services and accounting including accounting standards based on Regulation No. (EU) 1605/2002\_:

- (a) the own funds requirements for credit risk laid down in Articles 106 to 129, and in Articles 138 to 187;
- (b) the effects of credit risk mitigation in accordance with Articles 189 to 236 ;
- (c) the own funds requirements for securitisation laid down in Articles 238 to 261;
- (d) the own funds requirements for counterparty credit risks in accordance with articles 267 to 300;
- (e) the own funds requirements for operational risk laid down in Articles 304 to 313;
- (f) the own funds requirements for market risk laid down in Articles 314 to 367;
- (g) the own funds requirements for settlement Risk laid down in Articles 368 and 369;
- (h) the own funds requirements for credit valuation adjustment risk laid down in Articles 373, 374 and 375;
- (i) Part Two and Article 95 only as a result of developments in accounting standards or requirements which take account of Union legislation\_.

Macro-prudential **or systemic** risk identified at the level of a Member State

1. If Member State designated **[...] authority identifies** changes in the intensity of macro-prudential **or systemic** risk **[...] in the meaning of a risk of disruption in the [...]** financial **[...] system with the potential to have serious negative consequences to the financial system and the real economy in a specific** Member State wants **[...] which the designated authority considers would better be addressed by means of national measures, it** shall notify the Commission, **the Council, [...]** the ESRB **and EBA** of that fact and submit relevant evidence **[...]**:
  - a) the changes in the intensity of macro-prudential **or systemic** risk;
  - b) the reasons why such changes **could** pose a threat to financial stability at national level; **[...] be) a justification of why Articles 119 and 160 of this Regulation and Articles 98, 99a, 100, 100a, 124a, and 126 of Directive [inserted by OP] cannot adequately address the identified macro-prudential or systemic risk taken into account the relative effectiveness of these measures.**
  - c) draft national measures **for domestically authorised institutions, or a subset of those institutions,** to mitigate the changes in the intensity of risk **[...]**:
    - (i) the level of own funds laid down in Article 87;
    - (ii) the requirements for large exposures laid down in Article 381 and Article 384 to 392;
    - (iii) the public disclosure requirements laid down in articles 418 to 440;
    - (iv) the level of the conservation buffer as set out in Article 123 of the Directive [inserted by OP]. [...]**
  - d) an explanation as to why such draft measures are deemed by the designated authorities to be suitable, **[...] effective and proportionate** to address the situation.

- e) an assessment [...] of [...] the likely impact of the measures on the single market based on information which is available to the Member State.

1a. When authorised to apply national measures in accordance with this Article Member States shall provide relevant competent authorities with all relevant information.

2. Within one month of receiving the notification referred to in paragraph 1 the ESRB and EBA shall provide its opinion on the points mentioned in paragraph 1 to the Commission. After receiving the opinion, the Commission shall within one month adopt an implementing act to allow the relevant Member State designated authority to address the threat by an individual measure as set out in paragraph (1)(c) for a period of up to two years if it is satisfied that:

- a) the changes in the intensity of macro-prudential or systemic risk are of such nature as to pose risk to financial stability at national level;
- b) Articles 119 and 160 of this regulation [...] the Articles 98, 99a, 100, 100a, 124a, and 126 [...] of Directive [inserted by OP] cannot adequately address the identified macro-prudential or systemic risk taken into account the relative effectiveness of these measures..
- c) the proposed national measures are more suitable to address the identified macro-prudential or systemic risk and do not entail disproportionate adverse effects on the whole or parts of the financial system in other Member States or of the EU as a whole, thus forming or creating an obstacle to the functioning of the internal market;
- d) the issue concerns only one Member State
- e) the risks have not already been addressed by measures in this Regulation or the Directive [inserted by OP]

[...]

**The assessment of the** Commission shall **take account of the opinion of the ESRB and EBA and shall be [...]** based on the evidence presented by designated authorities in accordance with paragraph 1. **[...]**

3. The Commission shall **[...]** in consultation with the ESRB and **EBA review at least every second year the situation and** may accordingly adopt **[...], in accordance with the procedure referred to in paragraph 2, a new decision for the extension of** the period of application of national measures for one additional year each time.

#### *Article 443b*

##### *Prudential requirements*

The Commission shall be empowered to adopt delegated acts in accordance with Article 445, to impose, **for a period of one year,** stricter prudential requirements **[...] [...]** for **[...] exposures [...]** **[...]** where this is necessary to address changes in the intensity of micro-prudential and macro-prudential risks which arise from market developments **[...] in at least [three] Member States or outside the Union affecting at least [three] Member States,** and where the instruments of this Regulation and the Directive **[...] inserted by OP]** are not sufficient to address these risks, in particular upon the recommendation or opinion of the ESRB or EBA, concerning

- (a) the level of own funds laid down in Article 87;
- (b) the requirements for large exposures laid down in Article 381 and Article 384 to 392
- (c) the public disclosure requirements laid down in articles 418 to 440.

This delegation of power shall be subject to the procedure referred to in Article 445 **[...]**

The Commission assisted by the ESRB shall, at least on an annual basis, submit to the European Parliament and the Council, a report on market developments potentially requiring the use of Article 443B.

**[...]**

## *Article 444*

## *Article 445*

### *Exercise of the delegation*

1. The power to adopt delegated acts is conferred on the Commission subject to the conditions laid down in this Article.
2. The delegation of powers referred to in Articles 441 to 444 shall be conferred for an indeterminate period of time from the date referred to in Article 488.
3. The delegation of power referred to in Articles 441 to 444 may be revoked at any time by the European Parliament or by the Council. A decision of revocation shall put an end to the delegation of the power specified in that decision. It shall take effect the day following the publication of the decision in the Official Journal of the European Union or at a later date specified therein. It shall not affect the validity of the delegated acts already in force.
4. As soon as it adopts a delegated act, the Commission shall notify it simultaneously to the European Parliament and to the Council.
5. A delegated act adopted pursuant to Articles 441 to 444 shall enter into force only if no objection has been expressed by the European Parliament or the Council within a period of 2 months of notification of that act to the European Parliament and the Council or if, before the expiry of that period, the European Parliament and the Council have both informed the Commission that they will not object. That period shall be extended by 2 months at the initiative of the European Parliament or the Council.

*Article 446*  
*Urgency procedure*

1. Delegated acts adopted under this Article shall enter into force without delay and shall apply as long as no objection is expressed in accordance with paragraph 2. The notification of a delegated act to the European Parliament and to the Council shall state the reasons for the use of the urgency procedure.
2. Either the European Parliament or the Council may object to a delegated act in accordance with the procedure referred to in Article 445(5). In such a case, the Commission shall repeal the act without delay following the notification of the decision to object by the European Parliament or the Council.

*Article 447*  
*European Banking Committee*

1. For the adoption of implementing acts, the Commission shall be assisted by the European Banking Committee established by Commission Decision 2004/10/EC. That committee shall be a committee within the meaning of Article 3(2) of Regulation (EU) No 182/2011.
2. Where reference is made to this paragraph, Article 5 of Regulation (EU) No. 182/2011 shall apply.

# **PART TEN**

## **TRANSITIONAL PROVISIONS, REPORTS AND REVIEWS**

### **Title I**

#### **Transitional provisions**

##### **Chapter 1**

###### **Own funds requirements, unrealised gains and losses measured at fair value and deductions**

###### **SECTION 1**

###### **OWN FUNDS REQUIREMENTS**

###### *Article 448*

###### *Own funds requirements*

1. By way of derogation from points (a) and (b) of Article 87(1) the following own funds requirements shall apply:
  - (a) at all times during the period from 1 January 2013 to 31 December 2013:
    - (i) a Common Equity Tier 1 capital ratio of a level that falls within a range with a lowest value of 3.5% and a highest value of 4.5%;
    - (ii) a Tier 1 capital ratio of a level that falls within a range with a lowest value of 4.5 % and a highest value of 6%;



- (b) at all times during the period from 1 January 2014 to 31 December 2014:
  - (i) a Common Equity Tier 1 capital ratio of a level that falls within a range of 4 % to 4.5 %;
  - (ii) a Tier 1 capital ratio of a level that falls within a range of 5.5 % to 6%.

2. Competent authorities shall:

- (a) determine the levels of the Common Equity Tier 1 and Tier 1 capital ratios in the ranges specified in points (a) and (b) of paragraph 1 that institutions shall meet or exceed;
- (b) publish the determination made in accordance with point (a).

3. Institutions shall meet or exceed the levels of the Common Equity Tier 1 and Tier 1 capital ratios referred to in paragraph 2.

## SECTION 2

### UNREALISED GAINS AND LOSSES MEASURED AT FAIR VALUE

#### *Article 449*

##### *Unrealised losses measured at fair value*

1. By way of derogation from Article 32, during the period from 1 January 2013 to 31 December 2017 institutions shall include in the calculation of their Common Equity Tier 1 items only the applicable percentage of unrealised losses related to assets or liabilities measured at fair value and reported on the balance sheet, excluding those referred to in Article 30 and all other unrealised losses reported as part of the profit and loss account.
2. The applicable percentage for the purposes of paragraph 1 shall fall within following ranges:
  - (a) 0 % to 100 % during the period from 1 January 2013 to 31 December 2013;
  - (b) 20 % to 100 % during the period from 1 January 2014 to 31 December 2014;
  - (c) 40 % to 100 % during the period from 1 January 2015 to 31 December 2015;
  - (d) 60 % to 100 % during the period from 1 January 2016 to 31 December 2016; and
  - (e) 80 % to 100 % for the period from 1 January 2017 to 31 December 2017.
3. Competent authorities shall:
  - (a) determine the applicable percentage in the ranges specified in points (a) to (e) of paragraph 2;
  - (b) publish the determination made in accordance with point (a).

*Article 450*

*Unrealised gains measured at fair value*

1. By way of derogation from Article 32, during the period from 1 January 2013 to 31 December 2017, institutions shall remove from their Common Equity Tier 1 items the applicable percentage of unrealised gains related to assets or liabilities measured at fair value and reported on the balance sheet, excluding those referred to in Article 30 and all other unrealised gains with the exception of those related to investment properties reported as part of the profit and loss account. The resulting residual amount shall not be removed from Common Equity Tier 1 items. Unrealised gains removed from Common equity Tier 1 shall be treated according to Article 461.
2. For the purposes of paragraph 1, the applicable percentage shall be 100 % during the period from 1 January 2013 to 31 December 2014, and shall, after that date, fall within the following ranges:
  - (b) 60 % to 100 % during the period from 1 January 2015 to 31 December 2015;
  - (c) 40 % to 100 % during the period from 1 January 2016 to 31 December 2016;
  - (d) 20 % to 100 % for the period from 1 January 2017 to 31 December 2017.
  - (e) As of 1 January 2015, where under Article 449 a competent authority requires institutions to include in the calculation of Common Equity Tier 1 capital 100% of their unrealized losses measured at fair value, that competent authority may also permit institutions to include in that calculation 100% of their unrealized gains at fair value.
  - (f) Competent authorities may not set an applicable percentage of unrealized gains under paragraph 2 that exceeds the applicable percentage of unrealized losses set in accordance with Article 449.

- 3.
4. Competent authorities shall:
  - (a) determine the applicable percentage of unrealised gains in the ranges specified in points (a) to (d) of paragraph 2 that is not removed from Common Equity Tier 1 capital;
  - (b) publish the determination made in accordance with point (a).

### **SECTION 3**

#### **DEDUCTIONS**

##### **SUB-SECTION 1**

##### **DEDUCTIONS FROM COMMON EQUITY TIER 1 ITEMS**

###### *Article 451*

###### *Deductions from Common Equity Tier 1 items*

1. By way of derogation from Article 33(1), during the period from 1 January 2013 to 31 December 2017, the following shall apply:
  - (a) institutions shall deduct from Common Equity Tier 1 items the applicable percentage specified in Article 458 of the amounts required to be deducted pursuant to points (a) to (h) of Article 33(1), excluding deferred tax assets that rely on future profitability and arise from temporary differences;
  - (b) institutions shall apply the relevant provisions laid down in Article 453 to the residual amounts of items required to be deducted pursuant to points (a) to (h) of Article 33(1), excluding deferred tax assets that rely on future profitability and arise from temporary differences;

- (c) institutions shall deduct from Common Equity Tier 1 items the applicable percentage specified in Article 458 of the total amount required to be deducted pursuant to points (c) and (i) of Article 33(1) after applying Article 452;
  - (d) institutions shall apply the requirements laid down in Article 453(4) or Article 453(10), as applicable, to the total residual amount of items required to be deducted pursuant to points (c) and (i) of Article 33(1) after applying Article 452.
2. Institutions shall determine the portion of the total residual amount referred to in point (d) of paragraph 1, that is subject to Article 453(4), by dividing the amount specified in point (a) by the amount specified in point (b):
- (a) the amount of deferred tax assets that are dependent on future profitability and arise from temporary differences referred to in point (a) of Article 452(2);
  - (b) the sum of the amounts referred to in points (a) and (b) of Article 452(2).
3. Institutions shall determine the portion of the total residual amount referred to point (d) of paragraph 1 that is subject to Article 453(10) by dividing the amount specified in point (a) by the amount specified in point (b):
- (a) the amount of direct and indirect holdings of the Common Equity Tier 1 instruments referred to in point (b) of Article 452(2);
  - (b) the sum of the amounts referred to in points (a) and (b) of Article 452(2).

## *Article 452*

### *Exemption from deduction from Common Equity Tier 1 items*

1. For the purposes of this Article, relevant Common Equity Tier 1 items shall comprise the Common Equity Tier 1 items of the institution calculated after applying the provisions of Articles 29 to 32 and making the deductions pursuant to points (a) to (h) and (j), (k) and (l) of Article 33(1), excluding deferred tax assets that rely on future profitability and arise from temporary differences.
2. By way of derogation from Article 45(1), during the period from 1 January 2013 to 31 December 2017, institutions shall not deduct the items listed in points (a) and (b) which in aggregate are equal to or less than 15 % of relevant Common Equity Tier 1 items of the institution:
  - (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 relevant Common Equity Tier 1 items;
  - (b) where an institution has a significant investment in a financial sector entity, the direct and indirect holdings by the institution of the Common Equity Tier 1 instruments of that entity that in aggregate are equal to or less than 10 % of relevant Common Equity Tier 1 items.
3. By way of derogation from Article 45(2), the items exempt from deduction pursuant to paragraph 2 shall be risk weighted at 250 %.

## *Article 453*

### *Items not deducted from Common Equity Tier 1*

1. By way of derogation from points (a) to (i) Article 33(1), during the period from 1 January 2013 to 31 December 2017, institutions shall apply this Article to the residual amounts of items referred to in points (b) and (d) of Article 451(1).

2. Institutions shall apply the following to the residual amount of losses of the current financial year referred to in point (a) of Article 33(1):
  - (a) losses that are material are deducted from Tier 1 items;
  - (b) losses that are not material are not deducted.
3. Institutions shall deduct the residual amount of the intangible assets referred to in point (b) of Article 33(1) from Tier 1 items.
4. The residual amount of the deferred tax assets referred to in point (c) of Article 33(1) shall not be deducted and shall be subject to a risk weight of 0 %.
5. The residual amount of the items referred to in point (d) of Article 33(1) shall be deducted half from Tier 1 items and half from Tier 2 items.
6. The residual amount of the assets of a defined benefit pension fund referred to in point (e) of Article 33(1) shall not be deducted from any element of own funds and shall be included in Common Equity Tier 1 items to the extent that amount would have been recognised as original own funds according to the national transposition measures for points (a) to (ca) of Article 57 of Directive 2006/48/EC.
7. Institutions shall apply the following to the residual amount of holdings of own Common Equity Tier 1 instruments referred to in point (f) of Article 33(1):
  - (a) the amount of direct holdings is deducted from Tier 1 items;
  - (b) the amount of indirect holdings, including own Common Equity Tier 1 instruments that an institution could be obliged to purchase by virtue of an existing or contingent contractual obligation is not deducted and is subject to a risk weight in accordance with Chapter 2 or 3 of Title II of Part Three and to the requirements laid down in Title IV of Part Three, as applicable.

8. Institutions shall apply the following to the residual amount of holdings of Common Equity Tier 1 instruments of a financial sector entity where the institution has reciprocal cross holdings with that entity referred to in point (g) of Article 33(1):
- (a) where an institution does not have a significant investment in that financial sector entity, the amount of its holding of the Common Equity Tier 1 instruments of that entity is treated as falling under point (h) of Article 33(1);
  - (b) where an institution has a significant investment in that financial sector entity, the amount of its holdings of Common Equity Tier 1 instruments of that entity is treated as falling under point (i) of Article 33(1).
9. Institutions shall apply the following to the residual amounts of items referred to in point (h) of Article 33(1):
- (a) the amounts required to be deducted that relate to direct holdings are deducted half from Tier 1 items and half from Tier 2 items;
  - (b) the amounts that relate to indirect holdings are not deducted and are subject to a risk weight [...] in accordance with Chapter 2 or 3 of Title II of Part Three and to the requirements laid down in Title IV of Part Three, as applicable;
10. Institutions shall apply the following to the residual amounts of the items referred to in point (i) of Article 33(1):
- (a) the amounts required to be deducted that relate to direct holdings are deducted half from Tier 1 items and half from Tier 2 items;
  - (b) the amounts that relate to indirect holdings are not deducted and are subject to risk weights in accordance with Chapter 2 or 3 of Title II of Part Three and to the requirements laid down in Title IV of Part Three, as applicable.



**SUB-SECTION 2**  
**DEDUCTIONS FROM ADDITIONAL TIER 1 ITEMS**

*Article 454*

*Deductions from Additional Tier 1 items*

By way of derogation from Article 53, during the period from 1 January 2013 to 31 December 2017, the following shall apply:

- (a) institutions shall deduct from Additional Tier 1 items the applicable percentage specified in Article 458 of the amounts required to be deducted pursuant to Article 53;
- (b) institutions shall apply the requirements laid down in Article 455 to the residual amounts of the items required to be deducted pursuant to Article 53.

*Article 455*

*Items not deducted from Additional Tier 1 items*

- 1. By way of derogation from Article 53, during the period from 1 January 2013 to 31 December 2017, the requirements laid down in this Article shall apply to the residual amounts referred to in point (b) of Article 454.
- 2. Institutions shall apply the following to residual amount of the items referred to in point (a) of Article 53:
  - (a) direct holdings of own Additional Tier 1 instruments that are shares are deducted at book value from Tier 1 items;
  - (b) [...]

- (c) indirect holdings of own Additional Tier 1 instruments, including own Additional Tier 1 instruments that an institution could be obliged to purchase by virtue of an existing or contingent contractual obligation, are not deducted and are risk weighted in accordance with Chapter 2 or 3 of Title II of Part Three and subject to the requirements of Title IV of Part Three, as applicable.

3. Institutions shall apply the following to the residual amount of the items referred to in point (b) of Article 53:

- (a) where an institution does not have a significant investment in a financial sector entity with which it has reciprocal cross holdings, the amount of its direct and indirect holdings of those Additional Tier 1 instruments of that entity is treated as falling within point (c) of Article 53;
- (b) where the institution has a significant investment in a financial sector entity with which it has reciprocal cross holdings, the amount of its direct and indirect holdings of those Additional Tier 1 instruments of that entity is treated as falling within point (d) of Article 53.

4. Institutions shall apply the following to the residual amount of the items referred to in points (c) and (d) of Article 53:

- (a) the amount relating to direct holdings required to be deducted in accordance with points (c) and (d) of Article 53 are deducted half from Tier 1 items and half from Tier 2 items;
- (b) the amount relating to indirect holdings required to be deducted in accordance with points (c) and (d) of Article 53 shall not be deducted and shall be subject to a risk weight in accordance with Chapter 2 or 3 of Title II of Part Three and to the requirements of Title IV of Part Three, as applicable.

**SUB-SECTION 3**  
**DEDUCTIONS FROM TIER 2 ITEMS**

*Article 456*

*Deductions from Tier 2 items*

1. By way of derogation from Article 63, during the period from 1 January 2013 to 31 December 2017, the following shall apply:
  - (a) institutions shall deduct from Tier 2 items the applicable percentage specified in Article 458 of the amounts required to be deducted pursuant to Article 63;
  - (b) Institutions shall apply the requirements laid down in Article 457 to the residual amounts required to be deducted pursuant to Article 63.

*Article 457*

*Deductions from Tier 2 items*

1. By way of derogation from Article 63, during the period from 1 January 2013 to 31 December 2017, the requirements laid down in this Article shall apply to the residual amounts referred to in point (b) of Article 456.

2. Institutions shall apply the following to the residual amount of items referred to in point (a) of Article 63:
  - (a) direct holdings of own Tier 2 instruments that are shares are deducted at book value from Tier 2 items;
  - (b) [...]
  - (c) indirect holdings of own Tier 2 instruments, including own Tier 2 instruments that an institution could be obliged to purchase by virtue of an existing or contingent contractual obligation are not deducted and are risk weighted in accordance with Chapter 2 or 3 of Title II of Part Three and subject to the requirements of Title IV of Part Three, as applicable.
3. Institutions shall apply the following to the residual amount of the items referred to in point (b) of Article 63:
  - (a) where an institution does not have a significant investment in a financial sector entity with which it has reciprocal cross holdings, the amount of its direct and indirect holdings of the Tier 2 instruments of that entity is treated as falling within point (c) of Article 63;
  - (b) where the institution has a significant investment in a financial sector entity with which it has reciprocal cross holdings, the amount of direct and indirect holdings of the Tier 2 instruments of that financial sector entity are treated as falling within point (d) of Article 63.
4. Institutions shall apply the following to the residual amount of the items referred to in points (c) and (d) of Article 63:
  - (a) the amount relating to direct holdings that is required to be deducted in accordance with points (c) and (d) of Article 63 is deducted half from Tier 1 items and half from Tier 2 items;

- (b) the amount relating to indirect holdings that is required to be deducted in accordance with points (c) and (d) of Article 63 is not be deducted and are subject to a risk weight under Chapter 2 or 3 of Title II of Part Three and the requirements laid down in Title IV of Part Three, as applicable.

#### **SUB-SECTION 4**

#### **APPLICABLE PERCENTAGES FOR DEDUCTION**

##### *Article 458*

##### *Applicable percentages for deduction from Common Equity Tier 1, Additional Tier 1 and Tier 2 items*

1. The applicable percentage for the purposes of points (a) and (c) of Article 451(1), point (a) of Article 454 and point (a) of Article 456 shall fall within the following ranges:
  - (a) 0 % to 100 % for the period from 1 January 2013 to 31 December 2013;
  - (b) 20 % to 100 % for the period from 1 January 2014 to 31 December 2014;
  - (c) 40 % to 100 % for the period from 1 January 2015 to 31 December 2015;
  - (d) 60 % to 100 % for the period from 1 January 2016 to 31 December 2016;
  - (e) 80 % to 100 % for the period from 1 January 2017 to 31 December 2017.
2. Competent authorities shall:
  - (a) determine an applicable percentage in the ranges specified in paragraph 1 for each of the following deductions:
    - (i) the individual deductions required pursuant to points (a) to (h) of Article 33(1), excluding deferred tax assets that rely on future profitability and arise from temporary differences;

- (ii) the aggregate amount of deferred tax assets that rely on future profitability and arise from temporary differences and the items referred to in point (i) of Article 33(1) that is required to be deducted pursuant to Article 45;
  - (iii) each deduction required pursuant to points (b) to (d) of Article 53;
  - (iv) each deduction required pursuant to points (b) to (d) of Article 63
- (b) publish the determination made in accordance with point (a).

## SECTION 4

### MINORITY INTEREST AND ADDITIONAL TIER 1 AND TIER 2 INSTRUMENTS ISSUED BY SUBSIDIARIES

#### *Article 459*

*Recognition in consolidated Common Equity Tier 1 capital of instruments and items that do not  
qualify as minority interests*

1. By way of derogation from Title III of Part Two, during the period from 1 January 2013 to 31 December 2017, recognition in consolidated own funds of the items that would qualify as consolidated reserves in accordance with national transposition measures pursuant to Article 65 of Directive 2006/48/EC that do not qualify as consolidated Common Equity Tier 1 capital for any of the following reasons shall be determined by the competent authorities in accordance with paragraphs 2 and 3:
  - (a) the instrument does not qualify as a Common Equity Tier 1 instrument, and the related retained earnings and share premium accounts consequently do not qualify as consolidated Common Equity Tier 1 items;
  - (b) as a result of paragraph 2 of Article 76;

- (c) because the subsidiary is not an institution or an entity that is subject by virtue of applicable national law to the requirements of this Regulation and Directive [inserted by OP];
  - (d) because the subsidiary is not included fully in the consolidation pursuant to Chapter 2 of Title II of Part One.
- 2. The applicable percentage of the items referred to in paragraph 1 that would have qualified as consolidated reserves in accordance with the national transposition measures for Article 65 of Directive 2006/48/EC shall qualify as consolidated Common Equity Tier 1 capital.
- 3. For the purposes of paragraph 2, the applicable percentages shall fall within the following ranges:
  - (a) 0 % to 100 % for the period from 1 January 2013 to 31 December 2013;
  - (b) 0 % to 80 % for the period from 1 January 2014 to 31 December 2014;
  - (c) 0 % to 60 % for the period from 1 January 2015 to 31 December 2015;
  - (d) 0 % to 40 % for the period from 1 January 2016 to 31 December 2016;
  - (e) 0 % to 20% for the period from 1 January 2017 to 31 December 2017.
- 4. Competent authorities shall:
  - (a) determine the applicable percentage in the ranges specified in paragraph 3;
  - (b) publish the determination made in accordance with point (a).

*Article 460*

*Recognition in consolidated own funds of minority interests and qualifying Additional Tier 1 and Tier 2 capital*

1. By way of derogation from point (b) of Article 79, point (b) of Article 80 and point (b) of Article 82, during the period from 1 January 2013 to 31 December 2017, the percentages referred to in those Articles shall be multiplied by an applicable factor.
2. For the purposes of paragraph 1, the applicable factor shall fall within the following ranges:
  - (a) 0 to 1 in the period from 1 January 2013 to 31 December 2013;
  - (b) 0.2 to 1 in the period from 1 January 2014 to 31 December 2014;
  - (c) 0.4 to 1 in the period from 1 January 2015 to 31 December 2015;
  - (d) 0.6 to 1 in the period from 1 January 2016 to 31 December 2016; and
  - (e) 0.8 to 1 in the period from 1 January 2017 to 31 December 2017.
3. Competent authorities shall:
  - (a) determine the value of the applicable factor in the ranges specified in paragraph 2;
  - (b) publish the determination made in accordance with point (a).



## SECTION 5

### ADDITIONAL FILTERS AND DEDUCTIONS

#### *Article 461*

#### *Additional filters and deductions*

1. By way of derogation from Articles 29 to 33, 53 and 63, during the period from 1 January 2013 to 31 December 2017, institutions shall make adjustments to include in or deduct from Common Equity Tier 1 items, Tier 1 items, Tier 2 items or own funds items the applicable percentage of filters or deductions required under national transposition measures for Articles 57, 61, 63, 63a, 64 and 66 of Directive 2006/48/EC, and for Articles 13 and 16 of Directive 2006/49/EC, and which are not required in accordance with Part Two.
2. For the purposes of paragraph 1, the applicable percentage shall fall within the following ranges:
  - (a) 0 % to 100 % for the period from 1 January 2013 to 31 December 2013;
  - (b) 0 % to 80 % for the period from 1 January 2014 to 31 December 2014;
  - (c) 0 % to 60 % for the period from 1 January 2015 to 31 December 2015;
  - (d) 0 % to 40 % for the period from 1 January 2016 to 31 December 2016;
  - (e) 0 % to 20 % for the period from 1 January 2017 to 31 December 2017.
3. For each filter or deduction referred to in paragraph 1, competent authorities shall:
  - (a) determine the applicable percentages in the ranges specified in paragraph 2;
  - (b) publish the determination made in accordance with point (a).

4. EBA shall develop draft regulatory technical standards to specify the conditions according to which competent authorities shall determine whether adjustments made to own funds, or elements thereof, in accordance with national transposition measures for Directive 2006/48/EC or Directive 2006/49/EC that are not included in Part Two should for the purposes of this Article be made to Common Equity Tier 1 items, Additional Tier 1 items, Tier 1 items, Tier 2 items or own funds.

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 procedures laid down in Articles 10 to 14 of Regulation (EU) No 1093/2010.

## Chapter 2

### Grandfathering of capital instruments

#### SECTION 1

#### INSTRUMENTS CONSTITUTING STATE AID

##### *Article 462*

##### *Grandfathering of State aid instruments*

1. By way of derogation from Articles 24 to 27, 48, 49, 59 and 60 during the period from 1 January 2013 to 31 December 201 7 [...] this Article applies to capital instruments where the following conditions are met:
  - (a) the instruments were issued prior to 20 July 2011;
  - (b) the instruments were issued within the context of a recapitalisation [...] measures pursuant to State aid-rules. Insofar as part of the instruments are privately subscribed, they must be issued in conjunction with those parts that are subscribed by the State;
  - (c) the instruments were considered compatible with the internal market by the Commission under Article 107 TFEU.
  - (d) in the case the instruments are subscribed by both the State and private investors, where there is a partly redemption of the instruments subscribed by the State, a corresponding share of the privately subscribed part of the instruments shall be grandfathered according to Article 463. When all the instruments subscribed by the State have been redeemed, the remaining instruments subscribed by private investors shall be grandfathered according to Article 463.**

2. Instruments that qualified in accordance with the national transposition measures for point (a) of Article 57 of Directive 2006/48/EC shall qualify as Common Equity Tier 1 instruments notwithstanding either of the following:
  - (a) the conditions laid down in Article 26 are not met;
  - (b) the instruments were issued by an undertaking referred to in Article 25 and the conditions laid down in Articles 26, or Article 27 as applicable, are not met.
3. Instruments that qualified in accordance with the national transposition measures for point (ca) of Article 57 and for Article 154 (8) and (9) of Directive 2006/48/EC shall qualify as Additional Tier 1 instruments notwithstanding the conditions laid down in Article 49(1) not being met.
4. Items that qualified in accordance with national transposition measures for points (f), (g) or (h) of Article 57 and for Article 66(1) of Directive 2006/48/EC shall qualify as Tier 2 instruments notwithstanding the items not being referred to in Article 59 or the conditions laid down in Article 60 not being met.

**SECTION 2**  
**INSTRUMENTS NOT CONSTITUTING STATE AID**  
**SUB-SECTION 1**  
**GRANDFATHERING ELIGIBILITY AND LIMITS**

*Article 463*

*Eligibility for grandfathering of items that qualified as own funds under national transposition measures for Directive 2006/48/EC*

1. This Article shall apply only to instruments that were issued prior to 20 July 2011 and are not those referred to in Article 462(1).
2. By way of derogation from Articles 24 to 27, 48, 49, 59 and 60 , this Article shall apply during the period from 1 January 2013 to 31 December 2021.
3. Subject to the limit specified in Article 464(2), capital within the meaning of Article 22 of Directive 86/365/EC, and the related share premium accounts, that qualified as original own funds under the national transposition measures for point (a) of Article 57 of Directive 2006/48/EC shall qualify as Common Equity Tier 1 items notwithstanding that capital not meeting the conditions laid down in Articles 26, or Article 27 as applicable.
4. Subject to the limit specified Article 464(3), instruments, and the related share premium accounts, that qualified as original own funds under national transposition measures for point (ca) of Article 57 and Article 154(8) and (9) of Directive 2006/48/shall qualify as Additional Tier 1 items, notwithstanding the conditions laid down in Article 49 not being met.
5. Subject to the limits specified in Article 464(4), items, and the related share premium accounts, that qualified under national transposition measures for points (e), (f), (g) or (h) of Article 57 of Directive 2006/48/EC shall qualify as Tier 2 items, notwithstanding those items not being included in Article 59 or the conditions laid down in Article 60 not being met.

Eligibility for inclusion in the Common Equity Tier 1 of share premium accounts related to items that qualified as own funds under national transposition measures for Directive 2006/48/EC

1. This Article shall apply only to instruments that were issued prior to 31 December 2010 and are not those referred to in Article 462(1).
2. Share premium accounts related to capital within the meaning of Article 22 of Directive 86/365/EC, that qualified as original own funds under the national transposition measures for point (a) of Article 57 of Directive 2006/48/EC shall qualify as Common Equity Tier 1 items if meet the conditions laid down in points (i) and (j) of Articles 26.

#### *Article 464*

*Limits for grandfathering of items within Common Equity Tier 1, Additional Tier 1 and Tier 2 items*

1. During the period from 1 January 2013 to 31 December 2021, the extent to which instruments referred to in Article 463 shall qualify as own funds shall be limited in accordance with this Article.
2. The amount of items referred to in Article 463(3) that shall qualify as Common Equity Tier 1 items is limited to the applicable percentage of the sum of the amounts specified in points (a) and (b):
  - (a) the nominal amount of capital referred to in Article 463(3) that were in issue on 31 December 2012;
  - (b) the share premium accounts related to the capital referred to in point (a).

3. The amount of items referred to in Article 463(4) that shall qualify as Additional Tier 1 items is limited to the applicable percentage multiplied by the result of subtracting from the sum of the amounts specified in points (a) and (b) the sum of the amounts specified in points (c) to (f):
- (a) the nominal amount of instruments referred to in Article 463(4), that remained in issue on 31 December 2012;
  - (b) the share premium accounts related to the instruments referred to in point (a);
  - (c) the amount of instruments referred to in Article 463(4) which on 31 December 2012 exceeded the limits specified in the national transposition measures for point (a) of Article 66(1) and Article 66(1a) of Directive 2006/48/EC;
  - (d) the share premium accounts related to the instruments referred to in point (c);
  - (e) the nominal amount of instruments referred to in Article 463(4) that were in issue on 31 December 2012 but do not qualify as Additional Tier 1 instruments pursuant to Article 467(4);
  - (f) the share premium accounts related to the instruments referred to in point (e).
4. The amount of items referred to in Article 463(5) that shall qualify as Tier 2 items is limited to the applicable percentage of the result of subtracting from the sum of the amounts specified in points (a) to (d) the sum of amounts specified in points (e) to (h):
- (a) the nominal amount of instruments referred to in Article 463(5) that remained in issue on 31 December 2012;
  - (b) the share premium accounts related to the instruments referred to in point (a);
  - (c) the nominal amount of subordinated loan capital that remained in issue on 31 December, reduced by the amount required pursuant to national transposition measures for point (c) of Article 64(3) of Directive 2006/48/EC;

- (d) the nominal amount of items referred to in Article 463(5), other than the instruments and subordinated loan capital referred to in points (a) and (c) of this paragraph, that were in issue on 31 December 2012;
  - (e) the nominal amount of instruments and items referred to in Article 463(5) that were in issue on 31 December 2012 that exceeded the limits specified in the national transposition measures for point (a) of Article 66(1) of Directive 2006/48/EC ;
  - (f) the share premium accounts related to the instruments referred to in point (e);
  - (g) the nominal amount of instruments referred to in Article 463(5) that were in issue on 31 December 2012 that do not qualify as Tier 2 items pursuant to Article 468(4);
  - (h) the share premium accounts related to the instruments referred to in point (g).
5. For the purposes of this Article, the applicable percentages referred to in paragraphs 2 to 4 shall fall within the following ranges:
- (a) 0 % to 90 % during the period from 1 January 2013 to 31 December 2013;
  - (b) 0 % to 80 % during the period from 1 January 2014 to 31 December 2014;
  - (c) 0 % to 70 % during the period from 1 January 2015 to 31 December 2015;
  - (d) 0 % to 60 % during the period from 1 January 2016 to 31 December 2016;
  - (e) 0 % to 50 % during the period from 1 January 2017 to 31 December 2017;
  - (f) 0 % to 40 % during the period from 1 January 2018 to 31 December 2018;
  - (g) 0 % to 30 % during the period from 1 January 2019 to 31 December 2019;
  - (h) 0 % to 20 % during the period from 1 January 2020 to 31 December 2020;
  - (i) 0 % to 10 % during the period from 1 January 2021 to 31 December 2021.



6. Competent authorities shall:
- (a) determine the applicable percentages in the ranges specified in paragraph 5;
  - (b) publish the determination made in accordance with point (a).

*Article 465*

*Items excluded from grandfathering in Common Equity Tier 1 or Additional Tier 1 items in other elements of own funds*

1. By way of derogation from Articles 48, 49, 59 and 60 , during the period from 1 January 2013 to 31 December 2021, institutions may treat as items referred to in Article 463(4), capital, and the related share premium accounts, referred to in Article 463(3) that are excluded from Common Equity Tier 1 items because they exceed the applicable percentage specified in Article 464(2), to the extent that the inclusion of that capital and the related share premium accounts, does not exceed the applicable percentage limit referred to in Article 464(3).
2. By way of derogation from Articles 48, 49, 59 and 60 , during the period from 1 January 2013 to 31 December 2021, institutions may treat the following as items referred to in Article 463(5), to the extent that their inclusion does not exceed the applicable percentage limit referred to in Article 464(4):
  - (a) capital, and the related share premium accounts, referred to in Article 463(3) that are excluded from Common Equity Tier 1 items because they exceed the applicable percentage specified in Article 464(2);
  - (b) instruments, and the related share premium accounts, referred to in Article 463(4) that exceed the applicable percentage referred to in Article 464(3).

3. EBA shall develop draft regulatory technical standards to specify the conditions for treating own funds instruments referred to in paragraphs 1 and 2 as falling under Article 464(4) or 464(5) during the period from 1 January 2013 to 31 December 2021.

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 466*

##### *Amortisation of items grandfathered as Tier 2 items*

The items referred to Article 463(5) that qualify as Tier 2 items pursuant to Article 463(5) or Article 464(4) shall be subject to the requirements laid down in Article 61.

**SUB-SECTION 2**  
**INCLUSION OF INSTRUMENTS WITH A CALL AND INCENTIVE TO REDEEM IN**  
**ADDITIONAL TIER 1 AND TIER 2 ITEMS**

*Article 467*

*Hybrid instruments with a call and incentive to redeem*

1. By way of derogation from Article 48 and 49, during the period from 1 January 2013 to 31 December 2021, instruments referred to in Article 463(4) and include in their terms and conditions a call with an incentive for them to be redeemed by the institution shall be subject to the requirements laid down in paragraphs 2 to 7.
2. The instruments shall qualify as Additional Tier 1 instruments provided the following conditions are met:
  - (a) the institution was able to exercise a call with an incentive to redeem only prior to 1 January 2013;
  - (b) the institution did not exercise the call;
  - (c) the conditions laid down in Article 49 are met from 1 January 2013.
3. The instruments shall qualify as Additional Tier 1 instruments with their recognition reduced in accordance with Article 463(4) until the date of their effective maturity and thereafter shall qualify as Additional Tier 1 items without limit provided:
  - (a) the institution was able to exercise a call with an incentive to redeem only on or after 1 January 2013;

- (b) the institution did not exercise the call on the date of the effective maturity of the instruments;
  - (c) the conditions laid down in Article 49 are met from the date of the effective maturity of the instruments.
4. The instruments shall not qualify as Additional Tier 1 instruments, and shall not be subject to Article 463(4), from 1 January 2013 where the following conditions are met:
- (a) the institution was able to exercise a call with an incentive to redeem between 20 July 2011 and 1 January 2013;
  - (b) the institution did not exercise the call on the date of the effective maturity of the instruments;
  - (c) the conditions laid down in Article 49 are not met from the date of the effective maturity of the instruments.
5. The instruments shall qualify as Additional Tier 1 instruments with their recognition reduced in accordance with Article 463(4) until the date of their effective maturity, and shall not qualify as Additional Tier 1 instruments thereafter, where the following conditions are met:
- (a) the institution was able to exercise a call with an incentive to redeem on or after 1 January 2013;
  - (b) the institution did not exercise the call on the date of the effective maturity of the instruments;
  - (c) the conditions laid down in Article 49 are not met from the date of the effective maturity of the instruments.

6. The instruments shall qualify as Additional Tier 1 instruments in accordance with Article 463(4) where the following conditions are met:
- (a) the institution was able to exercise a call with an incentive to redeem only prior to or on 20 July 2011;
  - (b) the institution did not exercise the call on the date of the effective maturity of the instruments;
  - (c) the conditions laid down in Article 49 were not met from the date of the effective maturity of the instruments.

*Article 468*

*Tier 2 items with an incentive to redeem*

1. By way of derogation from Articles 59 and 60 , during the period from 1 January 2013 to 31 December 2021, items referred to in Article 463(5) that qualified under the national transposition measures for points (f) or (h) of Article 57 of Directive 2006/48/EC and include in their terms and conditions a call with an incentive for them to be redeemed by the institution shall be subject to the requirements laid down in paragraphs 2 to 7.
2. The items shall qualify as Tier 2 instruments provided:
  - (a) the institution was able to exercise a call with an incentive to redeem only prior to 1 January 2013;
  - (b) the institution did not exercise the call;
  - (c) from 1 January 2013 the conditions laid down in Article 60 are met.
3. The items shall qualify as Tier 2 items in accordance with Article 463(5) until the date of their effective maturity, and shall qualify thereafter as Tier 2 items without limit, provided the following conditions are met:
  - (a) the institution was able to exercise a call with an incentive to redeem only on or after 1 January 2013;

- (b) the institution did not exercise the call on the date of the effective maturity of the items;
  - (c) the conditions laid down in Article 60 are met from the date of the effective maturity of the items.
- 4. The items shall not qualify as Tier 2 items from 1 January 2013 where the following conditions are met:
  - (a) the institution was able to exercise a call with an incentive to redeem only between 20 July 2011 and 1 January 2013;
  - (b) the institution did not exercise the call on the date of the effective maturity of the items;
  - (c) the conditions laid down in Article 60 are not met from the date of the effective maturity of the items.
- 5. The items shall qualify as Tier 2 items with their recognition reduced in accordance with Article 463(5) until the date of their effective maturity, and shall not qualify as Tier 2 items thereafter, where:
  - (a) the institution was able to exercise a call with an incentive to redeem on or after 1 January 2013;
  - (b) the institution did not exercise the call on the date of their effective maturity;
  - (c) the conditions set out in Article 60 are not met from the date of effective maturity of the items.
- 6. The items shall qualify as Tier 2 items in accordance with Article 463(5) where:
  - (a) the institution was able to exercise a call with an incentive to redeem only prior to or on 20 July 2011;

- (b) the institution did not exercise the call on the date of the effective maturity of the items;
- (c) the conditions laid down in Article 60 are not met from the date of the effective maturity of the items.

*Article 469*

*Effective maturity*

For the purposes of Articles 467 and 468, effective maturity shall be determined as follows:

- (a) for the items referred to in paragraphs 3 and 5 of those Articles, it is the date of the first call with an incentive to redeem occurring on or after 1 January 2013;
- (b) for the items referred to in paragraph 4 of those Articles, it is the date of the first call with an incentive to redeem occurring between 20 July 2011 and 1 January 2013;
- (c) for the items referred to in paragraph 6 of those Articles, it is the date of the first call with an incentive to redeem prior to 20 July 2011.

## **Chapter 3**

### **Transitional provisions for disclosure of own funds**

#### *Article 470*

#### *Disclosure of own funds*

1. Institutions shall apply ... this ... **Article** during the period from 1 January 2013 to 31 December 2021.
2. During the period from 1 January 2013 to 31 December 2015, institutions shall disclose the extent to which the level of Common Equity Tier 1 capital and Tier 1 capital exceed the requirements laid down in Article 448.
3. During the period from 1 January 2013 to 31 December 2017, institutions shall disclose the following additional information about their own funds:
  - (a) the nature and effect on Common Equity Tier 1 capital, Additional Tier 1 capital, Tier 2 capital and own funds of the individual filters and deductions applied in accordance with Articles 449 to 452, 454, 456 and 459;
  - (b) the amounts of minority interests and Additional Tier 1 and Tier 2 instruments, and related retained earnings and share premium accounts, issued by subsidiaries that are included in consolidated Common Equity Tier 1 capital, Additional Tier 1 capital, Tier 2 capital and own funds in accordance with Section 4 of Chapter 1;
  - (c) the effect on Common Equity Tier 1 capital, Additional Tier 1 capital, Tier 2 capital and own funds of the individual filters and deductions applied in accordance with Article 461;



(d) the nature and amount of items that qualify as Common Equity Tier 1 items, Tier 1 items and Tier 2 items by virtue of applying the derogations specified in Section 2 of Chapter 2.

4. During the period from 1 January 2013 to 31 December 2021, institutions shall disclose the amount of instruments that qualify as Common Equity Tier 1 instruments, Additional Tier 1 instruments and Tier 2 instruments by virtue of applying Article 463.

## Chapter 4

# Large exposures, own funds requirements, leverage and the Basel I floor

### *Article 471*

#### *Transitional provisions for large exposures*

1. The provisions on large exposures as laid down in Articles 376 to 392 shall not apply to investment firms whose main business consists exclusively of the provision of investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC and to whom Directive 93/22/EEC did not apply on 31 December 2006. This exemption is available until 31 December 2014 or the date of entry into force of any amendments pursuant to paragraph 2, whichever is the earlier.
2. By 31 December 2014, the Commission shall, on the basis of public consultations and in the light of discussions with the competent authorities, report to the Parliament and the Council on:
  - (a) an appropriate regime for the prudential supervision of investment firms whose main business consists exclusively of the provision of investment services or activities in relation to the commodity derivatives or derivatives contracts set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC;
  - (b) the desirability of amending Directive 2004/39/EC to create a further category of investment firm whose main business consists exclusively of the provision of investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC relating to energy supplies.

On the basis of this report, the Commission may submit proposals for amendments to this Regulation.

**3. By way of derogation from article 389 (2) the following shall apply for a transitional period until the entry into force of any legislative proposal following the review in accordance with Article 479 but not exceeding twenty years:**

**Member States or competent authorities may fully or partially exempt the following exposures from the application of Article 384(1):**

- (a) covered bonds falling within the terms Article 124(1), Article 124(2) and 124(5);**
- (b) asset items constituting claims on regional governments or local authorities of Member States where those claims would be assigned a 20 % risk weight under Part Three, Title II, Chapter 2 and other exposures to or guaranteed by those regional governments or local authorities, claims on which would be assigned a 20 % risk weight under Part Three, Title II, Chapter 2;**
- (c) exposures, including participations or other kinds of holdings, incurred by an institution to its parent undertaking, to other subsidiaries of that parent undertaking or to its own subsidiaries, in so far as those undertakings are covered by the supervision on a consolidated basis to which the institution itself is subject, in accordance with this Regulation, Directive 2002/87/EC or with equivalent standards in force in a third country; exposures that do not meet these criteria, whether or not exempted from Article 384(1) shall be treated as exposures to a third party;**
- (d) asset items constituting claims on and other exposures, including participations or other kinds of holdings, to regional or central credit institutions with which the credit institution is associated in a network in accordance with legal or statutory provisions and which are responsible, under those provisions, for cash-clearing operations within the network;**

- (e) asset items constituting claims on and other exposures to credit institutions incurred by credit institutions, one of which operates on a non-competitive basis and provides or guarantees loans under legislative programmes or its statutes, to promote specified sectors of the economy under some form of government oversight and restrictions on the use of the loans, provided that the respective exposures arise from such loans that are passed on to the beneficiaries via credit institutions or from the guarantees of these loans;**
- (f) asset items constituting claims on and other exposures to institutions, provided that those exposures do not constitute such institutions' own funds, do not last longer than the following business day;**
- (g) asset items constituting claims on central banks in the form of required minimum reserves held at those central banks which are denominated in their national currencies;**
- (h) asset items constituting claims on central governments in the form of statutory liquidity requirements held in government securities which are denominated and funded in their national currencies provided that, at the discretion of the competent authority, the credit assessment of those central governments assigned by a nominated ECAI is investment grade;**
- (i) 50 % of medium/low risk off-balance-sheet documentary credits and of medium/low risk off-balance sheet undrawn credit facilities referred to in Annex I and subject to the competent authorities' agreement, 80 % of guarantees other than loan guarantees which have a legal or regulatory basis and are given for their members by mutual guarantee schemes possessing the status of credit institutions;**

- (i) legally required guarantees used when a mortgage loan financed by issuing mortgage bonds is paid to the mortgage borrower before the final registration of the mortgage in the land register, provided the guarantee is not used as reducing the risk in calculating the risk weighted assets;**
- (k) assets constituting claims and other exposures to recognised exchanges.**

*Article 471a*

*Transitional provisions for large exposures*

1. By way of derogation from article 4 (23) (b), eligible capital may include Tier 2 capital up to the following:
- (a) 100 % of Tier 1 capital during the period from 1 January 2013 to 31 December 2013;
  - (b) 75 % of Tier 1 capital during the period from 1 January 2014 to 31 December 2014;
  - (c) 50 % of Tier 1 capital during the period from 1 January 2015 to 31 December 2015;

*Article 472*

*Own funds requirements under the IRB approach*

1. By way of derogation from Chapter 3 of Part Three, until 31 December 2017, the competent authority may exempt from the IRB treatment certain categories of equity exposures held by institutions and EU subsidiaries of institutions in that Member State as at 31 December 2007. The competent authority shall publish the categories of equity exposures which benefit from this treatment in accordance with Article 133 of Directive [inserted by OP].

The exempted position shall be measured as the number of shares as at 31 December 2007 and any additional share arising directly as a result of owning those holdings, provided they do not increase the proportional share of ownership in a portfolio company.

If an acquisition increases the proportional share of ownership in a specific holding the exceeding Part of the holding shall not be subject to the exemption. Nor shall the exemption apply to holdings that were originally subject to the exemption, but have been sold and then bought back.

Equity exposures subject to this provision shall be subject to the capital requirements calculated in accordance with the Standardised Approach under Part III, Title 2, Chapter II and the requirements set out in Title IV of Part Three, as applicable.

Competent authorities shall notify the Commission and EBA of the implementation of this paragraph. [...] 2. In the calculation of risk weighted exposure amounts for the purposes of Article 109(4), until 31 December 2015 the same risk weight shall be assigned in relation to exposures to the central governments or central banks of Member States denominated and funded in the domestic currency of any Member State as would be applied to such exposures denominated and funded in their domestic currency.

3. .

#### *Article 473*

##### *Own funds requirements for covered bonds*

1. Until 31 December 2015, the 10 % limit for senior units issued by French Fonds Communs de Créances [...] laid down in points (d) and (e) of Article 124(1) shall not apply, provided that:
  - (a) the securitised residential or commercial immovable property exposures were originated by a member of the same consolidated group of which the issuer of the covered bonds is also a member, or by an entity affiliated to the same central body to which the issuer of the covered bonds is also affiliated, where that common group membership or affiliation shall be determined at the time the senior units are made collateral for covered bonds;

- (b) a member of the same consolidated group of which the issuer of the covered bonds is also a member, or an entity affiliated to the same central body to which the issuer of the covered bonds is also affiliated, retains the whole first loss tranche supporting those senior units.

2. **Until 31 December 2015 competent authorities may waive in full or in part the 10 % limit for senior units issued by securitisation entities which are equivalent to French Fonds Communs de Créances laid down in points (d) and (e) of Article 124(1), provided that:**

**(a) the securitised residential or commercial immovable property exposures were originated by a member of the same consolidated group of which the issuer of the covered bonds is also a member, or by an entity affiliated to the same central body to which the issuer of the covered bonds is also affiliated, where that common group membership or affiliation shall be determined at the time the senior units are made collateral for covered bonds;**

**(b) a member of the same consolidated group of which the issuer of the covered bonds is also a member, or an entity affiliated to the same central body to which the issuer of the covered bonds is also affiliated, retains the whole first loss tranche supporting those senior units.**

3. Until 31 December 2014, for the purposes of point (c) in Article 124(1), institutions' senior unsecured exposures which qualified for a 20% risk weight under national law before the entry into force of this regulation shall be considered to qualify for credit quality step 1.
4. Until 31 December 2014, for the purposes of Article 124(4), institutions' senior unsecured exposures to which qualified for a 20% risk weight under national law before the entry into force of this regulation shall be considered to qualify for a 20% risk weight.

*Article 474*

*Exemption for Commodities dealers*

1. The provisions on capital requirements as set out in this Regulation shall not apply to investment firms whose main business consists exclusively of the provision of investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC and to whom Directive 93/22/EEC did not apply on 31 December 2006.

This exemption shall apply until 31 December 2014 or the date of entry into force of any modifications pursuant to paragraphs 2 and 3, whichever is the earlier.

2. By 31 December 2014, the Commission shall, on the basis of public consultations and in the light of discussions with the competent authorities, report to the Parliament and the Council on:
  - (a) an appropriate regime for the prudential supervision of investment firms whose main business consists exclusively of the provision of investment services or activities in relation to the commodity derivatives or derivatives contracts set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC;
  - (b) the desirability of amending Directive 2004/39/EC to create a further category of investment firm whose main business consists exclusively of the provision of investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC relating to energy supplies, including electricity, coal, gas and oil.
3. On the basis of the report referred to in paragraph 2, the Commission may submit proposals for amendments to this regulation.



## *Article 475*

### *Leverage*

1. By way of derogation from Article 416 and 417, during the period between 1 January 2013 and 31 December 2021, institutions shall calculate and report the leverage ratio by using both of the following as the capital measure:
  - (a) Tier 1 capital ;
  - (b) Tier 1 capital, subject to the derogations laid down in Chapters 2 and 3 of this Title.
2. By way of derogation from Article 436(1), institutions may choose whether to disclose the information on the leverage ratio based on either just one or both of the definitions of the capital measure specified in points (a) and (b) of paragraph 1. Where institutions change their decision on which leverage ratio to disclose, the first disclosure that occurs after such change shall contain a reconciliation of the information on all leverage ratios disclosed up to the moment of the change.
3. By way of derogation from Article 416(2), during the period from 1 January 2013 to 31 December 2017, competent authorities may permit institutions to calculate the end-of-quarter leverage ratio where they consider that institutions may not have data of sufficiently good quality to calculate a leverage ratio that is an arithmetic mean of the monthly leverage ratios over a quarter.

*Article 476*

*Transitional provisions – Basel I floor*

1. Until 31 December 2014, institutions calculating risk-weighted exposure amounts in accordance with Part Three, Title II, Chapter 3 and institutions using the Advanced Measurement Approaches as specified in Part Three, Title III, Chapter 4 for the calculation of their own funds requirements for operational risk shall meet both of the following requirements:
  - (a) they shall hold own funds as required by Article 87;
  - (b) they shall hold own funds which are at all times more than or equal to 80 % of the total minimum amount of own funds that the institution would be required to hold under Article 4 of Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions as that Directive and Directive 2000/12/EC stood prior to 1 January 2007.
- 1a. Subject to the approval of the competent authority, the amount referred to in paragraph 1 (b) may be replaced by a requirement to hold own funds which are at all times more than or equal to 80 % of the own funds requirements as required by Article 87 as this requirement would be if the institution calculated risk-weighted exposure amounts in accordance with Part Three, Title II, Chapter 2, and Part Three, Title III, Chapter 2 or 3, as applicable, in stead of in accordance with Part Three, Title II, Chapter 3, or Part Three, Title III, Chapter 4, as applicable.
- 1b. A credit institution may apply paragraph [...] 1a only if it started to use the IRB approach or the Advanced Measurements Approaches for the calculation of its capital requirements on or after 1 January 2010.
- 1c. Compliance with the requirements of paragraphs 1 (b) shall be on the basis of amounts of own funds fully adjusted to reflect differences in the calculation of own funds under Directive 2000/12/EC and Directive 93/6/EEC as those Directives stood prior to 1 January 2007 and the calculation of own funds under this Regulation deriving from the separate treatments of expected loss and unexpected loss under Part Three, Title II, Chapter 3, of this Regulation.

2. The competent authorities may, after having consulted EBA, waive the application of paragraph 1(b) to institutions provided that all the requirements for the Internal Ratings Based Approach set out in Part Three, Title II, Chapter 3, Section 6 and the qualifying criteria for the use of the Advanced Measurement Approach set out in Part Three, Title III, Chapter 4 are met.
3. The Commission shall by 1 January 2014 submit a report to the European Parliament and the Council as to whether it will be appropriate with an alternative floor as the model set out in paragraph 1 taking into account international development and international agreed standards. Where appropriate, the report shall be accompanied by a legislative proposal on the introduction of such a floor.

## Title II

### Reports and reviews

#### *Article 477*

##### *Cyclicalities of capital requirements*

The Commission, in cooperation with EBA, ESRB and the Member States, and taking into account the contribution of the European Central Bank, shall periodically monitor whether this Regulation taken as a whole, together with Directive [inserted by OP] has significant effects on the economic cycle and, in the light of that examination, shall consider whether any remedial measures are justified. By 31 December 2013, the EBA shall report to the Commission if and how methodologies of institutions under the IRB Approach should converge with a view to more comparable capital requirements while mitigating pro-cyclicality.

Based on that analysis and taking into account the contribution of the European Central Bank, the Commission shall draw up a biennial report and submit it to the European Parliament and to the Council, together with any appropriate proposals. Contributions from credit taking and credit lending parties shall be adequately acknowledged when the report is drawn up.

#### *Article 478*

##### *Own funds requirements for exposures in the form of covered bonds*

1. \_\_\_\_\_ The Commission shall, by 31 December 2014 and after consulting the EBA, report to the Parliament and the Council, together with any appropriate proposals, whether the risk weights laid down in Article 124 and the own funds requirements for specific risk in Article 325(3) are adequate for all the instruments that qualify for these treatments and whether the criteria in Article 124 are appropriate.

The report shall [...] also have regard to:

- a) the extent to which the current regulatory capital requirements applicable to covered bonds adequately [...] **cover** variances in the credit quality of covered bonds and the collateral against which the covered bonds are secured, including the extent of variations across member states;
- b) the transparency of the covered bond market and the extent to which this facilitates comprehensive internal analysis by investors in respect of the credit risk of covered bonds and the collateral against which they are secured **and the asset segregation in case of the issuer's insolvency. This shall take into account the mitigating effects of the underlying strict national legal framework according to Art. 124 CRR and Art. 52(4) UCITS on the overall credit quality of a covered bond and its implications on the level of transparency needed by investors;**
- c) **whether and in which way** [...] covered bond issuance by a credit institution impacts on the credit risk to which other creditors of the issuing institution are exposed;

2. The Commission shall, by 31 December 2014 and after consulting the EBA, report to the Parliament and the Council whether loans secured by aircrafts (aircraft liens) and whether residential loans secured by a guarantee, but not secured by a registered mortgage, under certain conditions should be considered as an eligible asset according to Article 124.

3. The Commission shall, by 31 December 2014, review the appropriateness of the derogation set out in Article 473 paragraph 1 and, if relevant, the appropriateness of extending similar treatment to any other form of covered bond. In the light of that review, the Commission may, if appropriate, adopt delegated acts in accordance with Article 445 to make that derogation permanent or make legislative proposals to extend it to other forms of covered bonds.

*Article 479*  
*Large exposures*

By 31 December 2013 the Commission shall review and report on the application of Article 389(1)(j) and 389(2), including whether exemptions in Article 389(2) should be discretionary, and shall submit this report to the European Parliament and the Council and, if appropriate, a legislative proposal.

With respect to the potential elimination of the national discretion under Article 389(2)(c) and its potential application at the Union level, the review shall in particular take into account the efficiency of group's risk management while ensuring that sufficient safeguards are in place to ensure financial stability in all Member states in which an entity of a group is incorporated.

*Article 480*  
*Level of application*

1. By 31 December 2013, the Commission shall review and report on the application of Part One, Title II, and Article 108(6) and 108(7) and shall submit this report to the European Parliament and the Council, and, if appropriate, a legislative proposal.
2. By 31 December 2014, the Commission shall report on whether and how the liquidity coverage requirement laid down in **[...] Part Six** should apply to investment firms and shall, after consulting EBA, submit this report to the European Parliament and the Council, and, if appropriate, a legislative proposal.
3. By 31 December 2015 the Commission shall, on the basis of consultation with EBA and ESMA and in the light of discussions with the competent authorities, report to the Parliament and Council on an appropriate regime for the prudential supervision of firms referred to in Article 4(8)
4. On the basis if the report referred to in paragraph 3, the Commission may submit proposals for amendments to this Regulation.

*Article 481*

*Liquidity requirements*

1. EBA shall monitor and evaluate the reports made in accordance with Article 403(1), across currencies and across different business models. EBA shall, [...] after consulting the ESRB, annually and for the first time by 30 [...] September 2013, report to the Commission on whether a specification of the general liquidity coverage requirement in [...] Part Six based on the criteria for liquidity reporting in Part Six Title II, considered either individually or cumulatively, is likely to have a material detrimental impact on the business and risk profile of Union institutions or on financial markets or the economy and bank lending, with a particular focus on lending to small and medium enterprises and on trade financing, including lending under official export credit insurance schemes.

EBA shall in its report assess in particular the appropriateness of

- (a) providing mechanisms restricting the value of liquidity inflows, in particular assessing whether an inflow cap of 75 % of the outflows is appropriate; taking into account different business models including pass through financing models;
- (b) the calibration of the outflows in accordance with Article 410(5);
- (c)
- (d) providing mechanisms restricting the coverage of liquidity requirements by certain categories of liquid assets
- (e) providing for specific lower outflow and/or higher inflow rates for intragroup flows. The report shall specify under which conditions such specific in- or outflows rates would be justified from a prudential point of view and shall set out the high level outline of a methodology using objective criteria and parameters in order to determine specific levels of inflows and outflows between the institution and the counterparty when they are not established in the same member state.

- (f) requirements on the composition of liquid assets that an individual bank should hold, such as for example a requirement for the share of the assets referred in Article 404(1)(a) and (b) to constitute a certain minimum share of an institution's liquid assets
- (g) derogations from requirements on the composition of the liquid assets institutions will be required to hold, where in a given currency the institutions' collective justified needs for liquid assets are exceeding the availability of those liquid assets and conditions such derogations should be subject to;
- (h) defining circumstances of stress, including principles for the use possible use of the stock of liquid assets and the necessary supervisory reactions under which institutions would be able to use their liquid assets to meet liquidity outflows and how to address non-compliance;

1a. [...]

2. EBA shall, by 30 June 2013, report to the Commission on appropriate uniform definitions of high and of extremely high liquidity and credit quality of transferable assets for purposes of Article 404 **and appropriate haircuts**. The report should also consider other categories of central bank eligible assets, for example RMBS of high liquid and credit quality and other non-central bank eligible but tradable assets, for example equities listed on a recognised exchange and gold. EBA shall in particular test the adequacy of the following criteria and the appropriate levels for such definitions:
  - (a) minimum trade volume of the assets
  - (b) minimum outstanding volume of the assets
  - (c) transparent pricing and post-trade information
  - (d) credit quality steps referred to in Part Three, Title II, Chapter 2;



- (e) proven record of price stability
- (f) average volume traded and average trade size
- (g) maximum bid/ask spread
- (h) remaining time to maturity
- (i) minimum turnover ratio

**EBA shall furthermore report about the appropriateness of treating assets referred to in Article 404(1)(c) as equivalent to assets of extremely high liquidity and credit quality.**

2a. By 31 December 2013, *taking into account the reports by EBA mentioned in paragraphs 1 and 2*, the Commission shall report together with a legislative proposal as appropriate to the European Parliament and to the Council to introduce by 31 December 2015 at the latest, but not before January 1<sup>st</sup> 2015, a liquidity coverage requirement under which institutions shall at all times hold liquid assets, the sum of the values of which equals, or is greater than, the liquidity outflows less the liquidity inflows under stressed conditions so as to ensure that institutions maintain levels of liquidity buffers which are adequate to face any possible imbalance between liquidity inflows and outflows under stressed conditions over a short period of time . The Commission shall [...] take into account the final Basel III framework as well as European specificities [...] together with any connected flexibility measures if necessary, including the possible introduction of liquidity requirements in Articles 443A and 443B. The report shall be accompanied, as appropriate, by a legislative proposal. In particular, the Commission shall address in its report [...] :

- (i) any appropriate changes to the categories and calibration of the inflows and outflows referred to in Part Six Title II, taking into account the report referred to in the first paragraph and international developments;

(ii) the need to limit the coverage of liquidity requirements by liquid assets referred to in points (d) of Article 404(1);

(iii) uniform definitions of high and extremely high liquidity;

(iv) the definition of established operational relationship for corporate clients as referred to in article 410(4)c).

(v) specific treatments for intra-group flows where appropriate, taking into account the report referred to in paragraph 1.

(vi) the need to limit the liquidity inflows as a cap on outflow taking into account the report referred to in the first paragraph and international developments.

(vii) mechanisms for grandfathering of transferable assets issued or guaranteed by entities with EU state aid approval until 2018.

3. By 31 December 2015, EBA shall report to the Commission on whether and how it would be appropriate to ensure that institutions use stable sources of funding, including an assessment of the impact on the business and risk profile of Union institutions or on financial markets or the economy and bank lending, with a particular focus on lending to small and medium enterprises and on trade financing, including lending under official export credit insurance schemes and pass through financing models.

By 31 December 2016, the Commission shall, on the basis of [...]the reports *mentioned in paragraphs 2 and 3*, submit a report [...] and, if appropriate, a legislative proposal to the European Parliament and to the Council.

## Article 482

### Leverage

1. Based on the results of the report in paragraph 2, the Commission shall submit by 31 December 2016 a report on the impact and effectiveness of the leverage ratio to the European Parliament and the Council. Where appropriate, the report shall be accompanied by a legislative proposal on the introduction of one or more levels of the leverage ratio that **different types of institutions would be required to meet**, suggesting an adequate calibration for those levels and any appropriate adjustments to the capital measure and the total exposure measure as defined in Article 416, ***together with any connected flexibility measures if necessary, including the possible introduction of those leverage ratio levels in Articles 443A and 443B.***
2. For the purposes of paragraph 1, the EBA shall report to the Commission by 31 October 2016 on at least the following:
  - a0) Whether the leverage ratio framework provided by this Regulation **and article 85 and article 94 of the Directive [inserted by OP]** is the appropriate tool [...] to suppress the risk of excessive leverage on the part of the institutions in a satisfactory manner and degree;
  - (a) whether the requirements laid out in Articles 75 and 85 of Directive [inserted by OP] in accordance with Articles 72 and 92 of Directive [inserted by OP] for addressing the risk of excessive leverage ensure sound management of this risk by institutions and, if not, which further enhancement they need in order to ensure these objectives;
  - (b) whether – and if so, which - changes to the calculation methodology detailed in Article 416 would be necessary to ensure that the leverage ratio can be used as an appropriate indicator of an institution's risk of excessive leverage;

- (c) whether, in the context of the calculation of the total exposure measure of the leverage ratio, the exposure value of items listed in Annex II determined by using the Original Exposure Method differs in a material way from the exposure value determined by using the Mark-to-Market Method;
- (d) whether using either own funds or Common Equity Tier 1 capital as the capital measure of the leverage ratio could be more appropriate for the intended purpose of tracking the risk of excessive leverage and, if so, what would be the appropriate calibration of the leverage ratio;
- (e) whether the percentage referred to in point (a) of article 416(8) for undrawn credit facilities, which may be cancelled unconditionally at any time without notice, is appropriately conservative based on the evidence collected during the observation period;
- (f) whether the frequency and format of the disclosure of items referred to in Article 436 are adequate;
- (g) whether 3% would be an appropriate level for the leverage ratio based on Tier 1 capital and, if not, what level would be the appropriate one;
- (h) whether introducing the leverage ratio as a requirement for institutions would necessitate any changes to the leverage ratio framework provided by this Regulation and, if so, which ones;
- (i) whether introducing the leverage ratio as a requirement for institutions would effectively constrain the risk of excessive leverage on the part of those institutions and, if so, whether the level for the leverage ratio should be the same for all institutions or should differ for different types of institution and, in the latter case, what additional calibrations would be required.

3. The report referred to in paragraph 2 shall cover at least the period from 1 January 2013 until 30 June 2016 and shall take account of at least the following:
- (a) the impact of introducing the leverage ratio, determined in accordance with Article 416, as a requirement that institutions would have to meet on:
    - (i) financial markets in general and markets for repurchase transactions, derivatives and covered bonds in particular;
    - (ii) the robustness of institutions;
    - (iii) business models and balance-sheet structures of institutions;
    - (iv) the migration of exposures to entities which are not subject to prudential supervision;
    - (v) financial innovation, in particular the development of instruments with embedded leverage;
    - (vi) institutions' risk-taking behaviour;
    - (vii) clearing, settlement and custody activities;
    - (viii) cyclicalities of the capital measure and the total exposure measure of the leverage ratio;
    - (ix) bank lending, with a particular focus on lending to small and medium enterprises and on trade financing, including lending under official export credit insurance schemes;
  - (b) the interaction of the leverage ratio with the risk-based own funds requirements and the liquidity requirements as specified in this Regulation;

- (c) the impact of accounting differences between accounting standards applicable under Regulation (EC) No 1606/2002, accounting standards applicable under Directive 86/635/EC and other [...] applicable accounting standards on the comparability of the leverage ratio.

3a. \_\_\_\_\_ [...]

### *Article 483*

#### *Exposures to transferred credit risk*

By 31 December 2013 the Commission shall report to the European Parliament and the Council on the application and effectiveness of the provisions of Part Five in the light of international market developments.

### *Article 483a*

1. By June 2014, the European Commission shall, after consulting ESRB and EBA, review whether the macro-prudential regulation contained on **this Regulation and the Directive [...]** [ [...] inserted by OP] is sufficient to mitigate systemic risks in sectors, regions and member states in the European union including assessing:
- i) whether the current macro-prudential tools in **this Regulation and the Directive [ [...]** [ [...] inserted by OP] are effective, efficient and transparent
- [...] inserted by OP [...] inserted by OP [...] iii) whether the coverage and **the possible degrees of [...]** overlap **between different macro-prudential tools for targeting similar risks [...]** in **this Regulation and the Directive** [Inserted by OP] are adequate and, if appropriate, propose new macro-prudential regulation [...].
- iv) **how internationally agreed standards for systemic institutions interacts with the provisions in this Regulation and the Directive [inserted by OP] and, if appropriate, propose new regulation taking into account these internationally agreed standards.**

By 31 December 2014 the Commission shall based on the consulting with ESRB and EBA report to the European Parliament and Council on this assessment and where appropriate submit a legislative proposal to the European Parliament and Council.

*Article 484*

*Counterparty Credit Risk and the Original Exposure Method*

By 31 December 2016 the Commission shall review and report on the application of Article 270 and shall submit this report to the European Parliament and the Council, and, if appropriate, a legislative proposal.

*Article 485*

*Retail exposures*

The Commission shall within 12 months after the entry into force of this Regulation, report on the impact of the own funds requirements laid down in this Regulation on lending to small and medium-sized enterprises and natural persons and shall submit this report to the European Parliament and the Council, and, if appropriate, a legislative proposal.

For these purposes, EBA shall report the following to the Commission with regard to Article 118:

- (a) a comparison between actual unexpected credit losses on lending to small and medium sized enterprises and natural persons within the European Union over a full economic cycle and the unexpected credit losses based on the credit risk weights applicable to lending to small and medium-sized enterprises;
- (b) an analysis whether the limit of EUR 1 million constrains the appropriate application of the risk-weighting.

*Article 486*

*Definition of eligible capital*

By 31 December 2013 the Commission shall review and report on the appropriateness of the definition of eligible capital being applied for the purposes of Title IV of Part Two and Part Four and shall submit this report to the European Parliament and the Council, and, if appropriate, a legislative proposal.



## PART ELEVEN

### FINAL PROVISIONS

#### *Article 487*

1. Subject to paragraph 2, this Regulation shall apply from 1 January 2013.
2. Article **7, 19 and** 436(1) shall apply from 1 January 2015.

#### *Article 488*

This Regulation shall enter into force on the day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the European Parliament*

*For the Council*

*The President*

*The President*

## Annex I

### Classification of Off-balance-sheet items

1. Full risk:
  - Guarantees having the character of credit substitutes,
  - Credit derivatives,
  - Acceptances,
  - Endorsements on bills not bearing the name of another institution,
  - Transactions with recourse,
  - Irrevocable standby letters of credit having the character of credit substitutes,
  - Assets purchased under outright forward purchase agreements,
  - Forward deposits,
  - The unpaid portion of partly-paid shares and securities,
  - Asset sale and repurchase agreements as defined in Article 12(3) and (5) of Directive 86/635/EEC,
  - Other items also carrying full risk.
2. Medium risk:
  - Documentary credits issued and confirmed (see also ‘Medium/low risk’),
  - Warranties and indemnities (including tender, performance, customs and tax bonds) and guarantees not having the character of credit substitutes,
  - Irrevocable standby letters of credit not having the character of credit substitutes,
  - Undrawn credit facilities (agreements to lend, purchase securities, provide guarantees or acceptance facilities) with an original maturity of more than one year,

- Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs),
  - Other items also carrying medium risk and as communicated to EBA.
3. Medium/low risk:
- Documentary credits in which underlying shipment acts as collateral and other self-liquidating transactions,
  - Undrawn credit facilities which comprise agreements to lend, purchase securities, provide guarantees or acceptance facilities with an original maturity of up to and including one year which may not be cancelled unconditionally at any time without notice or that do not effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness,
  - Other items also carrying medium/low risk and as communicated to EBA.
4. Low risk:
- Undrawn credit facilities comprising agreements to lend, purchase securities, provide guarantees or acceptance facilities which may be cancelled unconditionally at any time without notice, or that do effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness. Retail credit lines 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; and
  - Other items also carrying low risk and as communicated to EBA.

Annex II  
Types of derivatives

1. Interest-rate contracts:
  - (a) single-currency interest rate swaps;
  - (b) basis-swaps;
  - (c) forward rate agreements;
  - (d) interest-rate futures;
  - (e) interest-rate options purchased;
  - (f) other contracts of similar nature.
2. Foreign-exchange contracts and contracts concerning gold:
  - (a) cross-currency interest-rate swaps;
  - (b) forward foreign-exchange contracts;
  - (c) currency futures;
  - (d) currency options purchased;
  - (e) other contracts of a similar nature;
  - (f) contracts of a nature similar to (a) to (e) concerning gold.
3. Contracts of a nature similar to those in points 1(a) to (e) and 2(a) to (d) concerning other reference items or indices. This includes as a minimum all instruments specified in points 4 to 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC not otherwise included in points 1 or 2.

### Annex III

#### Items subject to supplementary reporting of liquid assets

1. cash;
2. central bank reserves, to the extent that these reserves can be drawn down in times of stress;
3. transferable securities representing claims on or claims guaranteed by sovereigns, central banks, public sector entities, regional governments and local authorities, the Bank for International Settlements, the International Monetary Fund, the European Commission, or multilateral development banks and satisfying all of the following conditions:
  - (a) they are assigned a 0% risk-weight under Section 2 of Title III, Chapter 2;
  - (b) they are traded in large, deep and active repurchase agreement or cash markets characterized by a low level of concentration;
  - (c) they have a proven record as a reliable source of liquidity by either repurchase agreement or sale even during stressed market conditions;
  - (d) they are not an obligation of an institution or any of its affiliated entities.
4. transferable securities other than those referred to in point (3) representing claims on or claims guaranteed by sovereigns or central banks issued in domestic currencies by the sovereign or central bank in the currency and country in which the liquidity risk is being taken or issued in foreign currencies, to the extent that holding of such debt matches the liquidity needs of the bank's operations in that third country;
5. transferable securities representing claims on or claims guaranteed by sovereigns, central banks, public sector entities, regional governments and local authorities, or multilateral development banks and satisfying all of the following conditions.
  - (a) they are assigned a 20% risk-weight under Section 2 of Title III, Chapter 2;
  - (b) they are traded in large, deep and active repurchase agreement or cash markets characterized by a low level of concentration;

- (c) they have a proven record as a reliable source of liquidity by either repurchase agreement or sale even during stressed market conditions;
  - (d) they are not an obligation of an institution or any of its affiliated entities.
- 6. transferable securities other than those referred to in points (3) to (5) that qualify for a 20% or better risk weight under Section 2 of Title III, Chapter 2 or are internally rated as having an equivalent credit quality, and fulfil any of the following conditions:
  - (a) they do not represent a claim on an SSPE, an institution or any of its affiliated entities;
  - (b) they are bonds as defined in Article 22(4) of Directive 85/611/EEC qualify for the treatment in Article 124

Annex 4 [deleted]

## Annex 5

### Correlation table

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