



**COUNCIL OF  
THE EUROPEAN UNION**

**Brussels, 20 December 2013  
(OR. en)**

**18159/13**

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**Interinstitutional File:  
2011/0202 (COD)**

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**EF 283  
ECOFIN 1188  
DELECT 110**

**COVER NOTE**

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From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
date of receipt:	20 December 2013
To:	Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union
No. Cion doc.:	C(2013) 9338 final
Subject:	COMMISSION DELEGATED REGULATION (EU) No .../.. of 20.12.2013 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, with regard to regulatory technical standards for specifying the calculation of specific and general credit risk adjustments

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Delegations will find attached document C(2013) 9338 final.

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Encl.: C(2013) 9338 final



Brussels, 20.12.2013  
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**COMMISSION DELEGATED REGULATION (EU) No .../..**

**of 20.12.2013**

**supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, with regard to regulatory technical standards for specifying the calculation of specific and general credit risk adjustments**

(Text with EEA relevance)

## EXPLANATORY MEMORANDUM

### **1. CONTEXT OF THE DELEGATED ACT**

Article 110(4) of Regulation (EU) No 575/2013 ('the Regulation') empowers the Commission to adopt, following submission of draft standards by the European Banking Authority (EBA), and in accordance with Article 10 of Regulation No (EU) 1093/2010, delegated acts specifying the calculation of specific credit risk adjustments and general credit risk adjustments under the applicable accounting framework for (i) the determination of exposure values according to Articles 111, 166 to 168, 246 and 266 of the Regulation; (ii) the treatment of expected loss amounts according to Article 159 of the Regulation; and (iii) the determination of default under Article 178 of the Regulation.

In accordance with Articles 10 to 15 of Regulation No (EU) 1095/2010 establishing the EBA, the Commission shall decide within three months of receipt of the draft standards whether to endorse the drafts submitted. The Commission may also endorse the draft standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in those Articles.

### **2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT**

In accordance with the third subparagraph of Article 10(1) of Regulation No (EU) 1093/2010, the EBA has carried out a public consultation on the draft technical standards submitted to the Commission in accordance with Article 110(4) of Regulation No (EU) 575/2013. A consultation paper was published on the EBA internet site on 17 July 2012, and the consultation closed on 30 September 2012. Moreover, the EBA invited the EBA's Banking Stakeholder Group set up in accordance with Article 37 of Regulation No (EU) 1093/2010 to provide advice on the consultation paper. Together with the draft technical standards, the EBA has submitted an explanation on how the outcome of these consultations has been taken into account in the development of the final draft technical standards submitted to the Commission.

### **3. ANALYSIS OF COSTS AND BENEFITS**

Together with the draft technical standards, and in accordance with the third subparagraph of Article 10(1) of Regulation No (EU) 1093/2010, EBA has submitted an analysis of the costs and benefits related to the draft technical standards submitted to the Commission. This analysis is available at: [http://www.eba.europa.eu/documents/10180/359972/EBA-RTS-2013-04-draft\\_RTS\\_on\\_Credit\\_Risk\\_Adjustments.pdf/9b8e37fe-f50a-4d3a-ab00-8618104afe5](http://www.eba.europa.eu/documents/10180/359972/EBA-RTS-2013-04-draft_RTS_on_Credit_Risk_Adjustments.pdf/9b8e37fe-f50a-4d3a-ab00-8618104afe5) and can be found between pages 15-19.

### **4. LEGAL ELEMENTS OF THE DELEGATED ACT**

All the provisions in this delegated act relate to the determination of own funds requirements for credit risk, which is why the required calculation is limited to the amounts of credit risk adjustments that both reflect losses exclusively related to credit risk according to the applicable accounting framework and that reduce the institution's Common Equity Tier 1 capital.

Any credit risk adjustment amount that is relevant for the purposes listed in Article 110(4) of the Regulation must be assigned to the calculation of either general credit risk adjustments or specific credit risk adjustments. In order to ensure this, the delegated act first provides criteria for qualifying certain credit risk adjustments amounts as general credit risk adjustments, so that all other credit risk adjustments amounts shall qualify as specific credit risk adjustments. Moreover, in order to facilitate for institutions the mapping of the criteria of this distinction between general and specific credit risk adjustments to the accounting framework they apply, the delegated act specifically includes a discussion of cases for general and specific credit risk adjustments. These are intended to enable institutions to apply the provisions under their accounting framework, without specifically having to reference them.

Some of the provisions in the scope of this delegated act according to Article 110(4) of the Regulation require the identification of the specific credit risk adjustment for a single exposure or sub-group of exposures, thus calling for a decision on how to treat specific credit risk adjustments that reflect losses related to credit risk of a whole group of exposures. The case is two-fold: how to assign the amount resulting from such specific credit risk adjustments in portions (i) to some of the exposures in the group of exposures the specific credit risk adjustment is stemming from or (ii) to a sub-group of exposures in the group of exposures subject to both the Internal Ratings Based Approach and the Standardised Approach as regards capital requirements. With regard to both cases the delegated act assigns the specific credit risk adjustment respectively to single exposures or to sub-group of exposures of the group proportionally to the risk-weighted exposure amounts. For this purpose exposure amounts are gross values before deduction of specific credit risk adjustments.

Finally, for the purpose of the determination of default, specific credit risk adjustments are restricted to those which are assigned individually to a single exposure or a single obligor.

**COMMISSION DELEGATED REGULATION (EU) No .../..**

**of 20.12.2013**

**supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, with regard to regulatory technical standards for specifying the calculation of specific and general credit risk adjustments**

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 575/2013 of 26 June 2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012<sup>1</sup>, and in particular the third subparagraph of Article 110(4) thereof,

Whereas:

- (1) Regulation (EU) No 575/2013 defines credit risk adjustments as the amount of general and specific loan loss provisions for credit risks that have been recognised in the financial statements of the institutions in accordance with the applicable accounting framework but does not lay down specific rules for determining what are specific and general credit risk adjustments.
- (2) Rules should be provided in relation to the specification of the amounts that need to be included in the calculation of credit risk adjustments which reflect losses exclusively related to credit risk. The calculation of credit risk adjustments for determining the own funds requirements should be limited to amounts that have reduced the Common Equity Tier 1 (CET1) of the institution.
- (3) Losses exclusively related to credit risk recognised under the applicable accounting framework in the current financial year should be recognised as credit risk adjustments provided that the institution recognises the effect in (CET1). This is relevant for situations where such impairment losses recorded in the course of a financial year occur, in spite of overall interim profits during the year or at year-end that are not approved in accordance with Article 26(2) of Regulation (EU) No 575/2013, and where their recognition as credit risk adjustments would result in an earlier impact on exposure values or on Tier 2 than on CET1. For interim losses as provided in Article 36(1) of Regulation (EU) No 575/2013 such an adjustment is not necessary to the

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<sup>1</sup> OJ L 176, 27.6.2012, p.1.

extent that losses for the current financial year under that article are immediately deducted from CET1.

- (4) Certain provisions of Regulation (EU) No 575/2013 relating to credit risk adjustments refer explicitly to off-balance sheet items. Where no such distinction is made, the relevant provisions apply to both on- and off-balance sheet items.
- (5) Rules should be laid down to cover those losses exclusively related to credit risk that are recognised under the applicable accounting framework by which an institution's Common Equity Tier 1 has been reduced. Those rules should cover impairments and value adjustments for financial assets or provisions for off-balance sheet items, to the extent that they reflect losses exclusively related to credit risk and provided they are recognised in the profit and loss account under the applicable accounting framework. To the extent that those losses relate to financial instruments valued at fair value, those rules should also cover amounts recognised as impairments under the applicable accounting frameworks, or similar adjustments made provided they reflect losses related to a deterioration or a worsening of an asset's or an assets portfolio's credit quality. It is not appropriate at this stage to regulate other amounts that are not an impairment of a financial instrument under the applicable accounting framework, or that do not reflect a concept of a similar nature, even if those changes could include a credit risk component.
- (6) In order to ensure full coverage of the calculation it is necessary that any amount that is relevant for the purposes listed in the first subparagraph of Article 110(4) of Regulation (EU) No 575/2013 is assigned either to the calculation of general credit risk adjustments (General Credit Risk Adjustments) or that of specific credit risk adjustments (Specific Credit Risk Adjustments).
- (7) In relation to the identification of the amounts that can be included in the calculation of Specific Credit Risk Adjustments, the only criterion provided by Regulation (EU) No 575/2013 is that Specific Credit Risk Adjustments are not eligible for inclusion into Tier 2 capital under the Standardised Approach for credit risk, according to Article 62(c) of Regulation (EU) No 575/2013. Therefore, the distinction of amounts to be included in the calculation of Specific Credit Risk Adjustments or General Credit Risk Adjustments needs to be done consistently with the criteria for identifying what can be included in Tier 2 capital
- (8) Regulation (EU) No 575/2013 implements the internationally-agreed standards of the Basel Committee on Banking Supervision' third International Regulatory Framework for banks<sup>2</sup> (hereinafter referred to as 'Basel III'). Therefore the appropriate rules on credit risk adjustments should also be consistent with the Basel framework which provides that one of the criteria for the distinction between General Credit Risk Adjustments and Specific Credit Risk Adjustments has to be that general provisions or general loan-loss reserves are 'freely available to meet losses which subsequently materialise'. According to Basel III, provisions or loan-loss reserves held against future, presently unidentified losses are freely available to meet losses stemming from credit risk which subsequently materialise and therefore qualify for inclusion within Tier 2 capital. In addition, amounts included in the calculation of General Credit Risk Adjustments should be fully available, as regards to timing and amount, to meet such

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<sup>2</sup> [http://www.bis.org/publ/bcbs189\\_dec2010.pdf](http://www.bis.org/publ/bcbs189_dec2010.pdf)

losses, at least on a gone-concern basis where capital is able to absorb losses in insolvency prior to depositors losing any money

- (9) It should be possible to apply the rules in this field irrespective of the applicable accounting framework. However, to enable institutions to distinguish between Specific Credit Risk Adjustments and General Credit Risk Adjustments in a common way, criteria for treatment of credit risk losses within an applicable accounting framework for each type of credit risk adjustment should be provided. Whereas the treatment of losses exclusively related to credit risk recognised under applicable accounting frameworks depends on the fulfilment of those criteria, the large majority of those amounts should normally be classified as Specific Credit Risk Adjustments given the restrictive nature of the criteria for General Credit Risk Adjustments.
- (10) International accounting standards are subject to revision which could necessitate changes to the criteria for distinguishing between Specific Credit Risk Adjustments and General Credit Risk Adjustments. In the light of ongoing discussions, particularly with regard to impairment models, it would seem premature to anticipate that model in credit risk adjustment criteria.
- (11) Regulation (EU) No 575/2013 requires the identification of the Specific Credit Risk Adjustments for a single exposure. It is therefore necessary to decide how to treat Specific Credit Risk Adjustments that reflect losses related to the credit risk of a whole group of exposures. Further, it is necessary to decide for which exposures in the group and to what extent the Specific Credit Risk Adjustments should be recognised. The assignment of portions of this amount resulting from such Specific Credit Risk Adjustments to the exposures in the group has to be done proportionally to the risk-weighted exposure amounts. For this purpose, the exposure values should be determined without taking into account any Specific Credit Risk Adjustments.
- (12) For the purpose of the determination of default under point (b) of Article 178(3) of Regulation (EU) No 575/2013, it is necessary to include only Specific Credit Risk Adjustments which are made individually for a single exposure or a single obligor, and not to include Specific Credit Risk Adjustments made for whole groups of exposures. Specific Credit Risk Adjustments made for whole groups of exposures do not identify obligors of exposures belonging to such groups for which a default event is considered to have occurred. In particular, the existence of Specific Credit Risk Adjustments for a group of exposures is not sufficient reason to conclude that default events have occurred for each of the obligor or exposures belonging to this group.
- (13) It is necessary for institutions to be able to demonstrate how the criteria for distinguishing between Specific Credit Risk Adjustments and General Credit Risk Adjustments are used in the context of the applicable accounting framework. Therefore, institutions should document that process.
- (14) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (15) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits, in accordance with Article 10 of Regulation (EU)

No 1093/2010<sup>3</sup>, and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010,

HAS ADOPTED THIS REGULATION:

### *Article 1*

#### *Identification of General and Specific Credit Risk Adjustments for the purposes of Articles 111, 159, 166, 167, 168, 178, 246 and 266 of Regulation (EU) No 575/2013*

1. For the purposes of this Regulation, the amounts required to be included in the calculation of general and specific credit risk adjustments by an institution shall be equal to all amounts by which an institution's Common Equity Tier 1 capital has been reduced in order to reflect losses exclusively related to credit risk according to the applicable accounting framework and recognised as such in the profit or loss account, irrespective of whether they result from impairments, value adjustments or provisions for off-balance sheet items.

Any amounts resulting pursuant to the first subparagraph which have been recognised during the financial year, may only be included in the calculation of general and specific credit risk adjustments if the respective amounts have been deducted from an institution's Common Equity Tier 1 capital, either in accordance with Article 36(1) of Regulation (EU) No 575/2013, or, in the event of interim profits or year-end profits that have not been approved in accordance with Article 26(2) of that Regulation, by way of a corresponding immediate reduction in Common Equity Tier 1 capital for the determination of own funds.

2. The amounts referred to in paragraph 1 shall be included in the calculation of general credit risk adjustments by the institution (General Credit Risk Adjustments) where they fulfil both of the following criteria:
  - (a) they are freely and fully available, as regards to timing and amount, to meet credit risk losses that have not yet materialised;
  - (b) they reflect credit risk losses for a group of exposures for which the institution has currently no evidence that a loss event has occurred.
3. All other amounts referred to in paragraph 1 shall be included in the calculation of specific credit risk adjustments (Specific Credit Risk Adjustments).
4. Subject to meeting the criteria of Paragraph 2, the institution shall include the following losses in the calculation of General Credit Risk Adjustments:
  - (a) losses recognised to cover higher average portfolio loss experience over the last years although there is currently no evidence of loss events supporting these loss level observed in the past;

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<sup>3</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).



- (b) losses for which the institution is not aware of a credit deterioration for a group of exposures but where some degree of non-payment is statistically probable based on past experience.
5. The institution shall always include the following losses in the calculation of Specific Credit Risk Adjustments referred to in Paragraph 3:
- (a) losses recognised in the profit or loss account for instruments measured at fair value that represent credit risk impairment under the applicable accounting framework;
  - (b) losses as a result of current or past events affecting a significant individual exposure or exposures that are not individually significant which are individually or collectively assessed;
  - (c) losses for which historical experience, adjusted on the basis of current observable data, indicates that the loss has occurred but the institution is not yet aware which individual exposure has suffered these losses.

## *Article 2*

### *Assigning Specific Credit Risk Adjustments for a group of exposures to the exposures within the group*

1. Where a Specific Credit Risk Adjustment reflects losses related to the credit risk of a group of exposures, institutions shall assign that Specific Credit Risk Adjustment to all single exposures of that group proportionally to the risk-weighted exposure amounts. For that purpose, the exposure values shall be determined without taking into account any Specific Credit Risk Adjustments.
2. For the treatment of expected loss amounts referred to in Article 159 of Regulation (EU) No 575/2013 for a group of non-defaulted exposures, institutions shall not be required to assign a Specific Credit Risk Adjustment to the single exposures of the group.
3. Where a Specific Credit Risk Adjustment relates to a group of exposures the credit risk own funds requirements of which are calculated partially under the Standardised Approach and partially under the Internal Ratings Based Approach, the institution shall assign that Specific Credit Risk Adjustment to the group of exposures covered by each of the Approaches proportionally to the risk weighted exposure amounts of the group before applying the actions referred to in paragraphs 1 and 2. For that purpose, the exposure values shall be determined without taking into account any Specific Credit Risk Adjustments.
4. When assigning the Specific Credit Risk Adjustments to exposures, institutions shall ensure that the same portion is not assigned twice to different exposures.

### Article 3

*Calculation credit risk adjustments for the purpose of determining the exposure value according to Articles 111, 166, 167, 168, 246 and 266 of Regulation (EU) No 575/2013*

For the purposes of determining the exposure value according to Articles 111, 166 to 168, 246 and 266 of Regulation (EU) No 575/2013, institutions shall calculate Specific Credit Risk Adjustments related to an exposure as the amounts of Specific Credit Risk Adjustments for that single exposure, or as the amounts of Specific Credit Risk Adjustments that the institution has assigned to that exposure according to Article 2.

### Article 4

*Calculation of general and specific credit risk adjustments for the purposes of the treatment of expected loss amounts according to Article 159 of Regulation (EU) No 575/2013*

1. For the purposes of the treatment of expected loss amounts according to Article 159 of Regulation (EU) No 575/2013, the institution shall calculate the total General Credit Risk Adjustments related to the exposures included in the treatment of expected loss amounts as the sum of those amounts, identified as General Credit Risk Adjustments according to Article 1 of this Regulation, that the institution has assigned pursuant to Article 110 (3) of Regulation (EU) No 575/2013.
2. For the purposes of the treatment of expected loss amounts according to Article 159 of Regulation (EU) No 575/2013, the calculation of total Specific Credit Risk Adjustments related to the exposures included in the treatment of expected loss amounts shall be the sum of the amounts of points (a) and (b), excluding exposures in default:
  - (a) amounts identified as Specific Credit Risk Adjustments according to Article 1 which are related to the credit risk of a single exposure;
  - (b) amounts identified as Specific Credit Risk Adjustments according to Article 1 which are related to the credit risk of a group of exposures and which have been assigned according to Article 2.
3. The total Specific Credit Risk Adjustments related to an exposure in default shall be calculated as the sum of all amounts of Specific Credit Risk Adjustments for that single exposure, or as the amounts of Specific Credit Risk Adjustments that the institution has assigned to that exposure according to Article 2.

*Article 5*

*Calculation of Specific Credit Risk Adjustments for own funds requirements for the purposes of the determination of default according to Article 178 of Regulation (EU) No 575/2013*

For the purposes of determining default according to Article 178 of Regulation (EU) No 575/2013, Specific Credit Risk Adjustments shall be calculated as the amounts of Specific Credit Risk Adjustments related to the credit risk of a single exposure or single obligor.

*Article 6*

*Documentation*

Institutions shall document the identification and calculation of General Credit Risk Adjustments and Specific Credit Risk Adjustments

*Article 7*

*Entry into Force*

This Regulation shall enter into force on the twentieth 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, 20.12.2013

*For the Commission  
The President  
José Manuel BARROSO*